TEXAS WATER DEVELOPMENT BOARD (TWDB)

Fiscal Year (FY) 2024 DEBT MANAGEMENT POLICY

Approved August 10, 2023

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I. Policy Objective

The purpose of the Texas Water Development Board (TWDB) Debt Management 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 the TWDB to make informed debt management decisions. The items outlined in the policy are not goals, nor a list of rules to be applied to the TWDB's debt issuance; rather, the policy should be utilized as a tool to ensure successful long-term debt management and adequate financial resources are available to support the TWDB's various programs. This policy will guide the TWDB in the following:

- Evaluating critical debt issuance options;
- promoting sound financial management of the portfolio and assets of the TWDB;
- 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 an applicable Request for Qualifications (RFQ) or Request for Proposals (RFP) process. Consultants to be utilized in the debt management process include:

A. Underwriters

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

- Providing access to municipal bond and capital markets to fund the various financial assistance programs of the TWDB;
- providing marketing and pricing expertise to maximize effectiveness of debt issuance;
- assisting with investor outreach and education;
- adhering to the Underwriting Policies and Procedures established by the 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 applicable tax codes.

Bond Counsel reviews the offering documents governing the offer and sale to ensure that the documents accurately describe the terms of the sale of the debt obligations and the documents authorizing their issuance. At the request of the 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 the TWDB financing programs.

In addition, Bond Counsel performs 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 and prepayments. Such additional services may include advice on tax matters, particularly when there have been tax law changes.

C. Financial Advisors

Financial Advisors have a fiduciary responsibility to the TWDB. They provide recommendations on matters 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. They play a critical role in the preparation of Preliminary and Final Official Statements as well as prepare and confirm final numbers associated with each bond sale. Additional services include analysis and evaluation of underwriter transaction proposals and expenses, financing costs and other related issues.

The Financial Advisors consult with the TWDB staff in analyzing opportunities to refund or defease outstanding debt obligations of the TWDB as well as assist in the coordination of communication with rating agencies and investors. The Financial Advisors also assist in the coordination efforts with the underwriting team charged with the sale of TWDB obligations to ensure the offering is cost effective to the TWDB and realizes the goals and objectives of the financing.

In addition, the Financial Advisors perform 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 and prepayments.

D. Disclosure Counsel

Disclosure Counsel performs legal services associated with the preparation of offering documents used by the 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, should it be necessary, Disclosure Counsel will render a written opinion with respect to any matters relating to the compliance requirements of Rule 15c2-12. The TWDB will designate firms to serve as Disclosure Counsel.

E. Arbitrage Consulting Services

The Arbitrage Consultant prepares a computation to determine the arbitrage rebate amount, if any, for the Bonds as described in relevant tax codes. 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 that 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 statewide participation goals for Historically Underutilized Businesses, Women and Minority owned firms in the underwriting and issuance of debt through the Request for Qualifications, Request for Proposals, and team selection processes.

IV. Debt Ratings and Rating Agency Presentations

The 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/or rating agencies on developments at the TWDB, as needed.

The 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

The TWDB staff will evaluate and recommend whether a negotiated, competitive, or direct placement method of sale is most suitable for a proposed transaction. Program participant needs, transaction size, program structure and demand, resulting 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 assets being financed, or 30 years. The TWDB will remain mindful of alternative terms for bonds for the underlying program participants, such as 25 or 40-year bonds, as well as market considerations affecting the pricing of the bonds, and will structure TWDB debt to best manage its 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. Analysis of the call dates of the underlying political subdivision obligations should be undertaken in an effort to mitigate TWDB call risk exposure, which may result in call dates less than ten years. Instances may exist when call provisions are either not necessary or counterproductive in the marketing of the bonds.

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

TIPRA is effective for all bonds issued after May 17, 2005. Bonds issued to finance the TWDB's Water Financial Assistance Programs, State Revolving Fund Programs and the State Water Implementation Revenue Fund for Texas bonds are subject to compliance with the TIPRA redemption requirements. As such, bonds issued to provide new political subdivision obligations, as well as bonds issued to refund outstanding bonds are subject to the requirement. The TWDB actively manages its bond issues and projected demand to mitigate the potential requirement to redeem bonds due to the non-origination of bond proceeds.

C. Rates

Debt shall be issued at the most cost-effective rates possible at the time of issuance. The TWDB will seek review from and rely on the recommendation of its Financial Advisors concerning the cost-effectiveness of the interest rates bid, whether negotiated, competitively bid, or placed.

VII. Refunding Opportunities

Any refunding should be structured to optimize present value savings and structure debt service savings in a manner designed to achieve overall program debt service coverage goals and portfolio optimization for the financial assistance programs of the TWDB. Timing, market conditions, underlying political subdivision obligations, and associated prepayment risk, and overall program risk will be the primary considerations in making this decision. The TWDB 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 TWDB 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 applicable tax codes and the impact a refunding may have on the program participants of the TWDB should be considered. Specifically, 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 financial assistance to underlying program participants. 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.

With the passage of the Tax Cuts and Jobs Act, tax-exempt advanced refundings are no longer permitted. The TWDB will judiciously take into consideration the impacts of a taxable advance refunding, with a focus on increasing savings thresholds, the negative arbitrage generated in the refunding escrow, and possible mismatches to the call dates of the underlying political subdivision obligations. Even though there may be a financial benefit to the TWDB by effectuating a taxable advanced refunding, the TWDB may decide not to proceed with the transaction for a number of reasons. Decisions will be made in consultation with Bond Counsel and the Financial Advisors.

Notwithstanding 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 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 or mitigating prepayment risks.

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, respective resolutions, and trust indentures, 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 program participants will be handled consistent with the IRS tax 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.

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

XII. Continuing Disclosure and Other Post-Issuance Compliance

The designated Disclosure Officers of the TWDB, currently the Chief Financial Officer and Development Fund Manager, will develop written procedures for the purpose of monitoring compliance with tax codes and other regulatory disclosure requirements of bonds issued for the benefit of the TWDB's Water Financial Assistance Programs, State Revolving Fund Programs, and State Water Implementation Revenue Fund for Texas. These written procedures will be maintained as part of the administrative practices of the staff and will be reviewed as prescribed in the procedures to determine adequacy and effectiveness.

In consultation with Bond Counsel and Disclosure Counsel, the Disclosure Officers 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. 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 only 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. Risk 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, prepayment, and tax risk. Staff will 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, and bond enhancement agreements depending on the market conditions and interest rates at the time. Risk factors to be considered in determining the use of alternate financing options include, but are not limited to cash flow, liquidity, remarketing, counterparty, prepayment, and tax.

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 financial assistance.

XIV. Entering the Bond Market

Programmatic demand and advantageous refunding opportunities are the two primary tools determining when the TWDB enters the bond market. After an analysis of program participant demand and the corresponding cash flow is completed, if it is determined that funds on hand are not sufficient to meet demand, staff will seek appropriate approvals and develop plans and documents to sell bonds. Timing is critical and staff must monitor economic indicators, in coordination with programmatic needs, to determine the optimal time to enter the bond market.

APPROVED and ordered of record this the 10th day of August 2023.

TEXAS WATER DEVELOPMENT BOARD

For: Brooke T. Paup, Chairwoman

ATTEST:

Jeff Walker, Executive Administrator