

The County of Chester

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## Debt Management Policies



The County of Chester

**TABLE OF CONTENTS**

Purpose..... 2

Refunding Policy ..... 4

Payment of the Expense Component of Underwriters Discount Policy ..... 6

Using Variable Rate Debt Instruments Policy..... 7

Issuing Taxable Debt Policy ..... 8

Debt Practices Policy ..... 9

Use of Debt-Related Derivatives Products Policy ..... 12

Debt Service Settlement Procedures Policy..... 18

Investment Bond Proceeds Policy..... 19

Selecting and Managing the Method of Sale of Bonds Policy ..... 20

Selecting Bond Counsel Policy ..... 21

Selecting Financial Advisors Policy..... 23

Selecting Underwriters for Negotiated Sale Policy ..... 24

Pricing Bond in Negotiated Sale Policy ..... 25

References..... 27

Definitions ..... 28

Appendices ..... 34

    Post Compliance Checklist..... 35

    Derivatives Checklist ..... 41

## PURPOSE

- a) The Debt Management Policies set forth comprehensive guidelines for the financing of capital expenditures. It is the objective of the policies that:
  - i) the County obtain financing only when necessary.
  - ii) the process for identifying the timing and amount of debt or other financing be as efficient as possible.
  - iii) the most favorable interest rate and other related costs be obtained.
  - iv) to the extent feasible, future financial flexibility be maintained.
- b) Adherence to debt policies helps to ensure that the County maintains a sound debt position and that credit quality is protected. Advantages of debt policies are as follows:
  - i) enhances the quality of decisions.
  - ii) rationalizes the decision-making process.
  - iii) identifies objectives for staff to implement.
  - iv) demonstrates a commitment to long-term financial planning objectives.
  - v) is regarded positively by the rating agencies and investors.
  - vi) maintains prudent level of financial risk.
- c) The policies establish criteria for the use of debt, create procedures and policies that minimize the County's debt service and issuance costs, retain the highest practical credit rating, and maintain full and complete financial disclosure and reporting. These policies are guidelines for general use in order to allow for individual application under various conditions.
- d) Regular, updated debt policies are an essential tool to ensure the use of the County's resources to meet its commitments to provide needed services to the citizens of the County and to maintain sound financial management practices. The County's debt program will be continuously monitored and updated to ensure that it is in compliance with the debt policies and capital market trends.
- e) The Local Government Unit Debt Act (the "Debt Act"), administered by Pennsylvania Department of Community and Economic Development (DCED), provides the procedure for Pennsylvania's local government units to issue debt and tax anticipation notes.
- f) Debt financing, which includes general obligation bonds, special assessment bonds, revenue bonds, temporary notes, lease/purchase agreements, and other County obligations permitted to be issued or incurred under the Debt Act shall only be used to purchase capital assets that cannot be acquired from either available current revenues or fund balances. The useful life of the asset or project is required by the Debt Act to exceed the payout schedule of any debt the County assumes.

## The County of Chester

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- g) To enhance creditworthiness and prudent financial management, the County is committed to:
  - i) Systematic capital planning.
  - ii) Intergovernmental cooperation and coordination.
  - iii) Long-term financial planning.
- h) Implementation of this commitment to capital planning will be demonstrated through adoption and periodic adjustment of the County's Strategic Plan and the annual adoption of a Capital Improvement Program (CIP) identifying the benefits, costs and method of funding each capital improvement or project planned for the succeeding five years.
- i) Debt financing will not be used for any recurring purpose such as current operating and maintenance expenditures except for tax revenue anticipation notes or court-appointed funding of unfunded debt. The County will use debt financing only for the purposes of constructing or acquiring capital assets and for making major renovations to existing capital assets or when the project is included in the County's adopted Capital Improvement Program.

## REFUNDING POLICY

- a) The primary objectives of proceeding with a current refinancing or an advance refunding shall be to benefit the County in one or more of the following areas by:
  - i) Providing net present value debt service savings.
  - ii) Eliminating burdensome or restrictive covenants imposed by the terms of the bonds to be refunded.
  - iii) Changing the type of debt instrument.
  - iv) Restructuring the County's overall debt service portfolio to take advantage of market conditions or complement the CIP.
  
- b) The County may consider different financing structures for refunding issues that typically meet the following guidelines:
  - i) Refunding issues should generate net present value savings as outlined in paragraph d) below.
  - ii) The final maturity of the refunding bonds should be no longer than the final maturity on the refunded bonds, except for restructuring.
  - iii) Refunding issues should be structured to achieve level annual debt service savings or to level out overall debt service of the total portfolio or of a specific debt type for budgeting certainty.
  
- c) Solely meeting one or more of the minimum guidelines will not necessarily result in the County executing a refunding issue. All costs and benefits of the refunding will be taken into account and analyzed by the County and its financial advisors in determining if the refunding is in the best interest of the County.
  
- d) A present value analysis shall be prepared to identify the economic effect of any proposed refunding. To proceed with a refunding a minimum net present value savings amount, as a percentage of the refunded par amount, should be achieved. Appropriate saving thresholds for the different refunding alternatives, based on the level of risk they pose to the County, are presented below. The savings shall be calculated net of all issuance fees and using a net debt service savings approach, which takes into consideration arbitrage rebate requirements.
  - i) Current Refunding: A minimum of 3% net present value savings should generally be achieved.
  - ii) Advance Refunding: A minimum of 3% net present value savings should generally be achieved. Prudent analysis should be performed to determine the most efficient method of funding the escrow portfolio.
  - iii) Forward Refunding: A minimum of 3% net present value savings should generally be achieved without relying on projected market conditions.
  - iv) Synthetic Refunding: A minimum of 3% net present value savings should generally be achieved.

- e) Because the level of risk will vary depending on the specific structure of the transaction and market conditions at the time of issuance, the County has the discretion to prescribe higher levels of target savings to optimize the County's financial objectives.
- f) In evaluating refunding opportunities and applying the above referenced guidelines, the County shall consider the following factors:
  - i) For advance refundings, adjustments to the savings threshold may be justified based on the length of time before the call and the length of time from the call to maturity. The longer the escrow, the higher the savings threshold should be. Conversely, shorter escrows may justify a lower savings threshold.
  - ii) For advance refundings with very short escrows, the County should consider forward refunding to preserve the ability under the Internal Revenue Code to advance refund the bonds at a future date.
  - iii) The couponing and/or callability of the refunding bonds may also justify adjustments to the savings threshold. Non-callable refunding bonds, for example, might justify a higher threshold.
  - iv) For advance refundings, adjustments to savings thresholds may be justified based on where interest rates are at the time of the refunding relative to historical markets. In low interest rate markets, a lower threshold may be justified while a higher threshold would be justified in high interest rate markets.

**PAYMENT OF THE EXPENSE COMPONENT OF UNDERWRITERS'  
DISCOUNT POLICY**

- a) The County will pay for reasonable and identifiable expenses outlined in the proposals submitted by the senior managing underwriters. Legitimate expenses include, however are not limited, to the following:
- i) Compensation for underwriters' counsel.
  - ii) Travel to and from the issuer's offices.
  - iii) Interest/day loan costs.
  - iv) Charges for communication, including the rating agency presentation.
  - v) Mailing, printing, and telephone expenses.
  - vi) Documented clearing charges.
  - vii) Closing costs.
- b) A full explanation from the senior managing underwriter shall be submitted for any expenses incurred and not included in the original proposal.

## USING VARIABLE RATE DEBT INSTRUMENTS POLICY

- a) Variable rate debt can be an important tool in managing the County's debt program. When issued prudently, variable rate debt can help lower the cost of borrowing and provide a hedge against interest rate risk. Interest rates on variable rate debt instruments are at the short end of the yield curve because they are periodically adjusted (e.g., daily, weekly, monthly) based on current market conditions. Variable rate debt should be used for two purposes:
  - i) As an interim financing device (during construction periods)
  - ii) Subject to limitations, as an integral portion of a long-term strategy to lower the County's effective cost of capital.
  
- b) Variable rate debt exposes the County to risk not present under the fixed rate structure.
  - i) Interest Rate Risk – The risk that interest rates will rise, on a sustained basis, above levels that would have been set if the issue had been fixed.
  - ii) Liquidity Risk – The risk of having to pay a higher rate to the liquidity provider in the event of a failed remarketing.
  - iii) Rollover Risk – The risk of the inability to obtain a suitable liquidity facility at an acceptable price to replace a facility upon termination or expiration of the contract period.
  
- c) To manage these risks, the County will limit the amount of variable rate debt to no more than 30 percent of its outstanding portfolio. The County may use derivative instruments/swaps to hedge exposure to movement in interest rates. The County will continually monitor the variable rates to determine whether or not the variable rate debt should be converted to fixed rate debt.

**ISSUING TAXABLE DEBT POLICY**

- a) Taxable debt shall be issued by the County when more attractive long-term financing opportunities are available.
- b) The County may issue taxable debt:
  - i) To avoid burdensome arbitrage regulations.
  - ii) If private activity bond rules limit the ability of the County to enter into public-private partnerships that may be advantageous to the citizens of the County.
- c) Under the American Recovery and Reinvestment Act of 2009 (ARRA), the County may issue Build America Bonds (BABs) to promote reinvestment in local capital projects within the County.
- d) Before taxable debt is considered, the County will complete a thorough analysis of all the attributes of such use, consider the legality of the issuance and evaluate the market conditions.

## DEBT PRACTICES POLICY

a) The Debt Act provides the borrowing limits for local government units.

b) *Debt Limits*

- i) The County will issue debt only for the purposes of constructing or acquiring capital assets and for making major renovations to existing capital assets or when the project is included in the County's adopted Capital Improvement Program.
- ii) The County can legally incur non-electoral debt equal to three hundred percent of its borrowing base. The borrowing base is the average of total revenues for the past three years minus certain statutory deductions.
- iii) The County will not construct or acquire a public facility if it is unable to adequately provide for the subsequent annual operation and maintenance costs of the facility.
- iv) The County will maximize the use of pay-as-you go financing to fund its Capital Investment Program whenever feasible and practical.
- v) Growth in debt service should be sustainable consistent with the projected growth of revenues.
- vi) In no case will debt maturity exceed the useful life of the project. The County will attempt to maximize the rapidity of principal repayment where possible.
- vii) The County will examine four statistical measures to determine debt capacity and compares these ratios to other counties, rating agency standards and the County's historical ratios to determine debt affordability. In order to determine its relative debt position, the County uses four measures:
  - 1) Debt per capita
  - 2) Debt to personal income
  - 3) Debt to taxable property value, and
  - 4) Debt service payments as a percentage of general fund revenues or expenditures
- viii) Debt financing shall not exceed 90 percent of the useful life of the capital project, but in no event to exceed 30 years.

c) *Debt Structuring Practices*

- i) The County will strive to maintain a credit rating of "AAA". The County will also maintain communication with bond rating agencies about its financial condition and will follow a policy of full disclosure in every financial report and official statement provided to bond rating agencies, to professional service providers for bond issues and to investors. The County will meet all debt service obligations when due and payable and will comply with all federal tax law provisions, such as arbitrage requirements.

## The County of Chester

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- ii) The County may use capitalized interest to offset debt service costs as needed in the CIP.
- iii) Capital projects financed through the issuance of bonds shall not be financed for longer than the expected useful life of the project.
- iv) The County will strive to structure debt issues to maintain level annual debt service payments over time.
- v) The County will use its best efforts to maintain no more than 30 percent of its outstanding debt as variable rate debt.
- vi) The County will monitor the market from time to time to determine if variable rate debt remains cost effective.

### d) *Debt Issuance Practices*

- i) It shall be the responsibility of the Director of Financial Services to coordinate the timing, process, and sale of the County debt required in support of the CIP. The Director of Financial Services shall make recommendations to the Chief Administrative Officer as necessary in order to accomplish the County financing objectives.
- ii) Prior to any debt issuance, an analysis of market conditions and other financing options will be conducted to determine the feasibility for entering the credit market at that time.
- iii) The County shall choose the method of sale of its bonds (competitive, invited, or negotiated) in light of financial and market conditions, considering an assessment of the different risks associated with each method. Thorough records shall be kept to document the process and reasons for selections.
- ix) A competitive process shall be used for selecting the County's financial advisor on a continuing basis and for the selection of bond counsel and underwriters on a transaction-specific basis.
- x) Conduit debt issued/sponsored shall have a general public purpose. All conduit financings must insulate the County completely from any credit risk or exposure and must be approved by the County's bond counsel and financial advisor before being submitted to the County Board of Commissioners for authorization.
- xi) Credit enhancements such as insurance, letters of credit, etc. will be used in those instances where deemed beneficial to do so.
- xii) The County may choose to issue short-term financing tools such as bond anticipation notes, tax anticipation notes, line of credit or pooled commercial paper where their use is judged by the County's financial advisor and bond counsel to be prudent and advantageous.

### e) *Debt Management Practices*

- i) The County will manage debt issuance to comply with the adopted debt limits and will evaluate those every year and revise them as necessary.
- ii) The Director of Financial Services is responsible for providing continuing disclosure information to established national information repositories and for maintaining compliance with disclosure standards promulgated by state and national regulatory bodies.

- iii) In order to comply with Federal arbitrage legislation, the County will not issue obligations except for identifiable projects with very good prospects of timely initiation. Debt obligations will be issued as closely in time as feasible to the time contracts are expected to be awarded.

## USE OF DEBT-RELATED DERIVATIVES PRODUCTS POLICY

- a) The County will exercise extreme caution in the issuance and sale of derivative instruments, and will consider their utilization only when sufficient understanding of the products and sufficient expertise for their appropriate use has been developed. Derivatives should not be used for speculation, but only to manage risks associated with the County's assets or liabilities and only in conformance with financial policies that reflect the risk tolerances and management capabilities of the County. All derivatives transactions will require the County Board of Commissioners' approval.
- b) These guidelines are intended for the use of various interest rate swaps and other financial products, including the contractual exchange of different fixed and variable rate payment streams through the use of derivative products. The swap policies are not intended in any way to require the County to modify or terminate existing interest rate swaps. The County has legal authorization to enter into swaps under the Debt Act. These Guidelines are designed to complement the Debt Act and the requirements thereof.

- c) *Interest Rate Swaps*

Interest rate swaps and options are appropriate interest rate management tools that can help the County meet important financial objectives. Properly used, these instruments can increase the County's financial flexibility, provide opportunities for interest rate savings or enhanced investment yields, and help the County manage its balance sheet through better matching of assets and liabilities. Swaps may be integrated into the County's overall debt and investment management guidelines and should not be used for speculation or leverage.

- i) The County, together with the County's Financial Advisor and Swap Counsel, shall periodically review the County's swap guidelines and recommend appropriate changes.
  - ii) The total notional amount of any one risk associated with interest rate swaps and options executed by the County shall not exceed an amount equal to 25 percent of the total of all general obligation debt of the County as a whole, unless the additional exposure results in debt service savings or assists the County in meeting certain financial objectives.
- d) *Examples of Rationales for Utilizing Interest Rate Swaps and Options*
  - i) Optimize capital debt structure, including fixed and variable rate allocations.
  - ii) Achieve appropriate asset/liability match.
  - iii) Manage risk, including:
    - 1) Interest rate risk
    - 2) Tax Risk
    - 3) Yield curve risk

## The County of Chester

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- 4) Liquidity renewal risk
- iv) Produce greater expected interest rate savings or incremental yield than cash market alternatives.
- v) Manage exposure to changing markets in advance of anticipated bond issuances (through the use of anticipatory hedging instruments).
- vi) Provide a specific benefit not otherwise available.

### e) *Permitted Instruments*

The County may utilize the following financial products on a current or forward basis, after identifying the objective(s) to be realized and assessing the risks:

- i) Interest rate swaps, including floating-to-fixed, fixed-to-floating and/or floating-to-floating basis swaps.
- ii) Interest rate caps/floors/collars.
- iii) Options, including swaptions, caps, floors, collars and/or cancellation or index based features.

### f) *Procedure for Submission and Execution*

The County may consider interest rate swaps and options that are either presented as proposals or that are developed by the County in consultation with consultants, advisors and legal counsel.

### g) *Procurement and Execution*

The County will not have a fixed guideline with respect to swap procurement and execution. The County will assess the benefits of competitively bidding financial products that are non-proprietary or generally available in the marketplace. On a product by product basis, the County will also have the authority to negotiate the procurement of financial products. For both competitive and negotiated procurements, the execution of any interest rate swap or option transaction shall be the subject of an independent review, analysis and finding by an independent financial advisor. As required by the Debt Act, that its terms and conditions reflect a fair market value of such agreement as of the date and time of its execution.

## h) *Counterparty Risk Assessment*

- i) The County will only do business with highly rated counterparties or counterparties whose obligations are supported by highly rated parties. The Debt Act requires the credit rating of any counterparty to be at least the third highest rating category from a nationally recognized rating agency.
- ii) The Debt Act requires swap counterparties, or their guarantor shall be rated at least “A”, or equivalent by any of the nationally recognized rating agencies (i.e. Moody’s, Standard and Poor’s, and Fitch). In addition, the counterparty must have a demonstrated record of successfully executing swap transactions.
- iii) The County should not have an immutable credit standard. However, it shall be the County’s preference to do business with highly rated counterparties of “Aa3” or “AA-” or better. For lower rated (below “Aa3” or “AA-”) counterparties, the County will consider credit enhancement in the form of:
  - 1) Contingent credit support or enhancement.
  - 2) Collateral consistent with the policies contained herein.

## i) *Swap Analysis*

In connection with any swap, the County and its Financial Advisor shall review the proposed transaction and outline any considerations associated with the transaction. Such an analysis shall include the assessment of the benefits outlined above and the risks listed below, as applicable.

## j) *Swap Risks*

- i) Termination Risk – The risk that a swap will be terminated by the counterparty prior to maturity and the swap has a negative value, causing the County to owe a termination payment to the counterparty. The Debt Act generally prohibits at-will terminations by a counterparty.
- ii) Basis Risk – The risk that the payment on the County’s leg of a swap or on its underlying bonds will exceed the swap receipt, e.g. a tax-exempt variable rate issue which trades at a spread over SIFMA while the County only receives SIFMA under the swap.
- iii) Tax Risk – A form of basis risk- the risk of higher tax-exempt interest rates if tax law changes and lowers the taxation rate on interest income e.g. a tax cut, which results in an increase in the ratio of tax-exempt rates to taxable rates.
- iv) Counterparty Risk – The risk that the counterparty cannot make future payments or cannot make termination payments due to the County.
- v) Yield Curve Risk – On swaps where an the County’s payment is based on a short-term index and its receipt is based on a long-term index, the risk that there will be negative cash flows and market value when the yield curve is flat or inverted.
- vi) Liquidity/Remarketing Risk – The risk that the County cannot secure a cost-effective renewal of a Liquidity Facility or Letter or Line of Credit with respect to its variable-rate bonds.

- vii) Market Access Risk – The risk that bonds related to a swap are not successfully issued or do not close.

### k) *Benefit Expectation*

Financial transactions, using fixed rate swaps or other derivative products, should generate 1% greater projected savings for a transaction without tax risk (e.g. SIFMA swap) or at least 2% greater projected saving for a transaction with tax risk (e.g. LIBOR swap) than the savings guidelines the County would consider for traditional bonds. This threshold will serve as a guideline and will not apply should the transaction, in the County's sole judgment, help to meet any of the other objectives outlined herein. The higher savings target reflects the greater complexity and higher risk of derivative financial instruments. For variable rate or other swap transactions that do not result in a fixed interest rate, the County will evaluate any additional value generated through the transaction in assessing the benefits of proceeding including the ability to meet the County's financial objectives. These benefits may include for example, modifying tax risk, asset liability management, or further reducing expected interest expense.

### l) *Legal and Contractual Requirements*

Unless otherwise approved by the County, it will use standard ISDA swap documentation including the Schedule to the Master Agreement and a Credit Support Annex as applicable. The County may use additional documentation if the product is proprietary or the County deems in its sole discretion that such documentation is otherwise in its interest.

### m) *Pennsylvania Legal Authorization and Requirements*

Under the Debt Act, any derivatives agreement entered by the County must relate to an outstanding debt instrument of the County. The Agreement must contain the following provisions:

#### i) Termination Provision

The agreement must contain a termination provision granting the County the right to optionally terminate a swap agreement at any time over the term of the agreement. In general, exercising the right to terminate an agreement should produce a benefit to the County, either through the receipt of a payment from a termination or, if the termination payment is made by the County, in conjunction with a conversion to a more beneficial (desirable) debt obligation, as determined by the County.

#### ii) Collateral

As part of any swap agreement, the County may require collateralization or other forms of credit enhancements to secure any or all swap payment obligations, as

deemed appropriate by the County and its Swap Counsel and Financial Advisor and under the following guidelines:

- 1) Each counterparty to the County may be required to post additional collateral if the credit rating of the counterparty or parent falls below a rating as determined by the County and its Financial Advisor at the time of executing the agreement.
- 2) Collateral shall be deposited with a third party trustee, or as mutually agreed upon between the County and the counterparty.
- 3) Acceptable securities that may be posted as collateral include cash, government treasuries and agency securities.
- 4) The County will not agree to post collateral under any circumstance.

iii) Interest Rate Management Plan

Under the Debt Act, the County and its Financial Advisor must prepare an Interest Rate Management Plan prior to entering any transactions under these Guidelines. Per the terms of the Debt Act, the County will receive a Fair Market Opinion from its Financial Advisor with respect to each transaction, specifically the estimated compensation to the counterparty, and will monitor the risks with respect to all outstanding transactions on a regular basis.

iv) Limitations on Termination Exposure to a Single Counterparty

- 1) In order to diversify the County's counterparty credit risk, and to limit the County's credit exposure to any one counterparty, limits will be established for each counterparty based upon both the credit rating of the counterparty as well as the relative level of risk associated with each existing and proposed swap transaction.
- 2) In addition, if the exposure limit is exceeded by a counterparty, the County shall conduct a review of the exposure limit per counterparty. The County, in consultation with its Swap Counsel and Financial Advisor, shall explore remedial strategies to mitigate this exposure.

v) Ongoing Management

Per the Debt Act, the County must contract to receive continuing monitoring of interest rate risk, basis risk, termination risk, credit risk, market-access risk, and other risks associated with the outstanding swaps. The County will seek to maximize the benefits and minimize the risks of derivative instruments by actively managing its derivative program. This will entail frequent monitoring of market conditions, by the County's Director of Financial Services and the Financial Advisor, for emergent opportunities and risks relating to existing qualified interest rate management agreements. Active management may require modifications of existing positions including for example:

- 1) Early termination.

- 2) Temporary suspension of cash flows.
- 3) Shortening or lengthening the term.
- 4) Sale or purchase of options.
- 5) Use of basis swaps.

vi) Ongoing Reporting Requirements

A written report providing the status of all interest rate swap agreements entered into by the County will be prepared by the Financial Advisor and provided to the Director of Financial Services and the Board of Commissioners at least on an annual basis (or other basis, if so directed by the Board of Commissioners) and shall include the following:

- 1) A listing of all outstanding qualified interest rate management agreements, type of derivative, rates paid and received by the County, total notional amount, forward start dates, and maturity date of each swap agreement.
- 2) Market value, including termination exposure of each of the County's qualified interest rate management agreements.
- 3) The credit rating (including any recent notable change) of each counterparty.
- 4) If applicable, information concerning any default by a counterparty to the County, including but not limited to the financial impact to the County, if any.

**DEBT SERVICE PAYMENT SETTLEMENT PROCEDURES POLICY**

- a) The County has a fiduciary responsibility to manage its funds in a manner that assures timely and accurate payment of debt service principal and interest. The responsibility also includes full use of funds for the benefit of the County until the payment due date. The County will ensure timely payment of funds for payments and negotiating terms with counterparties that serve both the County and bondholders' needs in accordance with bond documents.
  - i) The County will negotiate terms allowing for full investment of funds by it until the payment due date by utilizing electronic fund transfer.
  - ii) The County requires that trustees/fiscal agents/paying agents invoice the County for debt service payments a minimum of 30 days prior to the due date.
  - iii) The County will use electronic fund transfer to assure transfer to the trustee/fiscal agent/paying agent on the payment date. If payment must be made by check, the County will ensure paying the check no more than five (5) days prior to the payment date through a guaranteed delivery service.
  - iv) The County will ensure that all parties to the transaction (internal and external) are kept informed of the procedures established.

## INVESTMENT BOND PROCEEDS POLICY

a) *Purchase and Sale of Investments*

The County shall competitively bid the purchase of securities, investment agreements, float contracts, forward purchase contracts and any other investment products used to invest bond proceeds. Compliance shall be maintained with all applicable Federal, State, and contractual restrictions regarding the use and investment of bond proceeds. This includes compliance with restrictions on the types of investment securities allowed, restrictions on the allowable yield of some invested funds as well as restrictions on the time period over which some bond proceeds may be invested. The Director of Financial Services may direct the investment of bond proceeds in accordance with the permitted investments for any particular bond issue. Providers of structured investment products and professional services required to implement the product or agreement will be recommended based on a competitive process conducted by the Financial Advisor or Investment Advisor.

b) *Diversification*

Invested proceeds shall be diversified in order to reduce risk exposure to investment providers, types of investment products and types of securities held.

c) *Disclosure*

It shall be required that all fees resulting from investment services or sale of products to the County be fully disclosed to ensure that there are no conflicts of interest and investments are being purchased at a fair market price. Underwriters of the bonds, but not the Financial or Investment Advisor, may bid on the sale of investment products for the proceeds. The Financial or Investment Advisor shall document the bidding process and results and shall certify in writing that a competitive and fair market price was received.

## **SELECTING AND MANAGING THE METHOD OF SALE OF BONDS POLICY**

The Board of Commissioners shall review each transaction on a case-by-case basis to determine the most appropriate method of sale.

### *a) Competitive Sale*

In a competitive sale, bids for the purchase of the bonds are opened at a specified place and time and are awarded to the Underwriter (or syndicate) whose conforming bid represents the lowest true interest cost to the County. The County may take bids in person, by facsimile, or by electronic means.

- i) Bond sales shall be advertised as broadly as possible, including advertising in an industry newspaper. The Financial Advisors for each transaction shall undertake to market the bonds to prospective bidders and investors as relevant.
- ii) Terms of the bonds shall be amendable as late as possible and ideally until at least the day prior to the day bids are to be received.
- iii) Bond sales shall be cancelable at any time prior to the time bids are to be received.
- iv) Upon award to the bidder whose conforming bid represents the lowest true interest cost, the County may restructure the bonds in accordance with the Official Notice of Sale.
  - i. The County shall reserve the unfettered right to reject all bids or waive bid irregularities.
  - ii. The Board of Commissioners shall award any bonds sold via competitive sale.

### *b) Negotiated Sale*

In a negotiated sale, the County chooses the initial buyer of the bonds in advance of the sale date, after a competitive process where the potential buyer is invited to submit proposals. The initial buyer is usually an investment banking firm, or a syndicate of investment banking firms interested in reoffering the bonds to investors through an underwriting process. This type of sale allows the County to discuss different financing techniques with the underwriter in advance of the sale date.

### *c) Private Placement*

Private placement, also referred to as a direct placement is a variation of a negotiated sale. Instead of retaining the services of an investment banking firm to underwrite the securities, the County will sell the bonds directly to a limited number of investors. The County may use a placement agent to assist it in identifying likely investors.

## SELECTING BOND COUNSEL POLICY

- a) The Bond Counsel will be selected by competitive process through a Request for Proposals (RFP). The County's contracting policies that are in effect at the time will apply to the contracts with finance professionals. Bond Counsel shall issue a written opinion affirming the County is authorized to issue the proposed debt, that the County has met all constitutional and statutory requirements necessary for issuance, and a determination of the proposed debt's federal income tax status. Selection of the Bond Counsel should be based on the following.
  - i) Experience of the firm with financings of the County or comparable issuers, and financings of similar size, types and structures, including financings in Pennsylvania.
  - ii) Knowledge and experience in public finance tax law.
  - iii) Experience of the firm with and its approach to applicable federal securities laws and regulations.
  - iv) Experience and reputation of assigned personnel.
  - v) Fees and expenses.
  
- b) Bond Counsel will be expected to provide all professional services necessary for the authorization, issuance and sale of the issue(s), including but not limited to the following.
  - i) Assistance with the structuring of the proposed bond issue, including attending at least one working group meeting with the Director of Financial Services.
  - ii) Preparation of the required legal notices and coordination with local newspapers and the County Solicitor so as to insure that proper notification is given under the Debt Act and the Sunshine Law.
  - iii) Assistance with the preparation of the Debt Statement and Borrowing Base Certificate of the County.
  - iv) Drafting of the Ordinance authorizing the issuance and sale of the Bonds.
  - v) Review of the Official Statement, including the drafting of language describing the bonds and the tax implications of ownership of the bonds.
  - vi) Review of the bond purchase contract.
  - vii) Assembling and filing of the requisite documents and proceedings with the DCED under the Debt Act.
  - viii) Attendance at any meetings of the County's Board of Commissioners at which bonds are authorized or sold.
  - ix) Assistance in obtaining bond ratings.
  - x) Preparation of bond closing documents, including Tax Certificate, IRS Form 8038-G and any and all other documents needed to accomplish the closing.
  - xi) Drafting of and advice with respect to continuing disclosure undertakings of the County.
  - xii) Drafting of the bond forms, arranging for printing of the bonds and coordination with the Depository Trust Company and the Underwriter.

## The County of Chester

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- vi) Attendance at and supervision of bond closings.
- vii) To the extent requested by the underwriter, the rendering of supplemental opinions as to the accuracy of those portions of the Official Statement provided by Bond Counsel and whether the Bonds are exempt from registration under federal securities law.
- viii) Assembly of bound sets of closing documents for each issue to be provided to the County, the County Solicitor, the Financial Advisor, the Paying Agent and the Underwriter.
- ix) Assistance with any additional documentation required in issuing Build America Bonds.

## **SELECTING FINANCIAL ADVISORS POLICY**

- a) The Financial Advisor(s) will be selected by competitive process through a Request for Proposals (RFP). The County's contracting policies that are in effect at the time will apply to the contracts with finance professionals. Selection may be based on a best value approach for professional services or the lowest responsive cost effective bid based upon pre-determined criteria:
  
- b) Financial Advisor(s) will be selected to assist in the debt issuance and debt administration processes. Additionally, the Financial Advisor will conduct competitive processes to recommend providers of financial services and products, including but not limited to: bond underwriters, remarketing agents, trustees, bond insurance providers, letter of credit providers, investment advisors and managers, investment measurement services, and custody services. Selection of the Financial Advisor(s) should be based on the following:
  - i) Experience in providing consulting services to complex issuers.
  - ii) Knowledge and experience in structuring and analyzing complex issues.
  - iii) Ability to conduct competitive selection processes to obtain investment products and financial services.
  - iv) Experience and reputation of assigned personnel.
  - v) Fees and expenses.
  
- c) Financial advisory services provided to the County shall include, but shall not be limited to the following:
  - i) Evaluation of risks and opportunities associated with debt issuance.
  - ii) Monitoring of the debt portfolio and bond proceeds investments to alert the County to opportunities to refund or restructure bond issues or modify investments.
  - iii) Evaluation and recommendation regarding proposals submitted by investment banking firms.
  - iv) Structuring and pricing bond issues, financial instruments and investments.
  - v) Preparation of requests for proposals and selection of providers for bond counsel, underwriters, remarketing agents, letter of credit banks, investment products, financial products and financial services (trustee and paying agent services, printing, credit facilities, remarketing agent services, investment management services, custody services etc.).
  - vi) Provide advice, assistance and preparation for presentations with rating agencies and investors.

## **SELECTING UNDERWRITERS FOR NEGOTIATED BOND SALE POLICY**

- a) The Underwriting firm(s) will be selected by competitive process through a Request for Proposals (RFP). The County's contracting policies that are in effect at the time will apply to the contracts with finance professionals. The Underwriter(s) will resell the County's bonds to investors at a negotiated price. In addition, the Underwriter(s) will provide ideas and suggestions with respect to structure, timing and marketing of the bonds being sold. Selection of the Underwriter(s) should be based on the following.
- i) Experience of the firm and the individuals assigned to the County, and the identification and experience of the individual in charge of day-to-day management of the bond sale.
  - ii) A description of the firm's bond distribution capabilities including the experience of the individual primarily responsible for underwriting the proposed bonds.
  - iii) An understanding of the County's financial situation, including ideas on how the County should approach financing issues such as bond structures, credit rating strategies and investor marketing strategies.
  - iv) Knowledge of local political, economic, legal or other issues that may affect the proposed financing.
  - v) Access to sources of current market information to provide bond pricing data before, during and after the sale.
  - vi) The amount of uncommitted capital available and the ability and willingness of the firm to purchase the entire offering of the County, if necessary, in the case of a firm underwriting.
  - vii) Any contractual arrangements of the firm that could present a real or perceived conflict of interest.
  - viii) Fee and expenses.

## **PRICING BONDS IN A NEGOTIATED SALE POLICY**

- a) The cost of borrowing in a negotiated bond sale is established through the bond pricing process. The key items typically negotiated during the pricing process include bond yields, coupons, the Underwriter's discount, optional redemption provisions and the use of term bonds. The following practices shall be followed in a negotiated sale:
- i) Promote fairness in a negotiated sale by using a competitive underwriter-selection process that ensures multiple proposals are considered.
  - ii) Remain actively involved in each step of the negotiation and sale process to uphold the public trust.
  - iii) Ensure that either a County employee or an outside professional other than the issue underwriter, who is familiar with and abreast of the condition of the municipal market, is available to assist in structuring the issue, pricing, and monitoring sales activities.
  - iv) Consider the use of different firms to serve as the Financial Advisor and Underwriter of an issue to avoid potential conflicts of interest that may arise.
  - v) Review the "Agreement Among Underwriters" and ensure that it governs all transactions during the underwriting period.
- b) The cost of borrowing is one of the most important outcomes of the sale of bonds and is established through the pricing process. When issuing a bond, the County shall strive for the best balance between the yield for each maturity and the underwriters' compensation, which includes the takedown (sales commission), management fee, underwriting risk and expenses. The following practices shall be followed to improve the pricing process:
- i) Communicate to the Underwriter specific goals to be achieved in the pricing of bonds and expectations regarding the roles of each member of the financing team, including the issuer and an independent Financial Advisor hired to assist in the pricing process. The Director of Financial Services has authority to make key decisions and shall be available throughout the pricing process.
  - ii) Take steps during the Underwriter selection process and prior to final pricing to manage the compensation to underwriters.
  - iii) Develop an understanding of prevailing market conditions, evaluate key economic and financial indicators, and assess how these indicators likely will affect the outcome of the pricing.
  - iv) Work with the Underwriter to develop an appropriate pre-marketing effort to gauge and build investor interest.
  - v) Request that the Senior Managing Underwriter propose a consensus pricing scale on the day prior to the pricing that represents the individual views of the members of the underwriting syndicate.

- vi) Evaluate carefully whether the structural features that reduce the true interest cost (TIC) of a bond offering, but limit future flexibility in managing the debt portfolio, will result in greater overall borrowing costs.
  - vii) Give clear directions to Underwriters on how bonds should be allocated, consider how policy goals influence the pricing process, and review the “Agreement Among Underwriters” prior to the sale to ensure that it incorporates the County’s goals.
  - viii) The Director of Financial Services shall approve all information that will be sent out by the underwriter on the preliminary pricing wire, including the allocation of bonds and the takedown.
  - ix) Evaluate the bond sale after its completion to assess the level of up-front costs of issuance, including whether the Underwriters’ compensation was fair given the level of effort and market conditions, the pricing of the bonds, both in terms of the overall TIC and on a maturity-by-maturity basis, and the distribution of bonds and sales credits.
- c) Develop a database with information on each issue sold with regard to pricing performance, including the types of bonds sold (G.O. Bonds, etc.), credit rating, maturities, yield and takedown by maturity and the TIC.

## REFERENCES\*

1. Analyzing an Advance Refunding (1995)
2. Payment of the Expense Component of Underwriters' Discount (1996)
3. Using Variable Rate Debt Instruments (1997)
4. Issuing Taxable Debt by U.S. State and Local Governments (1998)
5. Debt Management Policy (1995, 2003)
6. Use of Debt-Related Derivatives Products and the Development of a Derivatives Policy (1995, 2003, 2005)
7. Debt Service Payment Settlement Procedures (2003, 2007)
8. Investment of Bond Proceeds (1996 and 2007)
9. Selecting and Managing the Method of Sale of State and Local Government Bonds (1994 and 2007)
10. Selecting Bond Counsel (1998 and 2008)
11. Selecting Financial Advisors (2008)
12. Selecting Underwriters for Negotiated Bond Sales (2008)
13. Pricing Bonds in a Negotiated Sale (1996, 2000, 2009) revised

\*GFOA Government Debt Management: Best Practices  
[http://www.gfoa.org/index.php?option=com\\_content&task=view&id=122&Itemid=135](http://www.gfoa.org/index.php?option=com_content&task=view&id=122&Itemid=135)

## DEFINITIONS

- a) **Accrued Interest** - Interest that has accumulated but has not yet been paid from the most recent interest payment date or issue date to a certain date.
- b) **Advance Refunding Bonds** - Bonds issued to refinance an outstanding bond issue before the date the outstanding bonds become due. Proceeds of the advance refunding bonds are deposited in escrow with a fiduciary, invested in U.S. Treasury Bonds or other authorized securities and used to redeem the underlying bonds at their maturity or call date, to pay interest on the bonds being refunded, or to pay interest on the advance refunding bonds.
- c) **Aggregate Present Value Savings** - The Present Value Savings in each year of the refunding transaction added together.
- d) **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.
- e) **Arbitrage** - The gain that may be obtained by borrowing funds at a lower (often tax exempt) rate and investing the proceeds at higher (often taxable) rates. The ability to earn arbitrage by issuing tax-exempt securities has been severely curtailed by the Tax Reform Act of 1986, as amended.
- f) **Basis Point** - One basis point is equal to 1/100 of one percent. For example, if interest rates increase from 4.25% to 4.50%, the difference is referred to as a 25-basis-point increase.
- g) **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.
- h) **Bond** - A security that represents an obligation to pay a specified amount of money on a specific date in the future, typically with periodic interest payments.
- i) **Bond Counsel** - An attorney (or firm of attorneys) retained by the issuer to give a legal opinion concerning the validity of the securities. The bond counsel's opinion usually addresses the subject of tax exemption. Bond counsel may prepare, or review and advise the issuer regarding authorizing resolutions or ordinances, trust indentures, official statements, validations proceedings and litigation.
- j) **Book Value** - The value of a held security as carried in the records of an investor. May differ from current market value of the security.
- k) **Build America Bonds (BABs)** - BABs are taxable bonds that either: (1) allow the issuer to receive a direct payment from the U.S. Treasury (Subsidy BABs) as of

each interest payment date or (2) provide a tax credit to the bondholder (Tax Credit BABs). Despite their taxable status, BABs are subject to the rules applicable to tax-exempt bonds, and may only be used to finance tax-exempt projects. Subsidy BABs may only be used as “new money,” but Tax Credit BABs may also be used to refund tax-exempt bonds. In the case of Subsidy BABs, the issuer will receive, as of each interest payment date, a payment equal to 35% of the interest payable on that date (excluding any original issue discount). Tax Credit BABs provide the bond holder with a tax credit equal to 35% of the interest they earn on the BABs they are holding.

- l) **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.
- m) **Capital Investment Program (CIP)** - A plan of financial expenditures for capital projects of a more permanent nature such as building improvements, construction, and the acquisition of major equipment or funding programs such as open space. It also includes pay-as-you-go projects. The plan includes expenditures to be incurred over a five year period.
- n) **Commercial Paper** - Short-term, unsecured promissory notes issued in either registered or bearer form and usually backed by a line of credit with a bank. Maturities do not exceed 270 days and generally average 30-45 days.
- o) **Competitive Sale** - The sale of securities in which the securities are awarded to the bidder who offers to purchase the issue at the best price or lowest cost.
- p) **Counter Party Risk** - The risk that the swap counterparty will not fulfill its obligation to honor its obligations as specified under the contract.
- q) **Coupon Rate** - The annual rate of interest payable on a security expressed as a percentage of the principal amount.
- r) **Credit Risk** - The risk to an investor that an issuer will default in the payment of interest and/or principal on a security.
- s) **Current Refunding**- Refunding bonds issued less than 90 days before the call date of the bonds being refunded.
- t) **Current Yield** - The annual income from an investment divided by the current market value. Since the mathematical calculation relies on the current market value rather than the investor’s cost, current yield is unrelated to the actual return the investor will earn if the security is held to maturity.
- u) **Debt Limitation** - The maximum amount of debt that is legally permitted by a jurisdiction’s charter, constitution, or statutes.

## The County of Chester

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- v) **Debt Service** - The amount necessary to pay principal and interest requirements on outstanding bonds for a given year or series of years.
- w) **Debt Service Fund** - The fund established to accumulate resources for and payment of long-term debt principal and interest by governmental funds.
- x) **Derivative** - A financial product that is based upon another product. Generally, derivatives are risk mitigation tools.
- y) **Discount** - The amount by which the par value of a security exceeds the price paid for the security.
- z) **Fair Value** - The amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.
- aa) **Financial Advisor** - A consultant who advises an issuer on matters pertinent to a debt issue, such as structure, sizing, timing, marketing, pricing, terms and bond ratings.
- bb) **Floating Rate Note** - A debt security whose interest rate is reset periodically (monthly, quarterly, annually) and is based on a market index (e.g. Treasury bills, LIBOR, etc.).
- cc) **Forward Refunding** - A refunding in which the bonds are sold with the intent to close or deliver at some future point in time, generally more than 30 days after pricing, and often to coincide with a date 90 days prior to the call date on the refunded bonds, thereby qualifying as a Current Refunding.
- dd) **Fund Balance** - The excess of a fund's assets over its liabilities. For accounting purposes, fund balance is identified as reserved or unreserved. See also, Working Capital Reserve.
- ee) **General Fund** - A governmental fund used to account for all financial resources not required to be accounted for elsewhere by legal, contractual or administrative requirement. The General Fund is the main operating fund of the County.
- ff) **General Fund Balance/Expenditures** - The annual dollar amount of reserves the municipality has in its general fund as a percentage of general fund expenditures at the end of the fiscal year.
- gg) **General Obligation Bonds** - Bonds whose repayment is backed by the full faith and credit of the government issuing them.
- hh) **Government Finance Officers Association (GFOA)** - An association of public finance professionals. Develops and promotes generally accepted accounting principles for state and local governments.

## The County of Chester

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- ii) **Household EBI % of U.S.** - Effective buying income measures income after taxes. Household EBI measures income on a household basis, regardless of the number of family members and compares it on a ratio basis to a national average.
- jj) **Interest Rate Risk** - The risk associated with changes in general interest rate levels or yield curves.
- kk) **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 cash flows and not principal amounts
- ll) **ISDA** - The International Swaps and Derivatives Association, a global trade association representing participants in the derivatives industry.
- mm) **Issue** - All bonds authorized to be sold in respect of a particular project, whether authorized to be sold at one time or from time to time in one or more series.
- nn) **LIBOR** - London Inter-Bank Offer Rate
- oo) **Liquidity Risk** - The risk that a given security or asset cannot be traded quickly enough in the market to prevent a loss (or make the required profit).
- pp) **Local Government Unit Debt Act (the Debt Act)** - Administered by Pennsylvania Department of Community and Economic Development (DCED). Provides the procedure for Pennsylvania's local government units to issue debt and tax anticipation notes. The Act also provides the borrowing limits for the local government units
- qq) **Market Value** - The price at which a security is trading and could presumably be purchased or sold.
- rr) **Net Present Value Savings** - A method of calculating the aggregate amount of savings on a refunding transaction taking into consideration the time value of money and net of all issuance fees.
- ss) **Nonelectoral Debt** - All debt determined, incurred or authorized to be incurred, except electoral debt and lease rental debt.
- tt) **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.
- uu) **Overall Net Debt % of Market Value** - Overall net debt to market value. A ratio of the dollar value of debt to the value of the underlying tax base. This number provides insight into how heavy or light the debt burden is on taxable property.
- vv) **Overall Net Debt per Capita** - This number generally includes underlying and overlapping debt and indicates how heavy the debt burden is for residents.

## The County of Chester

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- ww) **PC EBI % of U.S.** - Per capita effective buying income measures after tax income on a per person basis as a ratio of the nation's PC EBI.
- xx) **Population** - The number of residents in the community.
- yy) **Present Value Savings** - In each semi-annual period, the present value of the debt refunded bonds using the arbitrage yield on the refunding bonds as the discount rate.
- zz) **Series** - All the bonds or notes to be sold and delivered at one time in respect of one project or of any two or more projects which have been combined for purposes of financing or where the bonds or notes have been combined for sale as provided in this subpart.
- aaa) **SIFMA** - Securities Industry and Financial Markets Association.
- bbb) **Synthetic Refunding** - Includes more complex, alternative refunding instruments such as interest rates swaps, derivatives, and hedges (including interest rate swaptions, caps, floors, and collars).
- ccc) **Total Direct Debt** - The total amount of debt the issuer is directly responsible for repaying. It excludes overlapping and underlying debt.
- ddd) **Total Market Value** - The value of the municipality's taxable property.
- eee) **Underwriter** - A party that guarantees the proceeds to the firm from a security sale thereby in effect taking ownership of the securities. Or, stated differently, a firm, usually an investment bank that buys an issue of securities from a company and resells it to investors.
- fff) **Working Capital** - The amount of current assets that is in excess of current liabilities. Working capital is frequently used to measure a firm's ability to meet current obligations. A high level of working capital indicates significant liquidity.
- ggg) **Yield Curve** - The relation between the interest rate (or cost of borrowing) and the time to maturity of the debt.

## APPENDICES

### a) *Post Issuance Compliance Checklist*

- i) The County has adopted the recommended post issuance compliance checklist developed by the National Association of Bond Lawyers (NABL) and the Government Finance Officers Association (GFOA). The following checklist is to assist bond counsel in discussing with issuers and conduit borrowers, as applicable, post issuance compliance matters. The checklist is divided into three parts: tax, securities and State law matters.
- ii) The checklist can serve as a framework for discussion at an appropriate time during the transaction or as a written document prepared by bond counsel and furnished to the issuer or conduit borrower after completion of the financing. Bond counsel may need to explain various items on the checklist to provide the issuer with a more complete understanding of the noted concept.
- iii) The checklist can be amended or supplemented as needed to address the particular financing issue. Issuers and conduit borrowers are encouraged to contact bond counsel at any time they may have questions or concerns pertaining to tax, securities or State law issues. In the document reference column, where applicable, the financing document pertaining to the referenced point should be named. This will assist others on the finance team – present and future – to be able to locate the original notation. The responsibility column should list the various offices/desks within the government or legal or other professional that have been engaged for the purpose of that section who is/are responsible for maintaining the noted task.
- iv) The checklist is intended to help issuers and/or borrowers throughout the entire lifetime of the financing to identify matters that need to be analyzed by the issuer and perhaps by counsel. Issuers are encouraged to retain and distribute the checklist to all responsible parties and others who may find it useful during the lifetime of a financing.
- v) The completion and distribution of this checklist does not presume a contractual obligation on parties to complete these tasks.

### b) *Derivatives Checklist*

This checklist created by the GFOA is to be used prior to entering into any derivatives transaction. This checklist presumes the County has adopted a derivatives policy and that the County's staff has been trained in the evaluation and use of derivative products. An issuer that cannot answer the questions in this checklist is advised to continue its training prior to completing a derivatives transaction. Many of the capitalized terms used in this checklist are used as defined in International Swaps and Derivatives Association, Inc. (ISDA) documents.

**Post Issuance Compliance Checklist**

## General Information

1. Name of Governmental Issuer: \_\_\_\_\_
2. Date of most recent update to Issuer's Derivatives Policy: \_\_\_\_\_
3. (a) Names of Official and Backup(s) Responsible for Procurement of Derivative:  
\_\_\_\_\_
- (b) Names of Official and Backup(s) Responsible for Monitoring Derivative:  
\_\_\_\_\_
- (c) Have all of them satisfied the training standards prescribed in the Issuer's Derivatives Policy? Yes \_\_\_ No \_\_\_
4. Independent Derivatives Advisor, if any: \_\_\_\_\_
5. Independent Derivatives Monitor, if any: \_\_\_\_\_

## Authority

1. Will the Issuer's counsel deliver an unqualified opinion on the Issuer's authority to enter into the derivative? Yes \_\_\_ No \_\_\_

## General Terms

1. Type of Derivative: \_\_\_\_\_
2. Counterparty/ies: \_\_\_\_\_
3. (a) Expected Trade Date: \_\_\_\_\_
- (b) Effective Date: \_\_\_\_\_
- (c) Scheduled Termination Date: \_\_\_\_\_
- (d) If derivative is an option, Exercise Date(s): \_\_\_\_\_
4. Notional Amount \_\_\_\_\_
5. Identify debt, or assets, with which the derivative is associated:  
\_\_\_\_\_

## Financial Terms

1. (a) Basis for calculating Issuer's payments: \_\_\_\_\_
- (b) Frequency of calculation: \_\_\_\_\_
- (c) Frequency of payment: \_\_\_\_\_
- (d) Can the passage of time or future market conditions cause the basis for calculating these payments to change? Yes \_\_\_ No \_\_\_  
If yes, explain: \_\_\_\_\_  
\_\_\_\_\_
2. (a) Basis for calculating Counterparty's/ies' payments: \_\_\_\_\_
- (b) Frequency of calculation: \_\_\_\_\_
- (c) Frequency of payment: \_\_\_\_\_
- (d) Can the passage of time or future market conditions cause the basis for calculating these payments to change? Yes \_\_\_ No \_\_\_  
If yes, explain: \_\_\_\_\_

# The County of Chester

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\_\_\_\_\_

3. Identify any embedded options in the derivative: \_\_\_\_\_

4. Will either party make an upfront payment upon execution of the derivative?  
Yes \_\_\_ No \_\_\_

## Purpose

1. State the reason(s) for entering into the derivative.

2. Were other means considered for achieving such purpose(s)? Yes \_\_\_ No \_\_\_  
If yes, why was the derivative chosen? \_\_\_\_\_

## Risks

1. Has the Issuer evaluated the extent to which each of the following risks will be assumed upon execution of the derivative?

- (a) Basis Risk Yes \_\_\_ No \_\_\_
- (b) Tax Risk Yes \_\_\_ No \_\_\_
- (c) Interest Rate Risk Yes \_\_\_ No \_\_\_
- (d) Counterparty Risk Yes \_\_\_ No \_\_\_
- (e) Termination Risk Yes \_\_\_ No \_\_\_
- (f) Market-access Risk Yes \_\_\_ No \_\_\_
- (g) Rollover Risk Yes \_\_\_ No \_\_\_
- (h) Credit Risk Yes \_\_\_ No \_\_\_

2. Are the risks to be assumed within the risk parameters of the Issuer's Derivatives Policy?

Yes \_\_\_ No \_\_\_

3. Has Issuer run, or had run for it, stress tests on how the derivative could affect Issuer's budget and financial position under various market conditions?

Yes \_\_\_ No \_\_\_

4. How do the benefits of entering into the derivative outweigh the risks being assumed?

5. Upon execution of this derivative,

- (a) How many derivatives will Issuer have outstanding? \_\_\_\_\_
- (b) What is the total notional amount of those derivatives? \_\_\_\_\_
- (c) What percent of Issuer's long-term debt will be associated with derivatives? \_\_\_\_\_

## Documentation

1. Is Issuer's counsel experienced in derivatives transactions? Yes \_\_\_ No \_\_\_
2. Has Issuer discussed with its counsel:
  - (a) Required consents and approvals? Yes \_\_\_ No \_\_\_
  - (b) Relation of derivative payments to bond payments? Yes \_\_\_ No \_\_\_
  - (c) Default provisions? Yes \_\_\_ No \_\_\_
  - (d) Termination provisions? Yes \_\_\_ No \_\_\_
  - (e) Other remedies? Yes \_\_\_ No \_\_\_

## Counterparty/ies

1. On what basis did Issuer select Counterparty/ies?
  - Competitive
  - Negotiated
2. If competitive,
  - (a) Who was bidding agent? \_\_\_\_\_
  - (b) How many firms were invited to bid? \_\_\_\_\_
  - (c) How many firms bid? \_\_\_\_\_
  - (d) Is bidding agent providing a closing certificate? Yes \_\_\_ No \_\_\_
3. If negotiated,
  - (a) State reasons for negotiating derivative: \_\_\_\_\_  
\_\_\_\_\_
  - (b) State reasons for choosing Counterparty/ies: \_\_\_\_\_  
\_\_\_\_\_
  - (c) Estimated spread relative to mid-market or benchmark rate? \_\_\_\_\_
  - (d) Is Derivatives Advisor providing a certificate as to fair market valuation?  
Yes \_\_\_ No \_\_\_  
If no, what comfort will Issuer receive that the terms for the derivative are commercially reasonable? \_\_\_\_\_
4. Does Counterparty/ies meet credit criteria of Issuer's Derivatives Policy?  
Yes \_\_\_ No \_\_\_
5. What percentage of Issuer's total notional amount of derivatives will be with the same Counterparty/ies? \_\_\_\_\_
6. If Issuer will have more than one derivatives transaction with Counterparty or any of the Counterparties, will there be netting between or among separate derivatives transactions?  
Yes \_\_\_ No \_\_\_

## Credit Support

1. Credit Support will be provided for:
  - (a) Issuer? Yes \_\_\_ No \_\_\_  
If yes, name of provider: \_\_\_\_\_
  - (b) Counterparty/ies? Yes \_\_\_ No \_\_\_  
If yes, name of provider: \_\_\_\_\_

# The County of Chester

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2. Has Issuer's counsel reviewed Issuer's credit support obligations? Yes \_\_\_ No \_\_\_
3. Has Issuer established procedures sufficient to:
  - (a) Comply with any such obligations? Yes \_\_\_ No \_\_\_
  - (b) Renew or replace Credit Support, if required? Yes \_\_\_ No \_\_\_
  - (c) Monitor the credit level of the Counterparty/ies? Yes \_\_\_ No \_\_\_
  - (d) Receive the benefit of, and comply with any obligations relating to, any credit support obligations of Counterparty/ies? Yes \_\_\_ No \_\_\_

## Tax Issues

1. Tax counsel reviewing the documentation: \_\_\_\_\_
2. Has Issuer discussed with tax counsel:
  - (a) Integration of the derivative with a bond issue? Yes \_\_\_ No \_\_\_
  - (b) Whether yield monitoring is required? Yes \_\_\_ No \_\_\_
  - (c) Whether the derivative's performance or mark-to-market value should be included in arbitrage compliance calculations? Yes \_\_\_ No \_\_\_
3. Will tax counsel deliver an opinion in connection with the derivative? Yes \_\_\_ No \_\_\_

## Operations and Monitoring

1. If the Expected Trade Date and the Effective Date are different, is the derivative part of a series of transactions? Yes \_\_\_ No \_\_\_  
If yes,
  - (a) Describe the subsequent transactions being considered: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_
  - (b) Has Issuer established procedures or mechanisms to:
    - (i) Determine how and when any subsequent transaction will occur?  
Yes \_\_\_ No \_\_\_
    - (ii) Evaluate and handle risks to completion of any subsequent transaction?  
Yes \_\_\_ No \_\_\_
    - (iii) Complete, and pay expenses of, any subsequent transactions?  
Yes \_\_\_ No \_\_\_
2. Has Issuer discussed the appropriate accounting treatment for the derivative with its independent auditor? Yes \_\_\_ No \_\_\_
3. Does the Issuer intend to use hedge accounting? Yes \_\_\_ No \_\_\_  
If yes, has the issuer received or made arrangements to receive confirmation of hedge effectiveness? Yes \_\_\_ No \_\_\_  
If yes, from: \_\_\_\_\_
4. Who is responsible for confirming payment amounts and making necessary payments?  
\_\_\_\_\_
5. What is the source for Issuer's regular payments? \_\_\_\_\_
6. How are such payments budgeted? \_\_\_\_\_
7. Who is responsible for monitoring mark-to-market valuations? \_\_\_\_\_
8. What is the frequency of such monitoring? \_\_\_\_\_

## The County of Chester

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9. What is the frequency of:

(a) Reporting monitoring results to Chief Executive Officer/Chief Financial Officer?

(b) Sharing monitoring results with independent auditor? \_\_\_\_\_

10. Has Issuer discussed this derivative with the rating agencies? Yes \_\_\_ No \_\_\_

11. Who is responsible for delivery of future documents required by the derivative's documentation? \_\_\_\_\_

12. Who is responsible for answering investors' questions about Issuer's derivatives exposure?

Information Provided By:

\_\_\_\_\_  
(signature)

**Derivates Checklist**

## DERIVATIVES CHECKLIST

### Introduction

This checklist is a supplement to the Recommended Practice on Use of Debt-Related Derivatives Products and the Development of a Derivatives Policy (2005) and is designed to be an attachment to a government issuer's derivatives policy. It is designed to be used prior to entering into any derivatives transaction. This checklist presumes an issuer's compliance with the Recommended Practice—to wit, that the issuer has adopted a derivatives policy and that the issuer's staff has been trained in the evaluation and use of derivative products. An issuer that cannot answer the questions in this checklist is advised to continue its training prior to completing a derivatives transaction.

While the principles enunciated in the Recommended Practice are generally applicable to all derivatives transactions, it is impracticable to create a "one size fits all" checklist to address the specific issues of all derivatives transactions. First, over-the-counter derivatives transactions are not uniform. Each is customized to fit the needs of the parties. Second, the derivatives market and the products being used in that market change over time, sometimes quite quickly, in response to changes in the broader financial markets. Third, the experience and sophistication of users of derivative products varies. Many experienced users of derivatives will already have developed their own means of assuring that all relevant issues in a derivatives transaction have been considered and addressed. Therefore, this checklist is intended mostly to assist issuers that meet the presumptions described above but are relatively new to the derivatives market. The issues addressed in this checklist are broadly applicable, but the form of the checklist is one that issuers are encouraged to adapt to their particular circumstances.

Many of the capitalized terms used in this checklist are used as defined in International Swaps and Derivatives Association, Inc. ("ISDA") documents, and this checklist presumes that an issuer is familiar with such documents.

# The County of Chester

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## **General Information**

1. Name of Governmental Issuer: \_\_\_\_\_

2. Date of most recent update to Issuer's Derivatives Policy: \_\_\_\_\_

3. (a) Names of Official and Backup(s) Responsible for Procurement of Derivative:

\_\_\_\_\_

(b) Names of Official and Backup(s) Responsible for Monitoring Derivative:

\_\_\_\_\_

(c) Have all of them satisfied the training standards prescribed in the Issuer's Derivatives Policy?      Yes \_\_\_\_\_      No \_\_\_\_\_

4. Independent Derivatives Advisor, if any: \_\_\_\_\_

5. Independent Derivatives Monitor, if any: \_\_\_\_\_

## **Authority**

1. Will the Issuer's counsel deliver an unqualified opinion on the Issuer's authority to enter into the derivative?      Yes \_\_\_\_\_      No \_\_\_\_\_

## **General Terms**

1. Type of Derivative: \_\_\_\_\_

2. Counterparty/ies: \_\_\_\_\_

3. (a) Expected Trade Date: \_\_\_\_\_

(b) Effective Date: \_\_\_\_\_

(c) Scheduled Termination Date: \_\_\_\_\_

(d) If derivative is an option, Exercise Date(s): \_\_\_\_\_

4. Notional Amount: \_\_\_\_\_

5. Identify debt, or assets, with which the derivative is associated:

\_\_\_\_\_

**Financial Terms**

1. (a) Basis for calculating Issuer's payments: \_\_\_\_\_

(b) Frequency of calculation: \_\_\_\_\_

(c) Frequency of payment: \_\_\_\_\_

(d) Can the passage of time or future market conditions cause the basis for calculating these payments to change? Yes \_\_\_\_\_ No \_\_\_\_\_

If yes, explain: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

2. (a) Basis for calculating Counterparty's/ies' payments: \_\_\_\_\_

(b) Frequency of calculation: \_\_\_\_\_

(c) Frequency of payment: \_\_\_\_\_

(d) Can the passage of time or future market conditions cause the basis for calculating these payments to change? Yes \_\_\_\_\_ No \_\_\_\_\_

If yes, explain: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

3. Identify any embedded options in the derivative: \_\_\_\_\_

4. Will either party make an upfront payment upon execution of the derivative?

Yes \_\_\_\_\_ No \_\_\_\_\_

# The County of Chester

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## **Purpose**

1 State the reason(s) for entering into the derivative.

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2 Were other means considered for achieving such purpose(s)?

Yes \_\_\_\_\_ No \_\_\_\_\_

If yes, why was the derivative chosen? \_\_\_\_\_

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## **Risks**

1. Has the Issuer evaluated the extent to which each of the following risks will be assumed upon execution of the derivative?

(a) Basis Risk	Yes _____	No _____
(b) Tax Risk	Yes _____	No _____
(c) Interest Rate Risk	Yes _____	No _____
(d) Counterparty Risk	Yes _____	No _____
(e) Termination Risk	Yes _____	No _____
(f) Market-access Risk	Yes _____	No _____
(g) Rollover Risk	Yes _____	No _____
(h) Credit Risk	Yes _____	No _____

2. Are the risks to be assumed within the risk parameters of the Issuer's Derivatives Policy? Yes \_\_\_\_\_ No \_\_\_\_\_

3. Has Issuer run, or had run for it, stress tests on how the derivative could affect Issuer's budget and financial position under various market conditions?

Yes \_\_\_\_\_ No \_\_\_\_\_

If yes, please explain. \_\_\_\_\_

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# The County of Chester

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4. How do the benefits of entering into the derivative outweigh the risks being assumed?

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5. Upon execution of this derivative,

(a) How many derivatives will Issuer have outstanding? \_\_\_\_\_

(b) What is the total notional amount of those derivatives? \_\_\_\_\_

(c) What percent of Issuer's long-term debt will be associated with derivatives? \_\_\_\_\_

## **Documentation**

1. Is Issuer's counsel experienced in derivatives transactions?

Yes \_\_\_\_\_ No \_\_\_\_\_

2. Has Issuer discussed with its counsel:

(a) Required consents and approvals?	Yes _____	No _____
(b) Relation of derivative payments to bond payments?	Yes _____	No _____
(c) Default provisions?	Yes _____	No _____
(d) Termination provisions?	Yes _____	No _____
(e) Other remedies?	Yes _____	No _____

Counterparty/ies

1. On what basis did Issuer select Counterparty/ies?

- Competitive  
 Negotiated

2. If competitive,

(a) Who was bidding agent? \_\_\_\_\_

(b) How many firms were invited to bid? \_\_\_\_\_

# The County of Chester

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(c) How many firms bid? \_\_\_\_\_

(d) Is bidding agent providing a closing certificate?

Yes \_\_\_\_\_ No \_\_\_\_\_

3. If negotiated,

(a) State reasons for negotiating derivative \_\_\_\_\_  
\_\_\_\_\_

(b) State reasons for choosing Counterparty/ies \_\_\_\_\_  
\_\_\_\_\_

(c) Estimated spread relative to mid-market or benchmark rate? \_\_\_\_\_

(d) Is Derivatives Advisor providing a certificate as to fair market valuation?

Yes \_\_\_\_\_ No \_\_\_\_\_

(f) If no, what comfort will Issuer receive that the terms for the derivative are commercially reasonable? \_\_\_\_\_

4. Does Counterparty/ies meet credit criteria of Issuer's Derivatives Policy?

Yes \_\_\_\_\_ No \_\_\_\_\_

5. What percentage of Issuer's total notional amount of derivatives will be with the same Counterparty/ies? \_\_\_\_\_

6. If Issuer will have more than one derivatives transaction with Counterparty or any of the Counterparties, will there be netting between or among separate derivatives transactions? Yes \_\_\_\_\_ No \_\_\_\_\_

## **Credit Support**

1. Credit Support will be provided for:

(a) Issuer Yes \_\_\_\_\_ No \_\_\_\_\_

If yes, name of provider: \_\_\_\_\_

(b) Counterparty/ies Yes \_\_\_\_\_ No \_\_\_\_\_

If yes, name of provider: \_\_\_\_\_

# The County of Chester

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2. Has Issuer's counsel reviewed Issuer's credit support obligations?

Yes \_\_\_\_\_ No \_\_\_\_\_

3. Has Issuer established procedures sufficient to:

(a) Comply with any such obligations? Yes \_\_\_\_\_ No \_\_\_\_\_

(b) Renew or replace Credit Support, if required? Yes \_\_\_\_\_ No \_\_\_\_\_

(c) Monitor the credit level of the Counterparty/ies? Yes \_\_\_\_\_ No \_\_\_\_\_

(d) Receive the benefit of, and comply with any obligations relating to, any credit support obligations of Counterparty/ies? Yes \_\_\_\_\_ No \_\_\_\_\_

## **Tax Issues**

1. Tax counsel reviewing the documentation: \_\_\_\_\_

2. Has Issuer discussed with tax counsel:

(a) Integration of the derivative with a bond issue? Yes \_\_\_\_\_ No \_\_\_\_\_

(b) Whether yield monitoring is required? Yes \_\_\_\_\_ No \_\_\_\_\_

(c) Whether the derivative's performance or mark-to-market value should be included in arbitrage compliance calculations? Yes \_\_\_\_\_ No \_\_\_\_\_

3. Will tax counsel deliver an opinion in connection with the derivative?

Yes \_\_\_\_\_ No \_\_\_\_\_

## **Operations and Monitoring**

1. If the Expected Trade Date and the Effective Date are different, is the derivative part of a series of transactions? Yes \_\_\_\_\_ No \_\_\_\_\_

If yes,

(a) Describe the subsequent transactions being considered: \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_

# The County of Chester

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(b) Has Issuer established procedures or mechanisms to:

(i) Determine how and when any subsequent transaction will occur?

Yes \_\_\_\_\_ No \_\_\_\_\_

(ii) Evaluate and handle risks to completion of any subsequent transaction?

Yes \_\_\_\_\_ No \_\_\_\_\_

(iii) Complete, and pay expenses of, any subsequent transactions?

Yes \_\_\_\_\_ No \_\_\_\_\_

2. Has Issuer discussed the appropriate accounting treatment for the derivative with its independent auditor? Yes \_\_\_\_\_ No \_\_\_\_\_

3. Does the Issuer intend to use hedge accounting?

Yes \_\_\_\_\_ No \_\_\_\_\_

If yes, has the issuer received or made arrangements to receive confirmation of hedge effectiveness? Yes \_\_\_\_\_ No \_\_\_\_\_

If yes, from: \_\_\_\_\_

4. Who is responsible for confirming payment amounts and making necessary payments? \_\_\_\_\_

5. What is the source for Issuer's regular payments? \_\_\_\_\_

6. How are such payments budgeted? \_\_\_\_\_

7. Who is responsible for monitoring mark-to-market valuations? \_\_\_\_\_

8. What is the frequency of such monitoring? \_\_\_\_\_

9. What is the frequency of:

(a) Reporting monitoring results to Chief Executive Officer/Chief Financial Officer?  
\_\_\_\_\_

(b) Sharing monitoring results with independent auditor? \_\_\_\_\_

10. Has Issuer discussed this derivative with the rating agencies?

Yes \_\_\_\_\_ No \_\_\_\_\_

11. Who is responsible for delivery of future documents required by the derivative's documentation? \_\_\_\_\_

12. Who is responsible for answering investors' questions about Issuer's derivatives exposure? \_\_\_\_\_

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Information Provided By:

\_\_\_\_\_  
(signature)