MID-PENINSULA
WATER DISTRICT

DEBT MANAGEMENT POLICY

1. POLICY STATEMENT

The Mid-Peninsula Water District (District) funds its capital projects and meets other financing needs through a combination of current operating revenues, available reserves, outside funding (e.g., grants), and prudently issued debt. This policy documents the goals and guidelines of the District for the issuance and use of debt instruments.

Debt includes financing as a way to raise working capital or capital expenditures by selling bonds, bills, certificates, or notes to individual and/or institutional investors. In return for lending the money, the individuals or institutions become creditors and receive a promise to repay principal and interest on the debt. To achieve optimal credit ratings and endorse prudent financial management, the District is committed to long-term capital and financial planning, and continual review of its financing structure to optimize the overall cost of debt.

The issuance of debt by the District to finance major capital projects or to refinance existing obligations will only occur after the transaction is evaluated to be fiscally prudent and responsible under the prevailing economic conditions. Prior approval by the Board of Directors (Board) is required for the issuance of new debt or for the refinancing of existing debt.

2. PURPOSE OF POLICY

The purpose of this Debt Management Policy (Debt Policy) is to establish and maintain parameters for issuing debt, and promote objectivity in the decision-making process.

The District will adhere to the following legal requirements for the issuance of public debt:

- State law, which authorizes the issuance of debt;
- Federal and state law, which govern the eligibility of the debt for tax-exempt status;
- Federal and state law, which govern the issuance of taxable debt;
- Federal and state law, which govern disclosure, sale, and trading of the debt, both before and subsequent to issuance; and
- Generally Accepted Accounting Principles (GAAP).

This Debt Policy is intended to comply with Government Code Section 8855(i), effective January 1, 2017, and shall govern all debt issued by the District. The District hereby recognizes that a fiscally prudent debt policy is required to:

- Maintain the District's sound financial position.
- Ensure the District has the flexibility to respond to changes in future service priorities, revenues, and operating expenses.
- Protect the District's credit-worthiness.

- Ensure that all debt is structured to protect current and future taxpayers, ratepayers and constituents of the District.
- Ensure that the District's debt is consistent with the District's planning goals and objectives and Capital Improvement Program (CIP) or capital budget, as applicable.

3. PURPOSE AND USE OF DEBT

Debt financing is an acceptable and appropriate approach to fund the District's long-term capital improvements as approved by the Board of Directors and, thus, ensure inter-generational equity of such major improvements among existing and future users of the system. Debt can be issued to fund the capital cost of planning, pre-design, design, land and/or easement acquisition, construction, and related fixtures, equipment, and others costs as permitted by law.

3.1 Long-Term Debt. Long-term debt may be issued to finance the construction, acquisition, and rehabilitation of capital improvements and facilities, equipment and land to be owned and operated by the District. Long-term debt financings are appropriate:

- When a project to be financed is necessary to provide District services.
- When the project to be financed will benefit constituents over 10+ years.
- When total long-term debt financing does not constitute an unreasonable burden to the District and its taxpayers or ratepayers.
- When the debt is used to refinance outstanding debt to reduce the total cost of the debt or to realize other benefits of a debt restructuring, such as increased flexibility in the use of cash and reserves.
- When the weighted average maturity of the debt (or the portion of the debt allocated to the project) will not exceed the average useful life of the project to be financed by more than 20%, unless specific conditions exist that would mitigate the extension of time to repay the debt and it would not cause the District to violate any covenants to maintain the tax-exempt status of such debt, if applicable.

Long-term debt financings will not be considered appropriate for current operating expenses and routine maintenance expenses.

The District may use long-term debt financings subject to the following conditions:

- The project to be financed must be approved by the District Board of Directors;
- The District estimates that sufficient revenues will be available to service the debt through its maturity; and
- The District determines that the issuance of the debt will comply with the applicable state and federal law.

Periodic reviews of outstanding long-term debt will be undertaken to identify refunding opportunities. Refundings will be considered (within federal tax law constraints, if applicable) if and when there is a net economic benefit of the refunding. Refundings that are non-economic may be undertaken to achieve District objectives relating to changes in covenants, call provisions, operational flexibility, tax status of the issuer, or the debt service profile.

Refundings that produce a net present value savings of at least 4% of the refunded debt will be considered economically viable. Refundings that produce a net present value savings of less than 4% or negative savings will be considered on a case-by-case basis, and are subject to Board approval.

3.2 Short-term debt. Short term borrowing such as commercial paper and lines of credit will be considered as an interim source of funding in anticipation of long-term borrowing. Short-term debt may be issued for any purpose for which long-term debt may be issued, including capitalized interest and other financing-related costs. Prior to issuance of the short-term debt, a reliable revenue source shall be identified to secure repayment of the debt. The final maturity of the debt issued to finance the project shall be consistent with the economic or useful life of the project and unless the Board determines that extraordinary circumstances exist, must not exceed seven years.

3.3 Short-term debt may also be issued to provide financing for the District's operational cash flows in order to maintain a steady and even cash flow balance, due within one year, and may be rolled over or extended if necessary. Short-term debt may also be used to finance short-lived capital projects, such as undertaking lease-purchase financing for equipment.

4. TYPES OF DEBT THAT MAY BE ISSUED

The District may find that debt financings would be beneficial to further its public purposes and the Board of Directors may approve such debt without an amendment of this Debt Policy. Debt shall be issued as fixed rate debt unless the District makes a specific determination as to why a variable rate issue would be beneficial to the District in a specific circumstance.

5. RELATIONSHIP OF DEBT TO CAPITAL IMPROVEMENT PROGRAM AND BUDGET

The District is committed to long-term capital planning and may issue debt for the purposes stated in this Debt Policy for implementation of the District's capital budget and CIP.

5.1 The District's Debt Management Policy, Reserve Policy, and Investment Policy will be considered in the decision-making framework utilized in the preparation of the District's CIP and long-term capital and financial planning, and its fiscal year budgeting process.

5.2 The District will fund the upkeep and maintenance of its infrastructure and facilities improvements due to normal wear and tear through the expenditure of available operating revenues rather than incurring debt.

5.3 The District shall integrate its debt issuances with the goals of its CIP by timing the issuance of debt to ensure that projects are available when needed in furtherance of the District's public purposes, or may be less expensive due to construction costs or low interest rates

6. DEBT ISSUANCE

The District is committed to long-term financial planning, maintaining appropriate reserves and employing prudent practices in governance, management and budget administration, and systematic capital planning. The District will issue debt for the purposes stated in this Debt Policy and as approved by the Board of Directors to implement policy decisions incorporated in the District's annual operations and capital budgets. Adoption of this Debt Policy will help ensure that debt is issued and managed in a manner that protects the public interest.

6.1 Credit Rating. The District will do everything necessary to maintain optimum credit ratings for debt instruments. District staff, working with the District's Municipal Finance Advisor, shall be responsible for determining which of the major rating agencies will be asked to provide such a rating.

6.2 Method of Sale. Debt is typically issued under either a competitive or negotiated sale, or private placement. Determination of the appropriate method of sale will rest with the General Manager and the District's Municipal Finance Advisor. There are a number of market factors that will affect the success of a debt offering and each should be carefully considered before selecting a method of sale. These factors include, but are not limited to: 1) market perception of the District's credit quality, 2) interest rate volatility, 3) size of the proposed sale, term and average life, 4) complexity of the proposed issue, and 5) competition with other issuers for investor interest.

7. DEBT ADMINISTRATION

7.1 The District will comply with:

A. Applicable state and federal law as it pertains to the maximum term of debt and the procedures for levying and imposing any related taxes, assessments, rates and charges; and

B. Applicable policies regarding initial bond disclosure, continuing disclosure, post-issuance compliance, and investment of bond proceeds. Without limiting the foregoing, the District will periodically review the requirements of and will remain in compliance with the following:

1. Any continuing disclosure undertakings entered into by the District in accordance with SEC Rule 15c2-12;
2. Any federal tax compliance requirements, including, without limitation, arbitrage and rebate compliance;
3. The District's investment policies as they relate to the use and investment of bond proceeds; and

4. California Government Code Section 8855(i) and the annual reporting requirements therein.

7.2 Proceeds of debt will be held either by:

A. A third-party trustee or fiscal agent, which will disburse such proceeds to or upon the order of the District upon the submission of one or more written requisitions by the General Manager of the District (or their written designee); or

B. The District, to be held and accounted for in a separate fund or account to ensure debt proceeds are expended only for the purposes for which the debt was issued, the expenditure of which will be carefully documented by the District in records compliance with current accounting standards and subject to the District's annual audit.

7.3 Investment of Debt Proceeds. Proceeds of debt will be invested until used for the intended project(s) in order to maximize utilization of the public funds. The investments will be made to obtain the highest level of safety. The General Manager will oversee the investment of bond proceeds in a manner to avoid, if possible, and minimize any potential negative arbitrage over the life of the bond issue, while complying with arbitrage and tax provisions.

7.4 Debt Coverage Target. In determining the affordability of a proposed debt financing, the District will perform an analysis comparing projected annual net revenues, after payment of operating and maintenance expenditures, to estimated annual debt service and the estimate debt coverage ratio. The debt coverage ratio is the amount of net cash flow available, divided by the annual interest and principal payments on debt.

The District's existing debt covenants for its 2016 Certificates of Participation capital debt financing require a legal debt coverage ratio of at least 1.25.

7.5 Debt Service Reserve Balance. District staff will monitor dedicated debt service reserve fund balances, ensuring compliance with related reserve requirements (if applicable), and periodically review the advisability of prepayment or refunding of related debt. The financial advantages of a current refunding must outweigh the cost of issuing the refunding debt by a sufficient margin to justify it. (The California Special Districts Association's best practices for debt management recommend at least 3.0% of the principal amount of the bonds being refunded, determined on a net present value basis.)

7.6 Call Options/Redemption Provisions. District staff will evaluate and recommend to the Board the use of a call option, if any, and a call protection period for each issuance. A call option, or optional redemption provision, gives the District the right to prepay or retire debt prior to its stated maturity. The option may permit the District to achieve interest savings in the future through refunding the debt. The cost of call options can vary widely, depending largely on market conditions, an evaluation of factors such as the call premium, time until the debt may be called at a premium or at par, and interest rate volatility.

7.7 Quarterly Reports. District staff will provide quarterly review and reporting to the Board of the debt's financial performance, including capital expenditures and interest earnings.

7.8 Debt Service Payments. Necessary appropriations for annual debt service requirements will be reflected in the District's annual budget. Staff is responsible for timely annual payments.

7.9 Continuing Disclosure Requirements. The District is responsible for ensuring that the District's annual financial statements, continuing disclosure reports, and material event notifications are posted on the MPWD website and/or the Electronic Municipal Market Access (EMMA) website of the Municipal Securities Rulemaking Board. The District may also contract with third-party consultant(s) to comply with its continuing disclosure obligations, and with Securities and Exchange Commission Rule 15c2-12(b)(5).

The District shall submit an annual report to CDIAC for any issuance of debt for which it has submitted a report of final sale on or after January 1, 2017. The annual report shall comply with the requirements of Government Code Section 8855 and related regulations.

Failure to comply with disclosure requirements may restrict the ability of the District to issue debt.

7.10 Investor Relations. Information that the District intends to make available to the investing public, including bondholders, rating analysts, investment advisors, or any other members of the investment community shall be filed on the MPWD website and the EMMA website.

The District will maintain proactive communications with the investment community, including rating agencies and investors, to ensure future capital market access at the lowest possible interest rates.

7.11 Records Retention. A copy of all relevant documents and records will be maintained by the District through the final maturity of the debt financing plus ten (10) years. Relevant documents and records will include sufficient documentation to support the requirements related to maintaining the tax-exempt status of the debt financing.