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Policies and Procedures

No. 58

SUBJECT:

Board Approval: 07/17/08

INTEREST RATE SWAP POLICY

PURPOSE:

The purpose of this policy (the "Policy") is to establish guidelines for the execution and management of the Metropolitan Transit System's ("MTS's") use of interest rate swaps or similar financial instruments ("Swaps") and related transactions to meet the financial and management objectives as outlined herein.

This policy confirms the commitment of MTS management to adhere to sound financial and risk management practices.

SCOPE:

MTS recognizes that Swaps can be appropriate financial management tools to achieve MTS's financial and management objectives. This Policy sets forth the manner in which MTS shall enter into transactions involving Swaps. MTS shall integrate Swaps into its overall debt and investment management programs in a prudent manner in accordance with the parameters set forth in this Policy.

This Policy applies to any interest rate swap; swap option or related transaction that MTS may undertake.

POLICY:

58.1 AUTHORIZATIONS AND APPROVALS; COMPLIANCE WITH BOND DOCUMENTS AND COVENANTS

MTS shall obtain the approval of MTS's Board of Directors (the "Board") prior to entering into any interest rate swap, swap option or related transaction. MTS, in consultation with its Bond Counsel and Financial and Swap Advisors, will determine whether a proposed swap agreement complies with state law and any other applicable law and any other applicable provisions of MTS's bond resolutions and agreements with respect to its outstanding debt.

General Objectives

MTS may execute an interest rate swap, swap option, or related transaction to the extent the transaction can be reasonably expected to achieve one or more of the following objectives:

- Result in a lower net cost of borrowing with respect to MTS's debt, or achieve a higher net rate of return on the investment of MTS monies.
- Reduce exposure to changes in interest rates either in connection with a particular debt financing or investment transaction or in the management of interest rate risk with respect to MTS's overall debt and investment portfolios.
- Enhance financing flexibility for future capital projects.

58.2 PROHIBITED USES OF INTEREST RATE SWAPS AND RELATED INSTRUMENTS

MTS shall not execute interest rate swaps agreements or related instruments under the following circumstances:

- When a swap or other financial instrument is used for speculative purposes, such as potential trading gains, rather than for managing and controlling interest rate risk in connection with MTS debt or investments;
- When a swap or other financial instrument creates extraordinary leverage or financial risk;
- When MTS lacks sufficient liquidity to terminate the swap at current market rates; or
- When there is insufficient price "transparency" to permit MTS and its financial advisors to reasonably value the instrument, as a result, for example, of the use of unusual or highly complex structures or terms.

58.3 PERMITTED FINANCIAL INSTRUMENTS

MTS may utilize the following hedging instruments, if then permitted by law, on either a current or forward basis, after identifying the objective(s) to be realized and assessing the attendant risks, if permitted by law:

- Interest rate swaps, including fixed, floating and/or basis swaps.
- Interest rate caps, floors, and collars.
- Options, including on swaps, caps, floors and/or collars and/or cancellation or index-based features.

- Other related financial instruments that MTS and its financial advisors consider appropriate for use pursuant to the terms of the Policy.

58.4 IDENTIFICATION AND EVALUATION OF FINANCIAL AND OTHER RISKS

Prior to execution of an interest rate swap, option, or related transaction, MTS and its financial advisors shall identify and evaluate the financial risks involved in the transaction, and summarize them, along with any measures that will be taken to mitigate those risks. The types of questions that should be evaluated in connection with the identification and evaluation of financial risks shall include:

- Market or Interest Rate Risk: Does the proposed transaction hedge or create exposure to fluctuations in interest rates?
- Tax Law Risk: Is the proposed transaction subject to rate adjustments, extraordinary payments, termination, or other adverse consequences in the event of a future change in federal income tax policy?
- Termination Risk: Under what circumstances might the proposed transaction be terminated (other than at the option of MTS)? At what cost? Does MTS have sufficient liquidity to cover this exposure?
- Risk of Uncommitted Funding ("Put" Risk): Does the transaction require or anticipate a future financing(s) that is dependent upon third-party participation? What commitments can be or have been secured for such participation?
- Legal Risk: Is there any uncertainty regarding the legal authority of any party to participate in the transaction?
- Counterparty Credit Risk: What is the credit-worthiness of the counterparty? What provisions have been made to mitigate exposure to adverse changes in the counterparty credit standing?
- Ratings Risk: Is the proposed transaction consistent with MTS's current credit ratings or its desired future ratings and with related rating agency policies?
- Basis Risk: Do the anticipated payments that MTS would make or receive match the payments that it seeks to hedge?
- Tax Exemption on MTS Debt: Does the transaction comply with all federal tax law requirements with respect to MTS's outstanding tax-exempt bonds?
- Accounting Risk: Does the proposed transaction create any accounting issues that could have a material detrimental effect on MTS's financial statements? Would the proposed transaction have any material effect on MTS's rate covenant calculation or compliance? How are any such effects addressed?

- Administrative Risk: Can the proposed transaction be readily administered and monitored by MTS's finance team consistent with the policies outlined in MTS's Interest Rate Swap Policy?
- Subsequent Business Conditions: Does the proposed transaction or its benefits depend upon the continuation or realization of specific industry or business conditions?
- Aggregate Risk: To the extent that other departments of MTS or issuing entities of MTS also have swap exposures that may aggregate up to MTS level; i.e., they are not limited but involve some sort of pledge by MTS itself, MTS should include this risk in its overall analysis.

58.5 RISK LIMITATIONS

The total notional amount and term of all Swaps executed by MTS shall not exceed the notional amount and term specified from time to time by MTS Chief Financial Officer. It is expected that MTS's total variable rate exposure, net of Swaps that have the economic effect of reducing variable rate exposure, will be established from time to time based upon an evaluation of all relevant factors, including investment allocations, risk tolerance, credit strength, and market conditions. MTS will strive to manage its credit risk to any one counterparty by limiting its maximum potential termination exposure (as measured by the current mark-to-market value of its swaps plus any increase in value due to potential future changes in interest rates based on historical or projected measures applied over the remaining term of each swap) such that it does not exceed a prudent level as measured against gross revenues, available assets, or other financial resources of MTS. Such limits will be reviewed periodically and MTS may make exceptions to these limitations in its discretion after consultation with its Swap Advisor and Bond Counsel. If any exposure limit is exceeded by counterparty during the term of a Swap, the Chief Financial Officer shall consult with the Swap Advisors and Bond Counsel regarding appropriate actions to take, if any, to mitigate such increased exposure.

58.6 FORM OF SWAP AGREEMENTS

Each Swap executed by MTS shall contain terms and conditions as set forth in the International Swap and Derivatives Association, Inc. ("ISDA") Master Agreement, including the Schedule to the Master Agreement and a Credit Support Annex, as supplemented and amended in accordance with the recommendations of MTS's finance team. The swap agreements between MTS and each qualified swap counterparty shall include payment, term, security, collateral, default, remedy, termination, and other terms, conditions, and provisions as MTS, in consultation with its financial advisors and Bond Counsel deems necessary or desirable.

58.7 QUALIFIED SWAP COUNTERPARTIES

Qualified swap counterparties, or their guarantor or credit support provider, shall (1) be rated at least "Aa3" or "AA-", or equivalent by at least one of the three nationally recognized rating agencies (i.e. Moody's, Standard and Poor's, and

Fitch) and at least “A2” or “A” by the other two nationally recognized rating agencies; or (2) have, as support for their obligations, a “AAA” subsidiary or other entity (e.g. bond insurer) as rated by at least one nationally recognized rating agency.

58.8 PROCUREMENT PROCESS

MTS may either negotiate or competitively bid interest rate swap transactions with qualified swap providers. Each Swap executed by MTS shall be the subject of an independent review and analysis by a Swap Advisor or other qualified party and include a finding that its terms and conditions reflected a fair market value as of the date and time of its execution

58.9 TERMINATION PROVISIONS AND MTS LIQUIDITY

- Optional Termination: All interest rate swap transactions shall contain provisions granting MTS the right to optionally terminate a swap agreement at any time over the term of the agreement. In general, exercising the right to optionally terminate an agreement produces a benefit to MTS, either through receipt of a payment from a termination, or if a termination payment is made by MTS, in connection with a corresponding benefit from a change in the related MTS debt or investment, as determined by MTS. The Chief Financial Officer, as appropriate, in consultation with MTS’s finance team, shall determine if it is financially advantageous for MTS to terminate a swap agreement.
- Termination Events: A termination payment to or from MTS may be required in the event of termination of a swap agreement due to a default by or a decrease in the credit rating of either MTS or the counterparty. Prior to entering into the swap agreement or making any such termination payment, as appropriate, the Chief Financial Officer shall evaluate whether it would be financially advantageous for MTS to enter into a replacement swap as a means of offsetting any such termination payment.

Any swap termination payment due from MTS shall be made from available MTS monies. The Chief Financial Officer shall report any such termination payments to MTS at the next MTS meeting.

- Available Liquidity: MTS shall consider the extent of its exposure to termination payment liability in connection with each swap transaction and the availability of sufficient liquidity to make any such payments that may become due.

58.10 TERM AND NOTIONAL AMOUNT OF SWAP AGREEMENT

MTS shall determine the appropriate term for an interest rate swap agreement on a case-by-case basis. The slope of the interest rate swap curve, the marginal change in swap rates from year to year along the swap curve, and the impact that the term of the swap has on the overall exposure of MTS shall be considered in determining the appropriate term of any swap agreement. For any swap agreement entered into in connection with the issuance or carrying of bonds, the

term of such swap agreement shall not extend beyond the final maturity date of such bonds.

58.11 COLLATERAL REQUIREMENTS

As part of any swap agreement, MTS may require collateralization or other credit enhancement to secure any or all swap payment obligations of the counterparty. As appropriate, MTS may require collateral or other credit enhancement to be posted by each swap counterparty under the following circumstances:

- Each counterparty shall be required to post collateral, in accordance with its (or its guarantor's) credit rating equal to the positive net termination value of the swap agreement.
- Collateral shall consist of cash, U.S. Treasury securities, and U.S. Agency securities.
- Collateral shall be deposited with a custodian, acting as agent for MTS, or as mutually agreed upon between MTS and each counterparty.
- The market value of the collateral shall be determined on at least a monthly basis.
- MTS will determine reasonable threshold limits for the initial deposit and for increments of collateral posted thereafter.
- The Chief Financial Officer shall determine on a case-by-case basis whether other forms of credit enhancement are more beneficial to MTS.

In connection with any collateralization requirements that may be imposed upon MTS in connection with a swap agreement, MTS may post collateral or it may seek to obtain swap insurance in lieu of posting collateral. The Chief Financial Officer shall recommend a preferred approach to MTS on a case-by-case basis.

58.12 REPORTING REQUIREMENTS

MTS's finance team will monitor any interest rate swaps that MTS enters into on at least a monthly basis.

MTS's Chief Financial Officer will provide a written report to MTS regarding the status of all interest rate swap agreements on at least a semiannual basis and shall include the following information:

- Highlights of all material changes to swap agreements or new swap agreements entered into by MTS since the last report.
- Market value of each of MTS's interest rate swap agreement.
- For each counterparty, MTS shall provide the total notional amount position, the average life of each swap agreement, the

available capacity to enter into a swap transaction, and the remaining term of each swap agreement.

- The credit rating of each swap counterparty and credit enhancer insuring swap payments, if any.
- Actual collateral posting by each swap counterparty, if any, under each swap agreement and in total by that swap counterparty.
- A summary of each swap agreement, including, but not limited to, the type of swap, the rates and dollar amounts paid by MTS and received by MTS, and other terms.
- Information concerning any default by a swap counterparty under a swap agreement with MTS and the results of the default, including, but not limited to, the financial impact to MTS, if any.
- A summary of any planned swap transactions and the projected impact of such swap transactions on MTS.
- A summary of any swap agreements that were terminated.

58.13 SWAPS ACCOUNTING TREATMENT

MTS shall comply with any applicable accounting standards for the treatment of swaps and related financial instruments. MTS and MTS's external auditors shall implement the appropriate accounting standards.

58.14 PERIODIC REVIEW OF INTEREST RATE SWAP POLICY

The Chief Financial Officer and MTS's financial advisors shall review its swap policy on a periodic basis and recommend appropriate changes.

Original Policy adopted on 7/17/08.