Monterey One Water FY 2018-19 Budget
Debt Management Policy

1. Purpose

The purpose of this Debt Management Policy (the "Policy") is to establish debt management objectives for the effective governance, management, and administration of debt. This Policy is intended to improve the quality of decisions, articulate policy goals, provide guidelines for the structure of debt issuance, and demonstrate a commitment to long-term capital and financial planning. It also provides guidance in regards to the type of debt that may be issued, types and amounts of permissible debt, and the method of sale that may be used.

2. Background / General Statement

The Monterey Regional Water Pollution Control Agency (the "Agency") is committed to fiscal sustainability by employing long-term financial planning efforts, maintaining appropriate reserve levels, and employing prudent financial management practices. Debt levels and their related annual costs are important long-term obligations that must be managed with available resources. Adherence to a debt management policy communicates to rating agencies and the capital markets that an organization is well managed and should meet its obligations in a timely manner.

This Policy has been developed based on the Government Finance Officers Association Best Practices – Debt Management Policy; and in accordance with California Government Code Section 8855(i), effective January 1, 2017.

3. Authority and Responsibility

A. Board of Directors
The Board of Directors approves the Policy and any revisions to the Policy, and all debt Issuances

B. General Manager
The General Manager reviews the Policy and debt issuances prior to requesting Board approval.

C. Chief Financial Officer
The Chief Financial Officer of the Agency (the "CFO") is responsible for managing and coordinating all activities related to the structure, issuance, reporting, communicating and administration of long-term debt obligations. This includes contracting for professional services to assist in maintaining legal requirements and minimizing debt costs.

4. Legal and Financial Requirements

The Agency is classified as an Enterprise Fund and is not subject to California Government Code Section 43605 relating to property value assessments. Debt issuances of the Agency may be restricted by debt covenants in existing indebtedness documents.

5. Acceptable and Prohibited Uses of Debt

The Agency will consider financing for the acquisition, substantial refurbishment, replacement or expansion of physical assets, including land improvements. The primary purpose of debt is to finance the following items:

A. Acquisition of a capital asset with a minimum useful life equivalent to the term of debt service
B. Construction or reconstruction of a facility

5. Acceptable and Prohibited Uses of Debt (Continued)

C. Acquisition of land, right of way, or long-term easements

D. Refunding, refinancing, or restricting debt, subject to refunding objectives in accordance with Section (X)(B)(4) of this Policy.

E. Refinancing or advance funding of pension obligations, but only to the extent significant financial benefit is achieved and limited to Section (X)(B)(4) of this Policy.

F. Interim cash flow financing, such as a line of credit to support to support major construction projects that are funded through reimbursable grants or loans.

Long-term debt financing shall never be used to fund operating or maintenance costs; or projects or assets with a useful life that exceed the debt repayment period.

6. Approved Debt Instruments

Prior to the issuance of debt, the Agency will carefully consider overall long-term affordability of the proposed issuance. The Agency shall not assume additional debt without conducting an objective analysis of the Agency's ability to assume and support additional debt service payments. Consideration will be given to long-term revenue and expenditure trends, the impact on operational flexibility, debt coverage requirements, and the overall impact to rate payers. The CFO shall review benchmarking results from comparable organizations and related rating agency standards and report this information to the Board prior to any significant project financing. Types of debt authorized under this policy include:

A. Revenue Bonds
Payment for revenue bonds are secured by user fees. The Agency is responsible for establishing and collecting sufficient revenue through rates to retire the debt.

B. Certificates of Participation
Certifications of Participation provide debt financing through a lease agreement, installment sale agreement or contract of indebtedness. These certificates are issued for capital improvements or land acquisition. It is typical for the asset being acquired to act as the security for the debt service payments on the certificates; however the Agency is ultimately liable for all debt service.

C. Federal and State Government Loans
Government loans provide an important source of funds for capital financing at a low interest rate. Both the State and rating agencies require the Agency to disclose all incurred debt as they determine whether the Agency is able to meet required debt service coverage ratios.

D. Lines of Credit
A line of credit provides readily accessible funds to assist with cash flow. The Agency would typically use a line of credit to support significant projects that are funded by reimbursable grants, loans, or through Board-approved third party agreements.

E. Loans
The Agency may enter into loans, installment payment obligations, or other similar funding structures secured by a prudent source, or sources of repayment. In the event the Agency chooses to proceed with a direct loan or private placement for of debt, the Agency will issue a request for proposal seeking bids from responsible and credit-worthy

6. Approved Debt Instruments (Continued)

financial institutions. The request for bids shall include a description of the project and terms and conditions of the financing in accordance with prudent financial and industry standards. The Agency may award solely based upon true-interest cost but may take into consideration call features, debt service structure, and the requirement of any reserve fund prior to making any award.

F. Refunding Bonds
Refunding bonds can be issued to replace and refinance outstanding revenue bond obligations. The use of refunding is often driven by the desire to lower interest rates and reduce payment amounts on older more expensive debt.

G. Land-Secured Financings
The Agency may take appropriate steps to form a community facilities district to issue special tax bonds pursuant to the Mello-Roos Community Facilities Act of 1982, as amended, or issue limited obligation bonds under applicable assessment statutes.

7. Integration of Debt and Capital Improvement Budget

The CFO is responsible for developing and maintaining a multi-year rate model, which takes into consideration operating revenues and expenses; the capital improvement program; and debt covenant and reserve requirements. This model is used to develop rates sufficient to cover anticipated costs, as well as evaluate “pay as you go” or debt financing strategies to fund capital improvements.

8. Policy Goals and Objectives Related to Debt

The Agency has adopted a strategic goal to “ensure financial stability, sustainability and stewardship.” To assist in realizing this goal, the Agency seeks to maintain the highest possible credit ratings consistent with its current operating and capital needs. Consideration will be given to published ratings agency guidelines regarding best financial practice and guidelines for structuring its capital funding and debt strategies. The Agency has identified an ideal debt coverage ratio of 170%, with a minimum debt service coverage ratio of 125%.

9. Debt Structuring Practices

A. Term
The Agency will structure its debt issues so that the maturity of the debt is no greater than the economic or useful life of the capital project to be financed. Whenever possible and to save on interest costs, the Agency should consider shorter-term borrowings where appropriate.

B. Repayment
Typically, the Agency desires level debt service payments over the term of the debt. The cost of capital, financial risk, current economic conditions, future financial flexibility, credit rating, and available cash flow will be evaluated to determining the most appropriate method of debt amortization for the issue.

C. Redemption features
Redemption provisions and call features shall be evaluated in the context of each bond sale to enhance marketability of bonds; ensure flexibility of related to potential early redemption; and to foster refunding transactions. The potential for additional costs such as a call premium and higher interest rates will be evaluated in the decision to redeem bonds.

9. Debt Structuring Practices (Continued)

D. Fixed and Variable Rate Debt
The Agency's practice is to issue fixed rate debt. Such debt provides absolute certainty, at the time of the bond sale, as to the level of principal and interest owed annually. Specific conditions may arise where the Agency would consider variable interest bonds; however significant consideration should be given to the interest rate risk over the term of the financing. For variable rate debt, the variable rate may be based on one of a number of commonly used interest rate indices. Applicable issuances may include, but are not limited to, public marketed indexed notes, indexed notes or loans placed directly with financial institutions and other alternate variable rate and market access products as well as traditional variable rate demand obligations back by liquid facilities. Prior to the issuance of variable rate debt, the savings and other possible advantages compared to borrowing at a fixed rate and will be subject to evaluation and comparative analysis.

E. Credit Enhancement
A credit enhancement may be used to establish or improve a credit rating on an Agency debt obligation. Types of credit enhancements include bond insurance, surety policies, or letters of credit. The CFO will consider the use of a credit enhancement if it reduces the overall cost of a proposed financing or the credit enhancement furthers the Agency.

10. Debt Issuance Practices

A. Professional Assistance
The CFO shall be responsible for the solicitation and selection of financial professional services that are necessary to issue and manage debt. Such services, depending on the type of financing, may include financial advisory, underwriting, bond counsel, disclosure counsel, trustee, verification agent, arbitrage consulting, and special tax consulting. The Agency's attorney will also work with bond counsel on the issuance of debt, including any obligations under state and federal securities laws. The goal in selecting service providers, whether through a competitive process or when appropriate, a sole source selection, is to achieve an appropriate balance between service and cost. The selection of consulting services will be consistent with the Agency's Purchasing Policy.

B. Method of Sale
In the event of an issuance of bonds or certificates of participation by the Agency, the CFO will select the method of sale that best fits the type of bonds being sold, the prevailing market conditions, and the desire to structure bond maturities to enhance the performance of the entire debt portfolio. The following methods can be used for the issuance of bonds:

1. Competitive Sale – Bids for the purchase of bonds are opened at a specified place and time and are awarded to the underwriter or syndicate whose confirming bid represents the lowest true interest cost to the Agency.

2. Negotiated Sale – The Agency selects the initial buyer of the bonds in advance of the sale date. The initial buyer is usually an investment banking firm, or a syndicate of investment banking firms interested in reoffering the bonds to investors through an underwriting process. This type of sale allows the Agency to discuss different financing techniques with the underwriter in advance of the sale date, and is particularly appropriate for complex or unique bonds that may require education and marketing to the investment community.

3. Private placement – This method involves selling the Agency's bonds to a limited number of sophisticated investors. Bonds are not sold to the general investor community. Agency staff will perform due diligence in comparing interest costs and fees in private placement to those using a competitive or negotiated sale. The Agency may use a placement agent to assist in identifying likely investors.

10. Debt Issuance Practices (Continued)

4. Refunding criteria – Periodic reviews of outstanding debt will be undertaken to identify refunding opportunities. Refunding will be considered if and when there is a net economic benefit of refunding. Refundings which are non-economic may be undertaken to achieve City objectives relating to changes in covenants, call provisions, operational flexibility, tax status, issuer, or debt service profile.

In general, refundings which produce a net present value savings of at least three percent (3%) of the refunded debt will be considered economically viable. The net present value assessment shall factor in all costs, including issuance, escrow, and foregone interest earning of any contributed funds on hand. Any potential refinancing shall additionally consider whether an alternative refinancing opportunity with higher savings is reasonably expected in the future. Refundings with a negative savings will not be considered unless there is a compelling public policy objective that is accomplished by retiring the debt. The Agency will also consider the amount of uniform savings associated with the refunding. This calculation will review the realized savings in approximately equal annual amounts over the life of the refunded bonds. In addition, the CFO may consult with a financial advisor to model other savings structures to meet the Agency's financial needs.

11. Debt Management Practices

A. Investment of Bond Proceeds
The proceeds of bond sales will be invested until used for the intended project in order to maximize utilization of public funds. The investments will be made to obtain the highest level of safety and will be guided by the Agency's Investment Policy and bond indenture guidelines. The CFO will provide investment guidance to at Trustee or management firm holding bond proceeds whether for a project or debt service reserve funds.

B. Primary and Secondary Market Disclosures
The Accounting Supervisor is responsible for providing annual disclosure information to established national information repositories for maintaining compliance with disclosure requirements by state and national regulatory bodies. This includes providing ongoing disclosure information to the Municipal Securities Rulemaking Board's (MSRB's) Electronic Municipal Market Access system. Disclosures shall include the Comprehensive Annual Financial Report ("CAFR"), enumerated events defined by regulation or bond covenants; and any other information required by the bond indenture or regulatory body. The CFO may also employ the services of a firm to assist with financial disclosure requirements.

C. Arbitrage Rebate Monitoring and Filing
The Agency will, unless otherwise justified, use bond proceeds within the established timeframe pursuant to the bond ordinance, contract, or other documents to avoid arbitrage. Arbitrage is the interest earned on the investment of bond proceeds above the interest paid on the debt. If arbitrage occurs, the Agency will pay the amount of arbitrage to the Federal Government as required by Internal Revenue Service Regulation 1.148-11. The Agency will maintain a system of record keeping and reporting to meet the arbitrage rebate compliance requirements as designated by the Federal tax code. This effort shall include tracking investment earnings on bond proceeds, calculating rebate payments in compliance with tax law, and remitting any rebate earnings to the federal government in a timely manner. These activities are defined to preserve the Agency's tax-exempt status of the Agency's outstanding debt issuances.

D. Federal and State Law Compliance Practices
The CFO is responsible for maintain compliance with disclosure standards promulgated by state and national regulatory bodies, including the Government Accounting Standards Board, the National Federal of Municipal Analysts, the Securities and Exchange Commission, and Generally Accepted Accounting Principles.

11. Debt Management Practices (Continued)

E. Compliance with Bond Covenants
In addition to financial disclosure and arbitrage compliance, the Agency is responsible for verifying compliance with all activities, agreements, and requirements outlined in the bond documents on an ongoing basis. This typically includes: Ensuring an annual appropriation to meet debt service payments; relevant fees are levied and collected at a level sufficient to meet indenture requirements and debt service payments; the timely payment of debt service to a trustee or paying agent; and compliance with insurance, reserve, and other mandates.

F. Ongoing Market and Investor Relation Efforts
The Agency is committed to providing full and complete financial disclosure to rating agencies, institutional and individual investors, other levels of government, and the general public to share clear, comprehensible, accurate financial information. This information will be communicated through budget documents and presentations; periodic financial and CAFRs. A minimum of three years of annual budgets and CAFRs are placed on the Agency's websites

G. Internal Control Procedures Related to Intended Use
The Agency references the following internal controls to ensure all bond proceeds are expended for their intended use a.) Review approved use of bond proceeds with department representatives who are authorized to initiate contracts and expend funds to ensure expenditures are consistent with the terms of the bond sale b.) Educate staff responsible for preparing purchase orders and processing payments as to items that are can be expended using bond proceeds, as well as the proper account coding and c.) Require the CFO to review draw-down requests It is intended that this segregation of duties and redundancy will assist in assuring that all expenditures are consistent with the bond documents.

H. Debt Record Keeping
The Accounting Department is responsible for maintaining the documentation listed within this Section for the term of each bond issue. With respect to tax-exempt bonds, records should be generally retained for three years following the final maturity of the bonds, including a.) A copy of the legal documents, closing transcripts, bond counsel opinion, and other relevant documentation b.) Any credit enhancements or other elections made with the debt issuance; c.) Official Statements; d.) Resolutions e.) Trustee certificates f.) Any titles or assets purchased with bond proceeds; g.) Draw requests and supporting material, including contract and expense records; h.) Documentation pertaining to the investment of bond proceeds, including purchase and sale of securities; rebate calculations, and related items.

In addition, the Agency shall maintain evidence of all sources of payment or security for the bonds The Agency may maintain all records in a hard-copy or electronic format. All general ledger records, debt payment information, and purchasing order data are maintained in the Agencies financial software system. If the Agency chooses to store image copies in an electronic format, they must be in compliance with Section 4.01 of Internal Revenue Service Revenue Procedure 97-22.

12. Use of Derivatives

The use of certain derivative products to hedge variable rate debt, such as interest rate swaps, is not allowed unless approved by the Board. A comprehensive derivative policy will be adopted by the Agency prior to issuance of such debt.