Emerald People's Utility District
Limited Interest Rate Swap Policy
Draft of May 3, 2004

The 2003 regular session of the Oregon Legislative Assembly enacted House Bill 2131. That act authorizes the district to enter into agreements for the exchange of interest rates, or interest rate “swaps.” The administrative rules of the Oregon Municipal Debt Advisory Commission for swaps require the district to adopt a swap policy before the district approves any swaps.

The Board of Emerald People’s Utility District adopts this limited interest rate swap policy to establish guidelines for the execution of interest rate swaps for outstanding fixed rate bonds, that provide for the district to pay a floating interest rate and to receive a variable interest rate.

This limited interest rate swap policy confirms the commitment of the district’s board, management, staff, advisors, and other decision makers to adhere to sound financial and risk management practices, including achieving the lowest possible cost of capital within prudent risk parameters.

The Board intends to review this Policy periodically while it maintains an interest in entering into swaps, and to update this policy as necessary.

Philosophy Regarding Use of Swaps

The district intends to use interest rate swaps only in connection with its outstanding fixed rate bonds. The swaps will effectively allow the district to pay a variable rate of interest on those bonds. At the time this policy is adopted, all of the District’s outstanding bonds bear interest at fixed rates.

Permitted Instruments

This policy only authorizes the use of interest rate swaps in connection with outstanding bonds, and only if those swaps require the district to pay a floating rate of interest, and to receive a fixed rate of interest. These swaps are referred to in this policy as “Authorized Swaps.”

Swap Risk Analysis

Before approving an Authorized Swap the district shall evaluate the risks associated with the swap, and shall not approve an Authorized Swap unless the anticipated benefits outweigh the anticipated risks. Authorized Swaps present the following primary risks:

• Interest Rate Volatility: Authorized Swaps require the district to pay interest rates that vary over time. Before approving an Authorized Swap the district shall develop a plan to manage this interest rate volatility.

• Termination Risk – Swaps can be terminated under a variety of circumstances. Swaps are evaluated like investments, and their value varies over time as interest rates and conditions in the swap market change. If a swap is terminated and its value exceeds its current market value, the party with the advantage must pay the other party that difference in value. The amount of a termination payment varies with market conditions and the term of the swap, but can be quite large. Before approving an Authorized Swap the district shall develop plans for mitigating the risk of termination and funding a potential termination payment.

• Counterparty Risk – The creditworthiness of the counterparty affects the terms of the swap and the likelihood of a termination payment. All counterparties shall meet the requirements described below in “Swap Counterparties Policies” unless the Board specifically determines at the time an
Authorized Swap is approved that the benefits of dealing with a lower rated counterparty outweigh the risks.

• Risk of Change in Business Conditions – If the terms of the Authorized Swap or its benefits may vary depending changes in the business circumstances of the district or its counterparties, then before approving that Authorized Swap the district shall analyze those risks and develop a plan for mitigating them.

Limits

The District determines it is appropriate to have approximately twenty-five percent of its debt portfolio should bear interest at variable rates, and shall not enter into Authorized Swaps that exceed that amount unless the Board specifically determines that the benefits of authorizing a larger amount outweigh the risks.

The District shall calculate the effect of a 1% unfavorable change in interest rates on its swap payments program at least quarterly.

The term of Authorized Swaps shall not exceed the term of the district bonds associated with the swaps.

The total notional amount of the Authorized Swaps shall not exceed the total par amount of the district bonds associated with the swaps.

Financial Advisor, Swap Procurement and Execution

The District will retain an independent financial advisory firm (a “Financial Advisor”) to assist it on all matters related to procuring and executing an Authorized Swap.

The District will procure an Authorized Swap by competitive bid when feasible.

The District may procure an Authorized Swap by negotiated methods if it is determines that due to the size or complexity of a particular Agreement, competitive bidding is undesirable, impractical or impossible and a negotiated transaction would result in favorable terms. The District will have its Financial Advisor to assist in price negotiations and the determination of the method of procurement.

The District shall not enter into an Authorized Swap unless its Financial Advisor advises the district that the terms and conditions of the Authorized Swap are consistent with market conditions for that swap at the time it is executed.

Swap Counterparties Policy

The District shall require that its swap counterparties have strong credit ratings. While the District may have a flexible credit standard, it will attempt to do business with counterparties rated in the “AA” category or above as of the transaction date.

For lower-rated (below “AA” category) counterparties or for any counterparty which may have its rating reduced below “AA” the District shall confer with its Financial Advisor and seek credit enhancement in the form of:
• Collateral; or
• Guarantees.
Active Management

The District will seek to maximize the benefits it accrues and minimize the risks it bears by actively managing its swap program. The District shall monitor market conditions (such as current interest rates, credit ratings or the parties to a transaction and other relevant factors), to determine whether any of the following may be appropriate:
- Early termination of an Authorized Swap; and,
- Shortening, lengthening or otherwise modifying the term of an Authorized Swap.

Reporting and Disclosure

The District shall provide the Board with quarterly reports on the status of its swap transactions. These reports will include market values, cash flows, value at risk and other performance measures, as well as evaluations of each transaction's performance relative to benchmarks or goals set forth for the transaction or the District's general financial benchmarks or goals. The reports will also note all material changes to swap agreements or new swap agreements entered into by the District since the last report.

Effect on Ratings

Before entering into any Authorized Swap the District will confer with its Financial Advisor or bond rating agencies to determine the effect that the swap may have on the credit quality of the District.
Emerald People’s Utility District  
Resolution No. 2004-05  
A Resolution to Adopt a Limited Interest Rate Swap Policy

WHEREAS, Emerald People’s Utility District is required to adopt a Swaps Policy before the district approves any swaps; and

WHEREAS, the Board would like this future financial flexibility; and

WHEREAS, the Board adopts this limited interest rate Swap Policy to establish guidelines for the execution of interest rate swaps for outstanding fixed rate bonds, that provide for the district to pay a floating interest rate and to receive a variable interest rate;

BE IT THEREFORE RESOLVED THAT, the Board of Directors of Emerald PUD, adopts the Limited Interest Rate Swap Policy, which is attached.

ADOPTED by the Board of Directors of Emerald People’s Utility District at its regular meeting on May 11, 2004.

By: Katherine Schacht  
Katherine Schacht, Board President

ATTEST: Beth Matthews  
Beth Matthews, Board Secretary

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