



## Comprehensive Debt Policy

Relating to: Eastern Municipal Water District, Eastern Municipal Water District Financing Authority, Western Riverside Water and Wastewater Authority, and all Entities Formed Pursuant to the Mello-Roos Act and or Improvement Act(s) of 1911 and 1913 In Order to Issue Debt on Behalf of Eastern Municipal Water District

*April 7, 2021*

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## **1. Introduction**

Eastern Municipal Water District (District) was organized under the Municipal Water District Law, Division 20 of the Water Code of the State of California, as amended, on October 16, 1950 for the primary purpose of importing Colorado River water to its service area in order to augment local water supplies. The District's service area is primarily located in the westerly third of Riverside County. Prior to the District's formation, the local water supply largely consisted of groundwater wells.

The Comprehensive Debt Policy (Policy) sets forth the parameters for issuing debt and managing outstanding debt and provides guidance to decision makers regarding the timing and purposes for which debt may be issued, types and amounts of permissible debt, and method of sale that may be used. Adherence to a debt policy helps to ensure the District's debt is issued and managed prudently in order to maintain a sound fiscal position and optimal credit ratings. Other financial policies are outside the scope of this document and maintained within the District's Administrative Code or adopted via Board Resolutions.

The Policy updates and replaces the District's prior Special District Policy (Section 3), Swap Policy (Section 4), and Disclosure Procedures (Section 5). There is a summary of the District's Reserve Policy within Section 7. The Reserve Policy is not replaced as it maintains reserves not related to debt, but is intended to serve as a standalone document, to be updated by resolution. Debt specific reserve funds from within that policy will then be referenced within the Policy. In order to maintain relevance, the District will review the Policy annually or more often if there is a material change in risk exposures or conditions.

### **Purpose**

The purpose of this Policy is to document and memorialize District standards in connection with Eastern Municipal Water District obligations, including notes, bonds, loans, lease securities, and certificates of participation issued or delivered by the District, including Assessment District bonds and bonds issued by other entities controlled by the District, such as the Eastern Municipal Water District Financing Authority, Community Facilities Districts formed pursuant to the Mello-Roos Act (CFDs) and Assessment Districts formed pursuant to the Improvement Acts of 1911 and 1913 (ADs), along with the Western Riverside Water and Wastewater Financing Authority for which the District has overseen and utilized to issue securities.

The Policy as described herein is in accordance with current legislation and incorporates industry best practices. It has been devised to serve as a public representation of District objectives in relation to its use of any fixed rate debt, variable rate debt, public or privately placed debt obligation, interest rate swaps and/or other derivative transactions. The Policy is further intended to memorialize guiding directives from the District's Board of Directors (Board) to management and staff for decisions and recommendations related to the financial profile of the District.

## **2. Debt Issuances – General District Debt**

General District debt is primarily issued to fund long-term capital improvement projects, essential equipment and vehicle needs (collectively "New Money Debt") and to refinance existing debt

(Refunding Debt). Debt will be used to finance eligible projects as directed and approved by the Board. The method of sale, participants of the financing team, and types of debt to be issued are summarized below:

### **Method of Sale**

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

1. 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 General Manager, Deputy General Manager/Treasurer, and/or Chief Financial Officer is hereby authorized to sign the bid form on behalf of the District, setting the interest rates on bonds sold on a competitive basis.
2. Negotiated sale. The Deputy General Manager/Treasurer and Chief Financial Officer selects the underwriter, or team of underwriters, to market the District's securities in advance of the debt issuance, with approval by the Board. The Chief Financial Officer works with the underwriter to bring the issue to market and negotiates all rates and terms of the sale, with the concurrence of the Deputy General Manager/Treasurer. In advance of the sale, the General Manager, Deputy General Manager/Treasurer, and/or Chief Financial Officer 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 General Manager and/or Deputy General Manager/Treasurer is hereby authorized to sign the bond purchase agreement on behalf of the District, setting the interest rates on bonds sold on a negotiated basis.
3. Private placement/direct purchase. The District may elect to issue debt on a private placement or direct purchase basis. Such method may 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.

### **Roles and Responsibility**

The primary responsibility for developing debt financing recommendations rests with the Chief Financial Officer and Deputy General Manager/Treasurer. In developing such recommendations, the finance team shall consider the need for debt financing and assess progress on the current capital improvement program (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 presented to and approved by the Board.

### **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 Chief Financial Officer and Deputy

General Manager/Treasurer will 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 select independent municipal advisors. While serving as the District's municipal advisor, a firm may not also engage in the underwriting of the District debt 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. Municipal advisors shall be selected through a competitive qualification process after a review of proposals by the Chief Financial Officer, Deputy General Manager/Treasurer and/or other staff, and is subject to approval by the Board.

During the contract term of any party acting as municipal advisor, neither the firm nor any individual employed by that firm will perform financial advisory, investment banking or similar services for any entity other than the District in transactions involving a District financial commitment.

The municipal advisor will advise the District on refunding opportunities for current outstanding debt, as well as assist in evaluating the merits of competitive, negotiated or private placement of new debt, and determining the most appropriate structure to ensure effective pricing that meets the District's near-term and long-term cash flow needs. The municipal advisor will work with all parties involved in the financing transaction, including the District's bond counsel, trustee, underwriters, and credit liquidity providers, to develop and monitor the financing schedule and preparation of the Official Statement. The municipal advisor will assist the District in developing and distributing bid specifications for desired services, such as, trustee and paying agents, printing, remarketing, and credit liquidity service providers, and assist the District in its review process. The District also expects that its municipal advisor will provide objective advice and analysis, maintain confidentiality of the District's financial plans, and be free from any material conflict of interest.

### ***Underwriters***

For negotiated sales, the District will generally select or pre-qualify underwriters through a competitive process. This process may include a request for proposal or qualifications to firms considered appropriate for the underwriting of a particular issue or type of bonds. The Chief Financial Officer and Deputy General Manager/Treasurer will determine the appropriate method to evaluate the underwriter submittals and then select or qualify firms on that basis. The District will not be bound by the terms and conditions of any underwriting agreements, oral or written, to which it was not a party.

### **New Money Debt**

The District will utilize reasonable debt financing as an acceptable and appropriate approach to fund long-term investments, mitigating needed rate increases, and helping to ensure that existing and future ratepayers fund an appropriate share of long-lived assets. Long-term investments include the acquisition of land, facilities, works, improvements and supplies of water; and enhancements or

enlargements to existing capacity and facilities for obtaining, importing, transporting and delivering additional quantities of water, including water reclamation, water recycling, and other water related infrastructure. These investments are typically included in the District's Capital Improvement Program and District Master Plan. Bond proceeds can be issued to fund the planning, design, land acquisition, construction, attached fixtures or equipment and movable pieces or equipment, or other costs as permitted by law.

The District will issue New Money 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, or (ii) additional revenues have been identified as a source of repayment in an amount sufficient to pay for the proposed debt (including anticipated revenues from future rate increases).

The District will not issue debt to finance ongoing operating needs except in case of an extreme financial emergency which is beyond its control or reasonable ability to forecast, and unless specifically approved by the Board.

Debt issuance for a capital project will not be considered unless such project has been incorporated into the District's capital planning process, or as otherwise approved by the Board.

#### **State Revolving Funds**

The State Revolving Fund (SRF) loan program is a low or zero interest loan program generally for the construction of wastewater treatment and sewage collection systems, water recycling facilities, storm water projects, implementation of nonpoint source and storm drainage pollution control management programs, estuary conservation and management programs, and other water infrastructure and programs made available by the State. SRF debt service payments are factored into debt service coverage ratios as defined by applicable water and wastewater indentures and/or the District's Master Resolution.

SRF loans are generally structured such that the District is required to contribute a percentage of the total project cost and receives loan proceeds from the State for the balance. The SRF loan interest rate is typically calculated by taking half of the True Interest Cost (TIC) of the most recent State of California General Obligation Bonds issuance. The term of the loans can be 20 years or, if applicable, an extended financing term of 30 years. When compared to traditional bond financing, the District may realize savings as a result of the 20-year or 30-year amortization period of the SRF Loans, but should consider the timing, legal terms and covenants, and overall costs of administering an SRF loan as opposed to other forms of debt.

SRF Loans may provide additional assistance in the form of principal forgiveness or may incorporate a grant component. Principal forgiveness must be specified at the execution of the loan agreement for the amount forgiven to be counted against the total loan required to be provided by the SRF.

#### **Water Infrastructure Finance and Innovation Act ("WIFIA")**

WIFIA is a competitive federal loan program offering funding in the form of low-cost loans for eligible projects. WIFIA loans are eligible to finance up to 49 percent of Eligible Project Costs and can be used in conjunction with other forms of funding to pay for eligible capital projects. Repayment of

WIFIA loans can be developed in a flexible manner to accommodate specific borrower needs with a final repayment period up to 35 years after substantial completion of the project. While WIFIA loans are generally structured with terms and covenants similar to those of the bonds which are on parity, care needs to be taken to ensure that terms and covenants under the WIFIA loan do not conflict with existing terms and covenants and are advantageous for the District.

### **Refunding Debt**

Current and advance refundings are important debt management tools for the District. They are commonly used to achieve debt service (interest cost) savings, remove or change bond covenants, or restructure debt service obligations. Prior to the Tax Cuts and Jobs Act of 2017, Federal Tax law allowed only one advance refunding after the initial issuance. With the passage of the Tax Cuts and Jobs Act of 2017, municipal entities are no longer allowed to advance refund bonds on a tax-exempt basis, necessitating diligence in the review and monitoring of refunding opportunities.

To the extent that debt having fixed interest rates originally structured with a long-term amortization structure (10 years or greater) is refunded with fixed rate debt, the District will not generally issue refunding debt which extends the final maturity of the refinanced debt. Extending the final maturity may occur when warranted, such as restructuring of debt to match debt amortization with the useful life of the financed assets.

### ***Current Refunding***

To the extent that a refinancing is a current refunding (one which occurs not more than 90 days from the redemption date of the refunded debt), the District will generally apply an expectation that the refunded debt will generate not less than 4 percent aggregate net present value savings, measured as a percentage of the par amount of the refunded bonds.

### ***Advance Refunding***

To the extent that a refinancing is an advance refunding (one which occurs more than 90 days from the redemption date of the refinanced debt), the general guideline will be to achieve a minimum of 5 percent aggregate net present value savings (measured as a percentage of the par amount of the refunded bonds) and that the ratio of net present value savings to the sum of net present value savings and negative arbitrage is not less than 75 percent. This ratio is commonly referred to as “escrow efficiency” and is used as a guide in determining the amount of savings foregone in an advance refunding when escrow yields are less than the District’s borrowing cost.

Notwithstanding the above minimum, the overall target savings threshold for an advance refunding is 7 percent net present value savings as well as a minimum of 85 percent escrow efficiency.

Lower thresholds than those listed above may be justified if the refunding is being done for reasons other than economic savings, such as to make changes to bond covenants or for other sound business or policy reasons, and will be at the discretion of the Chief Financial Officer in consultation with the District’s Municipal Advisor, Bond Counsel, and Deputy General Manager/Treasurer.

### **Other Refinancing/Refunding**

To the extent that a refinancing involves either a prior issuance or new issuance of variable rate debt, the Finance Department will evaluate the refinancing based upon a combination of risk and economic considerations to be made at the time.



## **Debt Capacity**

There is no specific provision within the California Government Code that limits the amount of debt that may be issued by the District. The District's borrowing capability is limited by the additional bonds test and debt coverage ratio required in the Master Resolution on the Senior Lien and by the existing bond covenants on the Working Lien. The District will be mindful of its overall debt burden in the context of its revenues, expenses, reserves, and overall financial health.

## **Financing Criteria**

Revenue bonds, variable rate bonds, certificates of participation, SRF loans, federal loans or loan guarantees, bank loans, notes, commercial paper, and direct placements are authorized forms of debt to be considered by the District, subject to State Law. 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.

Each debt issuance should be evaluated on an individual basis within the context of the District's overall financing objectives, integration with the Capital Improvement Program, 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, evaluating demonstrable savings, terms and conditions, market access, and investor expectations.
- Call Options/Provisions – In general, the District's securities should include optional call provisions unless the cost of such an option is determined to exceed the benefit. 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 this policy.
- Short-Term Debt – The District may utilize short-term borrowing to serve as a bridge for anticipated revenues, construction financing or future bonding capacity.
- Variable Rate Debt – Variable rate debt products are priced at the short-end of the yield curve at low interest rates compared to fixed-rate bonds, but subject to various risks. Variable rate debt may be appropriate for the District's portfolio, depending on market conditions and a careful consideration of the risks involved. Variable rate debt products include variable rate demand obligations, commercial paper, floating rate notes, and other obligations which have interest rates adjusting periodically. The District may consider the use of variable rate debt products to achieve a lower cost of borrowing or for short-term borrowing. In determining whether to use variable rate debt, the District will analyze the risk associated with the variable rate debt, the impact on the District's overall portfolio, and means to mitigate those risks. The District will maintain a conservative level of outstanding variable debt in consideration of the District's current cash and reserve balances, in addition to maintaining adequate

safeguards against risk and managing the variable revenue stream. The District will mitigate variable interest rate risks by maintaining sufficient unrestricted reserve funds to hedge against market access risk, liquidity risk, and interest-rate escalation risk.

- Derivatives – The use of derivatives may increase the District financial flexibility and provide opportunities for interest rate savings or enhanced investment yields. Careful monitoring of such products is required to preserve District credit strength and budget flexibility. Derivatives will not be used to speculate on perceived movements in interest rates. The notional amount of derivative products shall not exceed 15 percent of total District outstanding debt. More detailed information is contained in Swap Policy Section 4.
- 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 Administrative Code.

### **Internal Control Procedures**

All debt transactions must be approved by the Board of Directors. The proceeds of debt issuance will be invested until used for the intended project(s) to maximize utilization of the public funds. The investments will be made to obtain the highest level of 1) safety, 2) liquidity, and 3) yield, and may be held as cash. The District’s investment guidelines and bond indentures will govern objectives and criteria for investment of bond proceeds. The Finance Department 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 debt 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 funds. The District’s Trustee or Fiscal Agent will administer the disbursement of bond proceeds pursuant to each certain Indenture of Trust or Fiscal Agent Agreement, respectively. To ensure proceeds from debt issuances are used in accordance with legal requirements invoices are approved by the Finance Department and General Manager for payment. A requisition for the disbursement of bonds funds will be approved by the District’s Chief Financial Officer or designated alternate. Responsibility for general ledger reconciliations and records is segregated from the invoice processing, cash receipting, and cash disbursement functions.

The Finance Department will be tasked with 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 will meet one of the spend-down exemptions from arbitrage rebate. Tax-exempt bonds will not be issued unless it can be demonstrated that 85 percent of the proceeds can reasonably be expected to be expended within the three-year temporary period.

### **3. Debt Issuances – Special District Financing**

The Special District Financing Policy Principles have been developed over decades of managing an active Land-Secured Financing Program. With more than 100 Special Financing Districts, the District is one of the largest issuers of land-secured debt within the State of California.

Land-Secured debt issued by Community Facilities Districts formed by the District through the Mello-Roos Act or Assessment Districts formed through the Municipal Improvement Acts of 1911 and 1913

is issued on behalf of local property owners and property developers in order to finance the cost of infrastructure. This type of debt is limited to financing authorized public improvements with a useful life of greater than five years.

### **Special District Policy Principles**

In view of increasing interest in the use of land-secured financing programs by property owners in various regions of the District, the following Special District Financing Policy Principals have been established, setting forth the terms and conditions under which EMWD would consider implementing such financing programs.

1. Special Tax Ratepayer Protection Principle: The District will limit special tax rates for Community Facilities Districts and Assessment Districts (collectively, “special districts”) to a reasonable level to protect ratepayers.
  - a. The total cumulative burden of all applicable special district overlapping taxes applied to a property (hereinafter referred to as the “effective tax rate”) will be at or below two percent (2%) at the time the special district is formed and at the time of debt issuance;
  - b. The effective tax rate will be evaluated no earlier than 90 days prior to the pricing of any proposed debt issuance. If the effective tax rate is above two percent (2%) at the time of evaluation, the size of the proposed debt issuance will be adjusted to bring the effective tax rate within compliance of the two percent (2%) effective tax rate policy requirement; and
  - c. The property developer/seller shall provide a written notice of the special tax to the homebuyer prior to close of escrow. The property developer shall provide documentation and certification of compliance with special tax disclosure obligation prior to the issuance of debt.
  
2. Investor Protection Principle: The District will levy and collect special taxes or special assessments from special districts to fully fund debt service payments or to pay for acquisition or construction of facilities each year.
  - a. Special taxes/assessments may be levied in advance of the issuance of bonds. In doing so, the special district’s credit will benefit by:
    1. Establishing revenues;
    2. Demonstrating the taxpayers’ willingness and ability to pay the special taxes/assessments; and
    3. Providing funding to pay for the first-year debt service payment.
  - b. All publicly offered special district bonds may be issued with a reserve fund.
  - c. Special taxes may be levied to fund an additional, non-pledged special reserve to secure the payment of debt service and administration fees.
  - d. The District will promptly initiate foreclosure proceedings in compliance with the foreclosure covenant once bonds have been issued.

3. Customer Protection Principle: The District will protect its customers and standing in the credit markets by managing and administering special districts in a prudent, efficient, and effective manner.
  - a. Growth pays for growth. Property developers shall make an advance deposit to fund the cost to form the special district.
  - b. The District's standing in the credit markets is paramount and must be preserved. The District seeks to form special districts with strong credit characteristics, as measured by:
    1. At a minimum, a value-to-lien ratio of four to one (4:1) at time of debt issuance;
    2. Taxpayer delinquency level at or below five percent (5%) at time of debt issuance;
    3. The District's possession of an irrevocable letter of credit from property owners with more than twenty percent (20%) of the special tax obligation;
    4. EMWD requires a development to have a minimum of 100 lots before being considered for the formation of a special district. Developments between 100 to 150 units will be required to provide additional security to mitigate any potential adverse impact from potential delinquencies (See description of Additional Special Reserve under the "Credit Conditions" Section).
    5. Other unique credit factors which may directly or indirectly impact the District's standing, credit worthiness, or potential access to the capital markets.

### **Special Funding Districts Team**

All proposed special districts shall be reviewed by the EMWD Special Funding Districts staff for adherence to policy prior to being presented to the District's Board of Directors. Any variance from policy as well as any other material information will be noted by Special Funding Districts staff and reported to the Board with recommendation for action.

### **Resource Consultants**

- Bond Counsel
- Disclosure Counsel
- Independent Registered Municipal Advisor
- Assessment Engineer
- Special Tax Consultant
- Appraiser
- Economist/Market Absorption Specialist
- Bond Underwriter/Placement Agent
- Trustee/Fiscal Agent

The District has the sole discretion as to the selection of consultants and determination of fees and expenses of all consultants necessary for the formation of a special district and the sale of bonds.

Prior consent of the proponent(s) will not be required in the determination by EMWD of the consulting and financing team.

No firm may serve as both design engineer and engineer of work and assessment engineer or special tax consultant on the same project, pursuant to Section 87100 of the Government Code.

### **Eligible EMWD Public Facilities**

The District-administered land-secured financing programs shall be generally limited to financing and refinancing of water and/or sewer infrastructure improvements and related fees and charges that significantly benefit the general public. Facilities that are to be owned and operated by Eastern Municipal Water District will be given priority over facilities that are to be owned and operated by other entities.

Special district programs may also finance local and/or in-tract facilities to serve individual lots or parcels of land being subdivided, excluding the lateral hookups to homes. Services will not be financed through special districts.

Under special circumstances, as determined by EMWD's Board of Directors, special district programs may be undertaken by EMWD to finance local water and/or sewer facilities and fees to serve lands previously subdivided, sold and improved by a significant number of property owners where the magnitude of the financial program precludes the financing of such facilities by other means.

### **Oversizing**

Requirements for and payment of oversizing of facilities will be addressed on an individual project basis and in accordance with EMWD Resolution Nos. 229, as amended, and 1643 as amended for water and sewer facilities respectively.

### **Credit Conditions**

The following credit conditions shall be required for any special district.

- a. **Value-to-Lien:** The value to lien ratio for all special districts shall be, at a minimum, four to one (4:1) taking into account, in addition to the other aspects of value, the value of the improvements to be financed, and considering all special tax and special assessment liens applicable to the subject property. Value may be established by reference to the assessed value of the subject property or by an appraisal thereof. Appraisals, when used to establish property values, shall be performed by a state certified real estate appraiser, as defined in subdivision (c) of Section 11340 of the California Business and Professions Code selected by EMWD, in accordance with the State of California appraisal standards and the Uniform Standards of Professional Appraisal Practice. The definitions, standards and assumptions to be used in such an appraisal shall be the definitions, standards and assumptions set forth in the California Debt and Investment Advisory Commission's "*Appraisal Standards for Land-Secured Financings*," May, 1994, revised July, 2004. In addition to an appraisal, a market absorption study may be required. The appraisal and/or absorption study shall be coordinated by, under the direction of, and addressed to EMWD. All costs associated with the preparation of the appraisal report and/or market absorption study shall be paid by the proponent(s).

- b. **Reserve Fund:** All land-secured financings shall include a reserve fund with a reserve requirement equal to the least of ten percent (10%) of the initial principal amount of the bond issue, or maximum annual debt service (MADS), or 125 percent (125%) of average annual debt service, or such lower amount as determined on a case-by-case basis based upon the credit quality of the debt issuance. For smaller CFDs or improvement areas within a CFD, with 100 to 150 units, an additional non-pledged special reserve fund, in addition to the standard reserve fund, may be required. The level of the additional special reserve fund will be between 50 to 75 percent of MADS, as determined by EMWD, to the extent permitted by state and federal law.
- c. **Anticipated Tax Rate:** The special tax applicable to any parcel in a special district which is expected to be developed for for-sale residential purposes shall be limited to an amount which, at the time of adoption of a rate and method of apportionment of special taxes for such special district, and at the time a bond financing is approved by the Board, is not expected to cause the total tax projected to be levied on such parcel in the year following its initial sale to a homebuyer to exceed two percent (2%) of the estimated initial sales price thereof. In connection with the foregoing, the estimated sales price shall be determined assuming that the subject home is complete and ready for occupancy and is being marketed contemporaneously with the adoption of the rate and method of apportionment of special taxes. EMWD, at its sole discretion, may limit the total tax burden to less than two percent (2%) for certain market segments, such as seniors in age-restricted communities, if homeowners in such segments have demonstrated market sensitivity to tax burdens of two percent (2%).
- d. **Special Tax Delinquency Level:** The property tax delinquency rate on properties within a special district shall be no greater than five percent (5%) at the time of any sale of bonds in connection with a special district, with exception for the issuance of refunding bonds.

### **Debt Issuance Guidelines**

The timing of any debt issuance in connection with a special district program and the conditions that must be satisfied prior to any such debt issuance shall be determined by the EMWD Board of Directors in its sole discretion; and, in connection therewith and in order to address the then prevailing conditions in the bond market, the Board may elect not to issue any such bonds unless and until the property whose special taxes or assessments will secure such bonds is all or substantially all developed and all or substantially all of the for-sale properties located in the special district have been conveyed to end-users thereof.

### **Financial Participation**

The proponent(s) of a special district program will be expected to advance sufficient funds to pay all costs associated with the formation of the special district and all costs associated with the issuance of any debt secured by the special taxes or assessments, as required and/or deemed necessary by EMWD. Any reimbursement of such costs from the proceeds of the debt issuance will be at the sole discretion of EMWD.

### **Acquisition of Facilities**

In the event the acquisition provision of the Municipal Improvement Act of 1913 or the Mello-Roos Act is utilized, EMWD at its sole discretion, will determine the facilities to be acquired and the method of determining reasonable acquisition costs. A Funding and Acquisition Agreement shall be

required and approved by the EMWD Board of Directors prior to the adoption of the Resolution of Formation to form the special district. Bidding and prevailing wage requirements will be addressed during the preparation of the agreement.

### **Terms and Conditions Debt Issuance**

EMWD shall be responsible for determining the financing method to be used, the structure of the debt to be issued including the method of sale (negotiated, competitive, or private placement), its consultants for the financing, the investment of proceeds, and all other terms and conditions incidental to structuring and closing a land-secured debt issue.

### **Security**

Prior to the sale of bonds, in connection with a special district program, each person who, together with any affiliate thereof, owns land within the special district which EMWD has determined, in its sole discretion, to use in the sizing of such series of bonds (the "sizing property"), the maximum special tax or assessment applicable to such sizing property equals or exceeds 20 percent of the aggregate maximum special taxes or assessments authorized to be levied in the special district on the sizing property (such person and affiliates collectively, a "20 percent owner") shall deliver to EMWD or as directed by EMWD a renewable, irrevocable instrument of credit from a financial institution rated "A" or better (a "security"). The security shall be in an amount equal to 200 percent of the product of the maximum annual debt service on the proposed bonds times a fraction, the numerator of which is the aggregate maximum annual special taxes or assessments applicable to the sizing property owned by the 20 percent owner and the denominator of which is the total maximum special taxes or assessments applicable to the sizing property (the "stated amount"). The security shall be maintained in full force and effect by the 20 percent owner until the sizing property owned by the 20 percent owner is responsible for less than 20 percent of the maximum special taxes or assessments authorized to be levied on the sizing property; provided that the stated amount may be reduced to an amount equal to 200 percent of the product of the maximum annual debt service on the bonds proposed, times a fraction the numerator of which is the aggregate maximum annual special taxes or assessments applicable to the sizing property owned by the 20 percent owner and the denominator of which is the total maximum special taxes or assessments applicable to the sizing property as of the first day of June of the applicable year (subject to EMWD's receipt of a replacement security from any person to whom a 20 percent owner conveys sizing property and who becomes a 20 percent owner as a result of such conveyance). The security shall name the water district, or its designee, as a beneficiary and shall provide that the water district, or its designee, may draw an amount equal to any delinquencies in payment of semiannual installments of the special taxes or assessments levied on sizing property owned by the 20 percent owner. The total amount to be drawn under the security shall not exceed an amount equal to the special taxes or assessments owed with respect to sizing property owned by the 20 percent owner that is delinquent at the time the draw is made. The amount drawn on the security shall be applied in the same manner and for the same purposes as the delinquent special taxes would have been applied, provided that the payment of a draw under the security will not be deemed to cure the delinquency in payment of the special taxes.

### **Disclosure**

Owners of land securing 20 percent or more of the debt service on bonds will be required to provide financial information, deemed appropriate by EMWD, for inclusion in the continuing disclosure

document EMWD must provide annually and will also be required to provide written undertakings to provide financial and operating data as required by the SEC's Rule 15c2-12 and by the underwriter of the bonds. It is the intent of EMWD that purchasers of property within a special district and purchasers of the bonds be fully informed of the amount and nature of the assessment or special tax. EMWD shall require the proponent(s) to provide disclosure of special taxes and assessments to the purchasers of property, to include, home buyer notifications, requiring signature, prior to home purchases. Upon request by staff, the proponent shall provide a certificate of compliance with the disclosure requirements.

### **Equity of the Proposed Special Tax or Assessment**

The allocation of any assessment or special tax shall be consistent with the methodology established by the engineer's report and/or the Rate & Method of Apportionment (RMA) as applicable. All special tax formulas shall include a maximum tax and a formula for pre-payment. EMWD will evaluate the equity of the proposed allocation of a special assessment or special tax consistent with the applicable statutes.

### **Special Tax Levy – CFD**

Special taxes shall be levied upon developed property which issues a building permit and, in all cases, in advance of the issuance of CFD bonds, in accordance with the rate and method of apportionment. Special taxes may be levied to fund an additional special reserve to pay debt service and administration fees. Special taxes may also be levied for authorized improvements prior to debt issuance. These improvement funds will be held in a deposit account until such time as bonds are sold, to ensure sufficient project funds while maintaining an effective tax rate of two percent (2%) or lower at the time of debt issuance. In the event of extenuating circumstances which make issuing bonds in a reasonable manner unfeasible, the funds in the Deposit Account could be released at the discretion of the District.

### **Application Process**

Early communication with EMWD staff is encouraged to assist the proponent(s) in evaluating the feasibility of available financing programs and to discuss program procedures. In general, EMWD will not form a CFD or improvement areas within a CFD and issue bonds for projects with less than 100 units for reasons of cost effectiveness and default risk mitigation. (CFDs with fewer than 150 units will be considered, but will require additional security in the form of an additional special reserve fund). The District formation of smaller CFDs or improvement areas within a CFD will be considered on a case-by-case basis.

If the project appears to be a viable one, the proponent(s) is (are) requested to submit:

- An application along with a minimum initial deposit of \$47,000 (or an amount determined by EMWD as sufficient to fund all expenses associated with CFD formation.) A minimum of \$5,000 of the deposit is non-refundable and will be used toward EMWD administrative costs. Additional deposits may be required if the debt issuance is delayed or if the project includes improvement areas or zones or if a Resolution of Consideration is filed. This and any subsequent deposit(s) are partially or fully refundable only if the sale of bonds is completed, and as determined by EMWD.



- A preliminary report containing a plan of facilities and area of benefit; estimate of cost; and an itemized property tax report showing there are no unpaid delinquent taxes on the land within the proposed special district.
- Preliminary interest petitions representing at least 60 percent of the property owners when requesting initiation of an Assessment District or a Community Facilities District.
- If the proposed special district is located totally or partially outside an EMWD improvement district, receipt of a petition(s) requesting completion of improvement district annexation/formation legal proceedings for all or a portion of the involved lands, as determined by EMWD.
- If EMWD implements a special district program involving facilities to be ultimately owned and operated by EMWD and certain other fees and/or facilities to be owned and operated by another entity, EMWD will be the lead agency and after entering into a Joint Community Facilities Agreement (JCFA) with the other agency(ies), priority of funds will be established, with EMWD's cost for facilities and fees being the first priority.

### **Implementation of EMWD Special District Financing Programs**

When only one or a limited number (as determined by EMWD) of major property owner(s) is/are involved, the interim financing will be provided by the proponent(s) pursuant to an agreement by and between EMWD and the proponent(s). Said agreement shall contain:

- The initial deposit required, as determined by EMWD. If additional funds are needed to offset costs and expenses incurred by EMWD, a written demand shall be made to the proponent(s) for such funds and the proponent(s) shall comply with each demand within seven (7) calendar days of receipt of such notice. If the proponent(s) fail to make any deposit of additional funds for the proceedings, EMWD may suspend all proceedings until receipt of such additional deposit. No interest will be paid on the proponent's initial or subsequent deposits with EMWD.
- Items eligible for reimbursement or acquisition from the debt issuance proceeds, conditioned upon the final approval of the program (either modified or without change) and actual sale of such bonds, will be identified in the Funding and Acquisition Agreement.
- If appropriate, as determined by EMWD, the successful completion of improvement district annexation must be completed prior to starting formation.
- Proponent(s) shall furnish EMWD, without cost to EMWD, duly executed rights of way and/or fee title documents, on lands owned by proponent(s), as determined necessary by EMWD.

When several owners or property (with diverse sizes of property and/or types of development) are involved, the interim financing will be financed by way of:

- An agreement as outlined above; or
- If appropriate, as determined by EMWD, the successful completion of the legal proceedings set forth in Chapter 2.5 of Division 12 (commencing at §10120) of the Streets and Highways Code may be used for Assessment Districts. These legal proceedings ensure EMWD's ability to recover its funding of the interim financing costs by allowing the levying of annual assessments over a five-year period.

## **1913 Act Assessment District Formation Proceedings**

The following is a summary of the Improvement Act of 1913 and is presented as a general overview of the provisions of the law that govern the taxing authority.

Assessment district formation proceedings under the Municipal Improvement Act of 1913 are subject to and contingent upon satisfaction of all environmental, zoning, and land use regulations.

### **1. Initiation of Proceedings**

Formal petitions, representing 60% of the land area, requesting the land-secured financing and waiving the Special Assessment Investigation, Limitation and Majority Protest Act of 1931 will be required except in cases in which the Board of Directors wishes to initiate proceedings itself. The petitions will be circulated to the involved property owners through the proponent(s) or a citizens committee formed by the property owners. The formal petitions are certified as to sufficiency and the Board adopts a resolution determining sufficiency of the petitions.

The design engineer prepares plans, specifications, and cost estimates of the proposed public improvements. The assessment engineer begins preparing the preliminary boundary map and the preliminary Engineer's Report, including the assessment diagram, assessment roll, description of improvements, preliminary method of assessment and provision for an annual amount for administrative costs. The California Environmental Quality Act (CEQA) process is started.

The initiation to proceed can also be done per the direction of EMWD's Board of Directors.

### **2. Presentation of Report**

Upon completion of the preliminary engineering work, the Board adopts a resolution of intention to form the assessment district, approves the preliminary boundary map and preliminary Engineer's Report, calls for construction bids, and sets the date, time and place for a public information meeting and public hearing.

### **3. Bid Process**

Construction bids are advertised and received by EMWD. The assessment engineer modifies the assessment roll and Engineer's Report accordingly and notifies property owners of revised assessments.

### **4. Public Hearing**

Notice of the public information meeting and public hearing in conformance with Proposition 218, together with official ballots, are mailed at least 45 days prior to hearing date to all property owners within the proposed special district (including tenants who have a lease) shown on the last equalized assessment roll. SB 321 effective January 1, 2010 has the following regulations: The notice must be in at least 10-point type and shall include: 1) the estimated assessment; 2) a description of the work; 3) address to mail a protest; 4) name and phone number of contact person for questions; and 5) the date, time and place of the public information meeting and public hearing. 6) "OFFICIAL BALLOT ENCLOSED" must appear on

the envelope containing the notice of public hearing and ballot mailed to the recorded owner of the property to be assessed.

The public hearing is conducted by the Board. The modified Engineer's Report is presented; testimony is received from property owners. At the public hearing, an impartial person designated by the agency who does not have a vested interest in the outcome of the proposed assessment must tabulate the ballots. An "impartial person" includes the clerk of the agency. Under certain circumstances, the ballots must be unsealed and tabulated in public view at the conclusion of the public hearing. Ballots are weighed according to the proportional financial obligation of the affected property. During and after the tabulation, the ballots and the information used to determine the weight of each ballot will be treated as disclosable public record and preserved as public record for a minimum of two years. If ballots submitted in opposition to the assessment exceed ballots submitted in favor, there is a majority protest. If there is not a majority protest, as determined by the ballots, the Board may adopt the resolution confirming the assessments and approving the debt issuance.

5. Cash Collection Period

During the 30 days following the confirmation of assessments, cash payments are received from property owners electing to pay off the assessment, or portion thereof, prior to the issuance of bonds. The 30-day cash collection period may be waived if all property owners within the financing district consent to the waiving and elect to have the bond(s) issued.

6. Authorize Issuance of Bonds

A list of unpaid assessments is prepared. The Board, by resolution, affirms the unpaid assessments, authorizes the issuance and sale of the bonds, and awards the construction contract contingent upon the sale and delivery of bonds.

7. Sale of Bonds

Bonds are issued in exchange for the cash proceeds of the sale. The funds are held by EMWD or its fiscal agent and utilized for the purposes described in the Engineer's Report.

**Mello-Roos Community Facilities District Formation Proceedings**

A Community Facilities District (CFD) is a legally constituted government entity created for the purpose of financing public facilities and services. The security for debt is a special tax which is subject to change each year. Community Facilities District formation proceedings are subject to and contingent upon satisfaction of all environmental, zoning, and land use regulations.

1. Initiation of Proceedings

Formal petitions, representing 10 percent (10%) of the registered voters (or 10% of the landowners by area if less than 12 registered voters) within the proposed special district, requesting the land-secured financing, will be required at this time. The petitions will be circulated to the involved property owners by the District's Bond Counsel.

2. Resolution of Intention

Within 90 days of the receipt of a written request or petition, EMWD must adopt a resolution of intention to establish a CFD, stating the name of the proposed project, the types of facilities

to be financed and that, except where funds are otherwise available; a special tax to pay for such facilities will be annually levied. The resolution of intention shall fix a time and place of a public hearing between 30 and 60 days after the adoption of the resolution of intention, describe the method of levy and apportionment of the special tax and describe the proposed voting procedure. In addition, the resolution may specify conditions under which the obligation to pay the special tax may be prepaid and permanently satisfied. The Board directs staff to study the proposed CFD and to file a report at or before the public hearing describing the proposed public facilities and an estimate of costs.

3. Public Hearing

Protests against the establishment of the CFD, the extent of the CFD or the furnishing of specified types of public facilities may be made orally or in writing by interested persons or taxpayers. If 50 percent or more of the registered voters, or 6 registered voters, whichever is more, residing within the proposed CFD or owners of 50 percent or more of the area of land in the proposed CFD file written protests against the establishment of the CFD, the proceedings are abandoned. If the protests are directed toward certain types of facilities, or against a specified special tax, those specific items may be eliminated from the resolution forming the CFD. The hearing may be continued for up to 30 days without special findings and up to 6 months if the Board makes specified findings.

4. Resolution of Formation

If the Board decides to establish the CFD, it shall adopt a resolution of formation containing similar information as contained in the resolution of intention.

5. Election

If the Board determines to form the CFD, it submits the questions of whether special taxes should be levied to an election of the voters (or landowners if less than 12 registered voters) within the proposed CFD. Combined with the tax proposition, there may be a proposition on the question of incurring bonded indebtedness. The tax, to be levied, must be approved by 2/3 of the votes cast and thereafter levied by adoption of resolution of the Board. The Act provides that the election shall be the next general election or at a special election to be held between 90 and 180 days following the close of the protest hearing. The election time limits may be shortened by the unanimous consent of the qualified electors within the proposed CFD and the concurrence of the Board.

6. Improvement Bonds

A CFD may be created to provide services as permitted by statute, however, EMWD will only consider the formation of a CFD for the purpose of levying special taxes to service bonded indebtedness incurred by the CFD in order to finance the construction of facilities. The proceedings to authorize and incur bonded indebtedness usually parallel the proceedings for formation of the CFD and the authorization to levy the special tax. The proceedings to authorize bonded indebtedness involve a resolution of intention, public hearing, and election, all conducted in a manner very similar to proceedings to form the CFD and levy the tax. CFD bonds may be sold competitively or through negotiated sale and may bear fixed or variable interest rates. In some cases, specified facilities may be provided by a CFD for only a portion

of the land within the CFD. In that event, the Act provides for the formation of improvement areas for which separate elections are conducted and to which a specified special tax applies.

7. Annexation of Lands

Property owners requesting annexation to a CFD will be handled in accordance with the proceedings set forth in the Act.

**Administration of EMWD Administered Special Districts**

Each special district will be administered in accordance with: 1) The appropriate provisions of the Streets and Highways Code or Government Code; 2) The Resolution of Intention and Issuance and Sale of Bonds; and 3) The Resolution of Formation, which may have been prepared relative to the respective special district. Additional provisions, rules, and regulations not specifically addressed above are set forth below:

1. Miscellaneous Fee Schedule (relative to any special district)

EMWD has established fees to recover its costs associated with requests for assessment payoff amounts and payment of delinquent assessments and penalties. These fees are included in EMWD's Resolution No. 2963, as amended. Additional fees may occur requesting a CFD payoff quote from EMWD special tax consultants or foreclosure attorney at a later date.

2. Treatment of Delinquencies

EMWD will develop a foreclosure covenant that will address (1) the amount of the delinquency; (2) the duration of the delinquency; and (3) the condition of the reserve fund. The specific details of the covenant will depend upon the size and duration of the bond issue along with the concentration of the special tax base at the time of bond issuance. The purpose is to foreclose when necessary to protect the credit quality of the bonds and to hold the property owners accountable to terms addressed in the covenant.

3. Procedure for Division of Land and Bond Assessment (relative to Assessment Districts only)

Whenever any parcel of land within an assessment district having an unpaid assessment is subdivided, the owner or sub-divider either pays the assessment in full, or:

- a. Submits a written application with EMWD requesting that the remaining unpaid assessment be apportioned in accordance with the provisions of §8740, et seq. of the Streets and Highways Code. EMWD will bill for the segregation fees as stated in resolution 2963, as amended, of which the invoice will be payable within seven (7) days from invoice date. If fees are not paid, this apportionment will be added to the first-year tax roll.
- b. Files with the County Auditor a certificate, prepared by EMWD, certifying that provision has been made for segregation of the remaining unpaid assessment to each of the proposed new parcels. The apportionment of the assessment payment obligation will be in the manner provided in the statute pursuant to which the assessments were levied or to which the bonds were issued. Payment of fees associated with said land division apportionment of unpaid assessments shall accompany all application in accordance with Resolution

2963 as amended. Said resolution is determined to be reasonable and is in amounts which will cover reimbursement for necessary costs in processing the apportionment of unpaid assessments for lands within any assessment district administered by EMWD. If no application is filed, at the time EMWD files the amended assessment pursuant to order of the Board of Directors, the fee is determined from the schedule, with each new parcel paying its proportionate share. Prior to making the division, EMWD shall notify the property owner as to the costs for the apportionment. In the event the costs are not paid within 15 days of notification, EMWD shall, in preparing the amended assessment, show separately thereon the amount of said fee charged to each individual parcel. The amount, if not paid, shall be added to the first applicable fiscal year's assessment roll for collection.

#### **Assessment Districts And/Or Community Facilities Districts Administered by Another Entity**

Whenever another entity implements a land-secured program involving facilities to be ultimately owned and operated by EMWD, such other entity and EMWD shall consider a Joint Community Facilities Agreement (JCFA) which sets forth all the obligations and responsibilities of the parties. JCFA's are at the discretion of the EMWD Board of Directors.

#### **Joint Community Facilities District where EMWD is not the Lead Agency**

EMWD will consider entering into a Joint Community Facilities Agreement to provide for the financing of EMWD public facilities only if the applicable lead agency agrees that (i) if and when the lead agency determines to issue bonds, the lead agency shall take such actions necessary in its reasonable discretion to ensure the total effective tax rate within the applicable Community Facilities District does not exceed two percent at the time of bond sale, and (ii) lead agency shall not include EMWD's name on property owners' special tax bills within the lead agency CFD. Additionally, EMWD will not consider entering into a Joint Community Facilities Agreement where the total dollar amount of the EMWD public facilities proposed to be financed by the lead agency CFD is greater than the total dollar amount of the lead agency's public facilities proposed to be financed by the lead agency CFD.

#### **Application of Bond Proceeds – Internal Control Procedures**

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 it has adopted the policies described in SB 1029.

The Finance Department will be tasked with 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 demonstrated that 85 percent (85%) of the proceeds will be expended within the three-year temporary period.

#### **4. Swap Policy**

The purpose of the Interest Rate Swap Policy is to establish guidelines for the use and management of all interest rate management agreements, including, but not limited to, interest rate swaps,

swaptions, caps, collars and floors (collectively "Swaps" or "Agreements") incurred in connection with the issuance of new bonds, notes and other obligations (collectively, the "bonds"), or to accompany bonds already issued.

This Policy sets forth the manner of execution of swaps, provides for security and payment provisions, risk considerations and certain other relevant provisions in the context of being responsive to the Recommended Practices of the Government Finance Officers Association (GFOA) regarding the contents of an interest rate swap policy. The failure by the District to comply with any provision of this Policy shall not invalidate or impair any Agreement.

### **Authority**

The District is authorized to issue bonds and to enter into Swaps from time to time to better manage assets and liabilities and take advantage of market conditions to lower overall costs and reduce interest rate risk.

The District has issued this Policy to provide guidance as to how the District intends to use and manage Swaps. While it is the intention of the District to adhere to this Policy in applicable circumstances, the District recognizes that changes in the capital markets and other unforeseen circumstances may from time to time produce situations that are not covered by the Policy which will require modifications or exceptions to achieve policy goals.

The General Manager, Deputy General Manager/Treasurer, Chief Financial Officer and their authorized designee(s) (the Authorized Representative) are the designated administrators of this Policy. The Board shall have oversight on the approval of each Agreement. However, the Authorized Representative, subject to Board approval, shall have the authority to enter into each Swap. Each Agreement shall be structured by staff and members of the financing team. The Authorized Representative shall have the day-to-day responsibility for implementing and managing the Agreements. The District shall be authorized to enter into Swaps only with qualified counterparties (each a "Counterparty"). Counterparties shall be selected pursuant to the criteria set forth in this Policy.

This Policy shall be reviewed on an annual basis by the Authorized Representative. Any recommended changes shall be presented to the Board of Directors and the Board's Administrative Committee for their consideration.

### **Purpose**

The issuance of bonds involves a variety of interest payment obligations and risks that a variety of financial instruments are available to reduce, offset, or hedge. The structure of the District's debt is often designed to manage the assets and liabilities on its balance sheet. It is the policy of the District to also consider the use of Swaps and other financial instruments to better manage its assets and liabilities. The District may execute a Swap if the transaction can be expected to result in one or more of the following or any similar type of benefit:

- Reduce exposure to changes in interest rates on a particular financial transaction or in the context of the management of interest rate risk derived from the District's overall asset/liability balance;

- Result in a lower net expected cost of borrowing with respect to bonds;
- Manage variable interest rate exposure consistent with prudent debt practices;
- Manage exposure to changing market conditions in advance of anticipated issuance of bonds (through the use of anticipatory hedging instruments);
- Achieve more flexibility in meeting overall financial objectives that cannot be achieved in conventional markets. For example, entering into a swaption with an upfront payment; and
- Provide customized cash flows to match required payment obligations or revenue projections.

The District will not use Agreements that:

- Are speculative or create extraordinary leverage;
- Lack adequate liquidity to terminate without incurring a significant bid/ask spread;
- Provide insufficient price transparency to allow reasonable valuation; and
- Provide exposure to currency risk, sovereignty risk, commodity risk or the use of credit derivatives - unless directly linked to the District's or the Counterparty's credit.

### **Aspects of Risk Exposure Associated with Swaps**

Before entering into a Swap, the District shall evaluate all the risks inherent in the Agreement. These risks to be evaluated should include basis risk, yield curve/maturity mismatch, tax risk, Counterparty risk, termination risk, rollover risk, liquidity risk and credit risk.

Type of Risk	Description	Evaluation Methodology
<b>Basis risk</b>	The mismatch between actual variable rate debt service and variable rate indices used to determine Swap payments. Defines the risk that the normal relationship between indices or prices might change.	District will review and consider based on the historical trading differentials between the indices relevant to the Swap agreement.
<b>Yield Curve / Maturity Mismatch</b>	This type of position is typically a deliberate arbitrage play or to take advantage of the shape of the yield curve. The risk created when swap payments are based on indices that lie along different parts of the yield curve (e.g., 7-day rates vs. 30-year rates)	District will evaluate historical trading relationships, and make sure to have adequate reserves or a hedging mechanism to offset unexpected movements.
<b>Tax risk</b>	The risk created by potential tax events that could affect Swap payments.	District will review the tax events in proposed Agreements. District will evaluate the impact of potential changes in tax law on LIBOR indexed Swaps.
<b>Counterparty risk</b>	The failure of the Counterparty to make required payments.	District will monitor exposure levels, ratings thresholds, and collateralization requirements.
<b>Termination risk</b>	The need to terminate the Agreement in a market that dictates a termination payment by the issuer.	District will compute its termination exposure for all existing and



Type of Risk	Description	Evaluation Methodology
		proposed Swaps at market value and under a worst case scenario.
<b>Rollover / Mismatch risk</b>	The mismatch of the maturity of the Swap and the maturity of the underlying bonds.	District will determine its capacity to issue variable rate bonds that may be outstanding after the maturity of the Swap.
<b>Liquidity risk</b>	The inability to continue or renew a liquidity facility.	District will evaluate the expected availability of liquidity support for swapped and unhedged variable rate debt.
<b>Credit risk</b>	The occurrence of an event modifying the credit rating of the Issuer or its Counterparty.	District will monitor the ratings of its Counterparties and guarantors.

Risk exposure should not be measured solely in terms of notional amount, but rather how changes in interest rates would affect the District's exposure on all of its Swaps (as measured by mark-to-market and termination risk exposure). The mark-to-market and termination value of the entire swap portfolio should be measured at least semi-annually by an independent third party. In addition, the District should measure the termination risk for the respective Counterparty each time it enters into a new Agreement.

1. Termination Value Risk Limit

The aggregate termination payment risk for all existing and projected Swaps shall equal that amount that would be paid by an individual Counterparty based on the reasonably expected termination payment of the proposed Counterparty for the existing swaps and the proposed swap.

The method of such analysis may provide a worst-case termination value, using a methodology such as a Value-At-Risk (VAR) Analysis, or a parallel yield curve sensitivity analysis PV(01) method.

2. Maximum Portfolio Termination Value

The District shall measure the expected termination payment for all Counterparties, collectively, the Maximum Portfolio Termination Value.

The District's goal is to limit the Maximum Portfolio Termination Value to an amount equal to approximately 30 percent of the District's Available Reserves. The District should not enter into additional agreements (except to unwind or offset any existing agreements), if the Maximum Portfolio Termination Value exceeds 50 percent of the District's Available Reserves.

3. Maximum Counterparty Termination Value

The District shall endeavor to diversify its exposure to Counterparties. To that end, before entering into an Agreement, it should determine its exposure to the relevant Counterparty

and determine how the proposed Agreement would affect the District's additional risk to termination.

*Maximum Counterparty Termination Exposure refers to the aggregate mark-to-market exposure to a counterparty net of the mark-to-market value of any collateral pledged to the District by such counterparty.*

The District's goal is to limit its Maximum Counterparty Termination Exposure attributable to a single swap counterparty, based on a three-tier structure.

The District shall establish a minimum termination value to one counterparty equal to 20 percent (20%) of the District's Available Reserves. The District shall not seek to diversify counterparties if its Maximum Portfolio Termination Value is below this level.

The District shall seek to diversify its counterparty termination exposure, once this minimum value has been met, as set forth in the table below.

The District shall limit its aggregate exposure to all counterparties, or the Maximum Portfolio Termination Value, equal to 50 percent of the District's Available Reserves.

<b>Credit Rating</b>	<b>Maximum Counterparty Termination Exposure*</b>
AAA	Equal to 75% of EMWD's Maximum Portfolio Termination Value
AA Category	Equal to 65% of EMWD's Maximum Portfolio Termination Value

\* The table above provides general exposure guidelines with respect to whether the District should enter into an additional agreement with an existing Counterparty. The District may make exceptions to the guidelines at any time to the extent that the execution of a Swap achieves one or more of the outlined benefits in this Policy or provides other benefits to the District. These limits shall only apply as of the time a Swap or related transaction, such as a cap, collar, etc. is entered into, and thus may be exceeded during the term of a Swap or Swaps with the same Counterparty.

Additional limits may be established for each Counterparty as well as the relative level of risk associated with each existing and projected Swap.

#### 4. Case-by-Case Analysis

The District should also consider the District's financial position and overall asset/liability management strategy when evaluating its termination exposure for each transaction.

The Authorized Representative shall determine the appropriate term for a Swap on a case-by-case basis. The slope of the swap curve, the marginal change in swap rates from year to year along the swap curve, and the impact that the term of the swap has on the overall exposure of the District in connection with its bonds shall be considered in determining the appropriate term of any Swap. In connection with the issuance of bonds, the term of a Swap

shall not extend beyond the final maturity date of the applicable issue of bonds, or in the case of a refunding transaction, beyond the final maturity date of the refunding bonds.

The total net notional amount of all Swaps related to an issue of bonds should not exceed the amount of the related outstanding bonds. For purposes of calculating the net notional amount, credit shall be given to any Swaps that offset a specific bond transaction.

### **Long Term Implications**

In evaluating a particular transaction involving the use of swaps, the District shall review long-term implications associated with entering into each agreement, including costs of borrowing, historical interest rate trends, variable rate capacity, credit enhancement capacity, liquidity capacity, opportunities to refund related debt obligations and other similar considerations.

1. Impact of use of Liquidity

The District shall consider the impact of any variable rate bonds issued in combination with a Swap on the availability and cost of liquidity support.

2. Call Option Value Considerations

When considering the relative advantage of variable rate bonds issued in combination with a Swap versus fixed rate bonds, the District will take into consideration the value of any call option on fixed rate bonds. When comparing potential cost savings by utilizing a swap, the District should take into consideration that a synthetic fixed-rate swap does not usually have an optional call provision; and therefore, should evaluate the potential impact on future cost savings and flexibility.

3. Qualified Hedges

The District understands that, (1) if payments on and receipts from the Agreement are to be taken into account in computing the yield on the related bonds, the Agreement must meet the requirements for a "qualified hedge" under federal tax law (sometimes referred to as an "integrated" Swap); and (2) if one of the goals of entering into the Agreement is to convert variable yield bonds into fixed yield bonds (sometimes referred to as a "super integrated swap"), then certain additional requirements must be met. In both situations, the terms of the Agreement and the process for entering into the Agreement must be reviewed and approved in advance by tax counsel.

### **Qualified Swap Counterparties**

Unless approved by the Board, the District will work with qualified Swap Counterparties that have a general credit rating of: (i) at least "Aa3" or "AA-" by two of the nationally recognized rating agencies and not rated lower than "A2" or "A" by any nationally recognized rating agency, or (ii) at least "A1" or "A+" by two of the nationally recognized rating agencies and has a continuing "AAA" subsidiary as rated by at least two nationally recognized credit rating agency. The nationally recognized rating agencies are Moody's Investors Services, Incorporated, S&P Global Ratings, and Fitch Ratings.

Swap Counterparties must have a demonstrated record of successfully executing Swap agreements as well as minimum capitalization of at least \$500 million.

Swap counterparties should serve as principal on each transaction, not as "agent" to ensure most efficient pricing and direct responsibility.

In addition to the rating criteria specified herein, the District will seek additional credit enhancement and safeguards in the form of:

- Contingent credit support or enhancement;
- Collateral consistent with the policies contained herein;
- Ratings downgrade triggers;
- Guaranty of parent, if any.

### **Form of Swap Agreements**

It is the District's intention to have a form of Swap Agreement to be used in all Swap Agreements, modified as necessary to meet the needs of a particular transaction. The form of the Agreement executed by the District shall contain terms and conditions as set forth in the International Swap and Derivatives Association, Incorporated ("ISDA") Master Agreement, including any schedules, and confirmations. All Agreements shall be subject to the approval of the Authorized Representative. The Agreements shall include payment, term, security, collateral, default, remedy, termination, and other terms, conditions and provisions as the Authorized Representative deems necessary or desirable.

The District will agree to comply with the ISDA August 2012 DF Protocol (DF Protocol), subject to such modifications as the Authorized Representative of the District may deem to be in the best interest of the District, based upon the advice of the District's Financial Advisor or Bond Counsel, in order to facilitate future swap transactions, including amendment, novation or termination (full or partial) of existing swap transactions. To that end, the District will comply with the policies and procedures for Qualified Independent Representatives (QIR) specified in the DF Protocol and developed and implement by District Staff.

#### **1. Conformance with Dodd-Frank**

It is the intent of the District to conform this policy to the requirements relating to legislation and regulations for over-the-counter derivatives transactions under Title VII of the Wall Street Transparency and Accountability Act of 2010, as supplemented and amended from time to time (herein collectively referred to as "Dodd-Frank"). Pursuant to such intent, it is the policy of the District that:

- a. Each swap advisor engaged or to be engaged by the District will function as the designated qualified independent representative of the District, sometimes referred to as the "Designated QIR";
- b. Each swap advisor agrees to meet and meets the requirements specified in Commodity Futures Trading Commission Regulation 23.450(b)(1) or any successor regulation thereto (herein referred to as the "Representative Regulation");
- c. Each swap advisor provide a written certification to the District to the effect that such swap advisor agrees to meet and meets the requirements specified in the Representative Regulation;

- d. The District monitor the performance of each swap advisor consistent with the requirements specified in the Representative Regulation;
- e. The District exercise independent judgment in consultation with its swap advisor in evaluating all recommendations, if any, presented by any counterpart with respect to transactions authorized pursuant to this Swap Policy; and
- f. The District rely on the advice of its swap advisor with respect to transactions authorized pursuant to the Swap Policy and not rely on recommendations, if any, presented by any counterpart with respect to transactions authorized pursuant to this Swap Policy.

The District may use legal counsel and/or outside professional advisors to assist in preparation of the swap documents.

### **Termination Provisions**

The District shall consider including in all Agreements provisions granting the District the right to optionally terminate an Agreement at any time over the term of the Agreement. Any termination of an Agreement shall be made by the Authorized Representative.

A termination event is deemed to occur should the Swap Counterparty (or its credit support provider) fail to maintain the ratings below and the Swap Counterparty has not delivered any collateral as required under the Credit Support Annex with the District:

- Credit Rating of at least "Baa1" from Moody's; or
- Credit Rating of at least "BBB+" from S&P; or
- Credit Rating of at least "BBB+" from Fitch; or
- An equivalent rating determined by a nationally recognized ratings service acceptable to both parties.

Furthermore, an additional termination event is deemed to occur should the Swap Counterparty (or its credit support providers) have one or more outstanding issues of rated unsecured, unenhanced senior debt and none of such issues has a rating of at least (i) Baa2 or higher as determined by Moody's Investors Service, Incorporated, or (ii) BBB or higher as determined by S&P Global Ratings or (iii) an equivalent investment grade rating determined by a nationally-recognized rating service acceptable to both parties.

A termination payment to or from the District may be required in the event of termination of an Agreement due to a default or a decrease in credit rating of either the District or the Swap Counterparty.

It is the intent of the District to avoid making a termination payment out of available District funds to a Counterparty that does not meet its contractual obligations. Prior to making any such termination payment, the Authorized Representative shall evaluate whether it is financially advantageous for the District to obtain a replacement Counterparty to avoid making such termination payment or finance the termination payment through a long-term financing product.

For payments on early termination and optional termination, Market Quotation and the

Second Method, as defined in the 1992 Form of the ISDA will apply.

### **Security and Source of Repayment**

While the District has a preference to subordinate swap payments to debt service payments, the District may use the same security and source of repayment (pari passu) for the Swap as is used for the underlying bonds. The District shall subordinate the termination payment under the swap to the debt service on the underlying bonds. The District shall consult with Bond Counsel regarding the legal requirements and compliance with the District's Master Resolution associated with making the payments under the Swap on a parity or non-parity basis with the applicable outstanding bonds.

### **Specified Indebtedness**

The specified indebtedness related to credit events in any Agreement should be narrowly defined and refers only to indebtedness of the District that could have a materially adverse effect on the District's ability to perform its obligations under the Swap. Debt should typically only include obligations within the same, or higher, lien as the Swap obligation.

### **Governing Law**

Governing law for Swaps may be New York or California, except that the capacity, power and authority of the District to enter into a Swap shall be governed by and construed in accordance with law of the State of California.

### **Events of Default**

Events of default of a Swap Counterparty shall include, but are not limited to the following:

- Failure to make payments when due;
- Breach of representations and warranties;
- Illegality;
- Failure to comply with downgrade provisions and/or provide collateral as required; and
- Failure to comply with any other provisions of the Agreement after a specified notice period.

### **Collateral Requirements**

As part of any Agreement, the District may require, or be required to post collateral or other credit enhancement to secure any or all Swap payment obligations. As appropriate, the Authorized Representative may require collateral or other credit enhancement to be posted by each Swap Counterparty under the following circumstances:

- Each Swap Counterparty may be required to post collateral if the credit rating of the Swap Counterparty or parent falls below the "A- or A3". Collateral for further decreases in credit ratings of each Swap Counterparty shall be posted by each Swap Counterparty in accordance with the provisions contained in the credit support annex to each Agreement;
- Collateral shall consist of cash, U.S. Treasury Securities, or Agency Securities;
- Collateral shall be deposited with a third-party trustee, or as mutually agreed upon between the District and each Swap Counterparty;
- A list of acceptable securities that may be posted as collateral and the valuation of such collateral will be determined and mutually agreed upon during negotiation of the Agreement;
- The market value of the collateral shall be determined on at least a monthly basis;
- The District will determine reasonable threshold limits for increments of collateral posting based on a sliding scale reflective of credit ratings; and

- The Authorized Representative shall determine on a case-by-case basis whether other forms of credit enhancement are more beneficial to the District.

### **Other Criteria**

The District may select a Swap Counterparty through either a competitive or negotiated process. The selection of a Swap Counterparty shall be done on a case-by-case basis. The conditions to be considered in determining the process shall include:

- Traditional swap or financial products such as synthetic fixed-rate swaps, reverse swaps, caps, floors, collars, and swaptions without significant deviations from standard ISDA contract;
- The proposed structure does not require customized features;
- Several counterparties are eligible and willing to provide bid(s);
- Terms of the swap match the underlying bond structure (i.e., same or shorter maturity, payment dates, amortization schedule);
- Marketing of the Swap will require complex explanations about the security for repayment or credit quality;
- Demand is limited among Swap Counterparties;
- Coordination of multiple components of the financing is required;
- The Swap has non-standard features, such as one-way collateral;
- Bond insurance is not available or not offered;
- Counterparty risk (termination exposure) to other providers is limited;
- Counterparties are likely to demand individual changes in bid documents;
- A Swap Counterparty has provided a structure or concept that is unique;
- The timing and facilitation benefit to the District of using a Swap Counterparty that is also managing an accompanying bond issue; and
- The transaction structure or financing structure has been developed for the District by a Counterparty and the District has determined that it is in its best interest to proceed with proposed transaction or a similar structure.

The District shall use outside professional advisors to assist in the price negotiation. The District shall obtain an opinion from an independent party that the terms and conditions of any financial product entered into reflect a fair market value as of the execution date.

### **Ongoing Reporting Requirements**

Written records noting the status of all Agreements will be maintained by the District and shall include the following information:

- Highlights of all material changes to Agreements or new Agreements entered into by the District since the last report, and a summary of any Agreements that were terminated;
- Basic term sheet containing trade date, effective date and termination date of each of the Agreement, as well as key terms such as: notional amount, rate paid by each Counterparty, day count basis, payment dates, and amortization/accretion schedules. This term sheet will also contain Counterparty contact information;
- Most recent (at least annually) mark-to-market valuation, performed by an independent third party advisor;

- For each Swap Counterparty, shall provide the total notional amount position, the average life of each Agreement, the available capacity to enter into a Swap, and the remaining term of each Agreement;
- The credit rating of each Swap Counterparty and credit enhancer insuring the Swap payments;
- Actual collateral posting by the Swap Counterparty, if any, per Agreement and in total by Swap Counterparty; and
- Information concerning any default by a Swap Counterparty and the results of the default, including but not limited to, the financial impact to the District if any.

The District shall reflect the use of derivatives on its financial statements in accordance with GASB Technical Bulletin No. 2003-1. The disclosure requirements include:

- Objective of the Derivative;
- Significant Terms;
- Fair Value;
- Associated Debt; and
- Risks.

## **5. Disclosure Procedures**

The purpose of these Disclosure Procedures (the “Procedures”) is to ensure that the District, associated Financing Authorities, Assessment Districts, and the CFDs continue to comply with all applicable disclosure obligations and requirements under the federal securities laws.

In offering Obligations to the public, and at other times when the District makes certain reports, the District must comply with the “anti-fraud rules” of federal securities laws. (“Anti-fraud rules” refers to Section 17 of the Securities Act of 1933 and Section 10(b) of the Securities and Exchange Act of 1934 (the “1934 Act”), and regulations adopted by the Securities and Exchange Commission under those acts, particularly Rule 10b-5 promulgated under the 1934 Act.)

The core requirement of these rules is that potential investors in Obligations must be provided with all “material” information relating to the offered Obligations. The information provided to investors must not contain any material misstatements and the District must not omit material information which would be necessary to provide to investors a complete and transparent description of the Obligations and the District’s financial condition (or, in the case of CFD Obligations, the development within the CFD and other factors which may affect the willingness or ability of the property owners therein to pay special taxes when due). In the context of the sale of securities, a fact is considered to be “material” if there is a substantial likelihood that a reasonable investor would consider it to be important in determining whether or not to purchase the securities being offered.

When the District issues Obligations, the two central disclosure documents which are prepared are a preliminary official statement (the “POS”) and a final official statement (the “OS” and, collectively with the POS, the “Official Statement”). The Official Statement generally consists of: (i) the forepart (which describes the specific transaction, including maturity dates, interest rates, redemption provisions, the specific type of financing, the security for the Obligations and other matters particular to the financing; (ii) a section or appendix which provides information on the District, including its



financial condition as well as certain operating information (which may be property tax assessments or may be other District revenues depending on the type of Obligations being issued) (the “District Section”); and (iii) various other appendices, including the District’s audited financial report, form of the proposed legal opinion, and form of continuing disclosure undertaking. With respect to CFDs, the Official Statement contains limited information about the District, as CFD Obligations are special obligations of the CFD and are not secured by any funds of the District, and instead contains a description of the Obligations and the special taxes securing the Obligations, a description of the CFD, the improvements and taxpayers therein, a property ownership and development section if the CFD is not fully built out, a risk factors section containing risks specific to the CFD and CFDs in general, in addition to other sections. Investors use the Official Statement as one of their primary resources for making informed investment decisions regarding the Obligations.

### **Disclosure Process**

When the District determines to issue Obligations, the District’s Deputy General Manager/Treasurer with responsibility for administrative services, or designee, requests the involved departments to commence preparation of the portions of the Official Statement (including particularly the District Section) for which they are responsible. While the general format and content of the Official Statement does not normally change substantially from offering to offering, except as necessary to reflect major events, the Deputy General Manager/Treasurer with responsibility for administrative services, or designee, is responsible for reviewing and preparing or updating certain portions of the District Section which are within such person’s particular area of knowledge. Once the Official Statement has been substantially updated, the entire Official Statement is shared with the General Manager for review and input. Additionally, all participants in the disclosure process are separately responsible for reviewing the entire Official Statement.

Members of the financing team, including Bond Counsel and the District’s Municipal Advisor with respect to the Obligations, assist staff in determining the materiality of any particular item, and in the development of specific language in the District Section. Members of the financing team also assist the District in the development of a “big picture” overview of the District’s financial condition, included in the District Section. This overview highlights particular areas of concern. Bond Counsel has a confidential, attorney-client relationship with officials and staff of the District.

The Deputy General Manager/Treasurer with responsibility for administrative services or a member of the financing team at the direction thereof schedules one or more meetings or conference calls of the financing team (which includes District officials, Bond Counsel, the District’s Financial Advisor, the underwriter of the Obligations, and the underwriter’s counsel), and new drafts of the forepart of the Official Statement and the District Section are circulated and discussed. Such communications may occur via electronic means rather than by meetings or conference calls. During this part of the process, there is substantial contact among District staff and other members of the financing team to discuss issues which may arise, determine the materiality of particular items and ascertain the prominence in which the items should be disclosed.

Prior to distributing a POS to potential investors, there is typically a formal conference call which includes District officials involved in the preparation of the POS, members of the financing team and the underwriters and the underwriter’s counsel, during which the Official Statement is reviewed in its entirety to obtain final comments and to allow the underwriters to ask questions of the District’s senior officials. This is referred to as a “due diligence” meeting.

With respect to CFD Obligations, when a CFD is ready to issue bonds, the District's Deputy General Manager/Treasurer with responsibility for administrative services requests, the Chief Financial Officer, and the Special Districts Funding Department organize the financing team to commence preparation of the Preliminary Official Statement. Typically, the initial draft of a CFD Official Statement is assembled with input from Bond Counsel, Disclosure Counsel, Financial Advisor, Special Tax Consultant, Appraiser, Developer and Developer's Counsel and Underwriter. The Chief Financial Officer and the Special Districts Funding Department reviews the draft Preliminary Official Statement once distributed by Disclosure Counsel, specifically the information included with respect to the CFD and the formation thereof by the District. Once the Preliminary Official Statement has been distributed, one or more due diligence conference calls or meetings with the entire CFD financing team are held until the Preliminary Official Statement is finalized. Typically, prior to printing the Preliminary Official Statement, the Developer will be required to sign a "10b-5" certificate stating that the information in the Preliminary Official Statement provided by or pertaining to the Developer and its development within the CFD does not contain any untrue statement of material fact or omit to state any material fact necessary to make the statements contained in the Preliminary Official Statement in light of the circumstances under which they were made, not misleading.

A substantially final form of the POS is provided to the District Board of Directors in advance of approval of the POS. Doing so affords the Board of Directors an opportunity to review the POS, ask questions and make comments. The substantially final form of the POS is approved by the Board of Directors which generally authorizes certain senior staff to make additional corrections, changes and updates to the POS in consultation with the District's general counsel and Bond Counsel.

When the POS is posted for review by potential investors, senior District officials execute certificates deeming certain portions of the POS complete (except for certain pricing terms) as required by Rule 15c2-12 promulgated under the 1934 Act.

Between the posting of the POS for review by potential investors and delivery of the final OS to the underwriter for redelivery to actual investors in the Obligations, any changes and developments will have been incorporated into the POS, including particularly the District Section, if required. If necessary, to reflect developments following publication of the POS or OS, as applicable, supplements will be prepared and published.

In connection with the closing of the transaction, one or more senior District officials execute certificates stating that certain portions of the Official Statement, as of the date of each OS and as of the date of closing, does not contain any untrue statement of material fact or omit to state any material fact necessary to make the statements contained in the Official Statement in light of the circumstances under which they were made, not misleading. The District's general counsel also provides an opinion letter advising the underwriters of the Obligations that information contained in the District Section (or specified portions thereof) as of its date did not, and as of the date of the closing, does not contain any untrue statement of a material fact or omitted or omits to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading. The District's general counsel does not approve any financial, statistical, economic or demographic data or forecasts, charts, tables, graphs, estimates, projections, assumptions or expressions of opinion, and certain other customary matters.

## **District Section**

The information contained in the District Section is developed by personnel under the direction of the Deputy General Manager/Treasurer with responsibility for administrative services, with the assistance of the financing team. In certain circumstances, additional officials will be involved, as necessary. The following principles govern the work of the respective staffs that contribute information to the District Section:

- District staff involved in the disclosure process are responsible for being familiar with their responsibilities under federal securities laws as described above.
- District staff involved in the disclosure process should err on the side of raising issues when preparing or reviewing information for disclosure. Officials and staff are encouraged to consult the District's general counsel, Bond Counsel or members of the financing team if there are questions regarding whether an issue is material or not.
- Care should be taken not to shortcut or eliminate any steps outlined in the Procedures on an ad hoc basis. However, the Procedures are not necessarily intended to be a rigid list of procedural requirements, but instead to provide guidelines for disclosure review. If warranted, based on experience during financings or because of additional Securities and Exchange Commission pronouncements or other reasons, the District should consider revisions to the Procedures.
- The process of updating the District Section from transaction to transaction should not be viewed as being limited to updating tables and numerical information. While it is not anticipated that there will be major changes in the form and content of the District Section at the time of each update, everyone involved in the process should consider the need for revisions in the form, content and tone of the sections for which they are responsible at the time of each update.
- The District must make sure that the staff involved in the disclosure process are of sufficient seniority such that it is reasonable to believe that, collectively, they are in possession of material information relating to the District, its operations and its finances.
- In light of Securities and Exchange Commission pronouncements in 2014, particular care should be given to disclosures in each POS and OS with respect to past compliance with Continuing Disclosure Agreements (as discussed below under the heading "ANNUAL CONTINUING DISCLOSURE REQUIREMENTS"). If the District has failed to comply with such Continuing Disclosure Agreements in the five years prior to the posting of a POS, such failure to comply must be described in each such POS and OS. The District must task personnel or retain outside consultants with responsibility to check the District's past compliance with its Continuing Disclosure Agreements before the posting of each POS.

## **Training**

Periodic training for the staff involved in the preparation of the Official Statement (including the District Section) is coordinated by the finance team and the Deputy General Manager/Treasurer with responsibility for administrative services. These training sessions are provided to assist staff members involved in identifying relevant disclosure information to be included in the District Section. The training sessions also provide an overview of federal laws relating to disclosure, situations in which disclosure rules apply, the purpose of the Official Statement and the District Section, a description of previous SEC enforcement actions and a discussion of recent developments in the area of municipal disclosure. Attendees at the training sessions are provided the opportunity to ask questions of finance team members, including Bond Counsel, concerning disclosure obligations and

are encouraged to contact members of the finance team at any time if they have questions.

### **Annual Continuing Disclosure Requirements**

In connection with the issuance of Obligations, including CFD Obligations, the District has entered into a number of contractual agreements (the “Continuing Disclosure Agreements”) to provide annual reports with: (i) financial data; (ii) operating data; and (iii) audited financial statements (the District should consider whether it should no longer provide the District’s entire Annual Comprehensive Financial Report (ACFR) rather than the audited financial statements alone). In addition, the Continuing Disclosure Agreements require the District to provide notice of certain events relating to the Obligations specified in the Continuing Disclosure Agreements. The District must comply with the specific requirements of each Continuing Disclosure Agreement. The District’s Continuing Disclosure Agreements generally require that the annual reports be filed within 210 days after the end of the District’s fiscal year (although securities law requires such annual reports only to be filed once each year), and event notices are generally required to be filed within 10 days of their occurrence. Such filings are to be made through the Municipal Securities Rulemaking Board’s Electronic Municipal Market Access System over the Internet.

- Specific events which require “material event” notices are set forth in each particular Continuing Disclosure Agreement.
- The Deputy General Manager/Treasurer with responsibility for administrative services shall be responsible for preparing and filing the annual reports and event notices required pursuant to the Continuing Disclosure Agreements. Particular care shall be paid to the timely filing of any changes in credit ratings on Obligations (including changes resulting from changes in the credit ratings of insurers of particular Obligations).
- With respect to CFD Obligations, the Continuing Disclosure Agreements are prepared by the District’s Special Tax Consultant(s) and reviewed by the Chief Financial Officer and the Special Funding District Department staff. The CFD Continuing Disclosure Agreements generally require that the annual reports be filed within eight months after the end of the District’s fiscal year and include the District’s ACFR and certain other operating data concerning the CFD itself.
- In addition to disclosing any failure to comply with prior Continuing Disclosure Agreements in each POS and OS (as discussed in the final bullet point under the heading “DISTRICT SECTION” and in the “CONTINUING DISCLOSURE” section of CFD POSs and OSs), the District must take steps to correct any such failure. Such steps could include filing amended annual reports, filing audited financial statements or providing notice of events specified in Continuing Disclosure Agreements.

### **6. Monitoring and Reporting Requirements**

The District’s Finance Team will monitor any Fixed Rate Debt, Variable Rate Debt and interest rate Swaps that the District has outstanding on at least a monthly basis. The following reports will be prepared at a minimum:

#### **District Plan of Finance**

The finance team will provide a written report to the District Administration Committee and Board of Directors on at least an annual basis which highlights all material changes to fixed rate

debt, variable rate debt, and interest rate Swaps entered into by the District since the last report. The finance team will also outline plans for the upcoming year to optimize debt service obligations and to detail any upcoming renewals such as liquidity, and remarketing contracts. Presentation of the District's debt portfolio will highlight any changes to fixed and variable rate debt, including any subsidy considerations, material bond proceeds fund investment issues, continuing obligation considerations, escrow considerations, rating triggers, or other developments which might affect the expected continuity and performance of the debt portfolio.

### **Variable Rate Debt**

The District's Finance Team will provide a written report to Senior Management regarding the status of all Variable Rate Debt on at least a weekly basis. Such report shall include the following information:

- The performance of Variable Rate Debt compared to relevant indices since the last report;
- Changes to any fees paid to any third parties including Credit Enhancement providers, remarketing agents, etc.

### **Swap Report**

Reports on the District's Swap agreements will be prepared on at least an annual basis in compliance with the District's Swap Policy outlined in Section 4 of the Comprehensive Debt Policy. The Finance Team will track the following:

- The credit ratings and outlooks (making particular note of any rating changes) for each interest rate Swap counterparty and credit enhancer associated with an interest rate Swap;
- A summary of each interest rate Swap, including, but not limited to, the type of interest rate Swap, the rates and dollar amounts paid by the District and received by the District, and other terms;
- For each counterparty, the District shall provide the total notional amount position, the average life of each interest rate Swap agreement, and the remaining term of each interest rate Swap agreement;
- Market value of each of the District's interest rate Swaps.

### **Arbitrage Review**

The use of bond proceeds and their investments must be monitored to ensure compliance with all Internal Revenue Code Arbitrage Rebate Requirements. District will fully comply with federal arbitrage and rebate regulations. Concurrent with this policy, the Chief Financial Officer 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 Finance Department will be responsible for the following:

- 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.
- 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 Comprehensive Financial Report (ACFR).

### **SBPA Quarterly Report**

On at least a quarterly basis, and in accordance with the Standby Bond Purchase Agreements held by the District, the Finance Team will provide a report to all providers of liquidity facilities for District variable rate debt. The report will contain:

- Certification of an authorized representative that no event of default or default occurred within that quarter.
- Quarterly financial records of the District to include Statements of Revenue and Expense and Changes in Net Assets.

## **7. Historical Financial Operations**

The District has historically managed its finances according to several policies, procedures and covenants.

### **Senior Lien – Master Resolution**

The District’s Master Resolution (Resolution Number 2667), adopted by the Board of Directors on May 13, 1993, provides for the allocation of revenues of the Water and Sewer system and establishes covenants to secure the payment of obligations payable from net water and sewer revenues.

Pursuant to the Master Resolution, the District has issued revenue bonds and entered into certain outstanding installment sale agreements which are secured by a pledge of and lien on Net Water and Sewer Revenues and constitute “Parity Obligations” under the Master Resolution. The Parity Obligations are payable from Net Water and Sewer Revenues on a senior basis to obligations issued under the Working lien.

The District has entered into various installment sale agreements and, in turn, caused the execution and delivery of various related series of certificates of participation, all in order to fund the District’s ongoing capital improvement plan. Each such installment sale agreement has required the District to make installment payments from the District’s Net Water and Sewer Revenues on deposit in the Installment Payment Fund held under the Master Resolution, and the District’s obligation to make each such installment payment has been secured in accordance with the terms of the Master Resolution.

Under the Master Resolution, the District is required to fix rates which are: (i) reasonably fair and nondiscriminatory; (ii) at least sufficient for the payment of all amounts to be payable from Net Water and Sewer Revenues in each Fiscal Year; and (iii) at least equal to: (1) 115% of Debt Service on all Parity Obligations plus the amount required to be deposited to the Operating Reserve Fund; and (2) 110% of Debt Service on all Parity Obligations and Subordinate Obligations plus the amount required to be deposited to the Operating Reserve Fund.

### **Working Lien – Debt Service Coverage Policy**

Under the Master Resolution, the District may incur obligations payable on a subordinate basis to the Senior Lien. It is the District's objective to continue to transition outstanding obligations to its subordinate (working) lien. All obligations issued on the working lien will be payable from Net Revenues, which consist of the Net Water and Sewer Revenues less all net amounts payable by the District on the Parity Obligations, and from amounts held in certain funds and accounts on hand at the District. Net Water and Sewer Revenues consist of Water and Sewer Revenues less Maintenance and Operation Costs (as such terms are defined in Appendix C of the District's most recent Official Statement).

The District will not engage in debt financing unless the proposed obligation, when combined with all existing senior and parity debts, will result in acceptable debt service coverage ratios. In determining the affordability of proposed revenue bonds, the District will perform an analysis comparing the projected annual net revenues (after payment of operating and maintenance expenses) to estimated annual debt service and the Debt Service Coverage. The Debt Service Coverage is the amount of cash flow available to meet the annual principal and interest payment obligations on debt issued. The use of Debt Service Coverage as a policy target is primarily to ensure that the District is meeting its financial obligations on a cash basis.

### **Reserve Funds**

The District's reserves have been developed as part of an overall financial management strategy. These funds do not constitute a surplus in excess of the District's actual needs, but rather are needed for important purposes specified in the District's Reserve Policy. The Reserve Policy is a stand-alone document which will be maintained separately from the District's Comprehensive Debt Policy.

The Reserve Policy states that the Chief Financial Officer will periodically present the status of each reserve and restricted fund balance to the Board of Directors, but not less than annually and prior to the adoption of the next year's operating budget. The most common approach to sizing Reserves is by number of days of expenses (most often described as Days' Cash).

Periodically the stand-alone Reserve Policy will be updated through Board Resolution and funds will be established, discontinued, or reaffirmed as necessary.

## **8. SB 1029 Compliance**

SB 1029, signed by Governor Brown on September 12, 2016, requires issuers to adopt debt policies addressing each of the five items below.

### **A) The purposes for which the debt proceeds may be used.**

Sections 2 (Debt Issuances – General District Debt), 3 (Debt Issuances – Special District Financing), and 7 (Historical Financial Operations) of this policy provide information regarding the purposes for which the District may spend debt proceeds.

### **B) The types of debt that may be issued.**

Sections 2 (Debt Issuances – General District Debt) and 3 (Debt Issuances – Special District Financing) of this policy provides information regarding the types of debt EMWD may issue.

**C) The relationship of the debt to, and integration with, the issuer’s capital improvement program or budget, if applicable.**

Section 2 (Debt Issuances – General District Debt) of this policy provides information regarding the relationship between the District’s debt and Capital Improvement Program.

**D) Policy goals related to the issuer’s planning goals and objections.**

The body of this policy describes the District’s planning goals and objectives.

**E) The internal control procedures that the issuer has implemented, or will implement, to ensure that the proceeds of the proposed debt issuance will be directed to the intended use.**

Sections 2 (Debt Issuances – General District Debt) and 3 (Debt Issuances – Special District Financing) of this policy provide information regarding the District’s internal control procedures designed to ensure that the proceeds of a debt issuance are spent as intended.

## **9. Conclusion**

The Policy was drafted with the intent of providing Eastern Municipal Water District’s Board-approved guiding directives to management and staff for decisions and recommendations related to the financial profile of the District, and is intended to support the District’s debt obligations to present and future generations of customers.

The Policy is intended to be revisited and updated periodically if there is a material change in the risk exposures or conditions.

The Policy is ultimately intended to serve as a guide and it in no way restricts the ability of the Eastern Municipal Water District Board to review proposed rate actions, debt issuances, or other actions of substance to the District. The Board maintains authorization to waive elements of the policy in connection with individual financings at its discretion.

## **10. Glossary of Terms**

**Available Reserves** - Cash balances, assets and investments of the District established as Reserves pursuant to the District's Reserves Policies. Amounts on deposit in the following reserve funds will be considered Available Reserves: Water Rate Stabilization Reserve; Operational Debt Service Reserve, Capital Replacement Reserve, Water Replacement & System Betterment Construction Reserve, and Sewer Replacement & System Betterment Construction Reserve.

**Basis Risk** - Basis risk refers to a mismatch between the interest rate received from the swap contract and the interest actually owed on the District's bonds. The risk, for example, in a floating to fixed rate swap is that the variable rate interest payments will be less than the variable interest payments actually owed on the hedged bonds.



**Credit Risk** - The occurrence of an event modifying the credit rating of the District or its Counterparty. Credit Events can trigger certain termination provisions or collateral provisions as outlined in the Agreements.

**Credit Support Annex** - An attachment to the ISDA that covers the mutual posting of collateral, if required. This schedule is based on the net mark-to-market values of the cash flows in the swap.

**Confirmation** - A form that is executed for a specific swap or financial product transaction and details the specific terms and conditions applicable to that agreement (fixed rate, floating rate index, payment dates, calculation methodology, amortization, maturity date, etc.).

**Continuing AAA subsidiary** - A wholly owned subsidiary of a Bank or Broker/Dealer organized to transact business as a "AAA" Counterparty to eligible clients. Eligible clients are those clients acceptable to the rating agencies. To the extent a "Trigger Event" occurs, the entity will maintain all of its Agreements to their original maturity with the assistance of an independent derivatives portfolio manager. A Trigger Event is typically a downgrade of the parent company, a bankruptcy of the parent company, failure to make a payment and/or failure to deliver collateral.

**Counterparty** - A principal to a swap or other derivative agreement, as opposed to an agent such as a broker.

**Counterparty Risk** - The risk that the swap Counterparty will not fulfill its obligations as specified by the terms of an ISDA Master Agreement or other similar contract. Under a fixed payer swap, for example, if the Counterparty defaults, the District would be exposed to an unhedged variable rate bond position. The creditworthiness of the Counterparty is indicated by its credit rating. The District has established minimum rating criteria for swap counterparties.

**Days' Cash** - Reserve balance divided by a ratio equal to O&M Expenses excluding depreciation, divided by 365, calculated thus as:

$$\frac{\text{Unrestricted Reserves}}{(\text{O\&M Expenses}/365)}$$

**Debt Service Coverage** - Revenues Available for Debt Service divided by Debt Service for the same fiscal year.

**Hedge** - A position taken in order to offset the risk associated with some other position. Most often, the initial position is a cash position and the hedge position involves a risk management instrument such as a swap.

**Interest Rate Cap** - An instrument that pays off on each settlement date based on the market value of a reference rate (i.e., SIFMA, SOFR, or LIBOR) and a specified contract rate; effectively establishing a maximum on a variable rate.

**Interest Rate Collar** - An instrument that provides protection within a band of interest rates; a combination of purchasing an Interest Rate Cap and selling Interest Rate Floor. Generally, it is structured so that the net cost of the collar is zero or close to zero. This means that the expense for the interest rate cap premium is offset by the credit received for the interest rate floor.

**Interest Rate Floor** - An instrument that pays off on each settlement date based on the market value of a reference rate (i.e., SIFMA, SOFR, or LIBOR) and a specified contract rate; effectively establishing a minimum on a variable rate.

**Interest Rate Risk** - The risk that variable rates will increase and thereby cause an increase in variable rate debt service costs and negatively impact cash flow margins.

**Interest Rate Swap** - A contract between two parties to exchange cash flows over a predetermined length of time. Cash flows are calculated periodically based on a fixed or variable interest rate against a set notional amount (amount used only for calculation of interest payments). Principal is not exchanged.

**ISDA** - The International Swap Dealers Association - The global trade association whose members are dealers in the derivatives industry. Most Swaps are executed under standard documentation created by ISDA.

**ISDA Master Agreement** - The primary document for the terms and conditions governing the swaps market. The ISDA Master Agreement contains the terms for events of default, termination events, representations and covenants, early termination provisions and payment calculations.

**Letter of Credit** - An irrevocable, transferable, standby letter of credit, issued by a major U.S. commercial bank or a U.S. branch office of a foreign bank—in either case—with a strong credit rating of at least (a) “A-” by S&P and/or “A3” by Moody’s, and (b) Total Assets of at least \$20 billion.

**LIBOR** - The London InterBank Offered Rate. The rate at which banks will lend Eurodollars to each other over various length terms: (e.g., 1-month, 3-month, 6-month, 12- month etc.). The most active dollar-based taxable interest rate benchmark utilized globally

**Notional Amount** - The stipulated principal amount for a swap transaction. There is no transfer of ownership in the principal for a swap; but there is an exchange in the cash flows for the designated coupons.

**Revenues Available for Debt Service** - Operating Revenues less Operating Expenses plus Depreciation plus Interest Expense.

**Rollover Risk** - The risk that the term of the swap contract does not match the term of the related bonds being hedged. Upon the maturity of the swap, the risk may need to be rehedged, causing the District to incur re-hedging costs.

**SIFMA Index** - The Securities Industry and Financial Markets Association (“SIFMA”) Municipal Swap Index is a 7-day high-grade market index comprised of tax-exempt Variable Rate Demand Obligations (VRDOs) with certain characteristics. The Index is calculated and published by Bloomberg. The Index is overseen by SIFMA’s Municipal Swap Index Committee.

**SOFR** - The Secured Overnight Financing Rate (SOFR) is a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities. SOFR is calculated as a volume-weighted median of transaction-level tri-party repo data collected from BNY Mellon as well as GCF Repo transaction data and data on bilateral Treasury repo transactions clears through FICC’s DVP service.

**Swap** - A contractual agreement evidenced by a single document in which two or more parties agree to exchange periodic (net) payments for an agreed period of time based upon a notional amount of principal.

**Swaption** - An option on a swap. The swaption purchaser has the right to enter a specific swap for a defined period of time. This option can be exercised on a specific exercise date or series of exercise dates.

**Tax Risk** - All issuers who issue tax-exempt variable rate debt inherently accept risk stemming from changes in marginal income tax rates. This is a result of the tax codes impact on the trading value of tax-exempt bonds. As marginal tax rates decline, the after-tax value of tax-exempt income declines, forcing the tax-exempt rates to increase. This risk is also known as a "tax event" risk, a form of basis risk under swap contracts. Percentage of LIBOR swaps and certain SIFMA swaps with tax event triggers, which can change the basis under the swap to a LIBOR basis from SIFMA, can expose issuers to tax event risk.

**Termination Risk** - The risk that the swap could be terminated as a result of any of several events, which may include a ratings downgrade for the District or the swap Counterparty, covenant violation by either party, bankruptcy of either party, swap payment default by either party, and default events under a bond indenture. The District could owe a termination payment to the Counterparty or

receive a termination payment from the Counterparty, depending on how interest rates at the time of termination compare with the fixed rate on the swap.

**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.