

APPENDIX A
THE CITY OF ROSEVILLE
Swap Guidelines

I. INTRODUCTION

The swap guidelines outlined herein are only intended to provide general procedural direction regarding the future use, procurement and execution of interest rate swaps and options. These guidelines are intended to relate to various interest rate hedging techniques, including the contractual exchange of different fixed and variable rate payment streams through interest rate swap agreements. The swap policies are not intended in any way to require the City of Roseville to modify or terminate existing interest rate swaps. The City of Roseville 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 swap guidelines shall not result in liability on the part of the City of Roseville to any party.

II. APPROACH AND OBJECTIVES

Interest rate swaps and options are appropriate interest rate management tools that can help the City of Roseville meet important financial objectives. Properly used, these instruments can increase the City of Roseville's financial flexibility, provide opportunities for interest rate savings or enhanced investment yields, and help the City of Roseville manage its balance sheet through better matching of assets and liabilities. Swaps should be integrated into the City of Roseville's overall debt and investment management guidelines and should not be used for speculation.

Swaps are appropriate to use when they achieve a specific objective consistent with the City of Roseville's overall financial strategies. Swaps may be used, for example, to lock-in a current market fixed rate or create additional variable rate exposure. Swaps may be used to produce interest rate savings, to alter the pattern of debt service payments, or for asset/liability matching purposes. Swaps may be used to cap, limit or hedge variable rate payments. Options granting the right to commence or cancel an underlying swap may be used to the extent the swap itself is consistent with these guidelines or the City of Roseville determines there are other advantages to be derived in granting the option; however, the City of Roseville must determine if the use of any such option is appropriate and warranted given the potential benefit, risks, and objectives of the City. The City of Roseville's staff, together with its Bond Counsel and its Financial Advisor, periodically shall review the City of Roseville's swap guidelines and recommend appropriate changes.

In connection with the use of any swaps, the City Council shall make a finding that, per Government Code Section 5922, the applicable swap is designed to reduce the amount or duration of the interest rate risk or result in a lower cost of borrowing when used in combination with the issuance or carrying of the Bonds or enhance the relationship between the risk and return with respect to the City of Roseville's investments or program of investment, as applicable.

Rationales for Utilizing Interest Rate Swaps and Options

1. Optimize capital structure; including schedule of debt service payments and/or fixed vs. variable rate allocations.

2. Achieve appropriate asset/liability match.
3. Reduce risk, including:
 - Interest rate risk;
 - Tax risk; or
 - Liquidity renewal risk.
4. Provide greater financial flexibility.
5. Generate interest rate savings.
6. Enhance investment yields.
7. Manage exposure to changing markets in advance of anticipated bond issuances (through the use of anticipatory hedging instruments).

III. PERMITTED INSTRUMENTS

The City of Roseville may utilize the following financial products on a current or forward basis, after identifying the objective(s) to be realized and assessing the attendant risks.

1. Interest rate swaps, including fixed, floating and/or basis swaps.
2. Options, including swaptions, caps, floors, collars and/or cancellation or index-based features.

IV. PROCEDURE FOR SUBMISSION AND EXECUTION

Unsolicited proposals are to be mailed to the City Manager, the Finance Director, and the Financial Advisor for evaluation. Such unsolicited proposals need to be received by the City Manager, the Finance Director, and the Financial Advisor four weeks prior to the next City Council meeting for consideration at such meeting. For proposals received within four weeks of the next City Council meeting, the City of Roseville reserves the right to consider the proposal at the following month's Council meeting.

Legal costs incurred in connection with an unsolicited proposal shall be paid by the firm submitting the proposal if for whatever reason the proposal does not close or should the City of Roseville elect for any reason not to proceed. If the City of Roseville elects to proceed with the proposed transaction and the proposed transaction closes, the City of Roseville will absorb such legal costs through costs of issuance.

The City of Roseville staff and the Financial Advisor shall review all unsolicited proposals prior to presentation to the City Council. The City of Roseville shall only present proposals to the Council that the City of Roseville, in its sole discretion, believes should be considered further given, for example, the projected savings or other benefits and the ability to meet one or more of the objectives outlined herein. Only proposals that meet the savings guidelines (as described in the "Guidelines for Financing and Selection of the Financing Team") or that the City of Roseville staff find compelling for other reasons, shall be presented.

Procurement and Execution

The City of Roseville will not have a fixed guideline with respect to swap procurement. The City of Roseville will assess the benefits of competitively bidding financial products that are non-proprietary or generally available in the marketplace. On a product-by-

product basis, the City of Roseville will have the authority to negotiate the procurement of financial instruments that have customized or specific attributes designed on the City of Roseville's behalf.

The use of financial derivative products will be recommended if they meet one of the benefits outlined herein or if they:

1. Provide a specific benefit not otherwise available;
2. Produce greater expected interest rate savings or incremental yield than cash market alternatives;
3. Are not speculative or do not create unreasonable leverage or risk;
4. Result in an improved capital structure or better asset/liability match; or
5. Reasonably pass the risk evaluation required by these guidelines.

Counter-Party Risk Assessment

The City of Roseville will only do business with highly rated counter parties or counter parties whose obligations are supported by highly rated parties. The City of Roseville will structure swap agreements to protect itself from credit deterioration of counter parties, including the use of credit support annexes or other forms of credit enhancement to secure counter party performance. Such protection shall include any terms and conditions which in the City of Roseville's sole discretion are necessary or appropriate or in the City of Roseville's best interest.

The City of Roseville shall enter into interest rate swap transactions only with qualified swap counter parties. Qualified swap counter parties are investment banks as will be identified by the Financial Advisor. Qualified swap counter parties should be 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, and Fitch) or have, as support for their obligations, a "AAA" subsidiary or other entity (e.g. bond insurer) as rated by at least one nationally recognized rating agency. In addition, the counter party must have a demonstrated record of successfully executing swap transactions as well as creating and implementing innovative ideas in the swap market. Each counter party shall have minimum capitalization of at least \$150 million.

The City of Roseville should not have an immutable credit standard. However, the City of Roseville will attempt to do business with highly rated counter parties of "Aa3" or "AA-" or better. For lower rated (below "Aa3" or "AA-") counter parties, the City should seek credit enhancement in the form of:

1. Contingent credit support or enhancement; or
2. Collateral consistent with the policies contained herein.

V. SWAP ANALYSIS AND PARTICIPANT REQUIREMENTS

In connection with any swap, the City of Roseville and its Financial Advisor shall review the proposed transaction and outline any considerations associated with the transaction to the City Council. Such a review should include the following:

1. The identification of the proposed benefit and potential risks, which shall include, but not necessarily be limited to, those risks outlined herein.
2. Independent analysis of potential savings from a proposed transaction.
3. Fixed versus variable rate and swap exposure before and after the proposed transaction.
4. Market Net Termination Exposure¹ (as outlined herein) for all existing and proposed transactions at the City of Roseville.

Swap Risks

1. Counter party Risk – The risk of a payment default on a swap by an issuer's Counter party.
2. Termination Risk - The risk that a swap has a negative value and the issuer owes a "breakage" fee if the contract has to be liquidated.
3. Tax Risk – A mismatch between changes in the rate or price on an issuer's underlying bonds and the swap caused by a reduction or elimination in the benefits of the tax exemption for municipal bonds, e.g. a tax cut, that results in an increase in the ratio of tax-exempt to taxable yields.
4. Basis Risk – A mismatch between the rate on an issuer's underlying bonds and the rate paid under the swap, e.g. a tax-exempt variable rate issue which trades at 62% of LIBOR while the issuer only receives 60% of LIBOR under the swap.
5. Tax Exemption Risk – The risk that the transaction may make the issuer's related bonds taxable.
6. Liquidity/Remarketing Risk – The risk that an issuer cannot secure a cost-effective renewal of a Letter or Line of Credit or suffers a failed auction or remarketing with respect to its variable-rate bonds.

Benefit Expectation

Financial transactions, using fixed rate swaps or other derivative products, should generate 2% greater projected savings than the savings guidelines (as described in the "Guidelines for Financing and Selection of the Financing Team") then in effect for traditional bonds. This threshold will serve as a guideline and will not apply should the transaction, in the City of Roseville's sole judgment, help to meet any of the objectives outlined herein. The higher savings target reflects the greater complexity and higher risk of derivative financial instruments. At a minimum, such financial transactions should provide a savings of no less than 5% over refunded par regardless of the spread between the financial transaction and a traditional bond refunding.

For example, assuming a refunding of \$100 million of existing bonds, a traditional fixed rate advance refunding that does not use derivative products would have a present value savings threshold of \$5.0 million, which is 5.0% of the refunded par. If the refunding structure utilizes a derivative product, the threshold would be \$7.0 million in present value savings, 7.0% of the refunded par. Therefore, the transaction utilizing a swap or other derivative product would have to generate an additional \$2.0 million to meet the target.

¹ Calculation of termination values for existing THE CITY OF ROSEVILLE swaps will be as of the last quarterly valuation date.

For variable rate or other swap transactions that do not result in a fixed interest rate, the City of Roseville will evaluate any additional value generated through the transaction in assessing the benefits of proceeding, including the ability to meet the objectives outlined herein. These benefits include, for example, reducing interest rate or tax risk, optimizing the capital structure or further reducing interest expense.

In determining any benefit in implementing a fixed-to-variable swap, the cost of remarketing, in addition to the cost of credit enhancement or liquidity fees must be added to the projected variable rate. Such a calculation should consider the trading performance of comparable bonds and any trading premium resulting from a specific form of credit enhancement or liquidity and/or any impact related to broader industry trends.

VI. LEGAL AND CONTRACTUAL REQUIREMENTS

Unless otherwise approved by Council, the City of Roseville will use standard ISDA swap documentation including the Schedule to the Master Agreement and a Credit Support Annex. The City of Roseville may use additional documentation if the product is proprietary or the City of Roseville deems in its sole discretion that such documentation is otherwise in its interest.

Terms and Notional Amount of Swap Agreement

The City of Roseville shall determine the appropriate term for an interest rate swap agreement on a case-by-case basis. In connection with the issuance or carrying of bonds, the term of the swap agreement between the City of Roseville and a qualified swap counter party shall not extend beyond the final maturity date of existing debt of the City of Roseville on the related Project, or in the case of a refunding transaction, beyond the final maturity of the refunding bonds. For purposes of calculating net exposure, credit shall be given to any fixed versus variable rate swaps that offset termination exposure for a specific Project or bond transaction. For variable rate transactions, credit may also be given for any assets that are used to hedge a transaction as long as in the City of Roseville's judgment such assets are reasonably expected to remain in place on a coterminous basis with the swap.

Terms and conditions of any swap shall be negotiated by the City of Roseville in the best interests of the City of Roseville subject to the provisions of the Government Code and, unless otherwise waived or altered by the City of Roseville, these guidelines. The swaps between the City of Roseville and each counter party shall include, as appropriate, payment, term, security, collateral, default, remedy, termination, and other terms, conditions and provisions as the City of Roseville, in consultation with its Bond Counsel and Financial Advisor, deems necessary or desirable.

Subject to the provisions contained herein, the City of Roseville swap documentation and terms should include the following:

1. Downgrade provisions triggering termination shall in no event be worse than those affecting the counter party.
2. Governing law for swaps will be New York law, but should reflect California authorization provisions.

3. The specified indebtedness related to credit events in any swap agreement should be narrowly drafted and refer only to specific Project debt.
4. Collateral thresholds should be set on a sliding scale reflective of credit ratings (see Collateral below).
5. Eligible collateral as set forth in the Collateral section below.
6. Termination value should be set by “market quotation” methodology, when the City of Roseville deems appropriate.
7. The City of Roseville should only agree to an Additional Termination Event for the City of Roseville to the extent that the ratings on the applicable the City of Roseville bonds fall below a ratings trigger acceptable to the City of Roseville and the counter party and no form of credit support or enhancement is in place.

Termination Provision

All swap transactions shall contain provisions granting the City of Roseville the right to optionally terminate a swap agreement at any time over the term of the agreement. Such a provision shall be required even if any termination is at market. In general, exercising the right to terminate an agreement should produce a benefit to the City of Roseville, either through the receipt of a payment from a termination or, if the termination payment is made by the City of Roseville, in conjunction with a conversion to a more beneficial (desirable) debt obligation of the City of Roseville.

Collateral

As part of any swap agreement, the City of Roseville shall require collateralization or other forms of credit enhancements to secure any or all swap payment obligations. As appropriate, the City of Roseville, in consultation with its Bond Counsel and Financial Advisor, may require collateral or other credit enhancement to be posted by each swap counter party under the following circumstances:

1. Each counter party to the City of Roseville may be required to post collateral if the credit rating of the counter party or parent falls below the “AAA” category. Additional collateral for further decreases in credit ratings of each counter party shall be posted by each counter party in accordance with the provisions contained in the collateral support agreement to each counter party with the City of Roseville the City of Roseville. Maximum un-collateralized exposure for: i) “AAA” rated counter parties is \$40 million; ii) “AA” rated counter parties is \$10 million; and iii) below “AA” category, uncollateralized exposure is zero.
2. Threshold amounts shall be determined by the City of Roseville on a case-by-case basis. The City of Roseville will determine the reasonable threshold limits for the initial deposit and for increments of collateral posting thereafter.
3. Collateral shall be deposited with a third party trustee, or as mutually agreed upon between the City of Roseville and the counter party.
4. A list of acceptable securities that may be posted as collateral and the valuation of such collateral will be determined and mutually agreed upon during negotiation of the swap agreement with each swap counter party. A complete list of acceptable securities and valuation percentages are included as Attachment A.
5. The market value of the collateral shall be determined on at least a monthly basis, or more frequently if the City of Roseville determines it is in the City’s best interest given the specific collateral security.

6. It shall be determined on a case-by-case basis whether other forms of credit enhancement are more beneficial to the City.

VII. LIMITATIONS ON TERMINATION EXPOSURE

In order to diversify the City's counter party credit risk, and to limit the City of Roseville's credit exposure to any one counter party, limits will be established for each counter party based upon both the credit rating of the counter party as well as the relative level of risk associated with each existing and projected swap transaction. The guidelines below provide general termination exposure guidelines with respect to whether the City of Roseville should enter into an additional transaction with an existing counter party. The City of Roseville Council may make exceptions to the guidelines at any time to the extent that the execution of a swap achieves one or many of the goals outlined in these guidelines or provides other benefits to the City.

Such guidelines will also not mandate or otherwise force automatic termination by the City of Roseville or the counter party. Maximum Net Termination Exposure is not intended to impose retroactively any terms and conditions on existing transactions. Such provisions will only act as guidelines in making a determination as to whether or not a proposed transaction should be executed given certain levels of existing and projected net termination exposure to a specific counter party. Additionally, the guidelines below are not intended to require retroactively additional collateral posting for existing transactions. Collateral posting guidelines are described in the "Collateral" section above. The calculation of net termination exposure per counter party will take into consideration multiple transactions, some of which may offset the overall exposure to the City of Roseville.

Maximum Net Termination Exposure will be based on the sum of (i) the market value of existing transactions as of the first day of the month prior to the execution of any new transaction plus (ii) the expected worse case termination value of the new transaction. The maximum termination exposure will also be tied to the credit rating of a counter party and whether or not the counter party has posted collateral against this exposure.

Under this approach, the City will set limits on individual counter party exposure based on existing as well as new or proposed transactions. For existing transactions, exposure will be based on the market value as of the last quarterly swap valuation report provided by the Financial Advisor. For a new or proposed transaction, the City of Roseville will calculate the projected maximum exposure based on the estimated maximum exposure assuming two standard deviations. Standard deviation is a statistic obtained by squaring the average difference from the mean of a distribution of numbers. Two standard deviations capture 95% of the population of a distribution of numbers. For purposes of the calculation, two standard deviations shall be calculated as the annualized standard deviation of weekly swap rates over the preceding 52 weeks. The time period may vary according to market conditions which could range from flat to volatile.

The sum of the existing market value and the projected maximum exposure shall constitute the Maximum Net Termination Exposure. For purposes of this calculation, the City of Roseville shall include all existing and projected transactions of an individual counter party and all transactions will be analyzed in aggregate such that the maximum exposure will be additive and netted on a per Project basis. The rationale behind

aggregating and netting on a Project basis is that the exposure will vary for individual members depending on their participation in different Projects.

For example, if the City of Roseville has \$13.0 million (i.e. the City of Roseville would owe termination payment) of exposure to a counter party, the Maximum Net Termination Exposure under the definition above, is the projected maximum termination exposure less the outstanding exposure. If projected maximum termination exposure on the proposed transaction, assuming two standard deviations, is \$20 million, net termination exposure would be \$7.0 million.

The exposure thresholds, which will be reviewed periodically to ensure that they remain appropriate, will also be tied to credit ratings of the counter parties and whether or not collateral has been posted. If collateral has been posted, the City of Roseville can not exceed \$30.0 million of collateralized exposure. In addition, there would be a further limit on the amount of uncollateralized exposure, including any threshold amounts under the Credit Support Annex. For AAA-rated counter parties, the City of Roseville could have up to \$40.0 million of uncollateralized exposure; for counter parties in the AA category, the City of Roseville could have up to \$10.0 million of uncollateralized exposure and for counter parties below the AA category, the City of Roseville could have no uncollateralized exposure. If a counter party has more than one rating, the lowest rating will govern for purposes of the calculating the level of exposure. A summary table is provided below.

Credit Ratings	Maximum Collateralized Exposure	Maximum Uncollateralized Exposure	Maximum Total Termination Exposure
AAA	NA	\$40.0 million	\$40.0 million
AA Category	\$30.0 million	\$10.0 million	\$40.0 million
Below AA	\$30.0 million	None	\$30.0 million

Assuming the same example as above, if the counter party is currently rated “Aa2” and “AA+,” the exposure thresholds would only take effect if Net Termination Exposure increased an additional \$3.0 million (from the original \$7.0 million above).

If the exposure limit is exceeded by a counter party, the City of Roseville shall conduct a review of the exposure limit per counter party. The City, in consultation with its Bond Counsel and Financial Advisor, shall explore remedial strategies to mitigate this exposure.

VIII. ONGOING MANAGEMENT

The City of Roseville will seek to maximize the benefits and minimize the risks it carries by actively managing its swap program. This will entail frequent monitoring of market conditions, by both the Financial Advisor and swap counter party, for emergent opportunities and risks. Active management may require modifications of existing positions including, for example:

1. Early termination;
2. Shortening or lengthening the term;

3. Sale or purchase of options; or
4. Use of basis swaps.

On an overall basis, the City's swap program is not expected to be very large relative to all of its investment and debt activities. Swaps will be used in response to particular market conditions and needs of the City for which swaps are the best investment or debt-management option.

IX. ONGOING REPORTING REQUIREMENTS

A written report providing the status of all interest rate swap agreements entered into by the City of Roseville will be provided to the City Council on an annual basis (or other basis, if so directed by Council) and shall include the following:

1. A description of all outstanding interest rate swap agreements, including Project and bonds series, type of swap, rates paid and received by the City of Roseville, total notional amount, average life of each swap agreement, remaining term of each swap agreement.
2. Highlights of all material changes to swap agreements or new swap agreements entered into by the City of Roseville since the last report.
3. Termination Exposure of each of the City of Roseville's interest rate swap agreements.
4. The credit rating of each swap counter party and credit enhancer insuring swap payments, if any.
5. If applicable, information concerning any default by a swap counter party to the City of Roseville, including but not limited to the financial impact to the City of Roseville, if any.
6. If applicable, information concerning any default by the City of Roseville to a swap counter party.
7. A summary of swap agreements that were terminated or that have expired.
8. For a swap transaction entered into to generate debt service savings, the City of Roseville will calculate on an annual basis the actual debt service requirements versus the projected debt service on the swap transaction at the original time of execution. Such a calculation shall include a determination of the cumulative actual savings (or, if applicable, additional payments made by the City of Roseville) versus the projected savings at the time the swap was executed.

THE CITY OF ROSEVILLE
Attachment A – Acceptable Collateral

<u>Security</u>	<u>Valuation Percentage</u>
(A) Cash	100%
(B) (x) Negotiable debt obligations issued by the U.S. Treasury Department or the Government National Mortgage Association (“Ginnie Mae”), or (y) mortgage backed securities issued by Ginnie Mae (but with respect to either (x) or (y) excluding interest only or principal only stripped securities, securities representing residual interests in mortgage pools, or securities that are not listed on a national securities exchange or regularly quoted in a national quotation service) and in each case having a remaining maturity of:	
(i) less than one year	100%
(ii) one year or greater but less than 10 years	98%
(iii) 10 years or greater	95%
(C) (x) Negotiable debt obligations issued by the Federal Home Loan Mortgage Corporation (“Freddie Mac”) or the Federal Home Loan Mortgage Association (“Fannie Mae”) or (y) mortgage backed securities issued by Freddie Mac or Fannie Mae but excluding interest only or principal only stripped securities, securities representing residual interests in mortgage pools, or securities that are not listed on a national securities exchange or regularly quoted in a national quotation service.	95%
(D) Any other collateral acceptable to the City of Roseville in its sole discretion.	The valuation percentage shall be determined by the Valuation Agent from time to time and in its reasonable discretion.

For example, if a counter party is required to post \$1.0 million of collateral and wished to use Ginnie Mae’s with five years remaining to maturity, it would be required to post \$1,020,409 (\$1.0 million/0.98) to satisfy the collateral requirement.