

1 **SOUTH FLORIDA WATER MANAGEMENT DISTRICT**

2
3 **RESOLUTION NO.**

4
5 **A RESOLUTION OF THE GOVERNING BOARD OF THE**
6 **SOUTH FLORIDA WATER MANAGEMENT DISTRICT**
7 **AMENDING SECTIONS 110-41, 110-44, 110-47 and 110-53 OF**
8 **ARTICLE IV, CHAPTER 110, OF THE DISTRICT POLICIES**
9 **CODE REGARDING ISSUANCE OF DEBT TO REVISE DEBT**
10 **ISSUANCE RATIOS, TO INCLUDE PROVISIONS REGARDING**
11 **THE USE OF DERIVATIVE PRODUCTS AND INTEREST RATE**
12 **HEDGE CONTRACTS AND TO MAKE OTHER CHANGES;**
13 **REPEALING SECTION 110-48, DISTRICT POLICIES CODE,**
14 **RELATING TO FINANCING FOR ACCELER8 PROJECTS;**
15 **PROVIDING FOR INCLUSION IN THE DISTRICT POLICY**
16 **CODE; PROVIDING FOR SEVERABILITY; PROVIDING AN**
17 **EFFECTIVE DATE**

18
19 **WHEREAS** the Governing Board had determined that it is necessary,
20 appropriate and in the public interest to amend Sections 110- 41, 110-44, 110-47
21 and 110-53, District Policies Code, to revise debt issuance ratios, adopt a policy
22 regarding the use of derivative products and interest rate hedge contracts and to
23 repeal Section 110-48, District Policies Code, to repeal provisions relating to the
24 financing of Acceler8; now therefore

25 **BE IT RESOLVED BY THE GOVERNING BOARD OF THE SOUTH FLORIDA**
26 **WATER MANAGEMENT DISTRICT:**

27 **Section 1.** The Governing Board adopts the following amendments to the
28 Sections 110-41(a), 110-44(b), 110-47 and 110-53 of the District Policies Code:

29 **CHAPTER 110 FINANCE**

30
31 **ARTICLE IV. DEBT MANAGEMENT**

32 **Sec. 110-41. Purpose.**

33 (d) Debt management helps accurately evaluate the impact of each financing
34 decision on the District's debt position and credit quality. Sound debt issuance
35 and management enhances credit quality and improves access to credit markets
36 by demonstrating responsible management to credit analysts, underwriters,
37 rating agencies and investors. Adherence to the policy should enhance the
38 District's credit standing, improve the District's access to tax-exempt and taxable
39 credit markets and reduce costs of debt issuance.

40

41 **Sec. 110-44. Debt Consideration Factors.**

42 (b) All planning participants need to review a number of factors when
43 considering debt issuance. These include:

- 44 (1) The legal constraints and authority of Florida Statutes.
- 45 (2) The nature of projects to be financed: non-recurring major projects or
46 recurring routine projects.
- 47 (3) The demand or requirement timeline for the project.
- 48 (4) The condition of the District's water control system infrastructure and other
49 fixed assets and their need for replacement, or expansion.
- 50 (5) The urgency of the financing need and the economic cost of delaying.
- 51 (6) The balance between pay-as-you-go versus debt financing.
- 52 (7) The impact on current and future spending flexibility.
- 53 (8) The intergenerational equity of who should pay for the capital projects.
- 54 (9) The availability of alternative funding and debt repayment sources and future
55 uses of those revenue streams.
- 56 (10) The overall impact on the District's financial condition.
- 57 (11) The current debt interest rates and the tax-exempt and taxable bond
58 market.

59 This policy is set forth to provide a framework to apply the foregoing factors while
60 assuring access to debt markets.

61

62

63 **Sec 110-47. Measures of Debt Levels and Debt Issuance Limits.**

64 The District's debt burden shall not exceed the benchmark levels, set forth below,
65 and no additional debt shall be authorized if the projected debt burden would
66 exceed such levels:

67 (1) The net debt-per-capita shall not exceed \$350 ~~\$250~~.

68 (2) Debt service ~~(including payments required on certificates of participation to~~
69 ~~accelerate the Comprehensive Everglades Restoration Plan—Acceler8)~~ shall not
70 exceed 30% ~~20%~~ of revenues legally available to the District to pay debt service,
71 including. But not limited to, the available ad-valorem revenues, related interest
72 income thereon and permit fee revenue.

73 (3) The debt-to-assessed value shall not exceed .30% of the assessed value of
74 property within the District.

75

76 **Sec. 110-53 Derivative Products; -Interest Rate Hedge Contracts.**

77 (a) In structuring a particular financing, the District may employ the use of
78 derivative products, which include, but are not limited to the following, interest
79 rate swap agreements, interest rate exchange agreements, funding agreements,
80 hedges, collars, options, puts or caps. In determining whether to apply a
81 derivative product to a transaction, the District shall take into consideration all
82 relevant risk factors, including, by way of example: (i) the creditworthiness of the
83 provider of the derivative product provider (Counterparty Risk); (ii) the risk that
84 the derivative may be terminated early and that a termination payment may be
85 due from the District (Termination Risk); (iii) the risk that the payments received
86 by the District under the derivative product do not correspond to the payments
87 being made by the District on its underlying variable rate debt (Basis Risk); (iv)
88 the risk that a change in federal tax would adversely affect the relationship
89 between payments received under the derivative product and payments made on
90 underlying debt (Tax Risk); and the risk that the District may not be able to
91 assign the derivative product to another party (Liquidity Risk). Additionally, the
92 District will work with its financial advisor to carefully structure a derivative
93 product that best serves the needs of the District.

94 ~~The District shall adopt a comprehensive derivatives policy prior to the use of any~~
95 ~~derivative product. Additionally, the use of any derivative shall be subject to the~~
96 ~~same approval required for the issuance of debt, including review and approval~~
97 ~~by the Executive Office of the Governor, as required by the Memorandum of~~
98 ~~Agreement between the Executive Office of the Governor and the District dated~~
99 ~~October 14, 2004.~~

100

101 (b) Interest rate swaps, caps, collars and other hedging products (collectively
102 referred to herein as “hedges”) can be an effective tool to reduce financing costs,
103 diversify certain risks and take advantage of unique market conditions. The
104 District recognizes there may be occasion where it is prudent and useful to
105 consider the use of such derivative products. The final decision to enter into
106 such a contract will only be utilized in such cases where after careful analysis it is
107 shown that the hedge will reduce risk or lower costs, and must be approved by
108 the Chief Financial Officer and Executive Director prior to consideration by the
109 Audit and Finance Committee of the Governing Board. The following list includes
110 many of the conditions under which entering into a hedge may be appropriate:

111

112 (1) To achieve savings as compared to a traditional debt structure
113 available in the bond market (both fixed and variable rate
114 obligations).

115 (2) To achieve diversification of a particular debt offering.

116 (3) To reduce net interest expense within prudent risk guidelines.

117 (4) To prudently hedge risk in the context of a particular financing or
118 the overall asset/liability management of the District.

119 (5) To incur variable rate exposure within prudent guidelines.

120 (6) To achieve more flexibility in meeting overall financial objectives
121 than can be achieved in conventional markets, AND

122 (7) The District has received an opinion acceptable to the market from
123 a nationally recognized bond counsel firm that the agreement
124 relating to the hedge is a legal, valid and binding obligation of the

125 District and entering into the transaction complies with applicable
126 State and Federal laws, AND

127 (8) Hedges shall not be used for speculative purposes.
128

129 In evaluating a particular transaction involving the use of hedges, the District
130 shall review long-term implications including costs of borrowing, historical interest
131 rate trends, variable rate capacity, credit enhancement capacity, opportunities to
132 refund related debt obligations and other similar considerations. Guidelines for
133 such decision making will be outlined in the District's investment policy.
134

135 **(c) General Guidelines.** The District should follow the guidelines listed below in
136 evaluating and recommending all hedge transactions:

137 (1) When using Hedge instruments, the District should follow all
138 guidelines established by Standard & Poor's, Moody's and any other
139 nationally recognized rating service rating the District's debt.

140 (2) *Ratings and Outstanding Obligations:* Consideration should be
141 given to the impact that any hedge agreement will have on the
142 credit ratings of the District. The agreement should follow
143 outstanding commitments with bond insurers, credit enhancers, and
144 surety providers, if any.

145 (3) *Existing Covenants:* The hedge transaction must not conflict with
146 existing covenants and debt policies.

147 (4) *Long-Term Implications:* In evaluating Hedge transactions, the
148 District should review the long-term implications associated with the
149 proposed Hedges including historical interest rate trends, bond
150 capacity, and the potential impact on the ability to refund debt in the
151 future.

152
153 (5) *Accounting:* The impact on the District's accounting should be
154 determined before executing a Hedge. The District should reflect
155 the use of derivatives on its financial statements in accordance with

156 generally accepted accounting principles and must comply with
157 current GASB Technical Bulletins or other GASB issued directives.

158 (6) Prior to execution, the District should obtain estimates under
159 various scenarios of the potential termination costs that might
160 occur, and plan for how such costs would be funded.

161

162 **(d) Counterparty Standards.** Many hedges create an exposure to the
163 creditworthiness of the firms that serve as the District's Counterparties. To
164 protect its interests, the District should use the following standards in choosing its
165 Counterparties.

166

167 (1) The District shall attempt to enter into hedges transactions with
168 Counterparties, at the time of the transaction, rated at least equal to
169 the District, but in no event, lower than A-/A1/A by at least two of
170 the three nationally recognized credit rating agencies (Standard &
171 Poor's, Moody's, and Fitch Ratings, respectively) or the payment
172 obligations of the Counterparty should be guaranteed by an entity
173 with such ratings. Alternatively, the Counterparty could post
174 suitable and adequate collateral for the District's benefit or obtain
175 credit enhancement that gets the Counterparty to the "A" category
176 levels.

177 (2) The Counterparty must maintain a market for its derivative
178 products.

179 (3) The Counterparty should have presence in the municipal
180 derivatives market and should have demonstrated experience in
181 the successful execution of derivative transactions.

182

183 **(e) Form of Agreements and Other Documentation.** The hedges entered
184 into by the District shall contain the terms and conditions set forth in the
185 International Swap and Derivatives Association, Inc. ("ISDA") Master Agreement,
186 including any schedules, credit support annexes and confirmations. The

187 schedules and credit support annex should reflect specific requirements and
188 business terms desired by the District for a particular transaction. Each
189 agreement, including its modification and termination, should be approved by the
190 Governing Board. Within the agreement documents, Events of Default should
191 include the following:

- 192 (1) Failure to make payments when due
193 (2) Material breach of representations and warranties
194 (3) Failure to comply with downgrade provisions or with any other
195 provisions of the agreement after a specified notice period

196

197 Upon certain credit rating events, the agreement should provide for the right of
198 assignment by the affected party. If the District is the affected party, it should
199 request that the Counterparty post collateral or provide some other credit
200 support. If the Counterparty does not provide the required credit support, the
201 District should have the right to assign the agreement to another Counterparty
202 and based on terms acceptable to both parties. The credit rating thresholds
203 should be included in the documents. The mechanics for determining
204 termination values at various times and upon various occurrences must be
205 explicit in the hedge agreement. Prior to execution, the District staff and counsel
206 will prepare a resolution pertaining to the transaction, and the resolution will
207 contain the approval by the Governing Board to enter into the hedge transaction.

208

209 **(f) Termination Provision.** All swap transactions shall contain provisions
210 granting the District the right to optionally terminate a swap agreement at any
211 time over the term of the agreement. Such a provision shall be required even if
212 any termination is at market. In general, exercising the right to terminate an
213 agreement should produce a benefit to the District, either through the receipt of a
214 payment from a termination or, if the termination payment is made by the District,
215 in conjunction with a conversion to a more beneficial debt obligation of the
216 District or by the purchase of a similar product from others, all as determined by
217 the District.

218

219 **(g) Evaluation and Management of Derivative Risks.** The Chief Financial
220 Officer and the District's Financial Advisor shall review all proposals prior to
221 presentation to the Audit and Finance Committee. Only proposals that the
222 District, in its sole discretion, believes should be considered further given, for
223 example, the projected savings or other benefits and the ability to meet one or
224 more of the objectives outlined herein shall be presented to the Committee.
225 Before entering into a hedge, the District should assess all the risks inherent in
226 the transaction. Certain risks will inevitably be created as the District enters into
227 hedging transactions, and the District should periodically evaluate these risks
228 and exposures. In addition to the risks detailed below, market-access, interest
229 rate, tax, and bankruptcy risks should all be evaluated. Below are guidelines for
230 the management and mitigation of certain risks.

231

232 (1) **Counterparty Risk:** The risk of a defaulting Counterparty (or
233 Counterparty's insurer) that will not fulfill its obligations according to
234 the agreement should be evaluated and managed.

235

236 a. The District should require that the Counterparty meet the
237 Counterparty Standards (described previously).

238

239 b. If the Counterparty's credit rating is downgraded below the
240 specified threshold, the District should require that its exposure to the
241 Counterparty be collateralized according to the terms of the Credit
242 Support Annex.

243

244 c. The District should also diversify its exposure to Counterparties.
245 Before entering into a transaction, the District should determine its
246 outstanding exposure to the relevant Counterparty and determine
247 how the proposed transaction will affect that exposure. The

248 exposure should not only be measured in notional amount but also
249 in how the change in rates would affect the fair values.

250

251 d. The District should give written permission prior to the transfer of
252 the hedge agreement from the Counterparty to another
253 Counterparty. The District should not authorize the transfer of the
254 agreement to another Counterparty unless the replacement
255 Counterparty fits the Counterparty Standards detailed above.

256

257 e. The District should require collateralization if the credit of the
258 Counterparty negatively changes as a result of a merger or
259 acquisition.

260

261 (2) **Termination Risk:** The risk that a hedge's unscheduled end will
262 affect the District's asset/liability strategy or will present the District
263 with a significant unanticipated termination payment to the
264 Counterparty can be mitigated in the following ways:

265

266 a. The District should have the right to optionally terminate an
267 agreement at any time at the market value of the hedge at the time
268 of termination (as long as a Counterparty receiving payment upon
269 termination is not in default). Exercising this right should generally
270 be in the District's favor, either with the receipt of a termination
271 payment or if a termination payment is made by the District, with a
272 change to a more beneficial position in relation to the District's debt.
273 The termination value should be determined by the Second Method
274 Market Quotation.

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276 b. Upon downgrade or default by either party, a termination payment
277 by the District may be required. In some instances, the defaulting
278 party will be required to make a termination payment to the non-

279 defaulting party. However, sometimes the non-defaulting party may
280 be required to make a payment to the defaulting party. Prior to
281 making a termination payment to a defaulting Counterparty, the
282 District should evaluate whether it is financially advantageous for
283 the District to obtain a replacement Counterparty or make the
284 termination payment.

285

286 c. The District, upon a Counterparty default, should require that the
287 termination occur on the side of the bid-offer spread that is most
288 beneficial to the District. This would allow the District, if it desires,
289 to replace the defaulting Counterparty with another Counterparty at
290 no cost to the District.

291

292 (3) **Term Risk:** The District should determine the appropriate term for
293 a hedge agreement on a case-by-case basis.

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295 a. In choosing the appropriate term, the slope and steepness of the
296 curve, the change in rates and/or cost from year to year along the
297 curve, potential termination values, and the impact that the term of
298 the hedge has on the overall exposure to the District should all be
299 considered.

300

301 b. The term of any agreement should not exceed the final maturity of
302 the District's bonds or other obligations issued or outstanding in
303 connection with the agreement.

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305 (4) **Liquidity Risk:** Before entering into a hedge agreement, the
306 District should consider the liquidity of the proposed transaction (if
307 enough firms actively participate in the market for the proposed
308 transaction to allow the District, if it wishes, to assign the trade
309 and/or to have more transparent, fair pricing).

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(5) **Basis Risk:** Basis risk arises when the variable rates on the hedged item and the rates on the hedge are based on different indices. This variance can adversely affect the District's payments and/or synthetic interest rates and the savings may not be realized.

a. If there is not a direct relationship between the indices of the hedge and the underlying hedged item, the risk should be analyzed prior to execution of the hedge.

b. The index chosen as the basis of the hedge should be a recognized market index such as The Bond Market Association Index or London Interbank Offering Rate (LIBOR).

(6) **Tax Risk:** The risk that changes or proposed changes in the tax laws or events relating to the tax-exempt status of the Governmental Entity's obligations or of tax-exempt obligations generally will cause interest rates on the debt of the Governmental Entity to increase.

(7) **Interest Rate Risk:** The risk that an adverse move in variable rates increases the overall cost of borrowing.

(h) **Collateralization.** As appropriate, the District, in consultation with its Bond Counsel and Financial Advisor, may require collateral or other credit enhancement to be posted by each swap counterparty. At a minimum, collateral requirements shall be subject to the following guidelines for the District and the Counterparty:

(1) The Counterparty is required to post collateral should the credit rating of the either party fall below the "A-/A1/A" category by at least two of the nationally recognized rating agencies.

(2) Acceptable collateral is cash, treasuries, and AAA rated agency securities. The valuation of the collateral will be mutually agreed upon during negotiation of the agreement.

341 (3) The collateral should be marked-to-market periodically, either daily,
342 weekly, or monthly, by an independent third party.

343 (4) Failure by either party to collateralize when required under the
344 agreement will be considered a default.

345 (5) The hedge agreement should provide the minimum transfer amount
346 and reasonable threshold amounts for the posting of collateral.

347 **Section 2.** Section 110-48, District Policies Code, relating to the
348 financing of Acceler8 projects is repealed.

349 **Section 3.** Inclusion of Sections 1 and 2 of this resolution in the District
350 Policies Code is authorized and directed.

351 **Section 4.** If any section, subsection, subdivision, paragraph, sentence,
352 clause or phrase of this resolution is for any reason held to be unconstitutional or
353 invalid or ineffective by any court of competent jurisdiction, such decision shall
354 not affect the validity or effectiveness of the remaining portions of this resolution.

355 **Section 5.** This resolution shall take effect immediately on adoption.

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357 **PASSED** and **ADOPTED** this ___ day of _____, 2008.

358

359 **SOUTH FLORIDA WATER MANAGEMENT**
360 **DISTRICT, BY ITS GOVERNING BOARD**

361 By: _____

362 Chairman

363

364 ATTEST

365

366 _____

367 District Clerk

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Approved as to form:

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BY:

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Office of Counsel