FINANCIAL POLICIES FOR THE CITY OF LOS ANGELES

Click here to go to the Table of Contents or click on the bookmarks on the left.

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To navigate, click on a chapter below or a bookmark on the left.

CITY OF LOS ANGELES
FINANCIAL POLICIES

Table of Contents

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INTRODUCTION

The City of Los Angeles enjoys some of the highest credit ratings of any major urban area in the nation. These high ratings reflect a variety of factors, including the strength and diversity of the regional economy, moderate City debt levels and historically strong fiscal management, including the provision of adequate reserves. The City is committed to implementing and maintaining strong fiscal policies and financial discipline. In previous years, the City has established a Reserve Fund Policy, a Debt Management Policy, a one-time funding policy, and an ongoing funding policy for new programs. These existing policies have been updated and incorporated into one comprehensive City Financial Policy document as contained herein.

SECTION 1
FISCAL POLICIES

OBJECTIVE

The City is supported by various financial resources and must function within the limits of these financial resources each fiscal year. A balance must be maintained between revenues and expenditures so that the public can realize the benefits of a strong and stable local government. It is important to understand that these policies are to be applied over a period of time that extends beyond the current year appropriations. By law, the annual budget cannot exceed available resources, defined as revenues generated in the current year added to balances carried forward from prior years. Temporary operating deficits measured against current revenue can and do occur, but they will not be tolerated as extended trends. The City cannot develop a legacy of operating deficits or a legacy of mixing one-time revenues against ongoing expenditures and expect the continued delivery of high quality services to City residents.

As part of the City Administrative Officer’s (CAO) continuing responsibility to ensure the financial stability of the City, these Policies will be continuously updated and maintained as needed. Any recommendation put forth to the Mayor and Council that is not in compliance with these Policies will be indicated as part of any report.

BUDGETARY POLICIES

I. Current appropriations for all funds are limited to the sum of available, unencumbered cash balances and revenues estimated to be received in the current budget year.

II. General Fund expenditures and subsidy appropriations for mandated and priority programs are to be made against current revenue sources and not dependent upon uncertain reserves or fluctuating prior period cash balances.

III. Special Revenue Funds are supported by special levies and fees, grants or intergovernmental revenues. Expenditures in these funds are strictly limited to the mandates of the funding source. Special Revenue Funds are not to be used to subsidize other funds, except as required or permitted by program regulations.

IV. The City will consider General Fund requests for new or expanded programs during the course of the annual budget process. Only in extreme circumstances will such requests be considered on an interim basis during the course of the fiscal year.

V. To the extent possible, current operations will be funded by current revenues. The use of unencumbered prior year balances in all funds shall be scrutinized and carefully limited to be used primarily for one-time expenditures. One-time revenues will only be used for one-time expenditures. The City will avoid using temporary revenues to fund ongoing programs or services.

VI. Multi-year operating cost projections, which forecast revenues and expenditures, shall be prepared and updated each year, or as necessary, to identify and evaluate the financial condition of the City over a five year period, at a minimum. This forecast shall be recognized through City Council action, along with the adoption of the budget for the next fiscal year.

VII. The City recognizes the importance of emergency reserves that can provide a financial cushion in years of poor revenue receipts or in the event of a major emergency. A Reserve Fund Policy has previously been developed and approved by the Mayor and Council. The revised Reserve Fund Policy is incorporated herein in Section 4.

VIII. To the extent possible, the City shall annually budget one percent of General Fund revenue to fund capital or infrastructure improvements. This policy recognizes the importance of maintaining the City's capital assets on a regular basis to avoid major deferred maintenance and to extend the useful life of the asset.

IX. The Comprehensive Annual Financial Report, prepared by the Controller will include debt information on a consolidated basis for the entire City. The City Administrative Officer will also review the outstanding debt of the City and prepare a detailed report to Council, in conjunction with the annual budget.

X. All City funds shall be reconciled at the close of the fiscal year. This reconciliation will compare all fund revenue and liabilities to determine the available cash balance at year-end.

XI. Reports to the Mayor and Council shall include Fiscal Impact Statements that include the full cost of the program or service in the current year, plus the future annual costs.

XII. All City Council motions for consideration before Council shall include a statement that is easily identifiable indicating whether or not the motion or requested action conforms with the City's adopted financial policies.

REVENUE POLICIES

I. The City will charge fees for services where such an approach is permissible by state and federal law, and where a group of beneficiaries who can pay such fees is identifiable.

II. Sufficient user charges and fees shall be pursued and levied to support the full cost of operations for which fees are charged, including all operating (direct and indirect) and capital costs. All user charges and fees for the City shall be monitored annually to determine that rates are adequate and each source is maximized. If fees or charges are not set at 100 percent full cost recovery, the Mayor and Council will specifically recognize the subsidy and shall take specific action to appropriate the necessary funds to subsidize the fee for service.

III. Enterprise Funds are expected to derive 100 percent of their revenues from charges, user fees, and interest. Enterprise agencies or departments should be 100 percent self-supporting entities through annual reviews of its fee structure, charges for services, and other operating revenues and expenditures.

IV. New and expanded unrestricted revenues sources should be first applied to support existing programs prior to funding new programs.

V. The City will pursue federal, state, and private grants but will strictly limit financial support of these programs to avoid commitments that continue beyond available funding.

VI. The City will continuously seek new revenues and pursue a diverse revenue base to limit the dependence on one or only a few revenue sources. This revenue diversity will shelter the City from short-time fluctuations in any one revenue source.

VII. Any revenue reductions for both the General Fund and special funds shall only be approved as temporary adjustments with a sunset clause. Permanent revenue reductions should not implemented due to Proposition 218 restrictions that prohibit increasing revenue without voter approval.

VIII. Any surplus equipment and vehicles will be sold at current market rates to both profit and non-profit agencies except for agencies that are performing specific work for and in the City of Los Angeles.

SECTION 2
FEE WAIVER POLICY

OBJECTIVE

From time to time, Council may decide to waive fees when it can be demonstrated that a direct public benefit can be obtained. Separate fee waiver policies are included in this section so that they can be defined and presented for clarification purposes. These policies are not intended to replace or supersede Revenue Policy III stating “Sufficient user charges and fees shall be pursued and levied to support the full cost of operations for which fees are charged, including all operating (direct and indirect) and capital costs. All user charges and fees for the City shall be monitored annually to determine that rates are adequate and each source is maximized. If fees or charges are not set at 100 percent full cost recovery, the Mayor and Council will specifically recognize the subsidy and shall take specific action to appropriate the necessary funds to subsidize the fee for service.”

Fee Waiver Policies

I. Special Event Fee Waivers

A proposed policy is currently in review and will be incorporated into this document at a subsequent date.

II. Non-Profit Lease Agreements

A proposed policy will be developed and submitted for approval for incorporation into this document at a subsequent date.

III. Development Fee Waivers

A proposed policy will be developed and submitted for approval for incorporation into this document at a subsequent date.

IV. Convention Center Fee Waivers

A proposed policy will be developed and submitted for approval for incorporation into this document at a subsequent date.

SECTION 3
CAPITAL IMPROVEMENT EXPENDITURE PROGRAM FUNDING POLICY
(Facilities and Infrastructure)

OBJECTIVE

The City's Capital Improvement Expenditure Program includes the purchase, renovation, or upgrade of new and existing municipal facilities or physical plant infrastructure. The Program is also funded by multiple sources of funding depending on the type of project and the use of the facility. As such, the City should develop and maintain a five-year capital improvement program budget encompassing all City municipal and physical plant facilities. It is also important for the City to realize the impact of capital assets on the operating budget of the City and understand that capital assets need to be regularly maintained to avoid major deferred maintenance expenditures and to extend useful life whenever possible.

I. A five-year capital improvement program shall be prepared and updated each year. The operating impact of each project shall be identified and incorporated into the annual operating budget. Capital assets purchased by the City shall be maintained on a regular schedule. Within legal limits and the constraints of operating budgets, debt may be issued for the purchase or renovation of capital assets.

II. New projects shall be specifically approved to be added to the Capital Improvement Program. This approval shall include information on the complete scope of work, a description of the different project phases, a Class C cost estimate for the total project, which has been adjusted for inflation based upon the construction schedule, and recommended funding sources for the total project. Significant changes to the scope of work concerning existing projects must also be approved.

III. The City will recognize the impact of new capital projects on the annual operating budget of the City. Future maintenance costs need to be identified and incorporated into the annual operating budget when new projects are completed. These costs include items such as departmental staffing, building maintenance, custodial services, landscaping, furniture or fixtures, etc. It is important to understand that capital assets need to be regularly maintained to extend the useful life of the capital asset.

IV. The City Administrative Officer will prepare a Capital Financing Plan in conjunction with the Capital Budget. The Plan will detail the sources of financing for all facilities in the Capital Budget, establish funding priorities and review the impact of all borrowings on the long-term debt affordability ratios. The Plan will consider all potential sources of financing, including non-debt options. This Plan shall be revised annually by the City Administrative Officer and presented for approval as part of the Adopted Budget.

V. The City will recognize the impact of depreciation of existing capital assets on the annual operating budget of the City. Maintenance costs need to be identified and incorporated into the annual operating budget as necessary. These costs include items such as building renovations and building maintenance. It is important to understand that capital assets need to be regularly maintained to extend the useful life of the capital asset.

SECTION 4
PENSION AND RETIREMENT FUNDING POLICY

OBJECTIVE

The City is committed to its employee workforce and will execute its Charter requirements by fully funding both its pension and retirement systems based on the annual actuarial studies. These actuarial studies may change from year-to year based on recent experience data, actuarial assumption changes, actuarial funding method changes, market conditions, future Governmental Accounting Standards Board reporting requirements, or other factors that may influence the actuarial process. It should be noted and understood by the City that both the Los Angeles City Employees' Retirement System and the Fire and Police Pension System are affected by market conditions over time. These market conditions affect the funding ratio calculated at the end of each fiscal year through the actuarial process for both Systems. Over time, depending on market conditions and the actuarial computed contribution rates, the City's annual contribution rate will increase and decrease.

POLICY

During those fiscal years when either the Los Angeles City Employees' Retirement System or the Fire and Police Pension System are over-funded (greater than 100% funded) and therefore the total annual required contribution, as adopted by the respective Boards, is less than the amount required to fund the normal cost of retirement and health benefits for employees, the City will limit the extent to which it will recognize these savings (negative unfunded actuarial accrued liability) in the budget. Specifically, the amount budgeted for retirement and health contributions will be no less than the amount derived by reducing the normal cost contribution rate to ninety (90) percent. An adopted contribution rate that would allow the City to contribute an amount less than ninety (90) percent of the normal cost shall trigger this provision that prohibits the City from utilizing this savings to fund the City's ongoing service and program costs. Any savings or reduction in funding calculated due to the incremental contribution rate below the ninety (90) percent threshold, will <u>only</u> be budgeted for one-time expenditures, such as capital projects, capital asset renovations, deferred capital maintenance, reduction of outstanding debt, or to build future reserves to offset future market conditions.

This policy would only be triggered when either System has a total, negative unfunded actuarial accrued liability (UAAL) that would cause the actual contribution rate to be below the ninety (90) percent threshold of the normal cost amount. When the total UAAL is positive, the City will continue to fully fund both the normal cost and UAAL as required by the City Charter.

An example is provided on the next page to illustrate this funding policy. The example use rates computed from the June 30, 2004 actuarial studies for both the Fire and Police Pension System (F&PPS) and the Los Angeles City Employees Retirement System (LACERS). These rates will be used to calculate the City's contributions in the 2005-06 Proposed Budget. The ninety (90) percent funding threshold would be applied to both F&PPS and LACERS as follows:

Provision Calculation	Rate as a Percent of Pay F&PPS	 LACERS
Normal Cost:		
Pension/Retirement Benefits (1)	14.92	8.44
Health Benefits (1)	1.76	2.03
Total Normal Cost	16.68	10.47
Funding Threshold (Normal Cost times 90%)	15.01	9.42
Normal Cost and Unfunded Actuarial Accrued Liability (1)	(15.69)	(18.96)
Credit (to be calculated against estimated salaries and used for one-time expenditures) or Cost of Unfunded Actuarial Accrued Liability (2)	(0.68)	(9.54)

(1) These percentages are available in both F&PPS' and LACERS' annual actuarial reports.
(2) If the rate is positive, then the City must set aside the calculated amount based on estimated salaries for one-time expenditures. If the rate is negative, a credit is not earned and funding would not be set aside per this provision.

Since the contribution rates (including normal costs and unfunded actuarial accrued liability) for F&PPS and LACERS were over the funding threshold of 15.01 percent and 9.42 percent, respectively, incremental savings were not available to fund one-time expenditures, such as capital projects, renovations, or deferred capital maintenance.

The City Administrative Officer will be required to complete this analysis in preparation of the Proposed Budget. Any subsequent changes approved by the Council that affect the annual contribution rate for either System will then require the City Administrative Officer to re-calculate the funding threshold for the final Adopted Budget amount.

SECTION 5
RESERVE FUND POLICY

OBJECTIVES

The Reserve Fund Policy is intended to provide guidelines during the preparation of and deliberations on the annual budget on sizing the Reserve Fund to ensure that sufficient reserves are maintained for unanticipated expenditures or revenue shortfalls, and to preserve flexibility throughout the fiscal year to make adjustments in funding for programs approved in connection with the annual budget. The objective is for the City to be in a strong fiscal position that will be better able to weather negative economic trends. This is important since the City is bound by the requirements of Proposition 218, which prevents the City from raising taxes without voter approval. Factors for maintaining sufficient Reserve Funds include the ability to:

- Mitigate State budget actions that may reduce City revenue;
- Mitigate economic downturns that the City may face in the future;
- Absorb escalating pension, retirement, and health insurance costs for the City.
- Fund the City's expenditures during the first few months of the year instead of issuing tax and revenue anticipation notes, which cost the City close to $3 million per year.
- Absorb large liability settlements without the need for issuing judgment obligation bonds;
- Purchase capital assets without the need to finance the purchase of assets; and,
- Front-fund or completely fund, if necessary, disaster or costs associated with the City being self-insured.

The Debt Management Policy for the City of Los Angeles recognizes the importance of emergency reserves and calls for the establishment of a Reserve Fund Policy. The Reserve Fund Policy was developed by the City Administrative Officer, in consultation with the City Controller and Chief Legislative Analyst, and was originally approved by the Mayor and City Council in connection with the approval of the Debt Management Policy, on August 4, 1998.

According to Ian Allan, Government Finance Officers Association's (GFOA) Government Finance Research Center Manager, in his article *Unreserved Fund Balance and Local Government Finance,* "Of particular importance to the credit rating agencies are the size of "fund balance" [the Reserve Fund] (resources available for contingencies) and the trend in the size of fund balance. A fund balance that decreases in size from year to year can be seen as an indicator of fiscal weakness. A small fund balance (under five (5) percent of annual operating expenditures) could also be looked upon negatively if the government has experienced financial difficulties in the past due to external factors, such as a slump in the economy."[1] The GFOA recommends a minimum of five (5) percent to be held in a unreserved fund balance. Below is a discussion of how each of the three credit rating agencies uses the Reserve Fund balance as a criterion for rating the City's financial condition.

Fitch Ratings (Fitch) indicates that a Reserve Fund provides a government with available resources in the event of unforeseeable occurrences. "Most [Fitch] analysts look to a fund balance [Reserve Fund] of about 5% of revenues as a prudent level to allow for a reasonable degree of error in budget forecasting. . . " but recognize that the "appropriate level may vary according to a city's needs."[2]

Moody's Investors Service (Moody's) uses the size of the Reserve Fund as well as a percentage of unreserved fund balance to revenues as an indicator of financial strengthen. "As a general rule of thumb, Moody's likes to* see a General Fund balance equal to at least 5% of revenues. . ."[3]

Standard and Poor's (S&P) states that a key credit rating factor for cities is the percentage of unreserved fund balances to budget. "The average [Reserve Fund] balance as a percentage of the budget for all "AAA" rated municipalities is very strong, at 25%. This financial cushion gives local governments great flexibility in dealing with unforeseen events such as an unexpected shortfall in revenues or rise in expenses."[4]

POLICIES

I. The City's total reserves shall include two funds:

A. Reserve Fund

The Reserve Fund shall include funding for unanticipated expenditures and revenue shortfalls in the general City budget. It shall also include two accounts within the fund, the Contingency Reserve and the Emergency Reserve.

B. Liability Claims Fund

The Liability Claims Fund shall include funding for liability claims.

Footnotes:
1. Allan, Ian J., GFOA Research Bulletin, Unreserved Fund Balance and Local Government Finance, November 1990.
2. Fitch Rating, Rating for General Obligation Bonds, July 2001.
3. Perspective on Municipal Issues, Key Factors in Moody's Credit Analysis *of* Tax-Support Debt, April 15, 1993.
4. Standard & Poor's Creditwire, Los Angeles, California General Obligation Bond Rating, November 2000.

II. Accessing City Reserves

A. Reserve Fund

1. Contingency Reserve Account

In the event that during the year there are unanticipated expenses or revenue shortfalls impacting programs already approved in conjunction with the current year budget, the Contingency Reserve Account will be the source of any additional funding for those programs. Funds must be appropriated by a vote of at least a majority of the Council, with Mayoral concurrence, or by a super-majority of the Council in the event of a Mayoral veto. The Contingency Reserve Account shall not be used to fund new programs or positions added outside of the current year budget. Such funding must come from other non-Reserve Fund sources.

2. Emergency Reserve Account

To utilize funds from the Emergency Reserve Account, a finding by the Mayor, with confirmation by the Council, of “urgent economic necessity” will be required, as well as a determination that no other viable sources of funds are available. A finding of urgent economic necessity would be based on a significant economic downturn after the budget is completed or an earthquake or other natural disaster.

B. Liability Claims Fund

The City Attorney will periodically recommend to the City Council that the City resolve or settle claims brought against the City. Upon review of the settlement terms, the City Council will then authorize payments from the Liability Claims Fund for these settlements.

III. Sizing of Total Reserves

A. Liability Claims Fund

The Liability Claims Fund shall be budgeted in an amount reasonably expected to be expended on liability claims for the ensuing fiscal year. The City Attorney shall provide an estimate based on potential pending claims against the City. Any unspent funds at year-end would revert to the Reserve Fund.

B. Reserve Fund

The Reserve Fund shall be five (5) percent of the General Fund budget. The amount placed in each of the Reserve Fund Accounts shall be determined as follows:

1. Contingency Reserve Account

   The Contingency Reserve shall be sized at approximately three (3) percent of the General Fund budget. The amount may be higher depending on recent experience with the need for supplemental funding during the year for programs approved in conjunction with the budget, but the amount is expected to remain relatively constant and will be determined as a percent of General Fund revenues of the Adopted Budget.

2. Emergency Reserve Account

   The Emergency Reserve Account shall be set at a minimum of two (2) percent of the General Fund Adopted budget.

IV. Phased-In Reserve Fund Sizing

Increasing and maintaining the overall Reserve Fund balance to five (5) percent may need to be phased in over a period of several years. The 2004-05 Adopted Budget set aside $112.7 million or approximately 3.1 percent of the General Fund budget. Due to the structural deficit between estimated revenues and expenditures in 2005-06, it may not be feasible to increase the Reserve Fund balance to the full five (5) percent. Depending on resolution of the structural deficit, a targeted annual increase should be established to increase the Reserve Fund balance to five (5) percent within ten years. For 2005-06, the Emergency Account shall be set at two percent, with any additional funds placed in the Contingency Account. For each subsequent year, the Reserve Fund balance shall be increased no later than 2006-07. However, should the performance of revenues and expenditures during the 2004-05 and 2005-06 be better than expected, the City shall increase the Reserve Fund by the amount available in conjunction with the adoption of the 2006-07 Budget.

V. Restoration of the Reserve Fund Balance to Five (5) Percent

In fiscal years where it becomes necessary for the City to utilize monies in the Reserve Fund on an interim basis or to offset a significant negative economic event wherein the Reserve Fund balance drops below the five (5) percent level, the City will initiate action in the subsequent year to replenish the Reserve Fund to the level of five (5) percent of General Fund revenue. If utilization of Reserve Fund monies is less than one (1) percent of General Fund revenue, the City shall attempt to replenish the five (5) percent balance in the subsequent fiscal year. If utilization of Reserve Fund monies is more than one (1) percent of General Fund revenue, the City shall attempt to replenish the five (5) percent balance by one (1) percent over a period of years as necessary to restore the Reserve Fund balance to the level of five (5) percent of General Fund revenue.

SECTION 6
DEBT MANAGEMENT POLICY
(As amended on April 19, 2005)

INTRODUCTION

The Debt Management Policy has been developed to provide guidelines for the issuance of bonds and other forms of indebtedness to finance capital improvements, equipment acquisition and other items for the City. Over the past five years, the City has approved several new debt policies in response to the issuance of a variety of debt instruments. This amended Policy incorporates the original Debt Management Policy approved by the Mayor and City Council in 1998, the Municipal Improvement Corporation of Los Angeles (the “MICLA”) Departmental Operating Policies approved by the Mayor and City Council in 2000 and the Variable Rate and Swap Policies approved by the Mayor and Council in 2003. Although the Mello-Roos Policies and Procedures, adopted in 1994, remain as separate policies based on the unique nature of this debt structure, they are incorporated and attached for reference.

While the issuance of debt is frequently an appropriate method of financing capital projects and major equipment acquisition, careful monitoring of such issuances is required to preserve the City's credit strength and budget flexibility. These guidelines will assist the City in determining the appropriate uses for debt financing, structuring debt financings and establishing certain debt management goals.

The City Administrative Officer, Debt Management Group (the “CAO”), as part of its ongoing responsibility to manage the City’s Debt Program, will use these policies in determining the appropriate uses for fixed-rate, long-term rate, variable rate debt, commercial paper and interest rate risk reduction products and establishing parameters for their use, when recommending their use to the Mayor and City Council. In evaluating a particular transaction involving the use of any of these financing products, the CAO will review the long-term implications, including costs of borrowing, historical interest rate trends, variable rate capacity, credit enhancement capacity, opportunities to refund related debt obligations and other similar considerations. This analysis will be included in the CAO report recommending a transaction to the Mayor and City Council. In addition, the CAO will report on revenue bonds issued by the propriety departments.

This policy describes the circumstances and methods with which certain types of financing products can be used, the guidelines that will be imposed on them, and who in the City is responsible for implementing these policies. A *Glossary of Key Terms* is provided at the end of this Policy.

OBJECTIVES

The City of Los Angeles has earned some of the highest credit ratings of any major urban area in the nation. These high credit ratings reduce the interest costs paid by the City on the amounts borrowed. Lower interest costs result in lower tax rates and a reduced burden on the General Fund. This Policy is intended to help in maintaining the City's high credit ratings so that access to borrowed funds is provided at the lowest possible interest rates. Additionally, these policies are intended to set forth selection criteria for certain financial consultants and attorneys that will ensure a fair and open selection process, provide opportunities for all firms, including minority, women and other business enterprise firms, to participate in City contracts, and result in the selection of the best qualified professionals.

GENERAL POLICIES

I. Designated Managers of City Debt

The City Administrative Officer, Debt Management Group structures debt issuances and oversees the ongoing management of all the General Fund and certain special fund debt programs. These include General Obligation Bonds, lease purchase obligations, revenue obligations, Judgment Obligation Bonds, special tax obligations, and Mello-Roos and special assessment obligations. Other programs are added from time to time as new debt instruments are developed.

The Departments of Airports, Harbor, Water and Power, the Housing and Industrial Development Authorities (IDAs) through the Housing and Community Development Departments, and the Community Redevelopment Agency, are responsible for issuing and administering their own debt due to the specialized aspects of the debt issued by these agencies and the integral ties between the debt that is issued and the programs these agencies administer. Charter Section 291(i) instructs the CAO to provide information or recommendations to the Mayor and City Council. As part of this duty, the CAO reviews and monitors the proprietary departments' debt programs. In accordance with Charter Section 609(a), the CAO makes recommendations to the Mayor and City Council on the proposed issuance of revenue bonds by these departments. Although the IDAs issue separately, they are still Council-controlled departments and are expected to adhere to the guidelines set forth in these Policies. As such, the City Council is the final issuer of all City debt and awards all contracts for the purchase of bonds.

II. Method of Sale

There are two methods of issuing debt obligations, a competitive sale and a negotiated sale. In a competitive sale, underwriters submit sealed bids and the underwriter or underwriting syndicate with the lowest True Interest Cost (TIC) is awarded the sale. In a negotiated sale, the underwriter or underwriting syndicate is selected through a Request for Proposal (RFP) process. The interest rate and underwriter's fee are negotiated prior to the sale, based on market conditions.

It shall be the policy of the City to issue debt through a competitive sale whenever feasible, as a competitive sale usually results in the lowest cost of borrowing to a high rated issuer like the City. This policy follows the City Charter and a City Attorney Opinion, dated November 27, 1985 (R85-1129), which stipulates that the sale of bonds is subject to Charter provisions relative to the award of contracts through a competitive process.

Charter Sections 371 and 372 describe the process that requires the use of competitive bidding with some exceptions. One of the exceptions, under Section 371(e)(2) states "(2) Contracts, as determined by the contracting authority, for the performance of professional . . . or other special services . . . finds that competitive bidding is not practicable or advantageous." Any finding that a negotiated bond sale is appropriate will be based on advice by an independent financial advisor and the City Attorney.

It is usually not feasible to issue bonds through a competitive sale for certain types of financings, such as variable rate debt, commercial paper and specialized financings like Mello-Roos. Still, a competitive process should be used to choose the appropriate underwriter and financing team to ensure the most qualified firms are used for a specific financing.

When determining whether to use a competitive or negotiated sale, the following criteria shall be used by the CAO:

A. Issuer Characteristics

1. Market Familiarity. A frequent issuer can generally sell most issues through a competitive sale since investors and underwriters are familiar with its credit quality. A successful sale does not require as much pre-marketing from frequent issuers. A negotiated sale may be appropriate if extensive pre-marketing to investors is advantageous.

2. Credit Strength. The higher the credit quality of the issuer, the less likely the need for a negotiated sale due to the demand for high quality municipal bonds. Strong issuers fare well in competitive bidding compared to issuers with credit ratings below "A."

3. Policy Goals. The competitive sale does not provide the issuer influence over choosing the underwriting syndicate. If the issuer finds that influencing the composition of the syndicate and the distribution of bonds are worthwhile policy objectives for a particular financing, then the issuer may have a negotiated sale. If the issuer chooses a negotiated sale for this policy reason, the issuer should then clearly specify the rationale and criteria for the selection of the underwriters to avoid the appearance of favoritism.

B. Financing Characteristics

1. Type of Debt Instrument. The market responds well to familiar debt instruments and is often leery of innovations. New types of instruments may require an education process that is more conducive to the negotiated sale. Thus, as the market becomes more familiar with the issuer's debt instrument, the need to educate the market diminishes. All things being equal, familiar debt instruments would be better suited to competitive sales.

2. Issue Size. The bond size influences both investor interest and the market's ability to absorb the bonds. In general, if the bond amount is too small or too large, then the issuer should consider a negotiated sale. A small bond sale may not attract market attention without a sales effort while a large sale may be difficult for the market to absorb without the pre-sale activity offered by the negotiated sale process.

3. Market Conditions. When the market has interest rate stability, flexibility in the timing of the sale is not critical. However, the timing of the sale is critical when there is a volatile market. If this is the case, then a negotiated sale could be more appropriate.

4. Story Bonds. When bonds are unique or have a "story" associated with them, then the pre-marketing process is essential. These bonds require additional explanation and are called "story" bonds because to develop sufficient market interest, the issuer has to "tell a story" and explain why the bonds are a solid investment.

III. Debt Capacity

A. Debt Affordability: The determination of how much indebtedness the City should incur will be based on a Capital Financing Plan (the "Plan"), which analyzes the long-term borrowing needs of the City and the impact of planned debt issuances on the long-term affordability of all outstanding debt. The Plan will incorporate the City's current five-year capital plan and will include all presently known City financings to be repaid from the General Fund and relevant special funds. The affordability of the incurrence of debt will be determined by calculating various debt ratios (itemized below) that would result after issuance of the debt and analyzing the trends over time.

B. Ceilings for Debt Affordability: One of the strengths behind the City's high credit ratings is its moderate debt level relative to other cities and as compared to the resources available to repay the debt. The issuance of debt must be carefully monitored to maintain a balance between debt and resources. Ceilings have been developed as guidelines in evaluating the affordability of future debt.

Table I provides the various debt ratios that are measured and the maximum levels for those ratios.

1. Debt Ratios.

Table I

Ratio	Ceiling
Total Direct Debt Service as Percent of General Fund Revenues	15%[1]
Non-voted Direct Debt Service as Percent of General Fund Revenues	6%[2]

Direct debt includes all debt that is repaid from the General Fund or from any tax revenues deposited into special funds not supporting revenue bonds, such as General Obligation bonds and City-wide parcel tax bonds. "General Revenues" consist primarily of the General Fund, as well as the revenues to the special funds supporting direct debt.

2. Rapidity of Debt Repayment. To provide additional debt capacity through relatively rapid retirement of outstanding debt, debt issuances will be structured to reach a target of 50% of all outstanding direct debt being repaid within 10 years.

3. Pay-As-You-Go Financing. Except in extenuating circumstances, the City will fund routine maintenance projects in each year's capital program with pay-as-you-go financing. Extenuating circumstances may include unusually large and non-recurring budgeted expenditures, or when depleted reserves and weak revenues would require the delay or deletion of necessary capital projects.

C. Plan Revision: The CAO will revise the Plan on an annual basis or as part of the annual budget process. The Debt Affordability Chart will be updated at least annually. In addition, each time the CAO recommends the issuance of debt, the Debt Affordability Chart will be included in the CAO report in conjunction with the Debt Impact Statement and Fiscal Impact Statement required by Charter.

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[1] The ratio of debt service payments to General Fund revenues for voter-approved debt shall be no more than 15% including the percent for non-voter approved debt.

[2] The 6% ceiling may be exceeded only in the following situation: (1) if there is a guaranteed new revenue stream for the debt payments and the additional debt will not cause the ratio to exceed 7.5% or, (2) there is not a guaranteed revenue stream but the 6% ceiling will only be exceeded for one year.

D. Monitor Impact on City Taxpayer of All Fees and Taxes: In addition to the analysis of the City's debt affordability, the Plan will review the impact of debt issuance on City taxpayers. This analysis will incorporate the City's tax levy, other jurisdictions' tax levies, additional taxes for voter-approved debt, and assessments and fees used by the City or related agencies to service revenue bonds.

E. Update Specific Revenue Sources: If the financing plan for a project incorporates assumptions that identified revenue sources sufficient to repay the debt, the CAO will annually prepare an analysis of whether the identified revenues are performing as expected.

IV. Rating Agency Strategy

A. Communication: The CAO will continue its practice of meeting regularly with credit analysts from the rating agencies to keep them informed of the City's borrowing plans and financial condition. Face-to-face meetings will generally occur at least once annually with each agency and, at a minimum, conference calls will be offered to credit analysts in connection with each issuance of debt.

B. Strategic Plan: The CAO will prepare an annual report to the Mayor and City Council detailing the City's credit strengths and weaknesses as perceived by credit analysts. The CAO will include recommended actions to address any weaknesses identified by the rating agencies. This report may occur as part of the annual budget deliberations. The annual report recommendations will take into consideration potential credit impacts of budget balancing options.

V. Refinancing Outstanding Debt

A. Monitor Potential Savings: The CAO, with the assistance of City's general financial advisors, will monitor on an ongoing basis potential savings available by refinancing outstanding debt of the City. Savings will be analyzed on a present value basis by using either a percent of maximum call option value or a percentage of the refunded par amount. All costs and benefits of the refinancing will be taken into account.

B. Target Savings Amounts: A present value analysis must be prepared to identify the economic effect of any proposed refunding. To proceed with a refinancing, either of two methodologies may be used to analyze the targeted savings. The first is that a minimum of 90% of the maximum call option value, as calculated by the City's general financial advisors, should generally be achieved. The CAO will have the final discretion to recommend individual refunding candidates above or below the target to optimize the City's financial objectives. Alternatively, the second method that may be used is the more traditional methodology of measuring the net present value savings as a percentage of the refunded par amount with a minimum average savings of 3% for any one refunding transaction. It is at the discretion of the CAO to utilize either method for recommendation to the Mayor and City Council.

C. Other Considerations: Some refundings may be executed for other than economic purposes, such as to restructure debt, to change the type of debt instrument, or to retire a bond issue and indenture for more desirable covenants. The CAO may recommend this type of refunding. In addition, if the benefits outweigh the costs and the refunding opportunity would otherwise be lost, the CAO may recommend a refunding that has economic benefit but does not meet the criteria stated above in the Target Savings Amount paragraph above. In either case, the CAO must inform the Mayor and City Council that this refunding does not meet the criteria set forth in the Target Savings Amount paragraph above.

VI. Structure of City Debt Instruments

A. General Obligation Bonds: The final maturity of General Obligation bonds will be limited to the shorter of the average useful life of the asset financed or 20 years. Principal will be amortized in equal annual amounts or faster to meet the rapidity of debt repayment goals. The bonds should be callable in no later than 10 years. General Obligation Bond issues will generally be sized to the amount reasonably expected to be required for one year's commitments. General obligation bonds issued for new money purposes will be sold at a minimum price equal to the par amount of the bonds offered for sale. Any premium above par received from the sale of the bonds will first be used to pay costs of issuance of the bonds. Any premium in excess of the costs of issuance of the bonds will either be deposited into the construction fund and used for voter approved project costs or into the debt service account.

B. Municipal Improvement Corporation of Los Angeles (MICLA) Lease Obligations. MICLA is a non-profit corporation established by the City of Los Angeles in 1984 to serve as the lessor in lease-purchase transactions involving the City. MICLA was organized for social welfare purposes within the meaning of Section 501(c)(4) of the Internal Revenue Code. MICLA plays no active role in either the procurement of funds or equipment, but must review and approve the projects proposed by the City for financing through MICLA. Board members were originally appointed by the Mayor and concurred by the City Council. Appointments to subsequent vacancies are made by the Board with the concurrence of the City Council. Representatives of the Board of Directors must execute documents assigning responsibility to other parties, including the City of Los Angeles and trustees.

In 2000, the Mayor and City Council adopted the MICLA departmental operating policies including:

1. MICLA funding shall only be provided for those vehicles, equipment, and capital projects for which final plans and/or design have been completed, which have been competitively bid, and which are ready for bid award. Equipment deviation requests (CAO Rule 11) shall not be approved beyond the date of MICLA funding availability, except for safety or regulatory reasons. Any other exceptions shall require Mayor and City Council approval. The General Services Department (GSD) has been instructed to only approve departmental purchase order changes that result from safety or regulatory reasons that occur during the ordering period. GSD and user departments have also been instructed to custom order vehicles only in instances when manufacturers do not have standard models that will reasonably meet the City's operational requirements.

2. Any existing and new MICLA funds that remain unspent for a period longer than three years from the date of availability shall be subject to reversion to pay debt service and/or to offset new MICLA projects. The City Controller and the CAO are authorized to implement this Policy and to ensure funds are closed at the appropriate time. Any exceptions shall require Mayor and City Council approval.

3. Any new MICLA funds remaining unencumbered after 18 months from the availability of the bond proceeds shall be subject to reversion and such funds may be reallocated for other capital projects with similar useful lives or to pay debt service. The City Controller and the CAO are authorized to implement this Policy and to ensure funds are either reappropriated or transferred to the Trustee with the necessary administrative approvals. Any exceptions shall require Mayor and City Council approval.

4. MICLA funding approved in the Adopted Budget will be made available to departments as early in the fiscal year as practicable, unless a determination is made by the City Council that an alternate financing method can efficiently meet the City's needs.

C. Other Lease-Purchase Obligations: The final maturity of equipment obligations will be limited to the average useful life of the equipment to be financed. The final maturity of real property obligations will be determined by the size of the financing, 10 to 15 years for small issues, 20 to 25 years for large issues and 30 years for exceptional projects or those with a direct revenue component such as a special tax. Principal will generally be amortized to result in level annual lease payments; however, more rapid principal amortization may occur where permissible to meet debt repayment goals. The obligations should be callable in no later than 10 years.

D. Revenue Obligations: The final maturity of bonds or other debt obligations secured by enterprise or other special revenues will be determined by the expected useful life of the financed project and the revenues available to repay the debt. Principal amortization will be appropriate for the project, based on the useful life of the project and other revenue bonds outstanding. The obligations should be callable in no later than 10 years. These include the Parking Revenue Bond Program, the Sanitation Equipment Charge Revenue Bond Program and the Wastewater System Revenue Bond Program.

E. Judgment Obligation Bonds: The final maturity of any bonds issued as a result of obligations arising from unusual and non-recurring court judgments will be limited to 10 years to demonstrate the willingness of the City to repay such obligations quickly. Principal amortization will be appropriate for the particular transaction.

F. Special Tax Obligations: The final maturity of special tax obligations will be limited to 20 years. Principal will be amortized as quickly as feasible, with a preference for equal annual principal payments. The obligations should be callable in no later than 10 years.

G. Mello-Roos and Special Assessment Obligations: These obligations, although repaid through additional taxes levied on a discrete group of taxpayers, constitute overlapping indebtedness of the City and have an impact on the overall level of debt affordability. The City has developed separate guidelines for the issuance of Mello-Roos and Special Assessment Obligations. The City of Los Angeles Policies and Procedures for Mello-Roos and Assessment Districts, adopted by the City Council on November 1, 1994, and all subsequent amendments, are hereby incorporated into the City's Financial Policies, Debt Management Section. A copy of the Mello-Roos Policy is attached.

H. Section 108 Loans: Section 108 loans are administered by the Housing Department. These loans will be structured to be sound loans to assist in economic development projects. In addition, Section 108 loans will also be structured to provide sufficient guarantees so that if the loan is in default, the General Fund would be the payment of last resort. It is preferable, in compliance with the Block Grant Investment Fund (BGIF) Policy, for block grants to be used as first guarantor for payment. In addition, the Housing Department will adhere to these Policies as feasible as it is a Council-controlled department.

I. Use of Capitalized Interest: Capitalized interest increases the amount of debt to be issued and therefore will be avoided unless essential from a credit standpoint, as in the case of lease-purchase obligations. Interest on General Obligation Bonds will not be capitalized. Generally, interest on lease-purchase obligations will be capitalized for a maximum of one year following a conservatively based estimate of project completion to provide a cushion for project slippage.

VII. Continuing Disclosure

The City will comply with Rule 15(c)2-12 of the Securities and Exchange Commission by filing an annual report with each Nationally Recognized Municipal Securities Information Repository and State Repository, if any, that provides certain financial information and operating data relevant to investors in City obligations. In addition, the City will take additional efforts to make information available to investors through its web site and other appropriate communication platforms. Below is a description of the City's Due Diligence process to be followed:

A. The City provides financial disclosure information in every bond issuance. The summary of City information, known as Appendix A, contains all City financial and municipal information and discloses the financial risks of the City. Appendix A is updated every time the City issues debt. In addition, the City Controller prepares the Basic Financial Statements of the City that are included in all Official Statements, known as Appendix B.

B. For bond issuances that the CAO administers, prior to submission to the Mayor and Council, staff from the CAO's Debt Management Group, Finance Group, and Employee Relations Group, the Risk Management Group, at least two Assistant CAOs and the CAO review the data included in Appendix A for accuracy and completeness, and discuss other information that should be considered for inclusion. Representatives from the Offices of the City Attorney, the Treasurer, the Controller and the affected departments also review the document.

C. To ensure that all disclosure information is available for Mayor and Council review and approval, the CAO includes the final Preliminary Official Statement in its bond issuance reports for Mayor and Council approval. The Mayor and Council then authorize the CAO to finalize the Official Statement, to disseminate the information to potential bond investors and to ensure that the information is accurate and complete. The City Council is, however, the final issuer of all City debt and awards all contracts for the purchase of bonds regardless of the City issuing agency.

Departments and agencies that issue their own debt, the Departments of Airports, Harbor, Water and Power, Housing and Community Development, the Community Redevelopment Agency and the Housing and Industrial Development Authorities, also use the general City information contained in Appendix A in their debt documents. To ensure consistent City disclosure regardless of the issuing City agency, the other agencies submit copies of their City information before disseminating the information. These departments and agencies should also abide by these same policies and their financial disclosure documents should be consistent with those of the rest of the City.

LONG-TERM FIXED-RATE DEBT

I. Purposes

Debt should be used to finance essential capital assets such as facilities, real property, and certain equipment where it is appropriate to spread the cost of the asset over more than one budget year. In so doing, the City recognizes that future taxpayers, who will benefit from the investment, will pay a share of its cost. Projects that are not appropriate for spreading costs over future years will not be debt financed. Under no circumstances will long-term debt be used to fund City operations or maintenance.

II. Uses of Long-Term Debt

A. <u>Equipment Financing</u>: Lease obligations are a routine and appropriate means of financing capital equipment. However, lease obligations also have the greatest impact on debt capacity and budget flexibility. Therefore, efforts will be made to fund capital equipment with pay-as-you-go financing where feasible, and only the highest priority equipment purchases will be funded with lease obligations. All equipment with a useful life of less than six (6) years shall be funded on a pay-as-you-go basis unless the following conditions are met:

1. In connection with the Proposed Budget, the Mayor makes a finding that there is an "economic necessity" based on a significant economic downturn, earthquake or other natural disaster and there are no other viable sources of funds to purchase the equipment.

2. The City Council concurs with the Mayor's finding in the adoption of the budget.

3. The various debt ceilings, as discussed in the above paragraph on Debt Capacity, are not exceeded except as provided in said paragraph.

B. <u>Lease Financing of Real Property</u>: Lease financing for facilities and real property is appropriate if the City desires to finance them from existing revenue sources, and not through voter-approved bonds secured by an increase in property taxes. Such financings will be structured in accordance with the above Other Lease Obligations paragraph.

C. <u>Identified Repayment Source</u>: The City will, when feasible, issue debt with a defined revenue source to preserve the use of General Fund-supported debt for projects with no stream of user-fee revenues. Examples of revenue sources include voter-approved taxes (General Obligation or special tax bonds), user fees (Sanitation Equipment Charge or the Sewer Construction and Maintenance Fund) and other appropriate revenues.

D. Use of General Obligation Bonds: Voter-approved General Obligation Bonds provide the lowest cost of borrowing to finance the acquisition or improvement of real property, and provide a new and dedicated revenue source in the form of additional ad valorem taxes to pay debt service. In recognition of the difficulty in achieving the required two-thirds voter-approval to issue General Obligation Bonds, such bonds will be generally limited to facilities that provide wide public benefit and that have generated broad public support.

E. Use of Revenue Bonds: Revenue bonds supported solely from fees are not included when rating agencies calculate debt ratios. Such bonds include those revenue bonds issued by the Wastewater System, Sanitation Equipment Charge Special Revenue Fund and the Special Parking Revenue Fund. Accordingly, to preserve General Fund debt capacity and budget flexibility, revenue bonds will be preferred to General Fund-supported debt when a distinct and identifiable revenue stream can be identified to support the issuance of bonds.

F. Use of Asset Transfer Lease: The City will use "asset transfer" or “asset strip” leases to finance capital needs when there are no other viable financing options or to reduce the amount of interest that must be capitalized from proceeds. Additionally, asset transfer leases may be used if significant savings in financing costs can be generated compared to other financing alternatives.

G. Deep Discount Debt: Deep discount debt is sold to investors at prices significantly less than the face value of the debt. Under certain market conditions, the use of deep discount debt may provide a lower cost of borrowing. The CAO will review the use of deep discount debt, taking into consideration the additional debt capacity that is utilized by the discount and the impact on future refinancing flexibility of the lower than market rate interest coupon.

III. Arbitrage Requirements

The City agrees to comply with all of its tax certificates for tax-exempt financings by monitoring the arbitrage earned on bond proceeds and by rebating all positive arbitrage, pursuant to Internal Revenue Code Section 148. The CAO may choose to hire an arbitrage consultant to prepare the calculations required by the Internal Revenue Service. Contractor payments shall be made from either the General Fund or from the special fund for which the calculation was made.

VARIABLE RATE AND SHORT TERM DEBT

I. Purposes

Variable interest rate debt instruments may be used for the following purposes:

A. As a balance sheet management tool, offsetting the risks inherent in variable rate assets. The maintenance of variable rate debt liabilities in an amount equal to or less than the amount of variable rate assets prudently reduces the City's risk of exposure to changes in interest rates. For example, the City currently maintains significant exposure from variable rate assets in the form of the short-term investment of available cash, while a large portion of its liabilities are in the form of fixed-rated debt. When interest rates fall, the City's Budget experiences reduced revenues. Offsetting this exposure with variable rate liabilities would serve to hedge against such interest rate risk. The CAO, with the assistance of the City Treasurer, will provide an analysis of asset and liability balance on a fund-by-fund basis and include it in its report to the Mayor and City Council when recommending variable rate debt.

B. To achieve an expected lower net cost of borrowing with respect to the City's debt by accepting a limited level of interest rate risk. Since the inception of municipal variable rate products in the early 1980s, variable interest rates have borne an average rate that is substantially below the average for fixed rates. For example, since 1990, the average rate on California variable rate bonds has been 3.25%, substantially lower than the lowest 30-year rate experienced over this same period (4.7%). Accordingly, issuers who have accepted variable rate risk have experienced reduced costs of borrowing. One of the goals of this Policy is to define a prudent range of risk exposure.

C. As a tool for interim financing. Since the expectations of variable-rate investors are, by their nature, short-term, variable rate debt can be redeemed on short notice without any penalty in the form of a call premium or higher initial interest rates. This feature makes variable rate debt a preferred tool for financing projects for which a prepayment or restructuring is a high probability. Certain variable rate products, most notably commercial paper, can be issued incrementally as funds are needed to finance current construction, and can reduce the long-term cost of construction financing. Often, commercial paper will be refunded with a long-term financing when the project is completed.

II. Uses of variable rate and short-term debt

A. Tax and Revenue Anticipation Notes: Borrowing for cash flow purposes through the use of tax and revenue anticipation notes is often desirable to manage the timing mismatch between revenues and expenditures over the course of a fiscal year.

B. Bond Anticipation Financing: In certain circumstances, it may be appropriate for the City to issue short-term obligations to finance a capital project, with this obligation refunded with a more conventional long-term financing.

C. Grant Anticipation Notes: The City 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 interest of the City. 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 variable rate debt to diversify the debt portfolio and improve the match of assets to liabilities. Variable rate debt may also provide interest cost savings. If variable rate debt is used, the CAO will periodically, but at least annually, determine if it is appropriate to convert the debt to fixed interest rate.

E. Commercial Paper: Commercial Paper (CP) is a short-term obligation with maturities ranging from 1 to 270 days. It is often used as interim financing until a project is completed to take advantage of lower interest rates. Once a project is completed, the CAO may recommend to refund CP with a long-term financing obligation, if appropriate.

III. Criteria for use of variable rate debt

Any staff recommendation for the use of variable rate debt must make findings consistent with the following criteria:

A. Balance sheet risk mitigation: In determining the appropriate amount of variable rate debt to be issued for risk mitigation purposes, the following factors should be analyzed on the basis of the fund that will be repaying the debt:

- The historic average of cash balances over the course of several prior fiscal years.
- Projected cash balances based on known demands on a given fund and on City fund balance policies.
- Any basis risk, such as the difference in the performance or duration of the City's investment vehicle compared to the variable rate debt instrument to be used by the City.

B. Risk exposure: It may be appropriate for the City to accept a moderate exposure to interest rate risk to benefit from what has been the historic out-performance of the variable rate market. This Policy incorporates the rating agencies guidelines that 20% to 25% of outstanding debt can be in a variable rate mode without representing undue risk. In determining the amount of such risk the City should take, the CAO should consider the specific fund exposed to the risk, and the budgetary flexibility that fund has in accommodating such risk. The analysis of risk exposure should be performed on the basis of "net" risk; that is, variable rate liability exposure net of any interest rate hedge provided by the availability of cash or risk mitigation tools such as interest rate swaps.

C. Interim financing: The City should consider issuing commercial paper in connection with its major debt-financed construction programs, especially when interest earnings on construction and capitalized interest funds are at a rate lower than the rate of long-term bonds, thereby increasing the amount of debt that must be issued to fund a program. Variable rate debt should also be considered in lieu of a long-term fixed rate financing when a refunding or restructuring of the debt is likely due to potential changes in use of the project or credit quality.

D. Synthetic fixed rate: In some markets, the City can simultaneously issue variable rate debt and enter into corresponding swap agreements that have the effect of creating a net fixed rate obligation at a significantly lower net interest cost than the cost of issuing traditional fixed rate debt. The use of variable rate debt should be considered in those instances where the issuance of synthetic fixed rate debt is a viable and cost-effective alternative, subject to the provisions of the Interest Rate Risk Mitigation Products section below.

IV. Selection and Diversification of Remarketing Agents and Counterparties

In selecting remarketing agents for its various variable rate programs, the City should choose remarketing agents that diversify its exposure and create competition among the various remarketing agents. Similarly, in selecting institutions to provide liquidity or credit enhancement, the City should seek to diversify its exposure.

V. Budgeting

The CAO will analyze each variable rate bond program to determine the budgeted amount for debt service. The factors to be analyzed will include historic interest rates, projected interest rates, the effect of risk mitigation products such as interest rate swaps or caps, and the availability of fund balances carried-forward from savings in previous years. To protect against volatile interest rate surges, some cushion will be includes in the budgeted amount. This analysis will be done in conjunction with the formulation of the Mayor’s Proposed Budget.

VI. Monitoring and Reporting

A. CAO Responsibilities: The CAO will manage the City’s variable rate programs, including the performance of actual interest rates compared to the interest rates assumed at the time of budget formulation. The CAO will recommend any appropriate mid-year budget adjustments. The CAO will review and report on the following on a periodic basis:

1. Whether balances remaining at the end of the fiscal year, accruing from actual lower interest rates than those assumed in the budget process, will

be reserved for future interest rate stabilization or otherwise applied for interest rate management.

3. The performance of the individual remarketing agents as compared to other remarketing agents, other similar programs and market indices.

4. The factual circumstances, such as balance sheet factors or the relative amount of debt that supported the original issuance of the variable rate debt.

C. Controller Responsibilities: The Controller will be responsible for monitoring the City's variable debt programs and will report as appropriate to the Mayor and City Council in accordance with the Controller's Charter responsibilities. In addition, the Controller is responsible for reflecting variable rate debt in accordance with Generally Accepted Accounting Principles (GAAP) and with rules promulgated by the General Accounting Standards Board (GASB).

INTEREST RATE RISK MITIGATION PRODUCTS

I. Purpose

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

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

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

II. Uses of Interest Rate Risk Mitigation Products

The purposes for which the City may use interest rate risk mitigation products are specified in Section 5922(a) of the Government Code of the State of California. The CAO will recommend the use of these products only in a manner consistent with the Government Code and only if the Mayor and City Council can make the requisite finding required therein.

As required by the Government Code, no local agency may enter into any contracts or arrangements unless its governing body first determines that the contract, arrangement or program of contracts is designed to reduce the amount or duration of payment, currency, rate, spread, or similar risk or result in a lower cost of borrowing when used in combination with the issuance of bonds or enhance the relationship between risk and return with respect to the investment or program of investment in connection with, or incident to, the contract or arrangement which is to be entered into. When the CAO recommends the use of interest rate reduction products, the CAO will provide information to the Mayor and City Council necessary to make the determinations required by the Government Code.

III. No Speculation

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

IV. Form of Swap Agreements

To the extent possible, the interest rate swap agreements entered into by the City will contain the terms and conditions set forth in the International Swap and Derivatives Association, Inc. (“ISDA”) Master Agreement, including any schedules and confirmation. However, the City reserves the right to amend these terms and conditions including the remedies and obligations as are appropriate to benefit the City. The schedule may be modified to reflect specific legal requirements, business terms and changes to the remedies and obligations as determined by the CAO. The CAO will consider whether to include provisions that permit it to assign its rights and obligations under interest rate swap agreements and to optionally terminate the agreement at its market value at any time. The CAO will transmit the proposed Form of Swap Agreements with negotiating parameters to the Mayor and Council for approval. The CAO will then request authority from the Mayor and City Council to negotiate and execute these agreements, within those parameters, with the assistance of the City Treasurer and the City Attorney, and to modify those agreements to achieve the best interests for the City.

V. Methods to solicit and procure Interest Rate Swaps:

The CAO will solicit and procure interest rate swap agreements by competitive bid whenever feasible. The CAO will determine which parties are allowed to participate in a competitive transaction but these parties must conform to the minimum credit standards outlined in this Policy.

Notwithstanding the above, the CAO may procure interest rate swap agreements by negotiated methods if it is determined that due to the size or complexity of a particular interest rate swap competitive bidding is undesirable, impractical or impossible and a negotiated transaction would result in the most favorable pricing.

Such finding will be based on advice by an independent financial advisory firm and with the assistance of the City Attorney. In this situation, the CAO should attempt to price the swap based upon an agreed-to methodology relying on available pricing screens to obtain inputs to a mathematical model. If appropriate, the CAO should use an independent financial advisory firm to assist in the price negotiations.

Regardless of the method of procurement, the CAO will obtain a finding from an independent financial advisory firm that the terms and conditions of the interest rate swap agreement reflect a fair market value of such agreement as of the date of its execution.

VI. Aspects of Risk Exposure

Before entering into an interest rate swap agreement, the CAO will evaluate the risks inherent in the transaction. The risks to be evaluated could include amortization risk, basis risk, credit risk, counterparty risk, interest rate risk, rollover risk, tax event risk and termination risk. Identification of the risks and discussion of the means, if any, employed to mitigate the risks will be contained in the CAO report recommending to the Mayor and City Council approval of the swap agreement.

A. Amortization Risk: Amortization risk is defined as the mismatch of the expiration of the underlying obligation and its hedge, the swap agreements. Amortization risk is the possibility that as the result of early redemption of the underlying variable rate bonds, the repayment schedule of the bonds differs from the underlying notional amount of the swap agreement. This risk will only arise if the City wants to redeem the variable rate bonds ahead of schedule, which is not expected for most City bond financings. Before undertaking a refunding of the bonds, the CAO will consider the implications on the related swap agreement**.**

B. Basis Risk: Basis risk refers to the mismatch between the actual variable rate debt service and variable rate index used to determine the swap payments. The CAO will evaluate different swap indices as part of its analysis of the swap agreement and identify the amount of basis risk that may result from various indices.

C. Credit Risk: Credit risk refers to the occurrence of an event modifying the credit rating of the counterparty. Certain interest rate risk mitigation products create a continuing exposure to the creditworthiness of financial institutions that serve as the City’s counterparties on such transactions. Setting credit standards that must be met by the counterparty to participate in a transaction can minimize this risk.

D. Counterparty Risk: Counterparty risk refers to the failure of the counterparty to make its required payments. The CAO will attempt to minimize counterparty risk by establishing strong minimum credit standards and diversifying the City’s exposure to counterparties. To that end, before entering into a transaction, the CAO will analyze the City’s existing exposure to that counterparty and then determine how the proposed transaction would affect the exposure. The exposure should not be measured solely in terms of the amount, but rather how changes in interest rates would affect the City’s exposure (“Value at Risk”). The Value at Risk should be based on all outstanding swap and interest rate risk reduction agreements of the City.

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

F. Tax Events Risk: Tax events risk is defined as the risk created by potential changes to Federal and State income tax codes on the interest rates to be paid by the City on its variable rate bonds. Tax events risk is a form of basis risk. The CAO will evaluate the potential impact of changes in marginal tax brackets as part of its analysis of basis risk.

G. Termination Risk: Termination risk refers to the possibility that, upon a default by the counterparty, the City may be required to make a large payment to the counterparty if the swap agreement is terminated prior to its scheduled maturity pursuant to its terms. For certain types of swaps, a payment by the City may be required if interest rates have fallen causing the market value of the remaining payments to be in favor of the counterparty. The CAO will minimize termination risk by recommending to the Mayor and City Council the selection of counterparties with strong creditworthiness, the requirement for the counterparty to post collateral in excess of the swap agreement's market value, the limitation of the circumstances where a payment may be required, and the ability to assign the agreement to a creditworthy entity in lieu of termination.

VII. Counterparty Credit Standards

To protect the City's interests in the event of a credit problem, the CAO will recommend entering into a swap agreement with a counterparty only if it meets the following standards:

A. At least two of the counterparty's credit ratings are rated at least "Aa3" or "AA-", or equivalent, by any two of the nationally recognized rating agencies (i.e. Moody's, Standard and Poor's, or Fitch); or

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

VIII. Collateralization on Downgrade

The obligations of the counterparty will be collateralized at levels and with securities acceptable to the CAO, as set forth in the swap agreement, should the rating:

A. of the counterparty, if its payment obligations are not unconditionally guaranteed by another entity, or

B. of the entity that unconditionally guarantees its payment obligations, if so secured.

IX. Termination

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

X. Legality

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

XI. Monitoring and Reporting

A. <u>CAO Responsibilities</u>: The CAO is responsible for determining the appropriate uses for interest rate risk mitigation products in conjunction with the City's debt financing and programmatic needs, and making recommendations to the Mayor and City Council.

The CAO may issue a quarterly report to the Mayor and City Council on the month following the end of each quarter in which the City enters into or continues to have an interest rate swap agreement. Alternatively, the CAO may provide information on swaps in a subsequent Financial Status Report. The report will include the following information, to the extent applicable:

1. Highlights of all material changes to interest rate swap agreements including counterparty downgrades and/or terminations;

2. A summary of any new interest rate swap agreements entered into by the City since the last report;

3. A summary of any planned interest rate swap transactions and the impact of such transactions on the City;

4. A description of each outstanding interest rate swap agreement, including a summary of its terms and conditions, the notional amount, rates, maturity, the estimated market value of each agreement, the method of procurement (competitive or negotiated), and the full name, description and credit ratings of the agreement's counterparty and, if applicable, its guarantor;

5. Any amounts that were required to be paid and received, and any amounts that were actually paid and received under each outstanding interest rate swap agreement;

6. Any credit enhancement, liquidity facility or reserves associated with the swap including an accounting of all costs and expenses incurred, whether or not in conjunction with the procurement of credit enhancement or liquidity facilities under each outstanding interest rate swap agreement;

7. An assessment of the counterparty risk, termination risk, and other risks associated therewith, which will include the aggregate marked to market value for each counterparty and relative exposure compared to other counterparties and a calculation of the City's Value at Risk for each counterparty; and,

8. A copy of this Policy in the quarter after it is adopted or subsequently modified.

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

MICLA COMMERCIAL PAPER POLICIES

I. Purpose

The Mayor and City Council approved the Lease Revenue Commercial Paper Note Program (the "CP Program") for the purpose of financing the acquisition of various capital assets, including equipment and real property. This Program gives the City tremendous flexibility in financing its capital program, including quicker implementation and reduced costs. The CP Program is designed to be a form of "bond anticipation note", with lease revenue bonds being issued from time to time refund the CP and provide permanent financing.

II. Administrative Procedures

The CAO has developed a set of administrative policies and procedures (the "CP Policies") and a computer model to assist in the management of this Program.

These documents will be amended from time to time as appropriate to incorporate staff's experience with the Program. The following are among the matters currently discussed in the CP Policies:

A. Project approval process: Although the Mayor and City Council have approved the establishment of a General Fund MICLA CP Program (currently $200 million), specific approval will be required for the funding of each project. From time to time, the CAO will prepare a report to the Mayor and Council recommending the allocation of a portion of this capacity and its appropriation to specific projects.

B. CAO administrative responsibilities: The CAO will be responsible for the overall management of this program and has been delegated to perform most MICLA responsibilities. These responsibilities include requesting that the dealers issue new CP as needed to fund approved projects; managing the roll-over of maturing notes until there is a long-term take out financing; planning and executing the take-out financing; and budgeting for debt service and on-going administrative expenses.

C. Controller responsibilities: The Controller is responsible for creating and maintaining the CP Fund, and approving demands in the same manner as other City funds. The Controller will also provide such reports as necessary and appropriate to show the financial condition of the CP Fund.

D. Departmental responsibilities: Each department is responsible for awarding contracts, encumbering funds, processing payment for approved projects, and providing the CAO sufficient information so that CP can been issued in a timely as-needed basis.

III. Debt Structure and Amortization

The City intends to pay interest on CP as it becomes due, and to begin amortization of the principal associated with each project in the same manner as if it were financed with long-term lease revenue obligations.

FINANCIAL MANAGEMENT GOALS

I. Multi-Year Budget

As part of its annual budget process, the CAO intends to prepare a multi-year budget, which forecasts revenues and expenditures to evaluate the financial condition of the City for the subsequent five years. This forecast shall be recognized through action of the Council along with the adoption of the budget for the coming fiscal year.

II. Fund Balance Policy

The City recognizes the importance of emergency reserves that can provide a financial cushion in years of poor revenue receipts. A Reserve Fund Policy has been developed and approved by the Mayor and Council. A copy of the Reserve Fund Policy is part of these Financial Policies of which this is a section.

III. Annual Debt Report

The CAO will annually prepare a report to the Mayor and City Council, which reviews the outstanding debt of the City. This may occur in conjunction with the annual budget.

IV. Work with Overlapping Jurisdictions

The City recognizes the impact that the borrowing of overlapping jurisdictions can have on the City's own debt affordability. The CAO will maintain contact with the major overlapping debt issuers to coordinate borrowing plans.

VI. Applicability of Policies to Other City Issuers

The Departments of Airports, Harbor, and Water and Power, the Housing and Industrial Development Authorities (IDAs) through the Community Development and Housing Departments, the Community Redevelopment Agency, and the Housing Authority issue debt on their own behalf. It is understood that various requirements of State law and the City Charter, which apply to these programs as well as unique aspects of these financing programs, make across the board application of these Policies in their entirety to all City issuers not possible. However, it is the intent of the Mayor and Council that where practicable, these policies apply to all City issuers, especially the Conduit Financing Policies detailed below to the Housing and Community Development Departments. Deviations from the Policies should be fully explained to the Mayor and Council at the time authority to enter into debt is requested.

FINANCIAL CONSULTANTS

I. Retention of Consultants

A. General: All financial advisors, bond counsel and underwriters will be selected through a Request for Proposals (RFP) or Request for Qualifications (RFQ) process, whichever is most appropriate given the circumstances. In isolated instances, such contracts may be awarded on a sole source basis if it is clear that a RFP/RFQ process would not be feasible or in the City’s interests. The City's contracting policies, including Affirmative Action, Child Care, Minority/Women/Other Business Enterprise (MBE/WBE/OBE) participation, Living Wage, and any other policies in effect at the time, will apply to all contracts with finance professionals, as permitted by Federal and State law. Generally, the terms of the contracts for financial advisor and bond counsel will depend on each financing program. In the event that the City issues bonds through a negotiated sale, the selection of underwriters will generally be for a single transaction. Underwriters may be selected for multiple transactions if multiple issuances are planned for the same project.

B. General Financial Advisor: The City will retain a general financial advisory team to provide general advice on the City's debt management program, financial condition, budget options and rating agency relations. Additionally, the general financial advisors will structure the City's General Obligation Bond issuances and may be used on an as-needed basis to structure bond issuances that do not fall into the other categories of City debt obligations.

C. Financial Advisors: The City will retain financial advisors for each of the City's various bond financing programs. The CAO will issue either a RFP or RFQ depending on the needs of the City. The CAO will recommend one or two advisors for each financing depending on the size, complexity and timing of the bond sale.

D. Bond Counsel Services: The City will select bond counsel teams for its current bond programs. As-needed bond counsel teams will be selected for those issuances that do not fall into any other categories of City debt obligations. Firms chosen to serve on teams may be called upon to provide general legal advice on a debt financing matter arising after the close of a transaction. A Bond Council team will consist of Bond Counsel, Special Tax Counsel and Disclosure Counsel depending on the specifics of the financing and may involve up to three different firms.

E. City Financing Teams: Financial advisors, bond counsel, and underwriters, where applicable, will be selected through a competitive process for the City's General Fund lease financings, Wastewater System Revenue Bond Program, Special Parking Revenue Fund Program, Sanitation Equipment Charge Revenue Bond Program, Mello-Roos and special assessment bonds, and any other bond program that may be created. Depending on particular expertise and consultant availability, some firms may be used on more than one program. However, efforts will be made to establish different teams to provide a number of firms the opportunity to participate in City contracts.

F. Location of Consultants: Generally, financial advisors, bond counsel, and underwriters who participate in City contracts must have an office in the City of Los Angeles. Exceptions may be made for small firms serving as co-bond counsel or co-financial advisor and who are seeking to expand their client base and open new offices. Additionally, exceptions will be made when specialized expertise is required and such expertise is best provided by a firm located outside of Los Angeles County.

II. Use of Independent Financial Advisors

A. Use of Independent Financial Advisors on Competitive Sales: The City will hire financial advisors who are independent and do not participate in the underwriting or trading of bonds or other securities. Under certain circumstances, however, it may be in the City's interests to hire an investment banking firm to act as co-financial advisor on a specific bond issue. In the event that a financial advisor working for the City does underwrite, the firm will, under no circumstances, be permitted to lead a syndicate that is bidding on the project for which the firm is acting as financial advisor. In some circumstances, such as very routine financings and financings for which the financial advisor did not play a lead role in structuring the transaction and upon request of the firm, the City may allow the firm to participate in a bidding syndicate in a non-book running role.

B. Use of Independent Financial Advisors on Negotiated Sales: In recognition of the fact that in a negotiated sale the goals of the underwriters and the issuer are inherently in conflict, the City **will** hire financial advisors who do not participate in the underwriting or trading of bonds or other securities to represent the City. The only exception to this policy would be that all independent financial advisory firms, which responded to the RFP, are found to be unqualified. In this event, the City may hire an underwriter to act as financial advisor to the City. However, the underwriter would be prevented from participating in the underwriting of the transaction, and no firm that has any profit sharing or other type of agreement with any member of the underwriting team for the transaction in question or any other transaction for any issuer will be allowed to serve as financial advisor.

C. Use of Financial Advisors for Investment Advice: Although the City Treasurer makes all investment decisions relative to temporary investments pending the expenditure of bond proceeds, the financial advisor may provide investment advice on refundings and other transactions with specialized investment needs. Under no circumstances will the City enter into any investments for which the financial advisor receives any fee or compensation from the investment provider or any outside party.

III. Disclosure by Financing Team Members

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. The extent of the disclosure may vary depending on the nature of the transaction. However, in general terms, no agreements will be permitted that would compromise any firm's ability to provide independent advice that is solely in the best interests of the City, or that could reasonably be perceived as a conflict of interest.

CONDUIT FINANCING POLICIES

I. General

A. Federal Tax Law: Federal tax law allows for state and local governments to issue tax-exempt securities on behalf of nonprofit corporations exempt from taxes under Section 501(C)(3) of the Internal Revenue Service (IRS) Code.

B. City Liability: While the City issues Certificates of Participation (COPs) on behalf of these organizations, repayment of the debt is secured solely by the nonprofit corporation. No City funds are pledged to support the COPs and no appropriation will be made in the event of default. As such, these financings are referred to as "conduit" financings.

C. Administration: Until Fiscal Year 1995-96, the CAO was the agency that structured conduit financings and was responsible for ongoing administration. The CAO will continue to administer conduit financings completed prior to 1995-96. However, beginning in 1995-96, the Industrial Development Authority (IDA) assumed the responsibility for conduit financings for the City. All future issuances will be structured and administered by the IDA. These policies will apply generally to conduit financings through the IDA and will apply to all future conduit issuances through the CAO, if any.

D. California Statewide Community Development Authority (CSCDA): The State has established the CSCDA to, among other things, act as the conduit for 501(C)(3) financings. The City's only involvement when the CSCDA acts as the conduit is to hold the public hearing as explained more fully below. These policies, therefore, apply only to those financings for which the City acts as the conduit.

II. Qualified Organizations

D. Charter Provisions: The City's legal ability to participate in conduit financings is derived primarily from Charter Section 102(b), which empowers the City to "participate in the financing efforts…with…other governmental bodies."

E. Tax-Exemption: Organizations for which the City acts as a conduit must be nonprofit corporations exempt from federal taxes under section 501(C)(3). The types of projects that have been financed in the past include hospitals, retirement facilities, museums and community centers.

III. Conduit Procedures

A. Pre-application Meetings: Early communication with Council Office staff and the CAO is strongly encouraged. In most cases, a meeting of the applicant, the CAO, and the Council district staff in which the project is located will be required prior to submission of the formal application for funding.

B. Selection of Financing Team: The applicant will select its own financing team (underwriters and bond counsel), subject to the approval of the City.

C. Form of Application: Applications will be in the form of a letter request, to be submitted to the Council Office in which the project is located. The letter will request that the matter be forwarded to the IDA or CAO for processing who will report back to the Mayor and Council. A copy of this letter will be sent to the City Administrative Officer, attention: Debt Management Group.

D. Application Information: The application letter should include the name, address and telephone number of all principals, including underwriter and bond counsel; a history of the applicant and its facilities; the population served by the facilities, including, if applicable, the percentages that receive some form of public assistance such as Medicare or MediCal and the percentages that are residents of the City of Los Angeles; the population employed at the facilities; a complete description of the proposed project(s) to be financed; the sources and uses of funds; and, a complete statement of the public purpose served through the financing.

E. Application Review: City staff will review the application and obtain other information as required. A report will be made to the Mayor and Council recommending whether or not the City should initiate financing activities. This action may include inducement of the project for federal tax purposes. Subsequently, assigned departmental staff will coordinate the completion of documents with the applicant, which will be submitted to the Council for approval.

F. Public Hearing: The Tax Code requires that a public hearing be held to allow for the public to voice any objections to the project (the "TEFRA" hearing). If the CSCDA or any entity other than the City is acting as the conduit, the City's involvement begins and ends with the TEFRA hearing. In cases where the City is acting as the conduit, the TEFRA hearing will be held in conjunction with consideration of the resolution authorizing the sale of the bonds.

IV. Conditions for Consideration

A. Minimum Credit Ratings: All conduit financings must have a minimum credit rating of AA from Fitch, Aa from Moody's, or AA from Standard & Poor's, and must be rated by two of the agencies. If the underlying rating of the borrower is not sufficient to provide the minimum rating, the financing must have credit support that will result in the minimum rating.

B. Public Benefit: The proposed financing must have a public benefit to the residents of the City of Los Angeles that is sufficient to merit the City's participation in the financing.

C. Non-Sectarian Nature: While religious ownership and sponsorship of a project are acceptable, the project for which bond proceeds will be utilized cannot be used for any sectarian purpose. In analyzing the sectarian nature of a project, the City may rely on an opinion issued by the California State Attorney General on this matter, which addressed both Federal and State constitutional prohibitions against public support for religious institutions.

D. Fees: The City will charge a fee, payable from bond proceeds, to finance all of its costs in undertaking a financing. The fee will vary depending on the complexity of the project and will be determined prior to adoption of the resolution authorizing the sale of the bonds.

E. Opinions of Counsel: Bond Counsel, underwriters counsel and the borrower's counsel will be required to provide the City with opinions as to the adequacy of the official statement as specified in Securities and Exchange Commission (SEC) Rule 10b-5 (a "10b-5 Opinion").

F. Document Requirements: The following will be applicable to all documents related to conduit financings:

    1. All contracts to which the City is a party will comply with all City contracting provisions in effect at the time the contracts are executed.

    2. The transaction will be clearly structured as a limited obligation payable strictly from revenues from the nonprofit organization, and the City will in no way be obligated to make payments on the bonds or foreclose on any organization as a result of default.

    3. The nonprofit organization will fully indemnify the City.

    4. The nonprofit corporation will provide annual financial statements to the City and a statement that there has been no default or other material event that requires disclosure. Additionally, the nonprofit corporation will covenant to expeditiously provide additional information to the City and investors as may reasonably be requested. The nonprofit corporation will covenant to immediately inform the City of any event which materially affects the organization and may require disclosure and be liable for any costs incurred in connection with providing additional disclosure to investors, bond rating agencies or other parties.

5. In addition to monthly statements and other information provided for in the indenture, the Trustee will covenant to provide information to the City and investors as may reasonably be requested.

6. Closing documents will include a contract with an arbitrage consultant.

7. The nonprofit corporation will deem the preliminary official statement final for SEC purposes and will sign the final official statement.

8. The name of the City of Los Angeles in the masthead of the official statement will be in the smallest type size used in that location and the name of the nonprofit corporation will be larger and more prominently displayed than that of the City.

9. Throughout the official statement, the limited obligation of the City will be clearly disclosed.

GLOSSARY OF KEY TERMS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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