

# Agenda Report

March 14, 2011

**TO:** Honorable Mayor and City Council

**THROUGH:** Finance Committee

**FROM:** Department of Finance

**SUBJECT: RESOLUTION AUTHORIZING THE SOLICITATION AND/OR NEGOTIATION OF AND ENTRY INTO ONE OR MORE INTEREST RATE SWAPS; APPROVING AND AUTHORIZING THE ENTRY INTO ONE OR MORE INTEREST RATE SWAP AGREEMENT(S) AND INTEREST RATE SWAP TRANSACTIONS TO REPLACE DEPFA BANK PLC AS SWAP COUNTERPARTY; AND APPROVING AND AUTHORIZING CERTAIN ACTIONS RELATING THERETO.**

## **RECOMMENDATION:**

It is recommended that the City Council:

- 1) Adopt a resolution authorizing entry into one or more interest rate transactions to replace DEPFA BANK, plc ("DEPFA") as swap counterparty and authorizing and approving certain actions related thereto; and
- 2) Terminate the swap associated with the Conference Center bonds and, on either a negotiated or competitive basis, contemporaneously enter into a replacement swap with a qualified swap provider rated in the AA category by Standard & Poor's (S&P) and Aa category by Moody's.

## **BACKGROUND:**

On July 31, 2006, City Council authorized the City to enter into an interest rate swap transaction (the "swap") with DEPFA related to the Conference Center bonds. The swap effectively converted the variable portion of the bonds into a synthetic fixed rate debt obligation at an interest rate that was more favorable than if the City had issued traditional fixed rate debt. The swap is reviewed annually and has been determined to be performing as expected.

The swap agreement provides, at the option of the City, that if DEPFA's (the counterparty) unsecured, unenhanced debt is not rated by at least two rating agencies at or above the following levels: Moody's A3, S&P A-, and Fitch A-, then the City may terminate the swap. Both Moody's and S&P have downgraded DEPFA below the minimum required credit ratings, which constitutes an "Additional Termination Event" per the swap agreement.

Staff has evaluated several options available to the City. The following describes each option analyzed by Finance staff.

1. Take no action. This option has market and other risks if the City needs to terminate later. Though there may not be immediate risk to the City, it contradicts City Council's policy to maintain fiscal responsibility and stability and violates the minimum credit rating requirement under the swap documents and the City's swap policy. This option is not recommended.
2. Terminate the DEPFA swap without replacement. This option will necessitate the City paying a substantial termination value to DEPFA Bank (estimated \$12-14 million) given the current market and eliminates the synthetic fixed rate structure of the Conference Center bonds, hence exposing the financing to the variable interest rate market. This option is not recommended.
3. Terminate the swap and issue fixed rate refunding bonds: This alternative is very expensive. The current synthetic fixed rate structure continues to provide a significant cost advantage over the traditional fixed rate financing and current market basis costs. This option is not recommended.
4. Provide a third-party guarantee related to the existing swap (offered by DEPFA to the City). After careful review of DEPFA's proposal, staff does not recommend this option for the following reasons:
  - a) The guarantee would not necessarily address issues in case of bankruptcy filing by DEPFA;
  - b) The guarantee may be limited to only three years; and
  - c) The guarantee does not present the potential economic benefits as compared to staff's recommended alternative.
5. Terminate the DEPFA swap and enter into a replacement swap transaction. This is staff's recommended option. This option cures the current termination event, provides the City with stronger counterparty credit, maintains the current synthetic fixed rate structure, and all costs related to the transaction will be borne by DEPFA Bank.

“Attachment B” provides background information of the swap, the early termination process as provided in the “Master Agreement,” a detailed description of the options available to the City, and the detail procedure of the proposed transaction.

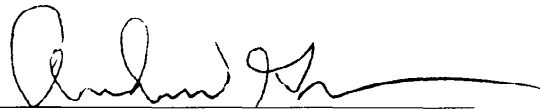
**COUNCIL POLICY CONSIDERATION:**

This action supports the City Council's strategic goal of maintaining fiscal responsibility and stability, including compliance with Section 14.9 "Minimum Counterparty Requirements" of the City's Debt Management Policy.

**FISCAL IMPACT:**

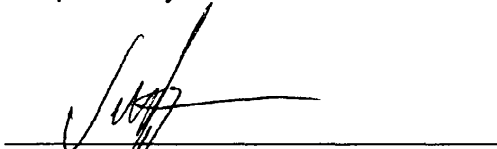
There is no fiscal impact to the City. The replacement transaction will have terms and provisions substantially identical to those of the swap and all costs and fees are payable from, and fully contingent upon, adjustments to amounts otherwise payable to DEPFA.

Respectfully submitted,



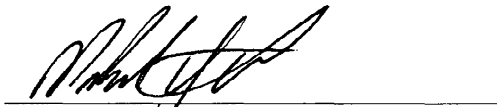
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Director of Finance

Prepared by:



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Approved by:



MICHAEL J. BECK  
City Manager

Attachments:

Attachment A – Resolution  
Attachment B - Memorandum