SAN LORENZO VALLEY WATER DISTRICT
DEBT MANAGEMENT POLICY
Effective: November 15, 2018

Policy Statement

This policy documents the goals and guidelines of the San Lorenzo Valley Water District (the "District") for the use of debt instruments for financing the District's water and sewer systems, and projects therefor, and other financing needs. The District recognizes the need to invest in ongoing capital replacement and rehabilitation of its facilities as well as new infrastructure to ensure future viability of services, and that the appropriate use of debt can facilitate the timely construction of such facilities.

The District expects to pay for infrastructure and other projects from a combination of current revenues, available reserves, and prudently issued debt. The District recognizes that debt can provide an equitable means of financing projects for its customers and provide access to new capital needed for infrastructure and project needs. Debt will be used to meet financing needs (i) if it meets the goals of equitable treatment of all customers, both current and future; (ii) if it is cost-effective and fiscally prudent, responsible, and diligent under the prevailing economic conditions; and (iii) if there are other important policy reasons therefor. All District debt must be approved by the Board of Directors ("Board").

To endorse prudent financial management and achieve the highest practical credit ratings, the District is committed to systematic capital planning, and long-term financial planning. Evidence of this commitment to long-term capital planning is demonstrated through adoption and periodic adjustment of the District's current capital improvement program or plan ("CIP") identifying the benefits, costs and method of funding capital improvement projects over the planning horizon.

Purpose of Policy

The purpose of this debt management policy is to:

- Establish parameters for issuing debt, including the purposes for which debt can be issued and used;
- Describe how debt and debt proceeds will be managed;
- Provide guidance as to the type of debt to be issued; and
- Provide guidance as to the relationship between the capital improvement plan and debt issuance.

Purpose and Use of Debt

The District will utilize reasonable debt financing to fund long-term improvements and thus ensure equitable allocation of costs. Long-term improvements may include the acquisition of land, facilities, and infrastructure; and enhancements or expansions to existing facilities for providing drinking water services and sewage collection and treatment services to those properties located within the District's boundaries. Debt can be issued to fund the planning, pre-design, design, land and/or easement acquisition, construction, and related fixtures, equipment and other costs as permitted by law. The District will not issue debt to cover operating needs.

The District may utilize short-term financing (including leases) to, among other things, finance certain essential equipment and vehicles. These assets can range from service vehicles to equipment. The underlying asset must have a minimum useful life of one year or more. Short-term financings, including loans, on bill financing and capital lease purchase agreements, are executed to meet such needs.

The District Manager will periodically evaluate the District's existing debt and recommend refinancings or prepayment (refunding) when economically beneficial. A refinancing may include the issuance of bonds to refund existing bonds or the issuance of bonds in order to refund other obligations, such as commercial paper or loans.

The District Manager, Underwriter and Municipal Advisor (if any shall then be retained) as appropriate shall be responsible for analyzing any debt financing proposal to determine if it is beneficial to the District and if it complies with the District's long-term financial planning objectives, including maintaining or improving the current credit ratings assigned to outstanding debt by the major credit rating agencies.

The proceeds of any debt obligation shall be expended only for the purpose for which it was authorized. Debt may only be issued upon Board authorization. No debt shall be issued with a maturity date greater than the expected weighted average useful life of the facilities or improvements being financed. The final maturity of bonds or state or federal loan debt shall be limited to 40 years after the date of issuance.

Debt Management

The District will provide for a periodic review of its financial performance and review its performance relative to the financial policies outlined herein. These financial policies will be taken into account during the capital planning, budgeting, and rate setting process. As part of the rate setting process, the District may choose to hire an independent Rate Consultant to prepare a Rate Study. 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 interest rates.

The following principles outline the District's approach to debt management:

- The District will issue debt only in the case where there is an identified source of repayment. Debt will be issued to the extent that (i) projected existing revenues are sufficient to pay for the proposed debt service together with existing debt service covered by such existing revenues, (ii) additional revenues, as necessary, have been identified as a source of repayment in an amount sufficient to pay for the proposed debt, and (iii) bond covenants will be maintained.

- Debt will be structured for the shortest period possible, consistent with an equitable allocation of costs to current and future users. Borrowings by the District should be of a duration that does not exceed the useful life of the improvement that it finances and where feasible, should be shorter than the projected economic life.

- The District may issue bonds on a fixed or variable interest rate basis. The District's standard practice shall be to issue bonds on a fixed rate basis. Fixed rate securities ensure budget certainty through the life of the securities and can be advantageous in a low interest rate environment. In rare instances, where the financial advantage of such financing structure is significant and only with the unanimous approval of the District's Board members, the District may choose to issue securities that pay a rate of interest that varies according to a predetermined formula or results from a periodic remarketing of the securities. Such variable rate bonds will be limited to no more than 25% of outstanding debt.

The proceeds of the bond sales 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 District's Investment Policy and the specific bond Indentures govern objectives and criteria for investment of bond proceeds. The District 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 issuance, while complying with arbitrage and tax provisions.

Bond proceeds will be deposited and recorded in separate accounts to ensure funds are not comingled with other forms of District cash and investments. The District's trustee will administer the disbursement of bond proceeds pursuant to an Indenture of Trust, a Trust Agreement, Installment Sale Agreement, or such other documents governing debt issuance (collectively, the "Indenture"). Requisition for the disbursement of bonds funds must be approved by the District Manager.

The District Manager will monitor dedicated debt reserve fund balances and periodically review the advisability of prepayment or refunding of related debt. The financial advantages of a current refunding must outweigh the cost of reissuing new debt. A potential refunding will be assessed in combination with any new capital projects requiring financing, and the benefits of the refunding will be evaluated in relation to its costs and risks.

Debt can be refunded to achieve one or more of the following objectives:

- To reduce future interest costs;
- To restructure future debt service in response to evolving conditions regarding anticipated revenue sources;
- To accomplish tax-exempt refundings (that is, refinancings within 90 days of the call date), which must meet a minimum net present value savings target of 2.5% of refunded bonds; and
- To restructure the legal requirements, termed covenants of the original issue to reflect more closely the changing conditions of the District or the type of debt.

Debt Service Coverage Target

The District will not engage in debt financing unless the proposed obligation, when combined with all existing debts, will result in acceptable debt service coverage ratios. In determining the affordability of proposed revenue bonds, the District will perform an analysis comparing projected annual net revenues (after payment of operating and maintenance ("O&M expense") to estimated annual debt service and estimated debt service coverage ratio ("DCR"). DCR is the amount of cash flow available to meet annual interest and principal payment on debt.

The District's objective is to maintain a DCR at or above 1.25 times to maintain its high quality credit rating.

Debt Instrument Rating

The District Manager, with the advice of the District's Municipal Advisor (if any shall then be retained), will assess whether a credit rating should be obtained for an issuance and make a recommendation to the Board. If it is determined that a credit rating is desirable, the probable rating of the proposed debt issuance is assessed before its issuance, and necessary steps are taken in structuring the debt issuance to ensure that the best possible rating is achieved.

Debt Structuring

In structuring a debt issuance, the District will manage the amortization of debt, and to the extent possible, match its cash flow to the anticipated debt service payments. The District will seek to structure debt with aggregate level principal and interest payments over the life of the borrowing. "Backloading" of debt service will be considered only when such structuring is beneficial to the District's aggregate overall debt payment schedule.

The District Manager, with the advice of the District's Underwriter or Municipal Advisor, as applicable (if any shall then be retained), will evaluate and recommend to the Board the use of a call option, if any, and 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. This option may permit the District to achieve interest savings in the future through refunding of the bonds. Because the cost of call options can vary widely, depending on market conditions, an evaluation of factors, such as the call premium, time until the bonds may be called at a premium or at par, and interest rate volatility will guide the decision to issue bonds with a call option. Generally, 30-year tax exempt municipal borrowings are structured with a 10-year call. From time to time, shorter call options (5-9 years) may also be used.

Types of Debt

Permissible types of debt issuable under this policy include, but are not limited to, revenue bonds, Certificates of Participation, variable rate bonds, state revolving fund ("SRF") loans, federal loans, bank loans, notes, commercial paper, direct placements, capital leases, and lease-purchase financing. The weighted average useful life of the asset(s) or project shall exceed the payout schedule of any debt the District assumes.

In addition to the aforementioned long and short-term financing instruments, the District may also consider joint arrangements with other governmental agencies. Communication and coordination will be made with local governments regarding cost sharing in potential joint projects, including leveraging grants and funding sources.

The District is authorized to join with other special districts and/or municipal agencies to create a separate entity, a Joint Powers Authority, to issue debt on behalf of the District, the special district or municipality. The District will only be liable for its share of debt service, as specified in a contract executed in connection with the joint venture debt.

Credit Enhancement

Credit enhancement may be used to improve or establish a credit rating on District debt obligation. Types of credit enhancement include Letters of Credit, bond insurance or surety policies. The District Manager will recommend to the Board the use of credit enhancement if it reduces the overall cost of the proposed financing or if, in the opinion of the District Manager (with the advice of counsel and the District's Municipal Advisor, if any shall then be retained), the use of such credit enhancement furthers the District's overall financial objectives.

Debt Service Reserve Fund/Surety Policy

Unless there are market requirements or it is important to increase credit ratings, the District will not fund a debt service reserve fund as part of its debt issuance. To the extent the District Manager (with the advice of counsel and the District's Municipal Advisor, if any shall then be retained) determine that a debt service reserve fund is advantageous, the debt reserves will be maintained in accordance with the applicable Indenture or the current District reserve policy (if any).

Capitalized Interest

Generally, interest shall be capitalized for the construction period of a revenue-producing project, and debt service does not begin until the project is expected to be operational and producing revenues. In addition, for lease back arrangements, such as those used for lease revenue bond transactions, interest may be capitalized for the construction period, until the asset is operational. Only under extraordinary circumstances, interest may be capitalized for a period longer than the construction period.

Credit Ratings

The District will seek to maintain the highest possible credit ratings that can be achieved for debt instruments without compromising the District's policy objectives. Ratings are a reflection of the general fiscal health of the District. By maintaining the highest possible credit ratings, the District can issue its debt at a lower interest cost. To enhance creditworthiness, the District is committed to prudent financial management, systematic capital planning, and long-term financial planning.

The District recognizes that external economic, natural, or other events may from time to time affect the creditworthiness of its debt. Each proposal for additional debt will be analyzed for its impact upon the District's debt rating on outstanding debt.

Rating Agency Relationships

The District may seek credit ratings from any or all of the major credit rating agencies - Standard & Poor's, Moody's Investors Service, and Fitch Investors Service, as appropriate. In addition, the District will evaluate the value of additional ratings on a case by case basis (e.g., Kroll Rating Services). District staff will provide periodic updates to the rating agencies, both formal and informal, on the District's general financial condition and coordinate meetings and presentations in conjunction with a new debt issuance when determined necessary.

The retention of a rating agency relationship will be based on a determination of the potential for more favorable interest costs as compared to the direct and indirect cost of maintaining that relationship.

Bond Ratings

The District Manager, with the advice of the District's Underwriter or Municipal Advisor, as applicable, (if any shall then be retained), shall be responsible for determining whether a rating shall be requested on a particular financing, and which of the major rating agencies shall be asked to provide such a rating.

Method of Sale

The District will select the method of sale which best fits the type of bonds being sold based on the term of the project, market conditions, and the structure of bond maturities which enhances the overall performance of the entire debt portfolio. Three general methods exist for the sale of municipal bonds:

I. ***Competitive sale***. Bonds will be marketed to a wide audience of investment banking (underwriting) firms. The underwriter is selected based on its best bid for its securities. The District will award the sale of the competitively sold bonds on a true interest cost ("TIC") basis. Pursuant to this policy, the District Manager is hereby authorized to sign the bid form on behalf of the District fixing the interest rates on bonds sold on a competitive basis.

II. ***Negotiated sale***. The District Manager shall select the underwriter, or team of underwriters, of its securities in advance of the bond sale, subject to Board approval. The District works with the underwriter to bring the issue to market and negotiates all rates and terms of the sale. In advance of the sale, after receiving approval from the Board of Directors, and with advice from the District's Municipal Advisor (if any shall then be retained), the District Manager will determine compensation for and liability of each underwriter employed and the designation rules and priority of orders under which the sale itself will be conducted. Pursuant to this policy, the District Manager is hereby authorized to sign the bond purchase agreement on behalf of the District fixing the interest rates on bonds sold on a negotiated basis.

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

Roles and Responsibility

The primary responsibility for developing debt financing recommendations rests with the District Manager. In developing such recommendations, the District Manager shall consider the need for debt financing and assess progress on the current CIP and any other program/improvement deemed necessary by the District. The Board authorizes and approves debt financing and/or debt service related recommendations and proposals.

All proposed debt financings shall be approved by the Board. Debt is to be issued pursuant to the authority of and in full compliance with provisions, restrictions and limitations of the Constitution and laws of the State of California, including Government Code ("CGC") §54300 et seq. and §53570 et seq.

Bond Counsel

The District will retain external bond counsel for all debt issues. As part of its responsibility to oversee and coordinate the marketing of all District indebtedness, the District Manager shall make recommendations for approval by the Board on the retention of bond counsel.

Bond counsel will prepare the necessary authorizing resolutions, agreements and other documents necessary to execute the financing. All debt issued by the District will include a written opinion by bond counsel affirming that the District is authorized to issue the debt, stating that the District has met all state constitutional and statutory requirements necessary for issuance, and determining the debt's federal income tax status.

Municipal Advisors

The District will seek the advice of the Municipal Advisor when necessary. The Municipal Advisor will advise on the structuring of obligations to be issued, provide information on various options, give advice as to how choices will impact the marketability of the District's obligations and will provide other services as required.

Underwriters

When a negotiated sale will provide significant benefits to the District that would not be achieved through a competitive sale, the District may elect to sell its debt obligations through negotiated sale, upon approval by the Board of Directors. Such determination may be made on an issue-by-issue basis, for a series of issues, or for part or all of a specific financing program. The District Manager shall select the Underwriter. A competitive process may be used but shall not be required. Before work commences on a bond issue to be sold at negotiated sale, the Underwriter shall provide the District Manager a detailed estimate of all components of their compensation, and disclose any potential conflicts of interest.

Federal Arbitrage and Rebate Compliance – Internal Controls

The District will fully comply with federal arbitrage and rebate regulations. Concurrent with this policy, the District Manager will take all permitted steps to minimize any rebate liability through proactive management in the structuring and oversight of its individual debt issues. All of the District's tax-exempt issues, including lease purchase agreements, are subject to arbitrage compliance regulations.

The District Manager shall be responsible for the following:

I. Monitoring the expenditure of bond proceeds to ensure they are used only for the purpose and authority for which the bonds were issued and exercising best efforts to spend bond proceeds in such a manner that the District shall meet one of the spend-down exemptions from arbitrage rebate. Tax-exempt bonds will not be issued unless it can be reasonably expected that 85% of the proceeds will be expended within the three-year temporary period.

II. Monitoring the investment of bond proceeds with awareness of rules pertaining to yield restrictions. Maintaining detailed investment records, including purchase prices, sale prices and comparable market prices for all securities.

III. Contracting the services of outside arbitrage consultants to establish and maintain a system of record keeping and reporting to meet the arbitrage rebate compliance requirements of federal tax code.

To the extent any arbitrage rebate liability exists, the District will report such liability in its annual audited financial statements.

Continuing Disclosure

The District will meet secondary disclosure requirements in a timely and comprehensive manner, as stipulated by the Securities Exchange Commission Rule 15c2-12. The District Manager shall be responsible for providing ongoing disclosure information to the Municipal Securities Rulemaking Board's Electronic Municipal Market Access system, the central depository designated by the SEC for ongoing disclosures by municipal issuers. The District Manager may determine to hire an outside consultant to assist the District with its secondary disclosure requirements under Rule 15c2-12.

The District will keep current with any changes in both the administrative aspects of its filing requirements and the national repositories responsible for ensuring issuer compliance with the continuing disclosure regulations. In the event a "listed event" occurs requiring immediate disclosure, the District Manager will ensure information flows to the appropriate disclosure notification parties.

Compliance with Bond Covenants

In addition to financial disclosure and arbitrage compliance, once the bonds are issued, the District is responsible for verifying compliance with all undertakings, covenants, and agreements of each bond issuance on an ongoing basis. This typically includes ensuring:

- Annual appropriation of revenues to meet debt service payments;
- Timely transfer of debt service payments to the trustee or paying agent;
- Compliance with insurance requirements;
- Compliance with rate covenants, where applicable; and
- Compliance with all other bond covenants.

On an annual basis, the District Manager will prepare all required debt related schedules and footnotes for inclusion in the District's audited financial statements. The audited financial statements shall describe in detail all funds, fund balances and debt service coverage tables, if applicable, established as part of any direct debt financing of the District, including the following information for each fiscal year:

- Debt authorized at the beginning of, during, and at the end of the fiscal year, whether or not such debt is issued, as well as debt authority lapsed during the fiscal year;
- Principal amount of initial outstanding debt, paid outstanding debt, and remaining outstanding debt at the end of the fiscal year;
- Amount of initial debt proceeds, expended debt proceeds and their purpose, and debt proceeds remaining at the end of the fiscal year.

The audited financial statements may also contain a report detailing any material or rate covenants contained in any direct offering of the District and whether or not such covenants have been satisfied.

Policy Review

On an as needed basis, the District Manager will be responsible for updating and revising this Policy which shall be reviewed at the Board meeting and adopted by the Board of Directors.