CITY AND COUNTY OF DENVER, COLORADO
DENVER INTERNATIONAL AIRPORT
VARIABLE RATE DEBT POLICY

POLICY

The City and County of Denver, Colorado ("City") on behalf of the Denver International Airport ("DIA"), which airport is owned and operated by the City, pursuant to this Variable Rate Policy, will consider the utilization of variable rate financial products to fund capital investments at DIA or to refinance outstanding DIA debt obligations. This Policy is only intended to provide general procedural direction regarding the future use, procurement and execution of variable rate debt and should be interpreted in connection with other debt related policies of the City.

PURPOSE

This Policy establishes guidelines to be used when considering the use of variable rate financial products, including the use, evaluation criteria, procurement, execution and reporting processes. These guidelines govern the issuance of such products (i.e. the incurring of liabilities). These guidelines do not govern the use of such products in the investment of funds. The City will consider innovative ideas for the structuring of a proposed transaction as well as variations from the following guidelines provided that such variations shall be fully examined in conjunction with the City's advisors and approved by the Manager of Finance.

SCOPE

For the purposes of this Policy, "variable rate financial products" is broadly defined as those debt obligations in which the interest rate payable by the City is periodically reset by a remarketing agent, through an auction process or set against a pre-determined market index; irrespective of the "stated maturity" of the product, the interest rate is periodically reset and applicable for a period of between one-day and one-year. These guidelines govern the use of traditional variable rate products including but not limited to, variable rate demand obligations, commercial paper notes and auction rate securities. (Synthetic variable rate debt and the basis exposure of synthetic fixed rate debt will be factored into the Authority's variable rate exposure, as detailed below, although the use of such non-traditional financing products is governed by the City's separate Derivatives Policy.)

AUTHORITY

The City's authority to issue variable rate financial products is governed by the Colorado Constitution, Denver Charter and Revised Municipal Code. The Manager of Finance hereby establishes the City and County of Denver, Colorado Variable Rate Debt Policy. Based upon this policy, independent consultants and financial advisor(s) with demonstrated expertise may be chosen to help manage the liabilities of the City. In order to capitalize on fast changing market conditions, the Manager of Finance may take proposals from, and/or negotiate with the appropriate parties, including remarketing agents, credit enhancement providers and/or liquidity facility providers, and may enter into any transaction consistent with this Policy, pursuant to the prior approval of the City Council (when required) of an ordinance setting the general parameters of the transaction.

The Manager of Finance, in consultation with the financial advisor, shall have the authority to determine if transactions shall be on a negotiated or competitive basis. Terms and conditions of any transaction consummated by the Manager of Finance in accordance with these guidelines shall be subject to the provisions of the applicable Colorado State statutes and these guidelines.

TRANSACTIONS

Transactions employing variable rate financial products, except as herein provided, shall comply with the City's *Debt Policy* as amended from time; City's *Derivatives Policy* as amended from time to time; outstanding bond ordinances; insurance covenants; and state law. In addition, transactions employing variable rate financial products shall be consistent with other applicable City debt policies and rating agency guidelines.

EVALUATION OF POTENTIAL ECONOMIC BENEFIT AND RISK

The potential benefits of variable rate financial products are that such products:

- have traditionally had lower costs than long-term fixed rates;
- allow for more restructuring flexibility because they can be called at any time with no call premium;
- help to diversify the City's investor base, thereby reducing the supply of fixed rate bonds and improving the relative pricing of new fixed rate issuance (i.e. law of supply and demand); and
- help to minimize negative arbitrage and capitalized interest requirements during the construction period.

Consideration of the potential economic benefit of using variable rate financial products requires an evaluation by the Manager of Finance and the financial advisors of various associated risks including, but not limited to those listed below. This evaluation should also, to the extent reasonable, (a) use conservative assumptions regarding future interest rates and trading relationships, based on historic information as well as a consideration of future probability; and (b) consider the sensitivity of the potential economics to these various risks. Each type of variable rate product has its unique advantages and disadvantages that should be reasonably considered. In general, when reviewing variable rate strategies, the Manager of Finance should consider at a minimum each of the following types of risk, as applicable:

- *Interest rate risk* – by definition, the primary risk of variable rate products is that the interest rate is reset periodically and sharp or prolonged increases in short-term interest rates could put stress on the finances of the City or DIA's rate and charges.

- *Letter of Credit/Liquidity Renewal Risk* – the risk that the City cannot secure a cost-effective or timely renewal of a Letter of Credit or Liquidity Facility.
- *Remarketing or Auction Risk* – the risk that the City suffers a failed remarketing or auction.
- *Credit Risk* – the risk that a potential ratings downgrade of the City or its letter of credit/liquidity facility provider could negatively affect the interest rate of the bonds.
- *Concentration Risk* – the risk that the City's letter of credit or liquidity providers are not sufficiently diverse that the performance of the City's portfolio of variable rate debt is too closely tied to the fortunes of a single or very limited number of financial institutions.
- *Market Liquidity Risk* – the risk that the financial product does not have a significant number of participating investors, thereby potentially affecting the efficient pricing.

VARIABLE RATE EXPOSURE

It is appropriate to measure the City's variable rate debt exposure as "net" permanent variable rate debt, as defined below, as a percentage of total indebtedness ("Net Permanent Variable Rate Exposure"). "Permanent" or "core" variable rate debt is debt that is not intended to be periodically refinanced by long-term fixed rate debt. For example, commercial paper program or Bond Anticipation Notes ("BANs") that are used to provide interim financing for capital expenditures and that is intended to be refinanced at the end of a construction period should not be considered a permanent or core component of the City's outstanding indebtedness.

As discussed below, variable rate bonds that are hedged with a fixed-payor interest rate swap should not be counted as part of the City's variable rate exposure. In addition, "Net" variable rate exposure is permanent variable rate debt outstanding that is not offset by the cash, cash equivalent and short-term investment assets of the City. If the investment of such short-term assets are expected to produce returns substantially in excess of the interest payable on the variable rate debt (e.g. through the investment in taxable securities), the Manager of Finance could factor this into its calculation of Net Permanent Variable Rate Exposure. ((A) For example, if the City has $100 of outstanding variable rate debt and $25 of short-term investments, the City could use $75 as net variable rate exposure. (B) Alternatively, if the $25 of taxable short-term investments is expected to produce returns that are 125% of short-term tax-exempt borrowing rates, then the City could determine that this investment offsets $31.25 of outstanding variable rate debt leaving a net variable rate exposure of $68.75. It should be noted that (A) is a more conservative view than (B).)

1. Interim Financing

Interim financing tools like a commercial paper program or BANs create flexibility in the amount and timing of market access, especially of value for dealing with market or project uncertainties. The interim financing program should be sized to meet no more than twelve months of capital investment requirements. The main benefits of an interim financing program include:

a) Access to capital on an as-needed basis (both in terms of amounts and timing), helping to mitigate the potential problem of selling too little or too much debt at once;
b) Minimize capitalized interest requirements; and
c) Potential for positive arbitrage earnings during the construction period.

The Manager of Finance shall then monitor project schedules and market conditions and consider converting its interim obligations to long-term fixed or variable rate debt as market conditions dictate. Given the intent to periodically refinance the interim debt, such obligations should not be considered part of the City's Net Permanent Variable Rate Exposure. Having said this, the City could use commercial paper as part of its core capital base, in which case it would be appropriate to include this debt as part of the City's Net Permanent Variable Rate Exposure. (The inclusion or exclusion of particular debt is not product-dependent but rather use-dependent.)

2. Components of Net Permanent Variable Rate Exposure

As stated above, the City should not count interim variable rate debt as part of its permanent variable rate exposure. In general, variable rate bonds that are hedged with a fixed-payor interest rate swap should also not be counted as part of the Authority's variable rate exposure. However, as discussed below, the existence of basis risk under a percentage of LIBOR[1] swap could lead to some portion of the hedged bonds being included in the calculation of variable rate exposure. Therefore, variable rate exposure includes:

a) the amount of outstanding variable rate debt not expected to be periodically refinanced with long-term fixed rate debt;
b) the notional amount of synthetic variable rate debt (i.e. fixed-to-floating interest rate swaps);
c) some portion of the notional amount of synthetic fixed rate debt (i.e. floating-to-fixed interest rate swaps) to the extent that the interest rate swap exposes the City to basis risk (i.e. the risk that the payments received from the swap counterparty may be insufficient to completely offset the interest payable on the underlying variable rate bonds). For example, if the receipt from the swap counterparty is 75% of LIBOR but the interest rate of the underlying bonds is expected to be 85% of LIBOR (i.e. expected ratio of BMA/LIBOR of 85%), then the swap's "bond equivalent exposure" is approximately equal to 10%, the

[1] London Interbank Offering Rate ("LIBOR") is an index of taxable, variable interest rates and forms the basis for the trillion dollar swap market.

difference between expected receipt and expected payment, applied to the notional amount.

3. **Exposure Target**
The City should target its outstanding indebtedness on behalf of DIA as being represented by Net Permanent Variable Rate Debt, as defined above, at a level deemed appropriate by the Manger of Finance.

ELIGIBLE CREDIT ENHANCEMENT AND/OR LIQUIDITY PROVIDERS

Qualified credit enhancement and/or liquidity providers shall demonstrate a record of successfully participating on transactions similar in nature to the transaction contemplated by the City. The City will use commercially reasonable efforts to work with qualified providers that have (a) senior unsecured long-term credit ratings in either of the top two ratings categories by two nationally recognized rating agencies and (b) short-term claims-paying abilities rated in either of the top two ratings categories by two nationally recognized rating agencies.

In addition, when evaluating the economics of using a particular credit enhancement provider and/or liquidity facility provider, the City will consider not only the fees payable for such facilities but also the expected relative trading value of variable rate securities secured or supported by such facilities.

METHOD OF SECURING CREDIT ENHANCEMENT AND/OR LIQUIDITY FACILITIES

In general, the City shall consider pre-qualifying and competitive bidding to ensure the most beneficial market conditions and efficient execution.

EXECUTION

No transaction shall be entered into without first employing experienced financial professionals charged with selecting and monitoring the performance of the variable rate financial products to be employed.

REPORTING

A written report providing the status of all variable rate financial products issued by the City will be provided to the Manager of Finance at least on an annual basis and shall include the following:

- A description of all outstanding variable rate bonds, including amount outstanding, credit enhancement provider, liquidity provider, remarketing agent or broker-dealer;
- Relative performance of each series of outstanding variable rate bonds measured against some pre-determined benchmark such as The BMA Index (a widely used index for short-term tax-exempt interest rates);

- The expiration date of credit enhancement and liquidity facilities;
- The change in credit rating of credit enhancement and liquidity facility providers, if any, since the previous Report;
- If applicable, information concerning any failed remarketing or auction and steps taken by the City to remedy the situation.