



Debt Service Reserve Fund Background and Considerations

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Debt Service Reserve Fund is Established for Bondholder Security

- ◆ Debt Service Reserve Fund (“DSRF”) is a fund that is established as part of some bond indentures or ordinances to enhance bondholder security and creditworthiness
 - Holds funds that are applied to pay debt service if pledged revenues are insufficient to timely satisfy debt service payment requirements
 - Intended to act as a financial buffer if pledged revenues are temporarily insufficient to pay debt service requirements
- ◆ DSRF may be advantageous or required for bond issuers depending on considerations related to borrower creditworthiness, borrower type, and the type of debt
 - Historically, DSRF has been found in most municipal credit packages except for those issued with a General Obligation pledge
 - Market preferences and the value investors attribute to a DSRF change over time
 - Credit considerations relative to specific bond issuers change over time



Debt Service Reserve Fund Sizing and Mechanics

- Amount required to be deposited in the DSRF (“Reserve Requirement”) is set with reference to credit needs and federal tax code limitations
- Valuation typically occurs upon each issuance and at least once annually on an ongoing basis
- Most commonly, Reserve Requirement is specified as either Maximum Annual Debt Service or as the lesser of three tests:
 - Maximum Annual Debt Service
 - 125% of Average Annual Debt Service
 - 10% of Principal Amount
- When bond documents provide for the issuance of multiple series of bonds over time that share the same lien on pledged revenues, a single DSRF may secure all outstanding series
 - In case of common DSRF, Reserve Requirement is calculated with reference to all outstanding bonds
 - In GLWA’s case, there are four common DSRFs that support bonds secured by the following systems and liens: (1) Water Senior (2) Water Second (3) Sewer Senior (4) Sewer Second



Options for DSRF Funding Include Cash and Eligible Surety Policies

- ◆ Provisions within the bond indenture or ordinance dictate the options available to an issuer for funding of a Reserve Requirement
- ◆ Two most frequently available funding options include:
 - Cash (and permitted securities)
 - Eligible surety policies
- ◆ Surety policy is generally issued by a bond insurance company and can be drawn upon to provide funds if the DSRF must be tapped to pay debt service
 - Surety policy is issued in exchange for an upfront payment and certain covenants of the issuer
 - Any draws on a surety policy must be repaid with interest
- ◆ Issuer's decision to use a surety bond in place of a cash-funded DSRF depends on multiple factors but impact is a reduction upfront borrowing requirement
 - Cash deposit and surety premium are both typically paid using bond proceeds



Current GLWA DSRF Requirements and Funding Composition

| GLWA DSRF Requirements by System and Lien ¹ | | | | |
|--|----------------------|---------------------|----------------------|---------------------|
| | Water System | | Sewer System | |
| <u>Lesser of:</u> | Senior Lien | Second Lien | Senior Lien | Second Lien |
| Maximum Annual Debt Service | \$162,594,984 | \$143,274,365 | \$172,618,249 | \$182,427,707 |
| 125% of Average Annual Debt Service ² | 108,604,583 | 48,316,814 | 108,624,794 | 40,963,245 |
| 10% of Principal | 168,929,500 | 67,807,000 | 177,946,500 | 76,602,500 |
| Reserve Requirement | \$108,604,583 | \$48,316,814 | \$108,624,794 | \$40,963,245 |

| GLWA DSRF Funding Amounts by System and Lien ¹ | | | | |
|---|----------------------|---------------------|----------------------|---------------------|
| | Water System | | Sewer System | |
| | Senior Lien | Second Lien | Senior Lien | Second Lien |
| Credit Facilities ³ | \$96,494,258 | \$45,815,645 | \$93,936,981 | \$40,300,000 |
| Cash and Investments | 12,210,325 | 3,368,591 | 14,787,813 | 763,245 |
| Total DSRF Funding | \$108,704,583 | \$49,184,236 | \$108,724,794 | \$41,063,245 |

(1) Shown as of December 5, 2023, the last valuation date for Water Senior, Sewer Senior, and Sewer Second. Water Second is shown on an indicative basis as of the same date.

(2) Sewer Second Lien calculated at 100% of Average Annual Debt Service in accordance with MBO requirements.

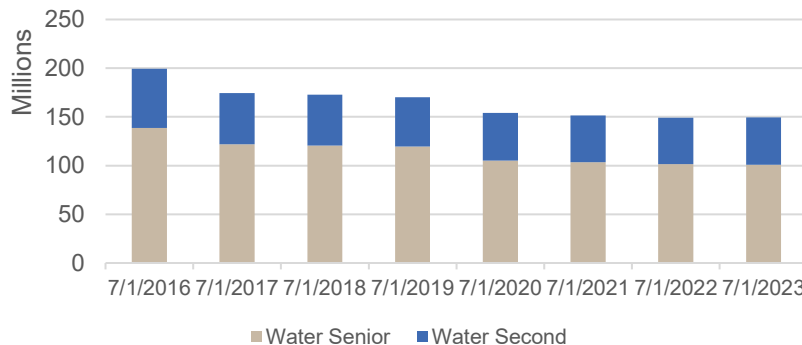
(3) Includes surety policies issued on a series-specific and parity basis.



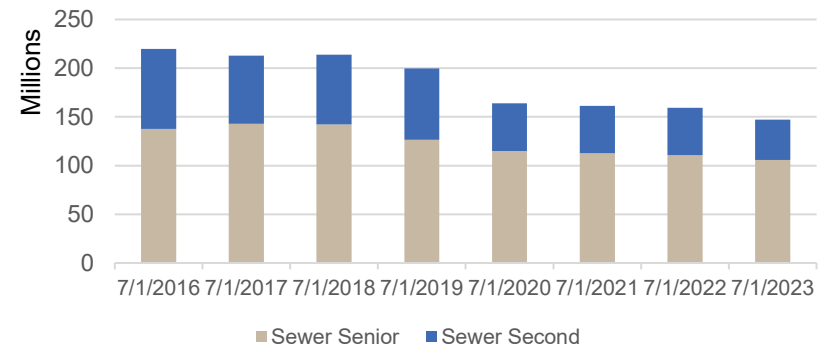
Successful GLWA Refinancing Program has Resulted in Significant DSRF Releases

- Reserve Requirement is recalculated upon each issuance and if debt service requirements are reduced can result in a release
- GLWA refinancing program has resulted in significant decreases in aggregate Reserve Requirements due to reduction in debt service and optimization of structure between liens

Water DSRF Requirement Over Time



Sewer DSRF Requirement Over Time



- Releases from DSRF are restricted to certain uses, and have generally been applied to reduce the size of a refunding debt issuance

| GLWA DSRF Releases Applied to Refunding Transactions | | | | | | |
|--|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| | Water System | | | Sewer System | | |
| | Senior Lien | Second Lien | Total | Senior Lien | Second Lien | Total |
| Series 2016 | \$14,367,220 | \$10,795,798 | \$25,163,017 | \$23,804,512 | \$19,927 | \$23,824,439 |
| Series 2018 | - | 1,602,152 | 1,602,152 | 11,201,491 | - | 11,201,491 |
| Series 2020 | 10,548,456 | - | 10,548,456 | 8,454,576 | 25,142,779 | 33,597,356 |
| Series 2022 | - | - | - | 1,572,882 | 7,303,667 | 8,876,550 |
| Series 2023 | - | - | - | - | 209,161 | 209,161 |
| Total | \$24,915,676 | \$12,397,949 | \$37,313,625 | \$45,033,465 | \$32,675,534 | \$77,708,996 |



2016 Amendment to GLWA Master Bond Ordinances

- Reserve Requirements for GLWA bonds are detailed in the Master Bond Ordinances and date back decades to prior DWSD Bond Ordinance
- Market preferences and credit considerations differed when Reserve Requirements were originally established
- Substantive changes to Master Bond Ordinances require investor consent to implement
- In 2016, GLWA Board adopted amendments to the Reserve Requirements within the Master Bond Ordinances that became effective with investor consent through a springing amendment
- Reserve Fund Amendment was adopted to modernize terms of Master Bond Ordinance and eliminate significant associated cost
- Reserve Fund Amendment allows GLWA the option (but not requirement) to reduce or eliminate the Reserve Requirement once conditions precedent have been met:
 - Attain ratings of at least AA- or Aa3 on the Senior Lien from at least two of Moody's, S&P, and Fitch ☒ and
 - Confirmation that ratings will not be reduced solely because of the change in the Reserve Requirement ☐



Multiple Considerations Surround Elimination of Reserve Requirement

- Limited immediate economic implications of eliminating Reserve Requirement
 - Cash balances are modest given prior aggressive refunding program structured to maximize releases
 - Surety policies that represent a substantial portion of DSRF balances have already been paid for in full
 - Releases from cash balances are restricted for certain purposes and have historically been used to reduce borrowing and enhance debt service savings related to refunding transactions
- Regardless of consents, some risk of modestly negative reception from rating agencies and certain investors
 - Rating agencies generally see limited value of funded DSRF except where a utility holds narrow liquidity
 - Some investors value a funded DSRF, regardless of rating agency views
- Cost of maintaining cash within DSRF is currently substantially lower than in 2016, as earnings on DSRF investments can now easily exceed GLWA tax-exempt long-term borrowing rate
- Elimination of Reserve Requirement reduces risks related to existing surety policies and future debt issuances
 - Potential for substantial future deposit requirements upon expiration of current surety policies (\$29 million in 2027) and in concert with each future debt issuance
 - Significant new money borrowings will occur through SRF program on Junior Lien, which does not require a DSRF
 - As GLWA credit quality increases, the availability of surety policies that must be rated at or above the level of the bonds will decrease



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