DEBT MANAGEMENT POLICY

PURPOSE AND OBJECTIVES

1.1 The purpose of this policy is to provide guidance regarding the issuance, management, continuing evaluation and reporting on all debt obligations issued by Hidalgo County, Texas (the "County"). The Hidalgo County Commissioners Court recognizes there are no absolute rules or easy formulas that can substitute for a thorough review of all information affecting the County's debt position. Debt decisions should be the result of deliberative consideration of all factors involved. This policy is intended to augment the deliberation process by addressing the methods, procedures and practices to be utilized to ensure effective and judicious fiscal management of County funds.

1.2 The terms of this Debt Management Policy (the "Policy") are intended to comply with all Texas and Federal Law governing debt, including, but not limited to, Texas law, Internal Revenue Service rules and regulations, United States Securities and Exchange Commission "(SEC)" regulations, Municipal Securities Rulemaking Board "(MSRB)" regulations, court rulings, and existing County debt covenants.

1.3 Debt Management shall be conducted with the primary objectives of:

a. Maintaining and improve the County's existing credit rating;

b. Maintaining access to capital; and

c. Minimizing borrowing costs.

SCOPE

2.1 This Policy shall govern debt obligations issued by the County that finance the construction or acquisition of infrastructure and other assets or to refinance existing debt. The County may also desire to issue debt obligations on behalf of external agencies, nonprofit corporations, or other authorities for the purpose of construction or acquisition of infrastructure or other assets that further the goals and objectives of County government. In that case, the County shall take reasonable steps to confirm the financial feasibility of the project and the financing solvency of any necessary borrower; and shall take all reasonable precautions to ensure the public purpose and financial viability of such transactions. This policy does not apply to the capital leases.

ROLES AND RESPONSIBILITIES

3.1 As provided by the Texas Local Government Code, each member of Commissioners Court has a fiduciary responsibility in the management of the County's indebtedness. All debt programs are to be made in accordance with applicable Texas and federal regulations. The Commissioners Court will approve all County indebtedness.

3.2 The Commissioners Court Executive Officer has the primary responsibility for making debt-financing recommendations to the Commissioners Court.

3.3 The Commissioners Court Executive Officer, or their designee, will coordinate all activities necessary to issue debt, including, but not limited to:

a. Review of resolutions provided by bond counsel;

b. Review of offering memoranda provided by financial advisors; and

c. Review of all related financial analyses.

3.4 The Commissioners Court Executive Officer, or his designee, will implement and oversee the Capital Reporting System for County offices and departments pursuant to Section 18 of this policy.

3.5 The Commissioners Court Executive Officer, or his designee, will recommend to the Commissioners Court a financing team consisting of bond counsel, financial advisors, and underwriters.

3.6 The Office of the County Auditor is responsible for assuring that all debt service payment are made in a timely manner to the appropriate paying agents.

3.7 Offices and Departments administering projects financed with debt funding are responsible to comply with Section 18 of this Policy.

REPORTING

4.1 The Commissioners Court Executive Officer, or his designee, will report annually to the Commissioners Court:

a. A projected list of expected capital needs for the year;

b. An annual debt issuance schedule for capital projects;

c. An updated five-year capital improvement plan as part of the budget;

d. Certification that the County is current on all debt service payments; and

e. Disclosure of any bond covenant violations or defaults over the past year.

4.2 The Office of the County Auditor is responsible for reporting monthly in its financial report a schedule that includes outstanding debt requirements as well as commercial paper activity. These reports will include principal and interest requirements, dates for each and related interest rates.

4.3 The Office of the County Auditor is responsible for preparing the annual continuing disclosure and the County's bond counsel is responsible for reviewing, approving, and submitting the continuing disclosure pursuant to SEC Rule 15c-12.

4.4 The Office of the County Auditor is responsible for the annual estimation of the cumulative rebate amount (arbitrage) for each debt issuance as defined in Section 148(f)(2) of the Internal Revenue code. These annual estimates are for informational and internal reporting purposes only.

4.5 The Office of the County Auditor is responsible for ensuring compliance with the filing requirements with the Internal Revenue Service related to arbitrage.

4.6 Offices and Departments administering projects financed with debt funding are responsible to comply with Section 18 of this Policy.

ORGANIZATIONS AFFECTED

5.1 All County offices and departments must comply with the guidelines and procedures set forth in this Policy.

USE OF DEBT INSTRUMENTS

6.1 Debt financing will not generally be considered appropriate for any recurring purpose such as current operating and maintenance expenditures. The County will use debt financing for one-time capital improvement projects including appropriate operating expenditures required to implement the projects under the following circumstances:

a. The project must be approved by Commissioners Court;

b. The project's useful life will be equal to or exceed the term of the financing;

c. The equipment has an expected useful life of at least the term of financing;

d. There are revenues sufficient to service the debt, whether from future property taxes, user fees, or other specified and reserved resources; or

e. Compliance with the appropriate provisions of Texas Law and the Internal Revenue Code of 1986, as amended.

6.2 Operating expenditures required to implement capital improvement projects will be funded using debt financing in accordance with Chapter 1201, as amended Texas Government Code and Chapter 1431, as amended Texas Government Code.

STRUCTURE AND TYPE OF DEBT

7.1 Debt service will be structured to match projected cash flows and minimize the impact on future property tax levies.

7.2 The term of the debt issuance should equal the lesser of the useful life of the asset being financed or the maximum of 40 years in accordance with Chapter 1201, as amended Texas Government Code.

7.3 The types of debt instruments to be issued by the County include:

a. General Obligation Bonds;

b. Certificates of Obligation;

c. Revenue Bonds;

d. Refunding Bonds;

e. Commercial Paper;

f. Tax Anticipation Notes; and

g. Any other debt instrument authorized for issuance by a County in accordance with the Texas Government Code or other applicable law.

7.4 Individual revenue streams considered for proposed debt service should meet a minimum debt service coverage ratio test of 1.10 along with any appropriate revenue or contingency funds. Debt coverage is defined as total revenue divided by total debt service.

DEBT LIMITS

8.1 The County will not exceed the debt issuance limits described in Article 3, Section 52 of the Texas Constitution and Chapter 1301 of the Texas Government Code.

8.2 The County shall use economic ratios as a tool to assist in providing an objective analytical approach to determine debt capacity for new projects. These ratios may include:

a. Debt per capita;

b. Debt as a percent of statutory debt limit;

c. Debt as a percent of appraised valuation;

d. Debt service payments as a percent of governmental expenditures; or

e. Level of overlapping net debt of all local taxing jurisdictions.

8.3 The County will maintain a debt service fund balance of at least 10 percent of the annual debt service requirement for the fiscal year; provided; however, that this requirement shall comply with the provisions of the Internal Revenue Code of 1986, as amended.

METHOD OF SALE

9.1 The County may use competitive sales, negotiated sales, or private placements. When considering the method of sale, the County will take into consideration:

a. Financial conditions;

b. Market conditions;

c. Transaction-specific conditions;

d. County-related conditions; and

e. Risks associated with each method.

9.2 Competitive sales are the preferred method under the following circumstances:

a. A general obligation pledge or annual appropriation of general revenue;

b. Simple structure and financial analysis;

c. Stable financial market; and

d. Moderate par amount.

9.3 Negotiated sales are the preferred method under the following circumstances:

a. Complex transactions that require extensive financial modeling, credit analysis, pre-marketing efforts, or that are interest rate sensitive; and

b. Volatile financial markets.

9.4 Private Placement is the preferred method under the following circumstances:

a. Small issue size;

b. Questionable security for the issue; and

c. Overall cost savings to the County.

REIMBURSEMENT RESOLUTION

10.1 As provided in the Texas Government Code, Section 1201.042, as amended, Department of the Treasury Regulation, Section 1.150-2 of the Internal Revenue Code of 1986 as amended, Commissioners Court may decide that it is in the County's best interest to pass a reimbursement resolution prior to the formal issuance of debt. The purpose of the resolution would be to announce the intent to reimburse itself for expenditures related to capital programs for which debt will be issued and the General Fund could then be reimbursed once the debt is sold. The County will intend to reimburse itself within 18 months from the later of date of the original expenditure or the date the property financed is placed into service (but in no event more than 3 years after the original expenditure is paid).

REFUNDING OF DEBT

11.1 The County may elect to refund existing debt for reasons including, but not limited to, the following:

a. To achieve Net Present Value (NPV) savings generally of at least 3 percent;

b. To update bond covenants on outstanding debt which impair efficient operations or prohibit necessary or desirable activities;

c. To restructure the debt service schedules associated with outstanding bond issues; or

d. To alter bond characteristics such as call provisions or payment dates.

11.2 If a refunding is undertaken, the County will evaluate:

a. Issuance costs that will be incurred;

b. Interest rate at which the refunding bonds can be issued;

c. Maturity dates of the refunded bonds;

d. Call date (if any) on the refunded bonds; and

e. Call premium (if any) on the refunded bonds.

VARIABLE RATE EXPOSURE

12.1 The County may use variable rate debt (including commercial paper) to lower the cost of borrowing and provide a hedge against interest rate risk.

12.2 The County should establish a target of not to exceed 20 percent of its total outstanding debt in a variable rate mode.

12.3 Variable rate debt should be converted to fixed rate debt as necessary to maintain the 20 percent target, to meet the particular needs of a financing program, or to lock in low long term fixed interest rates.

12.4 When issuing variable rate debt, the County will have appropriate contingency plans in place, such as reserves or hedging instruments, to mitigate the risk associated with rising interest rate environments.

INTEREST RATE SWAP AGREEMENTS

13.1 The County will consider the use of interest rate swap agreements on a case-by-case basis and consistent with Texas law and financial prudence.

13.2 Interest rate swap agreements may be used for the following purposes:

a. To achieve significant savings as compared to other, non-derivative type products available in the bond market;

b. To prudently hedge risk in the context of a particular financing or the overall asset/liability management of the County;

c. To incur variable rate exposure within prudent financial guidelines;

d. To achieve more flexibility in meeting overall financial objectives than available in conventional markets; or

e. To accomplish a financial objective not otherwise obtainable using traditional financing methods.

13.3 The County will not enter into an interest rate swap agreement without advice of an independent advisor and bond counsel.

13.4 The County may enter into an interest rate swap agreement if the counterparty has at least two long term unsecured credit ratings of at least equal to the County's long term general obligation rating from Fitch Ratings, Moody's Investors Service or Standard & Poor's Ratings Services and the party has demonstrated experience in successfully executing interest rate swap agreements.

13.5 The County will select counterparties utilizing one of the Methods of Sale as outlined in Section 9 of this policy.

13.6 Before entering into an interest rate swap agreement, the County shall evaluate all the risks inherent in the transaction including counterparty risk, termination risk, rollover risk, basis risk, tax event risk, credit risk and amortization risk. Evaluation of risk will also include the following considerations:

a. Uncertainty with respect to the County's future debt obligations;

b. Effect on the County's credit quality;

c. Cumulative exposure to all risk factors identified;

d. Difficulty and costs associated with terminations; and

e. Limitations on the ability to refund the swaps' underlying bonds.

13.7 The County will monitor interest rate swap agreements on a quarterly basis to ensure compliance with corresponding swap documentation.

CONTINUING DISCLOSURE

14.1 The County will periodically review the requirements of the Municipal Securities Rulemaking Board (MSRB) and the recommendations of the Government Finance Officers Association (GFOA), including the GFOA recommendation that financial statements be prepared and presented according to generally accepted accounting principles.

14.2 The County will remain in compliance with SEC Rule 15c2-12 by filing its annual financial statements and other financial and operating data for the benefit of its bondholders within six months after the end of each fiscal year.

MATERIAL EVENTS

15.1 Material Events are defined as those events, which are considered likely to reflect on the credit supporting the securities.

15.2 The County will issue a material event notice in accordance with the provisions of SEC Rule 15c2-12.

15.3 The events Hidalgo County will consider material are:

a. Principal and interest payment delinquencies;

b. Non-payment related defaults;

c. Unscheduled draw on debt service reserves reflecting financial difficulties;

d. Unscheduled draw on credit enhancements;

e. Substitution of credit or liquidity providers, or their failure to perform;

f. Adverse tax opinions or events affecting the tax-exempt status of the security;

g. Modification to rights of the security holders;

h. Bond calls;

i. Defeasances;

j. Release substitution, or sale of property securing repayment of the securities;

k. Rating changes; and

l. Any change in the County's fiscal year.

INVESTMENT OF DEBT PROCEEDS

16.1 Debt proceeds will be invested in accordance with the County's Investment Policy or as otherwise permitted in the order or resolution authorizing the issuance of the debt.

16.2 Interest earned on proceeds from bonds, certificates of obligation, commercial or other short-term or long-term debt proceeds (excluding capital lease proceeds) may be used for the same purposes for which the debt was issued or may be allocated to the Debt Service Fund.

16.3 Interest earned on proceeds from bonds, certificates of obligations, or other short-term or long-term debt proceeds (excluding capital lease proceeds) allocated to the Debt Service Fund shall be used solely to pay current and future debt service payments, as well as all related issuance cost.

ARBITRAGE

17.1 The County will follow a policy of full compliance with all arbitrage rebate requirements of the Internal Revenue Code of 1986, as amended and its adopted rules and regulations, and will perform (via contract consultant) arbitrage calculations for each debt issue subject to rebate on an annual basis. All necessary rebates liability will be filed and paid when due.

CAPITAL PROJECT REPORTING SYSTEM

18.1 The Capital Reporting System is an internal reporting system used to track actual cash needs for capital improvement projects to be debt financed by requiring offices and departments administering a capital project to detail the different phases of the project, a timeline for each phase, and cost per phase pursuant to 18.3 and 18.4 of this section.

18.2 As set forth in Section 3.2 of this policy, the Commissioners Court Executive Officer is responsible for making debt-financing recommendations to the Commissioners Court. In order to ensure sufficient cash flow is available to meet capital improvement project cash requirements, an annual debt issuance schedule is required. The Capital Reporting System will provide the basis for the annual debt issuance schedule.

18.3 Upon approval of a new debt-financed project during the annual budget process, each office or department will complete the Initial Project Outline form (Appendix A). This form will be submitted to the Department of Budget and Management not later than October 15th in any given fiscal year.

18.4 In order to update the annual debt issuance schedule, each office or department administering a project funded through debt financing will submit a Quarterly Project Report (Appendix B). The report will be submitted to the Department of Budget and Management not later than the 15th day following the end of each quarter of the County's fiscal year.

DEFINITIONS

19.1 Definitions:

a. Arbitrage – Arbitrage is the profit that results from investing tax-exempt proceeds in higher-yielding taxable securities. In general, Internal Revenue Service (IRS) Regulations require that positive arbitrage earnings be rebated back to the government.

b. Bond Indenture – The contract that sets forth the promises of a bond issuer and the rights of investors in the bond.

c. Bond Covenant – A clause in a bond indenture that either requires or forbids some act by, and the issuer is obligated to comply with the covenant by virtue of issuing its bonds.

d. Call Dates – The date, prior to maturity, on which a callable bond may be redeemed.

e. Call Premium – The price, as established in the bond covenant, at which bonds will be redeemed.

f. Certificate of Obligation – The Certificate of Act of 1971 (as amended) permits a County to issue certificates of obligations for the purpose of paying contractual obligations incurred in the construction of public works and the purchase of materials, supplies, equipment, buildings, professional services and real property. Certificates of obligation are normally secured by ad valorem tax revenue and there is no requirement for voter approval.

g. Call Provisions – A clause in a bond contract granting the issuer the right to buy back all or part of an issue prior to the maturity date.

h. Capital Lease – A contract for the purchase of capital equipment through installment payments.

i. Commercial Paper – Short-term, unsecured promissory notes usually backed by a line of credit with a bank. Maturities do not exceed 270 days.

j. Competitive Sales – A sale whereby the issuer determines the bond structure and solicits bids. The bonds are then awarded to the underwriting firm that submits the lowest interest costs for the debt.

k. Continuing Disclosure – The principal that accurate and complete information material to the transaction, which potential investors would be likely to consider material in making investment decisions with respect to the securities, be made available on an ongoing basis.

l. General Obligation – Bonds backed by the annual levy of an ad valorem tax as necessary, within the limits prescribed by law (if any), to pay off the bonds. Bonds are issued upon approval by the public in an election.

m. Interest Rate Management Agreement – An agreement entered into in connection with the issuance of debt by an issuer or in connection with debt already outstanding, with a counterparty to provide for an exchange of payments based upon fixed and/or variable interest rates.

n. Issuance Costs – The expenses associated with the sale of new securities, including such items as underwriter's spread, printing, legal fees and rating costs.

o. Negotiated Sales – A sale whereby the issuer selects an underwriter in advance so that the underwriter can assist with determining the appropriate structure of the bonds.

p. Private Placement – A sale whereby the issuer sells the bonds directly to an institutional investor.

q. Refunding Bonds – Bonds issued to retire a bond already outstanding that may be sold for cash and outstanding bonds redeemed with cash or exchanged with holders of outstanding bonds.

r. Revenue Bonds – Bonds issued where the money raised to pay off the bonds comes from a non-tax revenue source or a special/specific enterprise fund.

s. Tax Anticipation Notes – Short-term notes issued in anticipation of collections of taxes. Short-term notes issued by the county to finance current operations, with repayment from anticipated tax receipts. Also called tax anticipation warrant. These notes are issued at a discount, and must have a maturity of thirteen months or less, and mature either at a specific future date or when property and other taxes are collected. Tax anticipation notes hold first claim on tax receipts when collected.

t. Variable Rate Debt – Bonds with interest rates that fluctuate based upon an index or pricing procedure. These bonds often offer lower interest rates and have short maturities.