OTAY WATER DISTRICT **BOARD OF DIRECTORS POLICY**			
Subject DEBT POLICY	Policy Number 45	Date Adopted 4/13/04	Date Revised 9/4/13

1.0: POLICY

It is the policy of the Otay Water District to finance the acquisition of high value assets that have an extended useful life through a combination of current revenues and debt financing. Regularly updated debt policies and procedures are an important tool to insure the use of the District's resources to meet its commitments, to provide the highest quality of service to the District's customers, and to maintain sound financial management practices. These guidelines are for general use and allow for exceptions as circumstances dictate.

2.0: SCOPE

This policy is enacted in an effort to standardize the issuance and management of debt by the Otay Water District. The primary objective is to establish conditions for the use of debt, to minimize the District's debt service requirements and cost of issuance, to retain the highest practical credit rating, maintain full and complete financial disclosure and reporting, and to maintain financial flexibility for the District. This policy applies to all debt issued by the District including general obligation bonds, revenue bonds, capital leases and special assessment debt.

3.0: LEGAL & REGULATORY REQUIREMENTS

The Chief Financial Officer (CFO) and the District's Legal Counsel will coordinate their activities to ensure that all securities are issued in full compliance with Federal and State law.

4.0: CAPITAL FACILITIES FUNDING

Financial Planning

The District maintains a six-year financial projection that identifies operating requirements and public facility and equipment requirements, and has developed a Rate Model for funding the District's 6-Year Capital Improvement Program (CIP). The District's CIP Budget places the capital requirements in order of priority and schedules them for funding and implementation. It identifies a full range of capital needs, provides for the ranking of the importance of such needs, and identifies all the funding sources that are available to cover the costs of the projects. In cases where the program identifies project funding through the use of debt financing, the budget should provide information needed to determine debt capacity. The Rate Model and the

CIP Budget give the Board part of the data needed to make informed judgments concerning the possibility of issuing debt.

Funding Criteria

The Chief Financial Officer (CFO) will evaluate all capital project requests and develop a proposed funding plan. Priority may be given to those projects that can be funded with current resources (annual cash flow, fund balances or reserves). Those projects that cannot be funded with current resources may be deferred or the CFO may recommend that they be funded with debt financing. However, debt financing will not be considered appropriate for any recurring purpose such as current operating and maintenance expenditures. The issuance of short-term cash-flow instruments is excluded from this limitation.

The General Manager will recommend the funding plan to the Board. The General Manager may deem it necessary or desirable in certain circumstances to convene a Finance Committee meeting to evaluate funding options presented by the Chief Financial Officer.

Funding Sources

The District's capital improvements can be classified in three categories: those related to an expansion of the system ("expansion"), those related to upgrading the existing system ("betterment") and those related to repairing or replacing existing infrastructure ("replacement"). In general, capital improvements for betterment or replacement are financed primarily through user charges, availability charges, and betterment charges. Capital improvements for expansion are financed through capacity fees. Accordingly, these fees are reviewed at least annually or more frequently as required and set at levels sufficient to ensure that new development pays its fair share of the costs of constructing necessary infrastructure. Additionally, the District will seek State and Federal grants and other forms of intergovernmental aid wherever possible.

Pay-As-You-Go Projects

The District's capacity fees are the major funding source in financing additions to the water system and the recycled water system. Over time, the fees collected and the cost to construct the capital projects should balance. However, collection of these fees is subject to significant fluctuation based on the rate of new development. Accordingly, the Chief Financial Officer, in developing the funding plan for the CIP, will determine that current revenues and adequate fund balances are available so project phasing can be accomplished. If this is not the case, the Chief Financial Officer may recommend that:

1. The project be deferred until funds are available, or
2. Based on the priority of the project, long-term debt is issued to finance the project.

Debt Financed Projects

If a project or projects are to be financed with long-term debt, the District should use the following criteria to evaluate the suitability of the financing for the particular project or projects:

1. The life of the project or asset to be financed is 10 years or longer and its useful life is expected to exceed the term of the financing.
2. Revenues available for debt service are deemed to be sufficient and reliable so that long-term financing can be marketed without jeopardizing the credit rating of the District.
3. Market conditions present favorable interest rates and demand for District financing.
4. The project is mandated by State and/or Federal requirements and current resources are insufficient or unavailable.
5. The project is immediately required to meet or relieve capacity needs and current resources are insufficient or unavailable.

5.0: DEBT STRUCTURE

General

The District will normally issue debt with a maturity of not more than 30 years. The structure should approximate level debt service for the term where it is practical or desirable. There will be no debt structures that include increasing debt service levels in subsequent years, with the first and second year of a debt payoff schedule the exception and related to projected additional income to be generated by the project to be funded. There will be no "balloon" debt repayment schedules that consist of low annual payments and one large payment of the balance due at the end of the term. There will always be at least interest paid in the first fiscal year after debt issuance and principal starting no later than the first fiscal year after the date the facility or equipment is expected to be placed in service. Capitalized interest will not be for a period of more than necessary to provide adequate security for the financing.

Limitations on the Issuance of Variable Rate Debt

The District will normally issue debt with a fixed rate of interest. The District may issue variable rate for the purpose of managing its interest costs. At the same time, the District should protect itself from too much exposure to interest rate fluctuations. In determining that it is in the District's best interest to issue certain debt at variable rates instead of fixed rates, at the time of issuing any variable rate debt, there should be at least a 10% estimated reduction in annual debt costs by issuing variable rate debt when compared to a similar issuance of fixed rate debt. If the estimated overall cost savings from issuing variable rate debt is not at least 10% at the time of issuance, relatively small fluctuations in rates could actually increase the District's financing costs over the life of the bonds compared to a similar fixed rate financing. By using this 10% factor at the time of issuance, the District can be relatively assured that its variable rate financing will be cost-effective over the term of the bonds.

The comparison will be based on the following criteria:

1. The interest rate used to estimate variable interest costs will be the higher of the 10 year average rate or the current weekly variable rate.

2. The variable rate debt costs will include an estimate for annual costs such as letter of credit fees, liquidity fees, remarketing fees, monthly draw fees and annual rating fees applicable to the letter of credit.

3. Any potential reserve fund earnings will reduce the fixed rate debt service or variable rate debt service as applicable.

Periodically, using the criteria described above, the Chief Financial Officer will compare the estimated annual debt service costs to maturity of any variable rate debt with estimated debt service if the debt was converted to fixed rates. If this analysis produces a break even in total payments over the life of the issue, the Chief Financial Officer will recommend converting such variable rate debt to fixed rate.

Variable rate debt should not represent more than 25% of the District's total debt portfolio. This level of exposure to interest rate fluctuations is considered to be manageable in an environment of increasing interest rates. At a higher ratio than this, the District might be faced with an unplanned water rate increase to meet its Rate Covenants. Rating agencies use this ratio in their analysis of the District's overall credit rating.

Further, Rate Covenants applicable to variable rate debt shall not compromise the issuance of additional debt planned by the District and variable rate debt should always contain a provision to allow conversion to a fixed rate at the District's option.

6.0: CREDIT OBJECTIVES

The Otay Water District seeks to maintain the highest possible credit ratings for all categories of long-term debt that can be achieved without compromising delivery of basic services and achievement of District policy objectives.

Factors taken into account in determining the credit rating for a financing include:

1. Diversity of the District's customer base.
2. Proven track record of completing capital projects on time and within budget.
3. Strong, professional management.
4. Adequate levels of staffing for services provided.
5. Reserves.
6. Ability to consistently meet or exceed Rate Covenants.

The District recognizes that external economic, natural, or other events may from time to time affect the creditworthiness of its debt. Nevertheless, the District is committed to ensuring that actions within its control are prudent and well planned.

7.0: COMPETITIVE AND NEGOTIATED SALE CRITERIA

Competitive Sale

The District will use a competitive bidding process in the sale of debt unless the nature of the issue or specific circumstances warrants a negotiated sale. The CFO will determine the best bid in a competitive sale by calculating the true interest cost (TIC) of each bid.

Negotiated Sale

Types of debt that would typically lend themselves to the negotiated sale format are variable rate debt and unrated debt. Circumstances that might warrant a negotiated sale may occur when the issue is of a limited size that would not attract wide-spread investor interest, during periods of high levels of issuance by other entities in the State, or during periods of market volatility or with relatively new financing techniques. In the event the District decides to use a negotiated sale, it will pay management fees only to those firms that place orders for bonds.

If the size of the District’s proposed issue is not cost effective, the District may also consider issuing its debt by private placement or through any qualified Joint Power Authority (JPA) in the State of California whose principal business is issuing bonds.

8.0: REFUNDING DEBT

Purpose

Periodic reviews of all outstanding debt will be undertaken by the Chief Financial Officer to determine refunding (refinancing) opportunities. The purpose of the refinancing may be to:

1. Lower annual debt service by taking advantage of lower current interest rates.

2. Update or revise covenants on outstanding debt issue if a Rate Covenant appears to be too high, has precluded the District from implementing its financing plan, or has caused the District to increase rates to customers.

3. Restructure debt service associated with an issue to facilitate the issuance of additional debt, usually in order to smooth out peaks in total debt service which can occur frequently as one debt issue is layered on top of existing debt issues.

4. Alter bond characteristics such as call provisions or payment dates.

5. Pay for conversion costs such as funding a reserve fund or paying for credit enhancement when converting variable rate debt to fixed rate debt.

Restrictions on Refunding

Tax-exempt bonds typically have provisions that preclude early redemption of the bonds for a period of years after issuance. The number of times a tax-exempt bond can be refinanced prior to its Optional Redemption date (known as Advance Refunding) is limited by the IRS. For debt issued after 1986, issuers may only provide for Advance Refunding of obligations in advance of the Optional Redemption date one time. There is no limit by the IRS on the ability of issuers to redeem bonds early once the Optional Redemption date has been reached (known as Current Refunding).

Savings Criteria

In cases where an Advance Refunding or Current Refunding is intended to provide debt service savings, the District may commence the refinancing process if a minimum five percent (5%) present value savings net of issuance costs and any cash contributions can be demonstrated. Since interest rates may fluctuate between the time when a refinancing is authorized and when the debt is issued, beginning the process with at least a 5% savings should provide the District with some level of protection that it can achieve a minimum of three percent (3%) net present value savings of the refunding bonds when and if the debt is issued. These minimum standards are intended to protect the District staff from spending time on refinancings that become marginally cost-effective after the entire issuance process is complete.

The savings target may be waived, however, if sufficient justification for lowering the savings target can be provided by meeting one or more of the other refunding objectives described above.

9.0: SUBORDINATE LIEN DEBT

The District will issue subordinate lien debt only if it is financially beneficial to the District or consistent with creditworthiness objectives. Subordinate lien debt is structured to be payable second in priority to the District's other outstanding debt. Typically, subordinate lien debt might be issued if the District desired a more flexible Rate Covenant with respect to its new obligations and did not want to refinance all of its existing debt to obtain that less restrictive Rate Covenant.

10.0: FINANCING PARTICIPANTS

The District's purchasing guidelines provide the process for securing professional services related to individual debt issues. The solicitation and selection process include encouraging participation from qualified service providers, both local and national, and securing services at competitive prices.

Financial Advisor: The use of a Financial Advisor is necessary for the sale of debt by a competitive bid process and is desirable when issuing debt through a negotiated sale. The Financial Advisor has a fiduciary duty to the District and will seek to structure the District's debt in the manner that is saleable, yet meets the District's objectives for the financing. The Financial Advisor will advise the District on alternative structures for its debt, the cost of different debt structures and potential pricing mechanisms that can be expected from underwriters (such as call features, term bonds and premium and discount bond pricing) and, at the District's direction, will write the offering document (preliminary official statement). With respect to competitive sales, the Financial Advisor will arrange for distributing the preliminary official statement, accepting bids via an internet bidding platform, verifying the lowest bid and provide detailed instructions for the flow of funds at closing to the winning Underwriter, the Trustee and the District. In a negotiated sale, the Financial Advisor will provide independent confirmation on the Underwriter's proposed pricing to ensure that interest rates and Underwriter's compensation are appropriate for the credit quality of the issue and competitive in the overall public finance market in California.

Underwriter: The Underwriter markets the bonds for sale to investors. While the District's preference is to select the Underwriter for the debt via sale of the debt at competitive bid, there are circumstances when a negotiated issue is in the best interests of the District. Negotiated sales are preferable if the security features are particularly complex or market conditions are volatile. The Chief Financial Officer will recommend whether the method of sale is competitive or negotiated based on the type of issue and other market conditions. In the case of negotiated sales, the Underwriter will be required to demonstrate sufficient capitalization and sufficient experience related to the specific type of debt issuance.

The Underwriter will work in connection with the District's Financial Advisor on structuring the issue and offering different pricing ideas.

Bond Counsel: The District's Bond Counsel provides the primary legal documents that detail the security for the bonds and the authority under which bonds are issued. The Bond Counsel also provides an opinion to bond holders that the bonds are tax-exempt under both State and Federal law. All closing documents in connection with an issue are also prepared by Bond Counsel.

Disclosure Counsel: The District's Disclosure Counsel provides legal advice to the District regarding the adequacy of the District's disclosure of financial information or risks of investing in the District's debt issue to the investing public. The Disclosure Counsel can prepare the official statement or review the official statement and gives the District an opinion that there is no information missing from the official statement of a material nature that would be necessary for an investor to make an informed decision about investing in the District's bonds.

Trustee: The Trustee is a financial institution selected by the District to administer the collection of revenues pledged to repay the bonds and to distribute those funds to bondholders.

Letter of Credit Bank: The Letter of Credit Bank is a U.S. or foreign bank that has issued a letter of credit providing both credit enhancement (the Letter of Credit Bank will pay the debt in the event that the District defaults on the payment) and liquidity for a variable rate bond issue. These banks have their own short-term credit rating, which can be higher than the District's short-term credit rating. Liquidity is needed because variable rate bondholders are allowed to "put" their bonds back to the District if they do not like the interest rate currently being offered. The District's Remarketing Agent then finds a new buyer for those bonds, but in the event that no buyer is found, a draw is made under the letter of credit to purchase the bonds that have been "put." As soon as the bonds are remarketed to another buyer, the letter of credit is repaid. The letter of credit fees are paid annually or quarterly. Letter of credits are typically issued for not more than 3 years and must be renewed during the life of the bonds. Credit enhancement is discussed further under the heading "CREDIT ENHANCEMENT."

Municipal Bond Insurer: The Municipal Bond Insurer can be one of several insurance companies that provide municipal bond insurance policies securing payment of the District's debt. These policies provide that the Municipal Bond Insurer will pay the District's debt in the event that the District defaults on its payments. Debt which is insured carries the Municipal Bond Insurer's credit rating. The insurance premium for the bond insurance policy is paid one time at the issuance of the debt and is non-cancelable for the term of the debt. Unlike a letter of credit, bond insurance policies do not provide liquidity and are most typically purchased for fixed rate debt.

Remarketing Agent: The Remarketing Agent is an investment bank that, each week, determines the interest rate for the District's variable rate obligations. The rate is set at the rate at which the obligations could be sold on the open market at 100% of their face value. The Remarketing Agent also finds new buyers for any of the obligations that are "put" back to the District.

Rating Agencies: Currently, there are three widely recognized rating agencies that rate municipal debt in the United States: Standard & Poor's, Moody's Investors Service, and Fitch Investors Service. Rating agencies establish objective criteria under which each type of financing undertaken by the District is to be analyzed. Upon request, a rating agency will rate the underlying strength of the District's financings, without regard to the purchase of any credit enhancement. The rating is released to the general public and thereafter, the rating agency will periodically update its analysis of a particular issue, and may raise or lower the rating if circumstances warrant. Investment-grade ratings range from "AAA" to "BBB-." A rating below "BBB-" is not investment grade. Many mutual funds cannot buy bonds that do not carry an investment grade.

Verification Agent: In a refunding, the District will deposit funds with an escrow agent (usually the trustee) in an amount sufficient, together with earnings thereon, to pay the debt service and redemption price of the debt being refunded through and including the call date. The Verification Agent verifies the mathematical accuracy of calculation of the amount to be deposited in escrow and the bond counsel relies on this verification in giving their opinion that the debt is defeased within the meaning of the indenture and that the lien of the debt on the revenues pledged to the debt being refunded is released.

11.0: CONFLICT OF INTEREST AND STANDARDS OF CONDUCT

Members of the District, the Board of Directors and its consultants, service providers and underwriters shall adhere to standards of conduct and conflict of interest rules as stipulated by the California Political Reform Act or the Municipal Securities Rulemaking Board (MSRB), 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. There shall be no conflict of interest with the District with any debt financing participant.

12.0: CONTINUING DISCLOSURE

The District acknowledges the responsibilities of the underwriting community and pledges to make all reasonable efforts to assist underwriters in their efforts to comply with SEC Rule 15c2-12 and MSRB Rule G-36. The District will file its official statements with the MSRB and the nationally recognized municipal securities information repositories. The District will also post copies of its comprehensive financial reports on the MSRB's Electronic Municipal Market Access (EMMA) website, and will disseminate other information that it deems pertinent to the market in a timely manner (For bonds issued after 2012, 10 days). While initial bond disclosure requirements pertain to underwriters, the District will provide financial information and notices of material events on an ongoing basis throughout the life of the issue. Material events are defined as those events which are considered to likely reflect on the credit supporting the securities.

(a) The events considered material according to the SEC are:

1. Principal and interest payment delinquencies;
2. Unscheduled draws on debt service reserves reflecting financial difficulties;
3. Unscheduled draws on credit enhancements reflecting financial difficulties;
4. Substitution of credit or liquidity providers, or their failure to perform;
5. Adverse tax opinions or the issuance by the Internal Revenue Service of proposed or final determinations of taxability or of a Notice of Proposed Issue (IRS Form 5701-TEB);
6. Tender offers;

7. Defeasances;

8. Ratings changes; and

9. Bankruptcy, insolvency, receivership or similar proceedings.

Note: for the purposes of the event identified in subparagraph (9) above, the event is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent or similar officer for an obligated person in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the obligated person, or if such jurisdiction has been assumed by leaving the existing governmental body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the obligated person.

(b) Pursuant to the provisions of this section (b), the District shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds, if material:

1. Unless described in paragraph (a) above, notices or determinations by the Internal Revenue Service with respect to the tax status of the Bonds or other material events affecting the tax status of the Bonds;

2. The consummation of a merger, consolidation or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms;

3. Appointment of a successor or additional trustee or the change of the name of a trustee;

4. Nonpayment related defaults;

5. Modifications to the rights of Owners of the Bonds;

6. Notices of redemption; and

7. Release, substitution or sale of property securing repayment of the Bonds.

Whenever the District obtains knowledge of the occurrence of a Listed Event under (b) above, the District shall as soon as possible determine if such event would be material under applicable federal securities laws.

13:0 INVESTMENT & ARBITRAGE COMPLIANCE

Tax-exempt bonds are required to meet certain provisions of the federal tax code in order to maintain their tax-exempt status. In order to prevent municipal issuers from borrowing money at tax-exempt rates solely for the purpose of investing the proceeds in higher yielding investments and making a profit ("arbitrage"), the federal tax code contains a provision that requires issuers to compare the interest earned on any bond funds held (such as a reserve fund) with interest that would theoretically be earned if the funds were invested at the yield of the bonds, and to "rebate" to the federal government any interest earned in excess of the theoretical earnings limit.

The Chief Financial Officer shall invest the bond proceeds subject to the District's Investment Policy in a timely manner, to ensure the availability of funds to meet operational requirements. In doing so, the CFO will maintain a system of record keeping and reporting to meet the arbitrage rebate compliance requirements of the federal tax code.

14.0: TYPES OF DEBT FINANCING

General Obligation Bonds

General obligation bonds are secured by a pledge of the ad-valorem taxing power of the issuer and are also known as a full faith and credit obligations. Bonds of this nature must serve a public purpose to be considered lawful taxation of the property owners within the District and require a two third's majority vote in a general election. The benefit of the improvements or assets constructed and acquired as a result of this type of bond must be generally available to all property owners.

The District can issue general obligation bonds up to but not in excess of 15% of the assessed valuation under Article XVI, Section 18 of the State constitution. An annual amount of the levy necessary to meet debt service requirements is calculated and placed on the tax roll through the County of San Diego. The District also has a policy that the ad-valorem tax to be used to pay debt service on general obligation bonds will not exceed $.10 per $100 of assessed value.

Voters within Improvement District No. 27 of the District authorized $100 million general obligation bonds in 1989. The District issued $11,500,000 general obligation bonds in 1992 and refinanced the bonds in 1998 and again in 2009. The District also has approximately $29 million in general obligation bonds authorized between 1960 and 1978 for various improvement districts throughout the District, but unissued. General obligation bonds can only be issued under these existing authorizations to the extent necessary to fund the improvements specified by each ballot measure.

General obligation bonds generally are regarded as the broadest and soundest security among tax-secured debt instruments. An unlimited-tax pledge would enable a trustee to invoke mandamus to force the District to raise the tax rate as much as necessary to pay off the bonds. General obligation bonds have other credit strengths as well: the property tax tends to be a steady and predictable revenue source, and when a vote is required to issue them, bondholders have some indication of taxpayers' willingness to pay. General obligation bonds carry the highest credit rating that a public agency can achieve and therefore, the lowest interest cost. General obligation bonds typically are issued to finance capital facilities and not for ongoing operational or maintenance costs.

The District will use an objective analytical approach to determine whether it can afford to assume new general obligation debt for the improvement districts, or in the case of projects not approved by the original ID 27 vote, prior to any submission of a general obligation bond ballot measure to voters. This process will compare generally accepted standards of affordability to the current values for the District. These standards will include debt per capita, debt as a percent of taxable value, debt service payments as a percent of current revenues and current expenditures, and the level of overlapping net debt of all local taxing jurisdictions. The process will also examine the direct costs and benefits of the proposed expenditures. The decision on whether or not to assume new debt will be based on these costs and benefits, the current conditions of the municipal bond market, and the District's ability to "afford" new debt as determined by the aforementioned standards.

Revenue Bonds

Revenue bonds are limited-liability obligations that pledge net revenues of the District to debt service. The net revenue pledge is after payment of all operating costs. Since revenue bonds are not generally secured by the full faith and credit of the District, the financial markets require coverage ratios of the pledged revenue stream and a covenant to levy rates and charges sufficient to produce net income at some level in excess of debt service (a Rate Covenant).

Also there may be a test required to demonstrate that future revenues will be sufficient to maintain debt service coverage levels after any proposed additional bonds are issued. The District will strive to meet industry and financial market standards with such ratios without impacting the current rating. Annual adjustments to the District's rate structure may be necessary to maintain these coverage ratios.

The underlying credit of revenue bonds is judged on the ability of the District's existing rates to provide sufficient net income to pay debt service and the perceived willingness of the District to raise rates and charges in accordance with its Rate Covenant. Actual past performance also plays a role in evaluating the credit quality of revenue bonds, as well as the diversity of the customer base. Revenue bonds generally carry a credit rating one or two investment grades below a general obligation bond rating.

The District may use a debt structure called "Certificates of Participation" to finance capital facilities. However, if the certificates contain a pledge of net revenues and a Rate Covenant, they are treated as essentially the same as a revenue bond.

Lease/Purchase Agreements

Over the lifetime of a lease, the total cost to the District will generally be higher than purchasing the asset outright. As a result, the use of lease/purchase agreements in the acquisition of vehicles, equipment and other capital assets will generally be avoided, particularly if smaller quantities of the capital asset(s) can be purchased on a "pay-as-you-go" basis.

The District may utilize lease-purchase agreements to acquire needed equipment and facilities. Criteria for such agreements should be that the asset life is three years or more, the minimum value of the agreement is $50,000 and interest costs must not exceed the interest rate earned by the District's portfolio for the average of the past 6 months. Lease payments of this type are considered operating expenses and would reduce net operating income available to pay any District revenue bonds. There are no coverage requirements or rate covenants associated with lease/purchase agreements.

State Water Loans

The State Water Resources Control Board makes certain funds available to water districts throughout the State. These loans typically carry a below-market rate of interest and are short term in nature. While State loans should be incorporated into the District's debt portfolio for the financing of capital improvements, the payment of the loan should not compromise the District's ability to issue other planned debt or cause the District to violate its rate covenants or make it necessary for the District to increase rates to maintain existing rate covenants.

Land Based Financing

The District may consider developer or property owner initiated applications requesting the formation of community facilities or assessment districts and the issuance of bonds to finance eligible District facilities necessary to serve newly developing commercial, industrial and/or residential projects. Facilities will be financed in accordance with the provisions of the Municipal Improvement Act of 1913 and the Improvement Bond Act of 1915, or the Mello-Roos Community Facilities Act of 1982.

Typically, the bonds issued would be used to prepay, in a lump-sum, the District's capacity fees with respect to a large tract of land under development, or to finance in-tract infrastructure that will eventually be dedicated to the District. The bonds are secured by a special tax or assessment to be levied on property within the boundaries established for the community facilities district (sometimes known as a "Mello-Roos" district) or the assessment district. If the District becomes the sponsoring public agency for such financing district and the issuance of debt, the District will be required to enter into a Funding, Construction and Acquisition agreement for any of the facilities to be dedicated to the District upon completion. This agreement governs the type of facilities to be constructed with bond proceeds and how the facilities will be accepted by the District.

In some cases, the District may not be asked to be the sponsoring agency for the formation of a financing district, rather, the developer or property owner may approach a school district or a city to be the sponsoring agency. Nonetheless, the property owner may want to include lump-sum payment of District fees in the financing or construction of certain facilities to be dedicated to the District upon completion. In this case, if the District desired to participate, the District would enter into a Joint Financing Agreement with the sponsoring agency, again governing the type of facilities to be constructed with bond proceeds and how the facilities will be accepted by the District.

On a case-by-case basis, the Board shall make the determination as to whether a proposed district will proceed under the provisions of the Assessment Acts or the Mello-Roos Community Facilities Act. The Board may confer with other consultants and the applicant to learn of any unique district requirements, such as long-term development phasing, prior to making any final determination.

All District and District consultant costs incurred in the evaluation of new development, district applications and the establishment of districts will be paid by the applicant(s) by advance deposits in those instances where a party or parties other than the District have initiated a proposed district. Expenses not legally reimbursable by the financing district will be borne by the applicant. The District may incur expenses for analyzing proposed assessment or community facilities districts where the District is the principal proponent of the formation or financing of the district.

Prior to the issuance of any land secured financing and in accordance with State law, the Board will adopt policies and procedures with criteria to be met before any special tax bonds or assessment district bonds may be issued. These criteria include the qualifications of the appraiser, the minimum value to lien ratio to be achieved prior to issuing the land secured debt and the maximum tax to be levied on different categories of property.

15.0: RATING AGENCY APPLICATIONS

The District may seek one or more ratings on all new issues that are being sold in the public market. These rating agencies include, but are not limited to, Fitch Investors Service, Moody’s Investors

Service, and Standard & Poor's. When applying for a rating on an issue over $1 million or more, the District shall make a formal presentation of the finances and positive developments within the District to the rating agencies. The District will report all financial information to the rating agencies upon request. This information shall include, but shall not be limited to, the District's Comprehensive Annual Financial Report (CAFR), and the Adopted Operating and Capital Budget.

16.0: USE OF CREDIT ENHANCEMENT

Credit enhancement is a generic term that means any third-party guarantee of debt service. Credit enhancement providers include municipal bond insurance companies or financial institutions. The purchase of credit enhancement allows the District's bond issue to carry the same credit rating as the credit provider. The District will seek to use credit enhancement when such credit enhancement proves cost-effective. Selection of credit enhancement providers will be subject to a competitive bid process using the District's purchasing guidelines, if applicable.

Fixed Rate Bonds

Credit enhancement for fixed rate bonds is obtained by the purchase of bond insurance. If a commitment for bond insurance is obtained for a particular issue, the District will estimate the annual debt service for the issue based on current interest rates applicable to the credit rating of the bond insurer. If the estimated debt service on this basis is less than or equal to estimated debt service for the issue based on interest rates for bonds with the District's underlying or stand-alone credit rating, the District will purchase the bond insurance. Any intention of the District to prepay the debt ahead of its scheduled maturity will be taken into account in the analysis. Credit enhancement may be used to improve or establish a credit rating on a District debt obligation even if such credit enhancement is not cost effective if, in the opinion of the Chief Financial Officer, the use of such credit enhancement meets the District's debt financing goals and objectives, such as, funding of a reserve fund for the bonds.

Variable Rate Bonds

Credit enhancement for variable rate bonds is comprised of two components: credit support and liquidity. The interest on variable rate bonds is based on a short-term investment rate (usually 7 days).

Any investor can tender their bonds back to the District to be repurchased on short notice (usually 7 days). Because of the short-term nature of the investment, the securities that the District is "competing" with for investors are AA-rated mutual funds. Therefore, variable debt needs to have credit enhancement to achieve a comparable AA rating, as well as liquidity support to provide the District with a mechanism to purchase any bonds that are tendered before they can be remarketed to new investors. A limited number of financial institutions offer letters of credit that combine both credit support and liquidity for one fee. An alternative is to purchase bond insurance to provide credit support and enter into a separate purchase agreement with a financial institution to provide liquidity. The difference in cost between the two structures will be analyzed before either alternative is selected for variable rate debt.

17.0: GLOSSARY

Ad Valorem Tax: A tax calculated "according to the value" of property. Such a tax is based on the assessed valuation of tangible personal property. In most jurisdictions, the tax is a lien on the property enforceable by seizure and sale of the property. General restrictions, such as overall restrictions on rates, or the percent of charge allowed, sometimes apply. As a result, ad valorem taxes often function as the balancing element in local budgets.

Advance Refunding: A procedure whereby outstanding bonds are refinanced by the proceeds of a new bond issue prior to the date on which outstanding bonds become due or are callable. Typically an advance refunding is performed to take advantage of interest rates that are significantly lower than those associated with the original bond issue. At times, however, an advance refunding is performed to remove restrictive language or debt service reserve requirements required by the original issue.

Amortization: The planned reduction of a debt obligation according to a stated maturity or redemption schedule.

Arbitrage: The gain that may be obtained by borrowing funds at a lower (often tax-exempt) rate and investing the proceeds at higher (often taxable) rates. The ability to earn arbitrage by issuing tax-exempt securities has been severely curtailed by the Tax Reform Act of 1986, as amended.

Assessed Valuation: The appraised worth of property as set by a taxing authority through assessments for purposes of ad valorem taxation.

Basis Point: One one-hundredth of one percent.

Bond: A security that represents an obligation to pay a specified amount of money on a specific date in the future, typically with periodic interest payments.

Bond Counsel: An attorney (or firm of attorneys) retained by the issuer to give a legal opinion concerning the validity of the securities. The bond counsel's opinion usually addresses the subject of tax exemption. Bond counsel may prepare, or review and advise the issuer regarding authorizing resolutions or ordinances, trust indentures, official statements, validation proceedings and litigation.

Bond Insurance: A type of credit enhancement whereby a monocline insurance company indemnifies an investor against a default by the issuer. In the event of a failure by the issuer to pay principal and interest in-full and on-time, investors may call upon the insurance company to do so. Once assigned, the municipal bond insurance policy generally is irrevocable. The insurance company receives an up-front fee, or premium, when the policy is issued.

Call Option: A contract through which the owner is given the right but is not obligated to purchase the underlying security or commodity at a fixed price within a limited time frame.

Cap: A ceiling on the interest rate that would be paid.

Capital Lease: The acquisition of a capital asset over time rather than merely paying rent for temporary use. A lease-purchase agreement, in which provision is made for transfer of ownership of the property for a nominal price at the scheduled termination of the lease, is referred to as a capital lease.

Certificate of Participation: A financial instrument representing a proportionate interest in payments such as lease payments by one party (such as the District acting as a lessee) to another party (often a trustee).

CIP: Capital Improvement Program.

Competitive Sale: The sale of securities in which the securities are awarded to the bidder who offers to purchase the issue at the best price or lowest cost.

Continuing Disclosure: The requirement by the Securities and Exchange Commission for most issuers of municipal debt to provide current financial information to the informational repositories for access by the general marketplace.

Debt Service: The amount necessary to pay principal and interest requirements on outstanding bonds for a given year or series of years.

Defeasance: Providing for payment of principal of premium, if any, and interest on debt through the first call date or scheduled principal maturity in accordance with the terms and requirements of the instrument pursuant to which the debt was issued. A legal defeasance usually involves establishing an irrevocable escrow funded with only cash and U.S. Government obligations.

Derivative: A financial product that is based upon another product. Generally, derivatives are risk mitigation tools.

Discount: The difference between a bond's par value and the price for which it is sold when the latter is less than par.

Financial Advisor: A consultant who advises an issuer on matters pertinent to a debt issue, such as structure, sizing, timing, marketing, pricing, terms and bond ratings.

General Obligation Bonds: Debt that is secured by a pledge of the ad valorem taxing power of the issuer. Also known as a full faith and credit obligation.

Municipal Securities Rulemaking Board (MSRB): The MSRB, comprised of representatives from investment banking firms, dealer bank representatives, and public representatives, is entrusted with the responsibility of writing rules of conduct for the municipal securities market.

Negotiated Sale: A sale of securities in which the terms of sale are determined through negotiation between the issuer and the purchaser, typically an underwriter, without competitive bidding.

Official Statement: A document published by the issuer that discloses material information on a new issue of municipal securities including the purposes of the issue, how the securities will be repaid, and the financial, economic and social characteristics of the issuing government. Investors may use this information to evaluate the credit quality of the securities.

Option: A derivative contract. There are two primary types of options (see Put Option and Call Option). An option is considered a wasting asset because it has a stipulated life to expiration and may expire worthless. Hence, the premium could be wasted.

Optional Redemption: The redemption of an obligation prior to its stated maturity, which can only occur on dates specified in the bond indenture.

Overlapping Debt: The legal boundaries of local governments often overlap. In some cases, one unit of government is located entirely within the boundaries of another. Overlapping debt represents the proportionate share of debt that must be borne by one unit of government because another government with overlapping or underlying taxing authority issued its own bonds.

Par Value: The face value or principal amount of a security.

Pay-as-you-go: To pay for capital improvements from current resources and fund balances rather than from debt proceeds.

Put Option: A contract that grants to the purchaser the right but not the obligation to exercise.

Rate Covenant: A covenant between the District and bondholders, under which the District agrees to maintain a certain level of net income compared to its debt payments, and covenants to increase rates if net income is not sufficient to meet such level.

Refunding: A procedure whereby an issuer refinances an outstanding bond issue by issuing new bonds.

Revenue Bonds: A bond which is payable from a specific source of revenue and to which the full faith and credit of an issuer with taxing power is not pledged. Revenue bonds are payable from identified sources of revenue, and do not permit the bondholders to compel a jurisdiction to pay debt service from any other source. Pledged revenues often are derived from the operation of an enterprise. Generally, no voter approval is required prior to issuance.

Special Assessments: A charge imposed against property or parcel of land that receives a special benefit by virtue of some public improvement that is not, or cannot be enjoyed by the public at large. Special assessment debt issues are those that finance such improvements and are repaid by the assessments charged to the benefiting property owners.

Swap: A customized financial transaction between two or more counterparties who agree to make periodic payments to one another. Swaps cover interest rate, equity, commodity and currency products. They can be simple floating for fixed exchanges or complex hybrid products with multiple option features.

True Interest Cost (TIC): A method of calculating the overall cost of a financing that takes into account the time value of money. The TIC is the rate of interest that will discount all future payments so that the sum of their present value equals the issue proceeds.

Underwriter: The term used broadly in the municipal market, to refer to the firm that purchases a securities offering from a governmental issuer.

Yield Curve: Refers to the graphical or tabular representation of interest rates across different maturities. The presentation often starts with the shortest-term rates and extends towards longer maturities. It reflects the market’s views about implied inflation/deflation, liquidity, economic and financial activity, and other market forces.