

**ADDENDUM TO SECTION 4.7
COUNTY OF SANTA CLARA
INTEREST RATE SWAP POLICY
(SWAP POLICY)**

INTRODUCTION:

The purpose of the Interest Rate Swap Policy (Swap Policy) of the County of Santa Clara (County) is to provide guidelines for the execution and management of swaps in connection with the County's Debt Management Policy. While the use of such derivatives can reduce the County's exposure to interest rate risk on its variable debt, careful monitoring of such a financial management tool is required to preserve and maintain the County's credit strength and budget flexibility.

This policy describes the circumstances and methods with which a swap can be used, the guidelines that will be imposed on them, and who in the County is responsible for implementing these policies.

I. PURPOSES FOR INTEREST RATE RISK MITIGATION PRODUCTS

The purposes for which the County may utilize Interest Rate Risk Mitigation Products are specified in Section 5922 (a) of the California Government Code. The Director of Finance shall evaluate the use of such products on a case-by-case basis to determine whether the potential benefits are sufficient to offset any potential costs.

As required by the Government Code, no local agency may enter into any contracts or arrangements unless its governing body first determines that the contract, arrangement or program of contracts is designed to reduce the amount or duration of payment, currency, rate, spread, or similar risk or result in a lower cost of borrowing when used in combination with the issuance of bonds or enhance the relationship between risk and return with respect to the investment or program of investment in connection with, or incident to, the contract or arrangement which is to be entered into. When the Director of Finance recommends the use of such derivatives, the Director of Finance shall provide information to the County Executive and Board of Supervisors (Board) necessary to make the determination required by the Government Code.

II. NO SPECULATION

Swaps will not be used for speculative purposes.

III. FORM OF SWAP AGREEMENTS

To the extent possible, the swap agreements entered into by the County will contain the terms and conditions set forth in the International Swap and Derivatives Association, Inc. (ISDA) Master Agreement, including any schedules and confirmation. However, the County reserves the right to amend these terms and conditions, including the remedies and obligations, and any other section of such agreement, as appropriate to benefit the County.

IV. PROFESSIONAL ASSISTANCE

The County shall utilize the services of independent financial advisors when deemed appropriate by the Director of Finance. The County shall utilize the services of bond counsel on all debt financings. The Director of Finance shall have the authority to periodically select service providers as necessary to meet legal requirements and minimize net County debt costs. Such services, depending on the type of financing, may include financial advisory, underwriting, trustee, verification agent, escrow agent, bond counsel, disclosure counsel, arbitrage consulting, and special tax consulting. The goal in selecting service providers, whether through a competitive process or negotiated sale, is to achieve an appropriate balance between service and cost.

V. METHOD OF SALE

Except to the extent a competitive process is required by law, the Director of Finance shall be responsible for determining the appropriate manner in which to offer any securities to investors. The County has used competitive bid, negotiated sale, and private placement to sell its bonds. On a case-by-case basis the Director of Finance will make a recommendation as to the most effective method of sale to the Finance and Government Operations Committee (FGOC).

VI. ASPECTS OF RISK EXPOSURE

Before entering into a swap agreement, the Director of Finance will evaluate risks inherent in the transaction. The risks to be evaluated may include, but are not limited to, the following: amortization risk; basis risk; credit risk; counterparty risk; interest rate risk; rollover risk; tax event risk; and termination risk. Important consideration will be given to diversifying counterparty risk by

having separate SWAP issuances with different counterparties as much as prudently possible.

Identification of the risks and discussion of the means, if any, employed to mitigate the risks will be contained in the Director of Finance report recommending to the County Executive and Board approval of the swap agreement.

VII. COUNTERPARTY CREDIT STANDARDS

To protect the County's interests in the event of a credit problem, the Director of Finance will recommend entering into a swap agreement with a counterparty only if it meets the following standards:

1. at least two of the counterparty's credit ratings are rated at least "Aa3" or "AA-", or equivalent, by any two of the nationally recognized rating agencies (i.e. – Moody's, Standard and Poor's, or Fitch); or
2. the payment obligations of the counterparty are unconditionally guaranteed by an entity with such a credit rating.

VIII. COLLATERALIZATION ON DOWNGRADE

In the event of a downgrade, the obligations of the counterparty will be collateralized at levels and with securities acceptable to the Director of Finance, as set forth in the swap agreements, should the rating:

1. of the counterparty, if its payment obligations are not unconditionally guaranteed by another entity, or
2. of the entity that unconditionally guarantees its payment obligations, if so secured,

does not satisfy the requirements set forth in *Section VII Counterparty Credit Standards* above.

IX. REFUNDING

While the adopted County Debt Policy threshold for a standard refunding is 3% net present value (NPV) savings, the criteria for a SWAP structured refunding threshold will be 5% NPV savings to compensate for the inherent higher risk

factor of a SWAP financing. The Director of Finance shall be responsible for determining the appropriate type of SWAP structure to be used in the refunding. Additionally, any SWAP structured refunding analysis will also take into account the percentage amount of SWAPS in the overall debt portfolio with the goal of having a balanced portfolio.

X. **DEBT PORTFOLIO DISTRIBUTION**

Aggregate net (including offsetting reverse SWAPS) notional amount of all County SWAPS should not exceed 40% of the County's overall debt, assuming that the SWAPS have an average life of 20 years. If the life of the SWAPS are longer or shorter than 20 years, percentages may be adjusted accordingly, e.g. – the percentage would be reduced for longer life since risk increases.

XI. **TERMINATION**

A termination payment to or from the County may be required in the event of termination of a swap agreement due to default of either the County or the counterparty, certain additional termination events or optional termination by the County. Prior to making any termination payment due to default of the counterparty, the Director of Finance will evaluate whether it is financially advantageous for the County to obtain a replacement counterparty to avoid making such termination payment.

XII. **LEGALITY**

The County shall receive appropriate legal opinion that swap agreements entered into by the County are legal, valid and binding obligations of the County.

XIII. **RESPONSIBILITIES**

The Director of Finance is responsible for determining the appropriate uses for derivatives in conjunction with the County's debt financing and programmatic needs and making recommendations to the County Executive and the Board of Supervisors.

The Board is responsible for approving all debt issuances and approval of all official documents related to such issuance. County Counsel is responsible for approving all documents in any such issuance.

The County Controller is responsible for monitoring and reporting on all County debt obligations and reporting on such debt to the County Executive and Board. In this capacity, the County Controller will review and report on the activities and assumptions related to the various swap transactions. In addition, the Controller is responsible for reflecting the use of interest rate swap agreements and other financing transactions on the County's financial statements in

accordance with Generally Accepted Accounting Principles (GAAP) and with rules promulgated by the General Accounting Standards Board (GASB).

XIV. MONITORING AND REPORTING

The Director of Finance will issue a report to the County Executive and Board as deemed appropriate during the term of the interest rate swap agreement. One such report that will be issued is a quarterly report on portfolio balance to the Finance and Government Operations Committee. Alternatively, the Director of Finance will include, in an Annual Debt Report, the following information, to the extent applicable:

1. Highlights of material changes to interest rate swap agreements including counterparty downgrades and/or terminations;
2. A summary of new interest rate swap agreements entered into by the County since the last report;
3. A summary of planned interest rate swap transactions and the impact of such transactions on the County;
4. A description of each outstanding interest rate swap agreement, including a summary of its terms and conditions, the notional amount, rates, maturity, the estimated market value of each agreement, the method of procurement (competitive or negotiated), and the full name, description and credit ratings of the agreement's counterparty and, if necessary, its applicable guarantor;
5. Amounts which were required to be paid and received, and any amounts which actually were paid and received under each outstanding interest rate swap agreement;
6. Credit enhancement, liquidity facility or reserves associated with the swaps including an accounting of all costs and expenses incurred, whether or not in conjunction with the procurement of credit enhancement or liquidity facilities under each outstanding interest rate swap agreement; and

7. An assessment of the counterparty risk, termination risk, and other risks associated therewith, which will include the aggregate marked to market value for each counterparty and relative exposure compared to other counterparties and a calculation of the County's Value at Risk for each counterparty.

This report will also include a copy of this Policy in the quarter after it is adopted or subsequently modified. The Director of Finance, with the assistance of the Counsel, and the County Controller, will periodically review this Policy for changes in best practices (i.e. - GFOA Recommended Practices) and recommend modifications to this Policy to the County Executive and Board.