Metro

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EXECUTIVE MANAGEMENT AND AUDIT COMMITTEE
MAY 17, 2004

SUBJECT: INTEREST RATE SWAP POLICY AND DEBT POLICY

ACTION: ADOPT ANNUAL UPDATES TO MTA DEBT POLICY AND INTEREST RATE SWAP POLICY

RECOMMENDATION

A. Adopt the updated MTA Debt Policy, Attachment A
B. Adopt the updated MTA Interest Rate Swap Policy, Attachment B

ISSUE

Debt Policy
The MTA Debt Policy governs the issuance and management of all debt, including the investment of bond and lease proceeds not otherwise covered by the MTA Investment Policy. The process for selection of debt and lease related investments, financial products and professional services is specified in the policy. The Debt Policy also governs all tax-exempt and taxable leases funded by the capital markets, by major financial institutions, or through private placement, other than those covered in the MTA's Defeased Lease Policy. The goals of the Debt Policy are to achieve the lowest possible cost of capital subject to prudent risk parameters while preserving future financial flexibility.

Interest Rate Swap Policy
The MTA, from time to time, has the opportunity to reduce its cost of capital by utilizing interest rate swaps and other related financial products. Because the characteristics of these products differ significantly from the debt obligations covered by the adopted Debt Policy, it is important that MTA also maintain a policy that will provide guidance in administering existing swaps and in selecting and implementing future interest rate swaps related to MTA bond issues.

POLICY IMPLICATIONS

The MTA's Debt Policy and Interest Rate Swap Policy govern the use and management of interest rate swaps as they are used in conjunction with MTA's debt issues. The policies establish guidelines to be used when considering the use of debt or swaps, as well as in the on-going management of existing obligations. Guidance is provided specifying appropriate uses, selection of acceptable debt and lease products, swap providers, negotiation of favorable terms and conditions, and stipulating annual surveillance of the swaps and the providers. The processes for selection of swap related financial products and professional

specified. Both the Debt Policy and Interest Rate Swap Policy stipulate that they will be reviewed and updated annually.

OPTIONS

The alternative of not adopting the updated Debt Policy and Interest Rate Swap Policy and thus rejecting the proposed updates is not recommended. Maintaining properly updated policies governing the management of debt and interest rate swaps facilitates MTA in its efforts to most effectively obtain the lowest cost of capital.

BACKGROUND

The Debt Policy and Interest Rate Swap Policy work together to assist MTA in achieving the lowest possible cost of capital, subject to prudent risk parameters, and while preserving future financial flexibility, as well as in effectively managing currently outstanding obligations. The Debt Policy and Interest Rate Swap Policy respectively establish appropriate practices regarding the issuance and management of debt and interest rate swaps. MTA currently has about $3.6 billion of debt outstanding in 31 transactions that are subject to the Debt Policy.

The use of interest rate swaps can benefit the MTA in refunding situations where issuance of traditional fixed rate bonds will not meet the refunding standards in the Debt Policy, as well as in reducing the cost of new money debt issues. Interest rate swaps have become recognized and established financial tools used by municipal issuers throughout the nation. The use of these products has become such a regular tool in the financial marketplace that the Government Finance Officers Association (GFOA) has adopted an official position, Recommended Practice, for policy statements governing the use and management of such swaps. Currently, there are four interest rate swaps subject to the Interest Rate Swap Policy, with outstanding notional amounts totaling about $690 million.

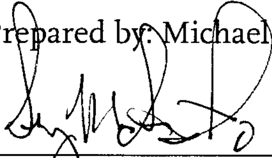
FINANCIAL IMPACT

There is no financial impact associated with implementing or not implementing the policy.

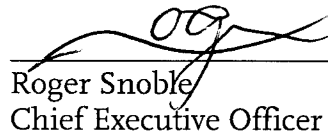
ATTACHMENT

A. Debt Policy
B. Interest Rate Swap Policy
C. Debt Policy (marked for changes)
D. Interest Rate Swap Policy (marked for changes)

Prepared by: Michael J. Smith, Assistant Treasurer



Terry Matsumoto
Executive Officer, Finance and Treasurer



Roger Snoble
Chief Executive Officer

Attachment A

MTA Debt Policy

MTA
DEBT POLICY

I. Introduction

The purpose of the Debt Policy of the Los Angeles County Metropolitan Transportation Authority (MTA) is to establish guidelines for the issuance and management of the MTA's debt. This Debt Policy confirms the commitment of the Board, management, staff, advisors and other decision makers to adhere to sound financial management practices, including full and timely repayment of all borrowings, and achieving the lowest possible cost of capital within prudent risk parameters. Priorities of the Debt Policy are as follows:

1. Achieve the lowest cost of capital
2. Maintain a prudent level of financial risk
3. Preserve future financial flexibility
4. Maintain strong credit ratings and good investor relations

II. Scope and Authority

This Debt Policy shall govern, except as otherwise covered by the MTA Investment Policy, Defeased Lease Policy or Interest Rate Swap Policy, the issuance and management of all debt and lease financings funded from the capital markets, including the selection and management of related financial services and products, and investment of bond and lease proceeds.

While adherence to this Policy is required in applicable circumstances, the MTA recognizes that changes in the capital markets, agency programs and other unforeseen circumstances may from time to time produce situations that are not covered by the Policy and will require modifications or exceptions to achieve policy goals. In these cases, management flexibility is appropriate, provided specific authorization from the Board is obtained.

The MTA's Debt Policy shall be reviewed and updated at least annually and presented to the Board for approval. The Chief Executive Officer, Chief Financial Officer and Executive Officer – Finance and Treasurer are the designated administrators of the MTA's Debt Policy. The Treasurer shall have the day-to-day responsibility and authority for structuring, implementing, and managing the MTA's debt and finance program, including the issuance of commercial paper in accordance with the Board authorized programs. The Debt Policy requires that the MTA Board specifically authorize each debt and lease financing.

III. Capital Budgeting and Debt Issuance Process

A. Capital Budgeting

1. The Capital Plan. A Capital Plan (the "CP") shall be developed for

consideration and adoption by the Board. The CP should have a planning horizon of at least a 5-year period and shall be updated at least annually. In addition to capital project costs, the CP will include the following elements:

a) Description and availability of all sources of funds
b) Timing of capital projects
c) Effect of capital projects on MTA debt burden
d) Debt service requirements

It is the MTA's current practice to include the CP in the Annual Budget for consideration and adoption.

2. Authorization for Issuance. The Board's adoption of the Annual Budget does not, in and of itself, constitute authorization for debt issuance for any capital projects. Each financing shall be presented to the Board in the context of the Annual Budget.

B. Debt Financing

1. Appropriate Use of Long-Term Debt

a) Purpose for Long-Term Debt. Long-term debt should be used to finance essential capital facilities, projects and certain equipment where it is cost effective and fiscally prudent. The scope, requirements, and demands of the Annual Budget or CP, and the ability or need to expedite or maintain the programmed schedule of approved capital projects will also be factors in the decision to issue long-term debt. Inherent in its long-term debt policies, the MTA recognizes that future taxpayers will benefit from the capital investment and that it is appropriate that they pay a share of the asset cost. Long-term debt will not be used to fund MTA operations.

b) Lease Financing. Lease obligations are a routine and appropriate means of financing capital equipment. These types of obligations should be considered where lease financing will be more beneficial, either economically or from a policy perspective. The useful life of the capital equipment, the terms and conditions of the lease, the direct impact on debt capacity and budget flexibility will be evaluated prior to the implementation of a lease program. Efforts will be made to fund capital equipment on a pay-as-you-go basis where feasible. Cash flow sufficiency, capital program requirements, lease program structures and cost, and market factors will be considered in conjunction with a pay-as-you-go strategy in lieu of lease financing. All leases providing tax-exempt financing

are subject to this policy, as are all leases, master leases and leasing programs having a cumulative value exceeding $10 million.

2. Use of Short-Term and Variable Rate Debt

a) Commercial Paper. Commercial paper is a cash management tool that the MTA uses to provide interim funding for capital expenditures that will ultimately be funded from another source such as a grant or long-term bond. The Board has previously approved the use of both the tax-exempt and taxable commercial paper programs for $350 million and $150 million, respectively. Periodic issuances or retirements of commercial paper notes within the Board approved programs do not require further Board action.

b) Tax and Revenue Anticipation Notes. Borrowing for cash flow purposes through the use of tax and revenue anticipation notes may be used to bridge temporary cash flow deficits within a fiscal year.

c) Grant Anticipation Notes. The MTA may issue short-term notes to be repaid with the proceeds of State or Federal grants if appropriate for the project and in the best interests of the MTA. Generally, grant anticipation notes will only be issued if there is no other viable source of up-front cash for the project.

d) Variable Rate Debt: It is often appropriate to issue short-term or long-term variable rate debt to diversify the debt portfolio, reduce interest costs, provide interim funding for capital projects and improve the match of assets to liabilities. The amount of unhedged variable rate debt will generally not exceed 20% of all outstanding debt, and the total of hedged and un-hedged variable rate debt will not exceed 50% of all outstanding debt . Under no circumstances will the MTA issue variable rate debt solely for the purpose of earning arbitrage. If unhedged variable rate debt is used, the MTA will periodically, but at least annually, determine whether it is appropriate to convert the debt to fixed interest rates. The MTA may issue commercial paper from time to time, but its use will generally be restricted to providing interim financing for capital projects programmed for long-term debt or grant funding.

IV. Debt Affordability Targets and Policy Limits

Target and policy maximum amounts of revenues to be used to pay debt service are listed as percentages of the respective revenue sources. These limits in combination

with the CP and multi-year planning documents ensure that the MTA will be able to continue providing its essential operational services while planning for replacement, rehabilitation and expansion of its capital investments.

Proposition A Sales Tax Revenue Debt Affordability Targets		
Category	***Allowable Uses & Status***	***Debt Policy Maximum***
Prop A Rail 35%	*Rail Operations & Capital.* Is currently committed to debt service in an amount close to the Policy Maximum.	87% of Prop A 35% Rail revenues.
Discretionary 40%	*Any transit purpose.* Current state law directs these funds to bus subsidies and incentives.	No further issuance.
Local Return 25%	*Any transit purpose.* Distributed to localities based on population.	N/A

Proposition C Sales Tax Revenue Debt Affordability Targets		
Category	***Allowable Uses & Status***	***Debt Policy Maximum***
Discretionary 40%	*Bus & Rail, Capital & Operating.*	40% of Prop C 40% Discretionary revenues.
Highway 25%	*Streets, Highways and Fixed Guideway Projects on Railroad Right-of-Way.*	60% of Prop C 25% Highway.
Commuter Rail 10%	*Commuter Rail and Park and Ride.* Operations or capital.	40% of Prop C 10% Commuter Rail.
Security 5%	*Transit Security.* Operations or capital.	No debt issuance.
Local Return 20%	*Any transit purpose and certain roadways heavily used by transit.* Distributed to	N/A

	localities based on population.	

Other Revenue Debt Affordability Targets		
Category	*Allowable Uses & Status*	*Debt Policy Maximum*
Fare Box Revenue	*Any transit purpose.*	No further issuance.
Federal Grant Revenue	*In accordance with grant.*	No further issuance.
State Grant Revenues	*In accordance with grant.*	No debt issuance.
TDA	*Various transit purposes.*	No further issuance.
Benefit Assessment Levies	*Historically to support rail construction.*	100% of levies.
Lease Revenues	*Any transit purpose.*	Limited issuance for special projects.
Other System Revenue	*Any transit purpose.*	Limited issuance for special projects.

V. Purpose of Financing

A. New Money Financing

New money issues are those financings that generate additional funding to be available for expenditure on capital projects. These funds will be used for acquisition, construction and major rehabilitation of capital assets. New money bond proceeds may not be used to fund operational activities. The funding requirement by sales tax ordinance category is determined in the context of the CP and Annual Budget. For competitive issuances, the financial advisor will recommend the financing structure based on the type of financial products to be used and in consideration of market conditions at the time of the sale.

MTA uses its commercial paper programs primarily to provide interim new money funding. Proceeds from the sale of commercial paper are used to provide interim funding for capital expenditures identified in the CP and approved Annual Budget pending receipt of grant funds or long-term bond proceeds to permanently fund those expenditures. The commercial paper notes are retired upon receipt of the grant funds or bond proceeds. The

retirement of commercial paper is most commonly a result of the issuance of long-term bonds.

B. Refunding Bonds

Refunding bonds are issued to retire all or a portion of an outstanding bond issue. Most typically this is done to refinance at a lower interest rate to reduce debt service. Alternatively, some refundings are executed for a reason other than to achieve cost savings, such as to restructure the repayment schedule of the debt, to change the type of debt instruments being used, or to retire an indenture in order to remove undesirable covenants. In any event, a present value analysis must be prepared that identifies the economic effects of any refunding being proposed to the Board. However, the target savings amounts listed below are not applicable for refunding transactions that are not solely undertaken to achieve cost savings.

The target savings amount shall be measured using either a call option pricing model or the savings as percentage of par method. When using the call option model to evaluate a refunding whose sole purpose will be to achieve cost savings, the target savings from any particular refunding candidate shall be approximately 80% of the expected value of the call option, net of all transaction expenses. The Treasurer shall have discretion in making the final determination to include individual refunding candidates that are above or below the target in order to optimize MTA policy and/or financial objectives.

Alternatively, the more traditional methodology of measuring the net present value savings as a percentage of the refunded par amount may be used with a minimum average savings of 3% for any one refunding transaction.

In the event that an interest rate swap or other derivative product is to be used as part of a refunding, the target savings shall be increased to account for any additional ongoing administrative costs, financial risk beyond that of a traditional fixed rate refunding, and loss of future financial flexibility. The call option target savings for the call option method shall be 85%, and for the percentage of par method shall be 3.5%.

VI. Types of Products

A. Current Coupon Bonds

Current coupon bonds are bonds that pay interest periodically and principal at maturity. They may be used for both new money and refunding transactions. Current coupon bonds may be structured to meet the demands of the investor and, thereby, reduce the cost of borrowing. Bond features may be adjusted to accommodate the market conditions at the time of sale, including changing the dollar amounts for annual principal maturities, offering discount and premium bond pricing, modifying the terms of the call provisions, utilizing

bond insurance and determining whether or not to cash fund the debt service reserve fund.

B Zero Coupon and Capital Appreciation Bonds

Zero coupon bonds and capital appreciation bonds have principal amortization that is much slower than level debt service resulting in increased interest expenditure over the life of the bond and, therefore, shall only be recommended in limited situations.

C. Lease Purchase Financing

Lease purchase financing represents a long-term financing lease that is suitable for financing capital expenditures, including the acquisition and/or construction of land, facilities, equipment and rolling.

1. Equipment. The MTA shall have the ability to consider lease purchase transactions, including certificates of participation, long-term vendor leases, and the use of master lease programs. Financing of equipment will be limited to contracts of at least $20,000 and a useful life that is greater than 3 years. The final maturity of equipment lease financings will be limited to the remaining useful life of the equipment.

2. Real Property. The final maturity of the financing shall not exceed the remaining useful life of the facility. A lease financing generally should not have a final maturity exceeding 30 years. Principal payments related to real property acquisition or construction are to be amortized so that there will be level debt service payments; although the MTA may also use a more rapid amortization to accelerate the repayment.

D. Derivative Products

Derivative products will be considered appropriate in the issuance or management of debt only in instances where it has been demonstrated that the derivative product will either provide a hedge that reduces risk of fluctuations in expense or revenue, or alternatively, where it will reduce total project cost. For interest rate swaps, the MTA will utilize the guidelines set forth in the Board approved Interest Rate Swap Policy. For derivatives other than interest rate swaps, the MTA will undertake an analysis of early termination costs and other conditional terms given certain financing and marketing assumptions. Such analysis will document the risks and benefits associated with the use of the particular derivative product. Derivative products will only be utilized with prior Board approval.

VII. Structural Features

A. Maturity of Debt

The final maturity of the debt shall be equal to or less than the remaining useful life of the assets being financed, and the average life of the financing shall not exceed 120% of the average life of the assets being financed.

B. Debt Service Structure

Combined principal and interest payments for any particular bond issue will be structured to have approximately level debt service payments over the life of the bond. Exceptions will occur for refunding bonds that will have varying principal repayments structured to fill in the gaps created by refunding specific principal maturities. The objective is to have level debt service in aggregate for each lien, with the debt service declining as bonds mature.

C. Lien Levels

Senior and Junior Liens for each revenue source will be utilized in a manner that will maximize the most critical constraint -- typically either cost or capacity -- thus allowing for the most beneficial use of the revenue source securing the bond.

D. Capitalized Interest

Unless otherwise required, MTA will avoid the use of capitalized interest in order to avoid unnecessarily increasing the bond size. Certain types of financings such as certificates of participation, lease-secured financings, and certain revenue bond projects may require that interest on the bonds be paid from capitalized interest until the MTA has constructive use of the project.

E. Discount and Premium Bonds

While discount and deep discount bonds may slightly reduce the interest cost of the bonds below that of non-discount bonds, the amount of discount will be structured to minimize the negative impact of discounting on MTA's ability to subsequently refund bonds for interest savings.

The MTA will also evaluate the impact of premium bonds that can be redeemed prior to maturity. The price on these bonds, and thus the amount the MTA receives, may be proportionally less in comparison to par bonds, or bonds with slight discounts or premiums. The MTA will compare the price of redeemable premium bonds to the yield savings, if any, and consider the higher potential for future refunding savings.

F. Debt Service Reserve Fund

The debt service reserve fund (the "DSRF") is generally cash funded with bond proceeds. The MTA's trustee maintains the DSRF throughout the life of the bonds. A cash funded DSRF is invested pursuant to investment of proceeds guidelines within the respective indenture and interest earnings are generally used to offset debt service payments. In the final year of the bond issue, the cash available in the DSRF is usually used to make the final debt service payment. Since a cash funded DSRF generates interest income, the MTA would have the potential to be in a financially neutral position if the interest earnings equal or exceed the interest rate of the bonds.

An alternative to having a cash funded DSRF is to use a DSRF surety policy that would be provided by an appropriately rated bond insurer. The surety policy requires an up-front fee payment to the insurer and results in a loss of future income to the DSRF. The Treasurer will evaluate and document the DSRF funding decision. Factors to be considered in this evaluation include: arbitrage yield restrictions, current interest rates, availability and cost of a surety policy, foregone interest and capital gains from a cash funded DSRF, the relative size of the reserve requirement compared to the prior reserve requirement (refunding issues only), and opportunities for the use of the funds withdrawn from the DSRF including additional capital projects or investment opportunities.

G. Amortization

The MTA will amortize its debt within each lien to achieve overall level debt service or may utilize more accelerated repayment schedules after giving consideration to bonding capacity constraints. The MTA shall avoid the use of heavily back-loaded principal repayment, bullet and balloon maturities except to achieve wrapped debt service so as to level aggregate outstanding debt service.

H. Financial and Risk Analysis of Issuance

Net present value cost analysis, assessment of structural risks and complexities, and consideration of restrictions to future financing flexibility will be assessed and documented to determine the most efficient bond type and structuring features. The MTA's long-term pooled investment rate will be used as the discount rate when comparing alternatives.

I. Call Provisions

In general, MTA securities will not include a non-call feature which is longer than 10 years. However, if determined to be financially advantageous, MTA may issue non-callable bonds for maturities longer than 10 years. Prior to the use of any non-call provision, the MTA will compare the option-adjusted yields

on the bonds with and without a non-call provision to determine which is most financially beneficial.

J. Credit Enhancement

1. Bond insurance. Bond insurance will be used when it provides an economic advantage to a particular bond maturity or entire issue. Bond insurance provides improved credit quality for the bonds as a result of the insurance provider's guarantee of the payment of principal and interest on the bonds. Because of the decreased risk of non-payment, investors are willing to purchase bonds with lower yields than uninsured bonds, thus providing the issuer with interest cost savings.

    a) Benefit analysis. The decision to use bond insurance is an economic decision. The analysis compares the present value of the interest savings to the cost of the insurance premium. Insurance will be purchased when the premium cost is less than the present value of the projected interest savings.

    b) Provider selection. The financial advisor will undertake a competitive selection process when soliciting pricing for bond insurance, or in the case of a competitive sale, facilitate the pre-qualification of bonds by insurance providers. MTA recognizes that all providers may not be interested in providing bids to the MTA or pre-qualifying the issue. The winning underwriter in a competitive sale will determine whether it will purchase insurance for the issue. For a negotiated sale, the Treasurer shall have the authority to purchase bond insurance when deemed advantageous and the terms and conditions governing the guarantee are satisfactory

2. Letters of Credit. When used for credit enhancement, letters of credit ("LOC") represent a bank's promise to pay principal and interest when due for a defined period of time, and subject to certain conditions. In the case of a direct pay LOC, the trustee can draw upon the letter of credit to make debt service payments. A stand-by LOC can be used to ensure the availability of funds to pay principal and interest of an obligation.

    a) Liquidity Facility. The issuance of most variable rate debt, including variable rate demand bonds and commercial paper requires the use of a liquidity facility.

    b) Provider selection. The financial advisor will conduct a competitive process to recommend a letter of credit provider. The Treasurer will obtain contract approval in accordance with established dollar award policies. Only those banks with long-term ratings greater than or equal to that of the MTA, and

short-term ratings of P-1/A-1, by Moody's Investors Service and Standard & Poor's, respectively, may be solicited.

c) Selection criteria will include, but not be limited to the following:
   (1) the bank(s) has long-term ratings at least equal to or better than the MTA's;
   (2) the bank(s) has short-term ratings of P-1/A-1;
   (3) the bank's acceptance of terms and conditions acceptable to the MTA. MTA will provide a term sheet along with the request for qualifications to which the banks will highlight modifications;
   (4) review of representative list of clients for whom the bank has provided liquidity facilities;
   (5) evaluation of fees; specifically, cost of LOC, draws, bank counsel and other administrative charges and estimate of trading differential cost.

VIII. Documentation of Transactions

The decision processes used in each financing process will be fully documented. The documentation will capture information regarding the selection of the financing team, decisions on product selection and structuring features, selection of vendors providing ancillary services and selection of investment securities or products. This information will be compiled into a post-pricing book "transaction file" which will be retained for each financing.

IX. Credit Objectives

The MTA will actively seek to:

1. Maintain and improve the credit ratings of its outstanding bonds.
2. Adhere to benchmarks, overall debt ratios and affordability targets.
3. Have frequent communications with the credit rating agencies.

X. Method of Bond Sale

A. The MTA will utilize a competitive sale process when it will provide the lowest interest cost for the bond. However, there are three methods of sale: competitive, negotiated and private placement. Each type of bond sale has the potential to provide the lowest cost given the right conditions. The conditions under which each type of bond sale is best used are provided below.

1. *Competitive Sale*
   a) Bond prices are stable and/or demand is strong.
   b) Market timing and interest rate sensitivity are not critical to the pricing.

c) Participation from DBE / SBE firms is best efforts only and not required for winning bid.
d) Issuer has a strong credit rating.
e) Issuer is well known to investors.
f) There are no complex explanations required during marketing regarding the issuer's projects, media coverage, political structure, political support, funding, or credit quality.
g) The bond type and structural features are conventional.
h) Bond insurance is included or pre-qualified (available).
i) Manageable transaction size.

2. *Negotiated Sale*
   a) Bond prices are volatile.
   b) Demand is weak or supply of competing bonds is high.
   c) Market timing is important, such as for refundings.
   d) Coordination of multiple components of the financing is required.
   e) Participation from DBE / SBE firms is enhanced.
   f) Issuer has lower or weakening credit rating.
   g) Issuer is not well known to investors.
   h) Sale and marketing of the bonds will require complex explanations about the issuer's projects, media coverage, political structure, political support, funding, or credit quality.
   i) The bond type and/or structural features are non-standard, such as for a forward delivery bond sale, issuance of variable rate bonds or where there is use of derivative products.
   j) Bond insurance is not available or not offered.
   k) Early structuring and market participation by underwriters are desired.
   l) The par amount for the transaction is significantly larger than normal.
   m) Demand for the bonds by retail investors is expected to be high.

3. *Private Placement* is a sale that is structured specifically for one purchaser such as a bank. While the MTA has not previously used this method of sale, the MTA reserves to the right to place its securities privately if the need arises.

XI. Investment of Bond Proceeds

A. Purchase and Sale of Investments. The MTA shall competitively bid the purchase of securities, investment agreements, float contracts, forward purchase contracts and any other investment products used to invest bond proceeds. The MTA shall comply with all applicable Federal, State, and contractual restrictions regarding the use and investment of bond proceeds. This includes compliance with restrictions on the types of investment securities allowed, restrictions on the allowable yield of some invested funds

as well as restrictions on the time period over which some bond proceeds may be invested. The MTA Treasurer may direct the investment of bond and lease proceeds in accordance with the permitted investments for any particular bond issue or lease. Providers of structured investment products and professional services required to implement the product or agreement, will be recommended based on a competitive process conducted by the financial advisor.

B. Diversification. The MTA shall diversify invested proceeds in order to reduce risk exposure to providers, types of investment products and types of securities held.

C. Disclosure. The MTA will require that all fees resulting from investment services or sale of products to the MTA be fully disclosed to ensure that there are no conflicts of interest and investments are being purchased at a fair market price. Underwriters of the bonds, but not the financial or investment advisor, may bid on the sale of investment products for the proceeds. The financial or investment advisor shall document the bidding process and results and shall certify in writing that the MTA received a competitive and fair market price on the investments based on the bidding process.

XII. Market Relationships

A. Rating Agencies and Investors. The Deputy Chief Executive Officer and the Chief Financial Officer shall be primarily responsible, along with the Executive Officer – Finance and Treasurer, for maintaining the MTA's relationships with Moody's Investors Service, Standard & Poor's and Fitch IBCA. In addition to general communications, the Deputy Chief Executive Officer and the Chief Financial Officer, or their appropriate designees, shall: 1) meet with each agency's credit analyst at least once each fiscal year, and 2) communicate with each agency's analysts prior to each competitive or negotiated sale.

B. Board Communication. As a means of providing feedback from rating agencies and/or investors regarding the MTA's financial strengths and weaknesses as perceived by the market place, information will be provided to the Board by Board Box Report as material information develops.

XIII. Continuing Disclosure

It is the policy of the MTA to remain in compliance with Rule 15c2-12 by filing its annual financial statements and other financial and operating data for the benefit of its bondholders within 195 days of the close of the fiscal year.

XIV. Consultants

The MTA will select its financial advisor(s) and its bond counsel by competitive process through a Request for Proposals (RFP). The MTA's contracting policies that are in effect at the time will apply to the contracts with finance professionals. Selection may be based on a best value approach for professional services or the lowest responsive cost effective bid based upon pre-determined criteria.

A. Financial Advisor. The MTA will select a financial advisor (or advisors) to assist in the debt issuance and debt administration processes. Additionally, the financial advisor will conduct competitive processes to recommend providers of financial services including investment management, investment measurement, and custody services. Selection of the MTA's financial advisor(s) should be based on the following:

1. Experience in providing consulting services to complex issuers.
2. Knowledge and experience in structuring and analyzing complex issues.
3. Ability to conduct competitive selection processes to obtain investment products and financial services.
4. Experience and reputation of assigned personnel.
5. Fees and expenses.

Financial advisory services provided to the MTA shall include, but shall not be limited to the following:

1. Evaluation of risks and opportunities associated with debt issuance.
2. Monitoring of the debt portfolio and bond proceeds investments to alert MTA to opportunities to refund or restructure bond issues or modify investments.
3. Evaluation and recommendation regarding proposals submitted to the MTA by investment banking firms.
4. Structuring and pricing bond issues, financial instruments and investments.
5. Preparation of requests for proposals and selection of providers for investment products, financial products and financial services (trustee and paying agent services, printing, credit facilities, remarketing agent services, investment management services, custody services etc.).
6. Provide advice, assistance and preparation for presentations with rating agencies and investors.

B. Bond Counsel. MTA debt will include a written opinion by legal counsel affirming that the MTA is authorized to issue the proposed debt, that the MTA has met all constitutional and statutory requirements necessary for issuance, and a determination of the proposed debt's federal income tax status. A nationally recognized bond counsel firm with extensive experience in public finance and tax issues will prepare this approving opinion and other

documents relating to the issuance of debt. The counsel will be selected from the pool of bond counsel firms.

C. Disclosure Counsel. The MTA will hire, when appropriate, Disclosure Counsel to prepare official statements in the event of a competitive sale. Disclosure Counsel will be responsible for ensuring that the official statement complies with all applicable rules regulations and guidelines. Disclosure Counsel will be a nationally recognized firm with extensive experience in public finance. The counsel will be selected from the pool of bond counsel firms.

D. Disclosure by Financing Team Members.
The MTA expects that all of its financial advisory team will at all times provide the MTA with objective advice and analysis, maintain the confidentiality of MTA financial plans, and be free from any conflicts of interest. All financing team members will be required to provide full and complete disclosure, under penalty of perjury, relative to any and all agreements with other financing team members and outside parties that could compromise any firm's ability to provide independent advice that is solely in the best interests of the MTA or that could be perceived as a conflict of interest. The extent of disclosure may vary depending on the nature of the transaction.

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Attachment B

MTA Interest Rate Swap Policy

MTA
INTEREST RATE SWAP POLICY

June 2004

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MTA
INTEREST RATE SWAP POLICY

I. Introduction

The purpose of the Interest Rate Swap Policy of the Los Angeles County Metropolitan Transportation Authority (MTA) is to establish guidelines for the use and management of interest rate swaps. The Interest Rate Swap Policy is prepared in accordance with the recommended practices of the Government Finance Officers Association regarding the contents of a derivatives policy published in 2003.

The MTA is authorized under California Government Code Section 5922 to enter into interest rate swaps to reduce the amount and duration of rate, spread, or similar risk when used in combination with the issuance of bonds.

II. Scope and Authority

This Interest Rate Swap Policy shall govern the MTA's use and management of all interest rate swaps. While adherence to this Policy is required in applicable circumstances, the MTA recognizes that changes in the capital markets, agency programs, and other unforeseen circumstances may from time to time produce situations that are not covered by the Interest Rate Swap Policy and will require modifications or exceptions to achieve policy goals. In these cases, management flexibility is appropriate provided specific authorization from the Board is obtained.

In conjunction with the MTA's Debt Policy, the Interest Rate Swap Policy shall be reviewed and updated at least annually and presented to the Board for approval. The Chief Executive Officer, Chief Financial Officer, and Executive Officer – Finance and Treasurer are the designated administrators of the MTA's Interest Rate Swap Policy. The Treasurer shall have the day-to-day responsibility and authority for structuring, implementing, and managing interest rate swaps.

The MTA Board shall approve any transaction involving an interest rate swap. The MTA shall be authorized to enter into interest rate swap transactions only with qualified swap counterparties. The Treasurer, in consultation with the Chief Executive Officer, Chief Financial Officer, and MTA Counsel, shall have the authority to select the counterparties, so long as the criteria set forth in the Interest Rate Swap Policy are met.

III. Conditions for the Use of Interest Rate Swaps

A. General Usage

The MTA will use swaps to lock-in a fixed rate or, alternatively, to create additional variable rate exposure. Interest Rate Swaps may be used to produce interest rate savings, limit or hedge variable rate payments, alter the pattern of debt service payments, or for asset/liability matching purposes.

In connection with the use of any swaps, the MTA's Board shall make a finding that the authorized swaps will be used to alter interest rate risk and/or alter the cost of borrowing in a beneficial manner, and when used in combination with new or outstanding bonds, will enhance the relationship between risk and return, or achieve other policy objectives of the MTA.

B. Maximum Notional Amount

The MTA will limit the total notional amount of outstanding interest rate swaps based on criteria set forth in this Interest Rate Swap Policy regarding the proper management of risks, calculation of termination exposure, and development of a contingency plan for mandatory termination.

C. Liquidity Considerations

The MTA shall consider the impact on the availability and cost of liquidity support for the new and existing MTA variable rate programs when evaluating the issuance of new variable rate bonds. requiring liquidity support The MTA recognizes that there is a limited supply of letter of credit or liquidity facility support for MTA variable rate bonds, and the usage of liquidity support in connection with an interest rate swap may result in higher overall costs.

D. Call Option Value Considerations

When considering the relative advantage of an interest rate swap to fixed rate bonds, the MTA, among other things, will consider the value of the call option on fixed rate bonds relative to the present value of the savings from using a swap. Unless a call option is purchased with the swap, all value derived from the ability to call bonds at a future date is foregone. Typically, MTA sells bonds that are callable after 10 years and could be refunded at that time. When entering into a swap, MTA will evaluate the cost of including a call option and purchase it whenever practical in order to retain future financial flexibility, including the ability to subsequently refund the bonds for savings.

IV. Interest Rate Swap Features

A. Interest Rate Swap Agreement

The MTA will use terms and conditions as set forth in the International Swap and Derivatives Association, Inc. ("ISDA") Master Agreement. The swap agreement between the MTA and each counterparty shall include payment, term, security, collateral, default, remedy, termination, and other terms, conditions, provisions and safeguards as the MTA, in consultation with its legal counsel, financial advisor and/or swap advisor deems necessary or desirable.

Subject to the provisions contained herein, the terms of any MTA swap

agreement shall use the following guidelines:

i. Downgrade provisions triggering termination shall in no event be worse than those affecting the counterparty.
ii. Governing law for swaps will be either New York or California.
iii. The specified indebtedness related to credit events in any swap agreement should be narrowly defined and refer only to indebtedness of the MTA that could have a materially adverse effect on MTA's ability to perform its obligations under the swap. Debt should typically only include obligations within the same lien as the swap obligation.
iv. Collateral thresholds stipulating when collateral will be required to be posted by the swap provider are designated in the policy and are based on credit ratings of the swap provider. Collateral requirements setting out the amount and types of collateral will be established for each swap based upon the credit ratings of the swap provider and any guarantor.
v. Collateral should be held by an independent third party.
vi. Eligible collateral should generally be limited to U.S. Treasury securities and obligations of Federal Agencies where the principal and interest are guaranteed by the full faith and credit of the United States government. At the discretion of the Treasurer, other high-quality obligations of Federal agencies, not secured by the full faith and credit of the U.S. government, may be used as collateral.
vii. MTA shall have the right to optionally terminate a swap agreement at "market," at any time over the term of the agreement.
viii. Termination value should be set by a "market quotation" methodology, unless MTA deems an alternate methodology appropriate.

B. Interest Rate Swap Counterparties

1. Credit Criteria

The MTA will make its best efforts to work with qualified swap counterparties that have a general credit rating of: (i) at least "Aa3" or "AA-" by at least one of the three nationally recognized rating agencies identified in this policy and not rated lower than "A2" or "A" by any of the nationally recognized rating agencies, or (ii) have a "AAA" subsidiary that is appropriately rated by at least one nationally recognized credit rating agency. The nationally recognized rating agencies are Moody's Investors Services, Inc., Standard and Poor's Rating Services, and Fitch Ratings.

For lower rated counterparties whose highest rating from any of the three nationally recognized firms is below "AA-" or "Aa3", the MTA will seek credit enhancement in the form of:

i. Contingent credit support or enhancement;
ii. Collateral consistent with the policies contained herein;
iii. Ratings downgrade triggers;

iv. Guaranty of parent, if any.

In addition, qualified swap counterparties must have a demonstrated record of successfully executing swap transactions as well as creating and implementing innovative ideas in the swap market.

2. Counterparty Termination Exposure

In order to diversify MTA's counterparty credit risk, and to limit MTA's credit exposure to any one counterparty, the MTA will compute the "Maximum Net Termination Exposure" prior to executing a swap.

"Maximum Net Termination Exposure" is the aggregate termination payment for all existing and projected swap transactions that would be paid by or received from a specific counterparty, parent or guarantor. For purposes of this calculation, the aggregate termination payment is equal to: (i) the termination payment based on the market value of all existing swaps as of the first business day of the month prior to the execution of any proposed transaction, plus (ii) the expected worst-case termination payment of the proposed transaction. The expected worst-case termination payment shall be calculated assuming interest rates, as measured by the Bond Buyer Revenue Bond Index, increased (or decreased) by two standard deviations from the sample mean over the last 10 years.

The following chart provides the Maximum Net Termination Exposure to a swap counterparty based on the lowest credit rating assigned by any of the three nationally recognized rating agencies.

Credit Rating	Maximum Collateralized Exposure	Maximum Uncollateralized Exposure	Maximum Total Termination Exposure
AAA	Not applicable	$40 million	$40 million
AA	$30 million	$10 million	$40 million
Below AA	$30 million	None	$30 million

C. Term and Notional Amount

In connection with the issuance or carrying of bonds, the term of the swap agreement shall not extend beyond the final maturity date of the related bonds. The total "net notional amount" of all swaps related to a bond issue should not exceed the amount of outstanding bonds. For purposes of calculating the net notional amount, credit shall be given in situations where there are off-setting fixed rate and variable rate swaps.

D. Collateral Requirements

As part of any swap agreement, the MTA will seek to include terms imposing collateral requirements based on credit ratings of the counterparty, requiring

collateralization or other forms of credit enhancements to secure any or all swap payment obligations. MTA will determine the collateral requirements in consultation with its counsel, financial advisor and/or swap advisor. and may require the posting of securities, surety bonds, letters of credit or other credit enhancement if the highest credit rating of the counterparty, parent, or guarantor falls below a rating of "AA-" or "Aa2". Additional collateral for further decreases in credit ratings of each counterparty shall be posted by each counterparty in accordance with the provisions contained in the collateral support agreement to each counterparty with the MTA.

Threshold collateral amounts shall be determined by the MTA on a case-by-case basis. The MTA will determine the reasonable threshold limits for the initial deposit and for increments of collateral posting thereafter. Collateral shall be deposited with a third party trustee, or as mutually agreed upon between the MTA 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 during negotiation of the swap agreement with each swap counterparty. The market value of the collateral shall be determined on a monthly basis, or more frequently if the MTA determines it is in its best interest given the specific nature of the swap(s) and/or collateral security.

E. Security and Source of Repayment

The MTA will generally use the same security and source of repayment (pledged revenues) for interest rate swaps as is used for the bonds that are hedged or carried by the swap, if any, but shall consider the economic costs and benefits of subordinating the MTA's payments under the swap and/or termination payment.

F. Prohibited Interest Rate Swap Features

The MTA will not use interest rate swaps that: (i) are speculative or create extraordinary leverage or risk, (ii) lack adequate liquidity to terminate without incurring a significant bid/ask spread, (iii) provide insufficient price transparency to allow reasonable valuation, (iv) are used as investments.

V. Evaluation and Management of Interest Rate Swap Risks

Prior to the execution of any swap transaction, the Chief Financial Officer, the Treasurer, and MTA's Financial/Swap Advisor and Bond Counsel shall evaluate the proposed transaction and report the findings to the MTA Board. Such a review shall include the identification of the proposed benefit and potential risks. As part of this evaluation, the MTA shall compute the Maximum Net Termination Exposure to the proposed swap counterparty.

A. Evaluation Methodology

The MTA will review the following areas of potential risk for new and existing interest rate swaps:

Type of Risk	Description	Evaluation Methodology
Basis risk	The mismatch between actual variable rate debt service and variable rate indices used to determine swap payments.	The MTA will review historical trading differentials between the variable rate bonds and the index.
Tax risk	The risk created by potential tax events that could affect swap payments.	The MTA will review the tax events in proposed swap agreements. The MTA will evaluate the impact of potential changes in tax law on LIBOR indexed swaps.
Counterparty risk	The failure of the counterparty to make required payments or otherwise comply with the terms of the swap agreement.	The MTA will monitor exposure levels, ratings thresholds, and collateralization requirements.
Termination risk	The risk that there will be a mandatory termination of the swap. A termination will almost always result in MTA either owing or being due to receive a termination payment.	The MTA will compute its termination exposure for all existing and proposed swaps at market value and under an expected worst-case scenario. A contingency plan will be periodically updated specifying how MTA would finance a termination payment and/or replace the hedge.
Rollover risk	The mismatch of the maturity of the swap and the maturity of the underlying bonds.	The MTA will determine, in accordance with its Debt Policy, its capacity to issue variable rate bonds that may be outstanding after the maturity of the swap.
Liquidity risk	The inability to continue or renew a liquidity facility supporting the	The MTA will evaluate the expected availability of liquidity support for

	variable rate bonds that are being hedged.	hedged (swapped) and unhedged variable rate debt.
Credit risk	The occurrence of an event modifying the credit quality or credit rating of the issuer or its counterparty.	The MTA will monitor the ratings of its counterparties, insurers, and guarantors.

B. Managing Interest Rate Swap Risks

1. Annual Report to Board

The MTA will evaluate the risks associated with outstanding interest rates swaps at least annually and provide a written report to the MTA Board of the findings. This evaluation will include the following information:

i. A description of all outstanding interest rate swaps, including related bond series, types of swaps, rates paid and received by MTA, existing notional amount, the average life and remaining term of each swap agreement, and the current termination value of all outstanding swaps.
ii. Separately for each swap, the actual debt service requirements versus the projected debt service on the swap transaction; and for any swaps used as part of a refunding, the actual cumulative savings versus the projected savings at the time the swap was executed.
iii. The credit rating of each swap counterparty, parent, guarantor, and credit enhancer insuring swap payments, if any.
iv. Actual collateral posting by swap counterparty, if any, per swap agreement and in total by swap counterparty.
v. Information concerning any material event involving outstanding swap agreements, including a default by a swap counterparty, counterparty downgrade, or termination.
vi. An updated contingency plan to replace, or fund a termination payment in the event an outstanding swap is terminated.
vii. The status of any liquidity support used in connection with interest rate swaps, including the remaining term and current fee.

The MTA shall update the Interest Rate Swap Policy at least annually and submit the update to the MTA Board for approval.

2. Contingency Plan for Mandatory Termination

The MTA shall compute the termination exposure of each of its swaps and its total swap termination payment exposure at least annually and prepare a contingency plan to either replace the swaps or fund the termination payments, if any, in the event one or more outstanding swaps are terminated. The MTA shall assess its ability to obtain replacement swaps and identify

revenue sources to fund potential termination payments.

C. Terminating Interest Rate Swaps

1. Optional Termination

The MTA, in consultation with its counsel, financial advisor and/or swap advisor, may terminate a swap if it is determined that it is financially advantageous, or will further other policy objectives, such as management of exposure to swaps or variable rate debt.

2. Mandatory Termination

In the event a swap is terminated as a result of a termination event, such as a default or a decrease in credit rating of either the MTA or the counterparty, the MTA will evaluate whether it is financially advantageous to obtain a replacement swap, or, depending on market value, make or receive a termination payment.

In the event the MTA makes a swap termination payment, the MTA shall attempt to follow the process identified in its contingency plan for mandatory termination. The MTA shall also evaluate the economic costs and benefits of incorporating a provision into the swap agreement that will allow the MTA to make termination payments over time.

VI. Selecting and Procuring Interest Rate Swaps

A. Financing Team

The MTA will retain the services of a nationally recognized municipal bond counsel firm, and will consider the use of a qualified financial advisor and/or swap advisor for all interest rate swaps.

B. Underwriter Selection

In the event bonds are issued in connection with interest rate swaps, the MTA will price the bonds according to the guidelines set forth in its approved Debt Policy.

C. Counterparty Selection

The MTA will utilize a competitive bidding process to select a swap counterparty and price a swap when that process will provide the lowest financing cost. The MTA may use a negotiated process to select a swap counterparty and price a swap when it believes market or competitive conditions justify such a process. The conditions under which a negotiated selection is best used are provided below.

i. Marketing of the swap will require complex explanations about the security for repayment or credit quality.
ii. Demand is weak among swap counterparties.
iii. Market timing is important, such as for refundings.
iv. Coordination of multiple components of the financing is required.
v. Participation from DBE / SBE firms is desired.
vi. The swap has non-standard features, such as being a forward starting swap.
vii. Bond or swap insurance is not available or not offered.
viii. The par or notional amount for the transaction is significantly larger than a typical transaction for that market..

VII. Disclosure and Financial Reporting

The MTA will take steps to ensure that there is full and complete disclosure of all interest rate swaps to the MTA Board, to rating agencies, and in disclosure documents. Disclosure in marketing documents shall provide a clear summary of the special risks involved with swaps and any potential exposure to interest rate volatility or unusually large and rapid changes in market value. With respect to its financial statements, the MTA will adhere to the guidelines for the financial reporting of interest rate swaps, as set forth by the Government Accounting Standards Board.

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Glossary of Terms

Asset/Liability Matching Matching the term and amount of assets and liabilities in order to mitigate the impact of changes in interest rates.

Bid/Ask Spread The difference between the bid price (at which a market maker is willing to buy) and the ask price (at which a market maker is willing to sell).

Call Option The right to buy an underlying asset (e.g. a municipal bond) after a certain date and at a certain price. A call option is frequently embedded in a municipal bond, giving the issuer the right to buy, or redeem, the bonds at a certain price.

Collateral Assets pledged to secure an obligation. The assets are potentially subject to seizure in the event of default.

Downgrade A negative change in credit ratings.

Forward Starting Swap Interest rate swaps that start at some time in the future. Used to lock-in current interest rates.

Hedge A transaction that reduces the interest rate risk of an underlying security.

Interest Rate Swap The exchange of a fixed interest rate and a floating interest rate between counterparties.

Liquidity Support An agreement by a bank to make payment on a variable rate security to assure investors that the security can be sold.

LIBOR The London Interbank Offer Rate. Used as an index to compute the variable rate on an interest rate swap.

Notional Amount The amount used to determine the interest payments on a swap.

Termination Payment A payment made by a counterparty that is required to terminate the swap. The payment is commonly based on the market value of the swap, which is computed using the rate on the initial swap and the rate on a replacement swap.

Attachment C

MTA Debt Policy (Marked to Show Changes)

MTA
DEBT POLICY

I. Introduction

The purpose of the Debt Policy of the Los Angeles County Metropolitan Transportation Authority (MTA) is to establish guidelines for the issuance and management of the MTA's debt. This Debt Policy confirms the commitment of the Board, management, staff, advisors and other decision makers to adhere to sound financial management practices, including full and timely repayment of all borrowings, and achieving the lowest possible cost of capital within prudent risk parameters. Priorities of the Debt Policy are as follows:

1. Achieve the lowest cost of capital
2. Maintain a prudent level of financial risk
3. Preserve future financial flexibility
4. Maintain strong credit ratings and good investor relations

II. Scope and Authority

This Debt Policy shall govern, except as otherwise covered by the MTA Investment Policy, Defeased Lease Policy or Interest Rate Swap Policy, the issuance and management of all debt and lease financings funded from the capital markets, including the selection and management of related financial services and products, and investment of bond and lease proceeds.

While adherence to this Policy is required in applicable circumstances, the MTA recognizes that changes in the capital markets, agency programs and other unforeseen circumstances may from time to time produce situations that are not covered by the Policy and will require modifications or exceptions to achieve policy goals. In these cases, management flexibility is appropriate, provided specific authorization from the Board is obtained.

The MTA's Debt Policy shall be reviewed and updated at least annually and presented to the Board for approval. The Chief Executive Officer, Chief Financial Officer and Executive Officer – Finance and Treasurer are the designated administrators of the MTA's Debt Policy. The Treasurer shall have the day-to-day responsibility and authority for structuring, implementing, and managing the MTA's debt and finance program, including the issuance of commercial paper in accordance with the Board authorized programs. The Debt Policy requires that the MTA Board specifically authorize each debt and lease financing.

III. Capital Budgeting and Debt Issuance Process

A. Capital Budgeting

1. The Capital Plan. A Capital Plan (the "CP") shall be developed for consideration and adoption by the Board. The CP should have a planning horizon of -at least a 5-year period and shall be updated at least annually. In addition to capital project costs, the CP will include the following elements:

   a) Description and availability of all sources of funds
   b) Timing of capital projects
   c) Effect of capital projects on MTA debt burden
   d) Debt service requirements

   It is the MTA's current practice to include the CP in the Annual Budget for consideration and adoption.

2. Authorization for Issuance. The Board's adoption of the Annual Budget does not, in and of itself, constitute authorization for debt issuance for any capital projects. Each financing shall be presented to the Board in the context of the Annual Budget.

B. Debt Financing

1. Appropriate Use of Long-Term Debt

   a) Purpose for Long-Term Debt.÷ Long-term debt should be used to finance essential capital facilities, projects and certain equipment where it is cost effective and fiscally prudent. The scope, requirements, and demands of the Annual Budget or CP, and the ability or need to expedite or maintain the programmed schedule of approved capital projects will also be factors in the decision to issue long-term debt. Inherent in its long-term debt policies, the MTA recognizes that future taxpayers will benefit from the capital investment and that it is appropriate that they pay a share of the asset cost. Long-term debt will not be used to fund MTA operations.

   b) Lease Financing.÷ Lease obligations are a routine and appropriate means of financing capital equipment. These types of obligations should be considered where lease financing will be more beneficial, either economically or from a policy perspective. The useful life of the capital equipment, the terms and conditions of the lease, the direct impact on debt capacity and budget flexibility will be evaluated prior to the implementation of a lease program. Efforts will be made to fund capital equipment on a pay-as-you-go basis where feasible. Cash_flow sufficiency, capital program requirements, lease program structures and cost, and market factors will be considered in conjunction with a pay-as-you-go strategy in

lieu of lease financing. All leases providing tax-exempt financing are subject to this policy, as are all leases, master leases and leasing programs having a cumulative value exceeding $10 million.

2. Use of Short-Term and Variable Rate Debt

a) Commercial Paper.: Commercial paper is a cash management tool that the MTA uses to provide interim funding for capital expenditures that will ultimately be funded from another source such as a grant or long-term bond. The Board has previously approved the use of both the tax-exempt and taxable commercial paper programs for $350 million and $150 million, respectively. Periodic issuances or retirements of commercial paper notes within the Board approved programs do not require further Board action.

b) Tax and Revenue Anticipation Notes.: Borrowing for cash flow purposes through the use of tax and revenue anticipation notes may be used to bridge temporary cash flow deficits within a fiscal year.

c) Grant Anticipation Notes.: The MTA may issue short-term notes to be repaid with the proceeds of State or Federal grants if appropriate for the project and in the best interests of the MTA. Generally, grant anticipation notes will only be issued if there is no other viable source of up-front cash for the project.

d) Variable Rate Debt: It is often appropriate to issue short-term or long-term variable rate debt to diversify the debt portfolio, reduce interest costs, provide interim funding for capital projects and improve the match of assets to liabilities. The amount of unhedged variable rate debt will generally not exceed 20% of all outstanding debt, and the total of hedged and un-hedged variable rate debt will not exceed 50% of all outstanding debt. Under no circumstances will the MTA issue variable rate debt solely for the purpose of earning arbitrage. If unhedged variable rate debt is used, the MTA will periodically, but at least annually, determine whether it is appropriate to convert the debt to fixed interest rates. The MTA may issue commercial paper from time to time, but its use will generally be restricted to providing interim financing for capital projects programmed for long-term debt or grant funding.

IV. Debt Affordability Targets and Policy Limits

Target and policy maximum amounts of revenues to be used to pay debt service are listed as percentages of the respective revenue sources. These limits in combination with the CP and multi-year planning documents ensure that the MTA will be able to continue providing its essential operational services while planning for replacement, rehabilitation and expansion of its capital investments.

Proposition A Sales Tax Revenue Debt Affordability Targets		
Category	***Allowable Uses & Status***	***Debt Policy Maximum***
Prop A Rail 35%	*Rail Operations & Capital.* Is currently committed to debt service in an amount close to the Policy Maximum.	87% of Prop A 35% Rail revenues.
Discretionary 40%	*Any transit purpose.* Current state law directs these funds to bus subsidies and incentives.	No further issuance.
Local Return 25%	*Any transit purpose.* Distributed to localities based on population.	N/A

Proposition C Sales Tax Revenue Debt Affordability Targets		
Category	***Allowable Uses & Status***	***Debt Policy Maximum***
Discretionary 40%	*Bus & Rail, Capital & Operating.*	40% of Prop C 40% Discretionary revenues.
Highway 25%	*Streets, Highways and Fixed Guideway Projects on Railroad Right-of-Way.*	60% of Prop C 25% Highway.
Commuter Rail 10%	*Commuter Rail and Park and Ride.* Operations or capital.	40% of Prop C 10% Commuter Rail.
Security 5%	*Transit Security.* Operations or capital.	No debt issuance.
Local Return 20%	*Any transit purpose and certain roadways heavily used by transit.* Distributed to localities based on population.	N/A

Other Revenue Debt Affordability Targets		
Category	***Allowable Uses & Status***	***Debt Policy Maximum***
Fare Box Revenue	*Any transit purpose.*	No further issuance.
Federal Grant Revenues	*In accordance with grant.*	No further issuance.
State Grant Revenues	*In accordance with grant.*	No debt issuance.
TDA	*Various transit purposes.*	No further issuance.
Benefit Assessment Levies	*Historically to support rail construction.*	100% of levies.
Lease Revenues	*Any transit purpose.*	Limited issuance for special projects.
Other System Revenues	*Any transit purpose.*	Limited issuance for special projects.

V. Purpose of Financing

A. New Money Financing

New money issues are those financings that generate additional funding to be available for expenditure on capital projects. These funds will be used for acquisition, construction and major rehabilitation of capital assets. New money bond proceeds may not be used to fund operational activities. The funding requirement by sales tax ordinance category is determined in the context of the CP and Annual Budget. For competitive issuances, the financial advisor will recommend the financing structure based on the type of financial products to be used and in consideration of market conditions at the time of the sale.

MTA uses its commercial paper programs primarily to provide interim new money funding. Proceeds from the sale of commercial paper are used to provide interim funding for capital expenditures identified in the CP and approved Annual Budget pending receipt of grant funds or long-term bond proceeds to permanently fund those expenditures. The commercial paper notes are retired upon receipt of the grant funds or bond proceeds. The retirement of commercial paper is most commonly a result of the issuance of long-term bonds.

B. Refunding Bonds

Refunding bonds are issued to retire all or a portion of an outstanding bond issue. Most typically this is done to refinance ~~to~~at a lower interest rate to reduce debt service. Alternatively, some refundings are executed for a reason other than ~~economic purposes~~ to achieve cost savings, such as to restructure the repayment schedule of the debt, to change the type of debt instruments being used, or to retire an indenture in order to remove undesirable covenants. In any event, a present value analysis must be prepared that identifies the economic effects of ~~the~~ any refunding being proposed to the Board. However, the target savings amounts listed below are not applicable for refunding transactions that are not solely undertaken to achieve cost savings.

The target savings amount shall be measured using either a call option pricing model or the savings as percentage of par method. When using the call option model to evaluate a refunding whose sole purpose will be to achieve cost savings, the target savings from any particular refunding candidate shall be ~~in the range of~~ approximately 80% of the expected value of the call option, net of all transaction expenses. The Treasurer shall have discretion in making the final determination to include individual refunding candidates that are above or below the target in order to optimize MTA policy and/or financial objectives.

Alternatively, the more traditional methodology of measuring the net present value savings as a percentage of the refunded par amount may be used with a minimum average savings of 3% for any one refunding transaction.

In the event that an interest rate swap or other derivative product is ~~are~~ to be used as part of a refunding, the target savings shall be increased to account for any additional ongoing administrative costs, financial risk beyond that~~ose~~ of a traditional fixed rate refunding, and loss of future financial flexibility. The call option target savings for the call option method shall be 85%, and for the percentage of par method shall be 3.5%. ~~The MTA will attempt to quantify the risks of a particular derivative based on the cost of offsetting or hedging transactions that would substantially eliminate the risks, and will add these costs to the target savings.~~

VI. Types of Products

A. Current Coupon Bonds

Current coupon bonds are bonds that pay interest periodically and principal at maturity. They may be used for both new money and refunding transactions. Current coupon bonds may be structured to meet the demands of the investor and, thereby, reduce the cost of borrowing. Bond ~~F~~features may be adjusted to accommodate the market conditions at the time of sale, including ~~such as~~

changing the dollar amounts for annual principal maturities, offering ~~the use of~~ discounts and premium bond pricing, ~~maturity of the debt,~~ modifying the terms ~~the parameters~~ of the call provisions, utilizing bond insurance and determining whether or not to cash funded the debt service reserve fund ~~or surety DSRF are adjusted to the market conditions at the time of sale~~.

B Zero Coupon and Capital Appreciation Bonds

Zero coupon bonds and capital appreciation bonds have principal amortization that is much slower than level debt service resulting in increased interest expenditure over the life of the bond and, therefore, shall only be recommended in limited situations.

C. Lease Purchase Financing

Lease purchase financing represents a long-term financing lease that is suitable for financing capital expenditures, including ~~equipment or~~ the acquisition and/or construction of land, facilities, equipment and rolling. ~~real property.~~

1. Equipment. ~~It has been the MTA's practice to purchase equipment and buses on a pay-as-you-go basis; however, t~~The MTA shall have the ability to consider lease purchase transactions, including certificates of participation, ~~as an alternative to~~ long-term vendor leases, ~~including the ability to implement a~~ and the use of master lease programs. ~~Only the highest priority equipment purchases will be lease purchased.~~ Financing of equipment will be limited to contracts of at least $20,000 and a useful life that is greater than 3 years. The final maturity of equipment lease financings will be limited to the ~~average~~ remaining useful life of the equipment.

2. Real Property. The final maturity of the financing shall not exceed the ~~estimated~~ remaining useful life of the facility. ~~In no case will the~~ A lease financing generally should not have a final maturity exceeding 30 years. Principal payments related to real property acquisition or construction are to be amortized so that there will be ~~such that it results in~~ level debt service payments; although the MTA may ~~consider~~ also use a more rapid amortization to accelerate ~~meet~~ ~~its~~ the repayment. ~~objectives.~~

D. Derivative Products

Derivative products will be considered ~~where~~ appropriate in the issuance or management of debt only in instances where it has been demonstrated that the derivative product will either provide a hedge that reduces risk of fluctuations in expense or revenue, or alternatively, where it will reduce total project cost. For interest rate swaps, the MTA will utilize the guidelines set forth in the Board

approved Interest Rate Swap Policy. For derivatives other than interest rate swaps, the MTA will undertake an analysis of early termination costs and other conditional terms given certain financing and marketing assumptions. Such analysis will document the risks and benefits associated with the use of the particular derivative product. Derivative products will only be utilized with prior Board approval.

VII. Structural Features

A. Maturity of Debt

The final maturity of the debt shall be equal to or less than the remaining useful life of the assets being financed, and the average life of the financing shall not exceed 120% of the average life of the assets being financed.

B. Debt Service Structure

Combined principal and interest payments for any particular bond issue will be structured to have approximately ~~equal~~level debt service payments over the life of the bond. Exceptions will occur for refunding bonds that will have varying principal repayments structured to fill in the ~~holes~~ gaps created by refunding specific principal maturities. The objective is to have level debt service in aggregate for each lien, with the debt service ~~trailing off~~ declining as bonds mature.

C. Lien Levels

Senior and Junior Liens for each revenue source will be utilized in a manner that will maximize the most critical constraint -- typically either cost or capacity -- thus allowing for the most beneficial use of the revenue source securing the bond.

D. Capitalized Interest

Unless otherwise required, MTA will avoid the use of capitalized interest in order to avoid unnecessarily increasing the bond size. Certain types of financings such as certificates of participation, lease-secured financings, and certain revenue bond projects may require that interest on the bonds be paid from capitalized interest until the ~~issuer~~ MTA has constructive use of the project.

E. Discount and Premium Bonds

While discount and deep discount bonds may slightly reduce the interest cost of the bonds below that of non-discount bonds, the amount of discount will be structured to minimize the negative impact of discounting on MTA's ability to subsequently refund bonds for interest savings.

The MTA will also evaluate the impact of premium bonds that can be redeemed prior to maturity. The price on these bonds, and thus the amount the MTA receives, may be proportionally less in comparison to par bonds, or bonds with slight discounts or premiums. The MTA will compare the price of redeemable premium bonds to the yield savings, if any, and consider the higher potential for future refunding savings.

F. Debt Service Reserve Fund

The debt service reserve fund (the "DSRF") is generally cash funded with bond proceeds. The MTA's trustee maintains the DSRF throughout the life of the bonds. A cash funded DSRF is invested pursuant to investment of proceeds guidelines within the respective indenture and interest earnings are generally used to offset debt service payments. In the final year of the bond issue, the cash available in the DSRF is usually used to make the final debt service payment. Since a cash funded DSRF generates interest income, the MTA would have the potential to be in a financially neutral position if the interest earnings equal or exceed the interest rate of the bonds.

An alternative to having a cash funded DSRF is to use a DSRF surety policy that would be provided by an appropriately rated bond insurer. The surety policy requires an up-front fee payment to the insurer and results in a loss of future income to the DSRF. The Treasurer will evaluate and document the DSRF funding decision. Factors to be considered in this evaluation include: arbitrage yield restrictions, current interest rates, availability and cost of a surety policy, foregone interest and capital gains from a cash funded DSRF, the relative size of the reserve requirement compared to the prior reserve requirement (refunding issues only), and opportunities for the use of the funds withdrawn from the DSRF including additional capital projects or investment opportunities.

G. Amortization

The MTA will amortize its debt within each lien to achieve overall level debt service or may utilize more accelerated repayment schedules after giving consideration to bonding capacity constraints. The MTA shall avoid the use of heavily back-loaded principal repayment, bullet and balloon maturities except to achieve wrapped debt service so as to level aggregate outstanding debt service.

H. Financial and Risk Analysis of Issuance

Net present value cost analysis, assessment of structural risks and complexities, and consideration of restrictions to future financing flexibility will be assessed and documented to determine the most efficient bond type and structuring features. The MTA's long-term pooled investment rate will be used as the

discount rate when comparing alternatives.

I. Call Provisions

In general, MTA securities will not include a non-call feature which is longer than 10 years. However, if determined to be financially advantageous, MTA may issue non-callable bonds for maturities longer than 10 years. Prior to the use of any non-call provision, the MTA will compare the option-adjusted yields on the bonds with and without a non-call provision to determine which is most financially beneficial.

J. Credit Enhancement

1. Bond insurance. Bond insurance will be used when it provides an economic advantage to a particular bond maturity or entire issue. Bond insurance provides improved credit quality for the bonds as a result of the insurance provider's guarantee of the payment of principal and interest on the bonds. Because of the decreased risk of non-payment, investors are willing to purchase bonds with lower yields than uninsured bonds, thus providing the issuer with interest cost savings.

   a) Benefit analysis. The decision to use bond insurance is an economic decision. The analysis compares the present value of the interest savings to the cost of the insurance premium. Insurance will be purchased when the premium cost is less than the present value of the projected interest savings.

   b) Provider selection. The financial advisor will ~~perform~~ undertake a competitive selection process when soliciting pricing for bond insurance, or in the case of a competitive sale, facilitate the pre-qualification of bonds by insurance providers. MTA recognizes that all providers may not be interested in providing bids to the MTA or pre-qualifying the issue. The winning underwriter in a competitive sale will determine whether it will purchase insurance for the issue. For a negotiated sale, the Treasurer shall have the authority to purchase bond insurance when deemed advantageous and the terms and conditions governing the guarantee are satisfactory

2. Letters of Credit. When used for credit enhancement, letters of credit ("LOC") represent a bank's promise to pay principal and interest when due for a defined period of time, and subject to certain conditions. In the case of a direct pay LOC, the trustee can draw upon the letter of credit to make debt service payments. A stand-by LOC can be used to ensure the availability of funds to pay principal and interest of an obligation.

a) Liquidity Facility. The issuance of most variable rate debt, including variable rate demand bonds and commercial paper requires the use of a liquidity facility.

b) Provider selection. The financial advisor will conduct a competitive process to recommend a letter of credit provider. The Treasurer will obtain contract approval in accordance with established dollar award policies. Only those banks with long-term ratings greater than or equal to that of the MTA, and short-term ratings of P-1/A-1, by Moody's Investors Service and Standard & Poor's, respectively, may be solicited.

c) Selection criteria will include, but not be limited to the following:
   (1) the bank(s) has long-term ratings at least equal to or better than the MTA's;
   (2) the bank(s) has short-term ratings of P-1/A-1;
   (3) the bank's acceptance of terms and conditions acceptable to the MTA. MTA will provide a term sheet along with the request for qualifications to which the banks will highlight modifications;
   (4) review of representative list of clients for whom the bank has provided liquidity facilities;
   (5) evaluation of fees; specifically, cost of LOC, draws, bank counsel and other administrative charges and estimate of trading differential cost.

VIII. Documentation of Transactions

The decision processes used in each financing process will be fully documented. The documentation will capture information regarding the selection of the financing team, decisions on product selection and structuring features, selection of vendors providing ancillary services and selection of investment securities or products. This information will be compiled into a post-pricing book "transaction file" which will be retained for each financing.

IX. Credit Objectives

The MTA will actively seek to:

1. Maintain and improve the credit ratings of its outstanding bonds.
2. Adhere to benchmarks, overall debt ratios and affordability targets.
3. Have frequent communications with the credit rating agencies.

X. Method of Bond Sale

A. The MTA will utilize a competitive sale process when it will provide the lowest interest cost for the bond. However, there are three methods of sale: competitive, negotiated and private placement. Each type of bond sale has the potential to provide the lowest cost given the right conditions. The conditions under which each type of bond sale is best used are provided below.

1. *Competitive Sale*
    a) Bond prices are stable and/or demand is strong.
    b) Market timing and interest rate sensitivity are not critical to the pricing.
    c) Participation from DBE / SBE firms is best efforts only and not required for winning bid.
    d) Issuer has a strong credit rating.
    e) Issuer is well known to investors.
    f) There are no complex explanations required during marketing regarding the issuer's projects, media coverage, political structure, political support, funding, or credit quality.
    g) The bond type and structural features are conventional.
    h) Bond insurance is included or pre-qualified (available).
    ~~b)~~ i) Manageable transaction size.

2. *Negotiated Sale*
    a) Bond prices are volatile.
    b) Demand is weak or supply of competing bonds is high.
    c) Market timing is important, such as for refundings.
    d) Coordination of multiple components of the financing is required.
    e) Participation from DBE / SBE firms is enhanced.
    f) Issuer has lower or weakening credit rating.
    g) Issuer is not well known to investors.
    h) Sale and marketing of the bonds will require complex explanations about the issuer's projects, media coverage, political structure, political support, funding, or credit quality.
    i) The bond type and/or structural features are non-standard, such as for a forward delivery bond sale, issuance of variable rate bonds or where there is use of derivative products.
    j) Bond insurance is not available or not offered.
    k) Early structuring and market participation by underwriters are desired.
    l) The par amount for the transaction is significantly larger than normal.
    m) Demand for the bonds by retail investors is expected to be high.

3. *Private Placement* is a sale that is structured specifically for one purchaser such as a bank. While the MTA has not previously used this method of sale, the MTA reserves to the right to place its securities privately if the need arises.

XI. Investment of Bond Proceeds

A. Purchase and Sale of Investments. The MTA shall competitively bid the purchase of securities, investment agreements, float contracts, forward purchase contracts and any other investment products used to invest bond proceeds. The MTA shall comply with all applicable Federal, State, and contractual restrictions regarding the use and investment of bond proceeds. This includes compliance with restrictions on the types of investment securities allowed, restrictions on the allowable yield of some invested funds as well as restrictions on the time period over which some bond proceeds may be invested. The MTA Treasurer may direct the investment of bond and lease proceeds in accordance with the permitted investments for any particular bond issue or lease. Providers of structured investment products and professional services required to implement the product or agreement,_will be recommended based on a competitive process conducted by the financial advisor.

B. Diversification. The MTA shall diversify invested proceeds in order to reduce risk exposure to providers, types of investment products and types of securities held.

C. Disclosure. The MTA will require that all fees resulting from investment services or sale of products to the MTA be fully disclosed to ensure that there are no conflicts of interest and investments are being purchased at a fair market price. Underwriters of the bonds, but not the financial or investment advisor, may bid on the sale of investment products for the proceeds. The financial or investment advisor shall document the bidding process and results and shall certify in writing that the MTA received a competitive and fair market price on the investments based on the bidding process.

XII. Market Relationships

A. Rating Agencies and Investors.: The Deputy Chief Executive Officer and the Chief Financial Officer shall be primarily responsible, along with the Executive Officer, – Finance and Treasurer, for maintaining the MTA's relationships with Moody's Investors Service, Standard & Poor's and Fitch IBCA. In addition to general communications, the Deputy Chief Executive Officer and the Chief Financial Officer, or their appropriate designees, shall: 1) meet with each agency's credit analyst at least once each fiscal year, and 2) communicate with each agency's analysts prior to each competitive or negotiated sale.

B. Board Communication.: As a means of providing feedback from rating agencies and/or investors regarding the MTA's financial strengths and weaknesses as perceived by the market place, information will be provided to the Board by Board Box Report as material information develops.

XIII. Continuing Disclosure

It is the policy of the MTA to remain in compliance with Rule 15c2-12 by filing its annual financial statements and other financial and operating data for the benefit of its bondholders within 195 days of the close of the fiscal year.

XIV. Consultants

The MTA will select its financial advisor(s) and its bond counsel by competitive process through a Request for Proposals (RFP). The MTA's contracting policies that are in effect at the time will apply to the contracts with finance professionals. Selection may be based on a best value approach for professional services or the lowest responsive cost effective bid based upon pre-determined criteria.

A. Financial Advisor. The MTA will select a financial advisor (or advisors) to assist in the debt issuance and debt administration processes. Additionally, the financial advisor will conduct competitive processes to recommend providers of financial services including investment management, investment measurement, and custody services. Selection of the MTA's financial advisor(s) should be based on the following:

1. Experience in providing consulting services to complex issuers.
2. Knowledge and experience in structuring and analyzing complex issues.
3. Ability to conduct competitive selection processes to obtain investment products and financial services.
4. Experience and reputation of assigned personnel.
5. Fees and expenses.

Financial advisory services provided to the MTA shall include, but shall not be limited to the following:

1. Evaluation of risks and opportunities associated with debt issuance.
2. Monitoring of the debt portfolio and bond proceeds investments to alert MTA to opportunities to refund or restructure bond issues or modify investments.
3. Evaluation and recommendation regarding proposals submitted to the MTA by investment banking firms.
4. Structuring and pricing bond issues, financial instruments and investments.
5. Preparation of requests for proposals and selection of providers for investment products, financial products and financial services (trustee and paying agent services, printing, credit facilities, remarketing agent services, investment management services, custody services etc.).
6. Provide advice, assistance and preparation for presentations with rating agencies and investors.

B. Bond Counsel. MTA debt will include a written opinion by legal counsel affirming that the MTA is authorized to issue the proposed debt, that the MTA has met all constitutional and statutory requirements necessary for issuance, and a determination of the proposed debt's federal income tax status. A nationally recognized bond counsel firm with extensive experience in public finance and tax issues will prepare this approving opinion and other documents relating to the issuance of debt. The counsel will be selected from the pool of bond counsel firms.

C. Disclosure Counsel. The MTA will hire, when appropriate, Disclosure Counsel to prepare official statements in the event of a competitive sale. Disclosure Counsel will be responsible for ensuring that the official statement complies with all applicable rules regulations and guidelines. Disclosure Counsel will be a nationally recognized firm with extensive experience in public finance. The counsel will be selected from the pool of bond counsel firms.

D. Disclosure by Financing Team Members.
The MTA expects that all of its financial advisory team will at all times provide the MTA with objective advice and analysis, maintain the confidentiality of MTA

financial plans, and be free from any conflicts of interest. All financing team members will be required to provide full and complete disclosure, under penalty of perjury, relative to any and all agreements with other financing team members and outside parties that could compromise any firm's ability to provide independent advice that is solely in the best interests of the MTA or that could be perceived as a conflict of interest. The extent of disclosure may vary depending on the nature of the transaction.

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Attachment D

MTA Interest Rate Swap Policy (Marked to Show Changes)

MTA
INTEREST RATE SWAP POLICY

~~June 2003~~~~May~~June 2004

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MTA
INTEREST RATE SWAP POLICY

I. Introduction

The purpose of the Interest Rate Swap Policy of the Los Angeles County Metropolitan Transportation Authority (MTA) is to establish guidelines for the use and management of interest rate swaps. The Interest Rate Swap Policy is prepared in accordance with the ~~proposed 2003~~ recommended practices of the Government Finance Officers Association regarding the contents of ~~an interest rate swap~~ derivatives policy published in 2003.

The MTA is authorized under California Government Code Section 5922 to enter into interest rate swaps to reduce the amount and duration of rate, spread, or similar risk when used in combination with the issuance of bonds.

II. Scope and Authority

This Interest Rate Swap Policy shall govern the MTA's use and management of all interest rate swaps. While adherence to this Policy is required in applicable circumstances, the MTA recognizes that changes in the capital markets, agency programs, and other unforeseen circumstances may from time to time produce situations that are not covered by the Interest Rate Swap Policy and will require modifications or exceptions to achieve policy goals. In these cases, management flexibility is appropriate provided specific authorization from the Board is obtained.

In conjunction with the MTA's Debt Policy, the Interest Rate Swap Policy shall be reviewed and updated at least annually and presented to the Board for approval. The Chief Executive Officer, Chief Financial Officer, and Executive Officer – Finance and Treasurer are the designated administrators of the MTA's Interest Rate Swap Policy. The Treasurer shall have the day-to-day responsibility and authority for structuring, implementing, and managing interest rate swaps.

The MTA Board shall approve any transaction involving an interest rate swap. The MTA shall be authorized to enter into interest rate swap transactions only with qualified swap counterparties. The Treasurer, in consultation with the Chief Executive Officer, Chief Financial Officer, and MTA Counsel, shall have the authority to select the counterparties, so long as the criteria set forth in the Interest Rate Swap Policy are met.

III. Conditions for the Use of Interest Rate Swaps

A. General Usage

The MTA will use swaps to lock-in a fixed rate or, alternatively, to create additional variable rate exposure. Interest Rate Swaps may be used to produce interest rate savings, limit or hedge variable rate payments, alter the pattern of debt service payments, or for asset/liability matching purposes.

In connection with the use of any swaps, the MTA's Board shall make a finding that the authorized swaps will be used to alter interest rate risk and/or alter the cost of borrowing in a beneficial manner, and when used in combination with new or outstanding bonds, will enhance the relationship between risk and return, or achieve other policy objectives of the MTA.

B. Maximum Notional Amount

The MTA will limit the total notional amount of outstanding interest rate swaps based on criteria set forth in this Interest Rate Swap Policy regarding the proper management of risks, calculation of termination exposure, and development of a contingency plan for mandatory termination.

C. Liquidity Considerations

The MTA shall consider the impact ~~-~~on the availability and cost of liquidity support for the new and existing MTA variable rate programs when evaluating the issuance of new ~~of any~~ variable rate bonds. requiring liquidity support ~~issued in combination with an interest rate swap on the availability and cost of liquidity support for other MTA variable rate programs.~~ The MTA recognizes that there is a limited supply of letter of credit or liquidity facility support for MTA variable rate bonds, and the usage of liquidity support in connection with an interest rate swap may result in higher overall costs.

D. Call Option Value Considerations

When considering the relative advantage of an interest rate swap to fixed rate bonds, the MTA, among other things, will consider the value of the call option on fixed rate bonds relative to the present value of the savings from using a swap. ~~A~~Unless a call option is purchased with the swap, all value derived from the ability to call bonds at a future date is foregone ~~when using a swap~~. Typically, MTA sells bonds that are callable after 10 years and could be refunded at that time. When entering into a swap, MTA will evaluate the cost of including a call option and purchase it whenever practical in order to retain future financial flexibility, including the ability to subsequently refund the bonds for savings. ~~Interest rate swaps will not have a par call provision, unless the MTA pays for this option, and cannot be refunded in the future to provide economic savings.~~

IV. Interest Rate Swap Features

A. Interest Rate Swap Agreement

The MTA will use terms and conditions as set forth in the International Swap and Derivatives Association, Inc. ("ISDA") Master Agreement. The swap agreement between the MTA and each counterparty shall include payment, term, security,

collateral, default, remedy, termination, and other terms, conditions, provisions and safeguards as the MTA, in consultation with its legal counsel, financial advisor and/or swap advisor, deems necessary or desirable.

Subject to the provisions contained herein, the terms of any MTA swap agreement shall use the following guidelines:

i. Downgrade provisions triggering termination shall in no event be worse than those affecting the counterparty.
ii. Governing law for swaps will be either New York or California.
iii. The specified indebtedness related to credit events in any swap agreement should be narrowly defined and refer only to indebtedness of the MTA that could have a materially adverse effect on MTA's ability to perform its obligations under the swap. Debt should typically only include obligations within the same lien as the swap obligation.
iv. Collateral thresholds stipulating when collateral will be required to be posted byfor the swap provider are designated in the policy and are based on should be set on a sliding scale reflective of credit ratings of the swap provider. Collateral requirements setting out the amount and types of collateral should will be established for each swap and based upon the credit ratings of the swap provider and anyor guarantor.
v. Collateral should be held by an independent third party.
v.vi. Eligible collateral should generally be limited to U.S. Treasuryies securities and obligations of Federal Agencies where the principal and interest are guaranteed by the full faith and credit of the United States government. At the discretion of the Treasurer, other high-quality obligations of Federal agencies, not secured by the full faith and credit of the U.S. government, may be used as collateral.
vi.vii. MTA shall have the right to optionally terminate a swap agreement at "market," at any time over the term of the agreement.
vii.viii. Termination value should be set by a "market quotation" methodology, unless MTA deems an alternate methodology appropriate.

B. Interest Rate Swap Counterparties

1. Credit Criteria

The MTA will make its best efforts to work with qualified swap counterparties that have a general credit rating of: (i) at least "Aa3" or "AA-" by at least one of the three nationally recognized rating agencies identified in this policy and not rated lower than "A2" or "A" by any of the nationally recognized rating agenciesy, or (ii) have a "AAA" subsidiary that is appropriately as rated by at least one nationally recognized credit rating agency. The nationally recognized rating agencies are Moody's Investors Services, Inc., Standard and Poor's Rating Services, and Fitch Ratings.

For lower rated ~~(below AA)~~counterparties whose highest rating from any of the three nationally recognized firms is below "AA-" or "Aa3", the MTA will seek credit enhancement in the form of:

i. Contingent credit support or enhancement;
ii. Collateral consistent with the policies contained herein;
iii. Ratings downgrade triggers;
iv. Guaranty of parent, if any.

In addition, qualified swap counterparties must have a demonstrated record of successfully executing swap transactions as well as creating and implementing innovative ideas in the swap market.

2. Counterparty Termination Exposure

In order to diversify MTA's counterparty credit risk, and to limit MTA's credit exposure to any one counterparty, the MTA will compute the "Maximum Net Termination Exposure" prior to executing a swap.

"Maximum Net Termination Exposure" is the aggregate termination payment for all existing and projected swap transactions that would be paid by or received from a specific counterparty, parent or guarantor.~~n individual counterparty.~~ For purposes of this calculation, the aggregate termination payment is equal to: (i) the termination payment based on the market value of all existing swaps as of the first business day of the month prior to the execution of any proposed transaction, plus (ii) the expected worst-case termination payment of the proposed transaction. The expected worst-case termination payment shall be calculated assuming interest rates, as measured by the Bond Buyer Revenue Bond Index, increased (or decreased) by two standard deviations from the sample mean over the last 10 years.

The following chart provides the Maximum Net Termination Exposure to a swap counterparty based on ~~given~~ the lowest credit rating assigned by any of the three nationally recognized rating agencies.

Credit Rating	**Maximum Collateralized Exposure**	**Maximum Uncollateralized Exposure**	**Maximum Total Termination Exposure**
AAA	Not applicable	$40 million	$40 million
AA	$30 million	$10 million	$40 million
Below AA	$30 million	None	$30 million

C. Term and Notional Amount

In connection with the issuance or carrying of bonds, the term of the swap agreement shall not extend beyond the final maturity date of the related bonds. The total "net notional amount" of all swaps related to a bond issue should not exceed the amount of

outstanding bonds. For purposes of calculating the net notional amount, credit shall be given in situations where there are off-setting fixed rate and variable rate swaps.~~to any fixed versus variable rate swaps that offset for a specific bond transaction.~~

D. Collateral Requirements

As part of any swap agreement, the MTA will seek to include terms imposing collateral requirements~~may,~~ based on credit ratings of the counterparty, requiring~~e~~ collateralization or other forms of credit enhancements to secure any or all swap payment obligations. MTA will determine the collateral requirements~~As appropriate, MTA,~~ in consultation with its counsel,~~ and~~ ~~F~~financial ~~A~~advisor and/or swap advisor.~~,~~ and may require the posting of ~~collateral~~ securities, surety bonds, letters of credit or other credit enhancement ~~to be posted by any swap counterparty~~ if the highest credit rating of the counterparty,~~ or~~ parent, or guarantor falls below a rating of ~~the~~ "AA-" or "Aa2".~~ credit rating category.~~ Additional collateral for further decreases in credit ratings of each counterparty shall be posted by each counterparty in accordance with the provisions contained in the collateral support agreement to each counterparty with the MTA.

Threshold collateral amounts shall be determined by the MTA on a case-by-case basis. The MTA will determine the reasonable threshold limits for the initial deposit and for increments of collateral posting thereafter. Collateral shall be deposited with a third party trustee, or as mutually agreed upon between the MTA 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 during negotiation of the swap agreement with each swap counterparty. The market value of the collateral shall be determined on a monthly basis, or more frequently if the MTA determines it is in its best interest given the specific nature of the swap(s) and/or collateral security.

E. Security and Source of Repayment

The MTA will generally use the same security and source of repayment (pledged revenues) for interest rate swaps as is used for the bonds that are hedged or carried by the swap, if any, but shall consider the economic costs and benefits of subordinating the MTA's payments under the swap and/or termination payment.

F. Prohibited Interest Rate Swap Features

The MTA will not use interest rate swaps that: (i) are speculative or create extraordinary leverage or risk, (ii) lack adequate liquidity to terminate without incurring a significant bid/ask spread, (iii) provide insufficient price transparency to allow reasonable valuation, (iv) are used as investments.

V. Evaluation and Management of Interest Rate Swap Risks

Prior to the execution of any swap transaction, the Chief Financial Officer, the Treasurer, and MTA's Financial/Swap Advisor and Bond Counsel shall evaluate the proposed transaction and report the findings to the MTA Board. Such a review shall include the identification of the proposed benefit and potential risks. As part of this evaluation, the MTA shall compute the Maximum Net Termination Exposure to the proposed swap counterparty.

A. Evaluation Methodology

The MTA will review the following areas of potential risk for new and existing interest rate swaps:

Type of Risk	Description	Evaluation Methodology
Basis risk	The mismatch between actual variable rate debt service and variable rate indices used to determine swap payments.	The MTA will review historical trading differentials between the variable rate bonds and the index.
Tax risk	The risk created by potential tax events that could affect swap payments.	The MTA will review the tax events in proposed swap agreements. The MTA will evaluate the impact of potential changes in tax law on LIBOR indexed swaps.
Counterparty risk	The failure of the counterparty to make required payments or otherwise comply with the terms of the swap agreement.	The MTA will monitor exposure levels, ratings thresholds, and collateralization requirements.
Termination risk	The risk that there will be a mandatory termination of the swap. A termination will almost always result in MTA either owing or being due to receive a termination payment. ~~The need to terminate the transaction in a market that dictates a termination payment by the issuer.~~	The MTA will compute its termination exposure for all existing and proposed swaps at market value and under an expected worst-case scenario. A contingency plan will be periodically updated specifying how MTA would finance a termination payment and/or replace the hedge.
Rollover risk	The mismatch of the maturity of the swap and the maturity of the underlying bonds.	The MTA will determine, in accordance with its Debt Policy, its capacity to issue variable rate bonds that may be outstanding after the maturity of the swap.
Liquidity risk	The inability to continue or renew a liquidity facility supporting the variable rate bonds that are being hedged.~~.~~	The MTA will evaluate the expected availability of liquidity support for hedged (swapped) and unhedged variable rate debt.
Credit risk	The occurrence of an event modifying the credit quality or credit rating of	The MTA will monitor the ratings of its counterparties, ~~and~~

	the issuer or its counterparty.	insurers, and guarantors.

B. Managing Interest Rate Swap Risks

1. Annual Report to Board

The MTA will evaluate the risks associated with outstanding interest rates swaps at least annually and provide a written report to the MTA Board of the findings. This evaluation will include the following information:

i. A description of all outstanding interest rate swaps, including related bond series, types of swaps, rates paid and received by MTA, existing notional amount, the average life and remaining term of each swap agreement, and the current termination value of all outstanding swaps.
ii. Separately for each swap, the actual debt service requirements versus the projected debt service on the swap transaction; and for any swaps used as part of a refunding, the actual cumulative savings versus the projected savings at the time the swap was executed.
iii. The credit rating of each swap counterparty, parent, guarantor, and credit enhancer insuring swap payments, if any.
iv. Actual collateral posting by swap counterparty, if any, per swap agreement and in total by swap counterparty.
v. Information concerning any material event involving outstanding swap agreements, including a default by a swap counterparty, counterparty downgrade, or termination.
vi. An updated contingency plan to replace, or fund a termination payment in the event an outstanding swap is terminated.
vii. The status of any liquidity support used in connection with interest rate swaps, including the remaining term and current fee.

The MTA shall update the Interest Rate Swap Policy at least annually and submit the update to the MTA Board for approval.

2. Contingency Plan for Mandatory Termination

The MTA shall compute the termination exposure of each of its swaps and its total swap termination payment exposure at least annually and prepare a contingency plan to either replace the swaps or fund the termination payments, if any, in the event one or more outstanding swaps are terminated. The MTA shall assess its ability to obtain replacement swaps and identify revenue sources to fund potential termination payments.

C. Terminating Interest Rate Swaps

1. Optional Termination

The MTA, in consultation with its counsel, ~~F~~financial ~~A~~advisor and/or swap advisor ~~Bond Counsel~~, may terminate a swap if it is determined that it is financially advantageous, or will further other policy objectives, such as management of exposure to swaps or variable rate debt.

2. Mandatory Termination

In the event a swap is terminated as a result of a termination event, such as a default or a decrease in credit rating of either the MTA or the counterparty, the MTA will evaluate whether it is financially advantageous to obtain a replacement swap, or, depending on market value, make or receive a termination payment.

In the event the MTA makes a swap termination payment, the MTA shall attempt to follow the process identified in its ~~swap~~ contingency plan for mandatory termination. The MTA shall also evaluate the economic costs and benefits of incorporating a provision into the swap agreement that will allow the MTA to make termination payments over time.

VI. Selecting and Procuring Interest Rate Swaps

A. Financing Team

The MTA will retain the services of a nationally recognized municipal bond counsel firm, and will consider the use of a qualified financial advisor and/or swap advisor for all interest rate swaps.

B. Underwriter Selection

In the event bonds are issued in connection with interest rate swaps, the MTA will price the bonds according to the guidelines set forth in its approved Debt Policy.

C. Counterparty Selection

The MTA will utilize a competitive bidding process to select a swap counterparty and price a swap when that process will provide the lowest financing cost. The MTA may use a negotiated process to select a swap counterparty and price a swap when it believes market or competitive conditions justify such a process. The conditions under which a negotiated selection is best used are provided below.

i. Marketing of the swap will require complex explanations about the security for repayment or credit quality.
ii. Demand is weak among swap counterparties.
iii. Market timing is important, such as for refundings.
iv. Coordination of multiple components of the financing is required.
v. Participation from DBE / SBE firms is desired ~~enhanced~~.

vi. The swap has non-standard features, such as being a forward starting swap.
vii. Bond or swap insurance is not available or not offered.
viii. The par or notional amount for the transaction is significantly larger than a typical transaction for that market. normal.

VII. Disclosure and Financial Reporting

The MTA will take steps to ensure that there is full and complete disclosure of all interest rate swaps to the MTA Board, to rating agencies, and in disclosure documents. Disclosure in marketing documents shall provide a clear summary of the special risks involved with swaps and any potential exposure to interest rate volatility or unusually large and rapid changes in market value. With respect to its financial statements, the MTA will adhere to the guidelines for the financialing reporting of interest rate swaps, as set forth by the Government Accounting Standards Board.

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Glossary of Terms

Asset/Liability Matching Matching the term and amount of assets and liabilities in order to mitigate the impact of changes in interest rates.

Bid/Ask Spread The difference between the bid price (at which a market maker is willing to buy) and the ask price (at which a market maker is willing to sell).

Call Option The right to buy an underlying asset (e.g. a municipal bond) after a certain date and at a certain price. A call option is frequently embedded in a municipal bond, giving the issuer the right to buy, or redeem, the bonds at a certain price.

Collateral Assets pledged to secure an obligation. The assets are potentially subject to seizure in the event of default.

Downgrade A negative change in credit ratings.

Forward Starting Swap Interest rate swaps that start at some time in the future. Used to lock-in current interest rates.

Hedge A transaction that reduces the interest rate risk of an underlying security.

Interest Rate Swap The exchange of a fixed interest rate and a floating interest rate between counterparties.

Liquidity Support An agreement by a bank to make payment on a variable rate security to assure investors that the security can be sold.

LIBOR The London Interbank Offer Rate. Used as an index to compute the variable rate on an interest rate swap.

Notional Amount The amount used to determine the interest payments on a swap.

Termination Payment A payment made by a counterparty that is required to terminate the swap. The payment is commonly based on the market value of the swap, which is computed using the rate on the initial swap and the rate on a replacement swap.