Memorandum

MIAMI-DADE COUNTY

Date: March 15, 2005

To: Honorable Chairman Joe A. Martinez
and Members, Board of County Commissioners

From: George M. Burgess
County Manager

Agenda Item No. 7(E)(1)(A)

Subject: Resolution Approving a Master Swap Policy

RECOMMENDATION

It is recommended that the Board approve the attached Resolution establishing a written swap policy (Master Swap Policy) for Miami-Dade County. The Master Swap Policy, attached as Appendix A to this Resolution, will serve as a source of information and guide for the County Manager, Finance Director, professional staff, as well as financial institutions wishing to do business with Miami-Dade County.

BACKGROUND

The "Government Finance Officers Association Recommended Practice" states that governmental entities should adopt a formal derivatives policy that provides a comprehensive set of guidelines governing the use of derivative products. The attached Resolution offers such a policy.

The Master Swap Policy addresses:

1. The authority to enter into swap transactions upon the approval of the Board;
2. Procedures for entering into a swap and items to be considered such as the appropriateness of the swap transaction balancing the risks and rewards;
3. The permitted uses of swaps by the County as a debt management tool and not for speculative purposes;
4. Counterparty credit standards to protect the County in the event of a counterparty credit problem;
5. Method of procurement shall be negotiated or competitive based on the product that is proposed and whether it is a relatively standard product in the marketplace;
6. The requirement for a fair market opinion from the swap financial advisor.
7. Evaluation and mitigation of the risk including risk management on an enterprise-wide or "macro" basis by evaluating individual transactions with the enterprise's financial strength, the magnitude of debt and the debt service coverage being considered; and
8. Requirement for annual report to the Board to include a summary of the key terms, mark-to-market value of the swaps as well as the amount of exposure to counterparties.

Assistant County Manager

MEMORANDUM

(Revised)

TO: Honorable Chairman Joe A. Martinez and Members, Board of County Commissioners

DATE: March 15, 2005

FROM: Robert A. Ginsburg County Attorney

SUBJECT: Agenda Item No. 7(E)(1)(A)

Please note any items checked.

_____ **"4-Day Rule" ("3-Day Rule" for committees) applicable if raised**

_____ **6 weeks required between first reading and public hearing**

_____ **4 weeks notification to municipal officials required prior to public hearing**

_____ **Decreases revenues or increases expenditures without balancing budget**

_____ **Budget required**

_____ **Statement of fiscal impact required**

_____ **Bid waiver requiring County Manager's written recommendation**

_____ **Ordinance creating a new board requires detailed County Manager's report for public hearing**

_____ **Housekeeping item (no policy decision required)**

_____ **No committee review**

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Approved _____ Mayor
Veto _____
Override _____

Agenda Item No. 7(E)(1)(A)

03-15-05

RESOLUTION NO. _____

RESOLUTION APPROVING MASTER SWAP POLICY FOR MIAMI-DADE COUNTY'S USE OF SWAPS, CAPS, FLOORS, COLLARS, OPTIONS AND OTHER DERIVATIVE FINANCIAL PRODUCTS IN CONJUNCTION WITH COUNTY'S MANAGEMENT OF ITS ASSETS AND LIABILITIES

WHEREAS, the County's Finance Department in conjunction with its swap financial advisor, Swap Financial Group LLC, has prepared the Master Swap Policy, attached to this Resolution as Appendix A, for the purpose of establishing policy for the County's use of swaps, caps, floors, collars, options and other derivative financial products (collectively, "Swaps") in conjunction with the County's management of its assets and liabilities; and

WHEREAS, this Board wishes to approve the Master Swap Policy in substantially the form attached as Appendix A,

NOW, THEREFORE, BE IT RESOLVED BY THE BOARD OF COUNTY COMMISSIONERS OF MIAMI-DADE COUNTY, FLORIDA that:

Section 1. The preamble to this Resolution and the County Manager's memorandum accompanying this Resolution are approved and incorporated by reference in this Resolution.

Section 2. The Master Swap Policy is approved in substantially the form attached to this Resolution as Appendix A.

The foregoing resolution was offered by Commissioner , who moved its adoption. The motion was seconded by Commissioner and upon being put to a vote, the vote was as follows:

Joe A. Martinez, Chairman
Dennis C. Moss, Vice-Chairman

Bruno A. Barreiro
Jose "Pepe" Diaz
Sally A. Heyman
Dorrin D. Rolle
Katy Sorenson
Sen. Javier D. Souto
Dr. Barbara Carey-Shuler
Carlos A. Gimenez
Barbara J. Jordan
Natacha Seijas
Rebeca Sosa

The Chairperson thereupon declared the resolution duly passed and adopted this 15th day of March, 2005. This resolution shall become effective ten (10) days after the date of its adoption unless vetoed by the Mayor, and if vetoed, shall become effective only upon an override by this Board.

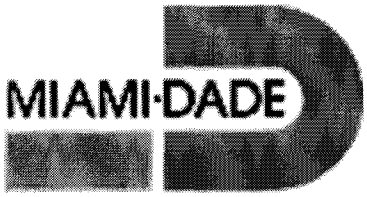
MIAMI-DADE COUNTY, FLORIDA
BY ITS BOARD OF COUNTY
COMMISSIONERS

HARVEY RUVIN, CLERK

Approved by County Attorney as
to form and legal sufficiency.

By:_____
Deputy Clerk

Gerald T. Heffernan



Miami-Dade County
MASTER SWAP POLICY

July 2004

1. Purpose

The purpose of this Swap Policy is to provide a policy for the Miami-Dade County's use of swaps, cap, floors, collars, options and other derivative financial products, collectively referred to herein as "Swaps," in conjunction with the County's management of its assets and liabilities. The policy is intended to serve as a source of information and guidance for the County Manager, Finance Director, professional staff, and the Board of County Commissioners, as well as financial institutions wishing to do business with Miami-Dade County.

2. Scope

The policy describes the circumstances and methods by which Swaps will be used, the guidelines to be employed when Swaps are used, and who is responsible for carrying out these policies.

3. Authority

The County's authority for using Swaps is based on the County's general contractual powers and home rule authority. Under this authority, the County may enter into Swaps as authorized by the Board of County Commissioners in connection with the issuance or payment of certain debt obligations, before, concurrently with, or after the actual issuance of the debt.

4. Procedure

Recommendations to enter into Swaps will be made based on analysis performed by the Finance Department. In finalizing its recommendations, the Finance Department should consider the following elements:

(i) The appropriateness of the transaction for the County based on the balance of risks and rewards presented by the proposed transaction, including a description of the transactional structure, a description of the risks it presents, and risk mitigation measures, where applicable;

(ii) The legal framework for the transaction within the context of Florida statutes, County ordinances, and relevant indenture and contractual requirements (including those contained in credit agreements), as well as any implications of the transaction under federal tax regulations;

(iii) Potential effects that the transaction may have on the credit ratings of any County obligations assigned by the rating agencies;

(iv) The potential impact of the transaction on any areas where the County's capacity is limited, now or in the future, including the use of variable-rate debt, bank liquidity facilities or letters of credit, and bond insurance;

(v) The ability of the County to handle any administrative burden that may be imposed by the transaction, including accounting and financial reporting requirements; and,

(vi) Other implications of the proposed transaction as warranted.

Approval to enter into a Swap will be subject to appropriate legal authorization (Swap Authorization) from the Board of County Commissioners. The Swap Authorization will authorize the swap agreement and its provisions, establish authorized parameters for notional amount, swap maturity, source of payments, and other relevant provisions. The Swap Authorization will specify the appropriate County officials to whom relevant authority is delegated to carry out the necessary steps to enter into, monitor and administer the Swap, and the parameters within which their delegated authority may function. In the event of a conflict between a Swap Authorization and this Master Swap Policy, the terms and conditions of the Swap Authorization will govern.

5. Permitted Uses

Because of the effects of continual innovation in the financial markets, this Master Swap Policy recognizes that the reasons for use of Swaps may change over time to take advantage of market opportunities as they evolve and are tested. Among the strategies which the County will consider in entering Swaps are:

(i) Managing the County's exposure to floating and fixed interest rates, through interest rate swaps, caps, floors, collars, and other option products;

(ii) Hedging floating rate risk with caps, collars, basis swaps, and other instruments;

(iii) Locking in fixed rates in current markets for use at a later date, through the use of forward swaps, swaptions, rate locks, options, and forward delivery products;

(iv) Reducing the cost of fixed or floating rate debt, through swaps and related products to create "synthetic" fixed or floating rate debt;

(v) More rapidly accessing the capital markets than may be possible with conventional debt instruments;

(vi) Managing the County's exposure to the risk of changes in the legal and regulatory treatment of tax-exempt bonds, including changes in federal marginal tax rates

and other changes in tax laws that may effect the value of tax-exempt bonds relative to other investment alternatives;

(vii) Managing the County's credit exposure to financial institutions and other entities through the use of offsetting swaps and other credit management products; and,

(viii) Other applications to enable the County to increase income, lower costs, or strengthen the County's balance sheet.

When a Swap is being used in preference to conventional bonds in order to produce savings, as a general rule the level of savings should exceed the County's traditional fixed rate refunding savings target of 5%. In general, savings should equal or exceed 8% to account for normal Swap risks (as detailed below in Section 8), but may be as low as 5% if risks have been eliminated or significantly mitigated. A particular transaction may be employed at a lower level of savings if warranted by specific circumstances.

While the County may use Swaps to increase or decrease the amount of floating-rate exposure on the County's balance sheet, the County will not enter into Swaps solely for speculative purposes.

6. Counterparty Credit Standards

Unlike conventional fixed-rate bonds, many Swap products can create for the County a continuing exposure to the creditworthiness of financial institutions that serve as the County's counterparties on Swap transactions. To protect the County's interests in the event of a counterparty credit problem, the County will take a three-tiered approach:

(i) *Use of high-rated counterparties*: Standards of creditworthiness, as measured by credit ratings, will determine eligible counterparties. Differing standards may be employed depending on the term, size and interest-rate sensitivity of a transaction, types of counterparty, and potential for impact on the County's or a specific enterprise fund's credit ratings. As a general rule, the County will enter into transactions only with counterparties whose obligations are rated in the double-A category or better from at least one nationally recognized rating agency. In cases where the counterparty's obligations are rated based on a guarantee or specialized structure to achieve the required credit rating, the County shall thoroughly investigate the nature and legal structure of the guarantee or structure in order to determine that it fully meets the County's requirements.

(ii) *Collateralization on downgrade*: If a counterparty's credit rating is downgraded below the double-A rating category, the County shall generally require that its exposure to the counterparty be collateralized.

(iii) *Termination*: If a counterparty's credit is downgraded below a second (lower) threshold, even with collateralization, the County may exercise a right to terminate the transaction prior to its scheduled termination date. The County will seek to require, whenever possible, that terminations triggered by a counterparty credit downgrade will occur on the side of the bid-offered spread which is most beneficial to the County, and which would allow the County to go back into the

market to replace the downgraded party with another suitable counterparty at no out-of-pocket cost to the County.

(iv) *Notice*: The County's swap counterparties will be required to notify the County 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).

In order to limit the County's counterparty risk, the County will seek to avoid excessive concentration of exposure to a single counterparty or guarantor by diversifying its counterparty exposure over time. Exposure to any counterparty will be measured based on the termination value of any Swap contracts entered into with the Counterparty, as well as such other measurements as the County may deem suitable to measure potential changes in exposure, such as "value at risk" or "peak exposure". Termination value will be determined at least annually, based on a mark-to-market calculation of the cost of terminating the Swap contract given the market conditions on the valuation date. Aggregate Swap termination value for each counterparty should take into accounting netting of offsetting transactions (i.e. fixed-to-floating vs. floating-to-fixed). As a matter of general principle, the County may require counterparties to provide regular mark-to-market valuations of Swaps they have entered into with the County, and may also seek independent valuations from third party professionals.

7. Method of Procurement

The County will choose counterparties for entering into Swap contracts on either a negotiated or competitive basis. As a general rule, a competitive selection process will be used whenever reasonable, if the product is relatively standard, if it can be broken down into standard components, if two or more providers have proposed a similar product to the County, or if competition will not create market pricing effects that would be detrimental to the County's interests.

Negotiated procurement may be used for original or proprietary products, for original ideas of applying a specified product to a County need, to avoid market pricing effects that would be detrimental to the County's interests, or on a discretionary basis in conjunction with other business purposes. Consideration may be given in negotiated transactions to those counterparties who have demonstrated their willingness to participate in competitive transactions and have performed well. If it is determined that a Swap should be competitively bid, the County may employ a hybrid structure to reward unique ideas or special effort by reserving a specified percentage of the swap to the firm presenting the ideas on the condition that the firm match or better the best bid.

To provide safeguards on negotiated transactions, the County should generally secure outside professional advice to assist in the process of structuring, documenting and pricing the transaction. The County will require a fair price opinion from a financial advisor or swap advisor. In any negotiated transactions, the counterparty shall be required to disclose all

payments to third parties (including lobbyists, consultants and attorneys) who had any involvement in assisting the counterparty in securing business with the County.

8. Risk Management

As a general rule, the County will manage the risks of its Swap exposure on an enterprise-wide or "macro" basis, and will evaluate individual transactions within the larger context of their impact across the relevant enterprise. Because of the size and complexity of the assets and liabilities of the County and its enterprise funds, and its established financial systems and controls, the County will manage the risks and rewards of a Swap program alongside its overall financial risks and rewards. As part of its risk management process, the County will evaluate the aggregate risk of its Swap exposure as measured by value at risk, peak exposure, and/or realistic worst case scenarios, as such measurements relate to each individual enterprise.

Among the risks that the County will track, evaluate, and seek to mitigate, are:

(i) *Counterparty Risk*: The risk of a failure of one of the County's Swap providers to perform as required under a Swap contract. (See above Sec. 6, "Counterparty Credit Standards")

(ii) *Termination Risk*: The risk that a Swap may be terminated prior to its scheduled maturity due to factors outside the County's control.

(iii) *Interest Rate Risk*: The risk that the County's debt service costs associated with variable-rate debt increase and negatively affect budgets, coverage ratios and cash flow margins. Variable-rate debt exposure may be created by a Swap from fixed to floating, or a Swap that otherwise creates some type of floating-rate liability. The interest rate risk presented by such a Swap may be increased as interest rates increase generally, as intra-market relationships change, or because of credit concerns relating to the County or the relevant enterprise fund.

(iv) *Basis Risk*: The risk that the floating rate on the Swap fails to offset the floating rate on the underlying asset or liability. Because Swaps are generally based on a floating-rate index, the chosen index should correlate with the floating rate on the underlying instrument, but may not correlate exactly. A common type of basis risk on Swaps used in conjunction with floating-rate tax-exempt debt is often referred to as "tax risk", or the risk of a mismatch between the floating rate on the tax-exempt debt and a Swap index, such as one based on a taxable index like LIBOR. The correlation between the LIBOR-based rate and the floating rate on the debt may change based on changes in tax law or other market events. The degree of risks should be evaluated in comparison with degree of benefit provided.

(v) *Amortization Risk*: The risk presented by a mismatch between the term of the Swap or the notional principal amortization schedule of the Swap and the term or principal amortization schedule of the underlying asset or liability being hedged by the Swap. This risk is increased when the amortization schedule of the underlying asset or liability is uncertain, as in certain forms of debt or assets that

are scheduled to be redeemed out of a future revenue stream that is subject to variability.

(vi) *Liquidity Rollover Risk*: When a Swap is used in conjunction with underlying puttable floating-rate debt, liquidity rollover risk exists if the term of a needed liquidity facility on the debt is shorter than the term of the Swap. The County is at risk as to both the availability and the price of successive liquidity facilities.

(vii) *Pricing Risk*: The risk that the Swap may not be priced competitively in comparison to the market for comparable swap transactions.

The County will measure and evaluate the effect of leverage contained within any Swap on the magnitude of any of the above-mentioned risks.

9. Reporting

The County will track and regularly report on the financial implications of the Swaps it enters into. An annual report will be prepared for the Board of County Commissioners including:

(i) A summary of key terms of the agreements, including notional amounts, interest rates, maturity and method of procurement, including any changes to Swap agreements since the last reporting period;

(ii) The mark-to-market value (termination value) of its Swaps, as measured by the economic cost or benefit of terminating outstanding contracts at specified intervals;

(iii) The amount of exposure that the County has to each specific counterparty, as measured by aggregate mark-to-market value, netted for offsetting transactions;

(iv) The credit ratings of each counterparty (or guarantor, if applicable) and any changes in the credit rating since the last reporting period; and,

(v) Any collateral posting as a result of Swap agreement requirements.

In addition, the County will perform such monitoring and reporting as is required by the rating agencies or for compliance with GASB requirements.