ERIE COUNTY WATER AUTHORITY

INTEROFFICE MEMORANDUM

October 05, 2022

To: Jerome D. Schad, Chair
Peggy A. LaGree, Vice Chair
Michele M. Iannello, Treasurer

From: Karen A. Prendergast, Chief Financial Officer KAP

Subject: Debt Management Policy

At its September 17, 2008 meeting, the Board adopted a Debt Management Policy governing the issuance and management of Authority debt. The Policy was last revised on December 15, 2016 to reflect changes to continuing disclosure and arbitrage requirements.

The Policy, as amended, establishes a debt limit based on a ratio of total liabilities to total assets of 40%. The implementation of GASB Statement 75 – *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* in 2018 required the addition of a $60 million liability, increasing our debt ratio significantly. Our current debt ratio is 30%.

In consultation with our financial advisor, Capital Markets Advisors, LLC, I am recommending a revision to the Debt Management Policy changing our debt limit to a debt to capitalization ratio of no more than 25%. This ratio aligns with the rating agencies methodology for debt analysis, and gives us more debt capacity. It measures total debt against net position plus debt. Using this measurement, our current ratio is 12%.

The change to the debt limit discussed above is the only substantive change to the policy. The revised Debt Management Policy is on the Finance Committee agenda for discussion, and on the general meeting of October 20, 2022 for Board consideration.

cc M. Carney
R. Stoll
T. McCracken
L. Kowalski
J. Tomaka

ERIE COUNTY WATER AUTHORITY
DEBT MANAGEMENT POLICY

PURPOSE

The following policy is enacted in an effort to standardize the issuance and management of debt by the Erie County Water Authority (the "Authority"). The primary objective is to establish conditions for the use of debt and enact policies that minimize the Authority's debt service and issuance costs, retain the highest practical credit rating, and maintain full and complete financial disclosure and reporting. This policy is a guideline for general use, and allows for exceptions in extraordinary conditions. The policy applies to all debt issued by the Authority. Nothing in this policy shall be deemed to affect or impair any outstanding obligations of the Authority or any obligations issued to renew such outstanding obligations. Failure to comply with any goal or limit established by this policy shall not itself be deemed to invalidate any obligations.

CREDITWORTHINESS OBJECTIVES, PURPOSES AND USES OF DEBT

Credit Rating

The Authority seeks to maintain the highest possible credit ratings for all categories of short and long-term debt that can be achieved without compromising delivery of water service and achievement of adopted policy objectives of the Authority.

The Authority recognizes that external economic, natural, or other events may from time to time affect the creditworthiness of its debt. The Authority remains committed to ensuring the actions within its control are prudent and beneficial to its ratepayers.

Financial Disclosure

The Authority is committed to full and complete financial disclosure, and to cooperating fully with rating agencies, institutional and individual investors, other levels of government, and the general public to share clear, comprehensible, and accurate financial information. The Authority is committed to complying with secondary market disclosure requirements as outlined in the Securities and Exchange Commission (SEC) Rule 15c2-12 on a timely and comprehensive basis. The Chief Financial Officer of the Authority or his or her designee, or such other person as the Authority shall designate in writing to the Trustee or as part of a Continuing Disclosure Agreement shall be the Responsible Party as defined in the Secondary Market Disclosure requirements. The Cash Manager will be responsible for ensuring compliance for required secondary market disclosures made on the Municipal Securities Rulemaking Board (MSRB's) Electronic Municipal Market Access system (EMMA) in a timely manner.

Capital Planning

To enhance creditworthiness and prudent financial management, the Authority is committed to systematic capital planning, intergovernmental cooperation and coordination, and long-term financial planning. Evidence of this commitment to systematic capital planning will be demonstrated through adoption of an annual capital budget, supplemented by an additional four-year capital budget forecast.

Capital Financing

The Authority will finance its capital improvement plan through revenue generation, grants, contributions from other governments, and responsible debt issuance.

Debt Limits

The Authority will keep outstanding debt at levels consistent with its creditworthiness objectives and capital financing plan. The Authority's debt to capitalization ratio, as defined below, is a measure of the relative leverage of the Authority as of the most recently issued December 31st independently audited financial statements and expressed as a percentage. The Debt-to-Capitalization Ratio shall not exceed 25% except in an emergency or an extraordinary event. If the Authority issues debt where a public body is contractually bound to pay the debt service, the Authority may disregard such debt for purposes of calculating the amount of its outstanding debt.

<u>Debt-to-Capitalization Ratio</u>

Numerator: The sum total of all short- and long-term debt both on the Authority's balance sheet and that which is allocable to the Authority, including draws on credit lines, commercial paper notes and other loans, debt, or material obligations.

Denominator: The total debt as calculated in the numerator plus the Authority's net position

DEBT STANDARDS AND STRUCTURE

Debt Coverage Ratio

The Authority shall adopt an annual budget which contains net revenues equal to 1.35 times the sum of the debt service on outstanding bonds for said fiscal year computed as of the beginning of such fiscal year.

Length of Debt

Debt will be structured for a period consistent with a fair allocation of costs to current and future ratepayers and consistent with the useful life of the assets being financed.

Debt Structure

Debt will be structured to achieve the lowest possible True Interest Cost (TIC) to the Authority given market conditions and the urgency of the capital projects. Moreover, to the extent possible, the Authority will design the repayment of its overall debt so as to repay principal as rapidly as possible consistent with maintaining a level debt service profile.

Types of Bonds

Bonds may be issued as serial bonds, term bonds, capital appreciation bonds, put bonds or variable rate bonds. Variable rate bonds will be limited to 20% of the Authority's total outstanding bond principal. The use of short-term borrowing, such as bond anticipation notes (BANs) will be undertaken only if the transaction costs plus interest on the debt are less than the cost of internal financing, or available cash is insufficient to meet capital requirements.

Use of Derivatives

The Authority will not use derivatives when issuing debt for Authority purposes. A derivative is a financial instrument created from or whose value depends upon (is derived from) the value of one or more separate assets or indices of asset values. As used in public finance, derivatives may take the form of interest rate swaps, futures and options contracts, options on swaps and other hedging mechanisms such as caps, floors, collars, and rate locks.

Debt Administration and Process

Bond Counsel

The Authority will retain an external Bond Counsel for all debt issues.

Municipal Advisor

The Authority will retain an SEC and MSRB registered Municipal Advisor for all debt issues. The Municipal Advisor shall advise and make recommendations on the execution of bond issuances, redemptions, and defeasances.

Types of Bond Sales

Authority debt shall be issued either through a competitive bidding process or by negotiated sale. The Authority shall retain the services of a Municipal Advisor to assist in the administration of the sale process. If a negotiated sale process is deemed appropriate, the Underwriter(s) shall be selected through a competitive process. The Authority may request the Authority’s Municipal Advisor to assist in this process, analyze proposals and provide recommendations with respect to the selection(s).

Investment of Bond Proceeds

All bond proceeds shall be invested in accordance with its bond indenture, applicable New York State Statutes, and the Authority's adopted Investment Guidelines

Arbitrage Bonds

Title 26 §1.148 of the Code of Federal Regulations (IRS Code) restricts the direct and indirect investment of bond proceeds in higher yielding investments and requires that certain earnings on higher yielding investments be rebated to the United States. Violation of these provisions cause the bonds in the issue to become arbitrage bonds, the interest on which is not excludable from the holders gross income. It is the policy of the Authority to comply with all of the IRS Code provisions necessary to protect the tax-exempt status of their bond issues.

The Cash Manager shall monitor the computation process in consultation with the Authority's Municipal Advisor and promptly make any arbitrage rebates resulting from the computation. The initial computation date can be no later than five years after the issue date. The final maturity date of a bond issue is also the final computation date.

Refunding of Outstanding Long-Term Obligations

The Authority's Chief Financial Officer, with the assistance of the Authority's Municipal Advisor, shall periodically review the Authority's outstanding long-term debt to identify refunding opportunities. If a refunding opportunity is identified, the Authority's Chief Financial Officer shall work in conjunction with the Authority's Municipal Advisor to determine if the potential benefits of the refunding outweigh the risks or costs of delaying the refunding.

Controlling Documents

If any portion of this policy conflicts with the terms of the Authority's General Bond Resolution, supplemental resolutions, closing documents, or any Tax Compliance Agreement (or similar document), or any tax advice rendered by nationally recognized bond counsel, this policy shall be superseded by such other document(s).