FINANCE AND ADMINISTRATION - INTEREST RATE MANAGEMENT AGREEMENTS POLICY (SWAPS)

BOT 6.8

Date of Last Update:
June 25, 2021

Approved By:

- Board of Trustees

Responsible Office:
Office of General Counsel

POLICY STATEMENT

6.8 Interest Rate Management Agreements Policy (Swaps)

1. Purpose - In order to reduce debt service cost and interest rate risk and to alter the debt mix, an interest rate management agreement ("Swap" or "Agreement") may be entered into for the purpose of hedging existing and planned General Revenue debt for financing capital items. Such Agreements include, but are not limited to: interest rate swaps or swaptions, interest rate caps, collars, floors, and rate locks.

Prior to entering into any Agreement, a review shall be conducted of the long-term implications associated with entering into such Agreement, including the costs of borrowing, historic interest rate trends, variable rate capacity, credit enhancement capacity, impact on current and future bond ratings, opportunities to refund related debt obligations, the fact that in most cases swaps are economically non-callable, the risks associated with the swap, as described below, and other similar considerations.

2. Authority - The Board may authorize a Swap as a part of its resolution for the approval of the original bond financing or in a subsequent resolution.

3. Legality - In order to enter into an Agreement, the University must receive a legal opinion acceptable to the market that the Agreement relating to the swap transaction is a legal, valid and binding obligation of the University and that entering into the transaction complies with applicable State and Federal Laws.

4. Features of the Agreements

a. Form of Agreements - Any Agreement shall include security, collateral, default, remedy, termination, and other terms, conditions, provisions and safeguards as deemed necessary or desirable by the Treasurer. All Agreements shall be payable only in the currency of the United States of America. Each transaction shall be evidenced by a Confirmation setting forth the payment terms, notional amount and amortization.

b. Terms of Swaps - Subject to the provisions contained herein, the terms of any Swap shall use the following; however the Treasurer may permit variances if the University is otherwise adequately protected:

1. "Downgrade provisions" triggering terminations or requiring collateralization shall in no event be worse for the University than those affecting the counterparty.

2. The "specified indebtedness" related to credit events in any Agreement should be narrowly defined and should refer only to General Revenue indebtedness of the University.

3. "Collateral thresholds" should be set on a sliding scale reflective of credit ratings, size and directional market risk of the transaction. Collateral requirements, including safekeeping requirements, should be established and based upon the credit ratings of the University and of the counterparty or its guarantor.

4. "Eligible collateral" shall be limited to those obligations determined by the Treasurer to be sufficiently liquid.

5. The University shall have the right to "optionally terminate" an Agreement at "Market" at any time over the term of the Agreement.

6. "Termination value" should be set by utilizing a Market Quotation Methodology, Second Method (as defined in the International Swaps and Derivatives Association, Inc. Master Agreement), unless the Treasurer deems an alternate method as appropriate.

c. Qualified Counterparties - The University shall not enter into an Agreement with a counterparty that does not have (1) (a) a general credit rating or a guarantor with a credit rating in the "A" rating categories, as assigned by a nationally recognized rating organization or (b) a subsidiary rated "AAA" by at least one nationally recognized rating organization and (2) a demonstrated record of successfully executing municipal swap transactions. In addition to the rating criteria specified herein, the University shall seek additional credit enhancement and safeguards concerning qualified counterparties in the form of contingent credit support or enhancement, collateral consistent with the policies contained herein, ratings downgrade triggers, or guaranty of parent, if any.

d. Counterparty Exposure - The University shall endeavor to diversify its exposure to counterparties.

e. Methods of Soliciting and Procuring Swaps - Agreements can be procured via competitive or on a negotiated basis as determined by the Treasurer on a case-by-case basis. The competitive process should include a minimum of three firms with counterparty ratings as set forth herein. Agreements may be procured on a negotiated basis when the Treasurer makes a determination that:

1. Due to the size, complexity, or credit features of a particular financing, a negotiated transaction would result in the most favorable pricing.

2. In light of the facts and circumstances, doing so will promote the University's interest by encouraging and rewarding innovation.

3. Marketing of the Swap will require complex explanations about the security for repayment or credit quality.

4. Market timing is important, such as coordination of multiple components of the financing is required.

5. To the extent consistent with law, participation from minority or women owned firms is enhanced.

6. Based on the recommendation of the Swap and Derivatives Advisors, special circumstances exist such that a negotiated transaction would result in the most favorable pricing.

7. If it determined that negotiations might allow greater flexibility in changing Agreement terms in the future.

8. Negotiation of the Agreement will not adversely affect the tax-exempt status of related bonds.

Regardless of the method of procurement, the Treasurer shall obtain an independent finding that the terms and conditions of any derivative entered into reflect a fair market value of such derivative as of the date of its execution.

f. Term and Notional Amount - The maximum term, including any renewal periods, of any Agreement may not exceed the latest maturity date of the bonds, notes, debt, or prospective debt referenced in the Agreement. From and after its effective date, the notional amount of any Agreement shall not exceed the outstanding principal amount of the debt to which such agreement relates.

g. Pledging of Collateral - As part of any Agreement, based on credit ratings of the counterparty or as may be requested by the counterparty or the University, collateralization or other forms of University credit enhancements to secure any or all payment obligations of the counterparty or the University under the Agreement may be required. As appropriate, the Treasurer may require of the counterparty, or grant thereto, collateral or other credit enhancement to be posted subject to the collateral threshold amounts specified for such Agreement. Additional collateral for a further decrease in the credit rating and/or an increase in mark-to-market exposure of either counterparty shall be posted by that counterparty in accordance with the provisions contained in the Agreement or collateral support agreements related thereto.

Threshold collateral amounts shall be determined by the Treasurer on a case by case basis who will determine the reasonable threshold limits for the initial deposit and for increments of collateral posting thereafter. Collateral shall be pledged to the trustee, an independent third-party, or as mutually agreed upon between the University and the counterparty. A list of acceptable securities that may be posted as collateral and the valuation of such collateral will be determined and mutually agreed upon under the Agreement. The market value of the collateral shall be determined on a not less than a monthly basis or more frequently if the Treasurer determines it is in its best interest given the specific collateral security.

h. Prohibited Agreements - The University shall not enter into Agreements that:

1. Are purely speculative or create extraordinary leverage or risk,

2. Lack adequate liquidity to terminate without incurring a significant bid/ask spread,

3. Provide insufficient price transparency to allow reasonable valuation, or

4. Are not connected to existing outstanding debt or debt that will be issued within five years from the inception of the Agreement.

5. Management of Swap Transaction Risk - In order to manage the associated risks, guidelines and parameters are as follows:

a. Interest Rate Risk - Interest rate risk is the risk that interest costs on a bond or an Agreement will increase and cost more than the rates associated with a fixed-rate obligation. In the initial financing program for each bond issue, the University will consider hedging the interest rate risk exposure in a manner that results in a net interest cost that is lower than that associated with a fixed-rate obligation. An annual evaluation of interest cost will be conducted. Interest rate risk also includes the risk that changes in the level of interest rates affects the mark-to-market (MTM) value of the University's swaps. Inherent in interest rate risk is also yield curve risk, as changes in the shape of the yield curve (i.e. flattening and steepening) affects the overall level of interest rates. For floating-to-fixed rate swaps, the University MTM will be favorably impacted when interest rates rise. Conversely, when interest rates decline the University MTM will be negatively impacted.

b. Basis Risk - Basis risk is the risk of a mismatch between the actual variable interest rate on the University's debt and the floating rate option index from which any payments under an Agreement are received. Prior to entering into any Agreement, a review of historical relationships and trading differentials between the variable rates on similar bonds and the index will be conducted when deciding whether the relationship is sufficiently close to accept such risk. Any index chosen as part of an interest rate swap agreement shall be a recognized market index including but not limited to The Bond Market Association (BMA) or the London Interbank Offered Rate (LIBOR).

c. Tax Risk - Tax risk is the risk that tax laws will change, resulting in a change in the marginal tax rates and the valuation of the swaps or the performance of the swaps in accomplishing the anticipated hedging or cost savings functions. Tax event provisions contained in proposed Agreements will be reviewed and also discuss the impact of potential changes in tax law on payments under related bonds, or under the proposed Agreement, based on modeling of historical data and taxable indices and shall take into account the reduction in the University's fixed payer rate in return for accepting tax risk.

d. Termination Risk - Termination risk occurs when a swap transaction is terminated prior to its stated expiration, which can happen for a variety of reasons, some of which may be beyond the control of the University. In the case of a termination, normally a settlement payment will owe from one party to the other, in order to maintain the original financial benefits of the transaction, and without regard to which party's actions may have caused the termination. Risks can arise either because the University may be required to make a settlement payment it did not anticipate, or because the University might not, in light of changed circumstances, be able to replace the swap on favorable terms, and could therefore lose some or all of the hedge or cost savings associated with the swap. Risk will be assessed by an annual review of the market value for all existing and proposed Agreements. The termination provisions of any swap agreement shall be bilateral; however, the Treasurer shall have the right to optionally terminate a swap agreement at any time over the term of the agreement (elective termination right). In general, 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.

e. Counterparty Risk - Counterparty risk occurs when there is the failure of the counterparty to make required payments under the Agreement. The Treasurer will monitor exposure levels, ratings thresholds, and collateralization requirements and will take action to enforce remedies when appropriate. The Treasurer will also consider termination of any counterparty whose ratings fall below the minimum required for entering into an Agreement with the University.

f. Liquidity Risk - As described in the University's Debt Policy, liquidity risk occurs when there is an inability to renew a liquidity facility on a related floating rate bond issue. In the event that a current provider has liquidity problems or will not renew its agreement at an acceptable price, the Treasurer shall request bids from other liquidity facility providers in addition to considering alternative bond structures, such as auction rate bonds.

6. Reporting Requirements - The University's financial statements include an annual disclosure on the status of all interest rate swaps, including descriptions of all swaps with notional value and interest rates, credit ratings for the relative counterparties and market valuation. The University will disclose information concerning any material event involving outstanding Agreements, including a counterparty's default or termination and actual collateral postings by the University, if any, per Agreement and in total by swap counterparty to the Finance and Audit Committee.