

SAN DIEGO COUNTY REGIONAL TRANSPORTATION COMMISSION DEBT POLICY

The purpose of the Debt Policy for the San Diego County Regional Transportation Commission (SANDAG) is to establish guidelines for the issuance and management of SANDAG's current and future debt. The Debt Policy is designed to inform decision making and provide transparency to SANDAG's financial market participants and the general public. The Debt Policy confirms the commitment of the Board of Directors, management, staff, and other decision makers to adhere to sound financial management practices. Objectives of the Debt Policy are as follows:

- Effectively manage and mitigate financial risk
- Preserve future program flexibility
- Maintain strong credit ratings and good investor relations
- Maintain ready and cost-effective access to the capital markets

1. Scope and Authority

This Debt Policy will govern, except as otherwise covered by the SANDAG Investment Policy (SANDAG Board Policy No. 003) and Interest Rate Swap Policy (SANDAG Board Policy No. 032), the issuance and management of all debt funded through the capital markets.

Section 10 of the *TransNet* Extension and Ordinance (Ordinance 04-01) specifies:

Upon voter approval of the ballot proposition to approve the extension of the tax and the issuance of bonds payable from the proceeds of the tax, bonds may be issued by SANDAG pursuant to Division 12.7 of the Public Utilities Code, at any time, and from time to time, payable from the proceeds of the existing tax and its extension and secured by a pledge of revenues from the proceeds of the tax, in order to finance and refinance improvements authorized by Ordinance 87-1 and this Ordinance. SANDAG, in allocating the annual revenues from the measure, shall meet all debt service requirements prior to allocating funds for other projects.

Day-to-day responsibility for managing the SANDAG debt and finance program will reside with the Chief Executive Officer. This Debt Policy requires that the Board specifically authorize each debt financing.

Board of Directors Responsibility:

- 1.1 Before making a decision regarding any bond issuance, the Board should review all of the documents to become familiar with their contents. Board members should pay particular attention to the information contained in the Official Statement to ensure there are no inaccuracies concerning SANDAG.

- 1.2 The Board members also should ensure that to the best of their knowledge all of the factual statements are true and correct in all material respects and that the information does not contain any untrue or misleading statement of a material fact or omit to state any material fact that would make the information in any of the documents regarding SANDAG misleading. It is the SANDAG Board of Directors, in its role as the San Diego County Regional Transportation Commission, that has responsibility for approving the transaction.
- 1.3 When carrying out their fiduciary responsibilities, public officials may rely upon employees, bond counsel, disclosure counsel, and other professionals to assure that they are in compliance with the antifraud provisions of the federal securities laws, as long as the reliance is reasonable. In order for the reliance to be considered reasonable, the public official must: (1) make complete disclosure to the appropriate professional of any potentially material mistake or omission in the documents; (2) request the professional's advice as to what disclosure is proper; (3) receive advice regarding the appropriate disclosure; and (4) rely in good faith on that advice.

2. Capital Budgeting and Planning for Debt Issuance

Borrowing needs will be identified and examined within the capital planning and budgetary framework of SANDAG. The primary elements of SANDAG capital planning and budgetary framework are described below.

- 2.1 Annual SANDAG Program Budget: The annual SANDAG Program budget is a Board-approved document that identifies current-year expenditures and funding sources. The Capital Program chapter is a multi-year budget updated on an annual basis that is developed within the context of the SANDAG long-range Transportation Plan, and serves as a basis for updates to the *TransNet* Plan of Finance.
- 2.2 Transportation Sales Tax: *TransNet*:
 - 2.1.1 TransNet Plan of Finance: In 2004, SANDAG adopted the San Diego County Transportation Improvement Program *TransNet* Ordinance and Expenditure Plan (Ordinance 04-01), which provides for an extension of the retail transactions and use tax for a 40-year period commencing on April 1, 2008, through March 31, 2048. The Ordinance outlines eight specific sub-programs that are funded with sales tax revenues. In accordance with the Ordinance, SANDAG may borrow for eligible projects within the sub-programs outlined in the Ordinance, with the debt service to be paid from each respective sub-program funds.
 - 2.1.2 The Early Action Program: is the major focus of the *TransNet* Plan of Finance and forms the basis for determining near to medium-term borrowing needs. The Early Action Program identifies projects within the Ordinance to advance for early delivery, based upon Board direction. Generally, projects included in the Early Action Program were candidates for delivery over the first 10 years. As such, the Early Action Program had a comparatively near-term horizon compared to the Plan of Finance, which extends through 2048.

- 2.1.3 Financial Feasibility Requirements: The Early Action Program included projects that SANDAG was either currently delivering or would soon be entering the project delivery phase. As such, the Early Action Program demonstrated financial feasibility and accounted for all project funding and costs, including debt service.
- 2.3 Borrowing requirements are determined for each eligible sub-program and debt service is allocated to each sub-program based upon its pro rata share of bond proceeds. It is the general principal for the *TransNet* Plan of Finance that the annual debt service for each sub-program be less than the annual sales tax revenue allocated to a sub-program on an annual basis. This 1.0x program debt service coverage requirement ensures that no single sub-program incurs more debt than it can afford.

3. Standards For and Appropriate Use of Debt Financing

As borrowing needs are identified, SANDAG will evaluate the nature of the capital investment (e.g., the use and useful life of the asset) to ensure that long-term debt is the appropriate financing mechanism to meet the funding need. Standards for the appropriate use of debt financing will include those described below.

- 3.1 Long Term Capital Projects: Long-term debt should be used to finance essential capital projects where it is cost-effective and fiscally prudent. The weighted average maturity of the tax exempt bonds may not exceed 120 percent of the weighted average useful life of the capital assets being financed. The ability or need to expedite or maintain the programmed schedule of approved capital projects will be a factor in the decision to issue long-term debt. Inherent in its long-term debt policies, SANDAG recognizes that future taxpayers will benefit from the capital investment and that it is appropriate that they pay a share of the asset cost. Consistent with Internal Revenue Service code and tax law, long-term debt will not be used to fund operations.
- 3.2 Debt Financing Mechanism: SANDAG will evaluate the use of financial alternatives available including but not limited to long-term debt, short-term debt, and variable-rate debt. SANDAG will consider cost, risk to the portfolio, stability, and future flexibility when considering alternative borrowing mechanisms.
- 3.3 Credit Quality: Credit quality is an important consideration for SANDAG. All SANDAG debt management activities for new debt issuances will be conducted in a manner conducive to receiving the highest credit ratings possible consistent with SANDAG debt management and project delivery objectives.

4. Purpose of Financing

The general purpose of bond financing falls into two general categories: (1) to finance new capital infrastructure or, (2) to refinance existing bonds to reduce financing costs, risk, or both. These two purposes are described in more detail below.

- 4.1 New Money Financing: New money issues are those financings that generate additional funding to be available for expenditure on capital projects. These funds will be used for acquisition, construction, and major rehabilitation of capital assets. New money bond proceeds may not be used to fund operational activities. New money issues will be proposed in the context of the Plan of Finance, Early Action Program, and the annual Program Budget and will be consistent with the Expenditure Plan and Ordinance and SANDAG Board Policy No. 031, “*TransNet* Ordinance and Expenditure Plan Rules.”
- 4.2 Refunding Bonds: Refunding bonds are issued to retire all or a portion of an outstanding bond issue. Most typically this is done to refinance at a lower interest rate to reduce debt service. Alternatively, some refundings are executed for a reason other than to achieve cost savings, such as to restructure the repayment schedule of the debt, to change the type of debt instruments being used, or to retire a trust indenture in order to remove undesirable bond covenants that may excessively restrict SANDAG’s ability to issue additional bonds. In any event, a present value analysis must be prepared that identifies the economic effects of any refunding being proposed to the Board.

As a general guideline, SANDAG will target a minimum debt service savings threshold goal of 3.0 percent of the refunded bond principal amount, on a maturity-by-maturity basis, unless there are other compelling reasons for defeasance.

5. Types of Debt

The market for municipal finance is well developed and provides numerous products or types of debt that SANDAG will evaluate on a case-by-case basis. The types of debt typically available to SANDAG are described in this section.

5.1 Long-Term Debt

- 5.1.1 Current Coupon Bonds: are bonds that pay interest periodically and principal at maturity. They may be used for both new money and refunding transactions.
- 5.1.2 Transportation Infrastructure Finance Innovation Act (TIFIA) Loan: is a loan provided by the United States Department of Transportation for certain transportation projects of regional importance. SANDAG may elect to apply for a TIFIA loan if it is determined that it is the most cost effective debt financing option or if the loan provides flexibility to the benefit of the larger *TransNet* Program.
- 5.1.3 Federally Subsidized Taxable Bonds: are municipal bonds whose interest cost is subsidized by the federal government. The subsidized interest cost creates a taxable bond that is cost-competitive with traditional tax-exempt bonds. SANDAG will consider the issuance of federally subsidized taxable bonds that may be available in the future and will compare the net cost to traditional tax-exempt options.

5.2 Short-Term Debt

5.2.1 Commercial Paper Notes: may be issued as an alternative to fixed rate debt, particularly when the timing of funding requirements is uncertain. SANDAG may maintain an ongoing commercial paper program to ensure flexibility and immediate access to capital funding when needed.

5.2.2 Grant Anticipation Notes: are short-term notes that are repaid with the proceeds of state or federal grants of any type.

5.2.3 Lines of Credit: will be considered as an alternative to or credit support for other short-term borrowing options.

5.2.4 Bond Anticipation Notes: are short-term notes that are repaid with the proceeds of future borrowings.

5.3 Variable Rate Debt: It is sometimes appropriate to issue short-term or long-term variable rate debt to diversify the debt portfolio, reduce interest costs, provide interim funding for capital projects, and/or improve the match of variable rate assets to variable rate liabilities.

6. Terms and Structure of Bonds

The terms and structure of a specific bond issuance will be developed within a prudent legal framework (e.g., SANDAG existing bond indenture) and with the objective of maintaining strong credit ratings, addressing investor concerns, minimizing risk to SANDAG, and preserving future flexibility in a cost-effective manner. A primary, but not exhaustive list of some of the terms and structural considerations are discussed below.

6.1 Term: All capital improvements financed through the issuance of debt will be financed for a period not to exceed the expiration date of the sales tax measure. Further, the weighted average maturity of the tax-exempt bonds may not exceed 120 percent of the weighted average useful life of the capital assets being financed.

6.2 Lien Levels: Senior and subordinate liens for each revenue source may be utilized in a manner that will maximize the most critical constraint - typically either cost or capacity - thus allowing for the most beneficial use of the revenue source securing the bond.

6.3 Debt Service Structure: SANDAG will examine debt service structures in the context of program needs. Combined principal and interest payments for any particular bond issue will first be examined as a level payment structure. Deferred principal can create increased program and project delivery capacity and also will be examined. The SANDAG debt service structure will be sized within conservative revenue constraints and with the objective of maintaining strong credit ratings.

6.4 Additional Bonds Test: Any new senior lien debt issuance must not cause the SANDAG debt service to exceed the level at which prior year revenues are less than two times (2.0x) the maximum annual principal and interest for the aggregate outstanding senior lien bonds, including the debt service for the new issuance.

- 6.5 Call Provisions: In general, fixed-rate, tax-exempt bonds will be issued with a provision that allows SANDAG to call outstanding bonds 10 years after the bond delivery date at par (i.e., no call premium). Shorter or longer call provisions may be utilized if there is a specific benefit to or need for their use.
- 6.6 Derivative Products: SANDAG will consider the use of derivative products only in instances where it has been demonstrated that the derivative product will either provide a hedge that reduces risk of fluctuations in expense or revenue, or alternatively, where the derivative product will reduce the total project cost. Interest rate swaps will be considered in the context of the SANDAG Interest Rate Swap Policy (SANDAG Board Policy No. 032). Derivative products will only be utilized with prior approval from the Board.

7. Credit Enhancement

SANDAG will consider the cost and benefit of credit enhancement strategies on a case-by-case basis with each separate bond issuance.

- 7.1 Bond Insurance: SANDAG will have the authority to purchase bond insurance when such purchase is deemed prudent and advantageous. The predominant determination shall be based on such insurance being less costly than the present value of the difference in the interest expense on insured bonds versus uninsured bonds.
- 7.2 Debt Service Reserves: When beneficial to SANDAG from a bond pricing and credit perspective, a reserve fund may be established. SANDAG will have the authority to purchase reserve equivalents (i.e., the use of a reserve fund surety) when such purchase is deemed prudent and advantageous. Such equivalents will be evaluated in comparison to cash funding of reserves on a net present value basis.
- 7.3 Letters of Credit: SANDAG will have the authority to enter into a letter of credit agreement when such an agreement is deemed prudent and advantageous. The long-term and short-term credit ratings of those financial institutions offering letters of credit will be a critical consideration before procuring any letter of credit.

8. Method of Bond Sale

SANDAG will determine on a case-by-case basis which method to use to sell its bonds. Generally, there are three methods of sale: competitive, negotiated, and private placement. Each type of bond sale has advantages and the potential to provide the lowest cost given the right conditions. SANDAG will work with its financial advisor to determine the appropriate method of sale under specific market conditions.

9. Market Relationships

As a periodic issuer who values cost-effective market-access, SANDAG will actively provide requested information and maintain relationships with rating agencies, investors, and other market participants, as needed. Staff will provide relevant market updates to the Board on a quarterly basis.

- 9.1 Rating Agencies: The Director of Finance will be primarily responsible for maintaining our relationships with those rating agencies (i.e., Moody's Investors Service, Standard & Poor's, and Fitch Ratings) from whom SANDAG requests and holds ratings. SANDAG may, from time to time, choose to deal with only one or two of these agencies as circumstances dictate.
- 9.2 Investor Relations: Timely and accurate information will be provided in response to inquiries from investors in order to maintain positive, ongoing investor relations.
- 9.3 Board Communication: As a means of providing feedback from rating agencies and/or investors regarding our financial strengths and weaknesses as perceived by the marketplace, information will be provided to the Board as material information develops. SANDAG staff currently provides written quarterly reports to the Board, which include current market information, an update on the SANDAG debt portfolio, relevant financial metrics (e.g., debt service coverage ratios), and anticipated borrowing needs over the next one to two years.

10. Continuing Disclosure

It is SANDAG policy to remain in compliance with SEC Rule 15c2-12 by filing annual financial statements and other financial and operating data for the benefit of bondholders within 210 days of the close of the fiscal year and file material event notices in a timely manner.

11. Consultants

SANDAG will select its primary consultant(s) through a competitive process, as required by Board Policy No. 016, "Procurement of Services."

12. Post-Issuance Compliance Procedures

SANDAG will establish and document procedures to ensure that SANDAG is in compliance with requirements of the Internal Revenue Code of 1986, as amended (the "Code"), that must be satisfied with respect to tax-exempt bonds and other obligations after the bonds are issued so that interest on the bonds is, and will remain, tax-exempt. Additionally, as part of the post issuance compliance procedures SANDAG will ensure that proceeds of the debt issuance are directed to the intended use. The Post-Issuance Compliance Procedures will be reviewed at least every three years.

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