TO: MICHAEL S. LEBRUN MSL
GENERAL MANAGER

FROM: LISA BOGNUDA
FINANCE DIRECTOR LSB

DATE: FEBRUARY 24, 2012

AGENDA ITEM

E-1

FEBRUARY 29, 2012

REVIEW DEBT MANAGEMENT POLICY

ITEM

REVIEW PROPOSED DEBT MANAGEMENT POLICY [RECOMMEND REVIEW PROPOSED POLICY, PROVIDE EDITS, BY MOTION AND ROLL CALL VOTE ADOPT DEBT MANAGEMENT POLICY]

BACKGROUND

The District is preparing for two of the largest projects in its 47 year history – The Supplemental Water Project and the Southland Wastewater Treatment Facility Upgrade.

The proposed funding mechanism for each of these projects includes a combination of cash reserves and bond issuance. In order to issue bonds, the District has retained the professional services of Bond Counsel, Maryann Goodkind of Fulbright & Jaworski, LLP and Financial Advisor Curt de Crinis of C.M. de Crinis & Co.

The Bond Counsel and Financial Advisor have advised the District to adopt a Debt Management Policy prior to the issuance of bonds.

A debt management policy establishes parameters for evaluating, issuing, and managing the District's debt. The policy outlines the District's approach to debt management. Debt management policies improve the quality of decisions, provide justification for the structure of the debt issuance, identify policy goals, and demonstrate a commitment to long-term financial planning. Adherence to a debt management policy signals to rating agencies and the capital market that a government is well managed and should meet its obligations in a timely manner.

At the February 8, 2012 Board Meeting, the Board reviewed the draft policy and directed edits. In addition, the Board requested Staff present proposed language on limitation on amount of debt issuance for inclusion into the Debt Management Policy (see page 14 of proposed draft Debt Management Policy - attached).

Ms. Goodkind has made the edits your Board directed (see pages 3 through 13 of proposed draft Debt Management Policy - attached) and will be available to address the Board and answer questions.

RECOMMENDATION

Staff recommends that your Honorable Board consider the draft proposed Policy direct any edits and by motion and roll call vote approve the Resolution adopting the Debt Management Policy.

ATTACHMENT

- Resolution (Pages 1-2)
- Debt Management Policy (Pages 3-13)
- Proposed language for Limitation on Amount of Debt Issuance Page 14)

t:\board matters\board meetings\board letter\2012\120229 debt policy.docx

NIPOMO COMMUNITY SERVICES DISTRICT

RESOLUTION NO. 2012-XXXX

A RESOLUTION OF THE BOARD OF DIRECTORS OF THE NIPOMO COMMUNITY SERVICES DISTRICT APPROVING THE ADOPTION OF THE DEBT MANAGEMENT POLICY FOR THE DISTRICT

WHEREAS, debt management policies establish parameters for evaluation, issuing, and managing the District's debt. The policies outlined in the attached debt management policy are not intended to serve as a list of rules to be applied to the District's debt issuance process, but rather to serve as a set of guidelines to promote sound financial management; and

WHEREAS, adherence to a debt management policy assures rating agencies and the capital markets that a government is well managed and should meet its obligations in a timely manner; and

WHEREAS, the Board of Directors of the Nipomo Community Services District ("District"), desires to adopt a debt management policy at this time; and

WHEREAS, Debt Management Policy (the "Policy") has been prepared and is hereby presented at this meeting; and

WHEREAS, it is appropriate at this time for the Board of Directors to consider approval of the adoption of the Policy.

NOW, THEREFORE, BE IT RESOLVED by the Board of Directors of the Nipomo Community Services District:

Section 1. The above recitals are true and correct.

Section 2. The Debt Management Policy (Exhibit "A") in the form presented at this meeting is hereby approved and adopted.

Section 3. The officers of the District are hereby directed to do and cause to be done any and all acts and things necessary or proper in order to effectuate the purposes of this resolution.

Section 4. This resolution shall take effect immediately.

NIPOMO COMMUNITY SERVICES DISTRICT

RESOLUTION NO. 2012-XXXX

A RESOLUTION OF THE BOARD OF DIRECTORS OF THE NIPOMO COMMUNITY SERVICES DISTRICT APPROVING THE ADOPTION OF THE DEBT MANAGEMENT POLICY FOR THE DISTRICT

Upon a motion by Director _________, seconded by Director ___________, on the following roll call vote, to wit:

AYES:

NOES:

ABSTAIN:

ABSENT:

the foregoing resolution is hereby passed and adopted on this 29th day of February, 2012.

____
JAMES HARRISON
President of the Board

ATTEST:

____
MICHAEL S. LEBRUN
Secretary to the Board

APPROVED AS TO FORM:

____
JON S. SEITZ
District Legal Counsel

DRAFT

NIPOMO COMMUNITY SERVICES DISTRICT

DEBT MANAGEMENT POLICY

As of February △[1]**29**,[2] 2012

NIPOMO COMMUNITY SERVICES DISTRICT

DEBT MANAGEMENT POLICY

Overview

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

The District's Debt Management Policy is integrated into the decision-making framework utilized in the budgeting and capital improvement planning process. As such the following policies outline the District's approach to debt management.

I. GENERAL MANAGEMENT POLICIES

The District will provide for a periodic review of its financial performance, and review its performance relative to the financial policies outlined herein. These financial policies will be taken into account during the capital planning, budgeting and ratesetting process.

- The District will △[3]adopt revised[4] rates, fees and charges △[5]in compliance with applicable law, including the Proposition 218 Omnibus Implementation Act[6], and will consider recommendations and input from the public as it relates to such proposed changes.

- All District funds will be invested according to the Investment Policy of the District.

- Necessary appropriations for annual debt service requirements will be routinely included in the District's annual budget.

II. FINANCIAL MANAGEMENT POLICIES

- The District will evaluate financing for each capital project on a case-by-case basis. The District will seek to pay for all capital projects from current revenues and available reserves prior to or in combination with the use of debt.

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

- User Fees and Rates will, be set at adequate levels to generate sufficient revenues to pay all operating and maintenance costs, to maintain sufficient operating reserves, and to pay debt service costs, if necessary.

III. DEBT AND CAPITAL MANAGEMENT POLICIES

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

In issuing debt, the District objectives △[7]**are**[8] to:

- Ensure ratepayer security
- Maintain high credit ratings and access to credit enhancement
- Preserve financial flexibility

A. Standards for Use of Debt Financing

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

- For growth **-**[9]related projects, debt financing will be utilized, as needed, to better match the cost of anticipated facility needs with timing of expected new connections to the system.
- Capital projects financed through debt issuance will not be financed for a term longer than the expected useful life of the project.
- Lease Agreements and Installment Sale Agreements shall be considered as an alternative to long-term debt. Although these forms of alternative financing are subject to annual appropriation, they shall be considered as long-term fixed rate debt until maturity.

B. Financing Criteria

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

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

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

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

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

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

Term - 10 to 30 years is standard, but up to 35 years may be acceptable, depending on cash flow assumptions, construction timeline and remaining useful life of the asset being financed.

Maximum Yield - Case by case[10],[11] as recommended by Financial Advisor and as governed by State law.

Maximum Premium - Case by case[12],[13] as recommended by Financial Advisor and as governed by State law.

Maximum Discount - Case by case as recommended by Financial Advisor and as governed by State law.

Payment Dates - After considering cash flow needs, the General Manager[14] will determine the occurrence of all new debt service payments.

Structure of the Debt - Prefer level debt service, but shall be determined on a case-by-case basis, [15]as recommended by[16] the General Manager and Financial Advisor.

Use of Variable Rate Debt - The District will not issue variable interest rate debt unless[17] the proposed debt is converted to a fixed rate or hedged.

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

Reimbursement Resolution - Must be adopted by the Board if the project [18]capital[19] costs are advanced by the District prior to the expenditure and/or commitment of funds, and bond sale.

C. Types of Long-[20]Term Funding[21]

The District shall consider several methods of financing capital projects. This policy will set forth guidelines for these decisions by indentifying parameters within each funding source that are considered appropriate. These parameters are defined below.

6

Certificates of Participation/Lease Revenue Bonds - Certificates of Participation (COP's) and Lease Revenue Bonds (LRB) can finance water, wastewater and electrical utilities, or other public facilities and are almost identical in structure and security. They are used to finance capital projects that either 1) have an identified budgetary system for repayment; 2) generate enterprise revenue 3) rely on a broader pledge of General Fund revenues; or 4) finance the purchase of real property and the acquisition and installation of equipment for the District's general government or enterprise purposes. COP's and LRB's are secured by a lease-back or installment sale arrangement between the District and another public entity. The general operating revenues of the District or an enterprise and/or a designated special fund are used to pay the lease or installment payments, which are, in turn, used to pay debt service on the COP's or LRB's. Bond covenants provide that revenues generated by enterprise funds must be sufficient to maintain required debt coverage levels, or the rates of the enterprise have to be raised to maintain the coverages and operations of the facility. For General Fund pledges, bond covenants include an annual appropriation covenant. COP's and LRB's do not constitute indebtedness under the state constitution and are not subject to voter approval.

Because COP's are not created by statute, but rather are used to securitize an underlying contract, they can be adapted to a number of financing situations They are commonly used for both lease revenue and enterprise revenue financings where no workable statutory framework is available or a joint powers financing authority is not available.

Revenue Bonds - Revenue Bonds also finance water, wastewater utilities, or other public facilities. They are payable by the revenues generated by the enterprise. This type of debt is considered self-liquidating. Revenue Bonds are payable solely from the enterprise funds and are not secured by any pledge of General Fund revenues of the District. Bond covenants provide that revenues generated by these enterprise funds must be sufficient to maintain required debt coverage levels, or the rates of the enterprise have to be raised to maintain the coverages and operations of the facility. A bond election may be required to issue Revenue Bonds.

Assessment Bonds - The District may issue assessment bonds under the 1911 and 1915 Improvement Acts through the formation of a special benefit assessment district under the 1911 or 1913 Acts. The bonds may be issued to finance facilities or provide services and are secured by assessments levied on parcels within a defined area that are proportionate to the special benefit conferred upon a parcel, as determined by a qualified assessment engineer. Assessments are subject to majority protest hearing and notice ballot requirements. Assessment Bonds, although repaid through additional assessments levied on a discrete group of property owners, constitute overlapping indebtedness of the District and have an impact on the overall level of debt affordability. Assessment Bonds are not obligations of the District's General Fund.

Mello-Roos Bonds - The Mello-Roos Act of 1982 allows the District to establish a Mello-Roos Community Facilities District (CFD) which allows for financing of public improvements and services. These CFD special taxes must be approved by a two thirds vote of registered voters within the special district (unless there are fewer than 12 registered voters, in which case the vote is by landowners), and are secured solely by a special tax on the real property within the special district. CFD Bonds, although repaid through additional special taxes levied on a discrete group of taxpayers, also constitute overlapping indebtedness of the District and have an impact on the overall level of debt affordability. CFD Bonds are not obligations of the District's

General Fund.

Capital Lease Debt - A lease purchase obligation placed with a lender without the issuance of securities may be used to finance certain vehicle and equipment purchases will be evaluated on a case-by-case basis.

D. Refinancing Outstanding Debt

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

- *Debt Service Savings* - The District shall establish a target savings level equal to 3% to 5% of par refunded on a net present value (NPV) basis. These figures should serve only as a guideline, the District must evaluate each refunding opportunity on a case-by-case basis, and must take into consideration: the time to maturity, size of the issue, current interest rate environment, annual cash flow sayings, and the value of the call option. The decision to take all savings upfront or on a deferred basis must be explicitly approved by the District's Board of Directors.

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

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

- *Escrow Structuring* - The District shall utilize the least costly securities available in structuring each escrow. A certificate will be required from a third party agent who is not acting as a broker-dealer, stating that the securities were purchased through an arms-length, competitive bid process (in the case of open market securities), that such securities were more cost effective than State and Local Government Series Securities (SLGS), and that the price paid was reasonable and within Federal guidelines. When evaluating the economic viability of an economic versus legal defeasance, the District shall take into consideration both the financial impact on a net present value basis as well as the rating/credit impact. The District shall take all necessary steps to optimize its escrows and to avoid negative arbitrage in its refundings.

E. Method of Issuance

The District will determine, on a case-by-case basis, whether to sell its bonds competitively or through negotiation. Public offerings can be executed through either a competitive sale or a negotiated sale. It shall be the policy of the District to issue debt through a competitive sale whenever feasible subject to advice of the District Financial Advisor.

Competitive Sale - In a competitive sale, the District's bonds shall be awarded to the lowest responsible [22]bidder providing the lowest true interest cost ("TIC"), as long as the bid adheres to requirements set forth in the official notice of sale.

Negotiated Sale - District recognizes that some securities are best sold through negotiation. In consideration of a negotiated sale, the District shall assess the following circumstances in determining the advisability such a sale:

- Issuance of variable rate or taxable bonds
- Complex structure or credit considerations (such as non-rated bonds), which requires a strong pre-marketing effort
- Significant par value, which may limit the number of potential bidders
- Unique proprietary financing mechanism (such as a financing pool), or specialized knowledge of financing mechanism or process
- Market volatility, such that the District would be better served by flexibility in the timing of its sale in a changing interest rate environment
- When an Underwriter has identified new financing opportunities or presented alternative structures that financially benefit the District that could not be achieved through a competitive bid.
- As a result of an Underwriter's familiarity with the project/financing, which enables the District to take advantage of efficiency and timing considerations.

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

F. Service Provider Selection

All financial advisors, bond counsel, disclosure counsel, trustees and underwriters will be selected pursuant to District's Purchase Policy relating to hiring consultants

G. Market Communication and Reporting Requirements

Rating Agencies and Investors - The General Manager shall be responsible for maintaining the District's relationships with one or more national rating agencies.

Continuing Disclosure - The District shall use its best efforts to be in compliance with Rule 15c2-12 by filing its annual financial statements and other financial and operating data for the

9

benefit of its bondholders.

△[23]

IV. POST-ISSUANCE COMPLIANCE POLICY[24]

A. In General

The Board of Directors of the District recognizes its responsibility to ensure compliance with all Federal laws and regulations ("Federal Requirements") applicable to the District's bonds and other obligations the interest on which is excluded from gross income for federal income tax purposes or are otherwise tax advantaged ("Tax-Exempt Bonds"). This policy and guidelines relate to requirements that must be met subsequent to the issuance of Tax-Exempt Bonds in order to maintain that exclusion or receive a federal tax credit payment including, without limitation, requirements relating to use of proceeds, arbitrage, private business use and record retention. This policy and guideline supersede any post-issuance compliance policy previously adopted by the District but do not supersede, limit or contravene any representations, statements or covenants of the District contained in the bond documents (the "Bond Documents") for its Tax-Exempt Bonds. The purpose of this policy is to provide guidelines and establish procedures for compliance with Federal Requirements in connection with the issuance of Tax-Exempt Bonds.

B. Policy

It is the policy of the District to adhere to all applicable tax requirements with respect to its Tax-Exempt Bonds as set forth in the Bond Documents including, but not limited to, requirements relating to the use of proceeds of Tax-Exempt Bonds and facilities financed and refinanced with Tax-Exempt Bonds (the "Bond-Financed Facilities"), arbitrage yield restrictions and rebate, timely return filings, and other general tax requirements set forth in the Bond Documents.

C. Compliance Monitoring

Consistent with the covenants of the District contained in the Bond Documents, the District will monitor compliance with the federal tax requirements applicable to its Tax-Exempt Bonds. The following officers or employees of the District are responsible for monitoring compliance with those requirements: General Manager△[25], with assistance from Bond and Tax Counsel and Financial Advisor.

D. Record Retention

In accordance with Internal Revenue Service ("*IRS*") requirements, the District will retain the following records with respect to its Tax-Exempt Bonds:

- Bond transcripts;
- Documentation showing the expenditure of proceeds of the Tax-Exempt Bonds for one or more Bond-Financed Facility;
- Documentation showing the use of the Bond-Financed Facilities;

- Documentation showing the sources of payment and security for the Tax-Exempt Bonds;

- Documentation related to the investment of proceeds of the Tax-Exempt Bonds, including the purchase and sale of securities, investment income received, yield calculations, and rebate calculations;

- All returns filed with the IRS for the Tax-Exempt Bonds (including, as applicable, IRS Forms 8038-G *Information Return for Tax-Exempt Governmental Obligations*, 8038-T *Arbitrage Rebate, Yield Reduction and Penalty in Lieu of Arbitrage Rebate*, and 8038-R *Request for Recovery of Overpayments under Arbitrage Rebate Provisions*), together with sufficient records to show that those returns are correct; and

- Any other documentation that is material to the exclusion of interest on the Tax-Exempt Bonds from gross income for federal income tax purposes.

Except as otherwise set forth in the Bond Documents, the District will retain the records described above in hard and/or electronic copy format for so long as the applicable Tax-Exempt Bonds remain outstanding and for a period of three years after final redemption of the applicable Tax-Exempt Bonds. With respect to Tax-Exempt Bonds that are refunding bonds, the District will retain the above-described records for the refunding and refunded bonds (and any earlier issue in the case of a series of refundings).

The following officers or employees of the District are responsible for retaining the records relating to the Issuer's Tax-Exempt Bonds: General Manager and Secretary.

E. Arbitrage Compliance

It is the policy of the District to maintain a system of record keeping and reporting to meet the arbitrage rebate compliance requirements of the federal tax code. Unless otherwise instructed by bond counsel, at closing the District will execute documentation covenanting to comply with Federal rebate and arbitrage requirements. Unless otherwise instructed by bond counsel, annually the District will engage a consultant to assist in the monitoring of the investment of bond proceeds, perform the required calculations to determine arbitrage rebate and yield restriction compliance, and file the required federal forms. Unless otherwise instructed by bond counsel, every five years the District will file (if arbitrage rebate is owed) with the Internal Revenue Service the appropriate required documentation demonstrating arbitrage rebate liability and provide payment of at least 90% to the US Treasury for arbitrage rebate liability, if any.

F. Remedial Action

If the District in complying with the terms and provisions the policies or guidelines set forth herein or determines that the requirements of these policies and guidelines or the tax covenants or representations in the Bond Documents may have been violated, the District will make final determinations, if necessary with the assistance of its Bond and Tax Counsel and Financial Advisors, and take appropriate actions related to such noncompliance including, if

11

appropriate, any remedial action described under applicable Treasury Regulations or through the Tax Exempt Bonds Voluntary Closing Agreement Program.

G. Coordination With Bond Documents

In the event of any conflict between these Procedures and Guidelines and the Bond Documents, the Bond Documents shall govern.

Document comparison by Workshare Professional on Wednesday, February 22, 2012 9:29:12 AM

Input:	
Document 1 ID	interwovenSite://US_DMS/US2011/95406403/2
Description	#95406403v2<US2011> - Debt Policy
Document 2 ID	interwovenSite://US_DMS/US2011/95406403/3
Description	#95406403v3<US2011> - Debt Policy
Rendering set	Standard with caret for deletes

Legend:	
Insertion	
~~Deletion~~	
~~Moved from~~	
Moved to	
Style change	
Format change	
~~Moved deletion~~	
Inserted cell	
Deleted cell	
Moved cell	
Split/Merged cell	
Padding cell	

Statistics:	
	Count
Insertions	12
Deletions	13
Moved from	0
Moved to	0
Style change	0
Format changed	0
Total changes	25

New III.D. Section

D. Limitations on Amount of Debt Issuance

Pursuant to Section 61126 of Government Code of the State of California, the District may incur general obligation bonded indebtedness in an amount not to exceed 15% of the total assessed valuation of all real and personal property in the District

Review of recent credit rating agency guidelines indicate that debt service of more than 10% of available revenues or expenditures is considered above average or high. The District shall strive to maintain its non-enterprise backed debt service as a percentage of available revenue below 10%.

Long-term obligations payable solely from specific pledged sources, in general, are not subject to a debt limitation. Examples of such long-term obligations include those which achieve the financing or refinancing of projects provided by the issuance of debt instruments that are payable from restricted revenues or user fees (enterprise funds) and revenues generated from a project. In determining the affordability of proposed enterprise obligations, the District will perform an analysis comparing projected annual net revenues (after payment of operating and maintenance expense) to estimated annual debt service. Generally, legal covenants requiring a minimum coverage ratio are set forth in the bond documents, and are based on the level of security provided to the bondholders (of the senior or subordinate debt obligations). The District's enterprise obligations shall include a coverage ratio requirement of at least 125% for senior bonds and a coverage ratio requirement of at least 105% for senior and subordinate debt combined. Per the rating agency guidelines, the District shall strive to maintain a coverage ratio of 115% using historical and/or projected net revenues to cover annual debt service for bonds issued on a subordinate basis which have a 105% coverage ratio requirement. The District will require a rate increase to cover both operations and debt service costs, and create debt service reserve funds to maintain the required coverage ratios.