

DETROIT WATER AND SEWERAGE DEPARTMENT
BOARD OF WATER COMMISSIONERS
DEBT MANAGEMENT POLICY

November 28, 2012-305

Purpose: The purpose of the Detroit Water and Sewerage Department's Debt Management Policy is to provide guidance to the Board of Water Commissioners, DWSD Management, DWSD's customer communities, the Rating Agencies, and the Capital Markets about the framework for decision-making inside DWSD regarding decisions to take on debt, refinance debt, and how to interact with the investment community. In adopting this policy, it is the objective of DWSD to accomplish the following goals:

- Minimize borrowing costs;
- Maintain access to cost-effective borrowing;
- Achieve the highest practical credit rating;
- Full and timely repayment of debt;
- Maintain full and complete financial disclosure and reporting;
- Ensure compliance with applicable local, state, and federal law; and
- Employ the use of debt to complement, but not replace, significant recurring commitments of annual appropriations for capital purposes.

Definitions:

SIFMA: The Securities Industry and Financial Markets Association Index. The index is based upon a seven day high grade market comprised of tax exempt variable rate debt notes.

Policy:

In reading this policy, all references to ratios and measures should be read to apply independently to the Water System and the Sewer System.

1. Responsible Party:

The Director and the Board of Water Commissioners, acting by and through the Department's Chief Financial Officer and the Board's Finance Committee, are committed to ensuring that actions within their control are prudent and consistent with the highest standards of public financial management, and supportive of the creditworthiness objectives defined herein.

The Board of Water Commissioners will approve all decisions with respect to taking on new debt, refinancing debt, and reviewing any recommended changes to this policy through its Finance Committee. The Finance Committee will review this debt management policy no less than every two years.

2. Capital Improvement Plan:

In accordance with the By-Laws of the Board of Water Commissioners, DWSD shall annually develop and adopt a five-year Capital Improvement Plan for both the Water System and the Sewer System. The five-year CIP shall require five affirmative votes of the Board of Water Commissioners for adoption. DWSD will aim to fund a portion of routine capital needs with revenue financed capital. In addition, DWSD will use its best efforts to utilize subsidized debt financing (i.e. State Revolving Fund Loans) to the greatest extent feasible.

3. Purposes for which Debt may be issued:

- A. Long-term Borrowing.** Long-term debt should be used to finance essential capital facilities, projects, and certain equipment where it is appropriate to spread the cost of the expenditure over more than one budget year but shall not have an average life longer than the average economic or useful life of the asset being financed. In so doing, DWSD recognizes that future customers who will benefit from the investment will pay a share of its cost. For projects where it is not appropriate to spread costs over future years, long-term debt financing will not be used. Long-term debt will not be used to fund operational costs.
- B. Short-term Borrowing.** May be considered in anticipation of long-term borrowing or any reason consistent with long-term borrowing objectives. Also, Short-term borrowing may be used to satisfy cash-flow needs over the course of the operating cycle.
- C. Refunding.** Absent any significant non-economic factors, it is the policy of DWSD that a refunding should produce minimum overall net debt service savings (net of reserve fund earnings and other offsets) of at least 3% of the par value of the refunded bonds on a net present value basis or one million dollars (\$1,000,000.00). Refundings of less than 3% may be considered if the refundings are of shorter term bonds (five years or less), already past the first optional call date, or if there is a compelling technical, legal, or other public policy objective that is accomplished by retiring the old debt. Refundings of unhedged variable rate debt must be submitted to the Finance Committee by the Director with a description of the economic or operational factors leading to the recommendation for the refunding since there is not a calculable savings threshold.

D. Revenue Financed Capital. Being mindful of the overall debt burden of the system, DWSD will be free to explore opportunities to utilize revenue financed capital as determined to be in the best interest of DWSD by the Director and the Finance Committee and adopted by the Board of Water Commissioners.

4. Affordability:

As part of the debt management process, DWSD will consider generally accepted affordability standards and the resulting impact on customer rates in evaluating the timing and amount of debt that is issued.

5. Structural Features:

A. 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. DWSD 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 taking into account previously issued and outstanding debt, not to exceed 40 years as provided by Michigan Public Act 94 of 1933. DWSD will make all reasonable attempts to avoid issuing debt for the acquisition, development, replacement, maintenance, or expansion of an asset with an expected useful life of less than five (5) years.

B. Variable Rate Debt. No more than 15% of DWSD's debt portfolio will be held as unhedged variable rate debt at any time. For budgeting purposes, the Chief Financial Officer shall submit proposed variable rate assumptions for use in developing the debt service elements of the DWSD budget and the Finance Committee will provide its recommendations on those assumptions before the Board of Water Commissioners votes on the proposed budget. In no event, however, shall DWSD submit a budget assumption for variable rate debt that is less than 1.5 times the five-year average SIFMA index.

C. Derivatives. In order to avoid the additional risk associated with investing in derivatives in a volatile economic environment, DWSD will not utilize derivative instruments or swaps in future bond issues. This policy decision will be subject to bi-annual review of the Board of Water Commissioners, through its Finance Committee, to determine if there are new derivative instruments available in the market place that provide financial benefit to the department without substantially increasing the department's risk portfolio.

6. Use of Professional Assistance on Debt Issuance:

- A. Financial Advisor. DWSD shall utilize an outside professional financial advisor, who is familiar with and abreast of the conditions of the municipal market and is available to assist in structuring the issue, pricing, and monitoring of sales activities. DWSD shall not use a firm to serve as both the financial advisor and underwriter.
- B. Bond Counsel. The Director of DWSD shall select Bond Counsel to represent DWSD in all bond transactions, upon receipt of input and advice from DWSD's General Counsel and/or its Legal Committee.
- C. Underwriter. DWSD may select an underwriter for each bond transaction in accordance with the method of sale selected pursuant to Section 8 of this policy.
- D. Use of Other Professionals. DWSD may utilize the services of other professionals as may be necessary to carry out the debt service activities of the Department including, but not limited to: Disclosure Counsel, Feasibility Consultant, Trustee, Paying Agent, Information Agent, Verification Agent, and Remarketing Agent. Selection of these professionals will be in accordance with DWSD's Procurement Policy unless otherwise expressly provided herein.
- E. Conflict of Interest. All Professional Service providers to DWSD under this policy shall be subject to compliance with the Ethics and Conflict of Interest Policies adopted by the City of Detroit until such time as the Board of Water Commissioners adopts its own Ethics and Conflict of Interest policy. At such time, all professional services providers to DWSD will be subject to the new DWSD policy.

7. **W/MBE and Local Business Participation:** DWSD shall encourage women and minority owned businesses (W/MBEs) as well as Detroit and Customer Based Businesses to submit their credentials to offer professional assistance on debt issuances.

8. **Method of Sale:** Negotiated, competitive, private placement.

There are three potential methods of sale: competitive, negotiated, and private placement. Each type of bond sale has the potential to provide the lowest cost given the right conditions. The conditions under which each type of bond sale is best used are provided below. All or some of the conditions discussed below will affect the method of sale DWSD determines to use.

- A. A Competitive Sale will generally be used under the following conditions:
 - 1. Bond prices are stable and/or demand is strong;
 - 2. The Issuer has a strong credit rating;

3. There are no complex explanations required during marketing, regarding the issuer's projects, media coverage, political structure or support, funding, or credit quality;
4. The bond type and structural features of the debt are conventional and well accepted by the Municipal Market;
5. The transaction size is manageable given market conditions; and/or
6. Market timing and interest rate sensitivity are not critical to the pricing.

B. A Negotiated Sale will generally be used under the following conditions:

1. Bond prices are volatile, market demand is depressed, and/or supply for competing bonds is high;
2. Market timing is important to the transaction, such as for refundings;
3. Coordination of multiple components of the financing is required;
4. Issuer has lower or weakening credit rating;
5. The sale and marketing of the bonds will require complex explanations about the issuer's projects, media coverage, political structure, political support, funding, or credit quality;
6. The bond type and/or structural features are non-standard, such as for a forward bond sale, issuance of variable rate bonds or where there is use or refunding of derivative products;
7. Early structuring and market participation by underwriters is desired;
8. The transaction is unusually large for the issuer;
9. There is an expected high retail demand; and/or
10. The Issuer desires to pre-qualify the underwriter's pool.

C. Private Placement.

A Private Placement is a sale that is structured specifically for one purchaser such as a bank. While DWSD has not previously used this method of sale, DWSD reserves the right to privately place its securities if the need arises, subject to the CFO finding that such a sale method would result in a lower overall cost than would be achieved by selling bonds at a public sale or will allow a financing to proceed when it might not otherwise succeed.

9. **Investment of Bond Proceeds:**

All investments of bond proceeds shall adhere to DWSD's Investment Policy approved periodically by the Board of Water Commissioners.

10. Disclosure Requirements:

- A. Financial Disclosures and continuing disclosures. DWSD is committed to full and complete financial disclosure, and to cooperating fully with rating agencies, institutional and individual investors, other levels of government, our customers, and the general public to share clear, comprehensible, and accurate financial information. We are committed to meeting disclosure and continuing disclosure requirements on a timely and comprehensive basis.
- B. Investor relations. We are committed to strong investor relations. As such, we commit to maintaining electronic access to certain types of financial information which will include at a minimum the following: (1) Summary term sheet for each outstanding issue including CUSIPs and amortization schedules; (2) FAQs; (3) CAFRs; (4) Annual Budgets; (5) Debt Management Policy Statement; and (6) Investment Policy Statement.
- C. Arbitrage compliance. DWSD will identify and have prepared annual arbitrage rebate calculations on all variable rate and other at risk issues to be used in the monitoring of the DWSD's unspent bond proceeds, and to allow timely recording of arbitrage related liabilities and filing in compliance with federal tax laws. We will contract with a reputable firm to perform annual analyses of our investment and expenditure of bond proceeds to ensure compliance with Federal arbitrage regulations.
- D. Rating Agency Communication. DWSD will make every reasonable effort to maintain and improve its bond ratings. To this goal, DWSD should keep a line of communications open with the rating agencies, informing them of major financial events in a timely manner. All communications should be made by the Director or Chief Financial Officer or individuals they specifically designate. In addition to phone calls updating the rating agencies on financial events, in-person meetings should be scheduled at least one a year or more often as conditions warrant.