INLAND EMPIRE UTILITIES AGENCY
DEBT MANAGEMENT POLICY
May 2020

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Policy Statement

This policy documents the Inland Empire Utilities Agency (Agency) goals and guidelines for the use of debt instruments for financing Agency water and sewer infrastructure, projects, and other financing needs issued or delivered by the Agency and debt instruments issued by other entities controlled by the Agency including the Chino Basin Regional Financing Authority. The Agency recognizes the need to invest in ongoing capital replacement and rehabilitation of its facilities to ensure future viability of services.

The Agency will pay for infrastructure, projects, and other financing needs from a combination of current revenues, available reserves, and prudently issued debt. The Agency acknowledges that debt can provide an equitable means of financing projects for its customers and provide access to new capital needed for infrastructure and project needs. Debt will be used to meet financing needs (i) if it meets the goals of equitable treatment of all customers, both current and future; (ii) if it is the most cost-effective means available; (iii) if it is fiscally prudent, responsible, and diligent under the prevailing economic conditions; and (v) if there are other important policy reasons therefor. The Agency will not issue debt without the approval of the Board of Directors (Board).

To achieve the highest practical credit ratings and endorse prudent financial management, the Agency is committed to systematic capital planning, and long-term financial planning. Evidence of this commitment to long term capital planning is demonstrated through adoption and periodic adjustment of the Agency's Ten Year Forecast identifying the benefits, costs and method of funding each capital improvement planned for the succeeding ten years. Capital projects included in the Ten Year Forecast are typically first identified in the Agency's long term planning documents, amongst them the Wastewater Facilities Master Plan, Asset Management Plan, Recycled Water Program Strategy, and Integrated Water Resources Plan.

Purpose of Policy

The purpose of this debt management policy is to:

- Establish parameters for issuing debt
- Provide guidance to decision makers:
    - With respect to options available to finance infrastructure, projects, and other financing needs,
    - So that the most prudent, equitable and cost-effective method of financing can be chosen
- Promote objectivity in the decision-making process.

The Agency will adhere to the following legal requirements for the issuance of public debt:

- The state law which authorizes the issuance of the debt
- The federal and state law which govern the eligibility of the debt for tax-exempt status

- The federal and state law which govern the issuance of taxable debt
- The federal and state laws which govern disclosure, sale, and trading of the debt both before and subsequent to issuance
- Generally Accepted Accounting Principles ("GAAP")

Purpose and Use of Debt

The Agency will utilize reasonable debt financing as an acceptable and appropriate approach to fund long-term improvements and thus ensure that existing and future users pay their fair share. Long-term improvements include the acquisition of land, facilities, infrastructure, and supplies of water; and enhancements or expansions to existing water and sewer capacity and facilities. Debt can be issued to fund the planning, pre-design, design, land and/or easement acquisition, construction, and related fixtures, equipment and other costs as permitted by law. The Agency will not issue debt to cover operating needs, unless specifically approved by the Board.

The Agency may issue short term financing to finance certain essential equipment and vehicles. These assets range from service vehicles to laboratory equipment. The underlying asset must have a minimum useful life of one year or more. Short-term financings, including loans, on bill financing and capital lease purchase agreements, are executed to meet such needs.

The EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/Assistant General Manager (EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM) will periodically evaluate the Agency's existing debt and execute re-financings or prepayment (refunding) when economically beneficial. A refinancing may include the issuance of bonds to refund existing bonds or the issuance of bonds in order to refund other obligations, such as commercial paper or loans.

All debt issuance or refunding proposals made by the Agency involving a pledge or other extension of the Agency's credit through the sale of securities, execution of loans or leases, or making of guarantees or otherwise involving directly or indirectly the lending or pledging of the Agency's credit shall be reviewed by the EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM. The EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM shall be responsible for analyzing the debt financing proposal to determine if it is beneficial to the Agency and complies with the Agency's long-term financial planning objectives, including maintaining or improving the current credit ratings assigned to outstanding debt by the major credit rating agencies.

The proceeds of any debt obligation shall be expended only for the purpose for which it was authorized. Debt may only be issued under Board authorization and when the Agency has appropriated sufficient funds to pay the obligation of principal and interest. No debt shall be issued with a maturity date greater than the expected weighted average useful life of the facilities or improvements being financed. The final maturity of bond or State Revolving Fund (SRF) loan debt shall be limited to 30 years after the date of issuance.

Debt Management

There are no specific provisions within the California Government Code that limit the amount of debt that can be issued by the Agency. The Agency 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 rate setting process. Necessary appropriations for annual debt service requirements will be routinely included in the Agency's budget. The Agency will maintain proactive communication with the investment community, including rating agencies, credit enhancers and investors, to ensure future capital market access at the lowest possible interest rates.

The Agency's Debt Management Policy, Reserve Policy and Investment Policy are integrated into the decision-making framework utilized in the budgeting and capital improvement planning process. As such, the following principles outline the Agency's approach to debt management:

- The Agency will issue 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.

- The Agency will not issue debt to cover operating needs, unless specifically approved by the Board.

- Debt will be structured for the shortest period possible, consistent with a fair allocation of costs to current and future users. Borrowings by the Agency will be of a duration that does not exceed the useful life of the improvement that it finances and where feasible, should be shorter than the projected economic life. The standard term of long-term borrowing is typically 20-30 years.

- The Agency currently issues debt instruments on a fixed and variable interest rate basis. Fixed rate securities ensure budget certainty through the life of the securities and can be advantageous in a low interest rate environment. When appropriate, the Agency may choose to issue securities that pay a rate of interest that varies according to a predetermined formula or results from a periodic remarketing of the securities.

The proceeds of the bond sales will be invested until used for the intended project(s) in order to maximize utilization of the public funds. The investments will be made to obtain the highest level of safety. The Agency's Investment Policy and the specific bond indentures govern objectives and criteria for investment of bond proceeds. The EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM 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 bond 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 Agency cash. The Agency's trustee will administer the disbursement of bond proceeds pursuant to that certain Indenture of Trust. Requisition for the disbursement of bonds funds will be approved by the Agency's General Manager or EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM.

The EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM will monitor dedicated debt reserve fund balances and periodically review the advisability of prepayment or refunding of related debt. The financial advantages of a refunding must outweigh the cost of reissuing new debt. A potential refunding will be assessed in combination with any new capital projects requiring financing, and the benefits of the refunding will be evaluated in relation to its costs and risks.

Debt can be refunded to achieve one or more of the following objectives:

- Reduce future interest costs; Restructure or reduce future debt service in response to evolving conditions regarding anticipated revenue sources and lower market interest rates; and

- Restructure the legal requirements, termed covenants of the original issue to reflect more closely the changing conditions of the Agency or the type of debt.

Debt Coverage Target

The Agency will not engage in debt financing unless the proposed obligation, when combined with all existing debts, will result in acceptable debt ratios. In determining the affordability of proposed revenue bonds, the Agency will perform an analysis comparing projected annual net revenues (after payment of operating and maintenance (O&M expense) to estimated annual debt service and estimated debt coverage ratio (DCR). DCR is the amount of cash flow available to meet annual interest and principal payment on debt.

The Agency's bond covenants require a legal DCR of at least 120% for senior bonds and a coverage ratio of at least 125% for senior and subordinate debt combined. As appropriate and as needed, the Agency will require a rate increase to cover both O&M and debt service costs and create debt service reserve funds to maintain the legally required DCR. The Agency's objective is to maintain a DCR above the legally required minimum that sustains a high quality credit rating.

Debt Instrument Rating

The EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM, with advice from a financial advisor as appropriate, will assess whether a credit rating should be obtained for an issuance and make a recommendation to the Board. If it is determined that a credit rating is desirable, the probable rating of the proposed debt issuance is assessed before its issuance, and necessary steps are taken in structuring the debt issuance to ensure that the best possible rating is achieved.

Debt Structuring

The Agency will seek to structure debt with aggregate level principal and interest payments over the life of the borrowing. "Backloading" of debt service will be considered only when such structuring is beneficial to the Agency's aggregate overall debt payment schedule.

A call option will be used unless there is a compelling reason not to do so. A call option, or optional redemption provision, gives the Agency the right to prepay or retire debt prior to its stated maturity. This option may permit the Agency to achieve interest savings in the future through refunding of the bonds. Because the cost of call options can vary widely, depending largely on market conditions, an evaluation of factors, such as the call premium, time until the bonds may be called at a premium or at par, and interest rate volatility. Generally, 30-year tax exempt municipal borrowings are structured with a 10-year call at no premium. From time to time, shorter call options (5-9 years) may be used at little or no premium.

<u>Types of Debt</u>

The Agency may issue debt, including but not limited to revenue bonds, variable rate bonds, state revolving fund (SRF) loans, bank loans, notes, commercial paper, direct placements, capital leases, lease-purchase financing, securitization and on bill financing. The weighted average useful life of the asset(s) or project shall exceed the payout schedule of any debt the Agency assumes. A definition on each type of debt is provided in Appendix A.

In addition to the aforementioned long-term and short-term financing instruments, the Agency 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.

The Agency is authorized to join with other special districts and/or municipal agencies to create a separate entity, such as a Joint Powers Authority (JPA), to issue debt on behalf of the Agency, the special district or municipality. The Agency will only be liable for its share of debt service, as specified in a contract executed in connection with the joint venture debt.

Credit Enhancement

Credit enhancement may be used to improve or establish a credit rating on an Agency debt obligation. Types of credit enhancement include Letters of Credit, bond insurance or surety policies. The EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM will recommend to the Board the use of credit enhancement if it reduces the overall cost of the proposed financing or if, in the opinion of the GM and/or EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM, the use of such credit enhancement furthers the Agency's overall financial objectives.

Debt Service Reserve Fund/Surety Policy

The
EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM, with counsel from the Agency's financial advisor, bond counsel, and underwriter, will determine whether it is prudent and cost-effective to fund a debt service reserve fund. The Agency may issue debt without a funded debt service reserve surety if market pricing will not be negatively impacted. Debt reserves will be maintained in accordance with the Agency's Reserve Policy.

Capitalized Interest

Generally, interest may be capitalized for the construction period of a revenue-producing project, such that debt service expense does not begin until the project is expected to be operational and producing revenues. In addition, for lease back arrangements, such as those used for lease revenue bond transactions, interest may be capitalized for the construction period, until the asset is operational. Only under extraordinary circumstances, interest may be capitalized for a period longer than the construction period. Capitalized interest is sometimes referred to as "funded interest."

Credit Ratings

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

The Agency recognizes that external economic, natural, or other events may from time to time affect the creditworthiness of its debt. Each proposal for additional debt will be analyzed for its impact upon the Agency's debt rating on outstanding debt.

Rating Agency Relationships

The Agency shall be responsible for maintaining relationships with the rating agencies; Standard & Poor's, Moody's Investors Service, and Fitch Investors Service, as appropriate. This effort shall include providing periodic updates, both formal and informal, on the Agency's general financial condition and coordinating meetings and presentations in conjunction with a new debt issuance as appropriate. Written disclosure documents to the rating agencies shall be provided by the Finance and Accounting Department.

The retention of a rating agency relationship will be based on a determination of the potential for more favorable interest costs as compared to the direct and indirect cost of maintaining that relationship.

Bond Ratings

The EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM in consultation with the Agency's financial advisor, shall be responsible for determining whether a rating shall be requested on a particular financing, and which of the major rating agencies shall be asked to provide such a rating.

Method of Sale

The Agency will select the method of sale that 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:

I. Competitive sale. Bonds will be marketed to a wide audience of investment banking (underwriting) firms. The underwriter is selected based on the best bid for the Agency's securities, (highest price/lowest yield) The Agency will award the sale of the competitively sold bonds on a true interest cost (TIC) basis. Pursuant to this policy, the GM and/or EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM is hereby authorized to sign the bid form on behalf of the Agency fixing the interest rates on bonds sold on a competitive basis.

II. Negotiated sale. The EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM selects the underwriter, or team of underwriters, of its securities in advance of the bond sale. The EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM works with the underwriter to bring the issue to market and negotiates all rates and terms of the sale. In advance of the sale, the GM and/or EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM will determine compensation for and liability of each underwriter employed and the designation rules and priority of orders under which the sale will be conducted. Pursuant to this policy, the GM and/or EXECUTIVE MANAGER OF FINANCE AND

ADMINISTRATION/AGM is hereby authorized to sign the bond purchase agreement on behalf of the Agency fixing the interest rates on bonds sold on a negotiated basis.

III. Private placement. The Agency may elect to issue debt on a private placement basis. Such method shall be considered if it is demonstrated to result in cost savings or provide other advantages relative to other methods of debt issuance, or of 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 EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM. In developing such recommendations, the EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM shall consider the need for debt financing and assess progress on the current capital improvement program or plan (CIP) and any other program/improvement deemed necessary by the Agency. The Board authorizes and approves debt financing and/or debt service-related recommendations and proposals.

All proposed debt financings shall be presented to the Board through the Finance, Legal, and Administrative Committee and approved by the Board. New bond issues will be issued through the Chino Basin Regional Financing Authority (CBRFA) pursuant to a corresponding Installment Purchase Agreement between the CBRFA and the Agency. The Installment Purchase Agreement, amongst other things, provides for the Agency's pledge of designated revenues, the setting of rates and charges sufficient to meet the debt obligations and the payment of debt obligations.

Debt is to be issued pursuant to the authority of and in full compliance with provisions, restrictions and limitations of the Constitution and laws of the State of California Government Code (CGC) §54300 et seq.

Bond Counsel

The Agency will retain external bond counsel for all debt issues. As part of the responsibility to oversee and coordinate the marketing of all Agency indebtedness, the EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM shall 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 Agency will include a written opinion by bond counsel affirming that the Agency is authorized to issue the debt, stating that the Agency has met all state constitutional and statutory requirements necessary for issuance, and determining the debt's federal income tax status.

Financial Advisors

The Agency will select financial advisors who may either be independent financial advisors or firms who engage in municipal bond underwriting or brokerage services. While serving as the Agency's financial advisor, a firm may not also engage in the underwriting of the Agency bond issue for which that firm acts as financial advisor. A firm may also not switch roles (i.e., from financial advisor to underwriter) after a financial transaction has begun. Financial advisors shall be selected through a competitive process after a review of proposals by the EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM and/or other staff.

During the contract term of any party acting as financial 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 Agency in transactions involving an Agency financial commitment without the specific direction of the Agency's EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM.

The financial advisor will advise the Agency 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 Agency's near-term and long term cash flow needs. The financial advisor will work with all parties involved in the financing transaction, including the Agency's bond counsel, trustee, underwriters, and credit liquidity providers, to develop and monitor the financing schedule and preparation of the Official Statement. The financial advisor will assist the Agency in developing and distributing bid specifications for desired services as, trustee and paying agents, printing, remarketing and credit liquidity service providers, and assist the Agency in its review process. The Agency also expects that its financial advisor will provide objective advice and analysis, maintain confidentiality of the Agency's financial plans, and be free from any conflict of interest.

Underwriters

For negotiated sales, the Agency will generally select or pre-qualify underwriters through a competitive process. This process may include a request for proposal or qualifications to all firms considered appropriate for the underwriting of a particular issue or type of bonds. The EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM will determine the appropriate method to evaluate the underwriter submittals and then select or qualify firms on that basis. The Agency will not be bound by the terms and conditions of any underwriting agreement; oral or written, to which it was not a party.

Federal Arbitrage and Rebate Compliance

The Agency will fully comply with federal arbitrage and rebate regulations. Concurrent with this policy, the EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM 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 Agency's tax-exempt issues, including lease purchase agreements, are subject to arbitrage compliance regulations.

The Department of Financial Planning shall be responsible for the following:

I. 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 Agency shall meet one of the spend-down exemptions from arbitrage rebate. Tax-exempt bonds will not be issued unless it can be reasonably expected that 85% of the proceeds will be expended within the three-year temporary period.

II. 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.

III. 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 Agency will report such liability in its annual Comprehensive Annual Financial Report CAFR).

Continuing Disclosure

The Agency will meet secondary disclosure requirements in a timely and comprehensive manner, as stipulated by the Securities Exchange Commission (SEC) Rule 15c2-12 and consistent with the Agency's Disclosure Procedures Policy. The GM or EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM shall be responsible for providing ongoing disclosure information to the Municipal Securities Rulemaking Board's (MSRB's) Electronic Municipal Market Access (EMMA) system, the central depository designated by the SEC for ongoing disclosures by municipal issuers. The Agency will provide financial information and operating data no later than 270 days following the end of the Agency's fiscal year each year, and will provide notice of certain enumerated events with respect to the bonds, if material, as defined in the Agency's bond covenants.

The Agency will keep current with any changes in both the administrative aspects of its filing requirements and the national repositories responsible for ensuring issuer compliance with the continuing disclosure regulations. In the event a 'material event' occurs requiring immediate disclosure, the Agency will ensure information flows to the appropriate disclosure notification parties.

Compliance with Bond Covenants

In addition to financial disclosure and arbitrage compliance, once the bonds are issued, the Agency is responsible for verifying compliance with all undertakings, covenants, and agreements of each bond issuance on an ongoing basis. This typically includes ensuring:

- Annual appropriation of revenues to meet debt service payments
- Timely transfer of debt service payments to the trustee or paying agent
- Compliance with insurance requirements
- Compliance with rate covenants where applicable
- Compliance with all other bond covenants

On an annual basis, the Finance and Accounting Department will prepare all required debt related schedules and footnotes for inclusion in the Agency's CAFR. The CAFR shall describe in detail all funds and fund balances established as part of any direct debt financing of the Agency.

The CAFR may also contain a report detailing any material or rate covenants contained in any direct offering of the Agency and whether or not such covenants have been satisfied.

Policy Review

On an as needed based, the EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM will be responsible for updating and revising this Policy which shall be reviewed by the Finance, Legal, and Administrative Committee and adopted by the Board.

APPENDIX "A"

Definitions of Types of Debt

Bank Loans and Notes

Use of short-term borrowing, such as bank loans and notes, will be undertaken only if available cash or reserves are insufficient to meet both project needs and current obligations.

Capital Lease

Capital lease debt may be considered to finance capital improvements, including vehicles and equipment with an expected useful life of less than ten years. A capital lease is a lease in which the lessor finances the lease and all other rights of ownership transfer to the Agency.

Derivatives

The Agency may choose to enter into contracts and financing agreements involving interest rate swaps, floating/fixed rate auction or reset securities, or other forms of debt bearing synthetically determined interest rates as authorized under the applicable statutes. The Agency will consider the use of derivative products on a case-by-case basis and consistent with state statute and financial prudence. Before entering into such contracts or agreements, the Agency will review the risks and benefits of such financing techniques and expected impacts on the Agency's long-term financial operations and credit ratings, and prepare a report to be presented to the Board of Directors through the Finance, Legal and Administration Committee for approval.

Lease-Purchase Financing

The use of lease-purchase agreements in the acquisition of vehicles, equipment and other capital assets shall be considered carefully relative to any other financing option. The lifetime cost of a lease typically will be higher than other financing options or pay-go purchases. Nevertheless, lease-purchase agreements may be used by the Agency as funding options for capital acquisitions if operational or cash-flow considerations preclude the use of other financing techniques.

On Bill Financing

The Agency may choose to enter into low or zero interest financing agreements with utility providers who offer On Bill Financing. This type of financing offers financing of business improvements with little to no stated interest or fees or costs to the Agency. Repayment amounts will be based on projected savings associated with the project and will be part of the monthly bill received from the issuer. Financing terms can range from three to ten years depending on the project to be financed.

Revenue Bonds

Revenue bonds issued by the Agency are long term obligations issued to fund capital projects. The Agency will generally issue revenue bonds on a fixed interest rate basis, wherein at the time of the bond sale all interest rates are known and do not change while those bonds are outstanding. Particular conditions may arise where the Agency would consider the use of variable interest rate bonds. Variable interest rate bonds have interest rates that reset on a periodic basis (e.g. daily, weekly, monthly, etc.). Revenue bonds are payable solely from Agency revenues in accordance with the agreed upon bond covenants.

Variable Rate Debt

Variable rate debt is an alternative to fixed rate debt. It may be appropriate to issue short-term or long-term variable rate debt to diversify the Agency's debt portfolio, reduce interest costs, provide interim funding for capital projects and improve the match of assets to liabilities. Variable rate debt typically has a lower cost of borrowing than fixed rate financing and shorter effective lives in the range of 7 to 35 days. The Agency may consider variable rate debt in certain instances. The Agency will maintain a conservative level of outstanding variable debt in consideration of general rating agency guidelines and limits outstanding variable rate debt to a maximum of 30% of total outstanding debt, in addition to maintaining adequate safeguards against risk and managing the variable revenue stream. Under no circumstances will the Agency issue variable rate debt solely for the purpose of earning arbitrage.

Short Term Debt

Pending the issuance of bonds, the Board may authorize the issue of short-term debt. Short-term borrowing may be utilized for the temporary funding of operational cash flow deficits or anticipated revenues, where anticipated revenues are defined as an assured revenue source with the anticipated amount based on conservative estimates. The EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM will determine and utilize the least costly method for short-term borrowing. Such debt shall be authorized by resolution of the Board.

These short-term notes may be structured as:

- Bond Anticipation Notes (BANs) - BANs are short term obligations that will be repaid by proceeds of a subsequent long-term bond issue. The Agency may choose to issue Bond Anticipation Notes as a source of interim construction financing. Before issuing such notes, financing for such notes must be planned for and determined to be feasible by the GM and EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM.

- Commercial Paper (CP) - CP is a note that has maturities up to 270 days and may be rolled to a subsequent maturity date. Tax Exempt Commercial Paper may be issued for Agency capital programs if a program size and efficiency can be put in place.

- Tax and Revenue Anticipation Notes (TRANs) - TRANs are short term notes secured by a pledge of taxes and other revenues in the current fiscal year. TRANs, if issued, will constitute direct obligations of the Agency backed by the full faith and credit of the Agency. All TRANs will be redeemed in the same fiscal year in which they are issued. The Agency may choose to issue Tax Revenue Anticipation Notes to fund internal working capital cash flow needs, if such notes are judged by the GM and EXECUTIVE MANAGER OF FINANCE AND ADMINISTRATION/AGM to be prudent and advantageous to the Agency.

State Revolving Funds

The State Revolving Fund (SRF) loan program is a low or zero interest loan program 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, and for the development and implementation of estuary conservation and management programs. SRF debt service payments are factored into debt service coverage ratios as defined by applicable water and wastewater indentures.

SRF loans are generally structured such that the Agency is required to contribute a percentage of the total project cost and receives loan proceeds from the State for the balance. In general, the SRF loan interest rate is calculated by taking half of the True Interest Cost (TIC) of the most recent State of California General Obligation Bonds sale. The term of the loans can be 20 or, if applicable, an extended financing term of 30 years. When compared to traditional bond financing, the Agency may realize substantial savings as a result of the lower interest rate.

SRF Loans may provide additional assistance in the form of principal forgiveness. 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.

Letters of Credit

The Agency shall have the authority to enter into a letter-of-credit agreement when such an agreement is deemed prudent and advantageous. Only those financial institutions with short-term credit ratings of at least VMIG 1/A-1, F1 by Moody's Investor Services, Standard & Poor's and Fitch IBCA, may participate in the Agency's letter of credit agreements.