



Yorba Linda Water District

Policies and Procedures

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POLICY: DEBT MANAGEMENT

1.0 INTRODUCTION

1.1 Purpose and Overview

In its publication entitled Best Practice Debt Management Policy, the Government Finance Officers Association (GFOA) states that Debt management policies are written guidelines, allowances, and restrictions that guide debt issuance practices of Board adopted issuance processes, management of a debt portfolio, and adherence to state and federal laws and regulations. A debt management policy should improve the quality of decisions, and articulate policy goals, provide guidelines for the structure of debt issuance, and demonstrate a commitment to long-term capital financial planning. The Yorba Linda Water District Debt Management Policy as set forth herein provides a set of comprehensive guidelines for the issuance and management of District's debt portfolio. Adherence to the policy is essential to ensure the District maintains a diversified debt portfolio that supports the District's financing needs and minimizes the District's cost of funds.

1.2 Roles and Responsibilities

Finance Manager - The primary responsibility for debt management rests with the Finance Manager. The Finance Manager shall:

- Provide for the issuance of District debt at the lowest possible cost and risk;
- Determine the available debt capacity of the District;
- Provide for the issuance of District debt at appropriate intervals and in reasonable amounts as required to fund approved and budgeted capital expenditures;
- Recommend to the District's Board of Directors (the "Board") the method and manner of sale of District debt;
- Monitor opportunities to refund debt and recommend such refunding as appropriate to reduce costs or to achieve other policy objectives;
- Comply with all Internal Revenue Service (IRS), Municipal Securities Rulemaking Board (MSRB), Securities and Exchange Commission (SEC), and California Debt Investment Advisory Commission ("CDIAC") rules and regulations governing the issuance of debt;

- Maintain a current database with all outstanding debt;
- Provide for the timely payment of principal and interest on all debt;
- Comply with all terms and conditions, including continuing disclosure, required by the legal documents governing the debt issued;
- Submit to the Board all recommendations to issue debt in accordance with this Policy;
- Distribute to appropriate repositories information regarding the District's financial condition and affairs at such times and in the form required by law, regulation and general practice;
- Provide for the frequent distribution of pertinent information to the rating agencies;
- Apply and promote prudent fiscal practices; and
- To ensure that proceeds of any debt issued in accordance with its governing documents and this Policy no disbursements shall be made without the approval of the Finance Manager and General Manager. The draw request shall be provided to the District by the project engineer with the consent of the District's inspector. Approval shall only be provided when the Finance Manager is in receipt of an appropriate certification from the construction project manager with supporting invoices from suppliers and / or contractors evidencing appropriate expenses in connection with the project.

In the case of an issue of bonds the proceeds of which will be used by a governmental entity other than the District, the District may rely upon a certification by such other governmental entity that it has adopted the policies described in SB 1029.

2.0 LEGAL GOVERNING PRINCIPLES

In the issuance and management of debt, the District shall comply with all legal constraints and conditions imposed by federal, state and local law. The following section highlights the key governing documents and certain debt limitations.

2.1 Governing Law

County Water District Law – The District was established in 1959 as a county water district under the County Water District Law, Division 12 of the Water Code of the State of California, as the successor to a private water company that was incorporated in or about 1909, for purposes of supplying water for domestic, irrigation, sanitation, industrial, commercial, recreation and fire suppression use.

Federal Tax Law – The District shall issue and manage debt in accordance with the limitations and constraints imposed by federal tax law, to maximize its ability to sell tax-exempt debt. Such constraints include, but are not limited to, private activity tests, review of eligible projects, spend-down tests, and arbitrage rebate limitations.

Securities Law – The District shall comply with the requirements of federal and state securities laws in offering District debt and the District shall comply with securities law requirements in providing ongoing disclosure to the securities markets.

2.2 Governing Legal Documents

Indenture – The District's debt issuance is further governed in part by the Indenture of Trust, adopted September 8, 2016 of which constitutes the "Indenture." The Indenture establishes the basic security structure of debt

issued by the District that is secured by Net Water Revenues. Key terms and conditions include, but are not limited to, the definition of pledged revenues, the rate covenant and the additional bonds test. A copy of the Indenture can be found in Appendix B. The District shall comply with all limitations imposed under the Indenture, so long as such Indenture is in full force and effect.

2.3 Permitted Debt by Type

The District may legally issue both short-term and long-term debt, using the debt instruments described below. The Director of Administrative Services, in consultation with the District's General Counsel, Bond Counsel, and Financial Advisor shall determine the most appropriate instrument for funding purposes.

General Obligation Bonds – The District is empowered, under California law, to levy taxes on all taxable property within its boundaries for the purpose of paying its voter-approved general obligation bonds and, subject to certain limitations.

Certificates of Participation – Certificates of Participation (COP) provide debt financing through a lease, installment sale agreement or contract of indebtedness and typically do not require voter approval. Board action is sufficient to legally authorize a COP issue. The District shall pledge net revenues to the repayment of its COPs, under the terms and conditions specified in the Indenture.

JPA Revenue Bonds – As an alternative to COPs, the District may obtain financing through the issuance of Debt by a joint exercise of powers agency with such Debt payable from amounts paid by the District under a lease, installment sale agreement, or contract of indebtedness.

Commercial Paper – The District may issue short-term revenue certificates, including commercial paper and extendable commercial paper. Board action is sufficient to legally authorize a commercial paper issue. The District's commercial paper is secured by net revenues. Voter approval is not required to issue commercial paper.

Lines of credit - The District may enter into financing arrangements providing for a source of funds that can be readily accessed by the District for capital or operational needs. Board action is sufficient to legally authorize the establishment of a line of credit. Voter approval is not required to establish or access a line of credit.

Variable Rate Debt – The District is authorized to issue variable rate debt including, but not limited to, public market indexed notes, indexed notes or loans placed directly with financial institutions and other alternative variable rate and market access products as well as traditional variable rate demand obligations backed by bank liquidity facilities. Prior to the issuance of variable rate debt, the savings and other possible advantages compared to a fixed rate borrowing will be evaluated and a comparative analysis presented to the Board of Directors as part of the approval process.

Refunding Revenue Bonds – The District is authorized to issue refunding revenue bonds to refund outstanding District indebtedness pursuant to the State of California local agency refunding revenue bond law (Articles 10 and 11 of Chapter 3 of Part 1 of Division 2 of Title 5 of the Government Code of the State of California).

Loans – The District is authorized to enter into loans, installment payment obligations, or other similar funding structures secured by a prudent source, or sources of repayment.

Assessment Bonds – The District is authorized to issue assessment bonds pursuant to the Improvement Bond Act of 1915, subject to requirements imposed by Proposition 218. Such bonds are typically repaid from assessments collected within an assessment district formed pursuant to the Municipal Improvement Act of 1913. Assessments are levies of charges on real property to pay for projects or services that specifically benefit that parcel of property.

2.4 Limitations on Debt Issuance

Short-Term Debt – The District’s short-term debt shall not exceed 30 percent of its total debt at the time of issuance. The calculation of short-term debt shall include any variable rate obligations, the authorized amount of commercial paper, any notes/bonds with a maturity equal to or less than five years.

Variable Rate Debt – The Finance Manager will consult with the District’s Financial Advisor to determine appropriate parameters for the issuance of variable rate debt and may rely on rating agency standard’s and other industry standards for establishing prudent financial goals and establishing the amount of variable rate debt to be issued.

Subordinate Lien Long-Term Debt - The District’s subordinate lien debt, for which net revenues are pledged, shall be limited to that amount for which current and projected revenues generate overall debt service coverage of at least 100 percent.

Senior Lien Long-Term Debt – The District’s senior lien long-term debt, for which net revenues are pledged, shall be limited to that amount for which current and projected revenues generate a senior lien debt service coverage of at least 125 percent. The calculation of debt service shall not include General Obligation Bonds, Assessment Bonds, or Special Tax Bonds to which revenue sources other than pledged revenues, as defined in the Indenture, are pledged. It should be noted that the District will issue debt to attempt to meet the senior lien debt service coverage target of 225 percent in keeping with its prudent financial management practices and to maintain credit ratings aligned with rating agency methodologies.

2.5 Purpose for Borrowing

The District shall issue debt solely for the purpose of financing the cost of design, engineering acquisition, and/or construction of water and wastewater system improvements in furtherance of the District’s Capital Improvement Program (CIP). Additionally, the District may, subject to Federal tax code limitations, include operational expenses in any debt issuance.

2.6 Ethical Standards Governing Conduct

Members of the District, the Board and its consultants, service providers, and underwriters shall adhere to standards of conduct as stipulated by the California Political Reform Act, as applicable. All debt financing participants shall maintain the highest standards of professional conduct at all times, in accordance with:

- MSRB Rules, including Rule G-37 and G-42 shall be followed at all times;
- Debt financing participants will assist the District staff in achieving its goals and objectives as defined in this Debt Management Policy; and
- All debt financing participants shall make cooperation with the District staff their highest priority.

2.7 Use of Derivatives

The use of derivative products can, among other things, increase District financial flexibility and provide opportunities for interest rate savings or enhanced investment yields. Careful monitoring of such products is required to preserve District credit strength and budget flexibility. Swaps will not be used to speculate on perceived movements in interest rates. Before the District enters into any derivative product associated with debt, the Board shall adopt an interest rate swap policy.

3.0 INTEGRATION OF CAPITAL PLANNING AND DEBT ACTIVITIES

3.1 Evaluating Capital Improvement Program Spending

The District shall develop and maintain a capital finance model to evaluate the impact of capital program spending, operations and maintenance costs, and debt service on its financial condition. To that end, the Finance Director shall oversee the ongoing maintenance of quantitative modeling that includes, but is not limited to, the following:

- Five years of historic and projected cash flows;
- Five years of historic and projected capital expenditures;
- Five years of historic and projected operating costs;
- Five years of historic and projected fund balances for any funds established by the District's then-adopted Reserve Fund
- Five years of historic and projected debt service coverage;
- The most efficient mix of funding sources (long-term debt; short-term debt, and cash);
- Projected revenue requirements; and
- Projected rates and charges.

4.0 PROCUREMENT AND EVALUATION OF PROFESSIONAL SERVICES

4.1 Appointment of Service Providers – The Finance Manager may solicit from time to time bids, quotes or proposals, including sole source proposals for the following services on an as needed basis:

- Financial Advisor – Service provider that ensures the District complies with all financial management procedures and policies and ensures successful closing for bond transactions.
- Bond Counsel – Service provider that drafts appropriate documentation to ensure successful and timely closing and create valid and legally binding security for bond issues, and provide appropriate advice and taking appropriate actions to ensure legal validity of bond issues under state and federal laws as applicable.

5.0 TRANSACTION-SPECIFIC POLICIES

5.1 Method of Sale – The Finance Manager shall determine the most appropriate form of sale of its debt. In making a recommendation to the Board the Finance Manger may consult with the District's Financial Advisor

and Bond Counsel and may take into account, among other things, the type and tenor of the proposed debt; the District's credit ratings; the amount of funding necessary; the timing of the needed funds; local and national economic conditions; and general bond market conditions.

5.2 Competitive Bid Method - When necessary to minimize the costs and risks of any District borrowing, the Director of Administrative Services may submit to the Board a request to sell bonds on a competitive basis. Such bids may take the form of hand-delivered or electronically transmitted offers to purchase the bonds. Any competitive sale of District debt will require approval of the Board. District debt issued on a competitive bid basis will be sold to the bidder proposing the lowest true interest cost to the District provided the bid conforms to the official notice of sale.

5.3 Negotiated Bid Method – A negotiated bond issue will provide for the sale of debt by negotiating the terms and conditions of the sale, including price, interest rates, credit facilities, underwriter or remarketing fees, and commissions. Examples of such sales include:

- Variable rate demand obligations;
- An issue of debt so large that the number of potential bidders would be too limited to provide the District with truly competitive bids;
- An issue requiring the ability to react quickly to sudden changes in interest rates (e.g. refunding bonds);
- An issue requiring intensive marketing efforts to establish investor acceptance;
- An issue of debt with specialized distribution requirements; and
- An issue of debt sold during a period of extreme market disruption or volatility.

If bonds are sold on a negotiated basis, the negotiations of terms and conditions shall include, but not be limited to, prices, interest rates, underwriting or remarketing fees, and underwriting spreads and timing of sale. The District, with the assistance of its Financial Advisor, shall evaluate the terms offered by the underwriting team. Guidelines with respect to price, interest rates, fees, and underwriting spreads shall be based on prevailing terms and conditions in the marketplace for comparable issuers, credit ratings, tenor and par amount.

If more than one underwriter is included in the negotiated sale of debt, the District shall establish appropriate levels of liability, participation and priority of orders. Such levels shall be based upon District policy with regards to the underwriting responsibility among the team members, the desired allocation of total fees, and the desired distribution of bonds. Guidelines for establishing liability, participation, and priority of orders shall be based on prevailing terms and conditions in the marketplace for comparable issuers.

The District shall, with the assistance of its Financial Advisor, oversee the bond allocation process. The bond allocation process shall be managed by the lead underwriter, with the following requirements:

- The bonds are allocated fairly among members of the underwriting team, consistent with the previously negotiated terms and conditions;
- The allocation process complies with all MSRB regulations governing order priorities and allocations;
- The lead underwriter shall submit to the Director of Administrative Services a complete and timely account of all orders, allocations, and underwriting activities with the investor names identified as appropriate.

The Finance Manager Services shall require a post-sale analysis and reporting for each negotiated bond sale. The Financial Advisor or the lead underwriter may perform such analysis. A post-sale analysis will include, but not be limited to:

- Summary of the pricing, including copies of the actual pricing wires;
- Results of comparable bond sales in the market at the time of the District's pricing;
- Detailed information on orders and allocation of bonds, by underwriting firm;
- Detailed information on final designations earned by each underwriter; and
- Summary of total compensation received by each underwriter.

STRUCTURAL ELEMENTS

5.4 Pledge of Revenues – The District's pledge of revenues shall be determined for each debt issue depending upon the debt instrument:

- *General Obligation Bonds* of the District shall be repaid from voter-approved property taxes on property within the jurisdiction of the District.
- *Certificates of Participation* of the District shall be repaid from net revenues, as defined in the Indenture.
- *Revenue Bonds* of the District shall be repaid from net revenues, as defined in the Indenture.
- *Loans* of the District may be repaid from net revenues of the water and or wastewater systems, or other financially prudent sources of repayment.
- *Assessment Bonds* of the District shall be repaid levies or charges collected within an assessment district formed by the District pursuant to the Municipal Improvement Act of 1913.
- *Special Tax Bonds* of the District shall be payable from net special taxes collected in applicable taxing jurisdiction as a result of the levy of special taxes.

5.5 Maturity – The District may issue tax-exempt debt with an average life equal to, but no greater than 125% of, the average life of the assets being financed. The final maturity of the debt should be no longer than 40 years absent compelling circumstances or facts. Factors to be considered when determining the final maturity of debt include: the average useful life of the assets being financed, relative level of interest rates, intergenerational equity and the year-to-year differential in interest rates.

5.6 Maturity Structure – The District's long-term debt may include serial and term bonds. Other maturity structures may also be considered if they are consistent with prudent financial management practices.

5.7 Coupon Structure – Debt may include par, discount and premium. Discount and premium bonds must be demonstrated to be advantageous relative to par bond structures taking into consideration market conditions and opportunities. For variable rate debt, the variable rate may be based on one of a number of commonly used interest rate indices and the index will be determined at the time of pricing.

5.8 Debt Service Structure – Debt service may be structured primarily on an approximate level (combined annual principal and interest) basis. Certain

individual bond issues, such as refunding bonds, may have debt service that is not level. However, on an aggregate basis, debt service should be structured primarily on a level basis.

5.9 Redemption Features – In order to preserve flexibility and refinancing opportunities, District debt will generally be issued with call provisions. The District may consider calls that are shorter than traditional and/or non-call debt when warranted by market conditions and opportunities. For each transaction, the District will evaluate the efficiency of call provision alternatives.

5.10 Credit Enhancement – The District shall competitively procure credit enhancement for an original sale of bonds if the Finance Director, in consultation with the Financial Advisor and the senior underwriter, determines that it is cost effective to do so. The Finance Director may in consultation with the Financial Advisor and the senior underwriter determine that due to certain circumstances a sole source procurement process may be more advantageous than a competitive process.

5.11 Senior/Subordinate Lien – The District may utilize both a senior and a subordinate lien structure. The choice of lien will be determined based on such factors as overall cost of debt, impact on debt service, impact on rates, and marketing considerations.

5.12 Debt Service Reserve Funds – The District shall provide for debt service reserve funds to secure District debt when necessary.

6.0 COMMUNICATION AND DISCLOSURE

6.1 Rating Agencies

The District shall maintain its strong ratings through prudent fiscal management and consistent communications with the rating analysts. The Finance Director shall manage relationships with the rating analysts assigned to the District's credit, using both informal and formal methods to disseminate information. Communication with the rating agencies may include one or more of the following:

- Full disclosure on an annual basis of the financial condition of the District;
- A formal presentation, at least annually or as becomes necessary to the rating agencies, covering economic, financial, operational, and other issues that impact the District's credit;
- Timely disclosure of major financial events that impact the District's credit;
- Timely dissemination of the Comprehensive Annual Financial Report, following its acceptance by the District's Board;
- Full and timely distribution of any documents pertaining to the sale of bonds; and
- Periodic tours of the water system operations, as appropriate.

6.2 Bond Insurers

The Finance Director shall manage relationships with the bond insurers, to the extent any Debt is so insured, by providing appropriate information. Communication with other bond insurers shall be undertaken when the Director of Administrative Services, with the assistance of the District's

Financial Advisor, determines that credit enhancement is cost effective for a proposed bond issue.

Disclosure Reports – The District shall comply with its disclosure undertakings and make disclosure reports readily available to market participants through the Electronic Municipal Market Access website.

Web Site – The District may use its website as a tool for providing timely information to investors.

7.0 REFUNDING POLICIES

The District shall strive to refinance debt to maximize savings and minimize the cost of funds as market opportunities arise. A net present value analysis will be prepared that identifies the economic effects of any refunding to be proposed to the Board. The District shall target a 3% net present value savings for current and 5% for advance refunding transactions. Upon the advice of the Director of Administrative Services, with the assistance of the Financial Advisor and Counsel, the District will consider undertaking refundings for other than economic purposes, such as to restructure debt, change the type of debt instruments being used, or to retire a bond issue and indenture in order to remove undesirable covenants.

7.1 Savings Thresholds – Minimum savings thresholds have been established to help guide the economic analysis of refunding bonds. The minimum savings guidelines are applicable on a maturity-by-maturity basis and are expressed as a percentage of refunded bond par calculated by dividing the expected net present value savings generated by the proposed refunding by the par amount of refunded bonds. At the recommendation of the Director of Administrative Services, with the assistance of the Financial Advisor, the District may complete a refunding for net present values savings equal to the target specified above on an aggregate bond issue basis rather than a maturity by maturity basis. Generally, the District shall only refund bonds to generate debt service savings of the specified minimum savings set forth in the previous paragraph can be achieved.

7.2 Coupon on Refunded Bond – The Director of Administrative Services may take into consideration whether the coupon on the refunded bond is significantly higher or lower than the most common outstanding bond coupons of approximately five percent.

7.3 General Interest Rate Environment – The Director of Administrative Services may take into consideration whether the available refunding bond interest rates are generally high or generally low relative to long-term averages of historical rates.

7.4 General Interest Rate Outlook – The Director of Administrative Services may take into consideration the general outlook for future interest rates, as derived from economic forecasts, market forecasts, implied forward rates, or other sources.

7.5 Debt Management Considerations – The Director of Administrative Services may take into consideration debt management issues such as cost and staff efficiencies associated with combining multiple refunding bond issues or combining refunding and new money bond issues.

7.6 Call Date – The Director of Administrative Services may take into consideration the amount of time between the pricing/closing date of the refunding Debt and the call date of the Debt to be refunded.

7.7 Final Maturity Date – The Director of Administrative Services may take into consideration the amount of time remaining until the final maturity of the Debt to be refunded.

8.0 REINVESTMENT OF PROCEEDS

8.1 General – The District shall comply with all applicable Federal, State, and contractual restrictions regarding the use and investment of bond proceeds. This includes compliance with restrictions on the types of investment securities allowed, restrictions on the allowable yield of some invested funds, as well as restrictions on the time period during over which some bond proceeds may be invested. To the extent that a bond issue is credit enhanced, the District shall adhere to the investment guidelines of the credit enhancement provider.

8.2 Requirements of Indenture – The District will comply with all terms and conditions of the appropriate legal documents related to the Debt. Such limitations shall include, but not be limited to Investments in the Indenture.

9.0 CREATION AND MAINTENANCE OF FUNDS

The District maintains a number of different funds integral to the long-range financial planning process. Each of these funds is held for a specific purpose and can generally be categorized as either an operating, capital or debt reserve fund. The District will comply with all requirements and limitations created under its Reserve Policy.

10.0 COMPLIANCE

10.1 Arbitrage Liability Management

The District shall minimize the cost of arbitrage rebate and yield restrictions while strictly complying with tax law. Because of the complexity of arbitrage rebate regulations and the severity of non-compliance penalties, the District shall solicit the advice of bond counsel and other qualified experts about arbitrage rebate calculations. The District shall contract with a qualified third-party for preparation of the arbitrage rebate calculation.

The District shall maintain an internal system for tracking expenditure of bond proceeds and investment earnings. The expenditure of bond proceeds shall be tracked in the financial accounting system by issue. Investment may be pooled for financial accounting purposes and for investment purposes. When investment of bond proceeds are co-mingled with other investments, the District shall adhere to IRS rules on accounting allocations.

10.2 Post-Issuance Tax Compliance

The District has adopted Written Procedures to Ensure Compliance with Requirements for Tax-Exempt Bonds. The District shall comply with such procedures to maintain the tax-exempt status of District debt obligations or to maintain eligibility for direct pay subsidy payments, as applicable.

10.3 Continuing Disclosure

The District shall comply with the requirements of each Continuing Disclosure Certificate entered into at the time of a sale of bonds. Annual information provided by the District shall mirror the information in any District offering statement at the time of a primary offering. Annual financial information will be sent by the District or its designated consultant, within the time required under the Continuing Disclosure Certificate to the EMMA System This shall include:

- Comprehensive Annual Financial Report of the District; and
- Updated tables from the Official Statement, as detailed in the Continuing Disclosure Certificate.

In addition to annual disclosure, the District shall provide ongoing information about certain enumerated events, as defined by regulation, to the EMMA System.

The District may engage a firm to assist it in ensuring timely completion and filing of annual reports and in identifying, and making timely filings with respect to, the occurrence of reportable enumerated events.

10.4 Legal Covenants

The District shall comply with all covenants and conditions contained in governing law and any legal documents entered into at the time of a bond offering.

11.0 DEBT DATABASE MANAGEMENT

The District shall maintain complete information on its outstanding debt portfolio, in a spreadsheet or database program format. The information in the database shall include, but not be limited to, the following:

- Issue Name
- Initial Issue Par Amount
- Dated Date of the Issue
- Principal Maturity Amounts
- Coupon Rate by Maturity
- Amount Outstanding
- Call Provisions
- Purpose of the Issue
- Credit Enhancer, if any
- Competitive or Negotiated Sale
- Names of Underwriting Team Members

The District shall use the debt database for the following purposes:

- Generate reports
- Gross annual debt service
- Net annual debt service
- Refunding Analyses
- Output to Fund Accounting System