Refinancing Policy

Item A.10

Board Policy No. 2013-010

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MEMORANDUM

TO: Members of the Board

THROUGH: Craig D. Pedersen, Executive Administrator CP
J. Kevin Ward, Deputy Executive Administrator, OPFCA JKW
George E. Green, Director, Northern Project Management Division GEG

FROM: Lana Lutringer, Policy and Program Development Specialist LL

DATE: October 13, 1999

SUBJECT: Refinancing Policy - Development Fund II, Water Loan Assistance Fund, Drinking Water State Revolving Fund and Clean Water State Revolving Fund

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At the August Finance Committee, the Board requested two revisions to the proposed Refinance Policy and that a Focus Group comprised of outside consultants be assembled to comment on the policy with the suggested changes. Staff amended the draft policy to include:

- TWDB's primary goal in financing new construction versus refinancings, and
- The concept that refinancings will improve the credit quality of TWDB's program portfolios.

RECOMMENDATION

Based on the Focus Group participant comments, and in consideration of the Board's desire to ensure that the credit quality of the portfolios improve as a result in offering refinancing assistance to TWDB customers, staff recommends requiring bond insurance for SRF refinancings but does not advocate the same constraint be placed on the DFund II programs. Staff recommends that the Board adopt by minute order the general and program specific policy.

Changes from August Finance Committee Action:

Focus Group Comments. As requested, staff held a Focus Group meeting October 5, 1999 to involve professional consultants, financial advisors and bond counsels, in the development of TWDB's Refinancing Policy. Participants in the Focus Group identified only one area of the policy that may hinder their clients' accessing TWDB programs. The area in question (Item Number 2 under the General Policy section) establishes that a refinancing will be considered by TWDB if it *improves* the credit quality of the TWDB program portfolios.

Several participants stressed that issuers who were interested in State funds to finance infrastructure through the Development Fund II were typically not able to issue market-quality debt or at best, were considered to be of marginal credit quality. The participants believe that requiring an issuer's refinancing to improve the credit quality of the TWDB would result in an issuer needing to enhance the debt by purchasing insurance. Purchasing insurance was considered to be an additional cost to an already marginal issuer and could impose additional burden without the benefit of receiving a lower rate (interest rates for borrowers in Development Fund II are uniform for all issues regardless of credit quality). The assertion is that if there is an additional financial burden associated with accessing State programs without any benefits, an alternative funding source will be considered for both the refinancing and the new construction portion of the total financial assistance.

From the State's perspective, another reason for rewording the policy is TWDB State bonds are backed by the full faith and credit of the State. Having potential issuers insure their bonds will not directly benefit the bond rating or the program portfolios since offering lower rates to borrowers in DFund II will not ultimately result in lower rates to the Board for its general obligation bond issues. Additionally, the DFund II program is the primary resource where hardship borrowers can access funds from the TWDB. By restricting access to the DFund II to only those credits that would improve the portfolio, the Board will be eliminating the DFund as a resource that has been available to this class of borrowers since TWDB's inception in 1957. This point was not specifically discussed with the Focus Group but in subsequent discussion with the TWDB's financial advisor, it was confirmed that many DFund II applicants are unable to obtain bond insurance or other sources of financial assistance for their projects.

With respect to TWDB's federally funded programs, the Clean Water State Revolving Fund (CWSRF) and the Drinking Water State Revolving Fund (DWSRF), the participants readily acknowledged that an issuer that enhances the credit quality of its bonds by purchasing insuranc receives a direct benefit (lower interest rates). Credit enhancement has been a successful element in the Clean Water State Revolving Fund and will be in the Drinking Water State Revolving Fund.

The Focus Group recommended deleting the word, "improves" and substituting the words, "does not decrease", in Item Number 2 under the General Policy section. The policy was to then read:

2. Refinancing long-term debt will be offered if
   a) there is sufficient capacity in the funding program, and
   b) the refinancing does not decrease the credit quality of the program portfolio.

Board Member Comments. The lead sentence under the General Policy section was reworded for clarity and incorporated within the Refinancing Policy, which now reads:

> TWDB's primary goal in servicing its customers is to provide financing for new construction to meet the water supply and wastewater infrastructure needs of Texans. In the context of this primary goal, three financial policies will be applied in providing financing and refinancing services to TWDB customers.

Staff's Position. In weighing the needs of TWDB customers with the Board's desire to improve the credit quality of the portfolios in offering refinancing assistance and the Focus Group comments, staff feels it is appropriate to require bond insurance for SRF refinancings in order to ensure an improvement to the credit quality of those portfolios, but recommends that no such constraint be placed on the DFund II programs. Requiring bond insurance on SRF refinancings will result in these bond issues having an insured rating equivalent to a Aaa/AAA rating, which is more than the Board requested, but is acceptable to the bond community. Not requiring bond insurance on refinancings issued through DFund II will ensure accessibility to the DFund programs by TWDB customers. **For the DFund II programs, as is the case for all loans from TWDB programs, staff credit analysis will verify that adequate security is offered to ensure loan repayment.**

The Refinancing Policy has been revised to reflect staff's recommendation. All revisions to the August Finance Committee version of the policy have been highlighted in italics and underlined for the Board's convenience.

TWDB REFINANCING POLICY

GENERAL POLICY: *<u>TWDB's primary goal in servicing its customers is to provide financing for new construction to meet the water supply and wastewater infrastructure needs of</u>*

Texans. In the context of this primary goal, three financial policies will be applied in providing financing and refinancing services to TWDB customers.

1) The opportunity to refinance interim short-term debt will be offered if
   a) the short-term debt proceeds are for new construction, and
   b) TWDB staff have advance knowledge of the interim financing and notice of intent from the issuer.
2) Refinancing long-term debt will be offered if
   a) there is sufficient capacity in the funding program, and
   b) *in the case of the Drinking Water and Clean Water SRF programs, the refinancing issue is insured by a municipal bond insurance policy.*
3) TWDB, as a general rule, will not consider refinancing Board issues. The TWDB reserves the option to consider a customer's request for a refinancing when extreme circumstances exist.

All requests will be reviewed for individual merit and in meeting TWDB's Refinancing Policy. Compliance with other State and Federal requirements are required to be documented.

PROGRAM SPECIFIC POLICY

While developing a Refinancing Policy, TWDB staff identified there are typically two types of refinancings that TWDB encounters: interim financings (associated with new construction) and refinancings of prior issued debt (not associated with new construction).

Interim financings allow customers to move forward on a current project while maintaining the ability to access TWDB financial programs for long-term financing at a later date if all State and, *if applicable*, Federal program guidelines are met. Refinancings of prior issued debt are where TWDB staff frequently encounter circumstances where policy and additional TWDB guidance are needed. Questions surrounding the required security, rate covenants and program capacity arise with these types of refinancings.

A clear distinction of how interim financings and refinancings of prior issued debt will be treated has been outlined under each program.

Staff recommends the following program specific policies as the guide for the identified State-funded and Federally-funded programs with the understanding that when program capacities are under review, TWDB will, at that time, reconsider its ability and desire to provide Refinancings a financing tool to its TWDB customers.

State-Funded Programs:
Development Fund II (DFund II). The opportunity for a TWDB customer to refinance debt through DFund II is dependent on availability of program funds. Interim issues and refinancing of prior issued debt will be considered by the Board as long as the criteria and guidelines of an individual funding program and the Refinancing Policy are met.

In addition, if any refinancing request exceeds a fifty percent (50%) ratio of the refinancing of prior issued debt to the total financial assistance requested (including the new construction loan), these requests will be reviewed by the Deputy Executive Administrator for Office of Project Finance and Construction Assistance (Deputy) as to the individual merit of the request. If the Deputy determines the request merits Board consideration, the financing request will be placed on the next available Board agenda.

Water Loan Assistance Fund (WLAF). Historically, on a very limited basis, the TWDB has utilized WLAF funding, if available, to provide current TWDB customers funds for workouts/restructuring of debt held in other TWDB portfolios. Restructuring of TWDB loans occur when the customer is unable to repay an impending debt service payment. Recognizing that the WLAF has limited available funds, staff recommends continuing the practice of allowing a current TWDB loan customer access to funds, if available, in the event that a workout is warranted. Staff suggests that the opportunity for funding a workout be made only when every possible financing option has been tried to prevent an imminent payment default in another TWDB portfolio.

Federally-Funded Programs:
Because the TWDB's Federally-Funded Programs involve Priority Ranking Systems, staff has developed the Refinancing Policy with a focus on new construction as the highest priority. Requests for refinancing of interim debt of current new construction projects (not completed projects) will be ranked on an equal basis with new construction projects. Refinancings of Prior Issued Debt (associated with completed projects) will be given a lower priority ranking in relation to new construction projects, thereby giving new construction the higher priority. This will result in allowing for refinance of prior issued debt only in years that the annual program capacity exceeds the demand for new construction loans.

Amendments were proposed in September for the DWSRF in section 371.19(k), which read "Completed Projects, which involve refinancing, will be listed in the intended use plan as a separate group and will be placed below the group of projects for which construction has not been completed." We anticipate that comparable amendments will be proposed for the CWSRF program at the November Board meeting.

DWSRF. All projects that include an interim financing will be ranked in priority with other new construction projects. However, even though refinancings of prior issued debt (for projects that meet the program criteria and rank within the program funding) are an eligible funding activity under The Safe Drinking Water Act Amendments of 1996, at this point in time the DWSRF program is primarily intended to meet current project needs that would bring a system into compliance with drinking water standards. Staff strongly recommends limited access to DWSRF funds for refinancings of prior issued debt for the following reasons:

1) Federal requirements and the TWDB program cashflow dictate installments.
2) Federal guidance requires that refinancings may be drawn down only over a period of eight equal quarters.
3) Federal guidance also limits an up-front cashdraw to five percent (5%) of the cap grant.

The combined effect of these requirements limit TWDB's ability to offer refinancings to five percent (5%) of the yearly Federal grant amount until either the cashdraw rules are revised or the DWSRF program capacity allows up-front releases for refinancings.

CWSRF. The CWSRF is a leveraged program with sufficient cashflow to support up-front closings of loans for all projects. As in the other TWDB financial programs, interim financings are an initial and fundable part of this program process. In fact, the Capital Improvement Plan program, which was developed and instituted in October 1995, was a CWSRF program improvement specifically designed to fund large customers' ongoing wastewater construction, whereby a customer could finance all or a portion (through interim financings) of its capital improvement plan more efficiently. All projects that include an interim financing will be ranked in priority with other new construction projects. Refinancings of prior issued debt, on the other hand, can only be considered after all new construction projects have been funded (using the new priority concept).

This recommendation has been reviewed by legal counsel and is in compliance with applicable statutes and Board rules.

Gail Allan
Director, Legal Administration

LJL/jb