Debt Policy of the Redevelopment Agency of the City and County of San Francisco

Last Update: March 16, 2004

Purpose

This Debt Policy is intended to guide the staff of the Redevelopment Agency of the City and County of San Francisco ("Agency") involved in the issuance of debt. From time to time, circumstances may arise which could cause Agency staff to deviate from the policies set forth herein.

This policy and any subsequent amendments hereto shall be on file with the Finance Division of the Agency.

The Agency's Mission

The San Francisco Redevelopment Agency is the local agency dedicated to the elimination of economic and physical blight, the revitalization of designated urban districts ("Project Areas"), and the preservation and development of affordable housing. Incorporated in 1948, the Agency is authorized and organized under the California Community Redevelopment Law (CRL) and is an entity legally separate from the City and County of San Francisco, but existing solely to perform certain functions exclusively for and by authorization of the City.

State law vests redevelopment agencies with broad and unique powers to assemble land, utilize tax increment financing and implement long-range economic development and housing plans. To accomplish these goals, the Agency engages in community-based planning, collaborates with other city and state agencies, develops physical and social infrastructure to support community development, engages in public-private development partnerships, and finances the development and preservation of affordable housing citywide. The Agency currently has jurisdiction over twelve distinct "project areas." In addition, the Agency is completing multi-year community planning efforts on three additional areas ("Survey Areas"), with plan adoption and commencement of redevelopment activities scheduled for 2004.

To carry out redevelopment activities, the CRL authorizes the Agency to issue bonds and refunding bonds that may be repaid with tax increment funds allocated to the Agency pursuant to the CRL and other type of debt as indicated herein. The Agency is also a member of the City and County of San Francisco Redevelopment Financing Authority ("Authority"), a joint powers agency established pursuant to California law, to facilitate the issuance of bonds and refunding bonds for redevelopment purposes. State law provides that Agency and Authority bonds and obligations do not constitute a debt of the City and County of San Francisco.
Agency Debt Policy

The purpose of the Debt Policy is to provide guidance and standards to Agency staff in managing debt financing utilized by the Agency in funding projects and activities as set forth in its annual budget and approved by the Commission of the Agency. Activities financed with the issuance of debt include the provision of affordable housing, citywide physical improvements to infrastructure, and construction of parks, open space and cultural buildings. The overriding goal of these activities is to revitalize blighted areas and produce social and economic benefits to San Francisco.

I. Debt Management Objectives
   - Maintain access to financial markets through prudent policies.
   - Achieve the highest practical credit ratings.
   - Borrow at the lowest possible cost.
   - Maintain appropriate capital assets for present and future needs.
   - Promote sound financial management.
   - Protect and enhance the credit rating of the Agency.
   - Provide accurate and timely information on financial conditions.
   - Promote cooperation and coordination with other city agencies and private sector in the financing and delivery of services.

II. Types and Purposes of Debt
The Agency utilizes primarily four types of municipal debt obligations: tax allocation bonds, revenue bonds, special tax bonds, and mortgage revenue bonds. Long-term debt financing shall not be used to fund operating costs.

A. Tax Allocation Bonds are the primary financing tool utilized by the Agency to finance much of its work program. Commonly referred to as TABs, the principal of and interest on this kind of debt are paid with tax increment produced from redevelopment project areas. The two most important underwriting criteria required for the sale of TABs are: (i) a diversified tax base and (ii) $1.25 of tax increment per $1.00 of debt service, the latter known as the 1.25 coverage test. Consistent with state law, TAB proceeds must be spent in the redevelopment project area that generated the tax increment, with the exception of affordable housing funds which may be expended citywide.

B. Revenue Bonds are secured by an identified stream of revenues pledged to the repayment of principal and interest, e.g. hotel tax revenues, fees from an enterprise, lease agreements. Examples of such financings undertaken by the Agency are: bonds issued for the construction of the South Beach Harbor, hotel tax revenue bonds issued to build a portion of the Yerba Buena Gardens, and lease revenue bonds issued on behalf of the Agency to build the Moscone Convention Center North and South. This type of financing is considerably less common to the Agency because it is difficult to achieve the underwriting criteria required by investors.

C. Special Tax Bonds are typically used to fund the construction or improvements of infrastructure associated with new developments, whether they be housing or
commercial. Special tax bonds are secured by taxes imposed on property comprising a district created with voter approval by property owners and residences of the district. In addition to the formation of the district, property owners and residences of the district determine the size and allocation of the special taxes, the amount of debt to issue, and public improvements to be funded. The Agency has utilized special tax bonds to fund infrastructure improvements in Rincon Point-South Beach and Mission Bay and plans to use this method of financing in Hunters Point Shipyard. Importantly, special tax bonds are not obligations of the Agency because the Agency is pledging neither its assets nor revenues to the repayment of principal and interest on such bonds.

D. **Mortgage Revenue Bonds** are used to finance the acquisition, construction, and rehabilitation of rental housing. Such financings are project based, i.e. developer driven, and are commonly used by the Agency to fund many of its affordable housing projects and to a lesser extent market-rate developments which set aside at least 20% of the units for low-income renters. Mortgage revenue bonds are not obligations of the Agency but of a developer, since repayment of the principal and interest on such debt is the responsibility of the latter. Most affordable housing developments financed with mortgage revenue bonds would not be financially feasible without a financial commitment from the Agency, which may take the form of grants, subordinate loans, or guarantees.

E. **Refunding Obligations:** The CRL permits the issuance of bonds for the purpose of refunding previously issued bonds with approvals by the Board of Supervisors and/or Agency Commission. The primary reason to sell refunding bonds is to generate interest cost savings. A secondary reason is to restructure debt service on outstanding bonds to achieve a specific goal, e.g. improve coverage, increase debt capacity.

Absent any significant non-economic factors, a refunding should produce minimum net debt service savings (net of reserve fund earnings and other offsets) of at least 3% of the par value of the refunded bonds on a net present value basis, using the refunding issue’s True Interest Cost (“TIC”)¹ as the discount rate.

F. **Other Obligations:** There may be special circumstances when other forms of debt are appropriate and should be evaluated on a case-by-case basis. Such other forms include, but are not limited to, general obligation bonds and bond anticipation notes, also referred to as BANs. The Agency’s general obligation bonds are a form of borrowing secured solely by the credit worthiness of the Agency and are not to be confused with voter-approved general obligations bonds that are secured by the full faith and credit of the City and County of San Francisco. Though rarely used, the Agency successfully utilized general obligation bonds in the early 1990s to finance a portion of the Yerba Buena Gardens, which bonds were repaid with proceeds from the sale of land. BANs are a short-term type of borrowing (no longer than five-years in maturity), which may be either

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¹ A measure of the interest cost of an issue that accounts for the time value of money. The TIC is the annual discount rate (yield) which, when used to discount all debt service payments to the date of issuance, results in the aggregate present value of such debt service payments being equal to the original purchase price of the issue.
secured or unsecured with assets, that is typically used to fund infrastructure improvements associated with a specific residential and/or commercial real estate development. BANs are repaid with a permanent financing, for instance with a special tax bond as described in paragraph C above, upon completion of all or a specific phase of a development. Issuers use a number of strategies to improve the marketability and strengthen the credit quality of BANs, such as: (1) obtain credit enhancement from a bank or a corporate guarantee from developers, (2) select developers with strong balance sheets and proven track record in completing developments on schedule, (3) obtain a completion guarantee from developers assuring that certain improvements will be completed, and (4) set limits on pre-development reimbursable expenses.

III. Credit Enhancements
The Agency will consider the use of credit enhancement on a case-by-case basis, evaluating the economic benefit and cost of each case. Credit enhancement shall be utilized only if it permits savings to be achieved. The Agency will consider each of the following credit enhancements as alternatives by evaluating the cost and benefit of such enhancement.

A. Bond Insurance. The Agency shall have the authority to purchase bond insurance when such purchase is deemed prudent and advantageous. The decision to purchase bond insurance shall be based on such insurance being less costly than the present value of the difference in the interest cost on insured bonds versus uninsured bonds. The Deputy Director, Finance & Administration or his/her designee will obtain bond insurance by soliciting quotes from bond insurers and make the selection based on, but not limited to, fees proposed, timeliness of approval process, and conditions and covenants required.

B. Debt Service Reserves and Reserve Equivalents. When required, a reserve fund equal to the least of ten percent (10%) of the original principal amount of the bonds, one hundred percent (100%) of the maximum annual debt services, and one hundred and twenty five percent (125%) of average annual debt service, or, if permitted, 10 percent (10%) of par value of bonds outstanding (the "Reserve Requirement") shall be funded from the proceeds of each series of bonds, subject to federal tax regulations and in accordance with the requirements of credit enhancement providers and/or rating agencies.

The Agency may purchase reserve equivalents (i.e., an insurance policy known as a "surety bond") when such purchase is deemed prudent and advantageous. Such equivalents shall be evaluated in comparison to cash funding of reserves on a net present value basis.

C. Letter of Credit. A letter of Credit ("LOC") is a contractual obligation, typically provided by a bank with a high credit rating for a fee, which guarantees payment of principal and interest associated with a bond financing. A letter of credit is entered into for the purpose of reducing the interest cost to the issuer of the bonds. The Agency may enter into a LOC agreement when such an agreement is deemed prudent
and advantageous to a bond financing. The Agency shall prepare (or cause to be prepared) and distribute to qualified financial institutions as described below, a request for qualifications that includes terms and conditions that are acceptable to the Agency.

1. **Provider Selection.** Only those financial institutions with long-term ratings greater than or equal to that of the Agency, and short-term ratings of VMIG 1/A-1 F1, by Moody’s Investors Service, Standard & Poor’s and Fitch Inc., respectively, may be solicited.

2. **Selection Criteria.** The selection of LOC providers will be based on, but not be limited to, the following criteria:

   a) Ratings at least equal to or better than the Agency’s.

   b) Evidence of ratings (including “Outlook”).

   c) Trading value relative to other financial institutions.

   d) Terms and conditions acceptable to the Agency.

   e) Representative list of clients for whom the bank has provided liquidity facilities.

   f) Fees, specifically, cost of LOC, draws, financial institution counsel and other administrative charges.

**IV. Debt Approval Procedures**

*Commission Approval* is required of all debt issued by the Agency. The approval is in the form of one or more resolutions, which authorize such matters as the sale of the bonds of a specified amount, the method of sale, an indenture of trust, an official statement, inducement resolution, and other related documents. Commission authorization is requested shortly before the bonds are to be sold.

The sale of special tax bonds requires additional Commission approvals related to the formation of the district and adoption of the rate and method of apportionment.

*Other Approvals.* Approval by the Board of Supervisors is required for the Agency to sell tax allocation bonds and revenue bonds but not for mortgage revenue bonds, special tax bonds, or to refund previously issued bonds. Mortgage revenue bonds require that the Agency hold a public hearing (known as a TEFRA hearing) at which interested persons are given an opportunity to express their views for or against the issuance of such mortgage revenue bonds. The results of the TEFRA hearing are formalized in a certificate authorizing the issuance of the bonds, amount of bonds to be sold and project(s) to be funded, which certificate must be executed by an elected official of the City, such official typically being the Mayor, pursuant to the Internal Revenue Code.
Special tax bonds do not require Board approval; however, such bonds cannot be sold without entering into an acquisition agreement, which in most instances requires the approval of the Board of Supervisors. An acquisition agreement is the document by which the City and County of San Francisco acquires the public improvements built by the developer with proceeds from the sale of special tax bonds.

V. **Debt Limitations**

A. **Tax Allocation Bonds:** Limits on the amount of tax allocation bonds that can be sold or outstanding at a given time are set forth in redevelopment project plans pursuant to CRL, either implicitly or explicitly. Older project areas have a limit on the amount of tax increment that may be collected over the life of the project, which effectively sets a limit on the amount of tax allocation bonds that can be sold over a project’s life. Redevelopment plans associated with newer project areas explicitly contain a limit on the amount of tax increment bonds that can be outstanding at a given time. For instance, the amount of bonds that can be outstanding at any given time is $190,000,000 in Mission Bay North and $450,000,000 in Mission Bay South. It is important to note that those debt limits, whether implicitly or explicitly specified, set an upper boundary to the amount of debt that can be outstanding at any given time. The actual amount of debt that can be sold or be outstanding will be determined by the underwriting criteria set by financial market participants, including rating agencies, bond insurers, underwriters and investors. Agency staff will adhere to the limits specified in redevelopment project plans as well as the prudent underwriting standards acceptable to financial market participants.

B. **Revenue Debt:** There is no statutory restriction on the amount of revenue bonds that can be outstanding at any given time. However, the amount of revenues that can be sold and be outstanding any given time is dictated by the underwriting criteria -- diversity of revenue base, coverage requirements, financial strength of parties to the transaction -- used by financial market participants. Therefore, Agency staff will evaluate each proposed revenue bond transaction using accepted underwriting standards with the goal of achieving a prudent financing.

C. **Special Tax Bonds & Other Debt.** Same as B above.

VI. **Methods of Sale**

**Competitive Sale:** All Agency bonds will be sold competitively, except in those instances when a competitive sale is not feasible or would yield a less favorable result. Highly rated bonds with easy to understand credit structures can be sold competitively. However, non-rated bonds with complex credit structures cannot be sold competitively and require the services of one or more underwriters (see section related to “negotiated sale” below).

The Agency will receive bids by any means deemed by staff and its financial advisors to be acceptable to bidders, e.g. in person, facsimile, or electronically.

1. **Marketing:** Bond sales shall be advertised as broadly as possible, utilizing the internet, list of underwriters, and advertising in local and industry newspapers.
It is one of the key tasks of financial advisors to market the bonds to prospective bidders.

2. **Cancellation**: The Agency shall have the right to cancel a bond sale prior to the time bids are received by issuing a notice within the customary period acceptable by bidders.

3. **Award**: The Bonds shall be awarded to the bidder whose conforming bid represents the lowest true interest cost (TIC) to the Agency. The Agency may then restructure the bonds in accordance with the Official Notice of Sale to achieve its financial goal.
   i. The Agency shall reserve the unfettered right to reject all bids or waive bid irregularities.
   ii. The Agency’s Deputy Executive Director of Finance & Administration or his/her designee shall award the bonds to the winning bidder.

**Negotiated Sale**: There are certain types of bonds that cannot be sold competitively and, hence, must be sold on a negotiated basis, using the services of an investment banking firm (also commonly referred to as “underwriter”). Under a negotiated sale, it is the responsibility of the underwriter to market, price, and purchase the Agency’s bonds and re-sell the bonds to investors. There have been numerous occasions that the Agency has had to sell its bonds using the negotiated sale method. All non-rated bonds with complex credit structures need to be sold utilizing one or more investment banking firms. Variable rate bonds also are typically issued by negotiated sale.

**Private Placement**: Occasionally there might be a need to restrict the sale of a bond issue due to its complexity and high risk to sophisticated investors who have the ability to evaluate the complexity of the bonds being offered and the financial wherewithal to withstand potential loses. It is inappropriate to offer such complex, high-risk bonds to the investment community at large and issuers are forbidden by regulations from doing so. Another use of a private placement sale is in taking advantage of programs offered by lending institutions. Since such programs are specific to a particular financial institution, the bonds cannot be offered to the investment community but purchased by the financial institution offering the program. Such transactions are typically associated with funding low-income housing projects, such as when a bank agrees to purchase an entire tax-exempt bond issue, effectively making a loan to the project, as part of its Community Reinvestment Act program.

### VII. Debt Structuring Practices

A. **Standard Terms**: The following terms shall be applied to the Agency’s transactions as appropriate. Individual terms may change as dictated by the marketplace, CRL, or the unique qualities of the transaction.

1. **Fixed Rate Bonds**:
   i. **Term**: No longer than January 1, 2019 for project areas created prior to 1993 and 30 years for project areas created after 1993 pursuant to CRL
   ii. **Maximum Interest Rate**: not to exceed 12% pursuant to CRL
iii. Maximum Premium: case by case as recommended by the Agency's independent Financial Advisor ("FA")
iv. Maximum Discount: 5% pursuant to CRL
v. Call Provisions: shortest possible optional call consistent with optimal pricing
vi. Debt Service Reserve: lesser of 10% principal amount, 125% average annual debt service, 100% maximum annual debt service (or surety bond)
vii. Capitalized Interest: use to achieve financing objectives
viii. Reimbursement Resolution: adopted by Agency Commission if required
ix. Good Faith Deposit: generally 1% of par amount

2. Variable Rate Bonds: The Agency may elect to issue bonds as variable rate bonds, the rate on which is reset daily, weekly, monthly, or semi-annual. The rates may be reset by a remarketing agent or by an auction process. The following criteria shall apply solely to variable-rate debt that is an obligation of the Agency, i.e. variable-rate debt that is secured by assets or revenues of the Agency.

i. Purpose: reduction of net borrowing cost; matching of assets and liabilities
ii. Max. Portfolio Allocation: no more than 20% of the Agency's outstanding debt portfolio shall be in variable rate debt (excluding variable-rate mortgage revenue bonds)
ii. Term: consistent with policies for underlying debt types
iii. Maximum Interest Rate: not to exceed 12%
iv. Monitoring: the finance staff shall monitor all variable rate bonds periodically and shall determine, from time to time, whether to change modes, alter hedging strategies and/or replace a remarketing agent
v. Budgeting: if applicable, annually finance staff shall budget debt service on variable rate bonds at 1.5 times the 3-year average of the Bond Market Association index, or another relevant index.
vi. Remarketing Provisions: remarketing agent agreements shall contain a provision requiring the
vii. Call/Conversion Provisions: on any date without penalty after notice period;

viii. Liquidity: a liquidity facility shall be obtained for all short-term variable-rate debt containing a put feature. Agency shall seek liquidity providers with the highest short-term ratings that are cost effective.

ix. Disclosure: the Agency shall provide continuing disclosure in accordance with government regulations.

x. Mode: all bonds issued as variable rate bonds shall be issued as “multi-modal” bonds.

xi. Good Faith Deposit: liquidated damages

VIII. Derivatives Policy

Derivative products and other financial instruments can be beneficial interest rate management tools that can assist the Agency as part of its overall debt and investment management program, but need to be monitored very closely. See Appendix A (Includes swaps, swap options, caps, floors and collars.)

IX. Permitted Investments

All investments of bond proceeds shall be made in accordance with the California Government Code. Permitted investments are described below.

(a) Direct obligations of the United States of America and securities fully and unconditionally guaranteed as to the timely payment of principal and interest by the United States of America (“U.S. Government Securities”);

(b) The interest component of Resolution Funding Corporation strips which have been stripped by request to the Federal Reserve Bank of New York in book-entry form;

(c) Bonds, debentures, notes or other evidence of indebtedness issued or guaranteed by any of the following federal agencies and provided such obligations are backed by the full faith and credit of the United States of America (stripped securities are only permitted if they have been stripped by the agency itself): (i) direct obligations or fully guaranteed certificates of beneficial ownership of the U.S. Export-Import Bank; (ii) certificates of beneficial ownership of the Farmers Home Administration; (iii) Federal Housing Administration debentures; (iv)
participation certificates of the General Services Administration; (v) Federal Financing Bank bonds and debentures; (vi) guaranteed mortgage-backed bonds or guaranteed pass-through obligations of the Government National Mortgage Association; (vii) guaranteed Title XI financings of the U.S. Maritime Administration; and (viii) project notes, local authority bonds, new communities debentures and U.S. public housing notes and bonds of the U.S. Department of Housing and Urban Development;

(d) Bonds, debentures, notes or other evidence of indebtedness issued or guaranteed by any of the following non-full faith and credit U.S. government agencies (stripped securities only as stripped by the agency itself): (i) senior debt obligations of the Federal Home Loan Bank System; (ii) participation certificates and senior debt obligations of the Federal Home Loan Mortgage Corporation; (iii) mortgaged-backed securities and senior debt obligations of Fannie Mae; (iv) senior debt obligations of the Student Loan Marketing Association; (v) obligations of the Resolution Funding Corporation; and (vi) consolidated system-wide bonds and notes of the Farm Credit System;

(e) Money market funds registered under the Federal Investment Company Act of 1940, whose shares are registered under the Federal Securities Act of 1933, and having a rating by S&P of at least "AAAm-G," "AAAm" or "AAm," and a rating by Moody's of "Aaa," "Aa1" or "Aa2" (such funds may include funds for which the Trustee, its affiliates, parent or subsidiaries provide investment advisory or other management services);

(f) Certificates of deposit (including those of the Trustee, its parent and its affiliates) secured at all times by collateral described in (a) or (b) above, which have a maturity not greater than one year from the date of investment and which are issued by commercial banks, savings and loan associations or mutual savings banks whose short-term obligations are rated "A-1+" or better by S&P and "Prime-1" by Moody's, which collateral must be held by a third party and provided that the Trustee must have a perfected first security interest in such collateral;

(g) Certificates of deposit, savings accounts, deposit accounts or money market deposits (including those of the Trustee and its affiliates) which are fully insured by FDIC, including BIF and SAIF or which are issued by any bank the obligations of which are rated at least "A" by Moody's and S&P;

(h) Investment agreements, including guaranteed investment contracts, forward purchase agreements, reserve fund put agreements and collateralized investment agreements with banks, insurance companies or other financial institutions rated "A" or better by S&P and Moody's (or guaranteed by an entity rated "A" or better by S&P and Moody's);

(i) Commercial paper rated "Prime-I" by Moody's and "A-1+" or better by S&P;

(j) Bonds or notes issued by any state or municipality which are rated by Moody's and S&P in one of the two highest rating categories assigned by such agencies;
Federal funds or bankers acceptances with a maximum term of one year of any bank which an unsecured, uninsured and unguaranteed obligation rating of "Prime-I" or "A3" or better by Moody's, and "A-I+" by S&P;

The Local Agency Investment Fund which is administered by the California Treasurer for the investment of funds belonging to local agencies within the State of California.

X. Professional Assistance
A. Financial Advisors: The Agency shall utilize the services of independent financial advisors as needed. The Agency shall utilize a RFQ-selected pool of financial advisors to mitigate time constraints and reduce overhead costs of the Agency in procuring such services. Services shall be documented by contract and compensation shall be capped.

B. Underwriters: The Agency shall utilize one or more underwriters as needed to accomplish the successful sale of bonds that cannot be sold competitively. Underwriters will be selected using a RFP/Q selection process.

C. Bond Counsel: The Agency's legal staff shall select bond counsel for each transaction from a panel of attorneys created utilizing a RFQ process.

D. Remarketing Agents: For all variable rate bonds, the Agency’s finance staff shall select by RFP/Q remarketing agents for each transaction and monitor performance periodically. The Agency may replace a remarketing agent with notice at any time.

E. Trustees: Selected for each issue by competitive process, except if it is inefficient for the completion of a financing. The Trustee shall have a combined capital and surplus of at least $50,000,000 and be subject to supervision or examination by federal or state authority.

F. Rebate Consultant: Agency staff shall use rebate consultants as needed to prepare rebate calculations related to tax-exempt bonds. Rebate consultants shall be selected using a competitive bid process.

G. Financial Printer: Selected for each issue using a competitive bid process. Selection based on quality of work, ability to adhere to deadlines, price and recommendation of financial team.

H. Auction Agents: Selected for each issue by RFP/Q issued by the Agency or its agent and subject to negotiation of terms.

I. Liquidity Providers: Selected by RFP/Q issued by the Agency or its agent and subject to negotiation of terms.

XI. Ongoing Debt Administration
A. *Continuing Disclosure.* The Agency’s finance staff is responsible for providing ongoing information to financial market participants and for responding to requests as they may arise.

1. *Annual Report.* The Agency shall provide its annual disclosure report for all transactions subject to annual reporting by no later than 180 days following the end of a fiscal year. The Agency will use its best efforts to issue the Annual Report electronically and to post the Annual Report on its web site.

2. *Material Event:* The Agency will issue a material event notice in accordance with the provisions of SEC Rule 15c2-12. Prior to the issuance of any material event, the Agency’s finance staff will discuss such matter with its senior management, legal staff, and City staff and outside professionals as deemed appropriate, to discuss the materiality of any event and the process for equal, timely and appropriate disclosure to the marketplace.

B. *Arbitrage Rebate Compliance:* The Agency shall calculate or cause to have calculated rebate arbitrage on all bonds subject to arbitrage regulations periodically but not less than every five years that such bonds are outstanding. The Agency may use any methods acceptable to the IRS for determining rebate.

C. *Ratings:* The policy of the Agency’s finance staff is to secure underlying ratings on all of its debt obligations for which a rating is advantages to a financing. However, there are certain financings where obtaining a rating is not feasible.

D. *Meetings* - The Agency’s finance staff shall confer with rating agencies, bond insurers, and institutional investors as appropriate.

E. *Reporting* - The Agency’s finance staff shall ensure prompt delivery of the Agency’s Audited Financial Statements and other reports as required by each debt issuance to each rating agency.

F. *Agency Ratings Notification* - Any changes in ratings will be promptly noticed by the Agency.
Appendix A

Swap/Derivative Policy

Properly used, interest rate swaps, and related financial instruments such as swap options, can be beneficial interest rate management tools that can assist the Agency as part of its overall debt and investment management program. Interest rate swaps are appropriate for use when they are designed to achieve specific financial objective(s) consistent with the Agency’s overall financial policy and strategy. However, these products also carry with them certain risks not faced in standard debt instruments which are often difficult to quantify. If there is a compelling public policy reason to utilize derivative products, the Agency’s finance staff will review a proposed transaction and, where appropriate, provide an analysis and recommend approval by the Agency Commission.

I. Swap/Derivative Use Objectives:

- To achieve significant savings as compared to a product available in the bond market.
- To prudently hedge risk in the context of a particular financing OR the overall asset/liability management strategy of the Agency.
- To achieve more flexibility in meeting overall financing objectives. An example may be to alter debt service payment patterns, such as converting variable debt service payments to fixed payments.

II. Swap Approval Procedures:

B. Approval by the Commission of the Agency: If a proposed swap transaction or derivative product meets the objectives of the Agency as described herein, Agency staff shall provide to the Commission for review and approval an evaluation of the proposal, including risk factors, in connection with a recommendation to enter into such a proposed transaction.

1. Risk/Benefit Analysis: Identification and evaluation of proposed benefit and potential risks and any mitigations thereto. Such potential risks shall include:

   i. **Market/Interest Rate Risk:** Risk of exposure to fluctuations in interest rates.

   ii. **Tax Law Risk:** Risk of rate adjustments, extraordinary payments, termination or other adverse consequences in the event of a future change in Federal income tax policy.

   iii. **Termination Risk:** Risk of termination by the counterparty in an adverse market, i.e. other than at the option of the Agency. Mitigation is the maintenance of sufficient liquidity to cover this exposure.

   iv. **“Put” Risk:** Risk of a future financing(s) that is dependent upon third party participation. Mitigation is to obtain commitments that can be or have been secured for such participation.
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v. **Legal Authority Risk**: Risk of any party's legal authority to participate in the transaction.

vi. **Counterparty Credit Risk**: Risk of credit-worthiness of the counterparty. Mitigation is to include provisions in the documents to mitigate exposure to adverse changes in their credit standing.

vii. **Ratings Risk**: Risk that transaction could impact the Agency's current credit ratings or its desired future ratings and with related rating agency policies.

viii. **Basis Risk**: Risk that the basis for the anticipated payments that the Agency would make or receive would not match the payments that it seeks to hedge.

ix. **Tax Exemption of Agency Debt Risk**: Risk that transaction is not in compliance with all Federal tax law requirements with respect to the Agency's outstanding tax-exempt bonds.

x. **Accounting Risk**: Risk that transaction is not compliant with accounting procedures and consistent with the Agency's financial statements. Additional risk of impact on the Agency's rate covenant calculation or compliance, where applicable.

xi. **Administrative Risk**: Risk of ability of Agency to administer and monitor transaction consistent with the policies outlined in the Debt Policy of the Agency.

xii. **Subsequent Business Conditions**: Risk of dependence on the continuation or realization of specific industry or business conditions.

2. **Savings Analysis**: Independent analysis of potential savings from proposed transaction.

3. **Rate Exposure**: Fixed versus variable rate and swap exposure on a project and for a counterparty before and after proposed transaction.

4. **Market Net Termination Exposure**: Termination Exposure on a per-project and per-counterparty for all existing and proposed transactions.

5. **Notional Value**: Total notional value of swaps before and after current proposed transaction.
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III. Inappropriate Use/Characteristics of Swaps:
   A. Speculative purposes: Use of swaps or derivatives for speculative purposes such as potential trading gains.
   B. Extraordinary Leverage: Use of swaps or derivatives, which create extraordinary leverage or other financial risk.
   C. Insufficient Liquidity: Use of swaps or derivatives with insufficient liquidity to terminate at current market rate.
   D. Insufficient Price "Transparency": Use of swaps or derivatives in which the Agency's finance team is unable to reasonably value the instrument.

IV. Methods of Soliciting and Procuring Derivatives
Regardless of method of procurement, the Agency shall obtain an independent finding that the terms and conditions of any derivative entered into reflect a fair market value as of the date of its execution.
   A. Competitive: Limited competitive process from pre-qualified bidders. The Agency may select one or more bidders for the transaction in addition to the winning bidder if deemed in Agency's best interest.
   B. Negotiated: Agency staff may determine that (i) due to size or complexity of transaction, a negotiated process would result in the most favorable pricing, in which case an independent financial advisor should be retained to assist in the process or (ii) doing so will promote its interests by encouraging and rewarding innovation or the substantial commitment of time and resources by a counterparty.

V. Counterparty Requirements
Qualified investment banks which meet the following requirements:
   A. Minimum Rating: At least one Aa3 or AA- or an institution utilizing non-terminating AAA subsidiary
   B. Minimum capitalization:
      1. $250 million OR credit enhancement in the following form:
         i. Contingent credit support or enhancement
         ii. collateral held by 3rd party trustee and marked-to-market monthly [and/or]
         iii. ratings downgrade triggers
   C. Demonstrated Record:
      1. Successfully executing and performing in swap transactions
      2. Creating and implementing innovative ideas in the swap market.

VI. Standard Terms for Swaps and Derivatives
   A. Term: Consistent with the purpose for which swap it is utilized while taking into account the call dates for the related debt. In no event shall term extend beyond the existing debt (or other obligation being hedged).
      1. Swap options shall not exceed 5 years unless limited to a couple specified dates.
   B. Events of Default: An event of default by the counterparty shall lead to termination of the agreement with the termination payment being calculated on
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the side of the bid-offered spread most beneficial to the Agency. Events of
default of a counterparty shall include the following:
1. Failure to make payments when due,
2. Material breach of representations and warranties,
3. Failure to comply with downgrade provisions, or
4. Failure to comply with any other provision of the agreement after a
   specified notice period.

C. **Termination Provisions:**
1. **Optional:** All interest rate swap transactions shall contain provisions
   granting the Agency the right to optionally terminate a swap agreement at
   anytime over the term of the agreement. Agency staff in consultation with
   its financial advisors shall determine if it is financially advantageous for the
   Agency to terminate a swap agreement.
2. **Mandatory:** A termination payment to or from the Agency may be required
   in the event of termination of a swap agreement ONLY in the case of credit-
   related and non-payment events. Prior to entering into the swap agreement
   or making any such termination payment, as appropriate, Agency staff in
   consultation with its financial advisor(s) shall evaluate whether it would be
   financially advantageous for the Agency to enter into a replacement swap as
   a means of offsetting any such termination payment or obtaining insurance
   to guarantee performance of the counterparty. Any swap termination
   payment due from the Agency shall be made from available Agency monies
   and the agreement shall allow for appropriate legislative action.
3. **Available Liquidity:** Agency staff shall consider the extent of the Agency’s
   exposure to termination payment liability in connection with each swap
   transaction, and the availability of sufficient liquidity to make any such
   payments that may become due.

D. **Cure Provisions:** Timelines on Agency obligations to cure must provide for
   appropriate Commission action.

E. **Payment:** Payments may be structured on a monthly, semi-annual or annual
   basis.

F. **Security:** Agreement shall identify the security attributable to the swap.

G. **Collateral:**
1. **Required:** The Agency shall require collateral or other credit enhancement
   to be posted by each swap counterparty if the credit rating of the
   counterparty or its guarantor falls below the “AA” category from all three
   of the nationally recognized rating agencies (Moody’s, Standard & Poor’s
   and Fitch).
2. **Value:**
   i. The amount of collateral posted shall be equal to the positive
      termination value of the swap agreement to the Agency.
   ii. Agency will determine reasonable threshold limits for the initial deposit
       and for increments of collateral posted thereafter.
3. **Features of Collateral:**
   i. Cash, U.S. Treasury securities and U.S. Agency securities. The market
      value of the collateral shall be determined on at least a monthly basis.
Appendix A

ii. Deposited with a custodian, acting as agent for the Agency, or as mutually agreed upon between the Agency and each counterpart.

iii. The Agency shall determine on a case-by-case basis whether other forms of credit enhancement are more beneficial to the Agency.

VII. Monitoring and Reporting
Agency staff shall provide the Commission an annual report by October 1 for the fiscal year ending the preceding June 30 which includes the following:

A. Agreements:
1. A summary of each swap agreement, including but not limited to (i) the type of swap, (ii) the rates and dollar amounts paid by the Agency and received by the Agency, (iii) the rate and amounts that were required to be paid and received, and (iv) current market value.
2. Highlights of all material changes to swap agreements or new swap agreements since the last report.
3. Sensitivity analysis with net impact to the Agency of a 25 basis point movement (up or down) in the appropriate swap index or curve.
4. Actual collateral posting by each swap counterparty, if any, under each swap agreement and in total by that swap counterparty.
5. Information concerning any default by a swap counterparty under a swap agreement with the Agency, and the results of the default, including but not limited to the financial impact to the Agency, if any.
6. A summary of swap agreements that were terminated. Summary of key terms of agreements, including notional amounts, interest rates, maturity and method of procurement.
7. Values of early termination, shortening or lengthening the term to certain benchmarks, sale or purchase of options and application of basis swaps.
8. Discussion of other risks associated with each transaction.
9. A summary of any planned swap transactions and the projected impact of such swap transactions on the Agency.

B. Counterparties:
1. Full name, description and credit ratings of each counterparty and credit enhancer insuring swap payments, if any.
2. For each counterparty, the Agency shall provide the total notional amount position, the average life of each swap agreement, the available capital to enter into a swap transaction, and the remaining term of each swap agreement.
3. Listing of any credit enhancement, liquidity facility or reserves and accounting of all costs and expenses associated with the credit enhancement, liquidity facility or reserves.
4. Aggregate marked to market value for each counterparty and relative exposure compared to other counterparties.
5. Calculation of Agency’s Net Termination Exposure for each counterparty.

C. Future Transactions:
A summary of planned swap transactions and the projected impact of such swap transactions on the Agency.
Appendix A

VIII. Payments
   A. **Budgeting:** Termination payment risk shall be determined annually and offset by a hedge or reserve to a predetermined limit.
   B. **Priority of Payment:**
      1. Swap Payments - no greater than parity
      2. Termination Payments - subordinate to related debt payments
   C. **Swap Counterparty Termination Exposure Limit:**
      1. *AAA Counterparties:* $40 million Maximum collateralized Net Termination Exposure; $40 million Maximum Uncollateralized Net Termination Exposure; $40 million Maximum Total Net Termination Exposure
      2. *AA Counterparties:* $40 million Maximum collateralized Net Termination Exposure; $10 million Maximum Uncollateralized Net Termination Exposure; $40 million Maximum Total Net Termination Exposure
      3. *Counterparties Below AA:* $30 million Maximum collateralized Net Termination Exposure; $0 million Maximum Uncollateralized Net Termination Exposure; $40 million Maximum Total Net Termination Exposure
      4. **Disclosure and Documentation**
         A. Disclosure: Derivatives will be disclosed in the related Official Statement, if relevant, and in the Agency’s Annual Audited Financial Report pursuant to generally accepted accounting principals as determined by an independent auditor.
         B. Documentation: ISDA documents.