



Executive Summary Briefing

DWSD Debt Portfolio

January 18, 2012

Overview of Discussion

- Why did City decide to issue variable rate debt for the Water and Sewer Systems?
- How did City hedge risk of variable rate debt?
- What are the individual bonds that have associated swap agreements?
- What happened in 2008 / 2009 to impact these bonds?
- How did the City “fix” that problem?
- Why is the City terminating the swaps now?
- What is the financial impact of terminating swaps now?



Why did City decide to issue variable rate debt for the Water and Sewer Systems?

- Variable rate debt offered the Systems significant capital financing savings
 - ✓ *Variable rates generally lower than fixed rates*
- However the City also recognized the potential downside of variable rate debt, and structured any variable rate debt with hedging instruments (swaps)
 - ✓ *Fixed rates ALWAYS more stable than variable rates*
- Result is that the System's variable rate debt was designed to be “synthetically fixed”
 - ✓ *Combined result is lower than a traditional fixed rate*



How did City hedge risk of variable rate debt?

- Fundamentally, the hedging instruments (swaps) result in the Systems:
 - ✓ *Paying bondholders a variable interest rate*
 - ✓ *Paying to (or receiving from) swap partners a payment to “true up” the difference in the rates*
 - When variable rates are low, the City pays & vice-versa
 - ✓ *Thus the rate paid by the Systems is “synthetically fixed”*
- City embraced a portfolio management approach that:
 - ✓ *Set a minimum savings threshold of 25 basis points (bp) to consider these transactions (vs fixed rate debt)*
 - ✓ *Actual implementation often closer to 50 bp*
- **Strategy initially provided significant savings to the Systems and their customers**
 - ✓ *With an overall debt portfolio of ~\$5 billion*
 - Strategy could conceivably be designed to apply to ½ of the portfolio and produce minimum annual savings of \$6.25 to \$12.5 million



What are the individual bonds that have associated swap agreements?

DWSD Water Swaps - figures in \$ millions

	Original Par	Initial Est.	Original	Termination	Type of Swap	Why Enter?	Rate Paid by:	
	Value	Ann'l Svgs	Not'l Amt	Value			DWSD	Counterparty
2001C1	192.29	0.96	76.51	(27.59)	Float to Fixed	Debt service savings	4.869%	SIFMA
2001C Mirror			76.51	18.92	Fixed to Float	Offset existing swap	SIFMA	3.998%
2001C1			114.39	(38.77)	Float to Fixed	Debt service savings	4.900%	SIFMA
2001C Mirror			113.36	18.61	Fixed to Float	Offset existing swap	SIFMA	3.498%
2003B	172.95	0.86	14.25	(0.15)	Float to Fixed	Debt service savings	3.870%	CPI + 1.35%
2003C	46.36	0.23	4.34	(0.10)	Float to Fixed	Debt service savings	3.920%	CPI + 1.35%
2003D	151.37	0.76	151.37	(8.19)	Fixed to Float	Debt service savings	SIFMA	4.060%
2004A	77.01	0.39	77.01	(0.84)	Fixed to Float	Debt service savings	SIFMA	3.940%
2004B	163.59	0.82	163.59	(0.83)	Fixed to Float	Debt service savings	SIFMA	3.845%
2005B	195.00	0.98	195.00	(70.55)	Float to Fixed	Debt service savings	4.710%	SIFMA
2005B Mirror			195.00	39.21	Fixed to Float	Offset existing swap	SIFMA	3.652%
2006B	120.00	0.60	120.00	(57.33)	Float to Fixed	Debt service savings	5.000%	SIFMA
2006B Mirror			120.00	18.61	Fixed to Float	Offset existing swap	SIFMA	3.262%
Subtotal	1,118.56	5.59	1,421.33	(109.01)				
Forward Hedge			150.00	(88.47)	Float to Fixed	Debt service savings	5.067%	SIFMA
Forward Hedge			50.00	(24.44)	Float to Fixed	Debt service savings	4.932%	SIFMA
Subtotal	0.00	0.00	200.00	(112.91)				
Total	1,118.56	5.59	1,621.33	(221.92)				



What happened in 2008 / 2009 to impact these bonds?

- Certain of the bonds (VRDOs) were insured by bond insurance companies
 - ✓ *Design was to enhance credit ratings and lower interest rates*
- The credit market crisis called into question the viability of several of these companies, several of which failed (or were downgraded)
 - ✓ *Not envisioned by anyone “pre-2008”*
- Result for the Systems is that the variable rate structure contained within certain of the swap agreements could have had dramatically negative effects
 - ✓ *Interest rate penalties*
 - ✓ *Accelerated amortization*



What was the risk of that problem and how did the City “fix” it?

- Systems faced increased annual debt service of:
 - ✓ *At least \$50 million*
 - ✓ *Potentially \$150 million if opportunity to accelerate amortization were enforced*
- City remarketed the affected underlying variable rate bonds to a pure fixed mode, terminated most of the existing swap agreements and eliminated the risk associated with these instruments
- Annual cost was approximately \$25 million
 - ✓ *\$10 million Water / \$15 million Sewer*
- Some of the “fix” strategy included entering into “mirror swap” on certain of the existing agreements
 - *Avoided large termination payments*



Why is the City terminating remaining outstanding swaps now?

- To eliminate potential termination risk associated with the financial condition of the City
 - ✓ *Appointment of an Emergency Manager is a termination event*
- Should counterparties opt to terminate:
 - ✓ *May not be possible to directly debt finance (amortize) termination values*
 - ✓ *Short term impact of paying termination values could be significant*
- City believes it is more prudent to terminate all swaps now



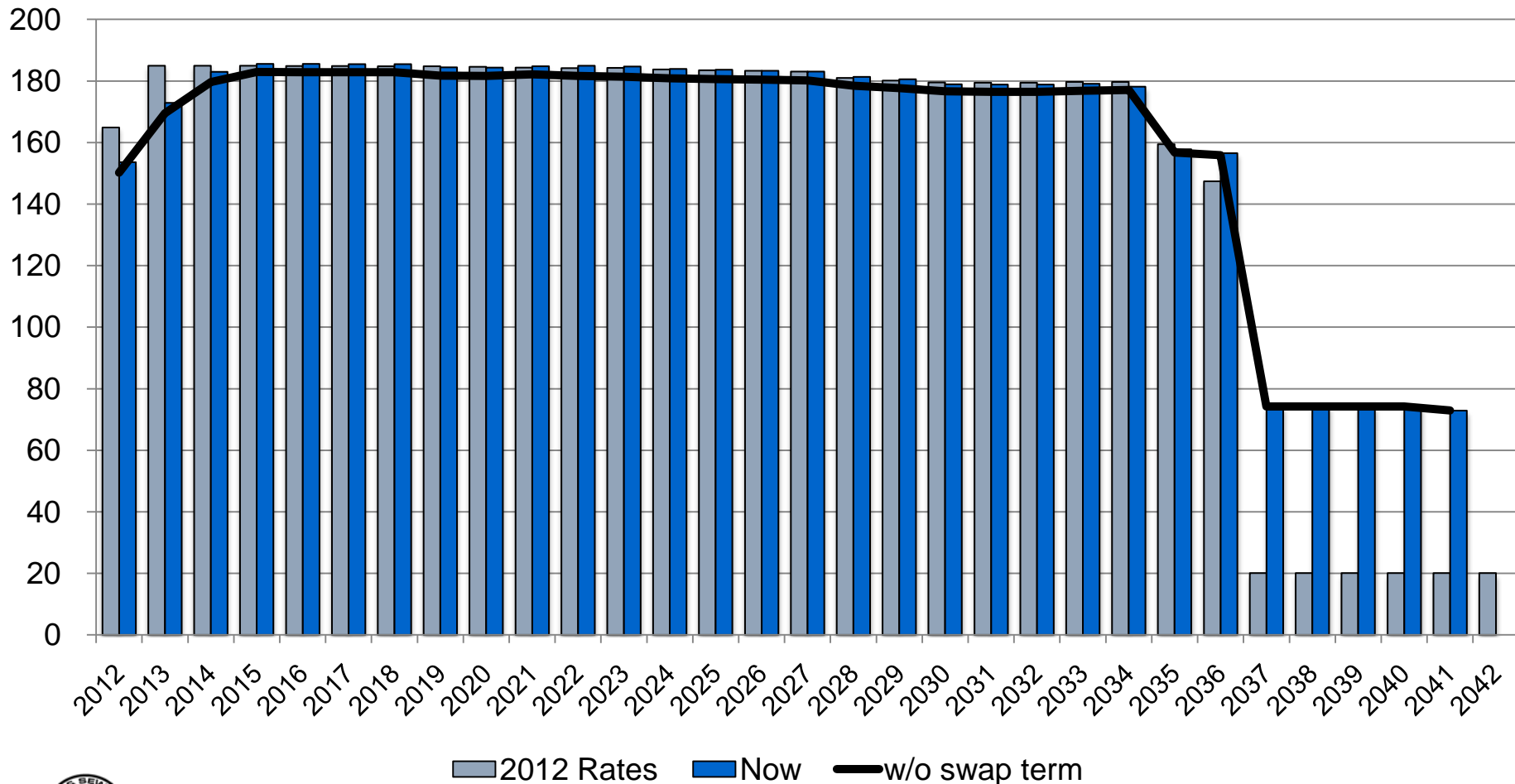
What is the financial impact of terminating swaps now?

- Increased water debt service
 - ✓ *Average annual = \$2.6 million*
 - ✓ *Present value = \$39.4 million*
 - ✓ *See chart on next page*
- Sewer figures are anticipated to be similar



The debt service structure resulting from the recent transaction is not materially different from that planned as part of the FY 2011-12 water rates

Water Debt Service - \$ millions



Why do the prior figures not include the forward starting swaps?

- These swaps are not associated with any outstanding bonds
- Rather, they were a contractual agreement to lock in a guaranteed fixed interest rate of ~5%
- It was always the City's intention to execute/ terminate these swaps upon the next issuance of "new money" bonds
- The 2011 Water Bonds / 2012 Sewer Bonds are the first issuance of new money bonds since the forward hedge was entered into in 2006
 - ✓ *CIPs were subsequently reduced, deferring originally forecasted bond sales*
- These instruments have worked in the manner envisioned



Additional Material



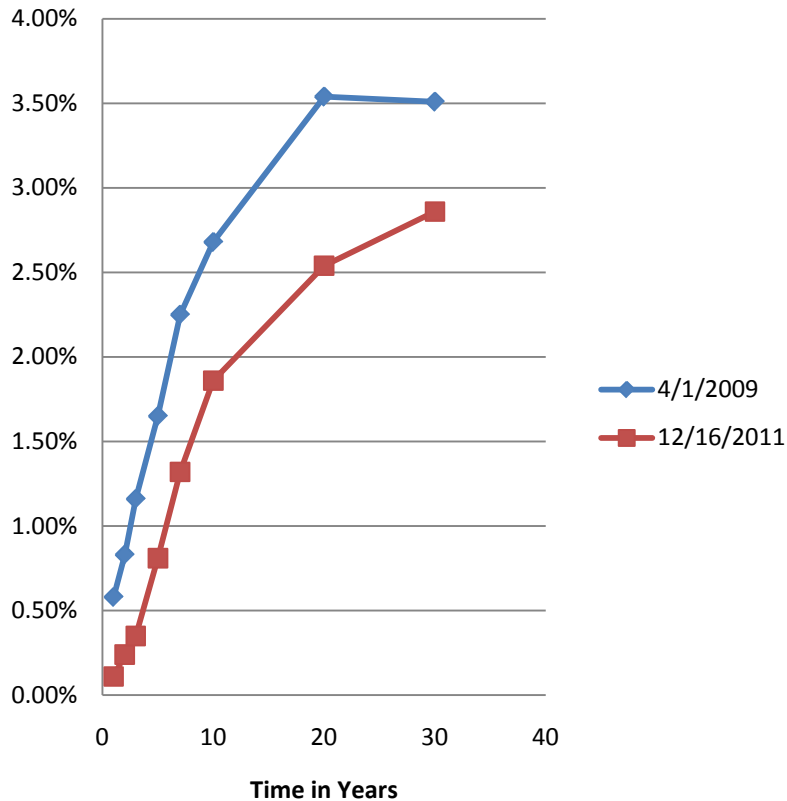
There are several categories of “swaps”

- Index Related
 - ✓ *Floating to Fixed*
 - ✓ *Fixed to Floating (Mirror)*
 - ✓ *Swaption*
 - ✓ *Forward Starting*
- Directly Related To Debt Issue



Discounting Future Cash Flows is key to determining swap termination values

Treasury Yields

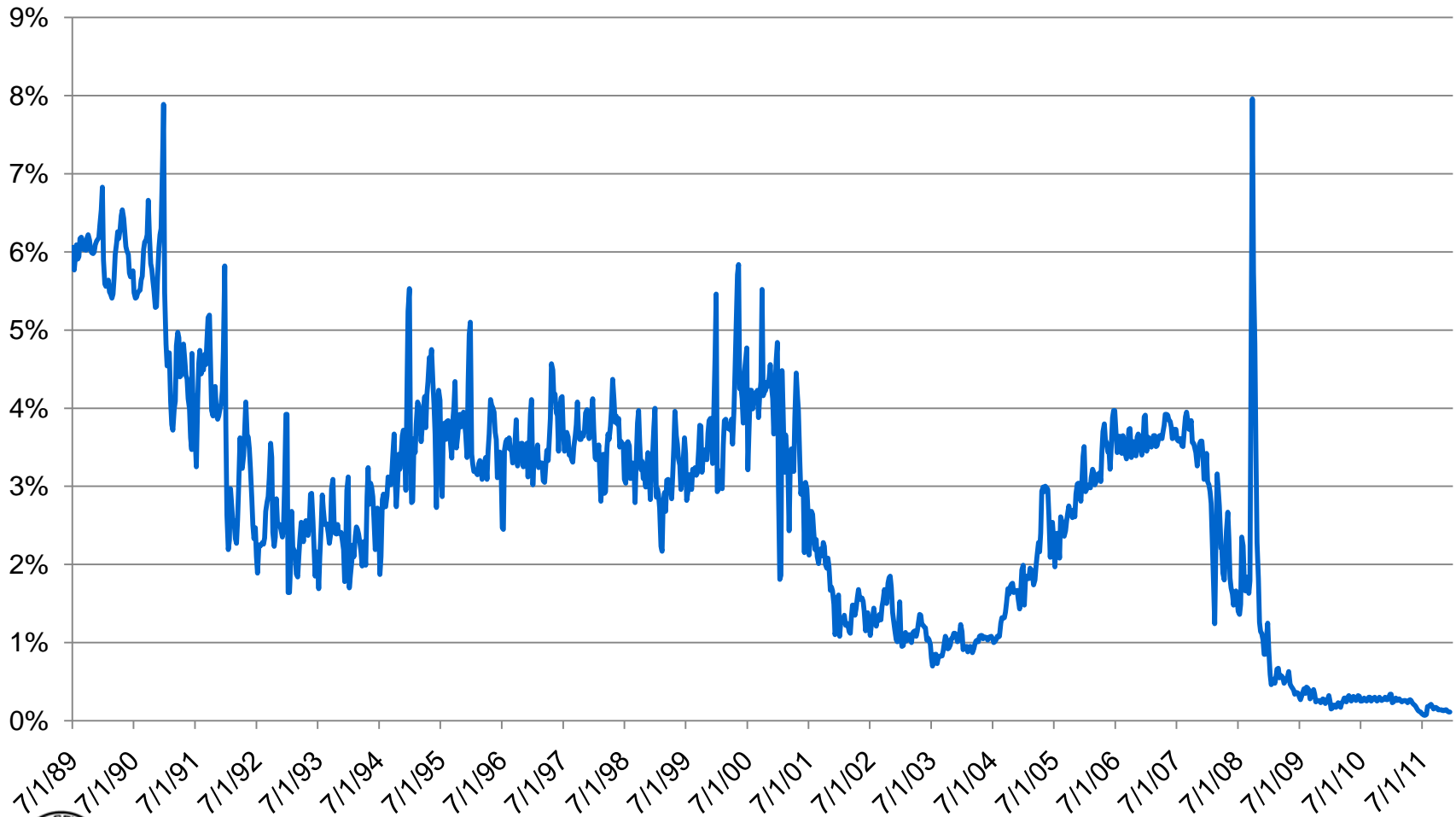


Year	Payment	NPV Treasury Yields	
		4/1/2009	12/16/2011
1	1,000	994	999
2	1,000	984	995
3	1,000	966	990
5	1,000	921	960
7	1,000	856	912
10	1,000	768	832
20	1,000	499	606
30	1,000	355	429
Total	8,000	6,343	6,723



The recent volatility in the SIFMA Index impacts the termination values

SIFMA Index



Swap Example - Water 2006-B Bonds

