CITY OF OAKLAND

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AGENDA REPORT

TO: DEANNA J. SANTANA
CITY ADMINISTRATOR

FROM: Katano Kasaine

SUBJECT: SUPPLEMENTAL REPORT
DEBT AND SWAP POLICIES

DATE: September 11, 2012

City Administrator Approval

Date 9/12/12

COUNCIL DISTRICT: City-Wide

RECOMMENDATION

Staff recommends that the City Council adopt the proposed debt and swap policies as amended. The adoption of the amended Debt Policy and Swap Policy will set forth parameters for issuing debt, including debt involving interest rate swap agreements. When adopted, copies of these policies will be maintained at the City Clerk's Office and at the City Administrator's Office, and be posted on the City's official website, www.oaklandnet.com.

OUTCOME

Approval of the Debt Policy and Swap Policy will have no immediate fiscal impacts. However, the implementation of these policies may assist the City in minimizing borrowing costs in the future due to the rating agencies favorable outlook on such policies.

REASON FOR SUPPLEMENTAL

At the July 10, 2012 meeting, the Finance and Management Committee asked staff to provide the following additional information regarding the Debt Policy and Swap Policy:

1. Specific criteria for entering into a swap policy in the future
2. Information regarding the social responsibility component used around the country associated with debt management and swap policy.
3. The red-lined version of the proposed policies. ***(Exhibits A & B)***

ANALYSIS

Derivative Structures

When appropriate, the City can use interest rate swaps or derivative hedging products to produce debt service savings, limit or hedge overall interest rate exposure, enhance investment returns within prudent risk guidelines, achieve market flexibility not available in the traditional market, optimize capital structure, or for asset/liability matching purposes. Recognizing the potential risks associated with a swap transaction, the City shall only enter into a Swap upon approval from the City Council on a case-by-case basis. The City Council shall authorize the parameters of any Swap transaction, including the terms, conditions and other provisions as described in the Swap policy.

Swap Policy

In light of the aftermath from the 2008 mortgage credit crisis and associated financial market turmoil, many issuers of derivatives, including those with swap agreements, experienced severe losses. Since then, there has been a strong emphasis on policy reform to reinforce protections for derivatives. The Government Finance Officers Association (GFOA) recommends that state and local governments exercise great caution in the use of derivatives. In 2010, the GFOA issued an advisory for the use of debt-related derivatives products and the development of a derivatives policy, which identifies specific policies and procedures necessary to minimize a government's exposure to potential loss in connection with its financial management activities. The City's Swap Policy has been expanded to reflect GFOA best practice recommendations.

The Swap Policy governs the use and management of interest rate swaps as they may be used in conjunction with the City's debt issues. The policy establishes guidelines to be used when considering the use of swaps. Guidance is provided specifying appropriate uses, selection of acceptable providers, negotiation of favorable terms and conditions, and stipulating annual surveillance of the swaps and the providers. The processes for selection of swap related financial products and professional services are also specified. In the proposed Swap Policy, the following conditions for entering into a swap have been added:

- Before entering into a swap agreement, the City reserves the right for its financial advisors to review the International Swap and Derivatives Association, Inc. ("ISDA") Master Agreement, including the Schedule to the Master Agreement, the Credit Support Annex, and any other related document in order to amend the documents as changing market conditions warrant, provided the changes benefit the City.

- The City shall have the right to optionally terminate a swap agreement at "market" or at a below market value cost negotiated with the counterparty at any time over the term of the agreement.

- When selecting a counterparty, regardless of the method of proctirement, the City will obtain a valuation from an independent financial advisor that the terms and conditions of the swap agreement reflect a fair market value of such agreement as of the date of its execution. In all transactions, the counterparty must disclose any gifts or payments made to City elected officials and City finance professionals that the officials would be required to report on their California Fair Political Practices Commission Form 700. The counterparty shall also be required to disclose all payments to third parties (including lobbyists, consultants and attorneys) who assisted the counterparty in securing business with the City and all payments made to third parties for the benefit of the City in connection with the Swap transaction (such as fees to a broker or other intermediary). In addition, upon request of counsel to the City, the counterparty shall be required to disclose the terms of any "mirror" or "back-up" swap or other hedging relationship entered into by the counterparty in connection with the City's swap.

In addition, upon staff s recommendation to Council to enter into a Swap, the following criteria have been added in regards to managing a swap:

- The swap counterparty will be required to notify the City in the event a credit agency takes negative action with regard to the counterparty's credit rating, including both an actual downgrading of the credit rating as well as the publication of a notice by a rating agency that the counterparty's rating is in jeopardy of a downgrading (i.e., being placed on Standard & Poor's Credit Watch or being assigned a negative outlook by Moody's).

- Methods for mitigating potential risks associated with a swap such as basis risk, credit risk, counterpart risk, rollover risk, tax event risk, termination risk, and interest rate risk.

- When reporting to Council, staff will also discuss the termination value of the swap based on a current market calculation of the cost of terminating the swap contract given the market conditions on the valuation date as well as other risks associated with the swap transaction.

- The City will require that the counterparty provide monthly current market valuations of the swap, and the City may also seek independent valuations from third-party professionals.

- The City shall continuously monitor market conditions (such as current interest rates, credit ratings of the counterparty, counterparty exposure and other relevant factors) for opportunities and risks, in conjunction with the counterparty and the City's advisors.

In the municipal credit rating process, the rating agencies believe it is appropriate to place significant value on swap policies that have been implemented by cities. Sound financial management practices that include a swap policy will not only be viewed positively by the rating agencies but may lead to rating upgrades. Higher ratings will lead to lower borrowing costs to the City in the form of lower interest rates.

Social Responsibility Around the Country

The Debt Policy and Swap Policy work together to achieve the lowest possible cost of capital, subject to prudent risk parameters, while preserving future financial flexibility. Staff evaluated other debt and swap polices from municipalities across the country and found that the City of Oakland's policy objectives are consistent with the other municipalities' polices such as achieving the lowest cost of capital and ensuring strong credit ratings.

In considering the social responsibility component associated with these policies, staff did not find that a social responsibility component was emphasized in their swap policies. However, cities such as Los Angeles and Chicago do acknowledge this in selecting financial consultants. The City of Los Angeles requires that the City's contracting polices, which include Affirmative Action, Child Care, Minority/Women/Other Business Enterprise participation, Living Wage, and any other policies in effect at the time, apply to all contracts with the financial consultants (i.e. financial advisors, bond counsel and underwriters). The City of Chicago ensures that local, emerging and disadvantaged business enterprise investment banking and financial firms will be utilized in the sale of City debt.

Staff recommends that the City of Oakland also engage similar criteria when selecting the financing team for all debt issuances and encourage the use of local and disadvantaged banks and financial firms, whenever possible, in the issuance of City debt.

PUBLIC OUTREACH/INTEREST

This item did not require any additional public outreach other than the required posting on the City's website.

COORDINATION

This report has been prepared by the Treasury Division in coordination with City Attorney's Office and Budget Office.

COST SUMMARY/IMPLICATIONS

There are no costs associated with approval of the Debt Policy and Swap Policy. However, the implementation of these policies may assist the City in minimizing borrowing costs in the future due to the rating agency's favorable outlook on such policies.

SUSTAINABLE OPPORTUNITIES

Economic: The proposed policies demonstrate a commitment to sound financial management practices. Compliance to these policies indicates to rating agencies and capital markets that the City's financial resources are responsibly and well managed, which may assist the City in minimizing borrowing costs in the future.

Environmental: There are no impacts to environmental opportunities associated with this report.

Social Equity: The proposed debt policy advocates opportunities for local and disadvantaged banks and financial firms to do business with the City of Oakland.

<u>CEQA</u>

This report is not a project under CEQA.

For questions regarding this report, please contact Katano Kasaine, Treasurer, at (510) 238-2989.

Respectfully submitted,

Katano Kasaine

KATANO KASAINE
Treasurer

Reviewed by:
David Jones, Principal Financial Analyst
Treasury Division

Prepared by:
Bernadette de Leon, Treasury Analyst III
Treasury Division

Attachments (2):
Exhibit A: Red-lined version of the proposed debt policy
Exhibit B: Red-lined version of the proposed swap policy

[INCLUDING EXHIBIT A AND EXHIBIT B]

APPROVED AS TO FORM AND LEGALITY

DEPUTY CITY ATTORNEY

INTRODUCED BY COUNCIL MEMBER ____________________

OAKLAND CITY COUNCIL

RESOLUTION NO. ______________ C. M. S.

RESOLUTION AMENDING AND ADOPTING THE CITY OF OAKLAND'S DEBT MANAGEMENT POLICY AND THE SWAP POLICY, AND REQUIRING APPROVAL OF SWAPS BY COUNCIL ON A CASE-BY-CASE BASIS.

WHEREAS, a debt management policy which provides guidance to City of Oakland (the "City") staff and the City Council of the City (the "Council") by identifying parameters for issuing debt and for managing the City's debt portfolio would be beneficial to the City; and

WHEREAS, a swap policy which provides guidance to City staff and the Council by identifying parameters for issuing "swaps" and for managing the City's swap agreements would be beneficial to the City; and

WHEREAS, the proposed debt management policy and swap policy are to be effective until subsequent policies are adopted; and

WHEREAS, this proposed debt management policy and swap policy shall apply to the City and the successor agency to the former Redevelopment Agency of the City of Oakland: and

WHEREAS, the proposed debt management policy and swap policy have been considered at a public meeting of the Council; and now, therefore, be it

RESOLVED, that the Debt Management Policy of the City, in substantially the form attached hereto as <u>Exhibit A</u>, is hereby amended, approved and adopted, with such changes, additions, amendments or modifications as are approved by the City Administrator, in consultation with the City Attorney; and be it

FURTHER RESOLVED, that the Swap Policy of the City, shall be amended to provide that (1) the City shall enter into a Swap only upon express approval of the City Council on a case-by-case basis; and, (2) Such approval of the City Council shall authorize the structure of any Swap transaction, including the terms, conditions and all other provisions; and be it

FURTHER RESOLVED, that the Swap Policy of the City, in substantially the form attached hereto as Exhibit B, is hereby amended, approved and adopted, with such changes, additions, amendments or modifications as are approved by the City Administrator, in consultation with the City Attorney; and be it

FURTHER RESOLVED, that this Resolution shall take effect immediately upon its passage.

IN OAKLAND, COUNCIL, CALIFORNIA, ______________________, 2012

PASSED BY THE FOLLOWING VOTE:

AYES: - DE LA FUENTE, KERNIGHAN, NADEL, SCHAAF, BROOKS, BRUNNER, KAPLAN, AND PRESIDENT REID

NOES -

ABSENT –

ABSTENTION –

ATTEST: ______________________________

LATONDA SIMMONS
City Clerk and Clerk of the Council of the
City of Oakland, California

Exhibit A

City of Oakland
&
~~Oakland Redevelopment Agency~~

Debt Policy
~~for~~
~~Fiscal Year 2011-2012~~2012-2013

Prepared by
Treasury Division

Presented to the Finance & Management Committee
On September 25, 2012
City Administrator's Office
~~, Finance and Management~~

Adopted by the City Council ~~and Oakland Redevelopment Agency~~
On ~~July~~October ~~3~~2, 2012

Executive Summary of Debt Management Policy

I. Goals and Objectives. In implementing a formal debt management policy, the goal of the City of Oakland ~~and the Oakland Redevelopment Agency (collectively,~~ the "City") is to maintain long-term financial flexibility while ensuring that the City's capital needs are adequately supported.

II. Approach to Debt Management. The City's approach to its financings is to ensure continued market access at the lowest cost of borrowing. As such, the Debt Policy denotes debt affordability for the City compared to capacity ratios which are established by the rating agencies (Moody's Investor Service, Standard & Poor's Ratings Services, and Fitch Ratings). Debt capacity ratios are defined as annual debt service payments as a percentage of General Fund and other revenues. Below are the debt capacity ratio ranges:

- Low debt capacity ratio <5%
- Moderate debt capacity ratio 5% - 15%
- High debt capacity ratio >15%

III. Standards for Use of Debt Financing. Debt financing will be utilized when public policy, equity and economic efficiency favor debt over pay-as-you-go financing.

- Debt will be used to finance long-term capital projects, and the respective maturities will not exceed the respective projects' useful lives.
- The City will seek to use the most economical financing alternative.
- The City will ensure good record-keeping and compliance with all debt covenants and State and Federal laws.

IV. Financing Criteria. Whether issuing long- or short-term debt, the City will determine the most appropriate structure, the mode (fixed or variable), and the possible use of synthetic fixed or floating rate debt. These decisions will be made within the context of already existing obligations.

V. Terms and Conditions of Bonds. In the issuance of its bonds, the City shall carefully consider and evaluate the term of the financing, use of capitalized interest, call provisions, original issue discount and the use of deep discount bonds.

VI. Credit Enhancement. The use of credit enhancement is to be considered on a case-by-case basis and will be purchased only when debt service savings can clearly be demonstrated.

VII. Refinancing Outstanding Debt. A minimum savings threshold of 3% or $500,000, whichever is lower, in present value savings is utilized except when there are legal or restructuring reasons for defeasance.

VIII. Methods of Issuance. The preferred sale method (negotiated or competitive) will be determined for each issuance of bonds. General Obligation Bonds and Tax and Revenue Anticipation Notes will be issued on a competitive basis, except on a case-by-case basis. However, other methods such as private placement may be considered on a case-by-case basis.

IX. Market Relationships. The City will actively manage its relationships with the various rating agencies and analysts through frequent and open communication. The City will also maintain compliance with S.E.C. Rule 15c2-12 by the timely filing of its annual financial statements and other financial and operating data for the benefit of its bondholders.

X. Consultants. The City shall utilize the services of independent financial advisors and bond counsel on all debt financing. The selection of financial consultant(s) shall be based upon firm and staff qualifications, and experience with debt structures similar to what is being proposed. However, depending on the type of financing, other service providers may be necessary which may include underwriting, trustee, verification agent, escrow agent, arbitrage consultant and special tax consulting. In addition, the City should be encouraged to use local and disadvantaged banks and financial firms, whenever possible. Consultants will be required to provide complete disclosure regarding any agreements with other financing team members and outside parties. Selling groups may be considered for certain transactions. All parties are subject to post-evaluation of performance.

City of Oakland
Debt Policy

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Introduction

So as to maintain the highest quality debt management program possible, the City of Oakland ~~and the Oakland Redevelopment Agency~~ (the "City") has adopted the guidelines and policies set forth in this document, referred to hereafter as the "Debt Management Policy." The Debt Management Policy is intended to guide decisions related to debt issued by the City. Debt issuance should be evaluated on a case-by-case basis as well as within the context of the City's general debt management program. The City recognizes that changes in the capital markets and other unforeseen circumstances may require action deviating from this Debt Management Policy. In cases requiring exceptions to the Debt Management Policy, approval from the City Council will be required. The Debt Management Policy is not applicable to intra-City borrowing.

I. Goals and Objectives

The Debt Management Policy formally establishes parameters for issuing debt and managing a debt portfolio, which encompasses the City's specific capital improvement, needs, its ability to repay financial obligations, and the existing legal, economic, financial and debt market conditions. The policies outlined in the Debt Management Policy are not goals or a list of rules to be applied toward the City's debt issuance; rather, these policies should be utilized as tools to ensure that adequate financial resources are available to support the City's long-term capital needs. Specifically, the policies outlined in this document are intended to assist the City in the following:

- Evaluating critical debt issuance options
- Promoting sound financial management
- Providing accurate and timely information on financial conditions
- Maintaining appropriate capital assets for present and future needs
- Protecting and enhancing the City's credit rating

A. Ensuring the legal use of City bonding authority through an effective system of financial security and internal controls

B. Promoting cooperation and coordination with other public entities and the private sector in the financing and delivery of services

II. Approach to Debt Management

In managing its debt, the City's greatest priorities are to:

- achieve the lowest cost of capital,
- ensure high credit quality,
- ensure full and timely payment of debt,
- maintain full compliance with financial disclosure and reporting,
- maintain a prudent level of financial risk,
- assure access to credit markets~~, and~~
- preserve financial flexibility, and
- utilize local and disadvantaged banking and financial firms, whenever possible, in the sale of City debt.

A. **Capital Plan Integration.** A sound debt management program begins with a well-devised capital plan. Therefore, a multi-year capital plan, which integrates pay-as-you-go projects and the projects to be financed, is critical. The multi-year capital plan (the "Capital Plan") shall be for a minimum of a 5-year period and shall be updated at least once annually. In addition to capital project costs, the Capital Plan shall include the following elements:

1. Qualified capital projects

2. Description of all sources of funds

3. Availability of current revenues (non-debt sources) which are reflected in the City's multi-year forecast

4. Timing of capital projects

5. A financing plan or methodology and debt service requirements

B. **Review of Capital Plan.** It is anticipated that the Capital Plan will be modified from time to time. Modifications to the Capital Plan shall be accompanied by a report from the City's Treasurer or designee ~~Finance Director of Administrative Services Agency~~ and Budget Director that discusses the impact of the proposed borrowing on the Capital Plan. The Capital Plan is reviewed and presented to the City Council at least once annually.

C. **Qualified Capital Projects.** Generally, the City will not issue bonds for capital improvements with a cost less than $250,000. The City shall not construct or acquire a public facility if it is unable to adequately provide for the subsequent annual operation and maintenance costs of the facility throughout its life.

D. Cash Financing of Capital Outlays. To demonstrate the City's commitment to a continued capital program, ensure careful consideration of capital expenditure levels, and enhance the City's overall credit worthiness, the City shall seek to fund at least between two and five percent of the overall capital program from current resources, depending upon the specific projects and annual budgetary constraints.

E. Authorization for Issuance. Debt issuance for capital projects shall not be considered unless such issuance has been incorporated into the Capital Plan.

F. Affordability Targets. The ratios, standards, and limits identified below are primarily intended to restrict the use of debt financing in order to facilitate long-term access to capital while ensuring that financial leveraging decisions do not negatively impact the City's annual operations.

1. **Debt Capacity** - The City's approach to its financings is to ensure continued market access at the lowest cost of borrowing. As such, the Debt Policy denotes debt affordability for the City compared to capacity ratios which are established by the rating agencies (Moody's Investor Service, Standard & Poor's Ratings Services, and Fitch Ratings). Debt capacity ratios are defined as annual debt service payments as a percentage of General Fund and other revenues. Below are the debt capacity ratio ranges:
   - Low debt capacity ratio <5%
   - Moderate debt capacity ratio 5% - 15%
   - High debt capacity ratio >15%

2. **Self-supporting Debt** - In some cases, the City will issue debt for which there is an identified repayment source. For debt to be characterized as self-supporting, the repayment source must support the issue through its maturity. Bond issues where interest has been capitalized are not considered to be self-supporting.

3. **Overlapping Debt** (including debt from all other jurisdictions, which tax City taxpayers) will be taken into consideration in planning debt issuance.

G. Credit Quality. All City debt management activities will be conducted to receive the highest credit ratings possible for each issue, consistent with the City's financing objectives, and to maintain the current credit ratings assigned to the City's debt by the major credit rating agencies.

III. Standards for Use of Debt Financing

The City's debt management program will promote the use of debt only in those cases where public policy, equity, and economic efficiency favor debt over cash (pay-as-you-go) financing. Whenever possible, the debt shall be self-supporting.

***A.* Long-Term Capital Projects.** Debt will be used primarily to finance long-term capital projects — paying for the facilities or equipment over some or all of their useful life and concurrent with the stream of benefits from these facilities. The City will consider the debt capacity in determining the use of debt financing.

***B.* Special Circumstances for Non-Capital-Project Debt Issuance.** Debt may be used in special circumstances for projects other than long-term capital projects such as pension obligations, only after careful policy evaluation by the City.

***C.* Debt Financing Mechanisms.** The City will evaluate the use of all financial alternatives available, including, but not limited to: long-term debt, pay-as-you-go, joint financing, reserve fund releases, lease-purchase, authority sponsored debt, special districts, community facility districts, special assessments, Mello-Roos bonds, state and federal aid, certificates of participation, tax increment, private placement, master lease programs, and interfund borrowing. The City will utilize the most cost advantageous financing ahemative available while limiting the General Fund's risk exposure.

***D.* Record-Keeping.** All debt related records shall be maintained within the Treasury Division. At a minimum, this repository will include all official statements, bid documents, ordinances, indentures, trustee reports, leases, etc., for all City debt. To the extent that official transcripts incorporate these documents, possession of a transcript will suffice (transcripts may be in hard copy or stored on CD-ROM). The Treasury Division will maintain all available documentation for outstanding debt and will develop a standard procedure for archiving transcripts for any new debt.

***E.* Rebate Policy and System**. The City will accurately account for all interest earnings in debt-related ftinds. These records will be designed to ensure that the City is in compliance with all debt covenants, and with State and Federal laws. The City will maximize the interest earnings on all funds within the investment parameters set forth in each respective indenture. The City will calculate and report interest earnings that relate to Internal Revenue Code rebate, yield limits, and arbitrage.

IV. Financing Criteria

***A.* Types of Debt.** When the City determines that the use of debt is appropriate, the following criteria will be utilized to evaluate the type of debt to be issued.

1. **Long-Term Debt** Long-term borrowing may be used to finance the acquisition or improvement of land, facilities, or equipment. The City may issue long-term debt (e.g., general obligation bonds, revenue bonds, conduit revenue bonds, tax increment bonds, lease obligations, or variable rate bonds) when required capital improvements camot be financed from current revenues. The proceeds derived from long-term borrowing will not be used to finance current operations or normal maintenance.

Long-term debt will be structured such that the obligations do not exceed the expected useful life of the respective projects.

The City shall not use any debt, lease financing or other instruments of installment repayments with terms longer than two years to finance its operating costs. Exceptions to the policy may be made on a case-by-case basis by the Council.

2. ***Short-Term Debt.*** Short-term borrowing may be utilized for the temporary funding of operational cash flow deficits or anticipated revenues (defined as an assured source with the anticipated amount based on conservative estlmates). The City will determine and utilize the least costly method for short-term borrowing. The City may issue short-term debt when there is a defined repayment source or amortization of principal, subject to the following policies:

   a) ***Bond Anticipation Notes (BANs)*** may be issued instead of capitalizing interest to reduce the debt service during the construction period of a project or facility. The BANs shall mature not more than 3 years from the date of issuance. BANs shall mature within 6 months after substantial completion of the financed facility.

   b) ***Tax and Revenue Anticipation Notes (TRANs)*** shall be issued only to meet projected cash flow needs consistent with a finding by bond counsel that the sizing of the issue fully conforms to Federal IRS requirements and limitations.

   c) ***Lines of Credit*** shall be considered as an alternative to other short-term borrowing options. The lines of credit shall be structured to limit concerns as to the Internal Revenue Code.

   d) ***Other Short-Term Debt,*** including commercial paper notes, may be used.

3. ***Lease-Purchase Debt.*** Lease-purchase debt, including certificates of participation, shall be considered as an alternative to long-term vendor leases. Such debt shall be subject to annual appropriation. In order to reduce the cost of lease borrowing and to improve control over leases, the City may adopt a master lease program.

4. ***Variable Rate Debt.*** To maintain a predictable debt service burden, the City may give preference to debt that carries a fixed interest rate. Variable rate debt, which is synthetically fixed, shall be considered fixed rate debt through the maturity of the swap. The City, however, may consider variable rate debt in certain instances, such as:

a) ***High Interest Rate Environment.*** Current interest rates are above historic average trends.

b) ***Variable Revenue Stream.*** The revenue stream for repayment is variable, and is anticipated to move in the same direction as market-generated variable interest rates, or the dedication of revenues allows capacity for variability.

c) ***Adequate Safeguards Against Risk.*** Financing structure and budgetary safeguards are in place to prevent adverse impacts from interest rate shifts; such structures could include, but are not limited to, interest rate swaps, interest rate caps and the matching of assets and liabilities.

d) ***As a Component to Synthetic Fixed Rate Debt.*** Variable rate bonds may be used in conjunction with a financial strategy, which results in synthetic fixed rate debt. Prior to using synthetic fixed rate debt, the City shall certify that the interest rate cost is lower than traditional fixed rate debt.

e) ***Variable Rate Debt Capacity.*** Consistent with rating agency guidelines, the percentage of variable rate debt outstanding (not including debt which has been converted to synthetic fixed rate debt) shall be hedged by cash flow liquidity.

V. Terms and Conditions of Bonds

The City shall establish all terms and conditions relating to the issuance of bonds, and will control, manage, and invest all bond proceeds. Unless otherwise authorized by the City, the following shall serve as bond requirements:

A. Term. All capital improvements financed through the issuance of debt will be financed for a period not to exceed the useful life of the improvements, but in no event greater than thirty years.

S. Capitalized Interest. Certain types of financings such as certificates of participation and lease-secured financings will require the use of capitalized interest from the issuance date until the City has beneficial use and occupancy of the financed project. Interest shall not be funded (capitalized) beyond a period of three years, or a shorter period if further restricted by statute. The City may require that capitalized interest on the initial series of bonds be funded from the proceeds of the bonds. Interest earnings may, at the City's discretion, be applied to extend the term of capitalized interest but in no event beyond the term statutorily authorized.

C. Debt Service Structure. Debt issuance shall be planned to achieve relatively rapid repayment of debt while still matching debt service to the useful life of facilities. The City shall avoid the use of bullet or balloon maturities except in those instances where these maturities serve to levelize existing debt service.

D. Call Provisions. In general, the City's securities will include a call feature, which is no later than 10 years from the date of delivery of the bonds. The City will avoid the sale of non-callable bonds absent careful evaluation by the City of the value of the call option.

E. Original Issue Discount. An original issue discount will be permitted only if the City determines that such discount results in a lower true interest cost on the bonds and that the use of an original issue discount will not adversely affect the project identified by the bond documents.

F. Deep Discount Bonds. Deep discount bonds may provide a lower cost of borrowing in certain markets. The City will carefully consider their value and effect on any future refinancings as a result of the lower-than-market coupon.

G. Derivative Structures. When appropriate, the City will consider the use of derivative structures as a hedge against future interest rate risk and as a means for increasing financial flexibility. The City will avoid the use of derivative structures for speculative purposes. The City will consider the use of derivative structures when it is able to gain a comparative borrowing advantage of ~~10~~ten or more basis points, and is able to reasonably quantify and understand potential risks.

The City shall not use derivative structures for the sole purpose of generating operating or capital proceeds, without a determination that such structure will accrue interest rate and borrowing costs benefits for the City. ~~For more information on "swaps", please refer to the City's Swap Policy.~~

1. **Swaps.** Recognizing the potential risks associated with a swap transaction, the City shall only enter into a Swap upon approval from the City Council on a case-by-case basis. The City Council shall authorize the parameters of any Swap transaction, including the terms, conditions and other provisions.

   For more information on "swaps", please refer to the City's Swap Policy.

H. Multiple Series. In instances where multiple series of bonds are to be issued, the City shall make a final determination as to which facilities are of the highest priority and those facilities which will be financed first, pursuant to funding availability and the proposed timing of facilities development, and which will generally be subject to the earliest or most senior lien.

VI. Credit Enhancements

The City will consider the use of credit enhancement on a case-by-case basis, evaluating the economic benefit versus cost for each case. Only when a clearly demonstrable savings can be shown shall enhancement be considered. The City will consider each of the following enhancements as alternatives by evaluating the cost and benefit of such enhancement.

A. Bond Insurance. The City shall have the authority to purchase bond insurance when such purchase is deemed prudent and advantageous. The predominant determination shall be based on such insurance being less costly than the present value of the difference in the interest on insured bonds versus uninsured bonds.

1. **Provider Selection.** The ~~Finance Director of Administrative Services Agency~~Treasurer or ~~or his/her~~ designee will solicit quotes for bond insurance from interested providers, or in the case of a competitive sale submit an application for pre-qualification on insurance. In a negotiated sale, the City Administrator or designee or the ~~Director or the Treasury Manager~~Treasurer or designee shall have the authority to select a provider whose bid is most cost effective and whose terms and conditions governing the guarantee are satisfactory to the City. The winning bidder in a competitive sale will determine whether it chooses to purchase bond insurance for the issue.

B. Debt Service Reserves. 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 service, 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 City may purchase reserve equivalents (i.e., the use of a reserve fund surety) 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. Letters of Credit. The City may enter into a letter-of-credit ("LOC") agreement when such an agreement is deemed prudent and advantageous. The City Administrator or designee or the ~~Finance Director of Administrative Services Agency or the Treasury Manager~~Treasurer or designee shall prepare (or cause to be prepared) and distribute to qualified financial institutions as described in paragraph 2 below, a request for qualifications which includes terms and conditions that are acceptable to the City.

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

2. **Selection Criteria.** The selection of LOC providers will be based on responses to a City-issued request for qualifications; criteria will include, but not be limited to, the following:

   a) Ratings at least equal to or better than the City's

   b) Evidence of ratings (including "Outlook")

   c) Trading value relative to other financial institutions

   d) Terms and conditions acceptable to the City; the City may provide a term sheet along with the request for qualifications to which the financial instimtion may make modifications

   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

VII. Refinancing Outstanding Debt

The ~~Treasury Manager~~Treasurer or designee –shall have the responsibility to analyze outstanding bond issues for refunding opportunities that may be presented by underwriting and/or financial advisory firms. In most cases, the goal of refunding or restructuring the debt portfolio is to reduce the City's annual debt service obligations. The ~~Treasury Manager~~Treasurer or designee –will consider the following issues when analyzing possible refunding opportunities:

A. **Debt Service Savings.** The City establishes a minimum savings threshold goal of three percent (3%) of the refunded bond principal amount or at least $500,000, whichever is less, in present value savings (including foregone interest earnings) unless there are legal or restructuring reasons for defeasance. Refunding which produce a net savings of less than three percent (3%) will be considered on a case-by-case basis. –The present value savings will be net of all costs related to the refinancing. The decision to take savings on an upfront or deferred basis must be explicitly approved by the City ~~Administrator~~City Administrator or designee, ~~or the Finance Director of Administrative Services Agency~~ or the Treasurer or designee.

B. **Restructuring.** The City will refund debt when in its best interest to do so. Refundings will include restructuring to meet unanticipated revenue expectations, terminate swaps, achieve cost savings, mitigate irregular debt service payments, release reserve funds, or remove unduly restrictive bond covenants.

C. **Term of Refunding Issues.** The City may refund bonds within the term of the originally issued debt. However, the City may consider maturity extension, when necessary to achieve a desired outcome, provided that such extension is legally permissible. The City may also consider shortening the term of the originally issued debt to realize greater savings. The remaining useful life of the financed facility and the concept of inter-generational equity should guide this decision.

D. **Escrow Structuring.** The City shall utilize the least costiy securities available in structuring refunding escrows. The City will examine the viability of an economic versus legal defeasance on a net present value basis. A certificate will be required from a third party agent who is not a broker-dealer, stating that the securities were procured through an arms-length, competitive bid process (in the case of open market securities), that such securities were more cost effective than State and Local Government Obligations (SLGS), and that the price paid for the securities was reasonable within Federal guidelines. Under no circumstances shall an underwriter, agent or financial advisor sell escrow securities to the City from its own account.

E. Arbitrage. Arbitrage regulations apply to all of the City's tax-exempt financings. The City shall take all necessary steps to optimize escrows and to avoid negative arbitrage in its refundings. Any resulting positive arbitrage will be rebated as necessary according to Federal guidelines.

VIII. Methods of Issuance

The City will determine, on a case-by-case basis, whether to sell its bonds competitively or through negotiation. General Obligation Bonds and Tax and Revenue Anticipation Notes will be issued on a competitive basis unless otherwise determined on a case-by-case basis that a negotiated sale is the most advantageous.

A. Competitive Sale. In a competitive sale, the City's bonds shall be awarded to the bidder providing the lowest ~~true interest cost~~~~sealed~~ bid as long as the bid adheres to the requirements set forth in the published official notice of sale.

S. Negotiated Sale. In a negotiated sale, the terms and price are negotiated by the City and the selected underwriter(s). The City recognizes that some securities are best sold through negotiation. In its consideration of a negotiated sale, the City shall assess the following circumstances:

1. Bonds issued as variable rate demand obligations

2. A complex structure which may require a strong pre-marketing effort

3. Size of the issue which may limit the number of potential bidders

4. Market volatility is such that the City would be better served by flexibility in timing its sale in changing interest rate environments

C. Private Placement. From time to time the City may elect to privately place its debt. Such placement shall only be considered if this method is demonstrated to result in a cost savings to the City relative to other methods of debt issuance.

D. Conduit Debt Issuance. The City may issue conduit revenue bonds that are not a debt or obligation of the City itself, but are obligations of a private borrower. Notwithstanding other credit requirements of the City, such conduit revenue bonds may be issued and sold with or without a credit rating, provided that for any bond with a rating lower than "A", the following conditions shall be met:

1. Bonds shall be issued only in denominations of not less than two-hundred and fifty thousand dollars

2. Bonds shall be eligible for purchase only by "qualified institutional buyers" as defined in Rule 144A of the Securities Act of 1933

3. Bonds shall be sold only to buyers who execute a standard form investor letter containing, among other things, representations of the buyer as sophistication as an investor and its familiarity with the transaction

E. Issuance Method Analysis. The City shall evaluate each method of issuance on a net present value basis.

F. Feasibility Analysis. Issuance of self-supporting revenue bonds will be accompanied by a finding that demonstrates the projected revenue stream's ability to meet future debt service payments.

G. Report of Final Sale. Existing law requires the issuer of any new debt issue of state or local government to submit a report of final sale, within 45 days after the signing of the bond purchase contract or acceptance of a bid in a competitive offering, to the California Debt and Advisory Commission, as specified. This bill would also require the issuer of any proposed new debt issue of state or local government to give written notice of a proposed sale, no later than 30 days prior to the sale of any debt issue at private or public sale, to the commission, as specified.

IX. Market Relationships

A. Rating Agencies and Investors. The City Administrator~~, Assistant City Administrator~~ or designee~~, the Finance Director of Administrative Services Agency,~~ and the ~~Treasury Manager~~Treasurer or designee -shall be responsible for maintaining the City's relationships with Moody's Investors Service, Standard & Poor's Ratings Services and Fitch Ratings. The City may, from time to time, choose to deal with only one or two of these agencies as circumstances dictate. In addition to general communication, the City Administrator~~, Assistant City Administrator~~ or designee,~~, the Finance Director of Administrative Services Agency~~ and the ~~Treasury Manager~~Treasurer or designee and the Budget Director -shall: (1) meet with credit analysts at least once each fiscal year, and (2) prior to each competitive or negotiated sale, offer conference calls with agency analysts in connection with the planned sale.

B. Continuing Disclosure. The City shall remain in compliance with Rule 15c2-12 by filing its annual financial statements and other financial and operating data for the benefit of its bondholders within ~~270 days~~ nine (9) months of the close of the fiscal year. The inability to make timely filings must be disclosed and would be a negative reflection on the City. While also relying on timely audit and preparation of the City's annual report, the ~~Treasury Manager~~Treasurer or designee -will ensure the City's timely filing with each Nationally Recognized Municipal Securities Information Repository.

C. Rebate Reporting. The use of bond proceeds and their investments must be monitored to ensure compliance with arbitrage restrictions. Existing regulations require that issuers calculate annual rebates, if any, related to each bond issue, with rebate, if due, paid every five years. Therefore, the ~~Treasury Manager~~ Treasurer or designee shall ensure that proceeds and investments are tracked in a manner that facilitates accurate calculation, calculations are completed, and rebates, if any, are made in a timely manner.

D. Other Jurisdictions. From time to time, the City will issue bonds on behalf of other public or private entities ("conduit" issues). While the City will make every effort to facilitate the desires of these entities, the ~~Finance Director of Administrative Services Agency and the Treasury Manager~~Treasurer or designee will ensure that the highest quality financings are done and that the City is insulated from all risks. The City shall require that all conduit financings achieve a rating at least equal to the City's ratings or that credit enhancement is obtained.

X. Fees. The City will charge an administrative fee equal to direct costs plus indirect costs as calculated by the City's OMB A87 model to reimburse its administrative costs incurred in debt issuance on behalf of other governmental entities.

XI. Consultants. The City shall select its primary consultant(s) by competitive process through a Request for Proposals (RFP), however, if there are unforeseen events that necessitate inmediate action including but not limited to redemption, defeasance, or restructuring to prevent the City from experiencing further losses, the ~~City Administrator~~City Administrator or designee or the Treasurer or designee ~~Director of Finance~~ can select a consultant without using the RFP process. In addition, the City should be encouraged to use local and disadvantaged banks and financial firms, whenever possible.

A. Selection of Financing Team Members. Final approval of financing team members will be provided by the City Council.

1. Selection of **Underwriter:** For any issue of debt, financing or debt instrument, the City shall select the underwriter through a request for proposal process, when appropriate. The request for proposal will be distributed to qualified candidates to determine the level of experience as well as fees in the proposed type of financing.

   Senior Manager Selection. The ~~Finance Director and/or the Treasury Manager~~Treasurer or designee shall recommend to the ~~City Administrator~~City Administrator or designee the selection of a senior manager for a proposed negotiated sale. Solicited or unsolicited RFP's or Request of Qualifications (RFQ) will be used to determine the selection and appointment of the senior managers and co-managers on the debt issuances. The criteria for selection as reflected in the RFP or RFQ shall include but not be limited to the following:

   - The firm's ability and experience in managing complex transactions
   - Prior knowledge and experience with the City
   - The firm's willingness to risk capital and demonstration of such risk
   - The firm's ability to sell bonds
   - Quality and experience of persomel assigned to the City's engagement
   - Financing plan presented

   Co-Manager Selection. Co-managers will be selected on the same basis as 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 the City's bonds.

Selling Groups. The City may establish selling groups in certain transactions. To the extent that selling groups are used, the City Administrator or designee and/or the ~~Finance Director and/or the Treasury Manager~~Treasurer or designee at his or her discretion, may make appointments to selling groups from within the pool of underwriters or from outside the pool, as the transaction dictates.

Underwriter's Discount.

- ~~The Finance Director and/or the Treasury Manager will evaluate the proposed underwriter's discount against comparable issues in the market. If there are multiple underwriters in the transaction, the Director and/or the Treasury Manager will determine the allocation of fees with respect to the management fee. The determination will be based upon participation in the structuring phase of the transaction.~~

- All fees and allocation of the management fee will be determined prior to the sale date; a cap on management fee, expenses and underwriter's counsel will be established and communicated to all parties by the ~~Treasury Manager~~Treasurer or designee. The senior manager shall submit an itemized list of expenses charged to members of the underwriting group. Any addhional expenses must be substantiated.

Evaluation. The City and/or FA will evaluate each bond sale after its 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.

Syndicate Policies. For each negotiated transaction, syndicate policies will be prepared that will describe the designation policies governing the upcoming sale. The ~~Treasury Manager~~Treasurer or designee or Financial Advisor shall ensure receipt of each member's acknowledgement of the syndicate policies for the upcoming sale prior to the sale date.

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

- Equitably allocate bonds to other managers and the selling group

- Comply with MSRB regulations goveming the priority of orders and allocations

- Within 10 working days after the sale date, submit to the ~~Finance Director or Treasury Manager~~Treasurer or designee -a detail of orders, allocations and other relevant information pertaining to the City's sale

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

Selection of **Financial** Advisor**:** The City shall conduct a request for qualifications from potential candidates every three years to establish a pool of qualified financial advisors for each of the following areas:

The City Administrator or designee and/or the Treasurer or designee ~~Finance Director of Administrative Services Agency~~ will make recommendations for financial advisors and the City shall utilize the services of qualified applicants in the pool on a rotational basis, as applicable, for any issue of debt, financing or debt instrument. The recommended pool has to be approved by finance committee.

Selection of the City's financial advisor(s) and financial advisor pool shall be based on, but not limited to, the following criteria:

- Experience in providing consulting services to complex issuers
- Knowledge and experience in structuring and analyzing complex issues
- Experience and reputation of assigned personnel
- Fees and expenses

B. Financial Advisory Services. Financial advisory services provided to the City shall include, but shall not be limited to the following:

1. Evaluation of risks and opportunities associated with debt issuance
2. Monitoring marketing opportunities
3. Evaluafion of proposals submitted to the City by investment banking firms
4. Structuring and pricing
5. Preparation of request for proposals for other financial services (trustee and paying agent services, printing, credit facilities, remarketing agent services, etc.)
6. Advice, assistance and preparation for presentations with rating agencies and investors
7. Assist in the preparation and review of legal and financing documents in coordination with the financing team in cormection with the financing

C. Bond Counsel. City debt will include a written opinion by legal counsel affirming that the City is authorized to issue the proposed debt, that the City has met all constitution and statutory requirements necessary for issuance, and a determinafion of the proposed debt's federal income tax status. 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 City will then make recommendafions to the City Attorney's Office where they will review the recommendations and fees before forwarding the recommendations and fees to council. Compensation will be based on a fixed fee schedule and will vary based on the complexity of the transaction.

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 shall be permitted which could compromise the firm's ability to provide independent advice which is solely in the City's best interests or which could reasonably be perceived as a conflict of interest.

***E.* Conflicts of Interest.** The City also expects that its financial advisor will provide the City with objective advice and analysis, maintain the confidentiality of City financial plans, and be free from any conflicts of interest.

Glossary

Arbitrage. 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. IRS regulations govern arbitrage on the proceeds from issuance of municipal securities.

Balloon Maturity. A later maturity within an issue of bonds which contains a disproportionately large percentage of the principal amount of the original issue.

Bond Anticipation Notes (BANs). Notes issued by the government unit, usually for capital projects, which are paid from the proceeds of the issuance of long term bonds.

Bullet Maturity. A maturity for which there are no sinking fund payments prior to the stated maturity date.

Call Provisions. The terms of the bond contract giving the issuer the right to redeem all or a portion of an outstanding issue of bonds prior to their stated dates of maturity at a specific price, usually at or above par.

Capitalized Interest. A portion of the proceeds of an issue which is set aside to pay interest on the securities for a specific period of time. Interest is commonly capitalized for the construction period of the project.

Certificates of Participation (COP). A bond from an issue, which is secured by lease payments made by the party leasing the facilities, financed by the issue. Typically certificates of participation ("COPs") are used to finance construction of facilities (i.e., schools or office buildings) used by a state or municipality, which leases the facilities from a financing authority. Often the leasing municipality is legally obligated to appropriate moneys from its general tax revenues to make lease payments.

Commercial Paper. Very short-term, unsecured promissory notes issued in either registered or bearer form, and usually backed by a line of credit with a bank.

Competitive Sale. A sale of securities by an issuer in which underwriters or syndicates of underwriters submit sealed bids to purchase the securities in contrast to a negotiated sale.

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

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

Debt Service Reserve Fund. The fund in which moneys are placed which may be used to pay debt service if pledged revenues are insufficient to satisfy the debt service requirements.

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

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

Designation Policies. Outline of how an investor's order is filled when a 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.

The highest priority is given to Group Net orders; the next priority is given to Net Designated orders and Member orders are given the lowest priority.

Escrow. A fund established to hold moneys pledged and to be used to pay debt service on an outstanding issue.

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

Lease-Purchase. A financing lease which may be sold publicly to finance capital equipment, real property acquisition or construction. The lease may be resold as certificates of participation or lease revenue bonds.

Letters of Credit. A bank credit facility wherein the bank agrees to lend a specified amount of funds for a limited term.

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

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

Moody's Median. Key financial, debt, economic and tax base stafisfics with median values for each statistic presented. Moody's uses audits for both rated and unrated cities to ensure that the medians presented are representative of all cities.

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

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.

Overlapping Debt. That portion of the debt of other governmental units for which residents of a particular municipality are responsible.

Pay-As-You-Go. An issuer elects to finance a project with existing cash flow as opposed to issuing debt obligations.

Present Value. The current value of a fiiture cash flow.

Private Placement. The original placement of an issue with one or more investors as opposed to being publicly offered or sold.

Rebate. A requirement imposed by Tax Reform Act of 1986 whereby the issuer of the bonds must pay the IRS an amount equal to its profit earned from investment of bond proceeds at a yield above the bond yield calculated pursuant to the IRS code together with all income earned on the accumulated profit pending payment.

Selling Groups. The group of securifies dealers that participate in an offering not as underwriters but as sellers who receive securifies, less the selling concession, from the managing underwriter for distribution at the public offering price.

Special Assessments. Fees imposed against properties, which have received a special benefit by the construction of public improvements such as water, sewer and irrigation.

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

Tax Increment. A portion of property tax revenue received by a redevelopment agency, which is attributable to the increase in assessed valuation since adoption of the project area plan.

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

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 reoffered to investors.

Variable Rate Debt. 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.

Exhibit B

City of Oakland
~~&~~
~~Oakland Redevelopment Agency~~

Swap Policy
~~*for*~~
~~Fiscal Year 2011~~2~~-2012~~3

Prepared by
Treasury Division~~, Finance and Management Agency~~Administrative ~~Services Agency~~

Presented to the Finance & Management Committee
On September 25, 2012

Adopted by the City Council~~ and Oakland Redevelopment Agency~~

On ~~July 3~~October 2, 2012

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I. Introduction

The purpose of the Swap Policy (the "Policy") of the City of Oakland (the "City") is to establish guidelines for the use and management of interest rate swaps. This Policy will provide the appropriate internal framework to ensure that consistent objectives, practices, controls and authorizations are maintained throughout the City in terms of debt related risks and the management of hedging thereof.

The City is authorized under California Government Code Section 5922 to enter into interest rate swaps to reduce the amount and duration of rate, spread, or similar risk when used in combination with the issuance of bonds.

II. Scope and Authority

This Policy shall govern the City's use and management of all interest rate swaps. While adherence to this Policy is required in applicable circumstances, the City maintains the right to modify this Policy and make exceptions to certain guidelines at any time to the extent that it achieves one or more of the City's overall financial and/or policy goals.

In conjunction with the City's ~~D~~debt Policy, this Policy shall be reviewed and updated, as needed, ~~at least annually~~ and presented to the City Council (the "Council") for approval. The -City Administrator or designee, in conjunction with the ~~Finance Director of Administrative Services Agency~~Treasurer or designee, are the designated administrators of this Policy. The ~~Finance Director of Administrative Services Agency and/or the Treasury Manager~~Treasurer or designee -shall have the day-to-day responsibility and authority for structuring, implementing, and managing interest rate swaps.

Council shall approve any transaction involving an interest rate swap. The City shall be authorized to enter into interest rate swap or derivative hedging transactions only with qualified counterparties. The ~~Finance Director of Administrative Services Agency~~Treasurer or designee, in consultation with the City Administrator or designee, shall have the authority to select the counterparties, so long as the criteria set forth in this Policy are met.

III. Conditions for the Use of Interest Rate Swaps

A. General Usage
The City will use interest rate swaps or derivative hedging products (collectively referred to as "swap products") to produce debt service savings, limit or hedge overall interest rate exposure, enhance investment returns within prudent risk guidelines, achieve market flexibility not available in the traditional market, optimize capital structure (i.e., alter the pattern of debt service payments), or for asset/liability matching purposes.

In connection with the use of any swap products, Council shall make a finding that the authorized swap product will be used in a beneficial manner that when implemented in combination with new or outstanding bonds, the swap product will enhance the relationship between risk and return, or achieve other policy objectives of the City.

Any agreement implementing the use of swap product will only be entered into after the careful assessment of all inherent risks. Swap products will not be used for speculative purposes.

B. Maximum Notional Amount
The City will limit the total notional amount of any interest rate swaps based on criteria set forth in this Policy regarding the proper management of risks, calculation of termination exposure, and development of a contingency plan for mandatory termination. ~~As outlined in this Policy, the total "net notional amount" of all swaps related to a bond issue should not oxcood the amount of outstanding bonds.~~

C. Interest Rate Swap Considerations
When considering the relative advantage of an interest rate swap versus traditional fixed rate or variable rate bonds, the City, among other things, will consider the impact of all associated up-front costs, ongoing support costs, and potential impact of market fluctuation.

IV. Interest Rate Swap Features

A. Interest Rate Swap Agreement
To the extent possible, any interest rate swap agreements entered into by the City will contain the terms and conditions as set forth in the International Swap and Derivatives Association, Inc. ("ISDA") Master Agreement, including the Schedule to the Master Agreement, the Credit Support Annex, and any other related document. As the City deems appropriate, these ISDA documents may be reviewed by the City's financial advisors in order to amend the documents as changing market conditions warrant, provided the changes benefit the City. The swap agreement between the City and each counterparty shall include payment, term, security, collateral, default, remedy, termination, and other terms, conditions, provisions and safeguards as the City, in consultation with its legal counsel, deems necessary or desirable.

Subject to the provisions contained herein, the terms of any City swap agreement shall use the following guidelines:

1. Downgrade provisions triggering termination shall in no event be worse than those affecting the counterparty.

2. Governing law for swaps will be New York, but should reflect California authorization provisions.

3. The specified indebtedness related to credit events in any swap agreement should be narrowly defined and refer only to indebtedness of the City that could have a materially adverse effect on City's ability to perform its obligations under the swap. Debt should typically only include obligations within the same lien as the swap obligation.

4. Collateral thresholds stipulating when collateral will be required to be posted by the swap provider are designated in the policy and are based on credit ratings of the swap provider. Collateral requirements setting out the amount and types of collateral will be established for each swap based upon the credit ratings of the swap provider and any guarantor.

5. Eligible collateral should generally be limited to cash, U.S. Treasury securities and obligations of Federal Agencies where the principal and interest are guaranteed by the full faith and credit of the United States government. At the discretion of the ~~Finance Director of Administrative Services Agency and/or the Treasury Manager~~Treasurer or designee, other high-quality obligations of Federal agencies, not secured by the full faith and credit of the U.S. government, may be used as collateral.

6. City shall have the right to optionally terminate a swap agreement at "market," or at a below market value cost negotiated with the counterparty at any time over the term of the agreement.

7. Termination value should be set by a "market quotation" methodology, unless the City deems an alternate methodology appropriate.

B. Interest Rate Swap Counterparties

1. Credit Criteria
   The City will make its best efforts to work with qualified swap counterparties that have a general credit rating of:

   a. at least "Aa3" or "AA-" by at least two of the three nationally recognized rating agencies, which are Moody's, S&P and Fitch, and not rated lower than "A2" or "A" by any of these rating agencies, or

   b. have a "AAA" subsidiary that is appropriately rated by at least one of the three nationally recognized rating agencies.

   For lower rated counterparties, where two of the three ratings from the nationally recognized firms is below "AA-" or "Aa3", the City will seek credit enhancement in the form of:

   a. Contingent credit support or enhancement;

   b. Collateral consistent with the policies contained herein;

   c. Ratings downgrade triggers;

d. Guaranty of parent, if any.

In addition, qualified swap counterparties must have a demonstrated record of successfully executing swap transactions as well as creating and implementing innovative ideas in the swap market.

The swap counterparty will also be required to notify the City in the event a credit agency takes negative action with regard to the counterparty's credit rating, including both an actual downgrading of the credit rating as well as the publication of a notice by a rating agency that the counterparty's rating is in jeopardy of a downgrading (i.e., being placed on Standard & Poor's Credit Watch or being assigned a negative outlook by Moody's).

2. Counterparty Termination Exposure
In order to diversify the City's counterparty credit risk, and to limit the City's credit exposure to any one counterparty, limits will be established for each counterparty based upon both the credit rating of the counterparty as well as the relative level of risk associated with each existing swap transaction. The risk measure will be calculated based upon the mark-to-market sensitivity of each transaction to an assumed shift in interest rates. Assuming a 25 basis point movement in the swap rate, the maximum net exposure (termination payment) per counterparty shall not exceed the following amounts based on the lowest credit rating assigned by any of the three nationally recognized rating agencies unless fully collateralized:

Credit Rating	Maximum Net Sensitivity to a 25 Basis Point Shift in Yield Curve*
Fully Collateralized	$10,000,000
AAA	$10,000,000
AA Category	$ 8,000,000

The calculation of net interest rate sensitivity per counterparty will take into consideration multiple transactions, some of which may offset market interest rate risk thereby reducing overall exposure to the City. In addition, additional exposure provisions are as follows:

a. The sum total notional amount per swap counterparty may not exceed 25 percent of City's total revenue bond indebtedness. The appropriate collateral amount will be determined on a case by case basis, and approved by the ~~Finance Director of Administrative Services Agency~~

* The maximum net exposure limitations establish guidelines with respect to whether City should enter into an additional swap agreement with an existing counterparty. For example, assume City executed a fifteen-year $400 million notional amount swap with a "AAA" rated counterparty. If the yield curve moved 25 basis points, City could have a significant market exposure to that swap counterparty (i.e. in order to terminate the swap City would have to make a payment of up to $10 million dollars). The same scenario would apply to a fully collateralized counterparty. If such event occurred~~, the Finance Director of Administrative Services Agency and/or~~ the ~~Treasury Manager~~Treasurer or designee -would evaluate whether it is prudent and advisable to enter into additional swap transactions with such counterparties in order to mitigate the exposure to such counterparty. For "AA" rated counterparties, the maximum net exposure limitation would be reduced to $8 million given its lower credit rating.

~~and/or the Troasury Manager~~Treasurer or designee -in consultation with the City Administrator or designee.

b. If the sensitivity limit is exceeded by a counterparty, City shall conduct a review of the exposure sensitivity limit calculation of the counterparty. The ~~Finance Director of Administrative Services Agency and/or tho Troasury Manager~~Treasurer or designee –shall evaluate appropriate strategies in consultation with the City Administrator or designee to mitigate this exposure.

C. Term and Notional Amount
The City shall determine the appropriate term for an interest rate swap agreement on a case-by-case basis.– ~~In connection with the issuance or carrying of bonds, tho form of the swap agroomont botwoen the City and a qualified swap provider shall not extend beyond the final maturity date of the related bonds. The total "not notional amount" of all swaps related to a bond issue should not excood tho amount of outstanding bonds.~~ For purposes of calculating the net notional amount, credit shall be given in situations where there are off-setting fixed rate and variable rate swaps. In addition, for variable rate transactions, credit may also be given for any assets that are used to hedge a transaction as long as in the City's judgment such assets are reasonably expected to remain in place on a conterminous basis with the swap.

D. Collateral Requirements
As part of any swap agreement, the City will seek to include terms imposing collateral requirements based on credit ratings of the counterparty, requiring collateralization or other forms of credit enhancements to secure any or all swap payment obligations. The City will determine the collateral requirements in consultation with its counsel and its financial advisor, if applicable, and may require the posting of securities, surety bonds, letters of credit or other credit enhancement if the highest credit rating of the counterparty, parent, or guarantor falls below a rating of "AA-" or "Aa3". Additional collateral for further decreases in credit ratings of the counterparty shall be posted by the counterparty in accordance with the provisions contained in the collateral support agreement to the counterparty with the City.

Threshold collateral amounts shall be determined by the City on a case-by-case basis. The City will determine the reasonable threshold limits for the initial deposit and for increments of collateral posting thereafter. Collateral shall be deposited with a third party trustee, or as mutually agreed upon between the City and the counterparty. 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. The market value of the collateral shall be determined on a monthly basis or more frequently if the City determines it is in its best interest given the specific nature of the swap(s) and/or collateral security.

E. Security and Source of Repayment
The City will generally use the same security and source of repayment (pledged revenues) for interest rate swaps as is used for the bonds that are hedged or carried by the swap, if any, but shall consider the economic costs and benefits of subordinating the City's payments under the swap and/or termination payment.

F. Prohibited Interest Rate Swap Features
The City will not use interest rate swaps that are:

1. speculative or create extraordinary leverage or risk,
2. lacking in adequate liquidity to terminate without incurring a significant bid/ask spread,
3. providing insufficient price transparency to allow reasonable valuation, or
4. used as investments.

V. Evaluation and Management of Interest Rate Swaps Risks

Prior to the execution of any swap transaction, the City Administrator or designee~~,~~ ~~the Finance Director of Administrative Services Agency~~, the ~~Treasury Manager~~Treasurer or designee -and Bond Counsel shall evaluate the proposed transaction and recommend the findings to Council. Such a review shall include the identification of the proposed benefit and potential risks inherent in the transaction. As part of this evaluation, the City shall compute the Maximum Net Termination Exposure to the proposed swap counterparty.

A. Evaluation Methodology
The City will review the following areas of potential risk for new and existing interest rate swaps:

Type of Risk	Description	Evaluation Methodology	Mitigation
Basis Risk	The risk where there is a mismatch between actual variable rate debt service and variable rate indices used to determine swap payment.	The City will review historical trading differentials between the variable rate bonds and the variable rate index.	The City will analyze historic relationships and consider mitigation techniques as warranted. When used in connection with an advanced refunding, mitigation techniques could include maintaining a cushion between the floating rate index and the expected trading level of the floating rate instrument, creating a reserve to cover potential basis risk mismatches, and including provisions for optional termination.

Credit Risk	The occurrence of an event modifying the credit quality or credit rating of the City or its counterparty.	The City will actively monitor the ratings of its counterparties, insurers and guarantors, if applicable.	The City can minimize cross defaults and the favorable negotiation of credit event triggers in the underlying documentation.
Counterparty Risk	The failures of the counterparty to make required payments or otherwise comply with the terms of the swap agreement.	The City will monitor exposure levels, ratings thresholds and collateralization requirements.	The City will diversify its counterparty exposure, impose minimum credit rating standards and require protective documentation provisions. (See Counterparty Credit Criteria)
Rollover Risk	The risk that the City can not secure a cost-effective renewal of a line or letter of credit.	The City will evaluate the expected availability of liquidity support for hedged (swapped) and unhedged variable rate debt.	This risk is shared generally by variable-rate debt structures. The City may use any of the following mitigation techniques: purchasing longer term facilities for credits where rollover risk is greatest; including SIFMA Index Bonds in the bond documents; and staggering the maturity dates of different liquidity facility programs to diversify points of market re-entry.
Tax Event Risk	The risk that the spread between taxable and tax-exempt rates will change as a result of changes in income tax laws or other conditions.	The City will review the tax events proposed in swap agreements and evaluate the impact of potential changes in tax law on LIBOR-based swaps.	The City should monitor its tax risk position, including taking steps to reduce tax risk when favorable market opportunities present themselves, limiting tax risk to within acceptable bounds, and considering the use of financial mechanisms to cap tax risk exposure.
Termination Risk	The risk that a swap has a negative value and the City will owe a "breakage" fee ~~is~~if the contract has to be liquidated for any reason.	The City will compute is termination exposure for all existing and proposed swaps at market value and under an expected worst-case scenario. A contingency plan will be periodically	The City will use protective documentation provisions and will evaluate sources of internal liquidity and market access that could be used in the event a termination payment were required to be made.

		updated specifying how much the City would finance a termination payment and/or replace the hedge.	
Interest Rate Risk	The risk that the City's costs associated with variable-rate exposure increase and negatively affects budgets, coverage ratios and cash flow margins. Variable-rate exposure may be created by a Swap from fixed to variable, or a Swap that otherwise creates some type of variable liability, such as basis risk, tax risk or yield curve risk. The interest rate risk presented by such a Swap may be increased as interest rates increase generally, as intramarket relationships change, or because of credit concerns relating to the District or a credit enhancer.	Prior to taking on interest rate risk, the City will measure its capacity for floating rate exposure, based on policy targets for its mix of fixed and variable rate debt and investments, taking into consideration future variable rate needs.	The City will make selected use of interest rate hedges, like caps and collars, to reduce that risk. In evaluating its variable rate exposure, the District will consider the residual risks of variable rate debt that is not fully hedged by swaps, such as basis and tax risk.

B. Managing Interest Rate Swap Risks

1. ~~Annual~~ Reporting

   The City will evaluate the risks associated with outstanding interest rate ~~swaps at least annually~~swaps, as needed, or as requested by the City Council, and provide a written report along with the updated Swap Policy to Council. This evaluation will include the following information:

   a. A description of all outstanding interest rate swaps, including related bond series, types of swaps, rates paid and received by the City, existing notional amount, the mark-to-market value of each swap, and the average life and remaining term of each swap agreement.

b. The credit rating of each swap counterparty, parent, guarantor, and credit enhancer insuring swap payments, if any.

c. Actual collateral posting by swap counterparty, if any, per swap agreement and in total by swap counterparty.

d. Information concerning any material event involving outstanding swap agreements, including a default by a swap counterparty, counterparty downgrade, or termination.

e. An updated contingency plan to replace, or fund a termination payment in the event an outstanding swap is terminated.

f. The status of any liquidity support used in connection with interest rate swaps, including the remaining term and current fee.

g. The termination value of the swap based on a current market calculation of the cost of terminating the swap contract given the market conditions on the valuation date. The City will require that the counterparty provide monthly current market valuations of the swap, and the City may also seek independent valuations from third-party professionals.

h. A discussion of other risks associated with the swap transaction.

The ~~Finance Director of Administrative Services Agency and/or the Treasury Manager~~Treasurer or designee –shall update, as needed, this Policy in accordance with its Debt Policy ~~at least annually~~ and submit the update to Council for approval.

2. Contingency Plan for Mandatory Termination
The City shall compute the termination exposure of each of its swaps and its total swap termination payment exposure at least annually and prepare a contingency plan to either replace the swaps or fund the termination payments, if any, in the event one or more outstanding swaps are terminated. The City shall assess its ability to obtain replacement swaps and identify revenue sources to fund potential termination payments.

3. Ongoing Management
The City shall actively monitor its swaps in order to manage the benefits and risks associated with a swap. The City shall continuously monitor market conditions (such as current interest rates, credit ratings of the counterparty, counterparty exposure and other relevant factors) for opportunities and risks, in conjunction with the counterparty and the City's advisors.

C. Terminating Interest Rate Swaps

1. Optional Termination

All swap transactions shall contain provisions granting the City the right to optionally terminate the agreement at its market value or at a below market value cost negotiated with the counterparty at any time. The City, in consultation with its counsel, may terminate a swap if it is determined that it is financially advantageous, or will further other policy objectives, such as management of exposure to swaps or variable rate debt.

In general, except in the event of the counterparty's ratings being downgraded below the ratings required by this Policy, the counterparty will not have the right to assign or optionally terminate the agreement.

2. Mandatory Termination
In the event a swap is terminated as a result of a termination event, such as a default or a decrease in credit rating of either the City or the counterparty, the City will evaluate whether it is financially advantageous to obtain a replacement swap, or, depending on market value, make or receive a termination payment.

It is the intent of the City not to make a termination payment to a counterparty that does not meet its contractual obligations.

In the event the City makes a swap termination payment, the City shall attempt to follow the process identified in its contingency plan for mandatory termination. The City shall also evaluate the economic costs and benefits of incorporating a provision into the swap agreement that will allow the City to make termination payments over time.

3. Events of Default
The City will incorporate into any swap contract the right to terminate the agreement upon an event of default by the counterparty. Such right may be conditioned on the consent of any person providing credit enhancement or liquidity to any transaction. Upon such termination, the counterparty will be the "defaulting party" for the purposes of calculating the termination payment owed. Events of default of a counterparty will include the following:

a. Failure to make payments when due
b. Material breach of representations and warranties
c. Illegality
d. Failure to comply with downgrade provisions, and
e. Failure to comply with any other provisions of the agreement after a specified notice period.

VI. Selecting and Procuring Interest Rate Swaps

A. Financing Team
The City will retain the services of a nationally recognized municipal bond counsel firm, and will consider the use of a qualified financial advisor and/or swap advisor for all interest rate swaps.

B. Underwriter Selection
In the event bonds are issued in connection with interest rate swaps and/or hedging products, the City will price the bonds according to the guidelines set forth in its approved Debt Policy.

C. Counterparty Selection
The City will determine, on a case-by-case basis, whether to select a counterparty (or counterparties, if applicable) through a competitive bid process or on a negotiated basis. Regardless of the method of procurement, the City will obtain a valuation from an independent financial advisor that the terms and conditions of the swap agreement reflect a fair market value of such agreement as of the date of its execution. In all transactions, the counterparty must disclose any gifts or payments made to City elected officials and City finance professionals that the officials would be required to report on their California Fair Political Practices Commission Form 700. The counterparty shall also be required to disclose all payments to third parties (including lobbyists, consultants and attorneys) who assisted the counterparty in securing business with the City and all payments made to third parties for the benefit of the City in connection with the Swap transaction (such as fees to a broker or other intermediary). In addition, upon request of counsel to the City, the counterparty shall be required to disclose the terms of any "mirror" or "back-up" swap or other hedging relationship entered into by the counterparty in connection with the City's swap.

VII. Disclosure and Financial Reporting

The City will take steps to ensure that there is full and complete disclosure of all interest rate swaps to rating agencies and in disclosure documents. Disclosure in marketing documents shall provide a clear summary of the special risks involved with swaps and any potential exposure to interest rate volatility or unusually large and rapid changes in market value. With respect to its financial statements, the City will adhere to the reporting and disclosure guidelines for derivative products as set forth by the Government Accounting Standards Board ("GASB").

Glossary of Terms

Asset/Liability Matching - Matching the term and amount of assets and liabilities in order to mitigate the impact of changes in interest rates.

Bid/Ask Spread - The difference between the bid price (at which a market maker is willing to buy) and the ask price (at which a market maker is willing to sell).

Collateral – Assets pledged to secure an obligation. The assets are potentially subject to seizure in the event of default.

Downgrade - A negative change in credit ratings.

Hedge - A transaction that reduces the interest rate risk of an underlying security.

Interest Rate Swap - The exchange of a fixed interest rate and a floating interest rate between counterparties.

Liquidity Support - An agreement by a bank to make payment on a variable rate security to assure investors that the security can be sold.

LIBOR - London Interbank Offer Rate. Often used as an index to compute the variable rate on an interest rate swap.

Notional Amount - The amount used to determine the interest payments on a swap.

Termination Payment - A payment made by a counterparty that is required to terminate the swap. The payment is commonly based on the market value of the swap, which is computed using the rate on the initial swap and the rate on a replacement swap.