INTEREST RATE RISK MANAGEMENT PRODUCTS POLICY (DERIVATIVES POLICY)

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CITY OF ORLANDO

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I. Introduction

The Interest Rate Risk Management Products Policy (Derivatives Policy) has been developed to provide guidelines for the use of interest rate risk management products such as swaps, caps, floors, collars and options in connection with the incurrence of debt obligations included in the City of Orlando (the "City") Debt Management Policy (see attached Glossary for further definitions of terms). While the use of these financing products can reduce the City's exposure to interest rate risk on its variable rate debt, careful monitoring of such products is required to preserve the City's credit strength and budget flexibility.

This policy describes the circumstances and methods with which interest rate risk management products can be used, the guidelines that will be imposed on them, and who in the City is responsible for implementing these policies. In evaluating a particular transaction involving the use of derivative financing products, the Chief Financial Officer will review the long-term implications associated with entering into such agreements, including costs of borrowing, historical interest rate trends, variable rate capacity, credit enhancement capacity, opportunities to refund related debt obligations and other similar considerations.

II. Scope of Policy

This derivative products policy shall apply to all swaps, caps, collars, floors, options, or any other interest rate risk mitigation product used to manage the debt of the City of Orlando.

III. Interest Rate Risk Mitigation Objectives

The objectives for which the City will consider the use of these products are as follows:

A. Hedging Strategy - To prudently reduce exposure to changes in interest rates in the context of a particular financing or the overall asset/liability management of the City; or

B. Reduce Cost - To achieve a lower net cost of borrowing with respect to the City's debt.

IV. No Speculation

Interest rate risk mitigation products will not be used for speculative purposes.

V. Form of Agreements

To the extent possible, Agreements entered into by the City 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 City reserves the right to amend these terms and conditions including the remedies and obligations as is appropriate to benefit the City. The schedule may be modified to reflect specific legal requirements, business terms and changes to the remedies and obligations as determined by the Chief Financial Officer. The Chief Financial Officer will consider whether to include provisions that permit it to assign its rights and obligations under Agreements and to optionally terminate the Agreement at its market value at any time. The counterparty shall not have the right to optionally terminate an agreement. The Chief Financial Officer will transmit the proposed form of Agreements to the Finance Committee and forward a request for authorization from City Council and the Mayor to approve and execute these Agreements within parameters delegated to the Chief Financial Officer.

VI. Methods to Solicit and Procure Interest Rate Swaps

The Chief Financial Officer will solicit and procure Agreements by competitive bid whenever feasible. The Chief Financial Officer will pre-qualify financial institutions as potential counterparties using the City's investment banking team and current counterparties to participate in a competitive transaction, but these parties must conform to the minimum credit standards outlined in this Policy.

Notwithstanding the above, the Chief Financial Officer may procure Agreements by negotiated methods if it is determined that due to the size or complexity of a particular transaction competitive bidding is undesirable, impractical or impossible and a negotiated transaction would result in the most favorable pricing. Such finding will be based on advice by an independent financial advisory firm and with the assistance of appropriate legal counsel. In this situation, the Chief Financial Officer should attempt to price the products based upon an agreed-to methodology relying on available pricing screens to obtain inputs to a mathematical model. If appropriate, the Chief Financial Officer should use an independent financial advisory firm to assist in the price negotiations.

Regardless of the method of procurement, the Chief Financial Officer will obtain a finding from an independent financial advisory firm that the terms and conditions of Agreements reflect a fair market value of such Agreement as of the date of its execution.

VII. Aspects of Risk Exposure

Before the City enters into an Agreement, the Chief Financial Officer will evaluate the risks inherent in the transaction. The risks to be evaluated could include amortization risk, basis risk, ~~,~~ counterparty risk, interest rate risk, rollover risk, tax event risk and termination risk. Identification of the risks and discussion of the means, if any, employed to mitigate the risks will be contained in the Chief Financial Officer's report recommending approval of the Agreements to the Finance Committee, Mayor and City Council.

A. Counterparty Risk – Counterparty risk is the risk that the counterparty will not fulfill its contractual obligations. Counterparty risk includes the risk of an occurrence of an event modifying the credit rating of the counterparty and the failure of the counterparty to make its required payments. Certain interest rate risk management products create a continuing exposure to the creditworthiness of financial institutions that serve as the City's counterparties on such transactions. The Chief Financial Officer will endeavor to minimize counterparty risk by establishing strong minimum counterparty credit standards and diversifying the City's exposure to counterparties. To that end, before entering into a transaction, the Chief Financial Officer will analyze the City's existing exposure to that counterparty and then determine how the proposed transaction would affect the exposure.

B. Basis Risk - Basis risk refers to the mismatch between the actual variable rate debt service and variable rate index used to determine the swap payments. The Chief Financial Officer will evaluate different swap indices as part of the analysis of the proposed agreement and identify the amount of basis risk that may result from various indices. Tax Events Risk, a form of basis risk, is the risk created by potential changes to the Federal and State income tax codes on the interest rates to be paid by the City on its variable rate bonds. The Chief Financial Officer will evaluate the potential impact of changes in marginal tax brackets as part of its analysis of basis risk.

C. Termination Risk – Termination risk refers to the possibility that, upon a default by the counterparty, the City may be required to make a large payment to the counterparty if the Agreement is terminated prior to its scheduled maturity pursuant to its terms. For certain types of Agreements, a payment by the City may be required if interest rates have fallen causing the market value of the remaining payments to be in favor of the counterparty. Chief Financial Officer will minimize termination risk by recommending to the Mayor and City Council the selection of counterparties with strong creditworthiness, under certain circumstances requiring the counterparty to post collateral in excess of the Agreement's market value, limiting the circumstances where a payment may be required and permitting the assignment of the Agreement to a creditworthy entity in lieu of termination.

D. Rollover Risk – Rollover risk refers to the potential need to find a replacement counterparty as part of the overall plan of finance if the interest rate swap does not extend to the final maturity of the underlying variable rate bonds. The rollover risk can be minimized through the initial plan of finance by not relying on the execution of future Agreements.

E. Market Risk – Market risk is the risk that a government will not be able to enter credit markets or that credit will become more costly. The Chief Financial Officer will evaluate the potential loss of market access and the risk that credit will become more costly as part of any proposed transaction.

VIII. Counterparty Credit Standards

To protect the City's interests in the event of a credit problem, the Chief Financial Officer will recommend entering into an Agreement with a counterparty only if it meets the following standards:

A. At least two of the counterparty's (or its guarantor'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) and not lower than "A3" or "A-" by any of the nationally recognized rating agencies; or

B. The payment obligations of the counterparty are unconditionally guaranteed by an entity with such a credit rating.

IX. Collateralization on Downgrade

The obligations of the counterparty will be collateralized at levels and with securities acceptable to the Chief Financial Officer, as set forth in the Agreements, should the rating:

A. of the counterparty, if its payment obligations are not unconditionally guaranteed by another entity, not satisfy the requirements set forth in Section VIII "Counterparty Credit Standards" above, or

B. of the entity that unconditionally guarantees its payment obligations, if so secured, not satisfy the requirements set forth in Section VIII "Counterparty Credit Standards" above.

X. Termination

A termination payment to or from the City may be required in the event of termination of an Agreement due to a default of either the City or the counterparty, certain additional termination events or optional termination by the City. Prior to making any termination payment due to the default of a counterparty, the Chief Financial Officer will evaluate whether it is financially advantageous for the City to obtain a replacement counterparty to avoid making such termination payment.

XI. Legality

The City Attorney must receive an opinion reasonably acceptable to the market from a nationally recognized law firm that any interest rate risk mitigation product contracts that the City enters are legal, valid and binding obligations of the City.

XII. Responsibilities

The Chief Financial Officer is responsible for determining the appropriate uses for interest rate risk management products in conjunction with the City's debt financing and programmatic needs and making recommendations for the use of such products to the Finance Committee, Mayor and City Council.

The Chief Financial Officer is responsible for monitoring and reporting on all City debt obligations and reporting on such debt to the Mayor and City Council. In this capacity, the Chief Financial Officer will review and report on the activities and assumptions related to the various interest rate risk mitigation transactions. In addition, the Chief Financial Officer is responsible for reflecting the use of Agreements and other financing transactions on the City's financial statements in accordance with Generally Accepted Accounting Principles (GAAP) and with rules promulgated by the Governmental Accounting Standards Board (GASB).

XIII. Monitoring And Reporting

The Chief Financial Officer will issue an annual report to the Finance Committee, which will be forwarded to the Mayor and City Council. The report will include the following information, to the extent applicable:

A. Highlights of all material changes to Agreements including counterparty downgrades and/or terminations;

B. A summary of any new Agreements entered into by the City since the last report;

C. A summary of any planned interest rate management product transactions and the impact of such transactions on the City;

D. A description of each outstanding 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;

E. Any amounts which were required to be paid and received, and any amounts which actually were paid and received under each outstanding Agreement;

F. Any credit enhancement, liquidity facility or reserves associated with the interest rate management products 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 Agreement; and

G. 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

This report will also include a copy of this Policy in the quarter after it is adopted or subsequently modified. The Chief Financial Officer, with the assistance of the City Attorney, and the City Treasurer, will periodically review this Policy for changes in best practices (i.e., GFOA Recommended Practices) and recommend modifications to this Policy to the Mayor and City Council.

XIV. Policy Review and Modification

The City's Interest Rate Risk Management Products Policy will be submitted by the Finance Committee for annual ratification by the City Council by May 1st of each year. The authority to effect any change, modification or amendment of this Policy shall rest solely with the City Council. Finance Committee and staff recommendations for policy changes may be submitted in conjunction with the annual ratification or more often as deemed necessary. Policy changes initiated by City Council may be made as deemed appropriate. Policy changes will become effective on the date stipulated by City Council.

XV. Effective Date

The City's Interest Rate Risk Management Products Policy was ratified and approved by the City Council on March 28, 2016.

Glossary of Key Terms

Agreement: A contract between the City and Counterparty related to interest rate risk management products such as swaps, caps, floors, collars and options in connection with the incurrence of debt obligations by City of Orlando.

Amortization Risk: Represents the cost to the issuer of servicing debt or honoring swap payments due to a mismatch between bonds and the notional amount of swap outstanding. Amortization risk is characteristic of swaps used to hedge variable rate bonds issued to finance amortizing assets, such as mortgages. Amortization risk occurs to the extent bonds and swap notional amounts become mismatched over the life of a transaction.

Basis Risk: Refers to a mismatch between the interest rate received from the swap contract and the interest actually owed on the issuer's bonds.

Call Option: A contract through which the owner is given the right but is not obligated to purchase the underlying security or commodity at a fixed price within a limited time frame.

Cap: A ceiling on the interest rate that would be paid.

Collar: The combination of owning Cap and selling a Floor. Generally, it is structured so that the net cost of the collar is zero or close to zero. This means that the expense for the long cap premium is offset by the credit received for the floor premium.

Counter Party Risk: The risk that the swap counterparty will not fulfill its obligation to honor its obligations as specified under the contract.

Derivative: A financial product that is based upon another product. Generally, derivatives are risk mitigation tools.

Floor: A lower limit on the interest rate that would be paid.

Interest Rate Risk: The risk associated with changes in general interest rate levels or Yield Curves (see Yield Curves below).

Interest Rate Swap: The contract whereby one party typically agrees to exchange a floating rate for a fixed coupon rate. An essential characteristic of swaps is the swapping of cashflows and not principal amounts.

ISDA: The International Swaps and Derivatives Association, a global trade association representing participants in the derivatives industry.

Notional Amount: The stipulated principal amount for a swap transaction. There is no transfer of ownership in the principal for a swap; but there is an exchange in the cash flows for the designated coupons.

Option: A derivative contract. There are two primary types of options (see Put Option and Call Option). An option is considered a wasting asset because it has a stipulated life to expiration and may expire worthless. Hence, the premium could be wasted.

Put Option: A contract that grants to the purchaser the right but not the obligation to exercise.

Rollover Risk: The risk that the swap contract is not coterminous with the related bonds.

Swap: A customized financial transaction between two or more counterparties who agree to make periodic payments to one another. Swaps cover interest rate, equity, commodity and currency products. They can be simple floating for fixed exchanges or complex hybrid products with multiple option features.

Tax Events Risk: Issuers that issue tax-exempt variable rate bonds inherently accept risk stemming from changes in marginal income tax rates. This is due to the tax code's impact on the trading value of tax-exempt bonds. This risk is also a form of basis risk under swap contracts.

Termination Risk: The risk that the swap could be terminated by the counterparty due to any of several events, which may include issuer or counterparty ratings downgrade, covenant violation by either party, bankruptcy of either party, swap payment default by either party, and default events as defined in the issuer's bond indenture. The events of default and termination, which could lead to involuntary termination of the contract, would include failure to pay, bankruptcy, merger without assumption of obligations and legality.

Yield Curve: Refers to the graphical or tabular representation of interest rates across different maturities. The presentation often starts with the shortest-term rates and extends towards longer maturities. It reflects the market's views about implied inflation/deflation, liquidity, economic and financial activity, and other market forces.