Debt Management Policy

Overview

The South Central Regional Transit District (SCRTD) or the district, provides public transportation to a four county regional in Southern New Mexico; Sierra, Otero and Dona Ana Counties and connecting service in El Paso County. The district is funded from membership fees of its members, New Mexico Department of Transportation grant funding and the Dona Ana County MOU. New funding is expected from urbanized grants funds provided from the City of El Paso Transit system via New Mexico regional grant funding in southern New Mexico. These funds are primarily capital funds.

The district is financially dependent on grant funding which is delayed from six to eight weeks. As such, cash flow to maintain operations is challenging. However, the use of this Debt policy is to manage capital funding requirements. The district operations have expanded, and its bus fleet is aging and in need of replacement. Attracting more capital funding requires acquisition of equipment, buses, that will require improved cash flow. Consequently, short term debt may require use of debt or a credit line from a bank to meet capital funding requirements.

Purpose

The purpose of the Debt Policy is to establish guidelines for the issuance and management of the Districts debt. The District has the ability to issue debt under its statutory authority. This Debt Policy confirms the commitment of the Board, management, staff, advisors, and other decision makers to adhere to sound financial management practices, including full and timely repayment of all borrowings, and achieving an appropriate level of capital within prudent risk parameters. The following objectives of the Debt Policy include the following:

- Obtain and maintain a high credit rating.
- Provide for an efficient overall cost of borrowing for the district.
- Provide specific guidelines with respect to the overall management of debt it incurred.
- Set forth a process for selecting various consultants who will assist the district in the issuance and management of the district’s debt.
- Support for the District’s strategic plan objectives.

This Debt Policy shall govern the issuance and management of all debt and lease financings (excludes small item leasing such as copiers, etc.…) funded from the capital markets, and shall include all obligations including investment of bond proceeds.

While adherence to this Debt Policy is required in applicable circumstances, the District recognized that changes in capital markets and unforeseen circumstances may produce situations that are not covered by the Debt Policy or require modifications or exceptions to achieve Debt Policy goals. In these cases, specific authorization from the Board is necessary to provide management appropriate flexibility. However, long term debt will be used on an as needed basis to fund the Districts capital investment needs.

The Debt Management Policy requires that each debt be specifically authorized by the District Board.

Debt Financing:

i. Principal maturity for debt will be linked to asset life and will not exceed thirty (30) years.
ii. Variable rate or other short term maturing debt maybe issued for capital purposes in anticipation of receipt of approved Federal and/or State grants, with the goal of repaying a portion or all of the debt issued upon receipt of funds.
iii. Issuance of debt must be linked to:
    1. Adequate encumbrance capacity to let contracts for the entire capital program in the most effective sequence.
    2. Cash flow requirements.
    3. Fund balance to guard against anticipated/unanticipated risks
iv. Membership fees and or County MOU will be used for the payment of annual debt service costs.
v. Debt will not be used for annual operating costs.

Lease Financing:

Lease obligations are a routine and appropriate means of financing capital equipment. These types of obligations maybe considered for equipment and assets that are not financed as a cost item under normal operating expenditures. The useful life of the equipment, the terms and conditions of the lease, and the direct impact on debt capacity and budget flexibility will be evaluated prior to the implementation of a lease program. Efforts will be made to fund capital equipment with a pay-as-you-go financing where feasible. Cash flow sufficiency, capital program requirements, lease program structures and cash and market factors will be considered in conjunction with a pay-as-you-go strategy in lieu of financing. Short-term equipment leases that do not access the capital markets are not covered by this policy.

Debt Service Coverage Ratios:

Debt Service coverage ratios establish a guideline for levels of annual operating costs relative to current and future debt service costs. This performance objective for Net debt service coverage is that the Operating Balance shall be greater than 1.25 times the annual debt service cost; however, the actual terms and conditions specific to each bond issue are controlled by the bond documents.

The net debt service coverage ratio is calculated as follows:

i. Operating income less operating expense equals the operating balance
ii. Operating balance divided by the annual debt service costs equals net debt service coverage ratio

The performance objective for Gross debt service coverage ratio (i.e., annual regional transit gross receipts tax/annual cumulative debt service cost) shall be maintained at a minimum of 3.0 times.

The maintenance of a debt service coverage ratio together with other performance measures provides multiple measures for the financial soundness of the SCRTD.

<u>Refunding Bonds</u>:

A present value analysis must be prepared that identifies the economic effects of any refunding to be proposed to the Board. It is acknowledged that some refunding may be executed for other than economic purposes, such as to restructure debt, change the type of debt instruments being used, or to retire a bond issue and indenture in order to achieve more desirable covenants. Approval by the Board is required for any refunding.

<u>Method of Bond Sale</u>:

The District will generally utilize a competitive sale process when complex bond structuring and marketing requirements are not an issue and the perceived pricing differential between competitive and negotiated sale is negligible. 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 will affect the method of sale.

A. Competitive Sale

1. Bond prices are stable and/or demand is strong.
2. Issuer has a strong credit rating.
3. Issuer is well known to investors.
4. There are no complex explanations required during marketing, regarding: issuer's projects, media coverage, political structure, political support, funding, or credit quality.
5. The bond type and structural features are conventional.
6. Bond insurance is included or pre-qualified (available).
7. Manageable transaction size.
8. Market timing and interest rate sensitivity are not critical to the pricing.

B. Negotiated Sale

1. Bond prices are volatile and/or demand is weak, or supply of competing bonds is high.
2. Market timing is important, such as for refunding.
3. Coordination of multiple components of the financing is required.
4. Issuer has lower or weakening credit rating.
5. Issuer is not well known to investors.
6. 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.
7. 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 of derivative products.
8. Bond insurance is not available or not offered.
9. Early structuring and market participation by underwriters desired.
10. Pre-qualified underwriter's pool.
11. Large transaction size.
12. Expected high retail demand.

C. Private Placement

A Private Placement is a sale that is structured specifically for one purchaser such as a bank. The District reserves the right to privately place its securities if the need arises. Furthermore, any member of the active underwriting pool who presents the District with a cost savings financing plan, will be awarded to manage the financing/restructuring transaction.

Bond Consultants:

The District will select its financial advisors and its bond counsel by competitive process through a Request for Proposals (RFP). The District's contracting policies, which are in effect at the time, will apply to all contracts with finance professionals. Selection may be based on a best value approach for professional services, or the lowest responsive cost effective bid based upon pre-determined criteria.

All financial advisors, bond counsel and underwriters will be selected through a Request for Proposals (RFP) or Request for Qualifications (RFQ) process, whichever is most appropriate given the circumstances. In isolated instances, such contracts may be awarded on a sole source basis if it is clear that an RFP/RFQ process would not be feasible or in the district's interests.

Financial Advisors:

The District may retain one or more financial advisory firms to provide general advice on the District's debt management program, financial condition, budget options, arbitrage rebate review, and rating agency relations. Additionally, a financial advisor may assist with the structuring of the District's Revenue Bond issuances and may be used on an as-needed basis to provide financial advisory services that do not fall into the other categories of District debt obligations.

Financing Teams:

Financial advisors, bond counsel, and underwriters, where applicable, will be selected through a competitive process. Depending on particular expertise and consultant availability, some firms may be used on more than one program. However, efforts will be made to establish different teams to provide a number of firms the opportunity to participate in District contracts.

Bond Counsel:

The District debt will include a written opinion by legal counsel affirming that the District is authorized to issue the proposed debt, that the District has met all constitutional and statutory requirements necessary for issuance, and a determination of the proposed debt's federal and state income tax status. An appropriately experienced bond counsel firm (or firms) will prepare this approving opinion and other documents relating to the issuance of debt with extensive experience in public finance.

Disclosure Counsel:

The District will hire Disclosure Counsel(s) to prepare official statements in the event of any debt restructuring/refinancing or new bond issue. Disclosure Counsel(s) will be responsible for ensuring that the official statement complies with all applicable rules, regulations, and guidelines. Disclosure Counsel(s) will be a well-recognized firm(s) with extensive experience in public finance.

Disclosure by Financing Team Members:

The District expects that all of its financial advisory team will at all times provide the District with objective advice and analysis, maintain the confidentiality of the financial plans if required, and be free from any conflicts of interest. All financing team members will be required to provide full and complete disclosure, under penalty of perjury, relative to any and all agreements with other financing team members and outside parties that could compromise any firm's ability to provide independent advice that is solely in the best interests of the District or that could be perceived as a conflict of interest. The extent of disclosure may vary depending on the nature of the transaction.

Note: The aforementioned financial performance measures are established as policy objectives for the district management to strive to achieve in managing the affairs of the district and may be temporarily suspended, modified, or amended upon management review and Board approval.