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.

Background / General Statement
The Soquel Creek Water District (the “District”) 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.

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. Finance and Business Services Manager
   The Finance and Business Services Manager of the District (the “Finance
   Manager”) 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.

C. General Manager

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

Legal and Financial Requirements

The District 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 District may be restricted by debt covenants in existing indebtedness documents.

Acceptable and Prohibited Uses of Debt

The District will consider financing for the acquisition, substantial refurbishment, replacement or expansion of physical or intangible 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.

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

D. Refunding, refinancing, or restructuring debt, subject to refunding objectives in accordance with the Debt Issuance Practices Section of this Policy.

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

F. Long-term debt financing shall not be used to fund operating or maintenance costs.

Approved Debt Instruments

Prior to the issuance of debt, the District will carefully consider overall long-term affordability of the proposed issuance. The District shall not assume additional debt without conducting an objective analysis of the District’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. Types of debt authorized under
this policy include:

A. **Revenue Bonds**

Payment for revenue bonds is secured by fees for water service. The District is responsible for establishing and collecting sufficient revenue through rates to retire the debt.

B. **Certificates of Participation**

Certifications of Participation (COP) 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, in some instances revenue is pledged as security for payment. Regardless of the debt surety, the District 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 District to disclose all incurred debt as they determine whether the District 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 District 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 District 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 District chooses to proceed with a direct loan or private placement of debt, the District will issue a request for proposal seeking bids from responsible and credit-worthy 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 District 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.

Integration of Debt and Capital Improvement Budget

The Finance Manager is responsible for developing and maintaining a multi-year finance model, which takes into consideration operating revenues and expenses; the capital improvement program; and debt covenant and reserve requirements. This model is used in the annual budget process, as well as to evaluate “pay as you go” or debt financing strategies to fund capital improvements.

Policy Goals and Objectives Related to Debt

The District has adopted a strategic goal to “ensure fiscal responsibility.” To assist in realizing this goal, the District 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 District has identified a target debt coverage ratio of 1.7 (170%).

Debt Structuring Practices

A. Term

The District will structure its debt issuances 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 District should consider shorter-term borrowings where appropriate.

B. Repayment

Typically, the District 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 determine 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 related to potential early redemption; and to foster refunding transactions. The potential for additional costs, such as a call premium and potentially higher interest rates, will be evaluated in the decision to redeem bonds.

D. Fixed versus Variable Rate Debt

The District’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 District 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 backed by liquid securities. Prior to the issuance of variable rate debt, the savings and other possible advantages compared to borrowing at a fixed rate will be subject to evaluation and comparative analysis.

Credit Enhancement

A credit enhancement may be used to establish or improve a credit rating on a District debt obligation. Types of credit enhancements include bond insurance, surety policies, or letters of credit. The Finance Manager will consider the use of a credit enhancement if it reduces the overall cost of a proposed financing.

Debt Issuance Practices

A. Professional Assistance

The Finance Manager 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 District’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 District’s Purchasing Policy.

B. Method of Sale

In the event of an issuance of bonds or COP by the District, the Finance Manager 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 overall performance of the entire debt portfolio. The following general methods can be used for the issuance of bonds:

- **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 District.

- **Negotiated Sale** – The District 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 District 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.

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

- **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 District 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 2.5% 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 District 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 Finance Manager may consult with a financial advisor to model other savings structures to meet the District’s financial needs.

**Debt Management Practices**

A. **Investment of Bond Proceeds**

The proceeds of bond sales may 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 District’s Investment Policy and bond indenture guidelines. The Finance Manager will provide investment guidance to a Trustee or management firm holding bond proceeds whether for a project or debt service reserve funds.

B. **Primary and Secondary Market Disclosures**

The Finance Manager 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 Annual Budget, 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 Finance Manager may also employ the services of a firm to assist with financial disclosure requirements.

C. **Arbitrage Rebate Monitoring and Filing**

The District 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 District will pay the amount of arbitrage to the Federal Government as required by Internal Revenue Service Regulation 1.148-11. The District 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.

D. Federal and State Law Compliance Practices

The Finance Manager is responsible for maintaining compliance with disclosure standards promulgated by state and national regulatory bodies, including the Government Accounting Standards Board, the National Federation of Municipal Analysts, the Securities and Exchange Commission, and Generally Accepted Accounting Principles.

E. Compliance with Bond Covenants

In addition to financial disclosure and arbitrage compliance, the District 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 budget allocation to meet debt service payments; ensuring relevant fees are levied and collected at a level sufficient to meet indenture requirements and debt service payments; guaranteeing the timely payment of debt service to a trustee or paying agent; and maintaining compliance with insurance, reserves, and other mandates.

Ongoing Market and Investor Relation Efforts

The District 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, periodic financial documents and annual CAFRs. A minimum of three years of annual budgets and CAFRs are placed on the District’s website.
Internal Control Procedures Related to Intended Use

The District references the following internal controls to ensure all bond proceeds are expended for their intended use.

- Review approved use of bond proceeds with department representatives who are authorized to initiate contracts and spend funds to ensure expenditures are consistent with the terms of the bond sale.
- Educate staff responsible for preparing purchase orders and processing payments as to items that can be paid using bond proceeds, as well as the proper account coding.
- Require the Finance Manager 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.

Debt Record Keeping

The Finance and Business Services 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.

- A copy of the legal documents, closing transcripts, bond counsel opinion, and other relevant documentation
- Any credit enhancements or other elections made with the debt issuance
- Official Statements
- Resolutions
- Trustee certificates
- Any titles or assets purchased with bond proceeds
- Draw requests and supporting material, including contract and expense records
- Documentation pertaining to the investment of bond proceeds, which include purchase and sale of securities, rebate calculations, and investment income and related items
- Evidence of all sources of payment or security for the bonds
The District 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 District’s financial software system. If the District 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. This Section requires an electronic storage system for image files that contains a retrieval system for indexing, storing, preserving, and retrieving, and reproducing all transferred information. The system must also ensure reasonable controls and quality assurances to ensure the integrity, accuracy, and reliability of the system. Detailed requirements can be found in Section 4.01 of Internal Revenue Service Revenue Procedure 97-22.

**Use of Derivatives**

This policy prohibits the use of derivative instruments, such as interest rate swaps, to hedge variable rate debt.