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DEBT MANAGEMENT POLICY

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I. POLICY STATEMENT

The Santa Clara Valley Water District (District) Debt Management Policy sets forth debt management objectives for the District, establishes overall parameters for issuing and administering the debt portfolio, and provides policy guidelines to decision makers.

Implementation of the Debt Management Policy will help to ensure that the District maintains a sound debt position and protects its credit quality, as well as maintain compliance with California Government Code section 8855 (i) which requires any issuer of public debt to certify with the California Debt and Investment Advisory Commission (CDIAC) that the issuer has adopted local debt policies concerning the use of debt and any proposed debt issuance is consistent with those policies as well as file certain annual reports with CDIAC by January 31 of each year (first report due by January 31, 2018).

Furthermore, the Debt Policy complies with District Board Governance Policy - Executive Limitation (EL-4.7) (Revision as of July 29, 2015) which states that the Board Appointed Officer shall:

- 4.7 Not indebt the organization, except as provided in the District Act, and in an amount greater than can be repaid by certain, otherwise unencumbered, revenues within 90 days, or prior to the close of the fiscal year.
 - 4.7.1 Not issue debt (long or short-term obligations that are sold within the financial marketplace) that conflicts with the District Act or the legal authority of the District without Board authorization;
 - 4.7.2 Not issue debt without a demonstrated financial need;
 - 4.7.3 Meet debt repayment schedules and covenants of bond documents;
 - 4.7.4 Establish prudent District Debt Policies that are consistent with Board policies and provide guidance to employees in regards to administering the debt programs and agreements, including consideration for the appropriate level of debt for the District to carry and structuring debt repayment to address intergenerational benefits;
 - 4.7.5 Be consistent with the District's Debt Policies and any addendums when issuing debt;
 - 4.7.6 Maintain strong credit ratings and good investor relations.

A. Legal Governing Principles

1. *Governing Law*

i. **The District Act**

The District is a multi-purpose special district duly organized and validly existing under the Constitution and the laws of the State of California. The District Act, which created the District, is consulted when issuing debt for compliance.



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ii. **California Law**

State law dictates certain requirements when issuing debt and certain statutes must be followed for any issuance or refunding.

iii. **Federal Tax law**

The District shall issue and manage debt in accordance with the limitations and constraints imposed by federal tax law to maximize its ability to sell tax-exempt debt. Such constraints include, but are not limited to, private activity tests, review of eligible projects, spend-down tests and arbitrage rebate limitations.

iv. **Governing Legal Documents**

The **Flood Control System Master Resolution** of the District, adopted on June 23, 1994 as Resolution 94-60 and subsequent amendments establishes the basic security structure of flood control related debt issued by the District. Key terms and conditions include, but are not limited to, the definition of pledged revenues, the rate covenant and the additional bonds test.

The **Water Utility System Master Resolution**, adopted June 23, 1994 as Resolution 94-58 and subsequent amendments (Resolution 06-80 adopted November 28, 2006), establishes the **senior lien** security structure for water utility related debt issued by the District.

The **Water Utility Parity System Master Resolution**, adopted February 23, 2016 as Resolution 16-10 and subsequent amendments (Resolution 16-82 adopted December 13, 2016), establishes the **parity lien** security structure for water utility related debt issued by the District. The parity lien is **subordinate** to the senior lien per the Water Utility System Master Resolution, adopted June 23, 1994 as Resolution 94-58.

2. **Permitted Debt Type**

The District may legally issue both short-term and long-term debt, using the debt instruments described below. The Financial Services Division, in consultation with the District Counsel, Bond Counsel and Financial Advisors, shall determine the most appropriate instrument for a proposed bond sale.

i. **General Obligation Bonds**

The District is empowered, under its District Act, to levy taxes on all taxable property within its boundaries for the purpose of paying its voter approved general obligation bonds, subject to certain limitations in the District Act, the California Revenue and Taxation Code and the California Constitution. The District is currently **not** authorized to sell general obligation bonds under Section 14 of the District Act. An amendment to the District Act, Section 17 to allow bonds to be paid by proceeds derived from an ad valorem property tax, subject to



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the approval of the State Legislature and the CA Governor, is required for the District to be able to issue general obligation bonds payable from ad valorem taxes, provided that the District obtains the approval of a two-thirds (2/3) majority of those voters in a local election.

ii. **Certificates of Participation**

Certificates of Participation (COPs) provide debt financing through a lease or installment sale agreement. The District’s issuance of COPs is facilitated by the Santa Clara Valley Water District Public Facilities Financing Corporation, a California nonprofit benefit corporation that was created by the District specifically to serve as party to the installment sale agreements and contracts of indebtedness securing District COPs.

For the Water Utility, because the District cannot issue Revenue Bonds to acquire new facilities or improvements with a net lien pledge, the authority to execute and deliver an Installment Purchase Agreement which will secure the COPs to be executed and delivered by the Santa Clara Valley Water District Public Facilities Financing Corporation (PFFC) is provided in Section 5 of the District Act.

For the Watershed Funds, a two-thirds (2/3) majority vote of the ratepayers is necessary to levy benefit assessments which would secure the COPs.

iii. **Commercial Paper**

On December 17, 2002, the Board of Directors passed Resolutions 02-76 and 02-77 which authorized the execution and delivery of a taxable and tax-exempt Tax and Revenue Anticipation Notes (“TRANS”) to support the Commercial Paper Program. Each fiscal year, the Board approves new resolutions for new TRANS to support the Commercial Paper Program. Voter approval is not required to issue commercial paper and the proceeds of commercial paper may be used for District purposes, including, but not limited to, capital expenditure, investment and reinvestment, and the discharge of any obligation or indebtedness of the District.

Commercial Paper is intended to be utilized as a short-term financing tool for bridge financing. The District will issue Commercial Paper in amounts up to the authorized limit with the intention of paying off the outstanding Commercial Paper debt when a long-bond is issued, or another source of revenue has been identified. Due to the quickness and ease of issuing Commercial Paper, it could be looked upon as “just-in-time” financing.

iv. **Revenue Bonds**

The authority to issue Revenue Refunding Bonds is provided in Section 25.1 of the District Act and Sections 53580-53589.5 of the California Government code.



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In the special election of November 6, 1984, voter approval was granted for revenue bonds only on a gross lien basis and only in accordance with certain limitations set forth in the Revenue Bond Law of 1941. On June 23, 1994, the District resolution 94-58 (Senior Master Resolution) included a variety of provisions intended to govern all future water revenue notes and other obligations, including a net lien requirement, which in effect superseded the 1986 Bond Resolution. Additionally, the pledge of 1% property taxes in the Senior Master Resolution is inconsistent with the Revenue Bond Act of 1941 which expressly prohibits the pledge of proceeds of taxation in Section 54478 of the Government Code. Without an amendment to Section 25.2 (b) of the District Act to allow the District to issue water revenue bonds on a net lien basis and payable from all water utility revenues including the 1% property taxes, the District cannot issue Revenue Bonds without voter approval.

Refunding Revenue Bonds may be issued without voter approval. Staff should consult with Bond Counsel for further directions on this matter.

v. **Assessment Bonds**

The District is authorized to issue assessment bonds upon majority (>50%) voter approval. Such bonds are typically repaid from assessments collected within an assessment district. Assessments are levies of charges on real property to pay for projects or services that specifically benefit that parcel of property.

vi. **Refunding Bonds**

Refunding outstanding bonds that will provide a net economic benefit to the District is allowable within the federal tax law constraints.

vii. **Loans, Letters of Credit, Lines of Credit**

The District may from time to time borrow through a loan with a commercial bank, Letter of Credit, Lines of Credit with a commercial bank, state revolving loan program or other governmental agency. Each loan will have a specific purpose. Voter approval is not required for obtaining a loan if such loan is structured as a COP, TRAN, or other forms and issued in conjunction with the PFFC.

3. Limitations of Debt Issuance

i. **Long Term Borrowing**

Long term borrowing may be used to finance the acquisition or improvement of land, facilities or equipment for which it is appropriate to spread these costs over more than a one year budget. Long term borrowing may also be used to fund capitalized interest, cost of issuance, required reserves, and any other financing related costs which may be legally capitalized. Long-term borrowing shall not be used to fund operating costs. The maximum maturity may not exceed 40 years.



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ii. Short Term Borrowing

Short-term borrowing, such as TRANS (tax and revenue anticipation notes), commercial paper and lines of credit, will be considered as an interim source of funding to be utilized when appropriate. Short-term debt may be issued for any purpose for which long-term debt may be issued, including capitalized interest and other financing related costs. TRANS and Commercial Paper may be used to fund operating costs when issued and retired in the same fiscal year.

The short term borrowing authority set in Section 25.6 of the special legislation which formed the Santa Clara Valley Water District (the District Act) provides a limit on short term debt (maturity of less than five years) of \$8,000,000 that can be borrowed under authority of that section. The District's commercial paper program, issued in accordance with the Government Code, is not subject to Section 25.6 of the District Act limit as opined by District Counsel and is issued in a transaction with the PFFC and others.

B. Debt Issuance

1. Debt Capacity

The District will keep outstanding debt within the practical limits of the District's debt rating, debt service coverage ratio constraints and any other applicable law.

The District shall assess the impact of a new debt issuance on the long-term affordability of all outstanding and planned debt issuance. Such analysis recognizes that the District has limited capacity for debt service in its budget, and that each newly issued financing will obligate the District to a series of payments until the bonds are repaid.

The District must not only evaluate the District as a whole, but specifically analyze debt capacity in relationship to issuances in the Watershed Funds, Water Utility Enterprise Division and the General Fund. Each Division has its own complexities, constraints and regulations; therefore, they must be analyzed separately and then as a whole.

2. Intergenerational Concerns

The District will review the issuance in light of utilizing Pay-As-You-Go financing vs. Long-Term debt and impact each financing method has on intergenerational benefits.

3. Credit Quality

The District seeks to obtain and maintain the highest possible credit ratings for all categories of short and long-term debt. Except for certain instruments, the District will not issue bonds or cause COPs to be executed and delivered that do not carry



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investment grade ratings (i.e. credit ratings below Baa3/BBB-/BBB- from Moody’s Investors Service, S&P Global and Fitch Ratings, respectively). Certain instruments, such as state loans or private placements, may not be rated.

Traditionally, the District has benefited from lower interest costs due to strong ratings and shall take any necessary steps to maintain favorable ratings.

Ratings may be obtained from Moody’s, S&P, Fitch, or other nationally recognized rating agencies. The District will always have at least one rating and when beneficial will request additional ratings for long term debt issuances that are publicly sold, whereas private placements may not require ratings.

4. Structural Features

i. Debt Repayment

Debt will be structured for a period consistent with a fair allocation of costs to current and future beneficiaries of the financed capital project. The District shall structure its debt issues so that the maturity of the debt issue is consistent with the economic or useful life of the capital project to be financed.

ii. Fixed Rate Debt / Variable Rate Debt

The District may at its discretion issue fixed rate debt or variable rate debt based upon District needs and market conditions. Fixed rate debt means that the coupon of the bond until its maturity remains fixed or the same as when issued. Variable rate debt means that the coupon will fluctuate throughout the life of the debt instrument. The variable rate may be based upon several indexes and which index will be determined at the time of issuance.

iii. Derivatives

A derivative product is a financial instrument which “derives” its own value from the value of another instrument, usually an underlying asset such as a stock, bond or an underlying reference such as an interest rate index. In certain circumstances these products can reduce borrowing costs, assist in managing interest rate risk, provide call flexibility, and smooth debt service expense. However, these products carry with them certain risks not faced in standard debt instruments. The Financial Services Division shall evaluate the use of derivative products on a case by case basis to determine whether the potential benefits are sufficient to offset any potential costs.

Some common forms of derivatives may be used to reduce the cost of borrowing; synthetically convert fixed rate debt to variable rate debt; synthetically convert variable rate debt to fixed rate debt; and provide protection against interest rate fluctuations (see section **1.E. Master Swap Policy** below for more information).



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iv. **Professional Assistance**

The District shall utilize the services of independent municipal advisors when deemed appropriate by the CEO or his delegates. The District shall utilize the services of bond counsel on all debt financings. The CEO or his delegates shall have the authority to periodically select service providers necessary to meet legal requirements and minimize the District's debt cost. Such services, depending on the type of financing, may include municipal advisory, underwriting, trustee, verification agent, escrow agent, arbitrage consulting, printer and special tax consulting. The goal in selecting service providers, whether through a competitive process or sole-source selection, is to achieve an appropriate balance between service and cost. Procurement for service providers shall follow Executive Limitations Policy EL-5 Procurement, as amended from time to time. Per EL-5 Procurement (Rev July 29, 2015) the CEO is authorized to execute contracts for consultant services up to \$225,000; contracts exceeding this limit would require Board approval. The District Counsel has sole discretion in entering legal services contracts with no dollar limit.

v. **Method of Sale**

Except to the extent a competitive process is required by law, the CEO or his delegates shall be responsible for determining the appropriate way to offer any securities to investors. The District has used both competitive bidding and negotiated sales to sell its bonds. Also, available to the District is a private placement method. On a case by case basis the CEO or his delegates will decide as to the most effective method of sale.

For negotiated sale, any underwriters that are currently suspended by the California State Treasurer's Office from its negotiated underwriting pool may not participate in the District's negotiated sale, pending Board approval.

vi. **Maturity**

The District shall issue debt with an average life less than or equal to the average life of the assets being financed. The final maturity of the debt should be no longer than 40 years. Factors to be considered when determining the final maturity of debt include: the average life of the assets being financed, relative level of interest rates and the year-to-year differential in interest rates.

vii. **Maturity Structure**

The District's long-term debt may include serial and term bonds. Serial bonds have various maturity dates scheduled at regular intervals until the entire issue is retired. Term bonds have a long-term maturity date and are outstanding until the debt is retired. Other maturity structures may also be considered which can be demonstrated to be consistent with the objectives of the District's Debt Policy.



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viii. Credit Enhancement

The District shall procure credit enhancement for a sale of bonds if the Financial Services Division, in consultation with the Municipal Advisor and the Underwriters, determines that it is cost effective to do so. Credit enhancement consists primarily of insuring the bonds over the life of their term.

ix. Senior/Subordinate/Super-subordinate Lien

The District may utilize a senior/subordinate/super-subordinate lien structure. The choice of lien will be determined based on such factors as overall cost of debt, impact on debt service, impact on water rates, marketing consideration and previous issuance bond documents. Senior debt has priority over subordinate debt which in turn has priority over super-subordinate debt. Subordinated or super-subordinate debt is repayable only after other debts with a higher claim have been satisfied (i.e. senior debt, subordinate debt).

x. Redemption Features

To preserve flexibility and refinancing opportunities, the District debt will generally be issued with call provisions which enable the District to retire the debt earlier or enable the refunding of the debt prior to maturity. The District may consider calls that are shorter than traditionally offered in the market and/or non-call debt when warranted by market conditions and opportunities. For each transaction, the District will evaluate the efficiency of call provisions alternatives.

xi. Coupon Structure

Debt may include par, discount, premium and capital appreciation bonds. Discount, premium, and capital appreciation bonds must be demonstrated to be advantageous relative to par bond structures. Debt issued at par means it is sold at its face value. Debt issued at discount means that the selling price is less than face value, or at a discount. Debt issued at a premium means it is sold at an amount higher than the face value. Capital appreciation bonds increase in value over the life of the bond.

C. Communication and Disclosure

1. Rating Agencies

The District shall maintain its strong ratings through prudent fiscal management and consistent communications with the rating analysts. The Financial Services Division shall manage relationships with the rating analysts assigned to the District's credit, using both informal and formal methods to disseminate information. Communication with the rating agencies shall include:

- Full disclosure, on an annual basis, of the financial condition of the District;



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- A formal presentation when requested by the rating agencies, covering economic, financial, operational and other issues that impact the District’s credit;
- Timely disclosure of major financial events that impact the District’s credit;
- Timely dissemination of the Comprehensive Annual Financial Report, following its acceptance by the District’s Board of Directors;
- Full and timely distribution of any documents pertaining to the sale of bonds; and
- Periodic tours of the Water Utility Enterprise and Watershed operations as appropriate.

2. **Bond Insurers**

The Financial Services Division shall manage relationships with the analyst at the bond insurers assigned to the District’s credit.

3. **Disclosure Procedures**

The District shall comply with Securities and Exchange Commission (“SEC”) and Municipal Securities Rulemaking Board (“MSRB”) regulations on disclosure, including SEC Rule 15c2-12 (the “Rule”), which require municipal debt issuers to provide specified financial and operating information at the time of new bond issuance (Official Statement) and during the life of the bonds (Continuing Disclosure Annual Report). **Refer to Attachment A-Disclosure Procedures for details.**

Effective February 27, 2019, District Counsel will provide written notice to debt management staff of receipt by the District or the Financing Corporation of any default, event of acceleration, termination event, modification of terms (only if- material or may reflect financial difficulties), or other similar events (collectively, a “Potentially Reportable Event”) under any agreement or obligation to which the District or the Financing Corporation is a party and which may be a “financial obligation” as discussed below. Such written notice should be provided by District Counsel to debt management staff as soon as District Counsel is placed on written notice by District staff, consultants, or external parties of such event or receives written notice of such event so that debt management staff can determine, with the assistance of bond counsel, whether notice of such Potentially Reportable Event is required to be filed on EMMA pursuant to the disclosure requirements of SEC Rule 15c2-12. If filing on EMMA is required, the filing is due within 10 business days of such Potentially Reportable Event to comply with the Continuing Disclosure Agreement for the various debt obligations of the District;

District Counsel or other senior staff (ie. Chief Executive Officer, Chief Operating Officer, Chief Financial Officer or other executive positions within the District), as applicable, will report to debt management staff the execution by the District or the Financing Corporation of any agreement or other obligation which might constitute a



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“financial obligation” for purposes of Rule 15c2-12 and which is entered into after February 27, 2019. Amendments to existing District or Financing Corporation agreements or obligations with “financial obligation” which relate to covenants, events of default, remedies, priority rights, or other similar terms should be reported to the debt management staff as well as soon as District Counsel or such other senior staff is placed on written notice by District staff, consultants, or external parties of such event or receives written a notice of such amendment requests. Notice to debt management staff is necessary so that debt management staff can determine, with the assistance of bond counsel, whether such agreement or other obligation constitutes a material “financial obligation” for purposes of Rule 15c2-12. If such agreement or other obligation is determined to be a material “financial obligation” or a material amendment to a “financial obligation” described above, notice thereof would be required to be filed on EMMA within 10 business days of execution or incurrence. The types of agreements or other obligations which could constitute “financial obligations” and which could need to be reported on EMMA are discussed in the memorandum from bond counsel attached hereto in **Attachment A-Disclosure Procedures** for details.

4. *Trustee*

The Financial Services Division shall procure the services of a Trustee for the creation and maintenance of District debt funds. Such accounts include, but are not limited to:

- Escrow;
- Rebate;
- Debt Service;
- Cost of Issuance; and
- Reserve.

D. Debt Administration

1. *Investment of Bond Proceeds*

Investment of bond proceeds shall be consistent with federal tax requirements and with requirements contained in the governing bond documents. Additionally, they will be governed by policies and procedures specified in the District’s Investment Policy as approved by the Board of Directors.

2. *Record Retention and Disbursement of Bond Proceeds*

The IRS guideline for record retention is life of bonds plus 3 years. For refundings, the refunded bonds retention schedule is reset to match the refunding bonds retention schedule of life of refunding bonds plus 3 years. The District’s record



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retention policy is cancellation, redemption or maturity of the bonds plus 10 years (records series number RS-0538).

Frequency of Reimbursement/Claims preparation

The preparation of reimbursement claims must be coordinated with the Financial Planning unit to determine the allocation of taxable versus tax-exempt bond proceeds and the appropriate level of funding from bond proceeds versus District operating reserves. The review of reimbursement requirements may be performed on a quarterly basis to assess the appropriate amount and timing of reimbursement claims.

Reimbursement Period

In general, the allocation of tax-exempt bond proceeds to reimburse a capital expenditure paid prior to the issue date of the bonds (provided that the Board has adopted a Resolution of Intention to Issue Tax-Exempt Bonds prior to the issue date of the bonds) must be made **not later** than: (a) 18 months after the later of the date (i) the original expenditure is paid or (ii) the project is placed in service or abandoned; **and** (b) 3 years after the original expenditure is paid.

Special rule for long-term construction projects

For a construction project for which both the issuer and a licensed architect or engineer certify that at least 5 years is necessary to complete construction of the project, the maximum reimbursement period is changed from “3 years” to “5 years”.

Special rule for preliminary expenditures

Preliminary expenditures (e.g., architectural costs, engineering costs, surveying costs, soil testing costs, costs of issuance and similar costs) not exceeding 20% of the issue price of the bonds issued to finance the project may be reimbursed without regard to the official intent requirement and the timing requirements. Preliminary expenditures do not include land acquisition, site preparation, and similar costs related to commencement of construction.

Refer to Attachment B– Record Retention and Disbursement Guidelines for details.

3. Arbitrage Compliance

The Financial Service Division shall engage a qualified firm to perform Arbitrage Rebate Calculations (“Rebate Service Provider”) for all District bond issuances and prepare reports and filing documents as necessary. Ninety percent (90%) of the Cumulative Rebate Liability (reduced by any applicable computation date credits) is required to be rebated (paid) to the United States Internal Revenue Service (IRS) no later than 60 days after the end of each fifth Bond/COP Year. Additionally, 100% of the Cumulative Rebate Liability (reduced by any applicable computation date credits)



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required to be paid to the IRS within 60 days of the full defeasance or final maturity of the Bonds/COPs (i.e., in the event of a refunding or refinancing).

4. Debt Service

The District shall fully budget all debt service obligations of the District. Utilizing the services of the Trustee, the District will make all debt service payments per the bond document schedule and shall not in any circumstance make the payment late. The interest and principal for commercial paper may be rolled into a new issue of commercial paper as part of the overall District financing plan. The commercial paper may also be budgeted to be fully paid off over a specified timeframe or it may be paid off with a bond issuance.

E. Master Swap Policy

The District currently has no swap transactions outstanding and has not entered any swap transactions in the last ten fiscal years. Any future swap transaction would require Board approval by resolution, and shall utilize the framework set forth in Attachment C – Swap Policy.

II. PURPOSE

The purpose of this Debt Management Policy is to assist the District in meeting the following objectives:

- Minimize debt service and issuance costs;
- Maintain access to cost-effective borrowing;
- Achieve the highest practical credit ratings;
- Make full and timely repayment of debt;
- Maintain full and complete financial disclosure and reporting;
- Comply with the District Act; and
- Ensure compliance with applicable State and Federal Laws.



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III. SCOPE, ASSUMPTIONS & EXCEPTIONS

The Debt Management Policy governs debt issuance and administration activities of the District as defined in this policy.

IV. ROLES & RESPONSIBILITIES

The Financial Services Division shall be responsible for managing and coordinating all activities related to the issuance and administration of debt. The Financial Services Division will work in partnership with the Capital Services Division and Watershed and Water Utility Enterprise Divisions to facilitate debt issuance and the management of outstanding debt.

The Investment Advisory Committee (consisting of Chief Operating Officer - Administration, Chief Financial Officer, Treasury/Debt Officer, District Counsel and Accounting Unit Manager) will meet quarterly or as needed to review and approve all staff policy guidelines.

The Board of Directors shall approve and authorize the issuance of debt, including refunding debt.

V. REQUIREMENTS

In the issuance and management of debt, the District shall comply with all legal constraints and conditions imposed by federal, state or local law, including the District Act and any contractual covenants associated with the debt.

The issuance and management of debt is governed by Board Governance Policy No. EL-4.7 as adopted and amended by the Board of Directors of the Santa Clara Valley Water District.

The Investment Policy is included as an attachment to the Resolution Delegating Authority to Deposit and Invest Funds which is adopted by the Board of Directors annually.

VI. ASSOCIATED FORMS & PROCEDURES

| DOCUMENT TITLE/ID # | DOCUMENT LOCATION(S) |
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| None | |
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VII. DEFINITIONS

None

VIII. CHANGE HISTORY

| DATE | REVISION | COMMENTS |
|------------|----------|--|
| 3/29/2012 | A | Supersedes 2008-03 with minor editorial corrections and includes the Addendum to District Debt Policy for the Master Swap Policy. |
| 9/13/2012 | B | Updated linkage to Board Governance |
| 03/01/2016 | C | Update the Debt Policy and add additional information in Attachments A and B |
| 01/01/2017 | D | Update the Debt Policy and add reference to California Government Code 8855 (i) and other modifications |
| 03/24/2017 | E | Update the Debt Policy with additional Post Issuance Tax Compliance requirements |
| 01/22/2019 | F | Update the Debt Policy to comply with additional disclosure requirements pursuant to SEC Rule 15c2-12 effective February 27, 2019. |

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Attachment A – Disclosure Procedures

PURPOSE

The purpose of these Disclosure Procedures (the “Procedures”) is to memorialize and communicate procedures in connection with obligations, including notes, bonds and certificates of participation, issued by or on behalf of the Santa Clara Valley Water District (the “District”) so as to ensure that the District continues to comply with all applicable disclosure obligations and requirements under the federal securities laws.

BACKGROUND

The District from time to time issues certificates of participation, revenue bonds, notes or other obligations (collectively, “Obligations”) to fund or refund capital investments, other long-term programs and working capital needs. These Obligations may be issued directly by the District, on behalf of the District by the Santa Clara Valley Water District Public Facilities Financing Corporation or through joint powers agencies (collectively, the “Issuer”). In offering Obligations to the public, and at other times when making certain reports, the District and/or the Issuer (if other than the District) must comply with the “anti-fraud rules” of federal securities laws. (“Anti-fraud rules” refers to Section 17 of the Securities Act of 1933 and Section 10(b) of the Securities and Exchange Act of 1934, and regulations adopted by the Securities and Exchange Commission under those Acts, particularly “Rule 10b-5” under the 1934 Act.)

The core requirement of these rules is that potential investors in Obligations must be provided with all “material” information relating to the offered Obligations. The information provided to investors must not contain any material misstatements, and the District and/or the Issuer (if other than the District) must not omit material information which would be necessary to provide to investors a complete and transparent description of the Obligations and the District’s financial condition. In the context of the sale of securities, a fact is considered to be “material” if there is a substantial likelihood that a reasonable investor would consider it to be important in determining whether or not to purchase the securities being offered.

When Obligations are issued, the two central disclosure documents which are prepared are typically a preliminary official statement (“POS”) and a final official statement (“OS”, and collectively with the POS, “Official Statement”). The Official Statement generally consists of (i) the forepart (which describes the specific transaction including maturity dates, interest rates, redemption provisions, the specific type of financing, the leased premises (in certificate of participation financings) and other matters particular to the financing, (ii) a section which provides information on the District, including its financial condition as well as certain operating information of the water division, the watershed division or information with respect to other sources of security as applicable (“District Section”), and (iii) various other appendices, including the District’s audited financial report, form of the proposed legal opinion, and form of continuing disclosure undertaking. Investors use the Official Statement as one of their primary resources for making informed investment decisions regarding the Obligations.



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DISCLOSURE PROCESS

When the District determines to issue Obligations, the District’s Treasury/Debt Officer will coordinate a Disclosure training and request the involved departments to commence preparation of the portions of the Official Statement (including particularly the District Section) for which they are responsible. While the general format and content of the District Section does not normally change substantially from offering to offering, except as necessary to reflect major events, the District’s Treasury/Debt Officer is responsible for reviewing and preparing or updating certain portions of the District Section which are within their particular area of knowledge. Once the Official Statement has been substantially updated, the entire Official Statement is shared with the Chief Executive Officer (CEO) (or Acting CEO/Interim CEO), Chief Financial Officer, Chief Operations Officer (Water Utility or Watershed, depending on the Obligation), and District Counsel for review and input. The officers of the District are requested to inform the financing team of any and all material changes that takes place up to and including the closing date of the transaction. for review and input. Additionally, all participants in the disclosure process are separately responsible for reviewing the entire Official Statement.

Members of the financing team, including the Bond Counsel and the District’s Municipal Advisor with respect to the Obligations, assist staff in determining the materiality of any particular item, and in the development of specific language in the District Section. Members of the financing team also assist the District in the development of a “big picture” overview of the District’s financial condition, included in the District section. This overview highlights particular areas of concern. Bond Counsel has a confidential, attorney-client relationship with officials and staff of the District.

The District’s Treasury/Debt Officer or a member of the financing team at the direction thereof schedules one or more meetings or conference calls of the financing team (which includes District officials, Bond Counsel, the District’s Municipal Advisor, the underwriter of the Obligations, and the underwriter’s counsel), and new drafts of the forepart of the Official Statement and the District Section are circulated and discussed. Such communications may occur via electronic means rather than by meetings or conference calls. During this part of the process, there is substantial contact among District staff and other members of the financing team to discuss issues which may arise, determine the materiality of particular items and ascertain the prominence in which the items should be disclosed.

For negotiated sales, prior to distributing a POS to potential investors, there is typically a formal conference call which includes senior District staff involved in the preparation of the POS, members of the financing team and the underwriters and the underwriter’s counsel, during which the Official Statement is reviewed in its entirety to obtain final comments and to allow the underwriters to ask questions of the District’s senior officials. This is referred to as a “due diligence” meeting.

A substantially final form of the POS is provided to the District Board of Directors in advance of approval to afford the Board of Directors an opportunity to review the POS, ask questions and make comments. The substantially final form of the POS is approved by the Board(s) of Directors which generally authorizes certain senior staff to make additional corrections, changes and updates to the POS in consultation with District Counsel and Bond Counsel.



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At the time the POS is posted for review by potential investors, senior District officials (and under certain circumstances the Issuer) execute certificates deeming certain portions of the POS complete (except for certain pricing terms) as required by SEC Rule 15c2-12.

Between the posting of the POS for review by potential investors and delivery of the final OS to the underwriter for redelivery to actual investors in the Obligations, any changes and developments will have been incorporated into the POS, including particularly the District Section, if required. If necessary to reflect developments following publication of the POS or OS, as applicable, supplements will be prepared and published.

In connection with the closing of the transaction, one or more senior District officials (and under certain circumstances the Issuer) execute certificates stating that certain portions of the Official Statement, as of the date of each OS and as of the date of closing, do not contain any untrue statement of material fact or omit to state any material fact necessary to make the statements contained in the Official Statement in light of the circumstances under which they were made, not misleading. District Counsel also provides an opinion letter (generally addressed to the underwriters) advising that information contained in the section of the Official Statement relating to the District and its operations (or specified portions thereof) as of its date did not, and as of the date of the closing, does not contain any untrue statement of a material fact or omitted or omits to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading. District Counsel does not opine to the underwriters to other third parties as to any financial, statistical, economic or demographic data or forecasts, charts, tables, graphs, estimates, projections, assumptions or expressions of opinion, and certain other customary matters.

DISTRICT SECTION

The information contained in the District Section is developed by personnel under the direction of the Treasury/Debt Officer. The Treasury/Debt Officer co-ordinates with Water Utility staff in the case of a water system financing or with Watershed staff in the case of a watershed system or Clean, Safe Water financing. The finance team assists as well in certain circumstances, additional officials will be involved, as necessary. The following principles govern the work of the respective staffs that contribute information to the District Section:

- District staff involved in the disclosure process is responsible for being familiar with its responsibilities under federal securities laws as described above.
- District staff involved in the disclosure process should err on the side of raising issues when preparing or reviewing information for disclosure. Officials and staff are encouraged to consult District Counsel, Bond Counsel or members of the financing team if there are questions regarding whether an issue is material or not.
- Care should be taken not to shortcut or eliminate any steps outlined in the Procedures on an ad hoc basis. However, the Procedures are not necessarily intended to be a rigid list of procedural requirements, but instead to provide guidelines for disclosure review. If warranted,



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based on experience during financings or because of additional SEC pronouncements or other reasons, the District should consider revisions to the Procedures.

- The process of updating the District Section from transaction to transaction should not be viewed as being limited to updating tables and numerical information. While it is not anticipated that there will be major changes in the form and content of the District Section at the time of each update, everyone involved in the process should consider the need for revisions in the form, content and tone of the sections for which they are responsible at the time of each update.
- The District must make sure that the staff involved in the disclosure process is of sufficient seniority such that it is reasonable to believe that, collectively, they are in possession of material information relating to the District, its operations and its finances.

TRAINING

Periodic training for the staff involved in the preparation of the Official Statement (including the District Section) is coordinated by the finance team and the Treasury/Debt Officer. These training sessions are provided to assist staff members involved in identifying relevant disclosure information to be included in the District Section. The training sessions also provide an overview of federal laws relating to disclosure, situations in which disclosure rules apply, the purpose of the Official Statement and the District Section, a description of previous SEC enforcement actions and a discussion of recent developments in the area of municipal disclosure. Attendees at the training sessions are provided the opportunity to ask questions of finance team members, including Bond Counsel concerning disclosure obligations and are encouraged to contact members of the finance team at any time if they have questions.

ANNUAL CONTINUING DISCLOSURE REQUIREMENTS

In connection with the issuance of Obligations, the District has entered into several contractual undertakings (“Continuing Disclosure Undertakings”) to provide annual reports related to its financial condition (including its audited financial statements) as well as notice of certain events relating to the Obligations specified in the Continuing Disclosure Undertakings. The District must comply with the specific requirements of each Continuing Disclosure Undertaking. The District’s Continuing Disclosure Undertakings generally require that the annual reports be filed by April 1 following the end of the District’s fiscal year, and event notices are required to be filed within 10 business days of their occurrence. Filing is centralized on the MSRB’s Electronic Municipal Market Access (“EMMA”) web site and portal.

Specific events which require “material event” notices are set forth in each particular Continuing Disclosure Undertaking.

The Treasury/Debt Officer shall be responsible for preparing and filing the annual reports and material event notices required pursuant to the Continuing Disclosure Undertakings. Particular care shall be paid to the timely filing of any changes in credit ratings on Obligations (including changes resulting from changes in the credit ratings of insurers of particular Obligations).



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Memorandum from Stradling Yocca Carlson & Rauth on Financial Obligations (dated 1/18/19)

An amendment to Securities and Exchange Commission (the “SEC”) Rule 15c2-12 (the “Rule”) becomes effective as to underwriters of publicly offered municipal securities on February 27, 2019 (the “Effective Date”). As a result, we would expect that with respect to any debt offered publicly by the District or the Financing Corporation after the Effective Date to which the Rule applies, the District will be required to enter into a continuing disclosure undertaking pursuant to which it will agree to provide notice on the EMMA electronic reporting system (“EMMA”) of the incurrence of any “financial obligation” if material and will be obligated to disclose default on and certain other information with respect to any “financial obligation” regardless of when the financial obligation was incurred.

The Rule provides a general definition of a “financial obligation.” While the impetus for the proposed changes to the Rule was a perception by the SEC and others that municipal issuers were increasingly entering into bank or other private placement debt, the final amendment to the Rule defines “financial obligation” more broadly to include “a debt obligation, derivative instrument ... or a guarantee of either a debt obligation or a derivative instrument.”

To date the SEC has provided limited guidance on the specific application of the definition of “financial obligation”. The SEC release accompanying the final amendment does suggest a key concept is that a “financial obligation” involves the borrowing of money. In public comments representatives of the SEC have declined to provide a definition of a “guarantee” but did indicate that the SEC will not look to state law definitions of a “guarantee” or “debt”.

The District will need to monitor agreements or other obligations entered into by the District or the Financing Corporation after the Effective Date, and any modifications to such agreements or other obligations, carefully to determine whether they constitute “financial obligations” under the Rule and, if material, would need to be disclosed on EMMA within 10 business days of execution or incurrence.

In addition, if the District or the Financing Corporation receives a notice of default or an event of default or of an acceleration, termination event, modifications of or other similar event on any agreement or other obligation after the Effective Date, the District will need to determine whether such obligation constitutes a financial obligation (regardless of when originally incurred) and whether such default or other event reflects financial difficulty (i.e., reduction in overall liquidity, creditworthiness or debt owner’s rights).

Types of agreement or other obligations which are likely to be “financial obligations” under the Rule include:

- 1 Bank loans or other obligations which are privately placed;
- 2 State or federal loans
- 3 Commercial paper or other short-term indebtedness for which no offering document has been filed on EMMA.



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- 4 Letters of credit, surety policies or other credit enhancement with respect to the District's publicly offered debt;
- 5 Letters of credit, including letters of credit which are provided to third parties to secure the District or Financing Corporation's obligation to pay or perform (an example of this is a standby letter of credit delivered to secure the District's obligations for performance under a mitigation agreement);
- 6 Capital leases for property, facilities, fleet or equipment; and
- 7 Agreements which guarantee the payment or performance obligations of a third party (regardless of whether the agreements constitute guarantees under California law);

Types of agreements which could be a "financial obligation" under the Rule include:

- 1 Payment agreements which obligate the District or the Financing Corporation to pay a share of another public agency's debt service (for example, an agreement with a joint powers agency whereby the District or the Financing Corporation agrees to pay a share of the joint powers agency's bonds, notes or other obligations);
- 2 Service contracts with a public agency or a private party pursuant to which the District or Financing Corporation is obligated to pay a share of such public agency or private party's debt service obligation (for example, certain types of P3 arrangements);
- 3 Water purchase, water banking or other similar agreements pursuant to which the District or the Financing Corporation is obligated to pay amounts expressly tied to the other party's debt service obligations, regardless of whether service is provided or not (for example, the District's SWP contract); and
- 4 Water purchase, water banking or similar agreements which include a rate component that expressly passes through debt service or capital obligation of the other party (for example, the District's CVP water service contact).

Types of agreements which may be a "financial obligation" subject to the Rule include:

- 1 Any agreement the payments under which are not characterized as an operation and maintenance expenses for accounting purposes if such agreement could be characterized as the borrowing of money;

The above list is based on bond counsel advice as of January 18, 2019. Debt management staff will continue to work with District Counsel and bond counsel to refine the definition of financial obligation going forward based on future SEC guidance, if any.



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Attachment B – Post-Issuance Tax Compliance, Record Retention and Disbursement Guidelines

I. General

The District’s Treasury/Debt Officer (the “Tax Compliance Officer”) shall be responsible for overseeing compliance with the provisions of this Policy.

External Advisors / Documentation

The District shall consult with bond counsel and/or other legal counsel and advisors, as needed, following issuance of bonds or other tax-exempt obligations to ensure that all applicable post-issuance requirements generally set forth in the Tax Certificate for the bonds (the “Tax Certificate”) are met. This shall include, without limitation, consultation in connection with any potential changes in the use of Bond-financed or refinanced Projects (as defined herein).

Unless otherwise provided by the indenture (or similar document) relating to the bonds, unexpended bond proceeds shall be held by a trustee or other financial institution, and the investment of bond proceeds shall be managed by the District. The District shall prepare (or cause the trustee or other financial institution to prepare) regular, periodic statements regarding the investments and transactions involving Bond proceeds.

Arbitrage Rebate and Yield Restrictions

The Tax Compliance Officer shall be responsible for overseeing compliance with arbitrage rebate and yield restriction requirements under federal tax law. Unless otherwise indicated, in writing, in the Tax Certificate or other similar documents that are prepared in connection with the issuance of the Bonds, the District shall:

- Engage the services of a Rebate Service Provider and, prior to each rebate calculation date, cause the trustee or other financial institution investing Bond proceeds to deliver periodic statements concerning the investment of Bond proceeds to the Rebate Service Provider;
- Provide to the Rebate Service Provider additional documents and information reasonably requested by the Rebate Service Provider;
- Monitor the efforts of the Rebate Service Provider;
- Assure the payment of required arbitrage rebate amounts, if any, no later than the applicable deadline under federal tax law;
- Retain copies of all arbitrage reports and trustee statements as described below under “Record Keeping Requirements;” and



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- Establish procedures to ensure that investments that are acquired with Bond proceeds are so acquired at their fair market value pursuant to federal tax law.

Use of Bond Proceeds and Bond-Financed or Refinanced Projects

The Tax Compliance Officer shall be responsible for:

- communicating to appropriate District staff with respect to the use of Bond proceeds (including investment earnings and including reimbursement of expenditures made before Bond issuance) and the use of Bond-financed or refinanced projects, such as facilities, furnishings or equipment (each a "Project" and collectively, "Projects") throughout the term of the Bonds to ensure compliance with covenants and restrictions set forth in the Tax Certificate relating to the Bonds;
- consulting with bond counsel and other legal counsel and advisers in the review of any change in use, or potential change in use, of Bond-financed or refinanced Projects communicated to the Tax Compliance Officer by appropriate District staff to ensure compliance with all covenants and restrictions set forth in the Tax Certificate relating to the Bonds; and
- to the extent that the District discovers that any applicable tax restrictions regarding use of Bond proceeds and Bond-financed or refinanced Projects will or may be violated, consulting promptly with bond counsel and other legal counsel and advisers to determine a course of action to remediate all nonqualified Bonds or take other remedial action, if such counsel advises that a remedial action is necessary.

Education and Training

The Tax Compliance Officer and appropriate staff of the District shall periodically and as necessary obtain education and training on federal tax requirements for post-issuance compliance applicable to the Bonds. The District will enable and encourage relevant personnel to attend and participate in educational and training programs offered by professional organizations and other entities with regard to monitoring compliance with federal tax requirements for the Bonds.

Correcting Non-Compliance

If any non-compliance of applicable federal tax requirements is identified or otherwise brought to the District's attention, the Tax Compliance Officer shall, in consultation with legal counsel and the appropriate tax compliance personnel of the District cause the District and any other parties involved with the issuance of the Bonds or the use of the proceeds of the Bonds, as required, to take all steps necessary or advisable in order to timely correct or remediate such non-compliance. The Tax Compliance Officer will conduct periodic reviews of compliance with these procedures to determine whether any violations have occurred so that such violations can be remedied through the "remedial action" regulations (Treas. Reg. Section 1.141-12) or the



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Treasury's Tax-Exempt Bonds Voluntary Closing Agreement Program ("TEB VCAP") described in IRS Notice 2008-31 (or successor guidance). If any changes to the terms or provisions of a bond issue are contemplated, the Tax Compliance Officer will consult bond counsel. The District recognizes and acknowledges that such modifications could result in a "reissuance" for federal tax purposes (i.e., a deemed refunding) of the bonds and thereby jeopardize the tax-exempt status of interest on the Bonds after the modifications.

II. Record Retention*

1. Record retention schedule: The IRS guideline is life of bonds plus 3 years. For refundings, the refunded bonds retention schedule is reset to match the refunding bonds retention schedule of life of refunding bonds plus 3 years.[†] The District's record retention policy is cancellation, redemption or maturity of the bonds plus 10 years (records series number RS-0538).
2. The **District Treasury/Debt Officer** shall be responsible for retaining all documentation relating to the issuance and administration of bonds. Such records shall include, but not limited to the following:
 - a. Federal tax or information returns (e.g. Form 8038 series returns)
 - b. Annual Continuing Disclosure and Compliance Filings per the bond covenants which may contain Audited Financial Statements and other documents as specified
 - c. Bond transcripts, official statements and other offering documents
 - d. Trustee statements for your bond financings
 - e. Correspondence (letters, e-mails, faxes, etc.) for your bond financings
 - f. Reports of any prior IRS examinations of your entity or bond financings
 - g. Maintain records documenting the allocation of bond-financing proceeds to expenditures (e.g., allocation of bond proceeds to expenditures for the construction, renovation, or purchase of facilities you own and use in the performance of your public purpose)
 - h. Maintain records documenting the allocations of bond-financing proceeds to bond issuance costs
 - i. Maintain an asset list or schedule of all bond-financed facilities or equipment
 - j. Maintain depreciation schedules for bond-financed depreciable property?
 - k. Maintain records that track your purchases and sales of bond-financed assets?
 - l. Maintain records of trade or business activities by or with non-governmental entities or persons with respect to your bond-financed facilities?

* Source: IRS Form 14002 Governmental Bond Financings Compliance Check Questionnaire.
<http://www.irs.gov/pub/irs-tege/f14002.pdf>

[†] Tax Exempt Bond FAQs regarding Record Retention Requirements

<http://www.irs.gov/taxexemptbond/article/0,,id=134435,00.html#6>



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- m. Maintain copies of the following agreements when entered into with respect to your bond-financed property:
 - i. Management and other service agreements
 - ii. Research contracts
 - iii. Naming rights contracts
 - iv. Ownership documentation (e.g., deeds, mortgages)
 - v. Leases
 - vi. Subleases
 - vii. Leasehold improvement contracts
 - viii. Joint venture arrangements
 - ix. Limited liability corporation arrangements
 - x. Partnership arrangements
 - n. The allocations and earnings and investments related to bond financings
 - o. Maintain records for investments of bond financing proceeds related to:
 - i. Investment contracts (e.g., guaranteed investment contracts)
 - ii. Credit enhancement transactions (e.g., bond insurance contracts)
 - iii. Financial derivatives (swaps, caps, etc.)
 - iv. Bidding of financial products
 - p. Maintain records of the following arbitrage documents related to bond financings:
 - i. Computations of bond yield
 - ii. Computation of rebate and yield reduction payments
 - iii. Form 8038-T, *Arbitrage Rebate, Yield Reduction and Penalty in Lieu of Arbitrage Rebate*
 - iv. Form 8038-R, *Request for Recovery of Overpayments Under Arbitrage Rebate Provisions*
 - v. Draw down schedules and expenditure requirements detailed in applicable tax certificates and schedules regarding yield restriction if applicable
3. The **Claims and Grants Reimbursement unit** shall be responsible retaining all documentation relating to the disbursement of bond proceeds. Such records shall include, but not limited to the following:
- a. Maintain copies of requisitions, draw schedules, draw requests, invoices, bills and cancelled checks related to bond proceeds spent during the construction period
 - b. Maintain copies of all contracts entered into for the construction, renovation or purchase of bond-financed facilities
 - c. Maintain records of expenditure reimbursements incurred prior to issuing bonds for facilities financed with bond proceeds

III. Bond Reimbursement

1. General Rule for Reimbursement. Tax-exempt bond proceeds may be allocated to reimburse prior expenditures so long as those expenditures were the subject of an appropriate "declaration of official intent" (e.g., a reimbursement resolution), the



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expenditures were paid no more than 60 days prior to the date of adoption such declaration of official intent, the bond-financed project was placed in service within 18 months of the date of reimbursement allocation, the expenditures constitute capital expenditures, and none of the expenditures were paid more than three years prior to the reimbursement allocation (except preliminary expenditures).

2. Frequency of Reimbursement/Claims preparation. The preparation of reimbursement claims must be coordinated with the Financial Planning unit to determine the allocation of taxable versus tax-exempt bond proceeds and the appropriate level of funding from bond proceeds versus District operating reserves. The review of reimbursement requirements should be performed on a quarterly basis to assess the appropriate amount and timing of reimbursement claims.
3. Reimbursement period. In general, the allocation of tax-exempt bond proceeds to reimburse a capital expenditure paid prior to the issue date of the bonds must be made not later than: (a) 18 months after the later of the date (i) the original expenditure is paid or (ii) the project is placed in service or abandoned, and (b) 3 years after the original expenditure is paid.
4. Special rule for long-term construction projects. For a construction project for which both the issuer and a licensed architect or engineer certify that at least 5 years is necessary to complete construction of the project, the maximum reimbursement period is changed from “3 years” to “5 years.”.
5. Special rule for preliminary expenditures. Preliminary expenditures (e.g., architectural costs, engineering costs, surveying costs, soil testing costs, costs of issuance and similar costs) not exceeding 20% of the issue price of the bonds may be reimbursed without regard to the official intent requirement and the timing requirements. Preliminary expenditures do not include land acquisition, site preparation, and similar costs related to commencement of construction.
6. Eligible project costs – In general, under the Internal Revenue Service’s regulations, only “capitalizable” expenditures are eligible for reimbursement from the proceeds of tax-exempt bonds.

Table 1 below illustrates some general categorizations of eligible versus ineligible project costs.

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| TABLE 1 General Guidelines for Eligible and Non-Eligible Expenditures of Tax-Exempt Bonds | | |
|--|---|-----------------------------------|
| Type of Expense | General Guideline | Tax-Exempt Bonds Eligible? |
| Construction and Design Costs - General | The cost of constructing property must be capitalized. This includes certain ancillary costs which are directly related to the construction of the property, such as: amounts expended for architectural services, design costs, accounting fees related to the construction, direct and indirect compensation costs of employees whose services are used in the construction, construction supervision fees, and overhead directly attributable to the construction. | Yes |
| Compensation - General | As a general rule, compensation to employees (including fringe benefits) is an operating expense rather than a capital cost. Unless the employee's duties are clearly associated with a capital project, compensation may not be capitalized . | No |
| Compensation to outside contractors, architects, engineers, etc. | Such costs paid to third parties are treated as a cost of the capital asset and are capitalized. | Yes |
| Compensation to Employees exclusively involved with capital projects | Compensation (including the cost of fringe benefits) paid to employees (e.g., engineers, architects, project managers, etc.) who are directly involved in the construction and design of the project are treated as a cost of the capital asset and are capitalized. | Yes |

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|--|---|-----------------------------------|
| Type of Expense | General Guideline | Tax-Exempt Bonds Eligible? |
| Compensation of management employees who spend a portion of their time providing support services for capital projects | Certain employees (administrative staff, supervisors, attorneys, accountants, finance specialists, etc.) spend time on multiple assignments, including capital projects. Such employees are generally required to keep track of the time spent with respect to each assignment regardless of whether the project is financed by bonds or other funding sources. To the extent that such employees have clear documentation of the time spent on each assignment, compensation (including the cost of fringe benefits) paid to such employees which is attributable to work performed with respect to capital projects may be capitalized. | Yes |
| Indirect Overhead and Benefits (OMB A-87) | Indirect costs that are allocated as overhead (including cost of fringe benefits) is not eligible . | No |
| Rent - General | As a general rule, rent for office space is an operating expense rather than a capital cost. Unless the office space is specifically obtained to house only employees whose duties are clearly associated with a specific capital project, rent should not be capitalized . Any allocation of office space rent to capital costs and operating costs would, especially if such allocation has never been required for other business purposes, also be risky. Even if the space is specifically and exclusively associated with a capital project, if the rental is for a very short period of time, (e.g., the rental of a room for a single meeting), such rent should not be capitalized. | No |

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| TABLE 1 General Guidelines for Eligible and Non-Eligible Expenditures of Tax-Exempt Bonds | | |
|--|--|-----------------------------------|
| Type of Expense | General Guideline | Tax-Exempt Bonds Eligible? |
| Longer-term Rent – space leased for a specific capital project | The rental cost of office space leased specifically for a particular capital project, and which will be rented for a substantial period of time (e.g., for the duration of the construction of the project) may be capitalized. | Yes |
| Purchased Office Equipment | The cost of office equipment with a <u>useful life of more than one year</u> (e.g., computers, copiers, etc.) is capitalizable from a federal tax perspective. To the extent such equipment is related to a specific tax-exempt eligible capital project , these costs may be eligible for reimbursement from tax-exempt proceeds. | Yes |
| Office Supplies | The cost of office supplies (e.g., stationery, paper, pens and pencils, staples, etc.) is not capitalizable . | No |
| Training, Professional Development, Licensing | Such costs are not capitalizable even though they may have some future benefit. These costs must be capitalized only in the unusual circumstance where the training is intended primarily to obtain future benefits significantly beyond those traditionally associated with training provided in the ordinary course of the employer’s trade or business (e.g., the costs of training employees to operate a new facility are akin to start-up costs of a new business). | No |



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| TABLE 1 General Guidelines for Eligible and Non-Eligible Expenditures of Tax-Exempt Bonds | | |
|--|--|-----------------------------------|
| Type of Expense | General Guideline | Tax-Exempt Bonds Eligible? |
| Automobiles | The cost of an automobile with a useful life of more than one year is capitalizable from a federal tax perspective. To the extent such equipment is related to a specific tax—exempt eligible capital project, these costs may be eligible for reimbursement from tax-exempt proceeds. | Yes |
| Meals and Refreshments | Such costs are not capitalizable , even if they are associated directly with a meeting relating to a capital asset. | No |
| Travel Costs | Travel costs (fuel, mileage, meals, lodging...etc) are eligible only for travel directly related to a specific tax-exempt eligible capital project | Yes |
| Repair and Maintenance | As a general rule, repair and maintenance for buildings, equipment and parts replacement is an operating expense and is not eligible for reimbursement from tax-exempt bond proceeds | No |



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Attachment C – Master Swap Policy

Board approval of a Master Swap Resolution would authorize Santa Clara Valley Water District (SCVWD) to enter into swap transactions from time to time to better manage assets and liabilities and take advantage of market conditions to lower overall costs and reduce interest rate risk.

The Master Resolution would authorize the execution of swaps related agreements, provides for security and payment provisions, and sets forth certain other provisions related to swap agreements between SCVWD and qualified swap-counterparties. In the event of a conflict between the terms of the Master Resolution and the terms of the Master Swap Policy, the terms and conditions of the Master Resolution shall control.

1. Purpose

The incurring or carrying of obligations and management of investments SCVWD involves a variety of interest rate payments and other risks that a variety of financial instruments are available to offset, hedge, or reduce. It is the policy of SCVWD to utilize such financial instruments to better manage its assets and liabilities. SCVWD may execute interest rate swaps if the transaction can be expected to result in the following:

- Reduce exposure to changes in interest rates on a particular financial transaction or in the context of the management of interest rate risk derived from SCVWD’s overall asset / liability balance.
- Result in a lower net cost of borrowing with respect to SCVWD’s debt or achieve a higher net rate of return on investments made in connection with, or incidental to the issuance, incurring, or carrying of SCVWD’s obligations or other SCVWD investments.
- Manage variable interest rate exposure consistent with prudent debt practices and guidelines approved by the Board.

SCVWD shall not enter into interest rate swaps for speculative purposes.

2. Form of Swap Agreements

Each interest rate swap executed by SCVWD shall contain terms and conditions as set forth in the International Swap and Derivatives Association, Inc. (“ISDA”) Master Agreement, including any schedules and confirmations that will be included in the District Resolution for the swap. The swap agreements between SCVWD and each qualified swap counterparty shall include payment, term, security, collateral, default, remedy, termination, and other terms, conditions and provisions as the Treasury/Debt Officer, in consultation with the District Counsel, deems necessary or desirable.



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3. Transaction Approval

The approval guidelines for each authorized swap transaction shall be as set forth in the Master Resolution and in this Section 4. The District Board must approve any swap transaction.

4. Qualified Swap Counterparties

SCVWD may enter into interest rate swap transactions only with qualified swap counterparties. Qualified swap counterparties are identified in SCVWD's Board approved investment banking team. The composition of the approved swap counterparties will change from time to time as changes are made to SCVWD's investment banking team. Qualified swap counterparties must be rated at least "A1" or "A+". In addition, the counterparty must have a demonstrated record of successfully executing swap transactions as well as creating and implementing innovative ideas in the swap market. Each counterparty shall have minimum capitalization of at least \$150 million.

SCVWD may negotiate or competitively bid an interest rate swap transaction based on a review of the market impact to SCVWD of such competitive bid.

5. Termination Provisions

All swap transactions shall contain provisions granting SCVWD the right to optionally terminate a swap agreement at any time over the term of the agreement. In general, exercising the right to optionally terminate an agreement produces a benefit to SCVWD, either through receipt of a payment from a termination, or if a termination payment is made by SCVWD, in conjunction with a conversion to a more beneficial (desirable) debt obligation of SCVWD as determined by SCVWD. The Treasury/Debt Officer or the Ad Hoc Committee (comprised of: Chief Operating Officer-Administration, Chief Financial Officer, Treasury/Debt Officer, Accounting Unit Manager, and District Counsel's Office) as appropriate, in consultation with the Bond Counsel, shall determine if it is financially advantageous for SCVWD to terminate a swap agreement.

Mandatory Termination: A termination payment to or from SCVWD may be required in the event of termination of a swap agreement due to a default or a decrease in credit rating of either SCVWD or the counterparty. *It is the intent of SCVWD not to make a termination payment to a counterparty that does not meet its contractual obligations. Prior to making any such termination payment, the Treasury/Debt Officer shall evaluate whether it is financially advantageous for SCVWD to obtain a replacement counterparty to avoid making such termination payment.*

In the event of default by a counterparty whereby SCVWD would be required to make a termination payment, SCVWD will proceed as follows:



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- In order to mitigate the financial impact of making such payment at the time such payment is due; SCVWD will seek to replace the terms of the terminated transaction with a replacement counterparty. The new or replacement counterparty will make an upfront payment to SCVWD in an amount that would offset the payment obligation of SCVWD to the original counterparty.
- If a satisfactory agreement with a replacement counterparty is not reached, SCVWD will be required to make a swap termination payment to the original defaulting counterparty. Funds for such payment shall be made from available monies. The Debt/Treasury Officer shall report any such termination payments to the Board at the next Board meeting.

6. *Term and Notional Amount of Swap Agreement*

SCVWD shall determine the appropriate term for an interest rate swap agreement on a case by case basis. The slope of the swap curve, the marginal change in swap rates from year to year along the swap curve, and the impact that the term of the swap has on the overall exposure of SCVWD shall be considered in determining the appropriate term of any swap agreement. In connection with the issuance or carrying of bonds, the term of a swap agreement between SCVWD and a qualified swap counterparty shall not extend beyond the final maturity date of existing debt of SCVWD, or in the case of a refunding transaction, beyond the final maturity date of the refunding bonds. At no time shall the total notional amount of all swaps exceed the total amount of outstanding water revenue bonds.

7. *Swap Counterparty Exposure Limits*

In order to diversify SCVWD's counterparty risk, and to limit SCVWD's credit exposure to any one counterparty, limits will be established for each counterparty based upon both the credit rating of the counterparty as well as the relative level of risk associated with each existing swap transaction. The risk measure will be calculated based upon the mark-to-market sensitivity of each transaction to an assumed shift in interest rates. Assuming a 25 basis point movement in the swap rate, the maximum net exposure (termination payment) per counterparty shall not exceed \$5 million.

The maximum net exposure limitations establish guidelines with respect to whether SCVWD should enter into an additional swap agreement with an existing counterparty. For example, assume SCVWD executed a 30-year \$100 million notional amount swap. If the yield curve moved 25 basis points, SCVWD would likely have market exposure to that swap counterparty (i.e. in order to terminate the swap SCVWD would have to make a payment of possibly \$3.0 million). If such event occurred, the Treasury/Debt Officer would evaluate whether it is prudent and



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advisable to enter into additional swap transactions with such counterparties in order to mitigate the exposure to such counterparty.

The calculation of net interest rate sensitivity per counterparty will take into consideration multiple transactions, some of which may offset market interest rate risk thereby reducing overall exposure to SCVWD. In addition, additional exposure provisions are as follows:

- The sum total notional amount per swap counterparty may not exceed 25 percent of SCVWD's total revenue bond indebtedness.
- The appropriate collateral amount will be determined on a case by case basis, and approved by the Treasury/Debt Officer in consultation with the District Counsel.

If the sensitivity limit is exceeded by a counterparty, SCVWD shall conduct a review of the exposure sensitivity limit calculation of the counterparty. The Treasury/Debt Officer shall evaluate appropriate strategies in consultation with the Office of the District Counsel to mitigate this exposure.

8. Collateral Requirements

As part of any swap agreement, SCVWD shall require collateralization or other credit enhancement to secure any or all swap payment obligations. As appropriate, the Treasury/Debt Officer, in consultation with the District Counsel may require collateral or other credit enhancement to be posted by each swap counterparty under the following circumstances:

- Each counterparty to SCVWD may be required to post collateral if the credit rating of the counterparty or parent falls below the "A1" or "A+" minimum rating. Additional collateral for further decreases in credit ratings of each counterparty shall be posted by each counterparty in accordance with the provisions contained in the collateral support agreement to each swap agreement with SCVWD.
- Collateral shall consist of cash, U.S. Treasury securities and U.S. Agency securities.
- Collateral shall be deposited with a third party trustee, or as mutually agreed upon between SCVWD and each counterparty.
- A list of acceptable securities that may be posted as collateral and the valuation of such collateral will be determined and mutually agreed upon during negotiation of the swap agreement with each swap counterparty.



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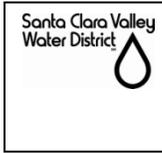
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- The market value of the collateral shall be determined on at least a monthly basis.
- SCVWD will determine reasonable threshold limits for the initial deposit and for increments of collateral posting thereafter.
- The Treasury/Debt Officer shall determine on a case by case basis whether other forms of credit enhancement are more beneficial to SCVWD.

9. Reporting Requirements

A written report providing the status of all interest rate swap agreements will be provided to the Board of Directors at least on a quarterly basis and shall include the following information:

- Highlights of all material changes to swap agreements or new swap agreements entered into by SCVWD since the last report.
- Market value of each of SCVWD's interest rate swap agreements.
- The net impact to SCVWD of a 25 basis point movement (up or down) with the appropriate swap index or curve.
- For each counterparty, SCVWD shall provide the total notional amount position, the average life of each swap agreement, the available capacity to enter into a swap transaction, and the remaining term of each swap agreement.
- The credit rating of each swap counterparty and credit enhancer insuring swap payments, if any.
- Actual collateral posting by swap counterparty, if any, per swap agreement and in total by swap counterparty.
- A summary of each swap agreement, including but not limited to the type of swap, the rates paid by SCVWD and received by SCVWD, and other terms.
- Information concerning any default by a swap counterparty to SCVWD, and the results of the default, including but not limited to the financial impact to SCVWD, if any.



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- A summary of any planned swap transactions and the impact of such swap transactions on SCVWD.
- A summary of any swap agreements that were terminated.