



DEBT AND FINANCIAL MANAGEMENT POLICIES

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RANCHO CALIFORNIA WATER DISTRICT

DEBT AND FINANCIAL
MANAGEMENT POLICIES

I. GENERAL MANAGEMENT POLICIES

The District will provide for a periodic review of its financial performance, and review its performance relative to the financial policies outlined herein. The Board of Directors may waive any provision of this Policy. These financial policies will be considered during the capital planning, budgeting, rate-setting, and debt-structuring process.

- In recognition of periodic changes in the cost of providing service to system users, service costs and fees will be reviewed annually and adjusted commensurately.
- The District will present any proposed adjustments to existing rates, fees, and charges at public meetings, and will consider recommendations and input from the public as it relates to such proposed changes.
- All District funds will be invested according to the Investment Policies of the District.
- Necessary appropriations for annual debt service requirements will be routinely included in the District's annual budget.
- The District will maintain proactive communication with the investment community, including rating agencies, credit enhancers, and investors, to ensure future capital market access at the lowest possible costs.

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 District staff in achieving its goals and objectives as defined in this Debt Management Policy; and
- All debt-financing participants shall make cooperation with District staff their highest priority.

II. FINANCIAL MANAGEMENT POLICIES

The District utilizes a comprehensive planning process to determine its long-term capital needs. The District evaluates each capital project in relation to established levels of reserves, current rate structure, expected asset life/replacement timeline, and available revenue sources to ensure that adequate financial resources are available to support the District's financial obligations.

The District's Debt and Financial Management, Land-Secured Financing, Reserve, Investment, and Swap Policies are integrated into the decision-making framework utilized in the budgeting and capital improvement planning process. As such, the following policies outline the District's approach to debt management.

- The District will evaluate financing options for each capital project on a case-by-case basis. The District will seek to pay for all capital projects from current revenues and available reserves prior to or in combination with the use of debt.
- The District will seek to issue debt only in the case where there is an identified source of repayment. Bonds will be issued to the extent that (i) projected revenues are sufficient to pay for the proposed debt service together with all existing debt service covered by such fixed revenues, or (ii) additional projected revenues have been identified as a source of repayment in an amount sufficient to pay for the proposed debt.
- 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, preference should be given for debt service to be structured primarily on a level basis unless other circumstantial factors apply. In all cases, the proposed form of structure should be presented to the Board as part of the review of the financing prior to approval.
- Debt issuance for a capital project will not be considered unless such issuance has been incorporated into the capital improvement plan (Long-Range Financial Plan).
- User Fees and Water Rates will be set at adequate levels, which are fair and nondiscriminatory, to generate sufficient revenues to pay all Operating and Maintenance costs, to maintain sufficient operating reserves, and to pay debt service costs, if necessary.
- Property Assessments and Connection Fees will be maintained at a level sufficient to finance a portion of growth-related capital costs and cover related annual debt service requirements.
- Property Assessments also will be utilized to finance a portion of replacement costs and related annual debt service payments.

III. DEBT AND CAPITAL MANAGEMENT POLICIES

The following policies formally establish parameters for evaluating, issuing, and managing the District's debt. The policies outlined below are not intended to serve as a list of rules to be applied to the District's debt issuance process, but rather to serve as a set of guidelines to promote sound financial management.

In issuing debt, the District objectives will be to:

- Achieve the lowest cost of capital;
- Ensure ratepayer equity;
- Maintain high credit ratings and access to credit enhancement; and
- Preserve financial flexibility.

Standards for Use of Debt Financing

When appropriate, the District will use long-term debt financing to: achieve an equitable allocation of capital costs/charges between current and future system users; to provide more manageable rates in the near and medium term; and to minimize rate volatility. 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).

- For growth-related projects, debt financing will be utilized, as needed, to better match the cost of anticipated facility needs with timing of expected new connections to the system.
- The District shall not construct or acquire a facility if it is unable to adequately provide for the subsequent annual operation and maintenance costs of the facility throughout its expected life.
- Capital projects financed through debt issuance will not be financed for a term longer than the expected useful life of the project.
- Lease Agreements and Installment Sale Agreements shall be considered as an alternative to long-term debt. Although these forms of alternative financing are subject to annual appropriation, they shall be considered as long-term fixed rate debt until maturity.

Financing Criteria

Each debt issuance should be evaluated on an individual basis within the framework of the District's Long Range Financing Plan and Master Installment Purchase Agreement, as well as within the context of the District's overall financing objectives and current market conditions.

The District will evaluate alternative debt structures (and timing considerations) to ensure the most cost-efficient financing under prevailing market conditions.

Credit Enhancement – The District will consider the use of credit enhancement on a case-by-case basis. Only when clearly demonstrable savings can be realized shall credit enhancement be utilized.

Cash-Funded Reserve vs. Surety – The District may purchase a surety policy or replace an existing cash-funded Debt Service Reserve Fund when deemed prudent and advantageous.

Call Provisions – In general, the District’s securities should include optional call provisions. The District will avoid the sale of non-callable long-term fixed rate bonds, absent careful evaluation of the value of the call option.

Additional Bonds Test/Rate Covenants - The amount and timing of debt will be planned to comply with the additional bonds tests and rate covenants outlined in the appropriate legal and financing documents, and these policies.

Short-Term Debt – The District may utilize short-term borrowing to serve as a bridge for anticipated revenues, construction financing or future bonding capacity.

Use of Variable Rate Debt – The District will not issue variable interest rate debt unless: the proposed debt is converted to a fixed rate or hedged (for an interim period or to maturity) by use of a put-type mode, swap agreement, or hedging mechanism (e.g., interest rate cap), or all outstanding (unhedged) variable rate debt, including the proposed new variable debt, does not exceed 1.2x the District’s “hedge position” in aggregate. For this purpose, the District’s hedge position will be calculated as the District’s cash reserves multiplied by a 1.5 hedge factor.

Use of Swaps & Derivatives – The use of any swap agreement in conjunction with the issuance or management of debt instruments will be governed by the District’s Swap Policy.

Investment of Bond Proceeds – Bond proceeds will be invested in accordance with the permitted investment language outlined in the bond documents for each transaction, unless further restricted or limited in the District’s Investment Policy. The District will seek to maximize investment earnings within the investment parameters set forth in each respective bond indenture. The reinvestment of bond proceeds will be incorporated into the evaluation of each financing decision; specifically addressing arbitrage/rebate position, and evaluating alternative debt structures and refunding savings on a “net” debt service basis, where appropriate.

Refinancing Outstanding Debt

The District shall have the responsibility to evaluate potential refunding opportunities presented by underwriting and/or financial advisory firms. The District will consider the following issues when analyzing potential refinancing opportunities:

Debt Service Savings – The District hereby establishes minimum target net present value (NPV) savings levels based upon the par amount of refunded debt. For Current Refunding transactions, the target level shall be 3% of the refunded par amount and for Advance Refunding transactions the NPV target level of savings shall be 5%. The target NPV savings levels, shall serve only as guidelines, the

District must evaluate each refunding opportunity on a case-by-case basis, and must take into consideration: the time to maturity, size of the issue, current interest rate environment, annual cash flow savings, escrow efficiency, and the value of the call option. A Current Refunding transaction is one which closes not more than ninety (90) days prior to the call date of the refunded debt. An Advance Refunding transaction is one which closes more than (90) days prior to the call date of the refunded debt.

The decisions to (i) deviate from the target NPV savings levels, or (ii) take all savings upfront or on a deferred basis must be explicitly approved by the District's Finance and Audit Committee and Board of Directors.

Restructuring – The District may seek to refinance a bond issue on a non-economic basis, in order to restructure debt, to mitigate irregular debt service payments, accommodate revenue shortfalls, release reserve funds, comply with and/or eliminate rate/bond covenants, or terminate a swap.

Term/Final Maturity – The District may consider the extension of the final maturity of the refunding bonds in order to achieve a necessary outcome, provided that such extension is legal. The term of the bonds should not extend beyond the reasonably expected useful life of the asset being financed. The District may also consider shortening the final maturity of the bonds. The remaining useful life of the assets and the concept of inter-generational equity should guide these decisions.

Escrow Structuring – The District shall utilize the least costly securities available in structuring each escrow. A certificate will be required from a third party agent who is not acting as a broker-dealer, stating that the securities were purchased through an arms-length, competitive bid process (in the case of open market securities), that such securities were more cost effective than State and Local Government Series Securities (SLGS), and that the price paid was reasonable and within Federal guidelines.

When evaluating the economic viability of an economic versus legal defeasance, the District shall take into consideration both the financial impact on a net present value basis as well as the rating/credit impact. The District shall take all necessary steps to optimize its escrows and to avoid negative arbitrage in its refunding transactions.

Method of Issuance

The District will determine, on a case-by-case basis, whether to sell its bonds competitively or through negotiation. Prior to approving the issuance of any debt, the District shall comply with Government Code Section 5852.1 by disclosing specified good faith estimates in a public meeting prior to the authorization of the issuance of bonds.

Competitive Sale – In a competitive sale, the District's bonds shall be awarded to the bidder providing the lowest true interest cost ("TIC"), as long as the bid adheres to requirements set forth in the official notice of sale.

Negotiated Sale – The District recognizes that some securities are best sold through negotiation. In consideration of a negotiated sale, the District shall assess the following circumstances:

- Issuance of variable rate or taxable bonds;
- Complex structure or credit considerations (such as non-rated bonds), which requires a strong pre-marketing effort;
- Significant par value, which may limit the number of potential bidders;
- Unique/proprietary financing mechanism (such as a financing pool), or specialized knowledge of financing mechanism or process;
- Market volatility, such that the District would be better served by flexibility in the timing of its sale in a changing interest rate environment;
- When an Underwriter has identified new financing opportunities or presented alternative structures that financially benefit the District; and
- As a result of an Underwriter's familiarity with the project/financing, and which enables the District to take advantage of efficiency and timing considerations.

Private Placement – From time to time the District may elect to issue debt on a private placement basis. Such method shall only be considered if it is demonstrated to result in cost savings or provide other advantages relative to other methods of debt issuance, or if it is determined that access to the public market is unavailable and timing considerations require that a financing be completed.

Market Communication, Debt Administration and Reporting Requirements

Rating Agencies and Investors – The Chief Financial Officer shall be responsible for maintaining the District's relationships with Moody's Investors Service, Standard & Poor's Ratings Services and Fitch Ratings. The District may, from time to time, choose to deal with only one or two of these agencies as circumstances dictate. Additionally, the District shall use its website as a tool to provide timely information regarding its debt issuances.

In addition to general communication, the Chief Financial Officer shall: (1) meet, either in person or electronically, with credit analysts at least once each fiscal year, and (2) prior to each competitive or negotiated sale, offer conference calls with agency analysts in connection with the planned sale.

Board Communication – The Chief Financial Officer shall include in an annual report to the Finance and Audit Committee and the Board of Directors feedback from rating agencies and/or investors regarding the District's financial strengths and weaknesses and recommendations for addressing any weaknesses.

Continuing Disclosure – The District shall remain in compliance with its continuing disclosure undertakings made with respect to Securities and Exchange Commission Rule 15c2-12 (“Rule 15c2-12”) by filing its annual financial statements and other financial and operating data for the benefit of its bondholders by no later than December 31st of each year and by filing notice of any listed events as required by the undertakings. A failure to make timely filings must be disclosed and would be a negative reflection on the District. The Chief Financial Officer will be responsible for ensuring the District's timely filing on the Electronic Municipal Market Access (EMMA) listing, or successor, and

as otherwise required by regulation.

Effective February 27, 2019, Rule 15c2-12 was amended to add two events to the required disclosure by issuers with respect to any “financial obligation” as defined in Rule 15c2-12. For purposes of Rule 15c2-12, the term “financial obligation” means a (i) debt obligation; (ii) derivative instrument entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation; or (iii) guarantee of (i) or (ii). The term “financial obligation” shall not include municipal securities (as defined in the Securities Exchange Act of 1934, as amended) as to which a final official statement (as defined in Rule 15c2-12) has been provided to the MSRB consistent with Rule 15c2-12.

Under the first of the added events, the District must disclose any default, event of acceleration, termination event, modification of terms, or other similar events with respect to any “financial obligation” as defined in Rule 15c2-12. To assist in complying with this added event, the General Counsel, General Manager, or other senior staff, or other executive positions within the District, will provide written notice to the Chief Financial Officer of receipt by Rancho California Water District of any default, event of acceleration, termination event, modification of terms or other similar events (collectively, a “Potentially Reportable Event”) under any agreement or obligation to which the District is a party and which may be a “financial obligation” as defined above. Such written notice should be provided by General Counsel to the Chief Financial Officer as soon as the General Counsel is placed on written notice by District staff, consultants, or external parties of such event or receives written notice of such event so that the Chief Financial Officer can determine, with the assistance of disclosure counsel, whether notice of such Potentially Reportable Event is required to be filed on EMMA pursuant to the disclosure requirements of Rule 15c2-12. If filing on EMMA is required, the filing is due within 10 business days of such Potentially Reportable Event to comply with continuing disclosure undertakings for debt obligations of the District issued after February 27, 2019.

Under the second of the added events, the District must disclose the incurrence of a “financial obligation” of the District, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the District, any of which affect security holders. To assist in complying with this added event, the General Counsel, General Manager, or other senior staff or other executive positions within the District, as applicable, will report to the Chief Financial Officer the execution by the District of any agreement or other obligation entered into after February 27, 2019, which might constitute a “financial obligation” for purposes of Rule 15c2-12 and any amendments to existing District agreements or obligations which might constitute a “financial obligation” for purposes of Rule 15c2-12, which relate to covenants, events of default, remedies, priority rights, or other similar terms. Such report to the Chief Financial Officer should be made as soon as the General Counsel, General Manager, or such other senior staff is placed on written notice by District staff, consultants, or external parties of such event or receives a written notice of such amendment requests. Notice to the Chief Financial Officer is necessary so that the Chief Financial Officer can determine, with the assistance of disclosure counsel, whether such agreement or other obligation constitutes a material “financial obligation” for purposes of Rule 15c2-12. If such agreement or other obligation is determined to be a material “financial obligation” or a material amendment to a “financial obligation,” notice thereof would be required to be filed on EMMA within 10 business days of incurrence or amendment.

The types of agreements or other obligations which could constitute a “financial obligation” under the Rule and which may need to be reported on EMMA include:

1. Bank loans or other obligations which are privately placed;
2. State or federal loans;
3. Commercial paper or other short-term indebtedness for which no offering document has been filed on EMMA;
4. Letters of credit, surety policies, or other credit enhancement with respect to the District’s publicly offered debt;
5. Letters of credit, including letters of credit which are provided to third parties to secure the District’s obligation to pay or perform (an example of this is a standby letter of credit delivered to secure the District’s obligations for performance under a mitigation agreement);
6. Capital leases for property, facilities, fleet or equipment;
7. Agreements which guarantee the payment or performance obligations of a third party (regardless of whether the agreements constitute guarantees under California law);
8. Payment agreements which obligate the District to pay a share of another public agency’s debt service (for example, an agreement with a joint powers agency whereby the District agrees to pay a share of the joint powers agency’s bonds, notes or other obligations);
9. Service contracts with a public agency or a private party pursuant to which the District is obligated to pay a share of such public agency or private party’s debt service obligation (for example, certain types of P3 arrangements); and
10. Any agreement the payments under which are not characterized as an operation and maintenance expenses for accounting purposes if such agreement could be characterized as the borrowing of money.

The Chief Financial Officer will continue to work with the General Counsel and disclosure counsel to refine the definition of “financial obligation” going forward, based on future SEC guidance.

Record-Keeping – A copy of all debt-related records shall be retained at the District’s offices. At minimum, these records shall include all official statements, bid documents, bond documents/transcripts, resolutions, trustee statements, leases, and title report for each District financing (to the extent available). To the extent possible, the District shall retain an electronic copy of each document – preferably in PDF format.

Arbitrage Rebate – The use of bond proceeds and their investments must be monitored to ensure compliance with all Internal Revenue Code Arbitrage Rebate Requirements. The Chief Financial Officer shall ensure that all bond proceeds and investments are tracked in a manner which facilitates accurate calculation; and, if rebate is due, such payments are made in a timely manner.

Reporting--Pursuant to Government Code section 8855(k), the District will submit annual debt transparency reports for any debt issued on or after January 21, 2017 every year until the debt is no longer outstanding and all proceeds have been fully spent.

The District will submit Marks-Roos Yearly Fiscal Status Reports for any debt issued pursuant to Government Code section 6599 1(b) of the Marks-Roos Local Bond Pooling Act of 1985, as amended, every year until the final maturity of bonds or the debt is no longer outstanding.

Compliance with Tax Exempt and Tax Advantaged Obligations

The Board of Directors of the Rancho California Water District recognizes its responsibility to ensure compliance with all Federal laws and regulations (“Federal Requirements”) associated with the issuance of tax-exempt debt (“Tax-Exempt Obligations”) and tax-advantaged direct pay notes, bonds or other form of repayment obligations issued under Section 54A or Section 1400U-2 of the Internal Revenue Code (“Tax Advantaged Obligations”). The purpose of this policy is to provide guidelines and establish procedures for compliance with Federal Requirements in connection with the issuance of Tax-Exempt Obligations and Tax Advantaged Obligations.

Procedures

Unless otherwise instructed by bond counsel, at least five business days before distributing a preliminary official statement in which the District contemplates offering Tax Advantaged Obligations for sale, the District will obtain the advice of bond counsel regarding applicable Internal Revenue Code compliance with respect to the Tax Advantaged Obligations and provide a written notice to financial advisor, underwriter, and its counsel, that none of the maturities which represent Tax Advantaged Obligations can have an issue price with more than a *de minimis* amount of premium as required by Section 54AA(d)(2)(c) of the Internal Revenue Code (or other applicable Section of the Internal Revenue Code or guidance provided thereunder as instructed by bond counsel) and that costs of issuance (including underwriter’s discount) cannot exceed 2% of the proceeds of the sale of the Tax Advantaged Obligations.

Unless otherwise instructed by bond counsel, prior to executing any purchase contract with respect to Tax Advantaged Obligations, the District will require written confirmation from the underwriter that at least the first ten percent of each maturity of Tax Advantaged Obligations has been sold to the public (and not to bond houses, brokers, or other intermediaries) at a price that does not have more than a *de minimis* amount of premium as required by Section 54AA(d)(2)(c) of the Internal Revenue Code (or other applicable section of the Internal Revenue Code or guidance provided thereunder as instructed by bond counsel) and that costs of issuance do not exceed 2% of the proceeds of the sale of the Tax Advantaged Obligations.

Unless otherwise instructed by bond counsel, monthly, the Treasurer will provide a written report to the Board of the expenditure of proceeds derived from Tax-Exempt Obligations and Tax Advantaged Obligations certifying the amount expended in the prior month, the total amount expended from the date of the closing of the transaction; that the expenditure was for capital projects (as defined by the applicable provisions of the Internal Revenue Code and guidance provided thereunder (or as otherwise permitted by bond counsel)); the amount remaining to be spent; and the amount remaining invested in a reasonably required reserve fund, if any.

Unless otherwise instructed by bond counsel, at closing the District will execute documentation covenanting to comply with Federal rebate and arbitrage requirements. Unless otherwise instructed by bond counsel, annually the District will engage a consultant to calculate and report the arbitrage rebate liability of the District. Unless otherwise instructed by bond counsel, every five years the District will file (if arbitrage rebate is owed) with the Internal Revenue Service the appropriate required documentation demonstrating arbitrage rebate liability and provide payment of at least 90% to the US Treasury for arbitrage rebate liability, if any.

Unless otherwise instructed by bond counsel, at least 67 days before an interest payment date pertaining to fixed rate Tax Advantaged Obligations, the District will calculate, or cause to be calculated:

the interest amount due on the next interest payment date; and
the refundable credit to be reported on Form 8038-CP.

Unless otherwise instructed by bond counsel, the Treasurer will file, or cause to be filed, the completed and executed Form 8038-CP with the Department of the Treasury not later than 45 days prior to the applicable interest payment date. The Treasurer is hereby designated as the staff person responsible for the District's compliance with this policy.

Internal Controls

In order to comply with the following internal controls, the Chief Financial Officer, Chief Engineer and applicable Project Manager (project engineer or construction manager) shall share responsibility to assure that disbursements are made only after each request for disbursement is substantiated with appropriate invoices, requisitions, and other supporting documentation. Each of the aforementioned shall thoroughly review any request for disbursement and may request further documentation as may be deemed appropriate.

- To ensure that proceeds of any debt issued, in accordance with its governing documents and this Policy, the following internal controls shall be implemented: (1) no disbursements shall be made without the written approval of the Chief Financial Officer and the Assistant General Manager or General Manager ; (2) The draw request shall be provided to the Chief Financial Officer by the Project Manager; and (3) approval shall only be provided when the Chief Financial Officer is in receipt of an appropriate certification from the Project Manager and Chief Engineer, 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 is has adopted the policies described in Senate Bill No. 1029 ("SB 1029"), an amendment to Section 8855 of the Government Code to require additional reporting on state and local outstanding debt, until fully repaid or redeemed. SB 1029 requires the submission of an annual report contacting specified information

about debt issued and the use of debt proceeds including a certification by the issuer that it has adopted local debt policies and that the contemplated debt issuance is consistent with those local debt policies.

Procurement and Evaluation of Primary Professional Services

Appointment of Service Providers – At the discretion of the Chief Financial Officer, the District shall solicit from time to time bids, quotes or proposals, including sole source proposals for the following services on an as needed basis to ensure the District is receiving the necessary level of service at competitive market rates: The selection shall be based on qualifications, experience, and fees so as to provide the most value to the District for the necessary level of service and expertise provides at or under competitive market rates.

- Municipal Advisor – Service provider that ensures the District complies with all financial management procedures and policies and ensures successful closing for bond transactions. While serving as the District’s municipal advisor, a firm may not also engage in the underwriting of the District bond issue for which that firm acts as municipal advisor. A firm may not switch roles (i.e., from municipal advisor to underwriter) after a financial transaction has begun.
- 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.
- Disclosure Counsel – Service provider that drafts offering documentation in connection with the sale of debt to ensure compliance with all federal and state securities laws and regulations; provides appropriate legal opinions in in connection with the offering documentation under state and federal laws as applicable.

Nothing in this Policy shall prevent the District from using the same law firm from acting as both Bond and Disclosure Counsel.