1.0 PURPOSE AND NEED

Hampton Roads Sanitation District (HRSD) was created in 1940 by the Virginia General Assembly as a political subdivision of the Commonwealth of Virginia and was established as a governmental instrumentality to provide for the public health and welfare. HRSD was created for the specific purpose of abating pollution in the Hampton Roads area of Virginia through the interception of existing wastewater outfalls, the construction of wastewater treatment facilities and the installation of interceptors throughout the service area.

HRSD operates under the direction of the Hampton Roads Sanitation District Commission (the Commission) comprised of eight members appointed by the Governor for staggered terms of four years.

Regulatory requirements to reduce nutrients, hydraulic expansion, aging infrastructure renewals and replacements, and increased treatment capacity are addressed through HRSD's Capital Improvement Program (CIP).

HRSD recognizes that one of the keys to sound financial management is the development of formal financial policy. This sentiment is echoed by bond rating agencies, investors and the Government Finance Officers Association.

This Financial Policy (Policy) is designed to help protect HRSD's financial resources by:

a. Promoting sound financial management;

b. Ensuring the legal and prudent use of HRSD's debt issuance authority; and

c. Guiding HRSD and its managers in policy, investment and debt issuance decisions.

2.0 DEFINITIONS

2.1 Annual Determined Contribution (ADC). The annual contribution requirement determined by an actuary for a defined benefit plan.

2.2 Arbitrage. The simultaneous purchase and sale of an asset in order to profit from a difference in the price. It is a trade that profits by exploiting price differences of identical or similar financial instruments in different markets or in different forms. For the purposes of this Policy, Arbitrage refers to the difference between the interest paid on the tax-exempt securities and the interest earned by investing the security proceeds in higher-yielding taxable securities. The IRS Code governs arbitrage on the proceeds from issuance of tax-exempt municipal securities.

2.3 **Asset Allocation.** An investment strategy that attempts to balance risk versus reward by adjusting the percentage of each asset in an investment portfolio according to the investor's risk tolerance, goals and investment time frame.

2.4 **Balloon Maturity.** A maturity within an issue of bonds, which contains twenty-five percent (25%) or more of the principal amount of the original issue.

2.5 **Bankers' Acceptance.** A draft or bill or exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer.

2.6 **Basis Swap.** An agreement between two parties to exchange interest payments based on different variable-rate indices, e.g. SIFMA vs. LIBOR; a floating-to-floating swap.

2.7 **Benchmark.** A comparative base for measuring the performance or risk tolerance of an investment portfolio. A benchmark should represent a close correlation to the level of risk and the average duration of the portfolio's investments.

2.8 **Bond Anticipation Notes.** Notes which are generally repaid from the proceeds of the issuance of long-term indebtedness.

2.9 **Broker.** Brings buyers and sellers together for a commission.

2.10 **Bullet Maturity.** A maturity within an issue of bonds for which there are no principal and/or sinking fund payments prior to the stated maturity date.

2.11 **Call Provisions.** The term of a bond giving the issuer the right to redeem all or a portion of such bond prior to its stated date of maturity at a specific price, usually at or above par.

2.12 **Capital Appreciation Bonds.** A municipal security on which the investment return on an initial principal amount is reinvested at a stated compounded rate until maturity. At maturity the investor receives a single payment (the "maturity value") representing both the initial principal amount and the total investment return.

2.13 **Capital Asset.** A unit of property purchased by, constructed by or donated to HRSD that: (1) was acquired or produced and has a value of $5,000 or more; and (2) has an economic useful life of a minimum of 60 months. Capital Assets must be capitalized and depreciated for financial statement purposes. Assets constructed and paid by HRSD that improve the performance of the Wastewater System and subsequently transferred to a Locality constitute Locality Assets and will not be capitalized by HRSD for any purpose.

2.14 Capital Improvement Program (CIP). The CIP is HRSD's planned program of capital projects (greater than $100,000), such as property, plant and equipment and related engineering, legal and construction services, and may consist of Capital Assets and Locality Assets.

2.15 Capitalized Interest. A portion of the proceeds of a bond issue which is set aside to pay interest on one or more bond issues for a specific period of time. Interest is commonly capitalized for the construction period of the project.

2.16 Certificate of Deposit (CD). A time deposit with a specific maturity evidenced by a Certificate. Large-denomination CDs are typically negotiable.

2.17 IRS Code. The Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

2.18 Collateral. Securities, evidence of deposit or other property, which a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposits of public monies.

2.19 Commercial Paper (CP). Short-term, unsecured promissory notes issued by corporations or governments to finance receivables for a maturity specified by the purchaser that ranges from three days to 270 days. Notes are generally sold at a discount, and carry credit ratings issued by an NRSRO.

2.20 Competitive Sale. A sale/auction of securities by an issuer in which underwriters or syndicates of underwriters submit sealed bids to purchase the securities.

2.21 Constant Maturity Swap. An interest rate swap that is predicated upon the shape of the forward implied yield curve whereby counterparties exchange interest rate payments based on an anticipated future interest rate and a variable swap index rate. The interest rate on one leg of the swap is reset periodically but with reference to a market swap rate rather than an index such as LIBOR. The other leg of the swap is generally a market index, such as LIBOR.

2.22 Continuing Disclosure. The principle that accurate and complete information material to a transaction or HRSD, which potential investors would likely consider material in making investment decisions with respect to the securities be made available on an ongoing basis. Pursuant to Rule 15c2-12 promulgated by the SEC, underwriters of HRSD's bonds are obligated to obtain a Continuing Disclosure Agreement (CDA) from HRSD prior to underwriting such bonds.

2.23 Corporate Notes. Unsecured promissory notes issued by corporations to raise capital for a maturity that is longer than 270 days. Notes are generally sold at a discount, and carry credit ratings issued by an NRSRO.

2.24 Credit Enhancement. Credit support purchased by the issuer to raise the credit rating of a debt issue. The most common credit enhancements consist of bond insurance, direct or standby letters of credit, and lines of credit.

2.25 Credit Support Annex. A legal document which regulates credit support (collateral) for derivative transactions.

2.26 Days Cash on Hand. Measured by current and non-current cash and investments, plus any restricted cash and investments, if available for general system purposes, divided by operating and maintenance expenses less depreciation, divided by 365. This calculation will exclude accrued debt service for the next fiscal year and all funds in the Risk Reserve and Renewal and Replacement Reserve.

2.27 Dealer. Acts as a principal in all transactions, buying and selling for his own account.

2.28 Debenture. A bond secured only by the general credit of the issuer.

2.29 Debt Service Coverage Ratio – GAAP. Calculated in accordance with HRSD’s Senior Trust Agreement, the ratio determined by dividing the Net Revenues by annual debt service. In such calculation, funds spent on Locality Assets are considered an expense. Annual debt service will be based on actual principal and interest payments during the year (i.e., not accrual based).

2.30 Debt Service Coverage Ratio - Adjusted. Calculated in accordance with HRSD’s Subordinate Trust Agreement, the ratio determined by dividing the Net Revenues by annual debt service. In such calculation, funds spent on Locality Assets may be excluded from the calculation of Net Revenues under the circumstances described within the definitions of Net Revenues and Operating Expenses. Annual debt service will be based on actual principal and interest payments during the year (i.e., not accrual based).

2.31 Debt Service Reserve Fund. The fund in which moneys are placed that may be used to pay debt service if revenues available for debt service and Credit Enhancements, if applicable, are insufficient to pay debt service on HRSD’s bonds secured by a Debt Service Reserve Fund as it becomes due and payable.

2.32 Deep Discount Bonds. Bonds which are priced for sale at a substantial discount from their face or par value.

2.33 Delivery versus Payment. Delivery of securities with an exchange of money for the securities. (See also Delivery versus Receipt)

2.34 Delivery versus Receipt. Delivery of securities with an exchange of a signed receipt for the securities. Also known as "**free**" delivery; (See also Delivery versus Payment).

2.35 Derivatives. A financial product whose value is derived from some underlying asset value.

2.36 Designation Policies. Outline how an investor's order is filled when a bond's maturity is oversubscribed when there is an underwriting syndicate. The senior managing underwriter and issuer decide how the bonds will be allocated among the syndicate. There are three primary classifications of orders which form the designation policy: Group Net orders; Net Designated orders and Member orders.

2.37 Discount. A bond that is issued for less than its par (or face) value, or a bond currently trading for less than its par value in the secondary market.

2.38 Diversification. A process of investing assets among a variety of security types by sector, maturity and quality rating.

2.39 Enabling Act. HRSD's Enabling Act is Chapter 66 of the Acts of Assembly of Virginia of 1960, as amended.

2.40 Encumbrances. Commitments related to unperformed contracts for goods and services (i.e., purchase orders, contracts and commitments). Encumbrance accounting is utilized to the extent necessary to assure effective budgetary control and accountability and to facilitate effective cash planning and control.

2.41 Escrow. A fund established to hold moneys pledged and to be used to pay debt service on a one or more series of HRSD's bonds or other indebtedness.

2.42 Federal Agency. Government sponsored/owned entity created by the U.S. Congress, generally for the purpose of acting as a financial intermediary by borrowing in the marketplace and directing proceeds to specific areas of the economy considered to otherwise have restricted access to credit markets, also referred to as Government Sponsored Enterprises (GSEs). The largest are Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC), Federal Home Loan Bank (FHLB), Federal Farm Credit Bank (FFCB), and Tennessee Valley Authority (TVA).

2.43 Federal Funds Rate. The rate of interest at which Federal Funds are traded. This rate is currently set by the Federal Reserve through open – market operations.

2.44 **Federal Funds.** Funds placed in Federal Reserve Banks by depository institutions in excess of current reserve requirements, and frequently loaned or borrowed on an overnight basis between depository institutions.

2.45 **FINRA.** The Financial Industry Regulatory Authority.

2.46 **Forward Swap.** A swap executed today, the exchange of interest payments on which starts at some future date (the Effective Date), based on rates and terms determined and agreed upon today. On the **Effective Date** of a Forward swap begin net exchange of swap payments. On the **Trade Date** of the swap:

- Enter into Forward swap agreement
- Set terms of the swap
- Pay commitment fees for swap and bond insurance (if done in conjunction with a synthetic forward refunding of bonds)

2.47 **Interest Rate Cap.** An option that pays its holder when and if the floating interest rate index is above the pre-determined fixed rate (strike price).

2.48 **Interest Rate Collar.** The simultaneous purchase and sale of an Interest Rate Cap and an Interest Rate Floor on a floating index.

2.49 **Interest Rate Floor.** An option that pays its holder when and if the floating interest rate index is below the pre-determined fixed rate (strike price).

2.50 **Interest Rate Swap.** A contract between two parties, referred to as “counterparties”, to exchange interest rate payments at specified dates in the future. One party under the swap contract normally makes payments based on a fixed rate while the other party makes payments based on a variable (floating) rate.

2.51 **Internal Controls.** Systematic measures (such as reviews, checks and balances, methods and procedures) instituted by an organization to: conduct its business in an orderly and efficient manner; safeguard its assets and resources; deter and detect errors, fraud, and theft; ensure accuracy and completeness of its accounting data; produce reliable and timely financial and management information; and ensure adherence to its policies and plans. An important concept in establishing appropriate internal controls is that the cost of the controls should not exceed their anticipated benefits.

2.52 **Knock-in Option.** An option the existence of which is conditional upon a pre-set trigger price trading before the option's designated maturity. If the trigger is not touched before maturity, then the option is deemed not to exist.

2.53 Letters of Credit. A bank credit facility wherein the bank agrees to lend a specified amount of funds for a limited term. Letters of Credit may be used as Credit Enhancement for HRSD's indebtedness.

2.54 Line of Credit. A bank facility wherein the bank permits the borrower to access funds at any time, subject to a maximum loan balance.

2.55 Liquidity. The ability of ease with which an asset can be converted into cash without a substantial loss of value.

2.56 Liquidity Facility. A type of bank credit facility wherein the bank agrees to purchase securities, typically variable rate debt, that cannot be immediately remarketed to investors. The Liquidity Facility provider purchases the securities until such time as they can be remarketed.

2.57 Locality Assets. Assets constructed and paid for by HRSD and subsequently transferred to a locality. A Commission Resolution is required to exclude these costs from the calculation of the Operating Expenses for purposes of the calculation of the Debt Service Coverage Ratio – Adjusted.

2.58 London InterBank Offered Rate (**LIBOR).** LIBOR is the rate on U.S. dollar denominated deposits with maturities from one day to 12 months transacted between banks in London. LIBOR is generally the benchmark floating index in the taxable or corporate swap market.

2.59 Management Fee. The fixed percentage of the gross spread which is paid to the senior managing underwriter for the structuring phase of a bond issue.

2.60 Market Value. The price at which a security is trading and could presumably be purchased or sold.

2.61 Master Repurchase Agreement. A written contract covering all future transactions between the parties to repurchase—reverse repurchase agreements that establishes each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller borrower.

2.62 Maturity. The date upon which the principal or stated value of an investment becomes due and payable.

2.63 Members. Underwriters in a syndicate other than the senior underwriter.

2.64 Moody's. Moody's Investors Service, Inc. is a NRSRO.

2.65 Nationally Recognized Statistical Rating Organization (NRSRO). A credit rating agency which issues credit ratings that the SEC permits other financial firms to use for certain regulatory purposes. Examples include Moody's and S&P.

2.66 Negotiated Sale. A method of sale in which the issuer chooses an underwriter to negotiate terms pursuant to which such underwriter will purchase and market the bonds.

2.67 Net Revenues. All revenues received by HRSD less Operating Expenses.

2.68 Nominal Interest Rate. The interest rate before taking inflation into account. Generally, it is the stated or quoted rate in a loan or deposit agreement.

2.69 Normal Cost. The annual current cost of a member's future retirement benefit.

2.70 Operating Expenses. As defined by the Enabling Act and as used in the Senior Trust Agreement, operating expenses includes the cost of maintaining, repairing and operating such system or systems or sewer improvements and to provide such reserves therefor as may be provided in the resolution providing for the issuance or such revenue bonds or in the trust agreement securing the same. As defined in the Subordinate Trust Agreement, Operating Expenses includes those expenses required to pay the cost of maintaining, repairing and operating the Wastewater System, including, but not limited to, reasonable and necessary usual expenses of administration, operation, maintenance and repair, costs for billing and collecting the rates, fees and other charges for the use of or the services furnished by the Wastewater System, insurance premiums, credit enhancement and liquidity support fees, legal, engineering, auditing and financial advisory expenses, expenses and compensation of the Trustee, and deposits into a self-insurance program. Operating Expenses shall exclude allowance for depreciation and amortization and expenditures for extraordinary maintenance or repair or improvements. Operating Expenses shall also exclude expenses for improvements that will not be owned by HRSD but which will, in the reasonable determination of the Commission, as evidenced by a resolution thereof, maintain or improve the integrity of the Wastewater System.

2.71 Original Issue Discount. The amount by which the original par amount of an issue exceeds its public offering price at the time it is originally offered to an investor.

2.72 Percentage of (% of) LIBOR Swap. A swap whose floating rate is reset based on a percentage of a taxable rate (e.g. 67% of LIBOR) rather than a true tax-exempt rate, e.g. the SIFMA Index. A Percentage of LIBOR swap generally carries a lower expected or nominal fixed rate than a comparable SIFMA swap to compensate the fixed payer (issuer) for the assumption of basis and tax risk.

2.73 Portfolio. Collection of securities held by an investor.

2.74 Premium. The difference between the higher price paid for a fixed-income security and the security's face amount at issue.

2.75 Present Value. The current value of a future cash flow.

2.76 Primary Dealer. A group of government securities dealers who submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and are subject to its informal oversight. Primary dealers include SEC, registered securities broker-dealers, banks, and a few unregulated firms.

2.77 Private Placement. The placement of an issue of indebtedness directly with one or more qualified or institutional investors.

2.78 Prudent Person Rule. An investment standard outlining the fiduciary responsibilities of public funds invested relating to investment practices.

2.79 Rate Lock. An interest rate hedge that is cash-settled at maturity based on the prevailing level of an agreed upon underlying index. (e.g. the SIFMA ‘AAA’ scales)

2.80 Rate of Return. The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond or the current income return.

2.81 Rebate. A requirement imposed by the Tax Reform Act of 1986 whereby the issuer of tax exempt bonds must pay the IRS an amount equal to its profit earned from investment of tax-exempt bond proceeds at rates exceeding the tax exempt borrowing rate. The tax-exempt borrowing rate (or bond yield) is calculated pursuant to the IRS code together with all income earned on the accumulated profit pending payment.

2.82 Repurchase Agreement (RP or REPO). An agreement under which the holder of securities sells these securities to an investor with a contract to repurchase the securities at a fixed price on a fixed date. The security “buyer” in effect lends the “seller” money for the period of the agreement, and the terms of the agreement are structured to compensate him for this.

2.83 Revenue (Limited Liability) Bonds. Bonds issued by HRSD secured by a specific revenue pledge of rates, rents or fees.

2.84 Revenue Anticipation Notes. Notes issued in anticipation of receiving revenues at a future date.

2.85 **Safekeeping.** A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank's vaults for protection.

2.86 **Securities and Exchange Commission (SEC).** Agency created by Congress to protect investors in securities transactions by administering securities legislation.

2.87 **SEC Rule 15C3-1.** See Uniform Net Capital Rule.

2.88 **Securities Industry and Financial Markets Association (SIFMA).** SIFMA is a high grade market index of 7-day variable rate demand notes that is produced by Municipal Market Data. SIFMA is the benchmark swap floating index in the tax-exempt swap market.

2.89 **Self-Liquidity.** A term used in connection with variable rate bond financings whereby the issuer agrees to repurchase with its own capital bonds that have been tendered but not yet remarketed without procuring a third-party Liquidity Facility. In this instance, the issuer uses its own funds to purchase securities.

2.90 **Selling Groups.** The group of securities dealers who participate in an offering not as underwriters but rather who receive securities less the selling concession from the managing underwriter for distribution at the public offering price.

2.91 **Senior Bonds.** Bonds and other indebtedness issued by HRSD secured by the Senior Trust Agreement.

2.92 **Senior Trust Agreement**. The Trust Agreement, dated March 1, 2008, as the same may be amended and supplemented from time, between HRSD and a trustee. The Senior Trust Agreement secures HRSD's Senior Bonds.

2.93 **Serial Bond.** A bond issue in which a portion of the outstanding bonds matures at regular intervals until eventually all of the bonds have matured.

2.94 **Standard & Poor's (S&P)**. Standard & Poor's Global Ratings is a NRSRO.

2.95 **Stripped Security.** Security that has been transformed from a principal amount with periodic interest coupons into a series of zero-coupon bonds, with the range of maturities matching the coupon payment dates and the redemption date of the principal amount.

2.96 **Subordinate Bonds**. Bonds and other indebtedness issued by HRSD and secured by the Subordinate Trust Agreement.

2.97 **Subordinate Trust Agreement**. The Trust Agreement, dated October 1, 2011, as amended and restated as of March 1, 2016, as the same may be amended and supplemented from time to time, between HRSD and a trustee. The Subordinate Trust Agreement secures HRSD's Subordinate Bonds.

2.98 **Swaption.** An option on a forward swap. The purchaser of a swaption (counterparty) has the right, but not the obligation, to compel the swaption seller (usually an issuer) to enter into a pre-negotiated swap agreement at some future date (exercise date). In exchange for this right, the swaption purchaser pays the swaption seller a premium amount. This amount can be paid up front, at some future date, or as an annuity over time.

2.99 **Syndicate Policies.** The contractual obligations placed on the underwriting group relating to distribution, price limitations and market transactions.

2.100 **Term Bonds.** Bonds from the same issue that share the same maturity dates and interest rate. A term bond is the opposite of a serial bond, which has various maturity schedules at regular intervals until the issue is retired.

2.101 **Termination Payment Risk.** The risk that an issuer is forced to liquidate a swap when it owes a termination payment to its counterparty.

2.102 **Treasury Bills.** A non-interest bearing discount security issued by the U.S. Treasury to finance the national debt. Most bills are issued to mature in three months, six months, or one year.

2.103 **Treasury Bonds.** Long-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities of more than 10 years.

2.104 **Treasury Inflation Protected Securities (TIPS).** The principal of a TIPS increases with inflation and decreases with deflation, as measured by the Consumer Price Index. When a TIPS matures, the adjusted principal or original principal, whichever is greater is paid.

2.105 **Treasury Notes.** Medium-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities from two to 10 years.

2.106 **Trust Agreements**. Collectively, the Senior Trust Agreement and the Subordinate Trust Agreement.

2.107 **Underwriter.** A dealer that purchases new issues of municipal securities from the Issuer and resells them to investors.

2.108 Underwriter's Discount. The difference between the price at which bonds are bought by the Underwriter from the Issuer and the price at which they are offered to investors.

2.109 Underwriter's Expenses. Compensates senior managers for out-of-pocket expenses including: underwriter's counsel; DTC charges, travel, syndicate expenses, dealer fees, overtime expenses, communication expenses, computer time and postage.

2.110 Uniform Net Capital Rule. SEC requirement that member firms as well as nonmember broker-dealers in securities maintain a maximum ratio of indebtedness to liquid capital also called net capital rule and net capital ratio. Indebtedness covers all money owed to a firm, including margin loans and commitments to purchase securities, one reason new public issues are spread among members of underwriting syndicates. Liquid capital includes cash and assets easily converted into cash.

2.111 Variable Rate Debt (VRD). An interest rate on a security which changes at intervals according to an index or a formula or other standard of measurement as stated in the bond contract.

2.112 Yield. The rate of annual income return on an investment, expressed as a percentage. Income/current yield is obtained by dividing the current dollar income by the current market price for the security. Net yield or yield to maturity is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.

3.0 GUIDING PRINCIPLES

3.1 RESERVES. An important metric of HRSD's financial flexibility is its liquidity position as measured by available cash and investments. Setting a minimum liquidity position for known risks and obligations will provide funding in emergency or other unexpected situations as they arise. The reserves represent an earmarking, for budgetary and Policy purposes, of cash and liquid investments (current and non-current). These reserves are in addition to existing reserves required by the Trust Agreements, if any, and any funds earmarked for capital improvements or budget carryover amounts.

3.1.1 General Reserve. HRSD will maintain sufficient liquidity to ensure adequate working capital for HRSD's operations. These funds are intended to help HRSD cover unanticipated expenses that cannot be paid from the current fiscal year's budgetary resources. Liquidity will be determined in terms of Days Cash on Hand which will be measured by current and non-current cash and investments, plus any restricted cash and investments, if available for general system purposes, divided by operating and maintenance expenses less depreciation, divided by 365. This calculation will exclude accrued debt service for the next fiscal year and all funds in the Risk Reserve and Renewal and Replacement Reserve, described below. Days Cash on Hand at the end of a fiscal year may not be less than 270 or more than 365 days.

In the event the cash and investments are used to provide funding for unanticipated expenses and the Days Cash on Hand falls below the 270 day minimum, the General Manager will submit a plan in writing to the Commission that will restore the Days Cash on Hand to the policy level over a period not to exceed five fiscal years.

3.1.2 Risk Reserve. HRSD maintains a self-insurance program for some of its risk exposures.

A. HRSD will maintain a Risk Reserve as of the end of the fiscal year of not less than 25 percent of projected annual self-insured claims costs for known, retained risks.

B. In the event the Risk Reserve is used and reduced to a level that is less than the 25 percent minimum to provide funding of unanticipated self-insured expenses, the General Manager will submit a plan in writing to the Commission that will restore the reserve to the policy level over a period not to exceed five fiscal years.

3.1.3 Renewal and Replacement Reserve. As required by the Enabling Act, HRSD's Trust Agreements establish a reserve to finance "anticipated renewals, replacements, extensions, additions and extraordinary repairs" to wastewater system the extent needed. Under the Trust Agreement, the funding of the Renewal and Replacement Reserve is discretionary.

3.2 BUDGETARY PRINCIPLES.

3.2.1 Long-Range Financial Forecast. Each fiscal year the General Manager will submit to the Commission a 20-year financial forecast of anticipated annual revenues and expenses and capital improvements.

This forecast will serve as the foundation for the General Manager's annual budget proposal to the Commission.

3.2.2 Annual Operating Budget Proposals. The Commission is required to adopt an operating budget no later than June 30 each fiscal year.

The Commission will adopt an operating budget that:

A. Is structurally balanced whereby current budgetary revenues are sufficient to meet current budgetary expenses (those that are ongoing in nature);

B. Considers the affordability of rates within the context of local wealth and income indicators;

C. Is at a level necessary to ensure the adequate maintenance and operations of the wastewater system;

D. Is sufficient to meet Actuarially Determined Contribution (ADC) for HRSD's defined benefit plans;

E. Includes amounts necessary to maintain the required reserves in amounts at least equal to the minimum balances as defined in this Policy;

F. Enables HRSD to meet the debt service coverage targets defined in these policies; and

G. Annually funds at least 15 percent of its capital improvement program in cash.

3.2.3 Capital Improvement Program (CIP). Each year HRSD will adopt a ten-year CIP that identifies projects to be undertaken over next ten years to meet projected needs for infrastructure renewal, expansion, replacing old or new facilities.

A capital project by definition involves expenditures to acquire or add assets of a relatively permanent nature such as property, plant and equipment. The CIP is typically for capital projects (not less than $100,000), new facilities, expansions and improvements requiring engineering and/or construction services.

3.2.4 Budgetary Accounting and Control. HRSD operates in accordance with annual operating and capital budgets prepared on a basis of accounting that is different from generally accepted accounting principles.

A. The operating budget is adopted by department, with budgetary controls exercised administratively by management at the department level. The General Manager is authorized to transfer funds among departments without further approval by the Commission. Appropriations lapse at the end of the fiscal year. Valid, outstanding encumbrances (those for which performance under a contract is expected in the next year) are re-appropriated without further approval by the Commission and become part of the subsequent year's budget.

B. The capital budget is a ten-year plan of CIP spending based on estimated project costs and prioritized schedules. Prior to the commencement of construction for any project, the Commission must appropriate funding for the total project cost. If a project is expected to exceed its initial appropriation, the Commission must approve any additional funding through a revised appropriation.

3.3 DEBT AFFORDABILITY. HRSD will comply with the debt service coverage ratios included in its Trust Agreements. Beyond the Trust Agreements' minimums, HRSD will adopt operating and capital budgets that it projects will enable HRSD to maintain a Debt Service Coverage Ratio – Adjusted at a minimum of 1.5 times on senior lien debt and 1.4 times on total debt.

3.4 DERIVATIVES. The derivatives section outlined herein is intended to provide general procedural direction regarding the use, procurement and execution of interest rate swaps and options by HRSD. The Policy is intended to relate to the use of various interest rate hedging techniques, including the contractual exchange of different fixed and variable rate payment streams through interest rate swap agreements. The Policy is not intended to relate to other derivative products, such as hedges for fuel or other commodities that HRSD may consider for hedging exposures other than to interest rates.

3.5 ACCOUNTING AND FINANCIAL REPORTING. HRSD will comply with all Generally Accepted Accounting Principles (GAAP). As permitted by the Subordinate Trust Agreement, HRSD may present, or cause to be presented, certain calculations that reflect certain adjustments that are not in accordance with GAAP.

HRSD will maintain a comprehensive framework of internal controls, and policies and procedures.

Over a period of not more than every five years, HRSD under the direction of the Finance Committee of the Commission will seek proposals from qualified certified public accountant firms, including the current auditors, if their performance has been satisfactory to perform an annual audit of HRSD's financial statements.

3.6 RISK MANAGEMENT. HRSD will make diligent efforts to protect and preserve HRSD assets through a Risk Management program that selectively transfers risk (purchase insurance) for high severity-low frequency exposures and retains risk (self-insurance) for low severity-high frequency exposures.

3.7 INTERNAL AUDIT. HRSD or its designee will conduct internal audits using a risk based approach. Such audit efforts will be approved and directed by the Finance Committee of the Commission.

4.0 PROCEDURES

4.1 DEBT MANAGEMENT. HRSD's debt management program represents an effort to smooth out the fiscal impact of major capital investments while aligning the costs of utility service with the payment of those who will actually use the service.

The proceeds of long-term indebtedness will not be used to finance current operations or expenses for normal maintenance. Long-term indebtedness will be structured such that financial obligations do not exceed the aggregate expected useful lives of the assets financed. Short-term borrowing may be utilized for the temporary funding of operational cash flow deficits or interim construction requirements.

The most appropriate instrument for a proposed sale of debt shall be determined by financing needs and expected market conditions at the time of sale.

4.1.1 Permitted Debt by Type.

A. **Lease Financing.** HRSD may use leasing for facilities or equipment if (1) it can be demonstrated that this is the most cost effective or appropriate way to secure financing, or (2) on small projects that do not warrant entry into the bond market.

B. **Installment Purchases or Conditional Sale Contracts.** HRSD may utilize installment purchase or conditional sale contracts having an original term of one year or less.

C. **Bond Anticipation Notes, Commercial Paper (CP) and Lines of Credit.** Each are typically short duration debt instruments issued to provide interim financing and due to their short duration, expose HRSD to interest rate risk and market access risk upon renewal. Bond Anticipation Notes, Commercial Paper and Lines of Credit may be used to

(1) To finance small projects until such time as the project or projects can be incorporated into a larger bond sale

(2) During times of high interest rates and when the expectation is that interest rates will stabilize in the future or trend downward

(3) When market conditions are such that a Bond Anticipation Notes, Commercial Paper or Lines of Credit may be more readily received in the market than long-term debt, or (4) as an interim financing tool during the construction period for a project(s) until such time as the project(s) is placed into service and / or HRSD sells long-term debt.

D. **Long-Term Revenue Bonds.** HRSD may issue long-term revenue bonds to fund Capital Assets and Locality Assets.

E. **Revenue Anticipation Notes.** May be issued to meet HRSD's operational cash flow needs.

4.1.2 Guidelines on Debt Issuance.

A. **Trust Agreements.** HRSD will abide by the covenants contained in its Trust Agreements. HRSD considers these covenants to be minimum requirements and generally expects to exceed the requirements of each covenant.

B. **Authorization.** Prior to the issuance of debt, the Commission will pass a resolution authorizing the financing arrangements and setting appropriate limits and parameters for the anticipated financing.

C. **Lowest Cost Financing.** Generally, HRSD intends to pursue the lowest cost of financing within the parameters of this Policy, the Trust Agreements and the Enabling Act.

D. **Cash Financing from Available Sources.** HRSD will contribute at least 15 percent of each year's CIP in cash.

E. **Project Costs Prior to Debt Issue.** If project costs are incurred prior to the issuance of debt, the Commission will pass a resolution documenting its intent to be reimbursed from bond proceeds.

F. **Variable Rate Debt (VRD) and Bond Anticipation Notes.** VRD and Bond Anticipation Notes carry inherent interest rate risk. Such securities historically have interest rates lower than fixed rate securities and offer the potential for lower debt service costs over the term of the bond issue. HRSD will consider using VRD when it improves matching of assets and liabilities, potentially lowers debt service costs, adds flexibility to HRSD's capital structure, or diversifies HRSD's investor base.

(1) Debt service on VRD will be budgeted at a conservative rate based on historical fluctuations in interest activity and current market assumptions. Before issuing VRD, HRSD will determine how potential spikes in the debt service will be funded and consider the impact of various interest rate scenarios on its financial position and on various debt ratios.

(2) HRSD will not issue VRD in excess of 15 percent of its total debt portfolio. This limitation, however does not apply to Bond Anticipation Notes with a maturity greater than nine months from the date of issue

or Bond Anticipation Notes issued as part of an interim financing program. In addition, if HRSD can demonstrate historical and projected sufficiency of offsetting principal and interest coverage from short-term and variable rate investment assets held in unrestricted, non-operating accounts, these assets may be netted from variable rate liabilities.

G. **Derivative Products.** HRSD recognizes that the use of derivatives may aid HRSD in reducing the cost of capital and gaining flexibility in structuring its debt portfolio. The use of such products are governed by the Derivatives section of this policy.

H. **Method of Sale.** HRSD will select a method of sale it believes is the most appropriate and economically advantageous in light of financial, market, transaction-specific and HRSD-related conditions. Acceptable methods of sale may include a competitive sale, a negotiated sale, or a private placement.

I. **Duration of Debt.** HRSD will not issue debt for a period longer than aggregate useful lives of the projects being financed. Pursuant to the Enabling Act, HRSD cannot issue debt with a final maturity more than 40 years from the date of issuance. Factors to be considered when determining the final maturity of debt include: the average life of the assets being financed, relative level of interest rates, and the year-to-year differential in interest rates.

4.1.3 Debt Structure

A. **Interest Rate Structure.** HRSD may make use of both variable and fixed rate debt in accordance with limitations set forth in this policy.

B. **Tax Status.** Tax-exempt debt will be used whenever possible and appropriate.

C. **Maturity Structure.** HRSD’s long-term debt may include serial and term bonds. Other maturity structures may also be considered when demonstrated to be advantageous to HRSD.

D. **Coupon Structure.** Fixed rate debt may include par, discount, premium and capital appreciation bonds.

E. **Redemption Features.** In order to preserve flexibility and refinancing opportunities, HRSD debt shall generally be issued with call provisions. HRSD may consider call provisions that are shorter than traditional and/or non-call debt when warranted by market conditions. For each transaction, various call option scenarios will be evaluated so that the most beneficial can be utilized.

F. **Credit Enhancement.** HRSD may use bond insurance and/or line and letters of credit for credit enhancement when it is economically advantageous to do so.

(1) When considering the use of bond insurance, HRSD will perform a maturity-by-maturity analysis. The economic feasibility of insurance will be analyzed based on the value of insurance as priced to the earlier of each maturity's' first applicable call date and the maturity date of such maturity. Enhancement will be used when present value savings result or when such use permits HRSD to incorporate less restrictive covenants into a transaction which results in greater flexibility or lower user charges. HRSD may insure bonds in maturities that are borderline from an economic feasibility standpoint if warranted by other factors (e.g., use of insurance to attract investor interest where certain bond maturities might otherwise be difficult to sell).

(2) When considering the use of a letter of credit or Liquidity Facility, HRSD will examine the economic feasibility of a credit facility by taking into account the trading spread, the cost of the credit facility and the interest costs of HRSD's debt if enhanced.

G. **Debt Service Reserve Fund.** The Senior Trust Agreement requires HRSD to fund a Debt Service Reserve Fund when certain debt service coverage and liquidity ratios are not met. HRSD will fund such reserve when and if it is required. The Subordinate Trust Agreement permits, but does not require, the funding of a Debt Service Reserve Fund.

H. **Capitalized Interest.** By definition, capitalization of interest increases the amount of debt that is issued. If HRSD capitalizes interest on one or more series of indebtedness, it will do so only until such time as the project being financed is expected to be placed in service.

I. **Refinancing of Debt.** HRSD will refinance debt from time to time to achieve debt service savings as market opportunities arise.

Since federal regulations limit a tax-exempt issue to one advance refunding (a refinancing prior to a bond's call provision), HRSD will ensure that the advance refunding results in a significant present value savings. A proposed refinancing should achieve a minimum cumulative, net present value savings of three percent of the amount refinanced, provided HRSD may refinance debt that does not meet this threshold if it obtains other benefits, financial or otherwise, from the refinancing and only if the Commission determines that the issuance of such bonds will be in the District's best interests. In addition, HRSD may consider the efficiency of a proposed refinancing transaction. The efficiency evaluation considers the value realized by HRSD when exercising its option to redeem its bonds early calculated under a variety of different interest rate environments versus the savings garnered. In general, HRSD believes a weighted average aggregate efficiency of 70 percent or greater is a reasonable benchmark.

In any refinancing transaction, HRSD maintains a bias to not extend maturities.

J. **Escrow Structuring.** HRSD will utilize the least costly securities available in structuring refinancing escrows. Unless State and Local Government Securities (SLGS) are used, a certificate will be provided by a third party agent stating that the securities were procured through an arms-length, competitive bid process (in the case of open market securities), and that the price paid for the securities was reasonable within federal guidelines. Under no circumstances will an underwriter, agent or financial advisor sell escrow securities to HRSD from its own account.

K. **Hiring of Professionals.** All members of the financial advisory team including underwriter, financial advisor, bond counsel, and other professionals will be selected in a manner consistent with HRSD's procurement policy for professional services.

4.1.4 Underwriter Selection.

A. **Senior Manager Selection.** HRSD will select a senior manager for any proposed negotiated sale. The selection criteria will include but not be limited to the following:

(1) The firm's ability and experience in managing transactions similar to that contemplated by HRSD

(2) Prior knowledge and experience with HRSD

(3) The firm's ability and willingness to risk capital and demonstration of the firm's capital availability and underwriting of unsold balances

(4) Quality and experience of personnel assigned to HRSD's engagement

(5) Financing plan presented

(6) Cost including underwriting fees and anticipated pricing

B. **Co-Manager Selection.** Co-managers may be selected on the same bases as the senior manager with the exception of underwriting fees, which are determined by the senior manager. In addition to their qualifications, co-managers appointed to specific transactions will be a function of transaction size and the necessity to ensure maximum distribution of HRSD's bonds.

C. **Selling Groups.** HRSD may establish selling groups in certain transactions. To the extent that selling groups are used, HRSD may make appointments to selling groups, as the transaction dictates.

D. **Underwriter's Counsel.** In any negotiated sale of HRSD debt in which legal counsel is required to represent the underwriter, the appointment will be made by the Senior Manager.

E. **Underwriter's Discount.** HRSD will evaluate the proposed underwriter's discount against other proposals and/or comparable issues in the market. If there are multiple underwriters in the transaction, HRSD will determine the allocation of underwriting liability and management fees. The allocation of fees will be determined prior to the sale date; a cap on management fees, expenses and underwriter's counsel fee will be established and communicated to all parties by HRSD. Any additional expenses must be substantiated.

F. **Evaluation of Underwriter Performance.** HRSD will evaluate each bond sale after completion to assess the following: costs of issuance including underwriters' compensation, pricing of the bonds in terms of the overall interest cost and on a maturity-by-maturity basis, and the distribution of bonds and sales credits.

G. **Syndicate Policies.** For each negotiated transaction, HRSD will establish syndicate policies that will describe the priority of orders and designation policies governing the upcoming sale.

H. **Designation Policies.** To encourage the pre-marketing efforts of each member of the underwriting team, orders for HRSD's bonds will be net designated, unless otherwise expressly stated. HRSD shall require the senior manager to:

(1) Fairly allocate bonds to other managers and the selling group.

(2) Comply with the Municipal Securities Rulemaking Board's (MRSB) regulations governing the priority of orders and allocations.

(3) Within 10 working days after the sale date, submit to HRSD a detail of orders, allocations and other relevant information pertaining to HRSD's sale.

4.1.5 Consultants.

A. **Financial Advisor.** HRSD will select a financial advisor (or advisors) to assist in its debt issuance and debt administration processes. Such financial advisor(s) will be an Independent Registered Municipal Advisor within the meaning of the Securities Exchange Act of 1934, as amended. Selection of HRSD's financial advisor(s) will be based on, but not limited to, the following criteria:

(1) Experience in providing consulting services to entities similar to HRSD

(2) Knowledge and experience in structuring and analyzing bond issues

(3) Experience and reputation of assigned personnel

(4) Fees and expenses

B. **Bond Counsel.** HRSD debt will include a written opinion by legal counsel affirming that HRSD is authorized to issue the proposed debt, that HRSD has met all legal requirements necessary for issuance, and, if the interest on the debt to be issued is to be exempt under the IRS Code, a determination consistent therewith. The approving opinion and other documents relating to the issuance of debt will be prepared by counsel with extensive experience in public finance and tax issues. The Bond Counsel will be selected by HRSD.

C. **Conflicts of Interest.** HRSD requires that its consultants and advisors provide objective advice and analysis, maintain the confidentiality of HRSD financial plans, and be free from any conflict of interest. In no case will HRSD's financial advisor be permitted to underwrite any portion of HRSD's bond issues, whether sold competitively or negotiated.

D. **Disclosure by Financing Team Members.** All financing team members will be required to provide full and complete disclosure, relative to agreements with other financing team members and outside parties. The extent of disclosure may vary depending on the nature of the transaction. However, in general terms, no agreements will be permitted which could compromise the firm's ability to provide independent advice which is solely in HRSD's best interests or which could reasonably be perceived as a conflict of interest.

4.1.6 Communication and Disclosure.

A. **Rating Agencies.** HRSD seeks to maintain the highest possible credit ratings it believes appropriate for its debt without compromising the delivery of its basic core services. The Director of Finance will manage relationships with the rating analysts assigned to HRSD.

B. **Investors, Bond Insurers, Liquidity Providers.** The Director of Finance will manage relationships using both informal and formal methods to disseminate information.

C. **Continuing Disclosure.** HRSD recognizes that accurate and complete disclosure is imperative to maintaining the high credit quality of its debt. HRSD will comply with all of its contractual obligations and applicable law and will meet such disclosure requirements in a timely and thorough manner.

D. **Arbitrage Compliance.** HRSD will maintain a system of record keeping and reporting in order to comply with the Arbitrage Rebate Compliance Requirements of the Internal Revenue Code of 1986, as amended.

E. **Post-Issuance Compliance Procedures.** Separate from this policy, HRSD will maintain and follow post-issuance compliance procedures. Such procedures will include provisions regarding continuing disclosure and arbitrage compliance, among others.

4.2 DERIVATIVES.

4.2.1 Approach and Objectives. Interest rate swaps and options (swaps) are tools that can help HRSD meet important financial objectives. Properly used, these instruments can increase HRSD's financial flexibility, provide opportunities for interest rate savings or enhanced investment yields, and help HRSD manage its balance sheet through better matching of assets and liabilities.

A. **Specific Objectives for Utilizing Swaps**. HRSD may consider the use of specific swaps if they meet one or more of the benefits previously described in this Policy or if they:

(1) Result in an expected lower net borrowing cost than traditional debt alternatives;

(2) Result in an improved capital structure (e.g., altered pattern of debt service payments or to create variable rate exposure) or better asset/liability matching;

(3) Cap, limit, or hedge HRSD's exposure to changes in interest rates on a particular financial transaction; or

(4) Provide a specific benefit not otherwise available.

(5) Swaps must not be speculative or create unreasonable risk. Each swap will be reviewed on a case-by-case basis to determine whether or not the level of risk is appropriate for HRSD. Examples of swaps that HRSD considers speculative and which create unreasonable risk include, without limitation:

- Basis swaps;
- Constant maturity swaps;
- Knock-in options on swaps;
- Swaps that including a floating index multiplier (e.g., three times SIFMA); and
- Swaps that are not associated with a specific bond issue.

(6) HRSD prefers Swaps that meet the "consistent critical terms method" for evaluating the effectiveness of Swaps as defined by the Governmental Accounting Standards Board in Statement #53: Accounting and Financial Reporting for Derivative Instruments.

B. **Prohibited Swap Features.** HRSD will not use Swaps that:

(1) Are speculative or create extraordinary leverage or risk;

(2) Lack adequate liquidity to terminate without incurring a significant bid/ask spread;

(3) Provide insufficient price transparency to allow reasonable valuation; or

(4) Are not reasonably uniform to the risk evaluation criteria by this Policy.

C. **Legal Authority.** As stated in Section 29 of HRSD's Enabling Act, as approved by the Virginia General Assembly on March 11, 2008,

"With respect to contracts concerning interest rates, currency, cash flow and other basis, the District may enter into any contract that the Commission determines to be necessary or appropriate to place any obligation or investment of the District, as represented by bonds or the investment of their proceeds, in whole or in part, on the interest rate, cash flow or other basis desired by the Commission. Such contracts may include, without limitation, contracts commonly known as interest

rate swap agreements, rate locks, forward purchase agreements, and futures or contracts providing for payments based on levels of, or changes in, interest rates. Such contracts or arrangements may be entered into by the District in connection with, or incidental to, entering into or maintaining any (i) agreement that secures bonds or (ii) investment, or contract providing for investment, otherwise authorized by law. These contracts and arrangements may contain such payment, security, default, remedy, and other terms and conditions as determined by the Commission, after giving due consideration to the creditworthiness of the counterparty or other obligated party, including any rating by any nationally recognized rating agency."

All derivatives contracts require Commission approval.

D. **Permitted Instruments.** HRSD may utilize the following financial products on a current or forward basis, after identifying the objective(s) to be realized and assessing the attendant risks.

(1) Interest rate swaps, including fixed and floating rate swaps.

(2) Options, including swaptions, Interest Rate Caps, Interest Rate Floors, and Interest Rate Collars.

HRSD prefers swaps that have strong price transparency and which are of a type referred to as "plain vanilla," e.g., a fixed to floating rate SIFMA based interest rate swap.

Swaps will be subject to the legal provisions set forth in HRSD's Trust Agreement, applicable debt documents, and statutory requirements.

E. **Procedure for Submission and Execution.** HRSD may consider swaps that are either presented as proposals or that are developed by HRSD in consultation with its financial advisor and legal counsel. HRSD will give detailed consideration only to proposals that HRSD, in its sole discretion, believes will offer the projected savings or other benefits and will have the ability to meet one or more of the objectives outlined herein.

(1) When feasible, swaps should be competitively procured either under a competitive sealed bid or competitive negotiation (e.g. RFP). On a product-by-product basis, HRSD will have authority to negotiate the procurement of financial instruments that have customized or specific attributes designed for HRSD.

(2) For both competitive and negotiated procurements, the execution of any swap transaction will be subject to receipt of a fairness opinion from HRSD's financial advisor, finding that the terms and conditions of the swap reflect a fair market value of such transaction as of the date and time of its execution.

(3) The execution of all Swaps will be subject to receipt of an opinion from a law firm with extensive experience in public finance and tax issues that the contract is a legal, valid and binding obligation of HRSD and complies with applicable law.

F. **Swap Analysis and Participant Requirements.** In connection with any swap, HRSD, its financial advisor and legal counsel will review the proposed transaction and outline considerations associated with the transaction. Such a review will include the following:

(1) The identification of the proposed benefit and potential risks, which will include, but not necessarily be limited to, those risks outlined in this Policy;

(2) Analysis of potential savings and stress testing of the proposed transaction;

(3) Fixed versus variable rate and swap exposure;

(4) To the extent HRSD deems relevant, any rating reports or criteria regarding swaps by rating agencies; and

(5) Legal constraints.

G. **Swap Risks.** In reviewing proposed or possible swaps, HRSD will consider at a minimum each of the following types of risks, as applicable:

(1) **Counterparty Risk.** The risk of a payment default on a swap by a swap counterparty.

(2) **Termination Risk.** The risk that a swap has a negative value and HRSD owes a "breakage" fee if the contract has to be terminated.

(3) **Tax Risk.** A mismatch between changes in the rate or price on HRSD's underlying debt and the swap caused by a reduction or elimination in the benefits of the tax exemption for municipal bonds, e.g. a tax cut that results in an increase in the ratio of tax-exempt to taxable yields.

(4) **Basis Risk.** A mismatch between the rate on HRSD's underlying debt and the rate paid under the swap, e.g. a tax-exempt variable rate issue which trades at 67% of LIBOR while HRSD receives 80% of LIBOR under the swap.

(5) **Liquidity/Remarketing Risk.** The risk that HRSD cannot secure a cost-effective renewal of a Letter or Line of Credit or suffers a failed remarketing with respect to its variable rate debt.

(6) **Rollover Risk.** The risk that a swap maturity does not match maturity of the related debt or asset.

H. **Counterparty Risk Assessment.** HRSD will only enter into a swap with highly rated financial institutions. Credit criteria for financial institutions are as follows:

(1) The institutions' long-term, unsecured and unsubordinated obligations are rated at the time of execution of the swap by at least one rating agency at least "Aa3" by Moody's Investors Services, Inc. ("Moody's") or "AA" by Standard & Poor's Rating Services ("S&P"), or "AA" by Fitch Ratings ("Fitch") and by at least one other rating agency at no lower than "A2" by Moody's, "A" by S&P, or "A" by Fitch; or

(2) The institutions' obligations under the swap and the Credit Support Annex are unconditionally guaranteed by a bank or non-bank financial institution the long-term, unsecured and unsubordinated obligations of which are rated at the time of execution of the swap by at least one credit agency at least "Aa3" by Moody's or "AA" by S&P or "AA" by Fitch and by at least one other rating agency at no lower than "A2" by Moody's, "A" by S&P, or "A" by Fitch.

In the event of downgrade of a swap counterparty below the minimal rating standard set forth above, the counterparty will be required to:

a. Provide a substitute guarantor or assign the swap contract to an acceptable counterparty meeting the rating criteria, or

b. Provide collateral as described in the Collateral section of this Policy.

I. **Benefit Expectation.** Financial transactions using swaps or other derivative products related to a debt issue should generate at least two percent or greater projected debt service savings than a traditional debt alternative. Such savings analysis will include, where applicable, the consideration of the probability (based on historical interest rate indices, where applicable, or other accepted analytic techniques) of the realization of savings for the derivative structure. The savings target requirement is intended to reflect the complexity and risk of derivative financial instruments, and should include a risk adjustment for other factors. For example, if the underlying debt is callable and the swap is not, then the analysis should include a risk adjustment for this factor.

In determining any benefit in implementing a swap, the cost of remarketing, in addition to the cost of credit enhancement or liquidity fees, will be added to the projected variable rate. Such a calculation should consider the trading performance of comparable indebtedness and any trading premium resulting from a specific form of credit enhancement or liquidity and/or any impact related to broader industry trends.

J. **Hedging Derivatives.** When utilizing a derivative to cap, limit or hedge HRSD's exposure to changes in interest rates, HRSD will evaluate various interest rate scenarios and the estimated impact on projected wastewater rates.

K. **Legal and Contractual Requirements.** HRSD will use standard International Swap and Derivatives Association, Inc. swap documentation, including the Schedule to the Master Agreement and a Credit Support Annex, and related protocols. HRSD may use additional documentation if the product is proprietary or HRSD deems in its sole discretion that such documentation is otherwise in its interest. The swap agreement between HRSD and each counterparty will include payment, term, security, collateral, default, remedy, termination, and other terms, conditions, provisions and safeguards as HRSD, in consultation with its legal counsel, deems necessary and desirable.

L. **Legal Terms of Swaps.** Terms and conditions of any swap will be negotiated by HRSD in the best interests of HRSD. Swap documentation and terms should include the following:

(1) Downgrade provisions triggering termination based on HRSD's credit rating will in no event be less advantageous than those permitting termination based on a downgrade of the counterparty.

(2) Governing law for swaps will be New York law to the extent permitted by law, but should reflect that HRSD's authorization of the related agreement is governed by Virginia law.

(3) The specified debt related to credit events in any swap agreement should be narrowly drafted and refers only to specific debt.

(4) Collateral thresholds will be set on a sliding scale reflective of credit ratings (see Collateral Section).

(5) Eligible collateral will be as set forth in the Collateral Section.

(6) Termination value will be established by "market quotation" methodology, which involves the solicitation of quotations from unrelated brokers regarding the valuation of the swaps.

M. **Notional Amount.** HRSD will limit the aggregate notional amount of derivatives to an amount not to exceed 20 percent of aggregate outstanding debt.

To the extent that HRSD is party to multiple derivatives contracts at any given time, HRSD will seek to diversify its counterparty credit risk by limiting its credit exposure to any single counterparty.

N. **Final Maturity.** The final maturity of any swap agreement will not extend beyond the lesser of the final maturity date of HRSD's related debt and the expiration date of any letter of credit or Liquidity Facility on the related bonds unless HRSD has the right to cancel the swap agreement without cost on such expiration date.

O. **Termination Provisions.** Swaps will contain provisions granting HRSD the right to optionally terminate a swap agreement at any time over the term of the agreement. Such a provision will be required even if the termination is at market. In general, exercising the right to terminate an agreement should produce a benefit to HRSD, either through the receipt of a payment from a termination or, if the termination payment is made by HRSD, in conjunction with the conversion of the related indebtedness to a more beneficial interest rate mode or mitigates a risk to HRSD, as will be determined by HRSD in its sole discretion.

Any termination payment will be established by a "market quotation" methodology, unless HRSD deems an alternate methodology to be appropriate. HRSD's Director of Finance will provide a written report to the Commission with respect to any termination, including the reason(s) why the swap was terminated.

P. **Collateral.** As part of any swap, HRSD will require collateralization or other forms of credit enhancement to secure any or all swap payment obligations.

As appropriate, HRSD, in consultation with its financial advisor, will require collateral or other credit enhancement to be posted by each swap counterparty as follows:

(1) Each counterparty to HRSD will be required to post collateral if the long-term credit rating of the counterparty or its guarantor falls below the requirements outlined in the Counterparty Risk Assessment section of this Policy. Additional collateral for further decreases in credit ratings of a counterparty will be posted by the counterparty in accordance with the provisions contained in the related Collateral Support Annex. Threshold amounts for collateral posting will be determined by HRSD on a case-by-case basis.

(2) In determining maximum uncollateralized exposure, HRSD will consider financial exposure that it may have to the same corporate entities through other forms of financial dealings, such as commercial paper investments.

(3) Collateral will be deposited with a third party trustee, or as mutually agreed upon between HRSD and the counterparty.

(4) A list of acceptable securities that may be posted as collateral and the valuation of such collateral will be determined and mutually agreed upon during negotiation of the swap agreement with each swap counterparty. A complete list of acceptable securities and valuation percentages is included in the Acceptable Collateral section of the Policy.

(5) The market value of the collateral will be determined on at least a weekly basis, or more frequently if HRSD determines it is in its best interest given the specific collateral.

Q. **Ongoing Management.** HRSD will seek to maximize the benefits and minimize the risks it carries by actively managing its swap program. This will entail frequent monitoring of market conditions for emergent opportunities and risks. Active management may require modification of existing positions including, for example:

- Early full or partial termination;
- Shortening or lengthening the term of swaps; or
- Sale or purchase of options.

Legal modification to an existing swap will require approval from the Commission. In modifying any swap, HRSD will fulfill all terms of this Policy and refer back to the original procurement and execution procedures outlined in this Policy.

R. **Ongoing Reporting Requirements.** HRSD will take steps to ensure that there is full and complete disclosure of all swaps to HRSD's Commission, to Rating Agencies. HRSD will also present a summary description of its swaps in its disclosure documents.

HRSD will provide a written report regarding the status of all swap agreements to the Commission at least on a semi-annual basis and will include the following:

(1) A description of all outstanding swap agreements, including, if and when applicable, bond series, type of swap, rates paid and received by HRSD, total notional amount, average life of each swap agreement, remaining term of each swap agreement and covenant compliance.

(2) Highlights of all material changes to swap agreements or new swap agreements entered into by HRSD since the last report.

(3) The credit rating of each swap counterparty and credit enhancer insuring swap payments, if any.

(4) A summary of swap agreements that were terminated or that have expired.

(5) A mark-to-market valuation of swap agreements and the source of the valuation, which HRSD may use for financial reporting purposes.

(6) A summary of Collateral postings.

S. **Acceptable Collateral.**

Security	Collateral Requirement: Valuation Percentage*	Collateral Requirement: Example: $ Value Based on $1.0 Million
Cash	100%	$1.0 million
(x) Negotiable debt obligations issued by the U.S. Treasury Department or GNMA, or		
(y) Mortgage backed securities issued by GNMA (but with respect to either (x) or (y) excluding interest only or principal only Stripped Securities, securities representing residual interests in mortgage pools, or securities that are not listed on a national securities exchange or regularly quoted in a national quotation service) and in each case having a remaining maturity of:		
• less than one year	98%	$1.02 million
• greater than one year	95%	$1.05 million

*To calculate the dollar amount required to satisfy the collateral requirement, divide the collateral requirement by the valuation percentage shown above.

T. **Conformance with Dodd-Frank Act.** It is the intent of HRSD to conform to the requirements relating to legislation and regulations for over-the-counter derivatives transactions under Title VII of the Dodd-Frank Wall Street Transparency and Accountability Act of 2010, as amended from time to time, and the regulations promulgated thereunder (herein collectively referred to as Dodd-Frank). It is the policy of HRSD that (i) each swap advisor engaged or to be engaged by HRSD will function as the designated qualified investment representative of HRSD (Designated Qualified Independent Representative or QIR); (ii) each swap advisor agrees to meet and meets the requirements specified in the Commodity Futures Trading Commission Regulation 23.450(b)(1) or any successor regulation thereto (hereinafter referred to as the QIR Regulation); (iii) each swap advisor provide a written certification to HRSD to the effect that such swap advisor agrees to meet and meets the requirements specified in the QIR Regulation; (iv) HRSD monitor the performance of each swap advisor consistent with the requirements specified in the QIR regulation; (v) HRSD exercise independent judgment in consultation with its swap advisor in evaluating all recommendations, if any presented by any counterparty with respect to transactions authorized pursuant to this Financial Policy; (vi) HRSD rely on the advice of its swap advisor with respect to transactions authorized pursuant to this Financial Policy and not rely on recommendations, if any, presented by any counterparty with respect to transactions authorized pursuant to this Financial Policy; (vii) HRSD comply with all recordkeeping reporting and certification requirements for end-users as applicable under the Commodity Exchange Act.

4.3 INVESTMENT

4.3.1 Ethics and Conflicts Of Interest. The Director of Finance and other employees involved in the investment process will comply with the Code of Virginia Section §2.2-3100 et seq., the state and Local Government Conflict of Interests Act.

A. Specifically, no officer or employee will:

(1) Accept any money, loan, gift, favor, service, or business or professional opportunity that reasonably tends to influence him in the performance of his official duties; or

(2) Accept any business or professional opportunity when he knows there is a reasonable likelihood that the opportunity is being afforded to influence him in the performance of his official duties.

B. All employees involved in the investment process will refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions.

C. All employees involved in the investment process will disclose to the Director of Finance and the General Manager any material interest in financial institutions with which they conduct business. They will further disclose any personal financial or investment positions that could be related to the performance of the investment portfolio.

D. All employees involved in the investment process will refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of HRSD.

4.3.2 Operating Funds

A. **Scope.** Except for funds maintained in trust for retirement and health and welfare benefits for employees and/or retirees, this Policy applies to all HRSD's cash and investments (the Investment Portfolio). The Policy will apply to such monies from the time of receipt until the time the monies leave HRSD's accounts. Although these assets may be pooled for investment purposes, they may be segregated as necessary for accounting and budgetary reporting purposes.

B. **Objectives.**

(1) All investments will be in compliance with the Code of Virginia Sections §2.2-4400 et seq. and §2.2-4500 et seq. and the Trust Agreements.

(2) The cash management and investment activities of HRSD will be conducted in a manner which is consistent with applicable law and prevailing prudent business practices which may be applied by other public organizations of similar size and financial resources.

(3) The Investment Portfolio will be managed to accomplish the following fundamental goals:

a. **Safety of Principal.** The single most important objective of the investment program is the preservation of principal of those funds within the Investment Portfolio.

b. **Maintenance of Liquidity.** The Investment Portfolio will be managed at all times with sufficient liquidity to meet all daily and seasonal needs, to fund special projects and other operational requirements which are either known or which might reasonably be anticipated, and to provide adequate Self-Liquidity, if applicable.

c. **Maximizing Return.** The Investment Portfolio will be managed so as to maximize the return on investments within the context and parameters set forth by the safety and liquidity objectives above.

C. **Standard of Prudence.** All investments will be in compliance with the Code of Virginia Sections §2.2-4400 et seq. and §2.2-4500 et seq. and the Trust Agreement. Public funds held and invested by HRSD are held for the benefit of its rate payers and any investment of such funds will be made solely in the interest of the rate payers and with the care, skill, prudence, and diligence under the circumstances then prevailing that a person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

The Director of Finance and other HRSD employees acting in accordance with written procedures and this Policy and exercising due diligence will be relieved of personal responsibility for an individual security's performance, provided that deviations from expectations are reported in a timely fashion to the Commission.

D. **General Account Structure.** In order to meet HRSD's general objectives, the Investment Portfolio is divided into three major investment strategies: an Operating Liquidity Strategy, a Total Return Strategy and a Capital Investment Strategy.

(1) The **Operating Liquidity Strategy** consists of funds that are expected to provide for HRSD's day-to-day disbursement and operational needs. As such, liquidity is the emphasis in this strategy. This strategy will be funded to meet all known operating needs. Selection of investment maturities will be consistent with the cash requirements of HRSD in order to minimize the forced sale of securities prior to maturity. It is expected that a portion of the Operating Liquidity Strategy will be invested in highly liquid funds such as money market funds, overnight repurchase agreements, bank deposit accounts, or other short-term investment vehicles. This strategy may be utilized to provide Self-Liquidity on debt financings.

(2) The **Total Return Strategy** consists of operating funds that are not expected to be a major source of HRSD's day-to-day disbursement requirements and operational needs. The Total Return Strategy may therefore be invested in longer-term securities in order to generate an investment return, which, over time, is higher than the total return of the Operating Liquidity Strategy. This strategy may be utilized to provide Self-Liquidity on debt financings.

(3) The **Capital Investment Strategy** is the source for capital improvement disbursements. The strategy will consist of unspent debt proceeds and unspent HRSD cash contributions to its CIP. It is anticipated that investments will be made in the Capital Investment Strategy with maturity dates matching the anticipated expenditures or invested in highly liquid funds such as money market funds, overnight repurchase agreements, bank deposits or other short-term investment vehicles.

E. **Authorized Investments.** Under the Trust Agreement, the Director of Finance may invest in the following securities that are in compliance with applicable law. The Director of Finance, however, may impose additional requirements and restrictions in order to ensure that HRSD's goals are met. Permitted investments for the Investment Portfolio include:

(1) **U.S. Treasury Obligations.** Bills, notes and any other obligation or security issued by or backed by the full faith and credit of the United States of America. The final maturity will not exceed a period of five years from the time of purchase.

(2) **Federal Agency Obligations.** Bonds, notes and other obligations of the United States, and securities issued by any federal government agency or instrumentality or government sponsored enterprise, provided that such investments must be rated in one of the two highest rating categories by at least one NRSRO and or the have the same rating as those of U.S. Treasury obligations. The final maturity will not exceed a period of five years from the time of purchase.

(3) **Municipal Obligations.** Bonds, notes and other general obligation indebtedness, upon which there is no default, with a rating of at least AA from S&P and Aa from Moody's Investor Services, maturing within five years of the date of purchase, and otherwise meeting the requirements of Code of Virginia §2.2-4501. However, HRSD is prohibited from purchasing its own debt for the purpose of investing its Operating Funds. Please see the *Self-Liquidity* section of this policy for important language related to Self-Liquidity and HRSD's purchase of its own debt.

(4) **Commercial Paper.** Prime quality commercial paper, with a maturity of 270 days or less, issued by domestic corporations (corporations organized and operating under the laws of the United States or any state thereof) provided that the issuing corporation, or its guarantor, has a short-term debt rating of no less than "A-1" (or its equivalent) from at least two of the NRSROs.

(5) **Bankers Acceptance.** Issued by domestic banks or a federally chartered office of a foreign bank, which are eligible for purchase by the Federal Reserve System with a maturity of 180 days or less. The issuing corporation, or its guarantor, must have a short-term debt rating of no less than "A-1" (or its equivalent) from at least two of the NRSROs.

(6) **Corporate Notes.** High quality corporate notes with a rating of at least "Aa" by Moody's and at least "AA" by S&P. The final maturity will not exceed a period of five years from the time of purchase.

(7) **Negotiable Certificates of Deposit and Bank Deposit Notes.** Negotiable certificates of deposit and negotiable bank deposit notes of domestic banks and domestic offices of foreign banks with ratings of at least A-1 from P-1 from Moody's, for maturities of one year or less, and a rating of at least AA from S&P and Aa Moody's, for maturities over one year. The final maturity may not exceed a period of five years from the time of purchase.

(8) **Money Market Mutual Funds (Open-Ended Investment Funds).** Shares in open-end, no-load investment funds provided such funds are registered under the Federal Investment Company Act of 1940, provided that the fund is rated at least "AAAm" or the equivalent by an NRSRO. The mutual fund must comply with the diversification, quality and maturity requirements of Rule 2(a)-7, or any successor rule, of the SEC, provided the investments by such funds are restricted to investments otherwise permitted by the Code of Virginia for political sub-divisions.

(9) **Local Government Investment Pool.** A specialized fund created in the 1980 session of the General Assembly designed to offer a convenient, liquid, and cost-effective investment vehicle for public entities. The Fund is administered by the Treasury Board of the Commonwealth of Virginia.

(10) **SNAP Fund.** Any pooled investment vehicle established for the investment of bond proceeds under the Government Non-Arbitrage Investment Act (Chapter 47 of Title 2.2 of the Code of Virginia).

(11) **Repurchase Agreements.** In overnight, term and open repurchase agreements provided that the following conditions are met:

a. The contract is fully secured by deliverable U.S. Treasury and Federal Agency obligations as described in paragraph 1 and 2 above (with a maximum maturity of five years), having a market value at all times of at least 102 percent of the amount of the contract;

b. A Master Repurchase Agreement or specific written Repurchase Agreement governs the transaction;

c. The securities are free and clear of any lien and held by an independent third party custodian acting solely as agent for HRSD, provided such third party is not the seller under the repurchase agreement;

d. A perfected first security interest under the Uniform Commercial Code in accordance with book entry procedures prescribed at 31 C.F.R. 306.1 et seq. or 31 C.F.R. 350.0 et seq. in such securities is created for the benefit of HRSD;

e. For repurchase agreements with terms to maturity of greater than one day, HRSD will value the collateral securities daily and require that if additional collateral is required then that collateral must be delivered within one business day (if a collateral deficiency is not corrected within this time frame, the collateral securities will be liquidated);

f. The counterparty is a:

(1) Primary government securities dealer who reports daily to the Federal Reserve Bank of New York; or

(2) A bank, savings and loan association, or diversified securities broker-dealer having at least $5 billion in assets and $500 million in capital and subject to regulation of capital standards by any state or federal regulatory agency; and

(3) The counterparty meets the following criteria: A long-term credit rating of at least ‘AA’ or the equivalent from an NRSRO; has been in operation for at least five years; is reputable among market participants.

(12) **Collateralized Bank Deposits.** Certificates of deposit and other evidence of deposit as permitted by Section 2.2.4400 et seq. of the Code of Virginia.

(13) **U.S. Dollar Denominated Supra Sovereign Agency Bonds.** Bonds and other obligations issued, guaranteed or assumed by the International Bank for Reconstruction and Development, by the Asian Development Bank or by the African Development Bank, provided that the obligation is rated by an NRSRO the higher of “AA” or the rating on U.S. Treasury obligations.

(14) **Virginia Investment Pool Trust Fund (VIP) Stable NAV Liquidity Pool.** This pool supports the cash management needs of municipalities, other governmental agencies and political subdivisions in Virginia that must manage investments conservatively. The objective of the fund is to obtain a competitive market yield on available financial assets consistent with the constraints imposed by the safety objectives, cash flow considerations and the laws of the Commonwealth of Virginia that govern the placement of public funds while facilitating daily liquidity and the maintenance of a stable Net Asset Value, with the price of shares in the portfolio targeted to maintain a value of $1.00. The fund is governed by the Board of Trustees of the VIP.

(15) **VIP 1-3 Year High-Quality Bond Fund.** This fund is a fixed income investment portfolio designed to provide another pooled investment alternative to those Participants that have excess funds and that have an investment horizon greater than that of money market instruments, typically one year or longer. The investment objective is to:

a. Exceed the return of the Bank of America Merrill Lynch One-to Three-Year U.S. Corporate & Government Index over three-year periods

b. Preserve capital

The VIP 1-3 Year High Quality Bond Fund will generally invest in securities with greater potential returns and risk than those offered by money market type instruments. The fund is governed by the Board of Trustees of the VIP.

E. **Portfolio Diversification.** The Investment Portfolio will be diversified by security type and institution. The maximum percentage of the portfolio permitted in each eligible security is as follows:

Permitted Investment	**Sector Limit**	**Issuer Limit**
U.S. Treasury Obligations	100%	100%
Federal Agency Obligations	100%	35%
Municipal Obligations	15%	5%
Commercial Paper	25%	5%
Bankers' Acceptances	25%	5%
Corporate Notes	25%	3%
Negotiable Certificates of Deposit and Bank Deposit Notes	25%	3%

Permitted Investment	Sector Limit	Issuer Limit
Money Market Mutual Funds	100%	100%
LGIP	100%	100%
SNAP Fund (bond proceeds only)	100%	100%
Repurchase Agreements	35%	35%
Collateralized Bank Deposits	100%	100%
Supra Sovereign Agency Bonds	15%	10%
VIP Stable NAV Liquidity Pool	100%	100%
VIP 1-3 Year High-Quality Bond Fund	100%	100%

The Sector Limit and Issuer Limit will be applied to the total Investment Portfolio value at the date of acquisition.

F. **Maximum Maturity.** Maintenance of adequate liquidity to meet the cash flow needs of HRSD is essential. Accordingly, to the extent possible, the investment portfolio will be structured in a manner that ensures sufficient cash is available to meet anticipated liquidity needs. Whenever practical, selection of investment maturities will be consistent with the known cash requirements of HRSD in order to minimize the forced sale of securities prior to maturity. For the purposes of the Investment Policy:

(1) The **Operating Liquidity Strategy** will be invested in short-term investments maturing in 12 months or less. Because of the difficulties inherent in accurately forecasting all cash flow requirements, at least 25 percent of this strategy will be continuously invested in readily available funds such as bank deposit accounts, money market funds and overnight repurchase agreements and at least 75 percent of this strategy will be invested in securities with maturities less than 180 days.

(2) The **Total Return Strategy** will be invested in permitted investments with a stated maturity of not more than five years from the date of purchase. To manage volatility, the Director of Finance will from time-to-time determine an investment duration target which will not exceed three years and which will be comparable to the selected performance standards as identified under the Performance Standards section of this Policy.

(3) The Capital Investment Strategy will be invested in compliance with the specific requirements of the Trust Agreements. However, in no case will bond proceeds, or funds set aside for capital projects, be

invested in securities with a term to maturity that exceeds the expected disbursement date of those monies.

(4) Debt service reserve funds with longer term investment horizons may be invested in securities exceeding five years, provided that such investments will mature no later than the first call date for the related bonds.

G. **Security Downgrades.** In the event that any security held in the Investment Portfolio is downgraded below AA or equivalent rating by any NRSRO, the security will be sold within 180 days of such downgrade.

H. **Self-Liquidity**. In the event that HRSD determines to provide Self-Liquidity for any issuance of CP, VRDs, or related indebtedness investments of the Operating Liquidity Strategy and the Total Return Strategy may be used to support such obligations, if necessary, provided that HRSD will not be legally obligated to pledge such funds for such purpose. The investments identified to provide self-liquidity coverage will be sufficient to meet the quality, volatility, liquidity, and maturity guidelines of the NRSRO's then providing ratings on HRSD's debt obligations. If needed, HRSD is permitted to purchase its own debt on a temporary basis or for the retirement of the debt. Such purchase will not be limited to the sector and issuer diversification limits as set forth in the Portfolio Diversification section of this policy or the maximum maturity requirement as set forth in the Capital Investment Strategy section of this Policy.

I. **Investment of Bond Proceeds**. HRSD intends to comply with all applicable sections of the Internal Revenue Code as it relates to Arbitrage Rebate and the investment of bond proceeds. All investment records will be maintained to ensure compliance with all regulations.

J. **Collateralization of Bank Deposits.** All bank deposits of HRSD should be considered Public Deposits as defined by Code of Virginia Security for Public Deposits Act (Section 2.2-4400 et seq.) and all deposits must be made with Qualified Public Depositories within the meaning of such law.

K. **Selection of Broker/Dealers.** All broker/dealers who desire to provide investment services to HRSD will be provided with current copies of HRSD's Financial Policy. Before an organization can provide investment services to HRSD, it must confirm in writing that it has received and reviewed HRSD's Financial Policy.

(1) At the request of the Director of Finance, broker/dealers will supply HRSD with information sufficient to adequately evaluate their financial

capacity and creditworthiness. The following information will be provided:

(a) Audited financial statements;

(b) Regulatory reports on financial condition;

(c) Proof of Financial Institution Regulatory Authority (FINRA) certification and of state registration;

(d) A sworn statement by an authorized representative of the broker/dealer pledging to adhere to Capital Adequacy Standards established by the Federal Reserve Bank and acknowledging the broker/dealer understands that HRSD has relied upon this pledge; and

(e) Any additional information requested by the Director of Finance in evaluating the creditworthiness of the institution.

(2) Only firms meeting the following requirements will be eligible to serve as broker/dealers for HRSD:

(a) “Primary” dealers and regional dealers that qualify under Securities and Exchange Commission Rule 15C3-1 (uniform net capital rule);

(b) Capital of at least $10,000,000;

(c) Registered as a dealer under the Securities Exchange Act of 1934;

(d) Member of the FINRA;

(e) Registered to sell securities in the Commonwealth of Virginia; and

(f) Engaged in the business of effecting transactions in U.S. government and agency obligations for at least five consecutive years.

(3) HRSD will designate broker/dealers on an annual basis.

L. **Competitive Selection of Investment Instruments.** All securities purchases and sales will be transacted only with designated broker/dealers through a formal and competitive process requiring the solicitation and evaluation of at least three bids/offers, taking into consideration current market conditions. Electronic bids will be accepted. HRSD will accept the bid which, in the sole judgment of the Director of Finance or his/her designee: (1) offers the highest rate of return within the maturity required; and (2) optimizes the investment objective of the overall investment portfolio, including diversification requirements. When selling a security, HRSD will select the bid that generates the highest sale price, consistent with the diversification requirements.

M. **Safekeeping and Custody.** All investment securities purchased by HRSD or held as collateral on deposits or investments will be held by HRSD or by a third-party custodial agent that may not otherwise be counterparty to the investment transaction.

(1) All securities in HRSD's investment portfolio will be held in the name of HRSD and will be free and clear of any lien. Further, all investment transactions will be conducted on a delivery versus payment basis. On a monthly basis, the custodial agent will provide reports that list all securities held for HRSD, the book value of holdings, and the market value as of month-end.

(2) HRSD officials and representatives of the custodial agent responsible for, or in any manner involved with, the safekeeping and custody process of HRSD will be bonded in such a manner as to protect HRSD from losses from malfeasance and misfeasance.

(3) Original copies of non-negotiable certificates of deposit and confirming copies of all other investment transactions must be delivered to HRSD or its custodial agent.

N. **Internal Controls.** The Director of Finance will establish a framework of internal controls governing the administration and management of HRSD's investment portfolio, and these controls will be documented in writing. Such controls will be designed to prevent and control losses of HRSD monies arising from fraud, employee error, and misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by any personnel. The internal control structure will be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits require estimates and judgments by management.

O. **Records and Reports.** The Director of Finance will prepare an investment report on at least a quarterly basis for the Commission.

P. **Performance Standards.** The investment portfolio will be designed to obtain at least a market level rate of return, given budgetary and economic cycles, commensurate with HRSD's investment risk and cash flow needs. HRSD's portfolio management approach will be active, allowing periodic restructuring of the investment portfolio to take advantage of current and anticipated interest rate movements.

(1) The returns on HRSD's investments will be compared on a quarterly basis to indices of U.S. Treasury securities having similar maturities or to other appropriate benchmarks.

(2) The applicable benchmarks for each of HRSD's three major Investment strategies are listed below:

Fund	**Benchmark**
Operating Liquidity	3-Month U.S. Treasury Bill or Effective Federal Funds rate
Total Return	Merrill Lynch 1-3 Year U.S. Corporate & Government Index over three-year periods
Capital Investment	3-Month U.S. Treasury Bill, Effective Federal Funds rate, Virginia LGIP or similar index appropriate to the duration of the expected cash flows

Q. **Engagement of Investment Managers.** The Director of Finance may engage one of more qualified firms to provide discretionary investment management services in compliance with this Policy for HRSD. All investment management firms who desire to provide investment services to HRSD will be provided with current copies of HRSD's Investment Policy. Before an organization can provide investment services to HRSD, it must confirm in writing that it has received and reviewed HRSD's Investment Policy. The Director of Finance will conduct appropriate due diligence in the selection of qualified investment management firms and will periodically confirm a manager's qualifications by visiting that manager's operational facilities that provide services to HRSD.

(1) Only firms meeting the following requirements will be eligible to serve as investment manager for HRSD:

(a) Registered with the SEC under the Investment Advisers Act of 1940;

(b) Must provide to HRSD an annual updated copy of Form ADV, Part II;

(c) Must be registered to conduct business in the Commonwealth of Virginia; and

(d) Must have proven experience in providing investment management services under Code of Virginia §Sections 2.2-4500 et seq.

(2) Any firm engaged by HRSD to provide investment services will:

(a) Maintain a list of approved security brokers/dealers selected by creditworthiness who are authorized to provide investment services in the Commonwealth of Virginia;

(b) Provide monthly reports of transactions and holdings to the Director of Finance;

(c) Provide performance reports, at least quarterly, that display investment performance in comparison to HRSD's investment benchmarks; and

(d) Not collect any soft dollar fees from any broker/dealer or other financial firm in relation to services provided to HRSD.

4.3.3 Retiree Health Plan Trust

A. **Background.** HRSD established the Hampton Roads Sanitation District Retiree Health Plan Trust (the Trust) originally effective July 1, 2002, and amended and restated effective January 22, 2008 and November 25, 2008. The Trust provides for funding of non-pension/Other Post-Employment Benefits for employees who meet the age and service requirements outlined in the Hampton Roads Sanitation District Health Benefits Plan (the Plan) originally effective July 1, 2002, as it may be amended from time to time.

B. **Purpose.** The main investment objective of the Trust is to achieve long-term growth of Trust assets by maximizing long-term rate of return on investments and minimizing risk of loss in order to fulfill HRSD's current and long-term OPEB obligations. The purpose of the Policy is to achieve the following:

(1) Document investment objectives, performance expectations and investment guidelines for Trust assets.

(2) Establish an appropriate investment strategy for managing all Trust assets, including an investment time horizon, risk tolerance ranges and asset allocation to provide sufficient diversification and overall return over the long-term time horizon of the Trust.

(3) Establish investment guidelines to control overall risk and liquidity.

(4) Establish periodic performance and cost reporting requirements that will effectively monitor investment results and ensure that the investment policy is being followed.

(5) Comply with all fiduciary, prudence, due diligence and legal requirements for Trust assets.

C. **Investment Authority.** HRSD, as Plan Administrator (the Administrator), has oversight authority of certain policies and procedures related to the operation and administration of the Trust. Pursuant to the terms of the Trust, the Trustee is to hold title to the trust assets held for the Plan and to operate exclusively in the capacity as a directed Trustee. HRSD, as the named Administrator, has the authority not only to direct the Trustee but to appoint one or more investment managers. The Administrator will have authority to implement the investment policy and guidelines in the best interest of the Trust to best satisfy the purposes of the Trust.

(1) The Administrator has a fiduciary duty to the Trust and the participants and beneficiaries, which requires integrity and competence. Integrity requires management of the Trust and the assets for the exclusive benefit of the Trust's participants and beneficiaries. The required level of competence is that of a prudent person acting in like capacity and familiar with such matters would act. This standard of competence extends to the retention and supervision of expert investment advice and all other areas of Trust's management.

(2) In implementing this Policy, the Administrator, in accord with the provisions of the Trust, may delegate certain functions to:

(a) An investment advisor (the Investment Advisor) to assist the Administrator in the investment process and to maintain compliance with this Policy. The Investment Advisor may assist the Administrator in establishing investment policy objectives and guidelines. The Investment Advisor will adjust asset allocation for the Trust subject to the guidelines and limitations set forth in this Policy. The Investment Advisor will also select investment managers (Managers) and strategies consistent with its role as a fiduciary for the Trust. The investment vehicles allowed may include mutual funds, commingled trusts, separate accounts, limited partnerships and other investment vehicles deemed to be appropriate by the Investment Advisor. The Investment Advisor is also responsible for monitoring and reviewing investment managers; measuring and evaluating performance; and other tasks as deemed appropriate in its role as Advisor for Trust assets. The Investment Advisor may also select investment managers with discretion to purchase, sell, or hold specific securities, such as Exchange Traded Funds, that will be used to meet the Trust's investment objectives. The Investment Advisor shall never take possession of securities, cash or other assets of the Trust, all of which shall be held by the custodian. The Investment Advisor must be registered with the SEC. The Director of Finance will conduct appropriate due diligence in the selection of the Investment Advisor and will periodically confirm the Investment Advisor's qualifications by visiting its operational facilities that provide services to the Trust and HRSD.

(b) A custodian to physically maintain possession of securities owned by the Trust, collect dividend and interest payments, redeem maturing securities, and effect receipt and delivery following purchases and sales, among other things. The custodian may also perform regular accounting of all assets owned, purchased, or sold, as well as movement of assets into and out of the Trust.

(c) A trustee appointed by the Trust, such as a bank trust department, if the Trust does not have its own Trustees, to assume fiduciary responsibility for the administration of Trust assets; provided, however, that if the Administrator shall have appointed an investment advisor, then any trustee appointed under this paragraph shall have no authority with respect to selection of investments.

(d) Specialists such as attorneys, auditors, actuaries and, retirement plan consultants to assist the Administrator in meeting its responsibilities and obligations to administer Trust assets prudently.

(3) HRSD members, staff, investment advisors, consultants and managers will refrain from engaging in any activity that impairs (or has the potential to impair) their ability to make impartial investment

decisions for the Trust. Persons who nevertheless engage in such conduct will immediately disclose the conduct to the Administrator. HRSD members, staff, investment managers and advisers will also immediately disclose to the Administrator any activity engaged in by their respective firms, employers, employees and agents which conflicts (or has the potential to conflict) with the execution of HRSD's investment program for the Trust.

D. **Statement of Investment Objectives.** The investment objectives of the Trust are as follows:

(1) **Funding.** The primary objective of the Administrator is to maintain the assets of the Trust at the funding level necessary to provide a pool of funds to be used to provide post-retirement welfare benefits to Plan participants. To obtain this objective the Administrator will diversify Trust assets and adopt an investment strategy consistent with the Trust's investment objectives.

(2) **Safety.** In order to maintain the safety of Trust assets the Administrator will:

(a) Invest assets of the Trust in a manner consistent with the following fiduciary standards: all transactions undertaken must be for the sole interest of Trust beneficiaries and defray reasonable expenses in a prudent manner, and assets are to be diversified in order to minimize the impact of large losses in individual investments.

(b) Conserve and enhance the value of Trust assets in real terms through asset appreciation and income generation, while maintaining a moderate investment risk profile.

(c) Minimize principal fluctuations over the Time Horizon (as defined below).

(d) Achieve a long-term level of return commensurate with contemporary economic conditions and equal to or exceeding the investment objective set forth in this policy under the Performance Expectations section of the Policy.

(3) **Liquidity.** The Trust's Investment Portfolio in combination with the projected net cash flows will provide sufficient liquidity to enable the Plan to meet all operating requirements which may be reasonably anticipated.

E. **Investment Guidelines.** Within this section of the Policy, several terms will be used to articulate various investment concepts. The descriptions are meant to be general and may share investments otherwise considered to be in the same asset class. They are:

(1) Growth Assets - a collection of investments and/or asset classes whose primary risk and return characteristics are focused on capital appreciation. Investments within the Growth Assets category can include income and risk mitigating characteristics, so long as the predominant investment risk and return characteristic is capital appreciation. Examples of such investments or asset classes are: domestic and international equities or equity funds, private or leveraged equity, certain real estate investments, and hedge funds focused on equity risk mitigation or equity-like returns.

(2) Income Assets - a collection of investments and/or asset classes whose primary risk and return characteristics are focused on income generation. Investments within the Income Assets category can include capital appreciation and risk mitigating characteristics, so long as the primary investment risk and return characteristic is income generation. Examples of such investments or asset classes are: fixed income securities, guaranteed investment contracts, certain real estate investments, and hedge funds focused on interest rate risk mitigation or income investment-like returns.

(3) Real Return Assets - a collection of investments and/or asset classes whose primary risk and return characteristics are focused on real returns after inflation. Investments within the Real Return category can include inflation protected securities, commodities, certain real estate investments and hedge funds.

F. **Time Horizon.** The Trust’s investment objectives are based on a market-cycle investment horizon so that interim fluctuations should be viewed with appropriate perspective. HRSD has adopted a long-term investment horizon such that the chances and duration of investment losses are carefully weighed against the long-term potential for appreciation of assets.

G. **Liquidity and Diversification.** Trust will hold an adequate amount of protected liquidity needs for benefit payments and expenses in cash or cash equivalents, as determined necessary. The liquidity assets will be invested in accordance with statutory requirements applicable to liquid assets, as determined by the Administrator. The remaining assets will be invested in longer-term securities.

Investments will be diversified with the intent to minimize the risk of long-term investment losses. The total portfolio will be constructed and maintained to provide prudent diversification with regard to the concentration of holdings in individual issues, issuers, countries, governments or industries.

H. **Asset Allocation.** The Administrator recognizes that asset allocation is one of the most important investment decisions that an investor makes. The Administrator or Investment Advisor, as appropriate, will allocate Trust assets in keeping with the Prudent Person Rule. The Administrator or Investment Advisor has determined that to achieve the greatest likelihood of meeting the applicable investment objectives and achieving the best balance between risk and return for optimal diversification, the Trust should allocate assets into two broad classes called Investment Assets and Liquidity Assets.

(1) The Investment Assets will be invested in accordance with the targets for each asset class as follows to achieve an average total annual rate of return that is equal to or greater than the Trust's actuarial discount rate as described in the Section titled "Performance Expectations." The Liquidity Assets will be held in cash equivalent investments and used to pay for benefits and expenses of the Trust.

(2) The Administrator, Investment Advisor, or Managers will have discretion to temporarily invest a portion of the assets in cash reserves when they deem it appropriate. However, the Investment Advisor and each Manager will be evaluated against their peers on the performance of the total funds under their direct management.

INVESTMENT ASSETS

Asset Classes	Asset Range	Weightings Target
Growth Assets		
Domestic Equity	19% - 59%	39%
International Equity	1% - 41%	21%
Other	0% - 10%	0%
Income Assets		
Fixed Income	20% - 60%	40%
Other	0% - 10%	0%
Real Return Assets	0% - 20%	0%
Cash Equivalents	0% - 20%	0%

LIQUIDITY ASSETS

Asset Classes	**Asset Range**	**Weightings Target**
Cash Equivalents	0% - 100%	100%

I. **Rebalancing Philosophy.** The asset allocation range established by this Policy represents a long-term perspective. For that reason, rapid unanticipated market shifts or changes in economic conditions may cause the asset mix to fall outside the Policy range. When these divergences occur, the Administrator or Investment Advisor, as appropriate, will rebalance the asset mix to its appropriate targets and ranges. Rebalancing will typically occur on at least a quarterly basis, unless the divergence is deemed an appropriate tactical strategy by the Administrator or Investment Advisor. Similarly, if the cash requirement to handle liquidity needs falls to a level at which near-term distributions (over the following six months or less) cannot be met and no contributions are anticipated, the Administrator or Investment Advisor will rebalance the fund to its appropriate targets and ranges.

Regarding allocating contributions to the Trust, the Administrator or Investment Advisor will review the Trust allocation and fill the liquidity allocation first and the remaining investment allocations last.

J. **Risk Tolerance.** The Trust will be managed in a style that seeks to minimize principal fluctuations over the established Time Horizon and that is consistent with the Trust's investment objectives.

K. **Performance Expectations.** Over the long-term, a rolling five- year period, the performance objective for Trust assets will be to achieve an average total annual rate of return that is equal to or greater than the Trust’s current actuarial discount rate. Additionally, it is expected that the annual rate of return on Trust assets will be commensurate with the then prevailing investment environment. Measurement of this return expectation will be judged by reviewing returns in the context of industry standard benchmarks, peer universe comparisons for individual Trust investments and blended benchmark comparisons for the Trust in its entirety. Costs will be reviewed by the Administrator and Investment Advisor to determine that they are minimized to the extent possible and are reasonable when compared to benchmarks.

L. **Selection of Investment Managers.** The Administrator or Investment Advisor will prudently select appropriate investment managers to manage the assets of the Trust. Managers must meet the following criteria:

(1) The investment manager must be a bank, insurance company, or investment adviser as defined by the Investment Advisers Act of 1940.

(2) With respect to Trust assets invested in a mutual fund, the Manager must provide historical quarterly performance data for the mutual fund compliant with SEC and Financial Industry Regulatory Authority (FINRA) standards.

(3) The investment manager must provide historical quarterly performance data compliant with Global Investment Performance Standards, SEC, FINRA or industry recognized standards, as appropriate, calculated on a time-weighted basis, based on a composite of all fully discretionary accounts of similar investment style and reported net of fees.

(4) The investment manager must provide detailed information on history of the firm, key personnel, key clients, fee schedule (including most favored nation clauses) and support personnel.

(5) The investment manager must clearly articulate the investment strategy that will be followed and document that the strategy has been successfully adhered to over time.

(6) The investment professionals making the investment decisions must have a minimum of three years of experience managing similar strategies either at their current or at previous firms.

(7) The investment manager for portfolios other than Pooled Vehicles (see the following Guidelines for Portfolio Holdings) must confirm that it has received, understands and will adhere to this policy and any manager specific policies by signing a consent form.

M. **Guidelines for Portfolio Holdings.** The Administrator will make every effort to prudently select funds that follow the guidelines listed below.

(1) Until the Trust reaches a size for which investment in separate accounts is viable and appropriate, the Trust will invest in Pooled Vehicles such as commingled and/or mutual funds. Pooled Vehicles are regulated by either the Office of the Comptroller of the Currency (OCC) or the SEC and provide the Trust the ability to appropriately

diversify its holdings in a cost effective manner. Inherent within the Pooled Vehicle structure is the limitation on customizing the underlying security selection based on Trust specific economic, social or other screens.

(2) **Direct Investments by Advisor.** Every effort shall be made, to the extent practical, prudent and appropriate, to select investments that have investment objectives and policies that are consistent with this Policy Statement (as outlined in the following sub-sections of the Guidelines for Portfolio Holdings). However, given the nature of the investments, it is recognized that there may be deviations between this Policy Statement and the objectives of these investments.

(3) **Limitations on Investment Manager's Portfolios.**

(a) **Growth Assets.**

Equities. Not more than five percent or weighting in the relevant index (Russell 3000 Index for U.S. issues and MSCI All County World Index (ACWI) ex-U.S. for non-U.S. issues) of the total equity portfolio valued at market may be invested in the common stock of any one corporation. MSCI is a publically traded company that is an independent provider of research-driven insights and tools for institutional investors. The MSCI ACWI is an index that captures all sources of equity returns in 23 developed and 23 emerging markets. Ownership of the shares of one company will not exceed two percent of those outstanding. Not more than 25 percent of stock valued at market may be held in any one sector, as defined by the Global Industry Classification Standard.

(1) **Domestic Equities.** Other than these constraints, there are no quantitative guidelines suggested as to issues, industry or individual security diversification. However, prudent diversification standards should be developed and maintained by the investment manager(s).

(2) **International Equities.** The overall non-U.S. equity allocation, if any, should include a diverse global mix that is comprised of the equity of companies from multiple countries, regions and sectors.

(b) **Income Assets.**

Fixed Income. Fixed income securities, other than U.S. Treasury/Federal Agency issues, of any one issuer will not exceed five percent of the total bond portfolio at time of purchase. The five percent limitation does not apply to issues of the U.S. Treasury.

The overall weighted rating of the fixed income assets will be at least "A", based upon the ratings of such assets from a NRSRO.

(c) **Other Assets (Growth and Income Assets).**

Other Assets (Alternatives). Alternatives may consist of non-traditional asset classes such as real estate and commodities, when deemed appropriate. The total allocation to this category may not exceed 10 percent of the overall portfolio.

Real Estate. Consists of publicly traded Real Estate Investment Trust (REIT) securities and/or non-publicly traded private real estate and shall be diversified across a broad array of property types and geographic locations. Investments of this type are designed to provide a stable level of income combined with potential for price appreciation, particularly in periods of unexpected inflation. For private real estate, the illiquid, long-term nature should be considered. For purposes of asset allocation targets and limitations, publicly traded REITs will be categorized as “Other” under the Growth Assets category. Depending on the investment characteristics of a private real estate fund, the fund will be categorized as “Other” under either the Income Assets category, for example, a core real estate fund, or under the Growth Assets category, for example, an opportunistic real estate fund where capital gains are expected to make up a significant portion of the total return.

Portfolio Risk Hedging. Portfolio investments designed to hedge various risks including volatility risk, interest rate risk, etc. are allowed to the extent that the investments are not used for the sole purpose of leveraging Trust assets. One example of a hedge vehicle is an Exchange Traded Fund (“ETF”) which takes short positions.

(d) **Real Return Assets.**

Inflation Hedge. Shall consist of pooled vehicles holding among other assets: TIPS, commodities or commodity contracts, index-linked derivative contracts, certain real estate or real property funds and the equity of companies in businesses thought to hedge inflation. Inflation hedge assets will be reported in the Real Return Assets category.

If the credit quality of any one issue should drop below investment grade (as defined by two of the three rating agencies – Fitch, Moody's and Standard & Poor's), the investment manager should notify the Administrator and Investment Advisor immediately detailing a plan of action regarding the security.

(e) **Cash Equivalents.** Liquidity and temporary cash equivalent reserves will be invested according to the provisions of Code of Virginia Sections 2.2-4500 through 2.2-4518 applicable to liquid assets.

(f) **Additional Limitations.**

(1) **Prohibited Investments.** Except for purchase within authorized investments, the following investments and transactions are not authorized and will not be purchased:

- Letter stock and other unregistered securities,
- Direct commodities or commodity contracts,
- Short sales,
- Margin transactions,
- Private placements (with the exception of Rule 144A securities),
- Venture capital funds,
- Private equity,
- Hedge funds;

Further, derivatives, options or futures for the sole purpose of portfolio leveraging (portfolio leveraging refers specifically to investments which can lead to losses in excess of 100 percent of initial invested capital) are also prohibited. Direct ownership of real estate, natural resource properties such as oil, gas or timber and the purchase of collectibles is also prohibited.

(2) **Safekeeping.** All securities will be held by a third-party custodian selected through a public procurement process by the Administrator, pursuant to contract approval, for safekeeping. The custodian will produce statements monthly listing the name and value of all assets held, and the dates and nature of all transactions. Assets of the Trust held as liquidity or investment reserves will, at all times, be invested in interest-bearing accounts. Investments and portfolio securities may not be loaned.

(g) **Control Procedures.**

(1) **Legal Requirements, Controls, and Investment Policy Statement Review.** At all times the Administrator will comply with all local, State, and federal reporting requirements. The Administrator will establish, maintain and review prudent internal controls for the assets of the Trust, including those used by HRSD staff, and the Trust's Investment Advisor and custodian. The Administrator will provide for annual review of the adequacy and compliance of these control procedures.

(2) The Administrator will review the Financial Policy no less than annually and provide documentation to HRSD when their review is complete. Specifically, the investment component of the Financial Policy will be reviewed when any one of the following occurs:

- Change in investment advisors
- Initial use of investment vehicles other than mutual funds
- Significant change in Trust assets
- Significant change in funded status
- Significant change in market conditions

(3) **Review of Investment Objectives.** The Administrator will review annually the appropriateness of the Policy for achieving the Trust's stated objectives. It is not expected that the Policy will change frequently. In particular, short-term changes in the financial markets should not require an adjustment in the investment policy.

(4) **Review of Investment Performance.** The Administrator, on a quarterly basis, will review the total Trust investment performance, including all fees and costs and provide a report to the Commission. In addition, should investment functions be delegated, the Investment Advisor will be responsible for keeping the Administrator advised of any material change in investment strategy, investment managers, and other pertinent information potentially affecting performance of the Trust.

The Administrator will compare the investment results including all fees and costs on a quarterly basis to appropriate benchmarks, as well as to market index returns in both equity and debt markets. Examples of benchmarks and indexes that will be used include the:

- Russell 3000 Index for broad U.S. equity strategies;
- S&P 500 Index for large cap U.S. equities,
- Russell 2000 Index for small cap U.S. equities,
- MSCI ACWI ex-U.S. Index for broad based non-U.S. equity strategies;
- MSCI Europe, Australasia, and Far East (EAFE) Index for developed markets international equities,
- Barclays Capital Aggregate Bond Index for fixed income securities, and
- U.S. 91 Day T-bill for cash equivalents
- Russell 3000 Index will be used to benchmark the U.S. equities portfolio;
- MSCI ACWI ex-U.S. Index will be used to benchmark the non-U.S. equities portfolio;
- Barclays U.S. Aggregate Bond Index will be used to benchmark the fixed income portfolio.

The categories “Other” will be benchmarked against appropriate indices depending on the specific characteristics of the strategies and funds used. The Administrator will also compare investment results with the Virginia Retirement System at the end of each fiscal year.

(5) **Voting of Proxies.** The Administrator recognizes that proxies are a significant and valuable tool in corporate

governance. The voting rights of individual stocks held in separate accounts or collective, common, or pooled funds will be exercised by the investment managers in accordance with their own proxy voting policies. The voting rights of funds will be exercised by the Investment Advisor.

Investment manager(s) are expected to be aware of corporate provisions that may adversely affect stockholdings, including but not limited to "golden parachutes," "super majorities," "poison pills," "fair price" provisions, staggered boards of directors, and other tactics. Proxies should be vigorously voted with the interest of preserving or enhancing the security's value.

The investment manager(s) of a commingled trust or mutual fund that holds the assets of the Trust along with assets of other funds with conflicting proxy voting policies must reconcile the conflicting policies to the extent possible, and, if necessary, to the extent legally permissible, vote the proxies to reflect the policies in proportion to each fund's interest in the pooled fund.

(6) **Review of Actuarial Data.** The Administrator will review the Trust's actuarial data at least once every two years or more frequently if deemed necessary, to determine whether any substantive change in the investment policy is appropriate. The Administrator will provide for an actuarial valuation in compliance with GAAP, at least bi-annually.

4.4 ASSET CAPITALIZATION

4.4.1 Notifications. Accounting must be notified when any asset is placed in service or is in the process of disposal to ensure accurate asset records are kept.

A. **Cost.**

(1) Property, plant and equipment purchased, donated or constructed is recorded at historical cost as of the date acquired.

(2) Cost includes capitalized interest borrowed to finance the construction of major capital additions.

(3) Generally, for projects funded with both debt proceeds and other resources, it is HRSD's policy to use available debt proceeds to pay project expenditures prior to using its own resources.

(4) Assets costing below the $5,000 threshold amount are recorded as an expense in HRSD's financial statements.

(5) Routine repairs and maintenance are expensed as incurred.

(6) Vehicles, office furniture, equipment, software and intangible assets are reviewed monthly to determine whether the asset meets the capitalization threshold.

(7) Assets that are constructed over a period of time, such as capital projects, treatment plants, buildings and facilities, and interceptor systems, are reviewed at completion to determine the appropriate capitalization value, which may include interest costs.

B. **Useful Life.**

(1) Assets with an economic useful life of less than 60 months are required to be expensed for financial statement purposes, regardless of the acquisition or production cost.

(2) Major repairs that substantially extend the life of an asset or expand its service capacity may be capitalized. For example, if a roof repair or coating is expected to extend the asset's useful life 20 years or beyond, the cost may be capitalized.

(2) The service lives for Capital Assets are as follows:

Treatment plants, buildings and facilities	30 years
Interceptor systems	50 years
Office furniture, computer hardware and equipment	5-10 years
Software and intangible assets	5-7 years
Automotive	5 years

5.0 RESPONSIBILITY AND AUTHORITY

These financial policies were created after much study and evaluation and were specifically adopted by the Commission. They were developed subject to the confines of HRSD's Trust Agreement, its Enabling Act and the Code of Virginia. Any changes and exceptions to these policies will be made in writing and approved by the Commission.

HRSD's General Manager and Director of Finance are the designated administrators of these policies. The Director of Finance shall have the day-to-day responsibility and authority for implementing the provisions of these policies.

HRSD understands that changes in the capital markets or other unforeseen circumstances may from time to time produce situations that are not covered by the Policy and will require modifications or exceptions to achieve the Policy goals. In these cases, HRSD's management flexibility is appropriate provided specific authorization from the HRSD Commission is obtained. Failure to comply in any manner with the Policy will not result in any liability on the part of HRSD to any party.

HRSD, together with HRSD's financial advisor and legal counsel, will no less than bi-annually review the Policy and recommend appropriate changes.

Approved: ______________________________ ______________
Frederick N. Elofson — Date
Commission Chair

Attest:

______________________________ ______________
Jennifer L. Cascio — Date
Commission Secretary

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Approved: Frederick N. Elofson 6/26/18

Frederick N. Elofson
Commission Chair
Date

Attest: Jennifer L. Cascio 6/26/18

Jennifer L. Cascio
Commission Secretary
Date