

Capability Review and Financial Assistance Requirements for Non-Governmental Entities

WIFA Policy #: III.8

Purpose:

Section 1: Outline qualifications to determine an applicant's financial, legal, technical, and managerial capability.

Section 2: Summarize content of WIFA's review of an applicant's historical performance.

Section 3: Detail financial assistance requirements.

Section 4: Define levels of loan security/documentation.

Policy:

Section 1: Capability Review – As more fully described below, WIFA shall review the applicant's financial, legal, technical, and managerial capability to enter into and repay WIFA financial assistance.

Financial Capability – Based on the review of an applicant's Project Finance Application (PFA), supporting materials, and the information listed within WIFA's financial capability rules, WIFA's Board of Directors will determine if an applicant is financially capable of receiving and repaying financial assistance. WIFA's Board of Directors may determine an applicant is not financially capable based on any one of the following criteria:

- The applicant and/or its parent company have declared bankruptcy, which has not yet been discharged.
- The applicant or related party is delinquent on one or more outstanding WIFA loans.
- The applicant or related party is in default of any of its financial obligations.
- The applicant does not have a reliable recurring revenue source to repay the WIFA loan and other loan security is not available.
- The projected annual residential user rate exceeds 5% of the area's Median Household Income.
- The applicant has sustained large net deficits, negative cash flow, and declining revenues which are not likely to be reversed as the result of WIFA's investment in the system.
- The applicant does not have or fails to provide adequate or reliable financial information for WIFA to evaluate the financial capability of the applicant.

Legal Capability – Based on the review of an applicant's PFA, supporting materials, and the information listed within WIFA's legal capability rules, WIFA's Board of Directors will determine if an applicant is legally capable of receiving and repaying financial assistance. WIFA's Board of Directors may determine an applicant is not legally capable based on any one of the following criteria:

- The applicant failed to establish itself in accordance with applicable state or federal law.
- The applicant does not have or fails to provide adequate or reliable documentation for WIFA to evaluate the legal capability of the applicant.
- The applicant failed to authorize the financial assistance in accordance with applicable state law.
- The applicant is not a community or a non-profit non-community water system as defined by the Arizona Department of Environmental Quality.
- The applicant failed to comply with the terms and conditions of existing indebtedness.

If the Board of Directors determines the applicant is not legally capable, the Board may recommend modifications to the applicant's legal structure and organization.

Technical Capability – WIFA's Board of Directors will determine if an applicant is technically capable of receiving and repaying financial assistance, based on review of an applicant's PFA and supporting materials, including reports from regulatory agencies and information required under WIFA's technical capability rules.

Managerial Capability – Based on the review of an applicant's PFA and supporting materials, reports from regulatory agencies, and the information listed within WIFA's managerial capability rules, WIFA's Board of Directors will determine if an applicant is managerially capable of receiving and repaying financial assistance.

Section 2: Historical Performance – WIFA shall review at least a three-year history of revenues and expenses related to the source of revenue pledged for repayment of financial assistance. WIFA shall evaluate historical performance including revenues, expenses, assets, liabilities, and equity to measure trends relative to, but not limited to, the following variables:

Financial Measures

Gross Revenues
 Operating and Maintenance Expenses
 Revenues Available for Debt Service
 Net Fixed Assets
 Net Working Capital

Ratios

Operating Ratio
 Operating Efficiency (Net Take-Down)
 Interest Coverage
 Debt Service Coverage
 Debt Service Safety Margin
 Current Ratio
 Debt Ratio

Section 3: Financial Assistance Requirements – WIFA will structure the financial assistance by applicant by source of repayment, and based on the applicant's historical performance and the trends of the revenue pledged.

Pledge Requirement – WIFA will accept any one or a combination of the following revenue sources as the pledged repayment source:

- Enterprise Revenues
- Other, if approved by WIFA's Board of Directors

Standard Loan Term - The standard loan term for design loans shall be three years. The standard loan term for long-term loans shall not exceed 20 years or the useful life of the facilities financed if the useful life is less than 20 years. In accordance with Policy III.6, the Board may designate an applicant as disadvantaged and extend the term for long-term loans beyond 20 years up to a maximum of 30 years.

Position Requirement – Unless approved by the Board of Directors, WIFA shall require indebtedness payable to owners, shareholders, or members to be subordinated to indebtedness payable to WIFA. WIFA shall require WIFA-funded indebtedness to be at least on parity with any of the applicant’s pre-existing indebtedness. As necessary, WIFA will execute subordinate and/or intercreditor agreements to define WIFA’s position relative to indebtedness evidenced by a third party lien or other formal encumbrance.

Additional Debt Test – Unless approved by WIFA’s Board of Directors, the applicant’s future indebtedness cannot be superior to previous WIFA indebtedness. Additional debt must also conform to WIFA’s coverage requirements.

Projected Coverage Requirements - As a condition for receiving financial assistance, WIFA may require different coverage levels by Repayment Source as detailed within Table 1.

Table 1: WIFA Projected Coverage Requirements by Repayment Source

Repayment Source	Coverage Requirement
Enterprise Revenues	Net Revenues = 1.2 * Maximum Annual Debt Service
Other	Varies by source, subject to approval by the Board of Directors

When calculating coverage requirements, WIFA shall exclude the following from maximum annual debt service:

- amounts projected to be paid pursuant to line extension repayment agreements,
- amounts projected to be as paid as meter deposit refunds, and
- related contingent liability expenses linked to non-reoccurring dedicated revenue sources.

Historical and Future Coverage – If an applicant failed to meet WIFA’s Coverage Requirements for one or more of the most recent three years and/or for one or more years of WIFA’s five year projection, WIFA may require:

- increases to rates and charges prior to the closing of financial assistance,
- additional loan security as defined within Section 4, or
- modifications to the project to decrease cost.

Rate Covenant – As a condition for receiving financial assistance, WIFA will require applicants to adopt Rate Covenants as summarized in Table 2.

Table 2: WIFA Rate Covenants

Repayment Source	Rate Covenant
Enterprise Revenues	Rates and charges sufficient to operate and maintain facilities and maintain WIFA's Coverage Requirement. In turn, WIFA's Coverage Requirement is the source to fund a Debt Service Reserve and a Replacement Reserve.
Other	Rates and charges sufficient to operate and maintain facilities and maintain Pro Forma Coverage Requirement.

Debt Service Reserve Requirements – As a condition for receiving financial assistance, WIFA will require an applicant to fund a Debt Service Reserve in accordance with Table 3.

Table 3: WIFA Debt Service Requirements

Repayment Source	Surety or Letter of Credit Accepted in Lieu of Reserve?	Reserve Amount	Period Funded	Reserve Depository
Enterprise Revenues	Yes	MADS*	w/in 5 Years	WIFA
Other	Yes	MADS	w/in 5 Years	WIFA

* MADS: *Maximum Annual Debt Service*

Frequency and Method of Repayment – As a condition for receiving financial assistance, WIFA will require the applicant to make fixed monthly payments of principal and interest.

Section 4: Loan Security Level and Required Loan Documentation – If WIFA's Board of Directors determines an applicant is capable of repaying financial assistance, WIFA will secure the financial assistance with one of four levels of security as defined below:

Level 1: Basic Security Agreement – includes the following documents:

- Loan Agreement,
- Promissory Note,
- Cash Collateral Agreement,
- Continuing Security Agreement,
- Subordination Agreement and/or Intercreditor Agreement, and
- UCC Financing Statement.

The Basic Security Agreement documents provide WIFA a first security interest in all of a non-governmental applicant's enterprise revenues, a Debt Service Reserve Fund (held by WIFA), accounts receivables, inventory, equipment and general intangibles. The documents further require an additional debt test, investment limitations, pre-approvals for asset sales, and lockbox or related control/intervention in the event of a default.

WIFA will require an applicant to execute loan documents under a Basic Security Agreement unless WIFA determines additional loan security, as more fully described below, is required.

Level 2: Fixture Filing – as an incremental increase in collateral security over Level 1, WIFA will require a legal description of a non-governmental applicant's real property and will perfect a security interest in a non-governmental applicant's fixtures financed by WIFA. The Level 2 documents are similar to Level 1 documents.

WIFA may require an applicant to execute a Fixture Filing under any one of the following circumstances:

- Loan amount exceeds 25% of the applicant's total assets.
- Loan amount exceeds \$100,000.
- The applicant serves fewer than 500 users.
- Current ratio is less than 1.5 for any two of the past five most recent years.
- Projected Net Revenues Coverage is less than 1.5.
- Debt ratio exceeds 40%.
- The applicant or related party has been substantially or frequently delinquent in making payments on financial obligations.

Level 3: Deed of Trust – in addition to Level 1 documents, WIFA's Board of Directors may require a lien on all or most of the assets of non-governmental applicants. To perfect Level 3, WIFA will require a Deed of Trust supported by a property survey to validate legal descriptions, title insurance, and, in some cases, an environmental review of real property to assess the presence of environmental liabilities.

WIFA may require an applicant to execute a Deed of Trust under any one of the following circumstances:

- Loan amount exceeds 50% of the applicant's total assets.
- Loan amount exceeds \$500,000.
- Current ratio is less than 1.2 for any two of the past five most recent years.
- Projected Net Revenues Coverage is less than 1.2.
- Debt ratio exceeds 60%.
- The applicant or related party has been substantially or frequently delinquent in making payments on financial obligations.

Level 4: Personal Guarantee – in limited circumstances, WIFA will require the system's owners, shareholders, or members to personally guarantee repayment of the financial assistance.

WIFA may require an applicant to execute a Personal Guarantee under any one of the following circumstances:

- WIFA confirms the presence of environmental liabilities which could cause WIFA to be exposed to significant liabilities in the event of a foreclosure on a Deed of Trust.
- WIFA determines that the regulatory compliance history of the applicant is unsatisfactory.
- Owner's compensation divided by sales exceeds 10%.
- The applicant or related party has been substantially or frequently delinquent in making payments on financial obligations.

Responsibility: Chief Financial Officer

Statutory Reference: A.R.S. § 49-1244 and 1245

Rule Reference: A.A.C. R18-15-104 and R18-15-307

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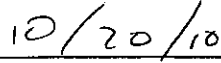
Previous Amendment Date(s): June 18, 2003 and April 18, 2007

Most Recent Amendment Date: October 20, 2010 (*Replaces All Previous Versions*)

Approval:



Interim Executive Director



Date