

Texas Water Development Board
Policy BP001



Debt Management Policy

January 29, 2015

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I. Policy Objective

The purpose of the Texas Water Development Board (TWDB) Debt Management Policy (the Policy) is to provide guidelines and parameters for the issuance and management of TWDB debt, both general obligation bonds and revenue bonds. Furthermore, the Debt Management Policy provides for on-going monitoring and reporting of all debt obligations issued by the TWDB. This framework is intended to allow TWDB to make informed debt management decisions. The items outlined in the Policy are not goals or a list of rules to be applied to the TWDB's debt issuance; rather, these policies should be utilized as tools to ensure successful long term debt management and that adequate financial resources are available to support the TWDB's various programs. This Policy will guide TWDB in the following:

- Evaluating critical debt issuance options;
- Promoting sound financial management of TWDB's portfolio and assets;
- Providing accurate and timely information on financial conditions affecting the public debt markets;
- Protecting and enhancing the TWDB's credit ratings; and
- Ensuring the legal and prudent use of the TWDB's bonding authority through an effective system of financial security and internal controls.

II. Selection of Consultants

Consultants will be selected through a Request for Qualifications (RFQ) process. Consultants to be utilized in the debt management process are:

A. Underwriters

The TWDB maintains a pool of underwriters, the primary responsibilities of which include:

- Providing access to municipal bond and capital markets for funding TWDB loan programs;
- Providing structuring advice to maximize effectiveness of TWDB debt issuance;
- Assisting with investor outreach and education regarding TWDB's programs;
- Adhering to the Underwriting Policies and Procedures established by TWDB; and
- Compliance with applicable laws and regulations.

The Municipal Advisor Rule states that when a firm offers what is construed as "advice" (a recommendation related to a transaction) that firm shall be construed as a municipal advisor. In order to avoid registering with the Securities and Exchange Commission and the Municipal Securities Rulemaking Board, underwriters must either refrain from offering any suggestion that could be construed as advice or obtain one of the exemptions available.

By publicly posting a written disclosure on its website, the Texas Water Development Board intends that market participants receive and use it for purposes of the independent registered municipal advisor exemption to the Securities and Exchange Commission Municipal Advisor Rule (Section 15B of the Securities Exchange Act of 1934).

B. Bond Counsel

External Bond Counsel performs all legal services associated with the issuance of debt, including: preparation or review of all debt-authorizing resolutions and related documents and agreements; the delivery of an approving legal opinion addressing the validity of the issuance of the debt under Texas law; and addressing matters relating to the treatment of interest under the Internal Revenue Code of 1986 (Code).

Bond Counsel reviews the offering document governing the offer and sale to ensure that the document accurately describes the terms of the sale of the debt obligations and the documents authorizing their issuance.

At the request of TWDB staff, Bond Counsel will undertake discussions with the Office of the Attorney General of Texas to address issues relating to the development and administration of TWDB financing programs.

Bond Counsel undertakes such services as may be necessary to assist the TWDB in satisfying the continuing disclosure requirements of Rule 15c2-12 promulgated by the Securities and Exchange Commission, and effective as to obligations sold on and after July 3, 1995 (rule effective date). Additionally, should it be necessary, Bond Counsel will render a written opinion with respect to any matters relating to the compliance requirements of Rule 15c2-12. TWDB will request and designate firms in its legal pool to serve as Disclosure Counsel as appropriate.

In addition, Bond Counsel performs additional services that may not pertain to a particular bond issue, but relate to financial assistance programs that are funded in whole or part with bond proceeds.

C. Financial Advisors

Financial Advisors provide recommendations (including the type and structure of financing, call, security and credit enhancement features, term of maturity, time and manner of sale, reasonableness of interest costs and other terms and conditions) and evaluate at the time of issuance underwriter fees, financing costs and other related issues. The Financial Advisors consult with TWDB staff in analyzing opportunities to refund outstanding debt obligations of the TWDB as well as assists in the coordination of communication with rating agencies, investors and credit enhancers, if applicable. The Financial Advisors also coordinate efforts with the underwriting team charged with the sale of TWDB obligations to ensure the offering is cost effective to TWDB and realizes the goals and objectives of TWDB.

D. Disclosure Counsel

Disclosure Counsel performs legal services associated with the preparation of offering documents used by TWDB in its debt offerings to ensure that the offering document fairly, accurately and completely addresses the information presented in the offering document so that it is true and correct in all material respects.

Disclosure Counsel undertakes such services as may be necessary to assist the TWDB in satisfying the continuing disclosure requirements of Rule 15c2-12 promulgated by the

Securities and Exchange Commission, and effective as to obligations sold on and after July 3, 1995. Additionally, Disclosure Counsel will render a written opinion to the TWDB to the effect that the offering document does not contain any untrue statement of a material fact or omits to state any material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading.

E. Arbitrage Consulting Services

The consultant prepares a computation to determine the arbitrage rebate amount, if any, for the Bonds as described in §148(f) (2) of the Code (the “Rebate Amount”). The consultant performs all required calculations, including a calculation of arbitrage liability, not less than annually for each issue of outstanding debt. Furthermore the consultant will perform all required calculations not less than semi-annually for the issues with a penalty election.

III. Historically Underutilized Businesses, Women and Minority Owned Firms

Good faith efforts will be made to achieve 33% participation by Historically Underutilized Businesses, Women and Minority owned firms in the underwriting and issuance of debt through the Request for Qualifications and team selection process.

IV. Debt Ratings and Rating Agency Presentations

TWDB staff shall maintain full disclosure and open lines of communication with the rating agencies at all times. In addition, the TWDB will coordinate periodically to provide updates to investors, bond insurers and rating agencies on developments at the TWDB.

TWDB staff shall evaluate in regular intervals outstanding debt and loan portfolios in an effort to ensure that the TWDB maintains the strongest credit ratings possible.

V. Type of Sale

Staff, in consultation with the Financial Advisor(s), will evaluate and recommend whether a negotiated or competitive method of sale is most suitable for a proposed transaction. Borrower needs, diversity of investment banks to efficiently and effectively sell bonds in institutional and retail markets, program structure and demands, debt service and projected interest rates are to be considered as part of this recommendation.

VI. Structure of Bond Issues

A. Term of Bonds

The initial consideration in structuring the term of the bond issue should be that the term is no longer than the lesser of the useful life of the asset(s) being financed or 30 years. However, TWDB will remain mindful of alternative terms for bonds for the underlying borrowers (i.e. 25, 30 or 40 year bonds), as well as market considerations affecting the pricing of the bonds, and will structure debt to best manage the program portfolios.

B. Redemption Provisions

Optional redemption provisions should be included to permit the TWDB to redeem bonds as soon after their initial issuance as possible, taking into account the impact on interest rates borne by the bonds, preferably at 10 years or less, callable at par, and consistent with the lowest interest cost to TWDB. The TWDB needs to remain mindful of the call dates of the

loans to the underlying borrowers in an effort to mitigate call risk exposure. Instances may exist when call provisions are either not necessary or counterproductive in the marketing of the bonds. Additional considerations may address structuring redemption provisions for bonds issued as obligations, the interest on which is included in the gross income of the holders of the bonds (taxable bonds).

In May of 2006, Congress enacted the Tax Increase Prevention and Reconciliation Act of 2005 (the "TIPRA"). TIPRA requires that 30% of bond proceeds be loaned and closed within 1 year and 95% of bond proceeds be loaned to eligible borrowers and closed within 3 years. This is known as the 1 year/3 year redemption provision. If either or both the 1 year and 3 year expectations are not met, an issuer must redeem within 90 days the bonds that represent the difference between what was loaned and the requirement. TIPRA is effective for all bonds issued after May 17, 2005.

All pooled financing bonds, including bonds issued to finance the TWDB's Financial Assistance Programs, State Revolving Fund Programs and the bonds issued for the State Water Implementation Revenue Fund for Texas, are subject to compliance with the TIPRA redemption requirements. As such, bonds issued to provide new loans, as well as bonds issued to refund outstanding bonds are subject to the requirement. In the latter case, compliance is measured by determining whether the refunded bonds, had they been issued after May 17, 2005, would have satisfied the 1 year/3 year redemption requirement.

C. Rates

Debt shall be issued at the most cost effective rates possible at the time of issuance. The Debt and Portfolio Management Division (DPM) will seek the review and rely upon the recommendation by its Financial Advisor on the cost-effectiveness of the interest rates bid or negotiated.

VII. Refunding Opportunities

Any refunding should be structured to maximize present value savings and achieve level debt service savings when appropriate. Timing, market conditions, underlying loans and overall program risk will be the primary considerations in making this decision. The DPM will consider refinancing outstanding debt issues when the net savings for that refinancing measure on a net present value basis is positive, as further discussed below.

In evaluating refunding opportunities, the DPM will consider the value of the call option to be exercised, including the amount of time to the call date and the amount of time from the call date to maturity. The structure of the debt, considerations under the Code and the impact a refunding may have on the political subdivisions who borrow from the TWDB should be considered.

Specifically, in evaluating current refundings, both the net present value savings and absolute savings will be taken into consideration in determining the financial impact on the portfolio's coverage and future capacity to provide additional loans to underlying borrowers. Also, the TWDB will evaluate the costs of issuance related to the present value savings and the current interest rate environment relative to historical trends.

Since the TWDB generally issues its bonds as tax-exempt obligations under the Code in the management of the pooled loan programs, application of the Code could affect the TWDB's ability or capacity to serve future program borrowers, should the TWDB consider an advance refunding of its bonds (i.e., TWDB issues refunding bonds and uses the proceeds to redeem and retire the refunded bonds more than 90 days after the refunding bonds are issued), the TWDB will judiciously take into consideration the impacts of an advance refunding on the underlying borrowers, since under federal income tax law the borrowers could be affected in any decision it may consider to refinance their bonds. Even though there may be a financial benefit to the TWDB by effectuating an advanced refunding or restructuring, the TWDB may decide not to implement a transaction if the impact on the TWDB's underlying borrowers associated with the proposed transaction is deemed detrimental. Decisions will be made in consultation with Bond Counsel and the Financial Advisor.

Additionally, the TWDB staff will analyze the impact of the refunding/restructuring as it relates to overall portfolio optimization and achievement of the TWDB's goals for its financial assistance programs. Based on the above factors, for any particular refunding transaction, the TWDB will seek to achieve a minimum Net Present Value savings threshold of 2% (2% being the minimum return of true savings over all costs of issuance). Refundings and restructurings that do not produce a 2% minimal amount of Net Present Value savings may be considered if they achieve other benefits, such as eliminating restrictive covenants.

VIII. Escrow Structuring

The TWDB shall structure escrows to ensure compliance with federal income tax law and applicable regulations and to utilize the least costly securities available in structuring of those escrows. Credit quality and safety of the securities shall be considered. Securities to be considered include State and Local Government Series treasury obligations issued by the U.S. Department of the Treasury (SLGs), and debt obligations eligible under State law for deposit as escrow securities that are traded on the open market (open market securities). Recognizing that there may be cases when open-market securities can significantly reduce negative arbitrage when open-market securities are used in lieu of SLGs, the securities must be procured through an arms-length competitive bid process. A certificate shall be delivered to the Director of Debt and Portfolio Management from the financial advisor or a qualified third party agent who is not a broker-dealer, and shall state that the securities were procured through an arms-length competitive bid process and that the price paid was reasonable within federal tax guidelines. Credit quality and safety of the securities shall also be considered.

IX. Prepayments

Prepayments from borrowers will be handled consistent with the Code and program needs. Analysis will include the need or ability to issue additional debt, debt service coverage, program considerations, and borrower needs.

X. Economies of Scale

Debt financings will be coordinated to the extent practicable so that multiple project needs can be accommodated in a single borrowing, thereby increasing the efficiency of the debt issuance. Since many issuance costs do not vary significantly with the size of a borrowing, a large bond

issue increases the efficiency of the financing by spreading fixed costs over a greater number of projects.

XI. Reporting Requirements

The Annual Financial Report (AFR), prepared by the TWDB staff, includes the status of all outstanding bond indebtedness. The AFR provides detailed information on the TWDB's outstanding bonds including, by series, the amount outstanding, interest rates, maturity dates, a summary of the changes in outstanding indebtedness and the associated debt service requirements.

TWDB staff will provide detailed debt information to the Texas Bond Review Board semiannually.

XII. Disclosure

In consultation with Bond Counsel and Disclosure Counsel, staff will regularly review debt activities to ensure that initial and on-going disclosure requirements established under Rule 15c2-12, are maintained as required including the filing of any material event notices and the TWDB's continuing disclosure undertakings set forth in the resolutions authorizing the issuance of bonds.

XIII. Post-Issuance Compliance (Tax exempt bonds)

The staff, under the direction of the Executive Administrator, General Counsel and Development Fund Manager, will develop written procedures for the purpose of monitoring compliance of the TWDB's Financial Assistance Programs and State Revolving Fund Programs with requirements of the Code. These written procedures will be maintained as part of the administrative practices of the staff and will be reviewed from time to time by such officers of the TWDB to determine adequacy and effectiveness.

TWDB will monitor compliance related to the Code, including but not limited to record keeping, filings, expenditure tracking of bond proceeds and arbitrage. Identified possible non-compliance by borrowers or TWDB will be reviewed with Bond Counsel for analysis and corrective action if applicable. Possible corrective actions may include the IRS Tax-Exempt Bonds Voluntary Closing Agreement Program, remedial action, and any other action recommended by Bond Counsel.

XIV. Permissible Types of Debt for Financing Programs

A. Fixed Rate Debt

Current interest bonds may be used for both new money and refunding transactions and may be structured to meet investor demand at the time of pricing. Capital appreciation and zero coupon bonds, which typically result in higher interest costs, shall be used in limited circumstances after an analysis is performed to determine whether the needs or objectives of a particular financing program can be met only through their use.

B. Variable Rate Debt

Variable rate debt structures may be used for both new money and refunding transactions and may be structured to meet investor demand at the time of pricing. Factors to be considered in

determining the use of variable rate debt shall include cash flow, liquidity, remarketing, cost of obtaining liquidity and/or credit support for the variable rate debt, and tax risk. Staff shall consider debt type and risk concentration.

C. Commercial Paper

Commercial paper may be issued for any financing program to minimize the interest cost or the use of capitalized interest during the design phase or construction period of eligible projects:

- for certain equipment purchases or capital improvements;
- cash management; or
- To diversify the TWDB's debt portfolio.

D. Alternate Financing Options

The TWDB may consider alternate plans of finance and instruments such as financing agreements, reimbursement resolutions, shelf registration programs and bond enhancement agreements depending on the market conditions and interest rates at the time. Factors to be considered in determining the use of alternate financing options include, but are not limited to cash flow, liquidity, remarketing, counterparty and tax risk as well as borrower specific information. Staff shall consider debt type and risk concentration.

E. Taxable and Private Activity Bonds

The TWDB may consider the issuance of taxable or private activity bonds if this provides a more appropriate, efficient or practical financing tool, or where federal income tax law precludes the issuance of governmental tax-exempt obligations to fund particular TWDB debt programs.

XV. Entering the Market

Programmatic demand and advantageous refunding opportunities are the two primary tools determining when the TWDB enters the market. After an analysis of borrower demand and the cash flows is completed, if it is determined those funds on hand are not sufficient to meet borrower demand, staff will seek TWDB approval and develop a plan to enter the market and sell bonds. Timing is critical and staff must monitor economic indicators, in coordination with borrower needs, to determine the optimal time to enter the market.

APPROVED and ordered of record this the 29th day of January 2015.

TEXAS WATER DEVELOPMENT BOARD

Carlos Rubinstein, Chairman

ATTEST:

Kevin Patteson
Executive Administrator