FAU
BOARD OF TRUSTEES
Florida Atlantic University

**Item: A-6**

**Wednesday, June 23, 2010**

## SUBJECT: APPROVAL OF AMENDMENT OF DEBT MANAGEMENT POLICY

### PROPOSED COMMITTEE ACTION

Provide approval of an amendment to the University's debt management policy to include guidelines on variable rate debt and interest rate swaps.

### BACKGROUND INFORMATION

This information was presented and approved during the June 9, 2010 Audit and Finance Committee meeting:

The Florida Atlantic University BOT adopted a debt management policy (the "Policy") for the University, effective April 27, 2006. The University's debt management guidelines outline the information that must be submitted to the Board of Governors' staff in support of any request for approval of the issuance of debt.

For issuances involving variable rate debt, the proposed policy amendment will require that the University or its Direct Support Organization ("DSO") issuing the debt must provide "*the average monthly balance, over the last year, of the short-term investments which will be hedged or the other products, such as interest rate caps, which will be used to mitigate the effect of rising interest rates, or an explanation as to why such protections are not being provided*". The proposed policy amendment also requires that a debt management plan be in place to mitigate, to the extent possible, liquidity and interest rate risks associated with variable rate debt over the life of the debt. Furthermore, where the University or its DSO uses derivatives to mitigate the risk of rising interest rates on variable rate debt, the University or its DSO must provide a swap management plan detailing information about the risks associated with the swap and the counterparty.

In certain circumstances it may be in the University's best interest to finance (in part or in whole) projects with variable rate debt. The amendment to the debt management policy has been created in consultation with the University's Financial Advisor to establish additional risk management processes for such debt. To that end, and as required by our Policy, the University requests that this Board approve the amendment to Debt Management Policy to include variable rate debt and interest rate swap guidelines.

## IMPLEMENTATION PLAN/DATE

Immediately upon approval by the Board of Trustees.

## FISCAL IMPLICATIONS

N/A

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**Supporting Documentation**: Debt Management Policy; Variable Rate Debt and Interest Rate Swap Guidelines

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DRAFT

# Florida Atlantic University

**VARIABLE RATE DEBT**

**And**

**INTEREST RATE SWAP**

**GUIDELINES**

**May __ 2010**

# Florida Atlantic University

## Variable Rate Debt Guidelines

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# VARIABLE RATE DEBT GUIDELINES

## I. Introduction

The variable rate debt and interest rate swap guidelines outlined herein are only intended to provide general procedural direction regarding the future use, procurement and execution of variable rate debt and interest rate swaps and options by the Chief Financial Officer (CFO). These guidelines will be used by the CFO until such time as the CFO, in conjunction with other State Universities and Agencies, adopt common guidelines for broader use by all. These guidelines are intended to relate to 1.) The use of variable rate debt as a component of the Florida Atlantic University, and its Direct Support Organizations, as a whole referred to as (the University) overall debt management, and 2.) The use of various interest rate hedging techniques, including the contractual exchange of different fixed and variable rate payment streams through interest rate swap agreements. These guidelines are not intended to relate to other derivative products that the University may consider. The University maintains the right to modify these guidelines and may make exceptions to any of them at any time in its sole discretion. Failure to comply in any manner with these guidelines shall not result in any liability on the part of the University as a whole to any party.

## II. Scope and Authority

These Variable Rate Debt Guidelines shall govern the University's use and management of all variable rate transactions. While adherence to this guideline is required in applicable circumstances, the University recognizes that changes in the capital markets, agency programs, and other unforeseen circumstances may from time to time produce situations that are not covered by the guideline and will require modifications or exceptions to achieve its intended goals. In these cases, management flexibility is appropriate provided specific authorization from the University's Board of Trustees (the "Board") is obtained.

The CFO and the University's Controller are designated administrators of the University's Variable Rate Debt Guidelines. The CFO shall have the day-to-day responsibility and authority for structuring, implementing, and managing variable rate debt.

Authority to allow for the use of variable rate instruments has been granted by Florida Statues 1010.62, furthermore the State of Florida Board of Governor's Debt Management Guidelines established on April 27, 2006.

## III. Guidelines for the Use of Variable Rate Debt

Variable rate debt can be a valuable tool for the University to use in the management of its assets and liabilities. However, the use of variable rate debt, though historically allowing lower borrowing costs, presents some risks that the University must consider. The following guidelines shall be used in determining if variable rate debt is appropriate, and under what circumstances it is appropriate for the CFO of the University to utilize variable rate debt as a financing alternative.

Due to the historical spread between long-term rates and short-term rates, and in order to integrate asset/liability management as a component of its overall financial management, the University should consider maintaining a portion of its portfolio in

variable rate debt. In doing so, the University shall attempt to manage and constrain its unhedged variable rate exposure within a range of no less than 5% and no more than 30% of the University's outstanding indebtedness. For purposes of this limitation, unhedged variable rate exposure shall include both the principal amount of direct issue variable rate debt and the notional amount of synthetic variable rate debt, less:

1. The amount of direct variable rate debt for which variable interest rate exposure has been eliminated or reduced by interest rate exchange agreements (swaps).

2. The amount of short-term assets within the University's Operating Fund Account – for purposes of these Guidelines defined as: a.) cash and cash equivalent investments, and b.) the market value of other investments with maturities of 30 days or less.

   As reflected above, in considering the use of variable rate debt, the University shall assess the amount of short-term investments and cash reserves since the earnings from these funds can serve as a natural hedge offsetting the impact of higher variable rate debt costs. In addition, the University should also consider other strategies to allow assets and liabilities to move in tandem, such as entering into interest rate swaps under appropriate hedging instruments, and in accordance with these guidelines. As also reflected above, any synthetic fixed rate debt, achieved through a swap transaction whereby the University swaps underlying variable rate for fixed rate should not be counted toward this variable rate ceiling.

   In general, and as guidance to the appropriate level of unhedged variable rate interest rate exposure as specified within these Guidelines, the University should maintain its flexibility and continuously review new products and opportunities to allow it to take advantage of changing interest rate environments and new products or approaches as they become available. In low interest rate environments, the University should consider ways to lock in low fixed rates, through conversions, fixed rate debt issuance, and either traditional or synthetic refunding. In high interest rate environments, the University should consider ways to increase variable rate debt exposure and evaluate other alternatives that will allow the University to reduce its overall cost of capital.

## IV. Variable Rate Debt Alternatives

The University may consider the use of alternative structures for the issuance and use of variable rate debt. Each mode of variable rate exposure has its unique advantages and disadvantages. Decisions about which mode the University should utilize at any point in time should be based on a number of factors including the relative costs, benefits, and risks to the University. Variable Rate Demand Obligations (VRDOs) are the traditional means of achieving variable rate exposure and provide governmental issuers with access to a large, well-established liquid market. Under appropriate market conditions, synthetic variable rate debt offers issuers access to the well established swap market, along with structuring flexibility and potentially lower borrowing costs.

The University may determine allocations to each class of variable rate debt within caps and floors and manage the precise allocation based on market constraints in advance of issuing bonds. Factors impacting decisions should include:

1. The capacity of insurers to insure University bonds,

2. The cost of bond insurance,

3. Swap market levels,

4. The cost and availability of letters of credit,

5. The ability of the University to provide self-liquidity in accordance with the limitations of these Guidelines and without adversely impacting investment returns to the University's invested funds,

6. Any other related considerations.

## V. The Use of Liquidity Facilities (Self-Liquidity)

For variable rate debt requiring liquidity facilities to protect against remarketing risk, the University should consider the factors listed in the previous section, and should look to provide required liquidity facilities itself via self-liquidity as a means of reducing the cost and increasing the benefits of variable rate debt. The provision of liquidity facilities by the University shall consider the following factors and limitations:

1. The total amount of self-liquidity obligations assumed by the University shall not exceed 1.25 times the average for the previous 12 months of the lowest aggregate value within each of such months within the University's General Revenue Account of a.) Cash, b.) The market value of cash equivalent investments and c.) The market value of investments maturing in 30 days or less.

2. The effect of providing self-liquidity on any applicable ratings of the University's investment accounts.

3. Any other applicable considerations. The ability of the University to provide self-liquidity for variable rate debt shall be determined by the CFO.

## VI. Definitions

**Advance Refunding** - A bond is treated as issued to advance refund another bond if it is issued more than 90 days before the redemption of the refunded bond.

**Amortization Risk** – the potential cost to the issuer resulting from a mismatch between the outstanding underlying bond amortization and the outstanding notional amount of the swap.

**Basis Risk** – movement in the underlying variable rate indices may not be perfectly in tandem, creating a cost differential that could result in a net cash outflow from the issuer. A mismatch risk can occur in a swap with both sides using floating, but different, rates such as LIBOR versus Fed Treasuries or SIFMA.

**SIFMA Index** – The Securities and Industry Financial Markets Association Municipal Swap Index, the principal benchmark for the floating rate payments for tax-exempt issuers. The index is a national rate based on a market basket of high-grade, seven-day tax-exempt variable rate bond issues.

**Capacity Expansion** - Capital expansion projects are those projects designed to accommodate new customers, acquisitions, and expansion of existing system capacity.

**Commercial Paper Note** - shall mean any debt obligation which has a maturity date which is not more than 270 days after the date of issuance thereof.

**Competitive Bid** - a method of submitting proposals for the purchase of new issue of securities by which the securities are awarded to the underwriting syndicate presenting the best bid according to stipulated criteria set forth in the notice of sale.

**Construction Loan Credit Facility** - means obligations of a particular credit facility for construction advance purposes which shall be similar to Bond Anticipation Notes.

**Counterparty risk** – the risk that the other party in the derivative transaction fails to meet its obligations under the contract.

**Credit Enhancement** - shall mean, with respect to the bonds of a Series, a maturity within a Series or an interest rate within a maturity, the issuance of an insurance policy, letter of credit, surety bond or any other similar obligation, whereby the issuer thereof becomes unconditionally obligated to pay when due, to the extent not paid by the University or otherwise, the principal of and interest on such Bonds.

**Credit Support Annex** - is a standard supporting document that is made part of the ISDA Master Swap Agreement that governs the use of posting collateral when required.

**Current Refunding** - A bond is treated as issued to current refund another bond if the refunding issue is issued not more than 90 days before the redemption of the refunded bond.

**Hedge** – a transaction entered into to reduce exposure to market fluctuations.

**Interest rate swap** – a transaction in which two parties agree to exchange future net cash flows based on predetermined interest rate indices calculated on an agreed notional amount. The swap is not a debt instrument between the issuer and the counterparty, and there is no exchange of principal.

**ISDA** – International Swap Dealers Association, the global trade association with over 550 members that include dealers in the derivatives industry.

**ISDA Master Agreement** – the standardized master agreement for all swaps between the Issuer and the dealer that identifies the definitions and terms governing the swap transaction.

**LIBOR** – the principal benchmark for floating rate payments for taxable issuers. The London Inter Bank Offer Rate (LIBOR) is calculated as the average interest rate on Eurodollars traded between banks in London and can vary depending upon the maturity (e.g. one month or six months).

**Long-dated swap** - a swap with a term of more than ten years. Often used in the municipal market, as issuers often prefer to use a hedge that matches the maturity of the underlying debt or investment.

**Mark-to-market** – calculation of the value of a financial instrument (like an interest rate swap) based on the current market rates or prices of the underlying instrument (i.e. the variable on which the derivative is based).

**Medium Term Note** - any obligation which has a maturity date which is more than 365 days, but not more than 15 years, after the date of issuance and is designated as a medium term note in the supplemental ordinance authorizing such bond.

**Negotiated Sale** - the sale of a new issue of municipal securities by an issuer through an exclusive agreement with an underwriter or underwriting syndicate selected by the issuer.

**Tax Event Risk** - the risk that tax laws will change, resulting in a change in the marginal tax rates on swaps and their underlying assets or, in a more extreme situation, remove the tax-exempt status of the issue and, therefore, its contractual obligations priced as tax-exempt facilities.

**Termination risk** – the risk that a swap will be terminated by the counterparty before maturity that could require the issuer to make a cash termination payment to the counterparty.

**True Interest Cost** - is the rate, compounded semi-annually, necessary to discount the amounts payable on the respective principal and interest payment date to the purchase price received for the bonds.

**Variable Rate Bond** - shall mean any debt obligation not bearing interest throughout its term at a specified rate or specified rates determined at the time of initial issuance.

**Variable Rate Demand Obligations (VRDO)** - A long term maturity security which is subject to a frequently available put option or tender option feature under which the holder may put the security back to the issuer or its agent at a predetermined price (generally par) after giving specified notice or as a result of a mandatory tender. Optional tenders are typically available to investors on a daily basis while in the daily or weekly mode and mandatory tenders are required upon a change in the interest rate while in the flexible or term mode. The frequency of a change in the interest rate of a variable rate demand obligation is based upon the particular mode the security is in at the time.

# Florida Atlantic University

## Interest Rate Swap Guidelines

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# INTEREST RATE SWAP GUIDELINES

## I. Introduction

The prudent use of hedging instruments, including interest rate swaps, swaptions, caps, options, and collars, can be an effective tool in meeting funding needs and structuring a balance sheet while managing risk associated with the movement of interest rates. Utilizing hedging products can provide Florida Atlantic University, and its Direct Support Organizations, as a whole referred to as (the University) with cost effective alternatives to traditional debt financing choices.

Utilizing interest rate swaps to achieve substantially lower interest cost is a main component in building the desired capital structure to allow the University to finance efficiently. The use of swaps must be tied directly to the University's current or future debt instruments. The University shall not enter into swap transactions for speculative purposes. There are three types of interest rate swaps the University is authorized to enter into:

- Floating to fixed rate swaps,
  - Hedge interest rate risk on variable rate debt,
  - Lock in fixed rates on refunding bonds or capital projects that will be issued in the future or
  - Take advantage of opportunities to obtain fixed swap rates that are lower than comparable fixed rate bonds.

- Fixed rate to floating rate swaps
  - Increase the amount of variable rate exposure without incurring the remarketing and liquidity costs.
  - Eliminate the put risk associated with variable rate debt.

- Basis swaps manage the risk associated with
  - The mismatch between two benchmarks.
  - Methodologies used to set interest rates.

## II. Scope and Authority

This Interest Rate Swap Guideline shall govern the University's use and management of all interest rate swaps. While adherence to this Guideline is required in applicable circumstances, the University recognizes that changes in the capital markets, university programs, and other unforeseen circumstances may from time to time produce situations that are not covered by the Interest Rate Swap Guidelines and will require modifications or exceptions to achieve Guideline goals. In these cases, management flexibility is appropriate provided specific authorization from the Board is obtained.

The University" Chief Financial Officer and Controller are designated administrators of the University's Interest Rate Swap Guidelines. The CFO shall have the day-to-day responsibility and authority for structuring, implementing, and managing interest rate swaps.

The University shall be authorized to enter into interest rate swap transactions only with qualified swap counterparties. The CFO and the University's Counsel, shall have the authority to select the counterparties, so long as the criteria set forth in the Interest Rate Swap Guidelines are met.

## III. Risks

Interest rate swaps and related hedging instruments may introduce additional risks to the University's credit profile. These risks include, but are not necessarily limited to, termination risk, counterparty risk, rollover risk, amortization risk, basis risk, and tax event risk. Prior to entering into each interest rate swap transaction, these risks are evaluated to ensure adequate provisions are in place to minimize the downside and provide the maximum benefit the transaction originally intended. (Refer to Section XVIII for a definition of these risks.)

## IV. Fixed to Floating Rate Swap Management

The CFO shall have the overall responsibility for the execution and management of fixed to floating interest rate swaps.

The CFO shall determine the size of the total interest rate swap program and the maturity date for the swaps within the parameters of the Guideline which has been approved by the University.

Interest rate caps and related hedging instruments may be utilized to help manage interest rate risk in the Debt Management Program.

From time to time, the CFO will evaluate the use of swaptions, collars (cap and floor instrument) and similar transactions as a hedging tool to minimize cost and risk and will utilize such instruments where financially prudent.

Forecasts of interest rate volatility over the intermediate term (4 to 7 years) and expected performance of the swaps, caps, collars, and related hedging instruments under various interest rate scenarios shall be updated on not less than a semi-annual basis. Short and long term interest rates will be monitored over varying time periods. If current interest rates are either above or below the moving averages as measured by varying time periods, the CFO or designee may elect to alter the timing of adding additional fixed to variable swaps to either increase or decrease the amount of variable exposure. Furthermore, the CFO may elect to enter into "reversing" swaps to take advantage of market opportunities. In the event a fixed to floating swap is "reversed", any associated floor will be simultaneously "reversed". Any associated cap will be evaluated and "reversed" if approved by the University.

## V. Floating to Fixed Rate Swap Management

The CFO shall have the overall responsibility regarding the execution and management of floating to fixed interest rate swaps. An additional component of the debt management strategy is to use floating to fixed rate swaps to lock in the lowest possible borrowing costs over a long period of time.

Floating to fixed rate swaps can be used in conjunction with issuing variable rate debt to obtain the lowest fixed rate when compared to traditional forms of fixed rate financings. In addition, floating to fixed swaps may be desirable when the cycle of long-term rates moves down to or near historical lows and "fixing" a portion of the outstanding variable rate debt appears advantageous. Swaps will be evaluated as alternatives to traditional financing instruments considering their comparable costs, ease of entry and exit provisions, and the amount of potential risk exposure.

Interest rate swaps will be executed for notional amounts, maturities and other related terms and conditions as determined by the CFO. Re-execution risk, amortization risk, tax event risk and basis risk will be evaluated in order to minimize any potential negative results.

Forecasts of interest rate volatility over the term of the swaps and expected performance of the swaps under various interest rate scenarios shall be analyzed prior to the execution of the swaps. Short and long term interest rates will be monitored over varying time periods. The CFO may elect to enter into "reversing" swaps to take advantage of market opportunities.

## VI. Compliance/Reporting Requirements

The CFO shall perform a review at least annually relating to interest rate swap management. The review shall include the following:

- Highlights of all material changes to swap agreements or new swap agreements entered into by the University since the last report.
- Market value of each of the University's interest rate swap agreements.
- For each counterparty, the University shall provide the total notional amount position, the average life of each swap agreement, the available capacity to enter into a swap transaction, and the remaining term of each swap agreement.
- The credit rating of each swap counterparty and credit enhancer insuring swap payments, if any.
- Actual collateral posting by swap counterparty, if any, per swap agreement and in total by swap counterparty.
- A summary of each swap agreement, including but not limited to the type of swap, the rates paid by the University and received by the University, and other terms.
- Information concerning any default by a swap counterparty to the University and the results of the default, including but not limited to the financial impact to the University, if any.
- A summary of any planned swap transactions and the impact of such swap transactions on the University.
- A summary of any swap agreements that were terminated.

Collateral reports will be updated on a monthly basis providing information relating to specific swap transactions that may require collateral posted based on mark to market valuations.

All outstanding debt will be reported annually in the Comprehensive Annual Financial Report as required by GASB rule.

## VII. Monitoring

The University may use an independent Swap Advisor to assist internal professional staff in monitoring its existing or proposed swap(s) if it is in the best interest of the University to do so. The University is solely authorized to enter into contract(s) to accomplish these monitoring efforts.

## VIII. Optional Termination

The University shall consider including a provision that permits the University optionally to terminate the agreement at the market value of the agreement at any time. Exercising the right to optionally terminate an agreement should produce a benefit to the University, either through receipt of a payment from a termination, or if a termination payment is made by the University, a conversion to a more beneficial debt instrument or credit relationship. In general, the counterparty shall not have the right to optionally terminate an agreement unless the University is in default. As practical as possible, the University shall have the right to assign its obligation to other counterparties.

## IX. Events of Default

Events of default of a counterparty shall include the following:

1. Failure to make payments or transfer collateral when due
2. Breach of representations and warranties
3. Illegality
4. Failure to comply with downgrade provisions
5. Failure to comply with any other provisions of the agreement after a specified notice period
6. Bankruptcy
7. Other events as defined by insurance companies, rating agencies or liquidity providers.

Each interest rate swap agreement shall provide that an event of default by the counterparty shall lead to termination of the agreement with the University being the affected party for purposes of calculating the termination payment owed.

## X. Aspects of Risk Exposure Associated with Such Contracts

Before entering into a derivative, the University shall evaluate all the risks inherent in the transaction. These risks to be evaluated should include the counterparty risk, termination risk, rollover risk, basis risk, tax event risk and amortization risk.

The University shall endeavor to diversify its exposure to counterparties. To that end, before entering into a transaction, it should determine its exposure to the relevant counterparty or counterparties and determine how the proposed transaction would affect the exposure. The exposure should not be measured solely in terms of notional amount, but rather how changes in interest rates would affect the University's exposure ("Value at Risk"). The Value at Risk should be based on all outstanding derivative transactions by the University. The University may also elect to take into account the exposure of the University and any related entities to a particular counterparty.

## XI. Provisions for Collaterialization

If the rating (a) of the counterparty, if its payment obligations are not unconditionally guaranteed by another entity, or (b) of the entity unconditionally guaranteeing its payment obligations, if so secured, does not meet or falls below the rating required by "Providers" below, then the obligations of such counterparty shall be fully and continuously collateralized by 100% cash, direct obligations of, or obligations the principal and interest on which are guaranteed by the United States of America or any agency thereof with a net market value of at least 102% of the net market value of the contract (subject to minimum threshold amounts specified by the University) to the authorized issuer and such collateral shall be deposited with the University or an agent thereof. (Collateral is also posted by a Counterparty over some "threshold amount" due to the market value of the swap. The same is usually true for the University. The University should try to be exempt from posting collateral.)

## XII. Approvals

The CFO must sign all interest rate swaps, swaptions, caps, options, or collar confirmations.

The CFO must approve the interest rate swap term sheet prior to execution. In addition, the purpose of the transaction, (asset matched, debt management, etc.) will be included as part of the swap paperwork file kept for each executed swap transaction.

## XIII. Form of Swap Agreements

Financial institutions and dealers executing interest rate swaps, caps, options, and other hedging instruments for the University shall be selected pursuant to a competitive process. The University shall require that all institutions and dealers entering into interest rate swap, cap, option, and other hedging instrument agreements execute a Master Swap Agreement, that shall contain terms and conditions as set forth in the International Swaps and Derivatives Association, Inc. (ISDA) Master Agreement that is signed by both parties. All transactions entered into shall adhere to the requirements of the Master Swap Agreement. The hedging agreements between the University and each qualified counterparty shall include payment, term, security, credit rating, collateral, default, remedy, termination, and other terms, conditions, and provisions as deemed necessary by the University CFO.

## XIV. Providers

The University shall enter into hedging transactions only with qualified counterparties. All providers will either, (1) be rated AA-/Aa3 or better by at least 2 of the rating agencies (Fitch, Moody's, or Standard & Poor's) at the time of execution and enter into a collateral agreement to provide collateral as determined by the Credit Support Annex in the event that the credit rating falls below the AA-/Aa3 level or (2) be rated A/A2 or better by at least 2 of the rating agencies at the time the Agreement is entered into, and enter into a collateral agreement.

To limit and diversify the University's counterparty risk and to monitor credit exposure to each counterparty, the University may not enter into a swap transaction with an otherwise qualified counterparty unless the cumulative mark-to-market value owed by the counterparty (and its unconditional guarantor, if applicable) to the University shall be less than or equal to the amounts in the following chart.

The limitations shall be the sum of all mark-to-market values between the subject counterparty and the University regardless of the type of swap transaction, net of collateral posted by the counterparty. Collateral will consist of cash, U. S. Treasury securities, and Federal Agency securities guaranteed unconditionally by the full faith and credit of the U. S. Government. Collateral shall be deposited with a third party trustee acceptable to the University, or as mutually agreed upon between the University and each counterparty.

Specific limits by counterparty are based on the cumulative mark-to-market value of the swap(s) and the credit rating of the counterparty. The limits are as follows:

| Counterparty Long- Term Debt Rating (lowest prevailing rating from Standard & Poor's/ Moody's) | Maximum Cumulative Mark-to-Market Value of Swaps Owed to the University by Counterparty (net of collateral posted) |
|---|---|
| AAA / Aaa | [$30 million][1] |
| AA+ / Aa1 | [$25 million][1] |
| AA / Aa2 | [$20 million][1] |
| AA- / Aa3 | [$15 million][1] |
| A+ / A1 | [$10 million][1] |
| A / A2 | [$5 million][1] |

If counterparty's credit rating is downgraded such that the cumulative mark-to-market value of all swaps between the counterparty and the University exceeds the maximum permitted by this Guideline, the counterparty must either, terminate a portion of the swap, post additional collateral, or provide other credit enhancement that is satisfactory to the University and ensures compliance with this Guideline

## XV. Diversification

Diversification of hedging vehicles must be examined by the CFO at least annually with intent to minimize termination risk. The CFO must make every effort to diversify its hedging activities across multiple providers. This assessment will assist in interest rate risk and liquidity management for the University.

## XVI. Bid

All "initial" interest rate swap and cap transactions shall be competitively bid by at least (3) three providers or shadow pricing providers obtained that have executed interest rate swap agreements or wire services that provide mid-market pricing such as Bloomberg. Upon approval by the University, 1) a "reversing transaction" resulting in an upfront payment to the University may be negotiated with the original swap, cap, option, or collar counterparty, or 2) a negotiated swap with a counterparty may be executed as part of a debt financing in the following situations:

i) A determination is made by the CFO that due to the complexity of a particular transaction, a negotiated bid would result in the most favorable pricing.

ii) The CFO makes a determination that, in light of the facts and circumstances, doing so will promote the University's interests by encouraging and rewarding innovation. When the University enters into an agreement for financing through the competitive bid process, this will satisfy any bid requirements for sub-contractors.

## XVII. Effective Date

This Guideline will become effective upon adoption by the University This Guideline shall be reviewed and amended from time to time as necessary with the approval of the University.

## XVIII. Definitions

**Advance Refunding** - A bond is treated as issued to advance refund another bond if it is issued more than 90 days before the redemption of the refunded bond.

**Amortization Risk** – the potential cost to the issuer resulting from a mismatch between the outstanding underlying bond amortization and the outstanding notional amount of the swap.

**Basis Risk** – movement in the underlying variable rate indices may not be perfectly in tandem, creating a cost differential that could result in a net cash outflow from the issuer. A mismatch can occur in a swap with both sides using floating, but different, rate basis such as LIBOR versus Fed Treasuries or SIFMA.

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**Capacity Expansion** - Capital expansion projects are those projects designed to accommodate new customers, acquisitions, and expansion of existing system capacity.

**Commercial Paper Note** - shall mean any debt obligation which has a maturity date which is not more than 270 days after the date of issuance thereof.

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**Credit Enhancement** - shall mean, with respect to the bonds of a Series, a maturity within a Series or an interest rate within a maturity, the issuance of an insurance policy, letter of credit, surety bond or any other similar obligation, whereby the issuer thereof becomes unconditionally obligated to pay when due, to the extent not paid by the University or otherwise, the principal of and interest on such Bonds.

**Credit Support Annex** - is a standard supporting document that is made part of the ISDA Master Swap Agreement that governs the use of posting collateral when required.

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**Hedge** – a transaction entered into to reduce exposure to market fluctuations.

**Interest rate swap** – a transaction in which two parties agree to exchange future net cash flows based on predetermined interest rate indices calculated on an agreed notional amount. The swap is not a debt instrument between the issuer and the counterparty, and there is no exchange of principal.

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**Long-dated swap** - a swap with a term of more than ten years. Often used in the municipal market, as issuers often prefer to use a hedge that matches the maturity of the underlying debt or investment.

**Mark-to-market** – calculation of the value of a financial instrument (like an interest rate swap) based on the current market rates or prices of the underlying instrument (i.e. the variable on which the derivative is based).

**Medium Term Note** - any bond which has a maturity date which is more than 365 days, but not more than 15 years, after the date of issuance and is designated as a medium term note in the supplemental ordinance authorizing such bond.

**Negotiated Sale** - the sale of a new issue of municipal securities by an issuer through an exclusive agreement with an underwriter or underwriting syndicate selected by the issuer.

**Tax Event Risk** - the risk that tax laws will change, resulting in a change in the marginal tax rates on swaps and their underlying assets or, in a more extreme situation, remove the tax-exempt status of the issue and, therefore, its contractual obligations priced as tax-exempt facilities.

**Termination risk** – the risk that a swap will be terminated by the counterparty before maturity that could require the issuer to make a cash termination payment to the counterparty.

**True Interest Cost** - is the rate, compounded semi-annually, necessary to discount the amounts payable on the respective principal and interest payment date to the purchase price received for the bonds.

**Variable Rate Bond** - shall mean any debt obligation not bearing interest throughout its term at a specified rate or specified rates determined at the time of initial issuance.

**Variable Rate Demand Obligations (VRDO)** - A long term maturity security which is subject to a frequently available put option or tender option feature under which the holder may put the security back to the issuer or its agent at a predetermined price (generally par) after giving specified notice or as a result of a mandatory tender. Optional tenders are typically available to investors on a daily basis while in the daily or weekly mode and mandatory tenders are required upon a change in the interest rate while in the flexible or term mode. The frequency of a change in the interest rate of a variable rate demand obligation is based upon the particular mode the security is in at the time.