LOS ANGELES COUNTY
SANITATION DISTRICTS
Converting Waste Into Resources

DEBT MANAGEMENT POLICY

Adopted by All Boards November 2022 through February 2023

TABLE OF CONTENTS

Debt Management Policy

SECTION 1. POLICY STATEMENT

1.1 This Debt Management Policy has been developed to provide guidelines for the issuance of bonds and other forms of debt to finance capital improvements, equipment purchases, and property acquisition for the Los Angeles County Sanitation Districts (Collectively Districts or individually District), in compliance with California Government Code Section 8855(i). These guidelines will assist in determining appropriate uses for debt financing, structuring of debt, and meeting each District's financial objectives. While long-term financing is an effective way to spread these costs over time, each District must also consider maintaining and improving credit strength, providing certainty and cash flow flexibility in the annual budgeting process, and prioritizing future capital infrastructure needs.

1.2 Each District will follow sound financial management practices, including:

1. Multi-year planning to facilitate timely and equitable changes to rates and charges;
2. Maintaining prudent reserves;
3. Ensuring access to the credit markets;
4. Establishing and maintaining good credit ratings;
5. Achieving the lowest aggregate financing costs consistent with an acceptable degree of risk and the recognition of ratepayer affordability.

SECTION 2. TREASURER; ADMINISTRATION

2.1 The Board of Directors (Board) of each District must approve debt issuance for that District.

2.2 Each District, through the Investment Policy, has appointed the District's Chief Engineer and General Manager as the Treasurer of the District. The Treasurer, or his or her designee, is hereby authorized to implement this Policy.

2.3 The Treasurer will use these guidelines to review and report to the Board any long-term debt implications, including costs of borrowing, historical interest rate trends, credit enhancement capacity, opportunities to refund existing debt obligations, and other financial considerations.

SECTION 3. PURPOSE OF DEBT

3.1 Debt for Long-Term Capital Improvements

Debt financing will only be used to fund long-term capital improvements, including construction, equipment purchases, and property acquisition costs. By spreading the cost of a project over a number of years the financial impact in any given year can be lessened, reducing the impact on the corresponding user charges. Long-term debt also helps ensure that future users, who will benefit from the improvements, will pay a share of its costs.

3.2 Refunding/Refinancing

If economically beneficial and cost-effective, new debt may be issued in order to refinance existing debt. This can include refunding existing bonds, prepaying loans, or other debt instruments, and converting short-term debt such as commercial paper into long-term debt.

3.3 Emergencies

Debt may be issued in the event of an unforeseen emergency that either impacts a District's ability to continue to operate or results in depletion of a District's reserves below the targets set in the most recently adopted Wastewater or Solid Waste Financial Reserve Policy.

3.4 No Debt for Operations & Maintenance

Debt will not be used to fund ongoing operational expenses.

SECTION 4. DEBT MANAGEMENT

4.1 Internal Control Procedures on the Use of Debt

Expenditures of the proceeds from each debt instrument must be expended in the manner detailed in the associated documents. Records must be maintained in accordance with any covenants related to the debt instrument and IRS regulations, including the following:

1. Requisitions to the trustee, if one is utilized, from the project construction fund
2. Trustee records relating to other funds and accounts
3. Verifiable information showing payments to third parties
4. An accounting of all proceeds spent on the approved capital project

4.2 Investment of Debt Proceeds

Any proceeds to be held by a District (or a trustee on a District's behalf) between the time the debt is issued and the time the proceeds are expended on the approved capital project will be invested to maximize safety, liquidity, and return. The Districts' Investment Policy and the requirements of the debt instrument govern objectives and criteria for investment of proceeds.

4.3 Credit Ratings

The Treasurer will seek to maintain the highest possible credit ratings that can be achieved for debt instruments without compromising rate payer affordability. Ratings are one reflection of the general fiscal soundness of a District and the capabilities of its management. By maintaining the highest possible credit ratings, a District can issue debt at a lower cost. To enhance creditworthiness, each District is committed to prudent financial management, systematic capital planning, and long-term financial planning.

4.4 Disclosure Requirements and Investor Relations

1. Each District will comply with disclosure requirements in a timely and comprehensive manner including:

   (a) Adhering to the “antifraud rules” as promulgated in the Securities Act of 1933, Section 17; Securities and Exchange Act of 1934, Section 10(b); and regulations adopted by the U.S. Security and Exchange Commission’s (SEC) under those Acts, particularly Rule 10b-5.

   (b) Preparing bond disclosures as stipulated by the SEC’s Rule 15c2-12.

   (c) Providing information to the Municipal Securities Rulemaking Board’s Electronic Municipal Market Access (EMMA) system.

   (d) Maintaining compliance with all accounting and disclosure standards promulgated by state and national regulatory bodies, including the Government Accounting Standards Board (GASB) and the SEC.

   (e) Reporting to the California Debt and Investment Advisory Commission (CDIAC).

   (f) Complying with any other reporting required by the issuer of debt.

2. Disclosure training sessions will be conducted as needed. Training sessions must include education on the Districts’ disclosure obligations under applicable federal and state securities laws and the disclosure responsibilities and potential liabilities of members of the Districts’ staff and members of the Board.

4.5 Debt Covenants

General financial reporting and other tax certification requirements embodied in debt covenants must be monitored to ensure that each District is in compliance. These may include:

1. Annual appropriation of revenues to meet debt service payments.

2. Timely transfer of debt service payments to the trustee or paying agent.

3. Compliance with insurance requirements.

4. Compliance with rate covenants where applicable.

5. Compliance with all other covenants.

4.6 Debt Service Coverage Target

Each District will set user charge rates with a targeted goal of maintaining a projected debt service coverage ratio of 130% on all senior plus subordinate debts. The debt service coverage ratio is calculated as the projected annual net revenues (i.e., revenues remaining after payment of operation and maintenance expenses) divided by the estimated annual debt service. The objective is to maintain a debt service coverage ratio above the legally-required minimum to sustain a high-quality credit rating.

4.7 Debt Service Reserve Fund

A debt service reserve fund will be established only if it:

1. Provides an economic or credit advantage that outweighs the cost of funding the reserve; or

2. Is a condition of the debt instrument.

If a debt service reserve fund is required, it must be maintained in accordance with the provisions of the debt instrument and the requirements of the Wastewater or Solid Waste Financial Reserve Policy.

SECTION 5. TYPES OF DEBT

If the use of debt is appropriate, the Treasurer will evaluate the types of debt available and make a determination as to the debt instrument best suited for the particular purpose. Unless otherwise specifically authorized by the Board, debt will be issued with fixed interest rates through final maturity. Types of debt that may be issued by a District include:

5.1 Revenue Bonds

These bonds are typically long-term obligations issued to fund a specific project or purpose. They are backed solely by the future revenues expected to be received by a District in accordance with the agreed-upon bond covenants. Pledged revenues may include user charges, ad valorem taxes, contract revenue, interest, or any other sources of allowable revenue. Revenue bonds can be issued individually by a District or as part of a pool with other Districts under the Marks-Roos Local Bond Pooling Act of 1985, including through the Los Angeles County Sanitation Districts Financing Authority. Approval by the Financing Authority Commission and each participating District's Board is required before revenue may be issued bonds.

5.2 Clean Water State Revolving Fund (CWSRF) Loans

The CWSRF program is a low-interest loan program administered by the California State Water Resources Control Board. Loan proceeds can be used to finance a variety of projects related to water quality, including sewers, treatment plants, water recycling facilities, and stormwater improvements. Board approval is required for each CWSRF loan.

5.3 Land-Secured Financing

The Mello-Roos Community Facilities Districts Act of 1982 authorizes a District to form community facilities districts (CFDs), subject to voter approval, for the sole purpose of financing infrastructure and certain services. CFDs are authorized to issue bonds secured by special taxes to finance both localized improvements and regional facilities. In addition to voter approval, Board approval is required to form a CFD.

5.4 Water Infrastructure Finance and Innovation Act (WIFIA)

The WIFIA program is a federal credit program administered by the Environmental Protection Agency. This program provides partial financing for eligible water and wastewater projects set based on U.S. Treasury rates with maturity dates of up to 35 years and up to 5 years of repayment deferral after completion of the project. Board approval is required for each WIFIA agreement.

5.5 Commercial Paper

Commercial Paper is a short-term, unsecured note that pays a fixed rate of interest for a term ranging from seven to 270 days. It may be used as a source of interim construction financing until it is appropriate to replace it with a long-term bond, usually at or near the end of the construction period. Maturing principal and the interest thereon can be rolled to a subsequent maturity date at the then-prevailing interest rate. Board approval is required to issue Commercial Paper debt.

5.6 Clean Renewable Energy Bonds (CREBs)

CREBs can only be used to finance clean renewable energy projects. Because bondholders of this type of debt receive federal tax credits in lieu of all or a portion of traditional bond interest, a District must apply to the Internal Revenue Service for a CREB allocation. Board approval is required before CREBs may be issued.

5.7 Leases

In certain cases, leases may be considered debt under Government Code Section 8855(i), in particular when the lease may lead to purchase of the asset, the total lease payments approach the value of the asset, or when the lease term approaches the life of the asset. A District will comply with all debt-related requirements for the lease in the event the lease is considered debt under the criteria of Section 8855(i). Board approval is required to enter into such a lease.

5.8 Other Debt Instruments

A District may consider other available financing mechanisms that satisfy the conditions of this Debt Policy if the costs and structure are the most cost-effective option for the District. This can include other state or federal loans that, from time to time, may make funds available at or below market interest rates for specific types of projects or programs. Board approval is required before incurring any such debt.

SECTION 6. METHOD OF SALE

When issuing bonds, the District(s) will select the method of sale which best fits the type of bond 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:

6.1 Competitive Sale

In a competitive sale, underwriters submit sealed bids and the underwriter or underwriting syndicate with the lowest true interest cost is awarded the sale.

6.2 Negotiated Sale

In a negotiated sale, the underwriter or underwriting syndicate is selected through a Request for Proposal (RFP) process. The underwriter's fee is negotiated prior to the sale. The interest rate, redemption features and principal amortization are based on current market conditions on the sale date.

6.3 Private Placement

Private placement bonds are not publicly issued or publicly traded but rather are funded through direct negotiation with one or a select number of private financial institutions. The private financial institution is effectively providing a loan to be repaid over time. In general, private placements do not require many of the disclosure requirements found in public offerings. Private financial institutions typically do not require the bonds to be rated by a credit rating agency.

SECTION 7. CRITERIA FOR ISSUING DEBT

7.1 The Treasurer will evaluate the need for issuing debt, taking into consideration the anticipated capital program and the long-term rate projections. The goals of reasonable and stable rates, compliance with the Wastewater and Solid Waste Financial Reserve Policies, and ensuring operations and maintenance are sufficiently funded per the Districts mission statement will be factored into the decision-making process.

7.2 Projects will only be financed if a District has the ability to repay the debt and fund appropriate operations and maintenance costs for the asset. The repayment period for any debt must not exceed the anticipated useful life of assets or improvements funded by the debt.

7.3 If incurring debt is the best option for funding a particular project, the following criteria will be used to determine the optimum debt structure: The term, repayment structure, and interest rate mode must ensure other financial objectives are met, specifically the need to comply with the Wastewater or Solid Waste Financial Reserve Policy and the desire for stable rates.

1. The type of debt instrument must be optimized to achieve the lowest net present value cost.

2. Any conditions for the debt must not place undue burdens or obligations on the District.

7.4 Prior to issuing debt, the following metrics must be calculated for each year during the term of the debt and compared to the indicated goals:

Metric (All District Debt)	**Targeted Goal**
Debt Service Coverage Ratio	≥ 1.30
Total debt service as a percent of total operating expenses plus debt service	≤ 30%
Debt-to-Capitalization Ratio	≤ 50%

7.5 An anticipated variation from the goals does not mean that the debt issuance cannot move forward but should be justified by a regulatory need or other mitigating factor. For example, a regulatory requirement that results in the construction of a major capital facility could push the percentage of debt to operating budget well above 20%. However, the debt issuance could proceed if the debt service coverage ratio remains above 1.30 and the Treasurer has demonstrated the District(s) have the ability to make the required annual payments and can absorb the debt. Similarly, a high debt-to-capitalization ratio can be offset by limited future capital needs.

7.6 If new debt is being proposed, the Treasurer will calculate both:

1. The proposed new total debt service as a percentage of operating expense plus debt service; and

2. The ensuing debt-to-capitalization ratio.

If either ratio does not comply with the targeted metrics, the Treasurer must develop a plan to address possible means of bringing the District(s) back into compliance or, if it is not possible, the justification for why the District(s) should proceed with issuing the new debt. The Treasurer must document the plan/justification in a report to the Board prior to any approval to take on additional debt.

7.7 Each year the Treasurer will evaluate and compare the Districts' debt service coverage ratio to the targeted goal. If the goal is unmet, the Treasurer will develop a plan to correct the problem and that plan will be used as part of the budget preparation process and for analyzing rates to be proposed during the next rate-setting cycle. The plan to re-establish an appropriate debt service coverage ratio must utilize a combination of adjustments to the anticipated capital projects, service charges adjustments and use of reserves. The plan must also consider compliance with the Wastewater and/or Solid Waste Financial Reserve Policy. The Treasurer will report the debt service coverage ratio, compliance with the goals, and the plan (if needed) to the Board with the annual budget.

SECTION 8. REFINANCING/REFUNDING EXISTING DEBT

8.1 A debt refinancing or refunding will be deemed to be of economic benefit and cost effective if the net present value savings as a percentage of the refunded par amount is at least 3% for any current refunding transaction and 5% for any advance refunding transaction.

8.2 Some refinancing's or refunding's may be executed for other than economic purposes, such as to restructure debt, to change the type of debt instrument, or to retire a bond issue and indenture for more desirable covenants. Likewise, if the economic benefits outweigh the costs, and the refunding opportunity would otherwise be lost, a refinancing or refunding may be recommended even if the savings do not meet the 3% criteria.

SECTION 9. CREDIT ENHANCEMENT

Credit enhancement may be used to improve or establish a credit rating on a District's debt instrument. Types of credit enhancement include letters of credit, bond insurance, and surety policies. The use of credit enhancement will be evaluated up until the time the debt instrument is priced but will only be used if it reduces the overall cost of the proposed financing or otherwise furthers the Districts' overall financial objectives.

SECTION 10. CDIAC REPORTING

10.1 The Treasurer will report all debt issuances to CDIAC and must comply with all CDIAC requirements in connection with the Districts' debt issuances.

10.2 In the case of debt issued by the Los Angeles County Sanitation Districts Financing Authority, the proceeds of which will be used by the District(s), the Treasurer will make all certifications required under Government Code Section 8855(i) for the purposes of the Financing Authority's Debt Policy or reporting. All certifications required by Government Code Section 8855(1) must be executed by the Treasurer or his or her delegate.

SECTION 11. MUNICIPAL ADVISOR

11.1 The Districts may hire a municipal advisor for assistance and advice in structuring its debt portfolio. This can include help in evaluating the best type of debt instrument to use, the merits of the various methods of sale, and assessing whether refunding opportunities exist. In particular with bond transactions, the municipal advisor will assist in selecting the rest of the financing team (including underwriters, trustees, and rating agencies), the development of the overall financing schedule, and preparation of the Official Statement.

11.2 The municipal advisor can come from a firm that also engages in municipal bond underwriting or brokerage services; however, preference will be given to firms that act as independent municipal advisors. While serving as the Districts' municipal advisor, any firm that engages in these other services may not act simultaneously or subsequently in those capacities on any financing for which the firm was hired to act as a municipal advisor. Additionally, any firm that is acting as a municipal advisor for the Districts may not act as a municipal advisor or investment banker for another party involved in the same municipal transaction.

SECTION 12. DISADVANTAGED BUSINESSES

As described in the Outreach Program of the Purchasing Policy, the Districts support and encourage participation by businesses owned and controlled by minorities, women, and disabled veterans; disadvantaged and small business enterprises; and other emerging businesses. When soliciting and selecting underwriting firms as needed for bond issuances, the Districts will follow the Outreach Program and will strive to maximize participation of such firms in each bond issuance.

SECTION 13. DEBT MANAGEMENT POLICY ADOPTION

This Policy will be reviewed on an annual basis and any modifications made must be approved by each Board. Prior to such review, the matter will be referred to the Personnel Committee (comprised of the Chairpersons of the Board of Directors of each active County Sanitation District of Los Angeles County) for its consideration.