FINANCIAL POLICIES FOR THE HARBOR DEPARTMENT OF THE CITY of LOS ANGELES

THE PORT OF LOS ANGELES

October 2014

HARBOR DEPARTMENT OF THE CITY OF LOS ANGELES
FINANCIAL POLICIES

Table of Contents

Page No.

Section 1 Introduction…………………………………………….. 1

Section 2 Fiscal Policy……………………………..………….. 3

- Budgetary Policy…………………………….…. 4
- Revenues and Expense Policy………………..…. 6

Section 3 Leasing Policy……………………………………….. 7

Section 4 Capital Improvement Plan Funding Policy…………... 8

Section 5 Financial Reserve Policy………………………………. 11

Section 6 Risk Management Policy……………………………… 13

Section 7 Disclosure Policy…………………………………….. 14

Section 8 Debt Management Policy……………………………… 15

GLOSSARY OF TERMS……………………………… 30

October 2014

SECTION 1 – INTRODUCTION

Financial policies assist in effective financial management. Such policies help in establishing and managing controls and in reporting accurate financial results. The maintenance of financial policies will:

1. Promote consistent financial procedures, operational efficiencies and best practices.
2. Assist in compliance with applicable laws, regulations, and accounting and reporting standards.

The City of Los Angeles Harbor Department (Port or Department) is a self-supporting proprietary department. As such, the Port operates independently, administering and controlling its own fiscal activities. The Port is under the control of a five-member Board appointed by the Mayor, subject to the oversight of the Council and administered by an executive director.

The Port, held in trust for the people of the State of California pursuant to a series of tideland grants and administered by the City of Los Angeles (City) under the City Charter (Charter), is located in San Pedro Bay, approximately 20 miles south of downtown Los Angeles. The Port's facilities lie within the shelter of a nine-mile long breakwater constructed by the Federal government in several stages, the first of which commenced in 1899. The California State Legislature granted tidelands occupied by the Port to the City under the State Tidelands Trust Act in 1911 for promoting commerce, navigation, and fishery. The Tidelands Trust Act has been amended many times, most recently in 2002 by Assembly Bill 2769 that expanded the permitted uses of tidelands to include recreational, environmental, and public meeting and assembly activities that are water-oriented and are intended to be of statewide benefit. The granted lands are subject to a public trust imposing certain restrictions on their use of the revenues derived from these lands.

The Port collects and deposits all fees, charges, rentals, and revenues in connection with its possession, management, and control of the Harbor District and Harbor Assets in the Harbor Revenue Fund. The Harbor Revenue Fund is a separate fund established by the Charter. The Port's operating expenses, as well as the construction, acquisition, purchase, lease, or maintenance of Harbor Assets are paid from the Harbor Revenue Fund.

The Port currently holds long-term debt ratings of AA/Aa2/AA from Standard & Poor's, Moody's, and Fitch Investor Services, the highest credit ratings of any non-tax backed seaport in the nation. These ratings reflect a variety of factors, including its competitive position, deep-draft waterways, facilities, large local service area, intermodal transportation links, and fiscal management. Adhering to a prudent financial policy will help to sustain the Port's credit position.

The Harbor is committed to maintaining strong financial policies and fiscal discipline. The Board of Harbor Commissioners may review and amend policies outlined in this document when necessary but on an annual basis, an update will be provided to the Board of Harbor Commissioners.

Responsibility

The Chief Financial Officer (CFO) or designee will be responsible for the maintenance and drafting of Financial Policies. The Board of Harbor Commissioners (Board) will approve all policies and amendments and all staff members of the Port are responsible for following these policies.

SECTION 2 – FISCAL POLICY

INTRODUCTION

These Fiscal Policies have been developed to codify and reinforce the Port's tradition of fiscal responsibility. The key objective is to balance prudently the Port's core business requirements and strategic objectives with its financial resources.

All fees, charges, rentals and revenue collected by the Port in connection with its possession, management and control of its assets are deposited in the Harbor Revenue Fund. All such moneys and revenues deposited in the Harbor Revenue Fund are under the direction and control of the Board.

Pursuant to the Charter, moneys deposited in the Harbor Revenue Fund may be appropriated or used only for the following core business purposes:

A. **Operations and Maintenance** – For the necessary expenses of operating the Port, including salaries and benefits, the operation, promotion and maintenance of the lands and waters, and interests therein, and Port improvements, works, utilities, facilities and watercraft, owned, controlled or operated by the Port;

B. **Development of Assets** – For the acquisition, construction, completion and maintenance of the Port and for the acquisition or taking by purchase, lease, condemnation or otherwise of property, real or personal, or other interest necessary or convenient for Port purposes;

C. **Debt Service Payment** – For the payment of the principal and interest on debt issued by the Port;

D. **Reimbursements** – For reimbursements to another department or office of the City on account of services rendered, or materials, supplies or equipment furnished to support Port purposes. (Such reimbursements must be for appropriate expenses that have been specifically authorized by the Port for services rendered at the request of Port.)

Annually, the Board will adopt a budget that is consistent with the Port's commitment to its strategies and goals as outlined in its strategic plan. Any recommendation put forth to the Board that does not comply with these Policies will be indicated as part of an appropriate report.

The annual audited financial statements, prepared by the Port, will be presented to the Board upon conclusion of the audit process.

The Port will maintain fiscal policies that will be consistent with its intent to:

- Hold ratings commensurate with strategy,
- Sustain transparency and accountability to its stakeholders.

BUDGETARY POLICY

The adopted budget represents the ongoing commitment of management and staff to operate and maintain the Port in a fiscally sound manner according to the guidelines, policies and direction set forth by the Mayor and the Board. The budget spans a fiscal year beginning July 1 and ending June 30 and contains operating and non-operating revenues and expenses, grants, capital expenditures and reserves for the Port. The budget is an appropriation document that gives the Port the authority to spend and allocate funds for the components outlined above.

Each year, the Port staff will develop a budget plan that will lead to the Board's review and adoption of the subsequent year's budget. The timing of this process will be consistent with the established strategy and priorities at the Port and within the requirements of the Charter and the guidelines of the Mayor.

A budget calendar for the fiscal year is to be established to make clear deliverables and deadlines.

After consultation with the Board, the Executive Director will start each budget year with a letter addressed to Division Heads discussing the broad financial targets for the coming fiscal year.

I. Each year the Port will establish a budget by:

   A. Providing a comprehensive view of Port's sources and uses of funds for operating and capital expenditures.

   B. Tailoring the budget process into an effective management tool for setting financial priorities and meeting strategic objectives.

   C. Managing financial resources in a manner that:

      1. Is prudent and sustainable

      2. Meets financial requirements of medium and long-term capital improvements

   D. Producing budget information that is:

      1. Clear, comprehensible and transparent to employees and other stakeholders

      2. Accurate, timely, and easy to access

   E. Monitoring and analyzing revenues and expenditures throughout the fiscal year for compliance and accountability.

II. A cash flow forecast report will be maintained as part of a 10-year projection model on an on-going basis.

III. Fund appropriations are limited to the sum of available, unrestricted cash balances, revenues estimated to be received in the current budget year, and , when necessary, debt issuance.

IV. All Port Divisions will operate within the adopted budget. From time to time, the Port will consider spending requests for new or expanded programs during the course of the fiscal year and, to the extent possible, such increases to current operations will be funded by current revenues. On occasion, there may be a need for Board action to draw funds from the Port's unappropriated balance in order to meet unforeseen financial requirements.

V. Capital assets owned by the Port shall be maintained on a regular schedule. The Port will recognize the impact of wear and tear of existing capital assets on the annual operating budget. Maintenance costs will be identified and incorporated into the annual operating budget as necessary. These costs include items such as renovations, maintenance and service contracts.

VI. All Port funds shall be reconciled at the close of the fiscal year to determine the available cash balance at year-end.

VII. Reports to the Board shall include Fiscal Impact and Economic Benefit discussions as to how the proposed action may affect the budget, the Department's financial condition, any benefits to the job market, plus the estimated cost and or benefit of the program or service in the current and future years.

REVENUES AND EXPENSE POLICY

I. The Port does not rely on any tax revenues to carry on its operations. Therefore, the Port charges fees for facilities and services provided to its customers. Each fee is structured to allow for marginal cost pricing and for the recovery of both direct and indirect costs incurred in the operation of the Port.

II. Consistent with the leasing policy and the required rates of return, the Port charges its occupants for the use of Port land, docks, wharves, transit sheds, terminals and other facilities pursuant to various permit agreements. These permit agreements are similar in form to lease agreements. Under the various permit agreements the occupants agree to pay the Port tariffs or fees in exchange for the right to use and occupy those properties permitted for use and occupancy by shipping or terminal companies, agents and other private firms. Although the Port owns these facilities, it has no direct hand in managing the daily movement of cargo. The Port also serves as a landlord to various oil terminals, fish markets, boat repair yards, railroads, restaurants and other similar operations.

III. The Port has three major sources of operating revenues: shipping revenues, rental revenues, and fee and royalty revenues. The Port recovers its costs of providing services and improvements through these charges for shipping services and permitted use and occupancy of facilities. The Port conducts regular reviews of its fee structure, rentals and charges for services, and other operating revenues and expenditures.

IV. Sufficient user charges, rents and fees shall be pursued and levied to support the cost of operations for which fees and rents are charged, including operating (direct and indirect) and capital costs. For any operating activity, the marginal revenue should exceed the marginal cost of the activity. The Port will monitor user charges, rents, and fees for the Port to determine that rates are adequate and appropriate. If fees, rents or charges are not set at a level that results in at least 100 percent full cost recovery, the Board will specifically recognize the subsidy and shall take specific action to appropriate the necessary funds to subsidize the fee for service. Operating expenses must be funded in whole by operating revenues.

V. The Port will pursue federal, state, and private grants but will assess the necessary on-going financial support of these programs to make clear the commitments that continue beyond available funding. The proceeds of such grants will be used to enhance security, construction of capital assets, the improvement of the surrounding environment, and the overall efficient operations of the Port.

VI. The Port should seek to maintain a stable and diverse revenue stream to the extent consistent with its business objectives.

SECTION 3 – LEASING POLICY

INTRODUCTION

In August 2013, the Board adopted a Leasing Policy for the Harbor Department for when the Department is the lessor. The Leasing Policy, in conjunction with the Debt Policy and this Financial Policy, provide guidance to financing decisions of the Harbor Department. The Port administers close to 300 property agreements throughout the Port's jurisdiction. These types of leases include agreements, concession agreements, leases, orders, permits and revocable permits. The objective of the Port of Los Angeles Leasing Policy is to provide a framework governing leasing and rental decisions as they relate to tenant retention, selecting new tenants, development of new agreements and, as appropriate, modifications to existing agreements by amendments. Leasing and rental decisions will be made in a transparent environment, while maintaining compliance with City, State and Federal laws.

POLICIES

Please see the Leasing Policy for complete information.

SECTION 4 – CAPITAL IMPROVEMENT PLAN FUNDING POLICY

INTRODUCTION

Amounts budgeted for Capital Improvements are taken from the Port's Capital Improvement Plan (CIP). The CIP is a planning document only, any appropriations for specific projects in excess of the authority of the Executive Director must be approved by the Board.

The CIP includes the purchase, renovation, or construction of Port facilities and may be funded by a variety of funding vehicles: the Harbor Revenue Fund, debt, and depending on availability, grants. While the Port develops and maintains a multi-year CIP encompassing all Port capital needs for its facilities, as well as the acquisition of land, a CIP is approved by the Board on an annual basis as part of the budget approval process.

POLICIES

The Project Development Committee reviews all Port capital projects to be recommended for inclusion in the CIP subject to the oversight and approval of the Board. A capital project either creates a new asset or significantly extends the life of an existing asset. Large capital equipment purchases, those in excess of $5,000, should be included and considered as part of the overall annual budget process. Expenditures for land and property acquisition and certain payments made for environmental mitigation purposes are also identified as Capital Projects.

In this capacity, the Project Development Committee will:

1. Affirm the linkage between proposed Capital Projects and Port's strategic goals and objectives;
2. Assess the linkage between the capital and operating budgets to ensure appropriate allocation of resources;
3. Reaffirm the validity of a proposed CIP for annual approval by the Board of Harbor Commissioners;
4. Provide discipline and enforcement to the approved CIP;
5. Monitor the progress of Capital Projects. Major changes in project scope or direction shall be presented to the Board for approval;
6. Review the qualitative and quantitative (including financial analysis) evaluation of Capital Projects to determine the priority of projects;
7. Review, assess and approve or deny the placement of proposed Capital Projects on to the CIP;

8. Review CIP policies and procedures periodically and implementing changes as necessary;
9. Provide a mechanism for financial and resource planning for the Port;
10. Ensure compliance with the City Charter, Section 610, by submitting a Debt Accountability and major Capital Improvement Plan to the Mayor, City Council and Controller every two years in conjunction with the submittal of Port' s annual budget;
11. Authorize total project cost and fiscal year cost allocation changes.

Capital Projects are evaluated on many criteria of which financial impact is only one key factor. The critical information required for a financial analysis is summarized below:

1. **Revenue**: A description of the anticipated level of revenue that might be generated due to the completion of the capital project should be explained. Potential revenue sources may include cost recovery mechanisms such as fees and terminal rentals, new facility rentals, new concession, parking or other third party revenues, and revenues from increased Port activity.
2. **Maintenance and Operations Expenses**: These are maintenance and operations (M&O) expense estimates for the operational costs of an asset after it has been placed into operation. These expense estimates should include incremental direct and incremental indirect costs.
3. **Total Project Cost**: Total project cost must include all components of the project (e.g., design, construction management, contingency, demolition of existing facilities, new building, infrastructure and support systems, etc.). Total project costs should include contractual payments for planning, construction and other services, internal Port direct costs, and appropriate contingencies.
4. **Project Contingency**: As a component of total project cost, the project contingency depends upon the level of planning and design completed for the project. At a preliminary stage, the contingency may be 5% - 25%. As the details of the project become more specific, the level of contingency may be adjusted accordingly. The level of contingency should be clearly identified in the proposal for each project. While the maximum contingency amount for a proposed project should be 5%, a higher percentage may be warranted, subject to Board approval.
5. **Economic Benefits**: A description of how the design, building, and maintenance of each project contribute to maximizing job creation in the 5-county region will be presented.

6. **Recreation**: A description is required if a particular project promotes recreation, which is one of the purposes of the tidelands trust.

All Port Capital Projects must be approved by the Board

SECTION 5 – FINANCIAL RESERVE AND TARGET BALANCE POLICY

INTRODUCTION

This policy seeks to manage the Port's financial reserves in order to:

A. Meet or exceed all debt indenture and Charter requirements, if any;

B. Maintain access to capital markets and other sources of capital funding at the most efficient cost of funds for each of the Port's programs; and

C. Manage financial risks prudently to meet the Port's financial needs

POLICIES

The Port establishes financial reserves to follow defined financial requirements under its bond indentures and other legal obligations. This is in order to meet needs that may occur that were not known during the budget cycle or were insufficiently defined to allow for a more specific appropriation. Additionally, reserves provide for liquidity to support one of the Port's key financial objectives of maintaining strong debt ratings. In doing so, the Port will seek, through the approval of the Board, the establishment of reserve funds for the department. Currently, the Port's reserve funds include an Emergency Fund, Debt Service Reserve Funds and a variety of mitigation reserve funds.

A. **Emergency/ACTA Fund:** This account holds funds for unanticipated expenditures, disaster related recovery and Alameda Corridor Transportation Authority revenue shortfalls. Any withdraws of the money that would bring the balance below the targeted minimum would require Board approval. The approved minimum amount to be held in this account is $47 million.

B. **Debt Service Reserve Fund:-** The Indentures for the Port, as amended and supplemented, pursuant to which Revenue Bonds have been issued to date, establish a Reserve Requirement of the lesser of:

1. Maximum Aggregate Annual Debt Service for Reserve Requirement for all Series of Bonds participating in the Reserve Fund or a separately created Debt Service Reserve Fund created pursuant a Supplemental Indenture,

2. 10% of the principal amount of Bonds that have been issued and are participating in the Reserve Fund or in a separately created Debt Service Reserve Fund created pursuant a Supplemental Indenture, less the amount of original issue discount with respect to

any Bond if such original issue discount exceeded 2% on such Bond at the time of its original sale,

3. 125% of the average Aggregate Annual Debt Service for Reserve Requirement for all Series of Bonds participating in the Reserve Fund or a separately created Debt Service Reserve Fund created pursuant a Supplemental Indenture.

This Reserve Requirement may be funded with a combination of cash, securities, an insurance policy or surety bond, or a letter of credit, in accordance with the requirements of the Indentures.

C. **Special Operating Fund:** The target balance in this fund will be considered in combination with the Emergency/ACTA Fund. The target balance in this Fund will be the difference between the average of the Port's operating expenses over a five year period and the Emergency/ACTA Fund. The five-year average period will be comprised of audited operating expenses for the four previous most recent fiscal years and the adopted budget for operating expenses for the current fiscal year. From this average will be subtracted the minimum level specified for the Emergency/ACTA Fund. Any surplus above the combined minimum balance may be transferred to Harbor Revenue Fund at any time. Any withdraws that would cause the combined minimum balance to drop below the target balance requires Board approval.

As an example, in June 2014, the average annual operating expenses as defined above over five years stood at $207 million, being four years of audited operating expense data from fiscal years 2010 through 2013 and the budgeted operating expense for fiscal year 2014. Finding the difference between the $207 million and the $47 million target minimum for the Emergency/ACTA Fund, generates a target minimum of $160 million for the Special Operating Fund.

SECTION 6 – RISK MANAGEMENT POLICY

INTRODUCTION

The Port is to be protected to a prudent extent against any liability or loss that would significantly affect personnel, property, finances or the ability of the Port to continue to fulfill its responsibilities as an independent, self-supporting proprietary port. This is to be accomplished through the continuous identification, analysis, and control of risk exposures, the determination of the best methods of preventing or limiting losses and the selection of the most economical method of insurance or other means.

POLICY

I. After identification of loss potential and development of loss prevention programs, the mitigation of the financial impact of loss, as it may occur, shall be based on the most economical method of providing funds to meet the obligations of the Port and to restore its facilities.

II. Risk management techniques shall include:
  A. Assumption of loss
  B. Use of available government programs
  C. Purchase of insurance
  D. Transfer options and any other program that will provide the Port with the most economical method of financing losses

III. The purchase of insurance shall be considered when:
  A. The estimate of the cost of potential loss exceeds an amount considered as an allowable retention of risk and there are no other techniques available at a lesser cost
  B. Services of loss adjustment and loss prevention are best secured through an insured program
  C. Legal or contractual obligations require insurance

SECTION 7 – DISCLOSURE POLICY

The Chief Financial Officer or designee shall establish and maintain reasonable procedures for the preparation, review and dissemination of the disclosure documents of the Harbor Department, including primary offering disclosure documents and continuing disclosure filings, to ensure the accuracy, completeness and timeliness of such disclosure documents. Disclosure includes posting to the Port's web site its comprehensive annual financial report, quarterly financial statements, and following annual disclosure requirements under the Municipal Securities Rulemaking Board.

SECTION 8 – DEBT MANAGEMENT POLICY

INTRODUCTION

The purpose of the Debt Management Policy (Debt Policy) of the Department is to establish guidelines for the issuance and management of the Harbor Department's debt. The Port has the authority, subject to Mayor and Council review in certain instances, to borrow money and issue debt under Section 609, Article VI of the Charter. The City Council has defined the procedure for the proprietary departments to issue debt in a Bond Procedural Ordinance, which is set forth at Sections 11.18.9 through 11.28.1 of the Los Angeles Administrative Code. Each proprietary department has the power to borrow money and to issue bonds, refunding bonds, notes, and other evidences of indebtedness (collectively referred to in this section as Revenue Bonds). Although the Port will apply its Debt Policy as a guideline, the actual terms and conditions governing debt issued by the Port are set forth in the actual documents associated with each Revenue Bond issuance.

This Debt Policy confirms the commitment of the Board, management, staff, advisors and other decision makers to adhere to sound financial management practices, including full and timely repayment of all borrowings, and achieving an appropriate level of capital within prudent risk parameters. Certain terms used in this Debt Policy are defined in the glossary located at the end of this document.

I. OBJECTIVES

The objectives of the Debt Policy include the following:

A. Maintain the Port's existing high credit ratings;

B. Provide for an efficient overall cost of borrowing for the Port;

C. Provide specific guidelines with respect to the overall management of the Port's debt;

D. Set forth a process for selecting various consultants who will assist the Port in the issuance and management of the Port's debt;

E. Support for the Port's strategic plan objectives;

F. Establish for three years a pool of underwriters from which firms will be chosen to assist in any financings;

G. Encourage participation of minority and women owned businesses in the pool of underwriters in compliance with the Departmental Small Business Enterprise (SBE) Program as well as local firms.

II. SCOPE AND AUTHORITY

This Debt Policy shall govern the issuance and management of all financings and shall include all obligations and ancillary facilities related to those financings, including investment of bond proceeds not otherwise covered by the City of Los Angeles' Investment Policy.

While adherence to this Debt Policy is required in applicable circumstances, the Port recognizes that changes in the markets and other unforeseen circumstances may produce situations that are not covered by the Debt Policy or require modifications or exceptions to achieve Debt Policy goals. In these cases, the Port will seek authorization from the Board.

The Debt & Treasury Section shall have the day-to-day responsibility and authority for structuring, implementing, and managing the Port's debt and finance programs, in accordance with Board approved authorizations. The Debt Policy requires that any financing be specifically authorized by the Port's Board.

III. CAPITAL BUDGETING AND DEBT ISSUANCE PROCESS

A. Capital Budgeting

1. The Capital Improvement Plan: A Capital Improvement Plan (CIP) shall be developed as outlined within the Capital Improvement Plan Policy for consideration and adoption by the Board. In addition to capital project costs, the CIP will include the following elements:

   a) Timing of capital projects;
   b) Effect of capital projects on the Department's debt burden; and,
   c) Debt service requirements.

2. Authorization for Issuance: Any debt issuance to fund capital project expenditures must be authorized by the Board. The Board's adoption of the Annual Budget and/or CIP does not, in and by itself, constitute authorization for debt issuance for proposed capital projects. Each financing shall be presented to the Board in the context of the Annual Budget or the CIP.

3. Review of the Capital Improvement Plan: Modifications to the CIP shall be preceded with a report, which among other items, discusses the impact of the proposed modifications on the Annual Budget and the CIP. The ten-year CIP is to be reviewed and presented to the Board at least annually. Modifications to the CIP may be included as a separate section to the Annual Budget and CIP. Major modifications to the CIP, which occur during a particular fiscal year, will be presented under a separate report to

the Board.

B. Debt Financing

1. Appropriate Use of Long-Term Debt

a) Purpose – Long-Term Debt should be used to finance essential capital facilities, projects, and certain equipment where it is cost effective and fiscally prudent. The scope, requirements, and demands of the Annual Budget or the CIP, and the ability or need to expedite or maintain the programmed schedule of approved capital projects should also be factored into the decision to issue long-term debt. The Port recognizes that the future viability of the Port is a result of capital investment. As a result, long-term debt will be used on an as needed basis to fund the Port's capital investment needs.

b) Lease Financing – Lease obligations are a routine and appropriate means of financing capital equipment. These types of obligations may be considered for equipment and assets that are not financed under a revenue-based financing program. The useful life of the capital equipment, the terms and conditions of the lease, and the direct impact on debt capacity and budget flexibility will be evaluated prior to the implementation of a lease program. Efforts will be made to fund capital equipment with pay-as-you-go financing where feasible. Cash flow sufficiency, capital program requirements, lease program structures and cost, and market factors will be considered in conjunction with a pay-as-you-go strategy in lieu of lease financing. Short-term equipment leases that do not access the capital markets are not covered by this policy.

2. Use of Short-Term and Variable Rate Debt

a) Commercial Paper – Commercial Paper is routinely used to provide interim new money funding to finance the acquisition and construction of various new capital facilities, projects, and equipment. When appropriate but no later than when these facilities are constructed and operational, it is the Port's intention to retire this debt with either long-term bonds or Harbor Revenue Fund. The scope and nature of these financed capital facilities will be evaluated in conjunction with the Port's long-term debt policy and included in the Annual Budget and/ or the CIP.

b) Variable Rate Debt – It may occasionally be appropriate to issue variable rate debt to diversify the debt portfolio, reduce interest costs, expand the pool of buyers for the Port's debt, provide interim funding for capital projects and improve the matching of assets with liabilities. The amount of unhedged, long-term variable rate debt will generally not exceed 20% of all outstanding debt, and be consistent with liquid financial assets of the Department. Variable rate debt shall be issued in conformance with applicable tax arbitrage restrictions. If variable rate debt is used, the Port will periodically, but at least annually, determines whether it is appropriate to convert the debt to fixed interest rates. The Port may use various forms of variable rate debt for construction financing or where pre-payment flexibility is desired.

c) Lines of Credit – It may be useful to hold available lines of credit from commercial banks as an additional source of liquidity. Such lines would be solely for working capital purposes and may also be used for providing a bridge for long term capital project financings.

IV. Debt Service Target Level

The target debt service coverage for the Port is listed below. This limit, in combination with the CIP and multi-year planning, will ensure that the Port will be able to continue providing its essential operational services while planning for replacement, rehabilitation, and expansion of its capital investments.

A. The Port will maintain a target minimum Debt Service Coverage of 2.0x, however, the actual terms and conditions specific to each bond issue are controlled by the bond documents.

B. The Port will seek to maintain its level of cash reserves and minimize the level of debt. Any prepayment or payment of debt will consider cost and term.

V. Purpose of Financing

For each financing, documentation will be prepared and retained in a permanent "deal file" regarding the various vendor selections, the decision process for sizing and structure, the method of bond sale, and investment decisions.

A. New Money Financing

New money issues are those financings that generate additional funding to be available for expenditure on capital projects. These funds will be used for acquisition, construction, and major rehabilitation of capital assets. New money bond proceeds may not be used to fund operational activities. For competitive issuances, the structure for any financing is based on the market conditions at the time of the sale.

The Port may utilize its commercial paper programs to provide interim new money funding.

B. Refunding Bonds

A present value analysis must be prepared that identifies the economic effects of any refunding to be proposed to the Board. It is acknowledged that some refundings may be executed for other than economic purposes, such as to restructure debt, change the type of debt instruments being used, or to retire a bond issue and indenture in order to achieve more desirable covenants. A finding by Chief Financial Officer and approval by the Board is required in such cases.

Target savings amounts shall be measured by using a call option pricing model. The target savings from any particular refunding candidate should be in the range of 80% of the expected value of the call option, net of all transaction expenses. Alternatively, the more traditional methodology of measuring the net present value savings as a percentage of the refunded par amount may be used with a minimum present value savings of 3% for any one refunding transaction. The Chief Financial Officer shall have discretion in making the final determination to include individual refunding candidates that are above or below the target in order to optimize the Port's policy and/or financial objectives.

Certain circumstances may require the Port to deviate from use of these refunding targets, such as the need to update inefficient covenants, restructure debt service payments or to alter bond payment dates. When any such circumstance arises, specific Board approval will be obtained.

When bonds are refunded, staff shall consider whether call features are to be preserved. Once decided to be preserved, staff, the financial advisors, the bond counsel, and disclosure counsel shall assure that documents prepared meet all requirements unless expressly waived.

VI. Types of Products

A. Current Coupon Bonds

Current Coupon Bonds are bonds that pay interest periodically and principal at maturity. They may be used for both new money and refunding transactions. Current coupon bonds may be structured to meet the demands of the investor and, thereby, reduce the cost of borrowing. Features such as annual principal maturities, the use of discounts, maturity of the debt, the parameters of the call provisions, or cash funded debt service reserve funds are adjusted to the market conditions at the time of sale.

B. Zero Coupon and Capital Appreciation Bonds

Zero coupon bonds and capital appreciation bonds have principal amortization that is much slower than level debt service resulting in increased interest expenditure over the life of the bond issue and, therefore, shall only be recommended in limited situations.

C. Lease Purchase Financing

Lease purchase financing represents a long-term financing lease that is suitable for financing capital equipment or the acquisition and construction of real property.

1. Equipment: It has been the Port's practice to purchase equipment on a pay-as-you-go basis; however, the Port shall have the ability to consider lease purchase transactions, as an alternative to long-term vendor leases, including the ability to implement a master lease program. Only the highest priority equipment purchases will be lease purchased.

2. Real Property: Principal payments related to real property acquisition or construction is to be amortized such that it results in level debt service payments although the Port may consider rapid amortization to meet its repayment objectives.

D. Derivative Products

Derivative products may be considered where appropriate in the issuance or management of debt only in instances where it has been demonstrated that the derivative product will either provide a Hedge that reduces risk of unfavorable fluctuations in expense or revenue, or alternatively, where it will reduce total project cost. An analysis of early termination costs and other conditional terms will also be performed given certain financing and marketing assumptions. Such analysis will document the risks and benefits associated with the use of the particular derivative product. Derivative products will only be utilized with prior Board approval. If the derivative product requires any contracts with third parties, such as a Letter of Credit or Swap agreement, the Port will only enter into contracts with financial institutions that have a long-term credit rating equal to or higher than the Port's long-term credit rating. If such long-term rating is not available to a particular financial institution, guarantees or collateralization will be required, such that an equivalent or higher long-term rating can be obtained.

VII. Structural Features

A. Maturity of Debt

The final maturity of the debt shall be equal to or less than the useful life of the assets being financed. In general, the average life of the financing should not exceed 120% of the average life of the assets being financed unless tax or other restrictions require a lesser percentage. In no case will the final maturity exceed 30 years. Exceptions to the matching of the average lives must be approved by the Board.

B. Debt Service Structure

Combined principal and interest payments for any particular bond issue should be structured to have approximately equal debt service payments over the life of the bond. Exceptions may occur depending on the type of bonds being issued. While the objective is to have level debt service in aggregate for each lien, with the debt service trailing off as bonds mature, depending on market availability, exceptions may be considered subject to Board approval.

C. Lien Levels

Net Revenues are the primary repayment source for the Port's outstanding debt. The Port's long-term and short-term debts are generally issued on a senior lien, parity basis; subordinate debt may be considered when appropriate. All senior lien debt will be utilized in a manner which will maximize the most critical constraint, typically either cost or capacity; thus, allowing for the most beneficial use of Net Revenues. Any subordinate lien debt must be considered in light of overall debt capacity and may only be issued with the approval of the Port's Board.

D. Capitalized Interest

The Port will seek to avoid the use of capitalized interest. Certain types of financings such as lease-secured financings, and certain revenue bond projects may require that interest on the bonds be paid from capitalized interest until the Port has constructive use of the project.

E. Discount Bonds

While discount and deep discount bonds may reduce the interest cost of the bonds below that of non-discount bonds, they should only be recommended in limited situations as they reduce the potential for savings from refunding of the bonds.

F. Debt Service Reserve Fund

A long term debt issue may require the establishment of a Debt Service Reserve Fund (DSRF), the amount of which is determined by Section 5 – Financial Reserve Policy, Debt Service Reserve Fund. Under current conditions, the Port's Debt Service Reserve will likely be funded by cash.

The Chief Financial Officer and the Director of Debt & Treasury will evaluate and document the DSRF funding decision. Factors to be considered in this evaluation include: arbitrage yield restrictions, current interest rates, availability and cost of a surety policy, and opportunities for the use of the funds withdrawn from the DSRF including additional capital projects or investment opportunities.

When a debt service reserve is funded with cash, the funds are maintained by trustee bank throughout the life of the bond issue. A cash funded DSR is invested pursuant to investment of proceeds guidelines within the issue's respective indenture and interest earnings are generally used to offset debt service payments. In the final year of the bond issue, the cash available in the DSR is usually used to make the final debt service payment. Since a cash-funded DSRF generates interest income, the Port will have the potential to be in a financially neutral position if the interest earnings equal or exceed the interest rate of the bonds.

G. Financial and Risk Analysis of Issuance

Net present value cost analysis, assessment of structural risks and complexities, and consideration of restrictions to future financing flexibility will be assessed and documented to determine the most efficient bond type and structuring features. The weighted average cost of capital or the marginal rate of borrowing long-term debt, whichever is higher, may be used as the discount rate when comparing alternatives.

H. Call Provisions

In general, the Port's securities will not include a redemption feature that is longer than 10 years. It is the Port's intent to maximize prepayment flexibility on all bond issues.

I. Credit Enhancement

1. The current market no longer ascribes economic value to bond insurance as risk mitigation for bonds so the Port no longer contemplates or uses credit enhancement tools to improve the ratings of its bond issues.

2. Letters of Credit – Letters of Credit (LOC*)* represent a bank's promise to pay, on behalf of the Port, the principal and interest when due for a defined period of time, and subject to certain conditions. In the case of a direct pay LOC, the trustee can draw upon the letter of credit to make debt service payments; under a stand-by LOC, the LOC can be used to cover the Port's default. If a letter of credit is to be used, the Debt & Treasury section shall prepare and distribute to qualified banks as described in paragraph (b) below, a request for qualifications that includes terms and conditions that are acceptable to the Port;

   a) Liquidity Facility – The issuance of variable rate debt, including variable rate bonds and commercial paper, requires the use of a liquidity facility. Debt & Treasury, with the approval of Chief Financial Officer, is hereby authorized to appoint a bank(s) to ensure the availability of liquidity support should the bonds or commercial paper be tendered or not remarketed.

   b) Provider selection – Only those banks with the necessary long and short-term ratings to support the contemplated credit may be solicited.

   c) Selection criteria will also include, but not be limited to the following:

      1. Terms and conditions acceptable to the Port; the Port will provide a term sheet along with the request for qualifications to which the banks will highlight modifications;
      2. Representative list of clients for whom the bank has provided liquidity facilities; and,
      3. Fees; specifically, cost of LOC, draws, bank counsel and other administrative charges and estimate of trading differential cost.

VIII. Documentation of Transactions

The decision processes used in each financing process will be fully documented. The documentation will capture information regarding, selection of the financing team, decisions on product selection and structuring features, selection of vendors providing ancillary services, and selection of investment securities or products. This information will be compiled into a post-pricing book, "deal file", which will be retained for each financing.

IX. Credit Objectives

A. The Port will actively seek to maintain the credit ratings of its to be issued and outstanding bonds.

B. The Port will adhere to appropriate benchmarks, overall debt ratios and affordability targets.

C. The Port will maintain communications with the credit rating agencies through the provision of monthly volume statistics, quarterly financial updates and annual personal visits, at the minimum.

X. Method of Bond Sale

The Port will follow the code established under the Charter of the City of Los Angeles under Section 609 (d) in the bond issuance process. There are three potential methods of sale: competitive, negotiated, and private placement. Each type of bond sale has the potential to provide the lowest cost given the right conditions. The conditions under which each type of bond sale is best used are provided below. All or some of the conditions discussed will affect the method of sale.

A. Competitive Sale

1. Bond prices are stable and/or demand is strong.
2. Issuer has a strong credit rating.
3. Issuer is well known to investors.
4. There are no complex explanations required during marketing, regarding: issuer's projects, media coverage, political structure, political support, funding, or credit quality.
5. The bond type and structural features are conventional.
6. Bond insurance is included or pre-qualified (available).
7. Manageable transaction size.
8. Market timing and interest rate sensitivity are not critical to the pricing.

B. Negotiated Sale

1. Bond prices are volatile and/or demand is weak or supply of

competing bonds is high.

2. Market timing is important, such as for refundings.
3. Coordination of multiple components of the financing is required.
4. Participation from MBE/ WBE/ OBE firms is enhanced, and the process will be in compliance with the Department's Small Business Enterprise (SBE) Program.
5. Issuer has lower or weakening credit rating.
6. Issuer is not well known to investors.
7. Sale and marketing of the bonds will require complex explanations about the issuer's projects, media coverage, political structure, political support, funding, or credit quality.
8. The bond type and/or structural features are non-standard, such as for a forward bond sale, issuance of variable rate bonds or where there is use of derivative products.
9. Bond insurance is not available or not offered.
10. Early structuring and market participation by underwriters desired.
11. Pre-qualified underwriters pool.
12. Large transaction size.
13. Expected high retail demand.
14. The Los Angeles Administrative Code under Section 11.28.4 requires that CFO issue a report specifying why a negotiated sale is required as a condition precedent to a negotiated sale.

C. Private Placement

A Private Placement is a sale that is structured specifically for one purchaser such as a bank. While the Port has not previously used this method of sale, the Port reserves the right to privately place its securities if the need arises. Furthermore, any member of the active underwriting pool who presents the Port with a cost savings financing plan, will be awarded to manage the financing/restructuring transaction.

XI. Small Business Enterprise (SBE) Program

The Port's policy is to provide minority business enterprises (MBE), women business enterprises (WBE) and all other business enterprises (OBE) with an equal opportunity to participate in the performance of Department contracts. This policy will be in compliance with Department's Small Business Enterprise Program and continues to be a high priority of management and the Board of Harbor Commissioners in all transactions.

XII. Investment of Bond Proceeds

A. Purchase and Sale of Investments

The Port shall competitively bid the purchase of securities, investment agreements, float contracts, forward purchase contracts, and any other investment products used to invest bond proceeds. The Port shall comply 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. Each bidding process and result shall be available to the public.

B. Diversification

The Port shall diversify invested proceeds in order to reduce risk exposure to providers, types of investment products, and types of securities held.

C. Disclosure

The Port will require that all fees resulting from investment services or sale of products to the Port 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 may bid on the sale of investment products for the proceeds. All bidding process and results shall be documented and it should be certified in writing that the Port received a competitive and fair market price on the investments based on the bidding process.

XIII. Market Relationships

A. Rating Agencies and Investors

The Chief Financial Officer and the Director of the Debt & Treasury Section shall be primarily responsible for maintaining the Port's relationships with Moody's Investors Service, Standard & Poor's, and Fitch Ratings. In addition to general communications, the Chief Financial Officer or an appropriate designee, shall: 1) meet with each agency's credit analyst, and 2) communicate with each agency's analysts prior to each competitive or negotiated sale. The Chief Financial Officer or appropriate designee will be responsible for communication with existing and potential bondholders. All efforts will be made to accommodate reasonable requests for information from investors in the Port's debt. When, and if appropriate, institutional investor communications may take the form of conference calls, one-on-one meetings, investor tours, and "virtual" road shows.

B. Board Communication

As a means of providing feedback from rating agencies and/ or investors regarding the Port's financial strengths and weaknesses as perceived by the market place, information will be provided to the Board as material information develops.

XIV. Compliance With Tax Law and Market Disclosure Obligations

A. Compliance with Federal Tax Law

The Chief Financial Officer shall establish a system of record keeping and reporting to meet the arbitrage rebate compliance requirements of the Federal tax code and ensure compliance with other Federal tax regulations as required by Bond Counsel at the time of issuance of the debt. This effort shall include tracking investment earnings on proceeds, retention of a rebate consultant to prepare and calculate rebate payments in compliance with tax law and remitting any earnings subject to rebate to the Federal government in a timely manner in order to preserve the tax-exempt status of the Department's outstanding debt issues that have been issued on a tax-exempt basis. The Department will comply with all covenants contained in tax certificates.

Trustee banks have been appointed for the Department's outstanding debt. The trustees shall perform all functions and duties required under the terms and conditions set forth in the respective bond indentures and trust agreements, including maintaining records of fund balances and investments.

B. Initial Disclosure

The Department and Board acknowledge their responsibilities under the securities laws to avoid material misstatements and omissions in offering documents used in the marketing of Department debt. The Chief Financial Officer shall coordinate the preparation of appropriate Disclosure documentation when required, with assistance from the City Attorney and the Department's Disclosure Counsel.

C. Continuing Disclosure

It is the policy of the Port to remain in compliance with Securities & Exchange Commission Rule 15c2-12 [17CFR Section 240.15c2-12] by filing, with the Municipal Securities Rule Making Board (MSRB) by posting to the Electronic Municipal Market Access (EMMA) its Annual Continuing Disclosure Statement and its audited financial statements; and statements of those material events which may occur during the year as Rule 15c2-12 requires.

In the interest of transparency, accountability, and educating the investor community, the Department will post its unaudited quarterly financial statements to the Harbor Department’s website within forty-five days after the close of each quarter. In addition, the Harbor Department will post its Financial Policies and its Comprehensive Annual Financial Report (CAFR) to the Port’s general website.

XV. POST-ISSUANCE TAX COMPLIANCE

The Chief Financial Officer shall establish and maintain reasonable procedures to ensure the Department, as a municipal bond issuer will remain in compliance with post-issuance tax regulations.

XVI. Consultants

The Port will select its financial advisors and its bond counsel by competitive process. The Port’s contracting policies, which are in effect at the time, will apply to all 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.

A. General

All financial advisors, bond counsel and underwriters will be selected through a Request for Proposals (RFP) or Request for Qualifications (RFQ) process, whichever is most appropriate given the circumstances. In isolated instances, such contracts may be awarded on a sole source basis if it is clear that a RFP/RFQ process would not be feasible or in the Department's interests. The City's contracting policies, including Affirmative Action, Child Care, Small Business Enterprise (SBE) Program, Minority/Women/Other Business Enterprise (MBE/WBE/OBE) participation, Living Wage, and any other policies in effect at the time, will apply to all contracts with finance professionals, as permitted by Federal and State law.

B. Financial Advisors

The Department may retain one or more financial advisory firms to provide general advice on the Department's debt management program, financial condition, budget options, arbitrage rebate review, and rating agency relations. Additionally, a financial advisor may assist with the structuring of the Department's Revenue Bond issuances and may be used on an as-needed basis to provide financial advisory services that do not fall into the other categories of Department debt obligations.

C. Financing Teams

Financial advisors, bond counsel, and underwriters, where applicable, will be selected through a competitive process. Depending on particular expertise and consultant availability, some firms may be used on more than one program. However, efforts will be made to establish different teams to provide a number of firms the opportunity to participate in Department contracts.

D. Bond Counsel

The Port debt will include a written opinion by legal counsel affirming that the Port is authorized to issue the proposed debt, that the Port has met all constitutional and statutory requirements necessary for issuance, and a determination of the proposed debt's federal and state income tax status. A nationally recognized bond counsel firm (or firms) will prepare this approving opinion and other documents relating to the issuance of debt with extensive experience in public finance. The firm(s) will be selected from the pool of bond counsel firms.

E. Disclosure Counsel

The Port will hire Disclosure Counsel(s) to prepare official statements in the event of any debt restructuring/refinancing, or new bond issue. Disclosure Counsel(s) will be responsible for ensuring that the official statement complies with all applicable rules, regulations and guidelines. Disclosure Counsel(s) will be well-recognized firm(s) with extensive experience in public finance. The firm(s) will be selected from the pool of bond counsel firms.

F. Disclosure by Financing Team Members

The Port expects that all of its financial advisory team will at all times provide the Port with objective advice and analysis, maintain the confidentiality of the Port's financial plans, and be free from any conflicts of interest. All financing team members will be required to provide full and complete disclosure, under penalty of perjury, relative to any and all agreements with other financing team members and outside parties that could compromise any firm's ability to provide independent advice that is solely in the best interests of the Port or that could be perceived as a conflict of interest. The extent of disclosure may vary depending on the nature of the transaction. Firms will be required to certify compliance with prohibition of underwriter gifts and political contributions under Charter section 609(e).

GLOSSARY OF TERMS

Aggregate Annual Debt Service: The sum of all interest and principal to be paid in one fiscal year.

Amortization: The gradual reduction in principal of an outstanding debt according to a specific repayment schedule, which details specific dates and repayment amounts on those dates.

Balloon Maturity: Final payment on a debt that is substantially larger than the preceding payments. An issue may be structured with such a Balloon Maturity when some projected event is expected to provide extra cash flow or when refinancing is anticipated.

Bond Counsel: The legal firm that provides an opinion as to the tax status, authenticity and legality of a bond or note issue as of the date of its issuance.

Bond Insurance: A financial guaranty issued by a private insurance company that guarantees the timely payment of principal and interest for a debt issue. In the event that an issuer is unable to make a timely payment, the company issuing the bond insurance is responsible to make the payment.

Bullet Bond: A debt instrument, which provides for regularly scheduled interest only payments up until a single and final principal payment is made upon the issue’s maturity date.

Call Provisions: Mandatory or optional provisions that allow or require an issuer to prepay a bond prior to its stated maturity date. These provisions identify which bonds may be called, when they may be called, and what premium, if any, must be paid upon redemption prior to the stated maturity date of the bond.

Capital Appreciation Bond: Non-interest bearing bonds which are sold substantially below par value. The difference between the discounted price and par value represents the compounded annual interest rate for the investor. Capital appreciation bonds are also known as zero-coupon bonds.

Capitalized Interest: Specific interest payments of a bond issue which are funded in advance, or capitalized, through proceeds of the same bond issue. These proceeds are set aside in a specially designated fund in order to pay these designated interest payments. In other words, the bond issue pays for itself for a designated period of time.

Commercial Paper: Promissory notes issued by state and local governments to finance construction of facilities, which are secured by pledged revenues of the issuer and a credit agreement. Commercial paper is issued with a short maturity of less than 270 days from the date of issue.

Competitive Sale: A method of sale in which an issuer solicits bids from underwriters to purchase its debt offering via electronic bidding, fax, sealed envelope, verbal or other type of auction method. The issue is awarded to the bidder judged to have submitted the best bid by offering the lowest interest rate, taking into account underwriting spread, interest rates and any discounts or premiums. A competitive sale is most frequently used when the credit structure of the issue is relatively simple, market conditions are stable and the issue is highly rated or insured.

Credit Rating Agencies: Firms that evaluate the credit quality and ability of debt issuers (corporations and governments) to repay obligations as well as their likelihood of defaulting on an obligation. The three major credit rating agencies are Moody's Investor Service, Standard and Poor's and Fitch Ratings, Inc.

Current Coupon Bonds: Traditional "plain vanilla" bond issues where the coupon is set at a fixed rate to maturity at the time of their issuance and immediately, upon issuance, begins to accrue interest, which is payable on pre-set interest payment dates.

Debt Affordability: The principal amount of debt that an issuer can afford within the constraints of net revenues and debt service coverage requirements.

Debt: A promise to pay back a specified sum of borrowed money, or the principal loan amount, according to a specified repayment schedule. For municipalities, a debt is usually incurred in the form of a bond issue, with a specific principal and interest repayment schedule.

Debt Service Coverage: The ratio of the Department's annual Operating Income divided by the principal and interest due in that same fiscal year. Debt service coverage ratios are most often used by rating agencies to determine repayment sufficiency with respect to bonds secured by a specific revenue stream.

Debt Service Reserve Fund: Traditional bond issues are structured with a debt service reserve fund, which assures the timely availability of sufficient moneys for the payment of debt service in the event that an issuer cannot make the required debt service payment(s). Typically, the required size of the reserve fund is determined by the lesser of: 100% of maximum annual debt service; 125% of average annual debt service; or 10% of the aggregate issue price. Reserve funds are usually fully funded out of bond proceeds and are set-aside in a separate fund held by the issue's trustee. Interest earned on the debt service reserve fund, as long as the debt service fund is fully funded, can be used to offset debt service payments.

Debt Service Safety Margin: (Net revenues - debt service) / Gross revenues and income. This measures how much revenue remains after meeting all O&M and debt service costs. For example, a debt service safety margin of zero indicates the port paid debt service without a penny left over. A higher ratio is better.

Derivative Product: A product, such as an option or futures contract, whose value is derived from the performance of an underlying security. Forward contracts, futures contracts, calls, puts and swaps are the most common types of derivatives.

Disclosure Counsel: The legal firm that provides the legal disclosure documentation for an issue, most often in the form of the preliminary and final official statement and continuing disclosure agreement, for dissemination to the public.

Discount Bonds: Debt sold for less than the stated principal or maturity value. If a discount bond pays no coupon throughout the life of an issue, it is called a zero coupon bond.

Discount Rate: The interest rate used for adjusting for the time value of money for net present value calculations, option pricing models and other market models. The term "discount rate" can also refer to the rate that the Federal Reserve Bank charges its members for overnight deposits.

Financial Advisor: Generally, an independent consulting firm that advises an issuer on financial matters ranging from the comprehensive financial health of an issuer to specific financings. Financial Advisors are generally not part of the underwriting syndicate that markets financings for an issuer.

Float Contracts: A contract which gives an investment provider the right to invest, for certain time periods, certain uninvested moneys. Generally, a float period is a period of time in which moneys of an escrow or similar vehicle are uninvested.

Forward Purchase Agreement: An agreement between an underwriter and an issuer, where the underwriter agrees to take delivery of certain bonds, at a predetermined interest rate and structure, at some point in the future. Forward delivery bonds which are "sold today" are usually delivered three months to a year from the sale date. Forward delivery bonds are normally structured in such a way to lock in "today's" interest rates and legally perform a current refunding on bonds which are not eligible to be advance refunded.

Indenture: A contract between the issuer of municipal securities and a trustee for the benefit of bondholders. The trustee administers the bonds on behalf of bondholders. The indenture establishes the rights, duties, responsibilities, and remedies of the issuer and the trustee and the exact nature of the security for the bonds.

Hedging: A strategy designed to reduce investment risk using call options, put options, short-selling, or future contracts. A hedge can help lock in profit; its purpose is to reduce the volatility of a portfolio by reducing the risk of loss.

Hybrid: An issue that combines features of more standard forms of issuance with derivative products. An example would be a variable rate bond issue that has been swapped into a fixed rate issue.

Investment Agreement: A contract between an investment provider and their client specifying the rights and responsibilities of each party in the structuring and operation of an investment product.

Lease Obligation: A lease obligation generally comes in the form of a lease revenue bond or a certificate of participation and is repaid much like a standard bond issue. The lease obligation represents an undivided interest in the payments made by a public agency pursuant to a financing lease or an installment purchase agreement. A portion of each lease payment is designated as being principal and the remainder as interest. Even though leases are not treated as indebtedness of the issuer under state law (particularly the California Constitution), the federal tax law treats the lease obligation as if it were a debt, and, as a result, the interest component of each lease payment may be treated as tax-exempt interest.

Letter of Credit: An agreement issued by a bank that guarantees the payment of a customer's drafts for a specified period and up to a specified amount. A letter of credit can be a form of supplement or, in some cases, direct security for a municipal bond under which a commercial bank or private corporation guarantees debt service payment on the bond under certain specified conditions.

Line of Credit: An arrangement in which a bank or other financial institution extends a specified amount of unsecured credit to a specified borrower for a specified time period.

Liquidity Facility: Variable rate securities are often secured by a liquidity facility, either in the form of a letter of credit or a line of credit. Such credit enhancement assures note holders that in the event of a tender and failed remarketing, funds will be available to purchase the notes on the tender date, with the issuer becoming obligated to the letter of credit or line of credit bank on a prearranged basis.

Long Term Debt: Loans and other financial obligations with a maturity of longer than one year; usually accompanied by interest payments.

Maturity Date: The date upon which a specified amount of principal or bonds matures, or becomes due and payable by the issuer of the bonds.

Negotiated Sale: A method of sale for bonds, notes or other financing vehicles in which an issuer selects in advance, on the basis of proposals received or by other means, one or more underwriters to work with it in structuring, marketing and finally offering an issue to investors. The negotiated sale method is often used when the issue is: a first time sale by a particular issuer (a new credit), a complex security structure, such as a variable rate transaction, an unusually large issue, or in a highly volatile or congested market.

Net Revenue: Gross revenues less operating and maintenance expenses.

Net Take Down: Net revenue / Gross revenue and income. This measures how much revenue is left from all sources after meeting O&M costs. The higher the ratio the better.

Option Pricing Model/Call Option Value: A financial model that calculates a value for an issue’s outstanding call option based upon the probability of future interest rate movements, remaining years to maturity and other variables. It is useful in determining whether a refunding should be executed or if the call should be preserved until a later date in the hopes of providing greater value.

Official Statement: A comprehensive statement issued by a governmental entity prior to the sale of bonds, notes or other financing vehicles that contains all the salient facts concerning the issuer, the issuer’s financial condition, the security pledged for the securities being offered, the projected use of the proceeds of the sale, and other facts deemed necessary to enable the investor to judge the quality of the securities being offered. Also known as the Disclosure Statement.

P-1/A-1+/F-1+: Ratings reflecting the credit quality of commercial paper and other short-term securities awarded by credit firms based on an evaluation of the issuer's ability to repay obligations or its likelihood of not defaulting. Moody's Investor Service (P-1), Standard and Poor's (A-1+) and Fitch Ratings, F-1+.

Present Value Analysis: An analysis used to determine the value today of a future payment, or to a stream of payments, discounted at some appropriate compound interest – or discount rate.

Private Placement: A private placement is a variation of a negotiated sale in which an issuer, usually with the help of a financial advisor or placement agent, will attempt to place the entire issue directly with an investor. The investor will negotiate the specific terms and conditions of the financing before agreeing to purchase the issue.

Redemption: Depending on an issue's call provisions, an issuer may on certain dates and at certain premiums, redeem or call specific outstanding maturities. When a bond or certificate is redeemed, the issuer is required to pay the maturities' par amount, the accrued interest to the call date, plus any premium required by the issue's call provisions.

Refunding Bond: A bond that retires another bond before the first bond matures in order to reduce financing costs, improve covenants, or alter maturities.

Rule 15c2-12: A Securities and Exchange Commission obligation on public issuers of securities to provide annual updating of financial information and operating data of the type included in the official statement for the primary bond offering. The issuer is obligated to provide a notice of the occurrence of certain material events.

Self-Insurance Fund: A cash reserve fund set aside by an entity to serve as a reserve in the case of an accident, catastrophe, or other such unexpected liability. The fund is an asset of the entity and is not an insurance policy issued by a private company.

Securities: Instruments of debt or ownership sold or traded on publicly organized exchanges and/or in over-the-counter markets.

Senior Lien Debt: Debt whose terms require it to be repaid with a priority claim on pledged revenues.

Short-Term Debt: Generally, debt that matures in one year or less.

Subordinate Lien Debt: Debt whose terms require it to be repaid with pledged revenues net of the amount necessary to make debt service payments on senior lien debt.

Surety Bond: An alternative to a fully funded debt service reserve fund. A surety bond can be purchased from a bond insurance provider to fulfill the role of a debt service reserve fund and can be drawn upon in the event an issuer cannot make a regularly scheduled debt service payment. A surety bond must be purchased and is subject to credit approval by a bond insurance provider. The provider charges an upfront fee for the surety bond of approximately 3.00% to 5.00% of the debt service reserve requirement.

Swap: A generic terms used to describe a broad range of Derivative products, including interest rate swap contracts.

Synthetic Variable Rate Debt: Debt created by issuing fixed rate debt and entering into an interest rate swap agreement to make floating rate payments in exchange for fixed receipts. The fixed rate swap receipts are intended to offset the fixed rate debt service payment, resulting in a net floating rate payment.

Tender: With variable rate debt, a bond or note holder has the option of tendering or putting his or her bonds or notes back to the remarketing agent upon specific dates (monthly, weekly) for the full par amount held. The remarketing agent then re-offers the tendered notes to investors. The proceeds received by the remarketing agent from the sale of the tendered notes are paid to the tendering note holder in full satisfaction of the obligation to purchase the notes on the tender date. A new interest rate is set at the lowest rate necessary to remarket the tendered notes at par.

Trading Differential: The interest rate spread between similar bond/note maturities based upon differences in credit quality, state tax issues and tax-exempt status of various bond issues.

Underwriter: A securities dealer who purchases a bond or note issue from an issuer and resells it to investors. If a syndicate or selling group is formed, the underwriter who coordinates the financing and runs the group is called the senior or lead manager.

Variable Rate Demand Bonds (or Notes): Variable rate demand bonds, which are often referred to as floating rate debt, are instruments that provide the purchaser with an option to tender or "put" the bonds back to the issuer, at par, at the end of each tender or “re-set” period. For example, an issue with a term of 30 years could have a tender period that is daily, weekly, monthly, quarterly or semi-annually. Since the variable rate bonds give the purchaser the option of a put at par at the end of each tender period, the yield on each bond approximates the yield on comparably rated securities having a final maturity equal to the selected tender period. In other words, a holder of an issue with a weekly tender period is only entitled to a seven-day interest rate. Variable rate issues can be viewed as short-term instruments containing a built-in refinancing mechanism.

Wrapped Debt Service: Debt service that has been structured in such a way as to be “wrapped” around an outstanding issue or issues. Debt service is often wrapped in order to achieve overall level debt service or to match the issuer’s revenue constraints.

Yield: The net rate of return, as a percentage, received by an investor on an investment. Yield calculations on a fixed income investment, such as a bond issue, take purchase price and coupon into account when calculating yield to maturity.

Zero Coupon: Non-interest bearing bonds that are sold substantially below par value. The difference between the discounted price and par value represents the compounded annual interest rate for the investor. Zero coupon bonds are also known as capital appreciation bonds.