



# **Interest Rate Risk Management Policy**

## **I. Purpose**

The purpose of the Interest Rate Risk Management Policy is to outline a framework for the utilization of interest rate swaps, and other financial products (Caps, Collars, etc.) available in the marketplace, as they relate to the City of Palm Bay's Debt Management Policy and programs. Derivative financial products will not be employed as investment instruments or for the purpose of speculation. Any swap or derivative product transaction should not impair the outstanding bond rating of the City or negatively affect the amount of credit enhancement capacity available to the City. The City will be open to innovative ideas for any proposed transaction as well as variations from the following guidelines provided that such variation shall be fully explored with the City's advisors and explained to the Council Members of the City.

## **II. The Transaction**

Derivative products can be an integral part of the City's asset / liability management process and can be used to hedge market risk. The financial products used are a function of the changing marketplace and must be addressed at any decision point in a manner designed to achieve the best economic advantage available to the City. Each transaction using financial products will be evaluated as an alternative to traditional intermediate or long-term financing options. Consideration should be given to the comparable cost, ease of entry and exit provisions, and degree of potential benefit and risk exposure (quantified to the greatest extent possible). The synthetic financing option should fit into the City's present strategy for aggregate fixed or floating debt. In order to address the City's need for ongoing flexibility, the guidelines set forth are not intended to establish any binding or arbitrary limits. Transactions that employ derivative financial products will:

- Comply with all applicable outstanding bond ordinances, insurance covenants, state law and rating agency guidelines.
- Contain terms and conditions as set forth in the International Swap and Derivatives Association, Inc. ("ISDA") Master Agreement, Schedules to the Master Agreement, Credit Support Annex and confirmation. (Collectively, the "ISDA Agreement")
- Be a market transaction for which competing good faith market quotations may be obtained at the discretion of the City and with the advice and recommendation of the City's swap advisor and other financial professionals.
- Include a provision for the right to early termination at market under the guidelines of the ISDA Agreement.
- Produce material economic benefit believed to not otherwise be attainable under the currently existing market conditions, or existing conventional debt structures, and improve the flexibility of debt management strategies.

- Not be intended to introduce leverage solely for the means of producing “additional” economic benefit.
- Interest Rate Swaps are typically non-callable instruments. Aside from the market termination, which is customary for interest rate swaps, the City will not unduly permit a synthetic rate transaction to impair its utilization of call features on outstanding bonds.
- Employ a structure that will attempt to minimize any additional floating rate basis risk, tax-law risk or credit risk to the City and offset risks for a particular transaction, with acceptable additional benefit to the City.
- Not cause the total amount of the financial product transactions to exceed the debt management limitations for fixed or floating debt on outstanding indebtedness, or of any particular asset / liability fund.

### **III. The Counterparty**

The following criteria will be used when considering the use of financial derivative products:

- The counterparty shall make reasonable disclosure costs whether or not embedded in the transaction. All fees and expenses paid by the counterparty and designated third parties will be fully disclosed in writing to the City.
- Consider downgrade protection when possible including collateral or credit support, to preserve the rating of any indebtedness and the cost effectiveness of the transaction.
- Not allow for assignment of financial product contracts without the consent of the City.
- Clearly explain the impact on the transaction of the counterparty’s bankruptcy and provide for enforceability opinions from the counterparty.
- Shall attempt to have domestically domiciled counterparties. Foreign domiciled counterparties may be utilized upon approval of Council of the City.
- The swap counterparty shall disclose relationships with third parties such as broker dealers, insurance companies and other swap providers which may effect the transaction,
- The swap counterparty shall provide its financial statements showing the economic capability of the entity, the amount of its swaps outstanding and credit ratings, all of which shall be reviewed by the Financial Advisor and be acceptable to the City. The composition of the approved swap counterparties will change from time to time as changes are made to the City’s investment banking team,

provided that the related swap provider(s) are rated at least AA-/Aa3/AA- by at least two of the three nationally recognized credit rating agencies and have a minimum capitalization of \$50 million, or alternatively, shall post suitable and adequate collateral, given the undertaking involved with the particular transaction.

- Derivative product companies (“DPCs”), that could terminate their existence upon short notice to bond Issuers, such as the City, with no penalty (“terminating” DPCs) require special analysis. If the City enters into a swap contract with a terminating DPC, rating agencies could assume that termination of the hedge could occur at any time during the life of the transaction. Therefore, executing a swap contract with any counterparty rated lower than 'A/A-1' or with a Terminating DPC has credit ramifications which will be carefully examined prior to execution of any agreement.

#### **IV. Review and Analysis**

Swap proposals submitted by a financial product(s) provider, for consideration by the City, shall include a clear analysis which identifies both the potential benefits and risks associated with the proposed transaction. Eligible providers may be required to run additional analysis in light of the existing goals and objectives of the working group and establish the financial product’s value in light of the City’s target benchmarks.

- The City’s Financial Advisor will provide independent analysis of the proposed financial product(s) transactions.
- The City’s cost of the transaction and any ongoing costs, such as remarketing fees liquidity fees, swap advisor fees, financial advisor fees, lawyer fees and other necessary costs will be included in the cost/benefit evaluations.
- A review of provisions requiring bond and/or swap insurance providers and the cost/benefit will be included in an evaluation of the transaction.
- The City’s Financial Advisor shall monitor the results of an adopted swap transaction throughout its life and recommend accordingly any modifications, assignments, collateralization requirements, or early termination when substantial economic benefit or other conditions which merit adjustment action by the City.

#### **V. Legal Analysis**

The documentation of the swap or derivative financial product shall be in the form of an enforceable written contract.

- The swap shall be governed by State law or, New York law with State or New York jurisdiction.
- Review of compliance with existing law and regulation (including but not limited to the Internal Revenue Code of 1986 as amended), bond indentures and bond

covenants should be completed before implementation of a financial product transaction. When required by law, approval of the transaction will first be obtained from other governing bodies.

## **VI. Synthetic Advance Refundings**

The City will consider synthetic advance refundings, which produce a material economic benefit and will in no way impair the outstanding bond rating of the City.

- The present value savings of the transaction must be quantifiable, achieve the target benchmarks set by the debt management policy, and / or annual average debt service savings as approved by the City Council.
- Proposals submitted by firms for consideration by the City shall identify and address not only the benefits of the proposed transaction, but should include a balanced review of the risks or detriments of for the proposed transaction.
- Additional transaction costs such as fees for bond counsel, trustee, independent auditors, liquidity providers, and swap advisor (when applicable) shall be included in the savings calculations.
- The City's Financial Advisor shall produce an independent analysis of the implications of paying a forward premium versus waiting to the current call date of the bonds.

## **VII. Swap Pricing**

One of the primary benefits of derivative products is the degree of customization they can offer. When determining the procurement of a derivative product on a competitive or a negotiated basis, it is essential to establish that the terms and conditions for the product offered reflect industry standard conventions and are evaluated in light of their fair market value. The more generic the size and terms of the product desired, the more likely a competitive bid will result in the best price. The complexity of certain projects, circumstances surrounding innovation, and limiting exposure to counterparties may all be valid reasons to negotiate a particular derivative product transaction. Depending upon the complexity and sizing of the particular transaction, the working group will decide on their recommendation of competitive versus negotiated pricing. The Financial Advisor will provide the working group with the potential benefits and disadvantages of each method. If other firms are allowed to match the lowest cost submitted for a transaction the size of the transaction has to be large enough so that the fixed costs for each of the counterparties do not impact the efficiency of the particular transaction. The allowance of matching of the lowest cost bid should be disclosed in writing to all permitted providers.