Metropolitan's Interest Rate Swap Program

Business and Finance Committee
October 12, 2009

Metropolitan's Swap Program

- Master Swap Resolution and Master Swap Policy approved in September 2001
- Interest rate swaps are "hedges"
  - Reduce interest rate risk
  - Lower debt service cost
- Interest rate swaps are a valuable tool – especially for highly rated entities with sufficient liquidity
- Monthly swap report to Business and Finance Committee
- $1.41 billion outstanding

How has Metropolitan Used Interest Rate Swaps?

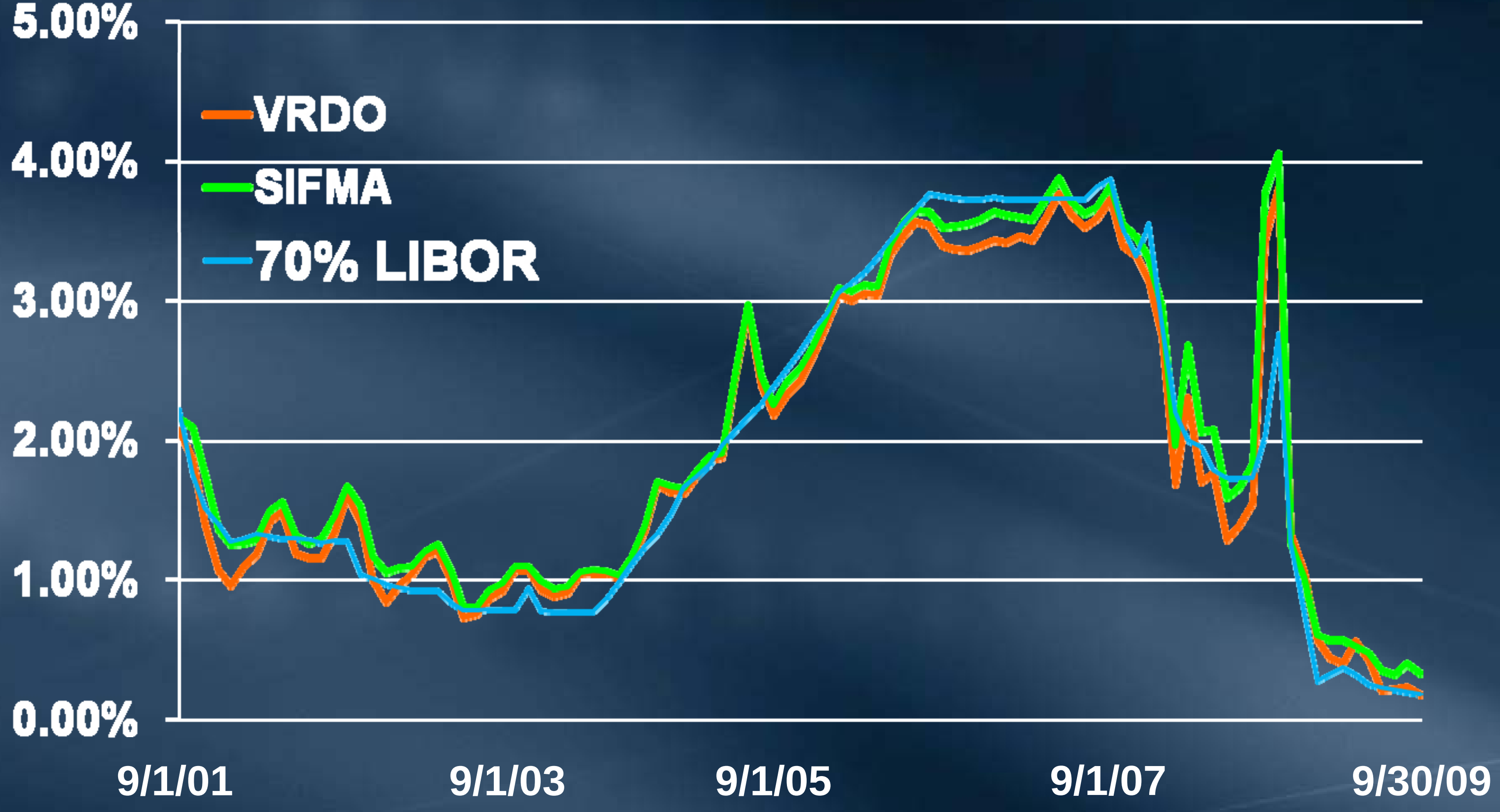
- Refunding debt for savings
  - savings to date: $61 million
- Increase variable rate debt exposure in a cost effective way
- Flexibility to take advantage of favorable market conditions
  - access more efficient taxable market
  - preserve call option on existing bonds
- Financial tool to enhance asset – liability management

Interest Rate Swaps: Risks

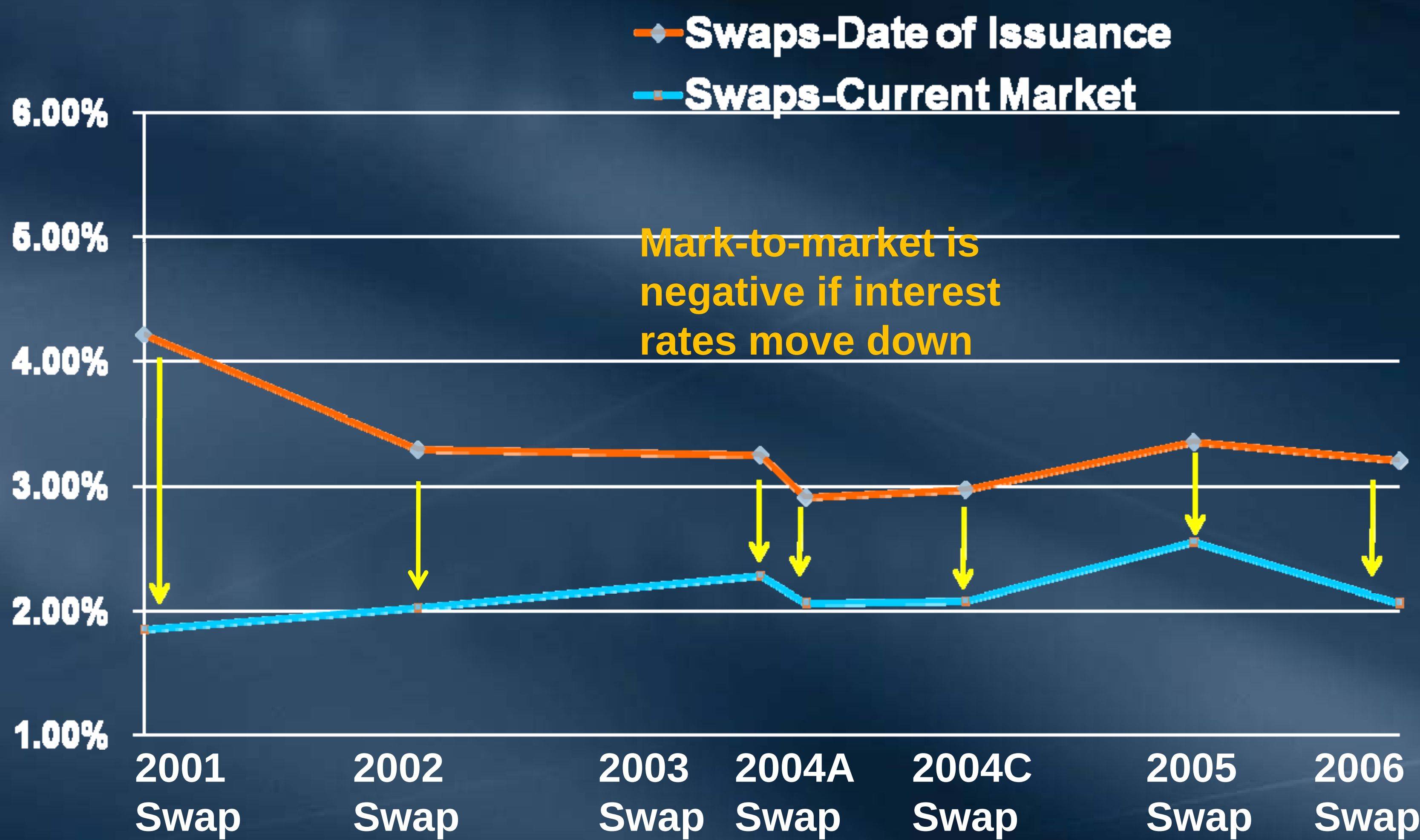
- Basis risk – the difference between actual interest rates and the index
  - Market dislocations for extended periods
- Tax risk - change in marginal tax rates will affect value and cash flow
- Counterparty risk
- Termination payments

Basis Risk – Index vs. MWD Bonds

September 2001 to September 2009

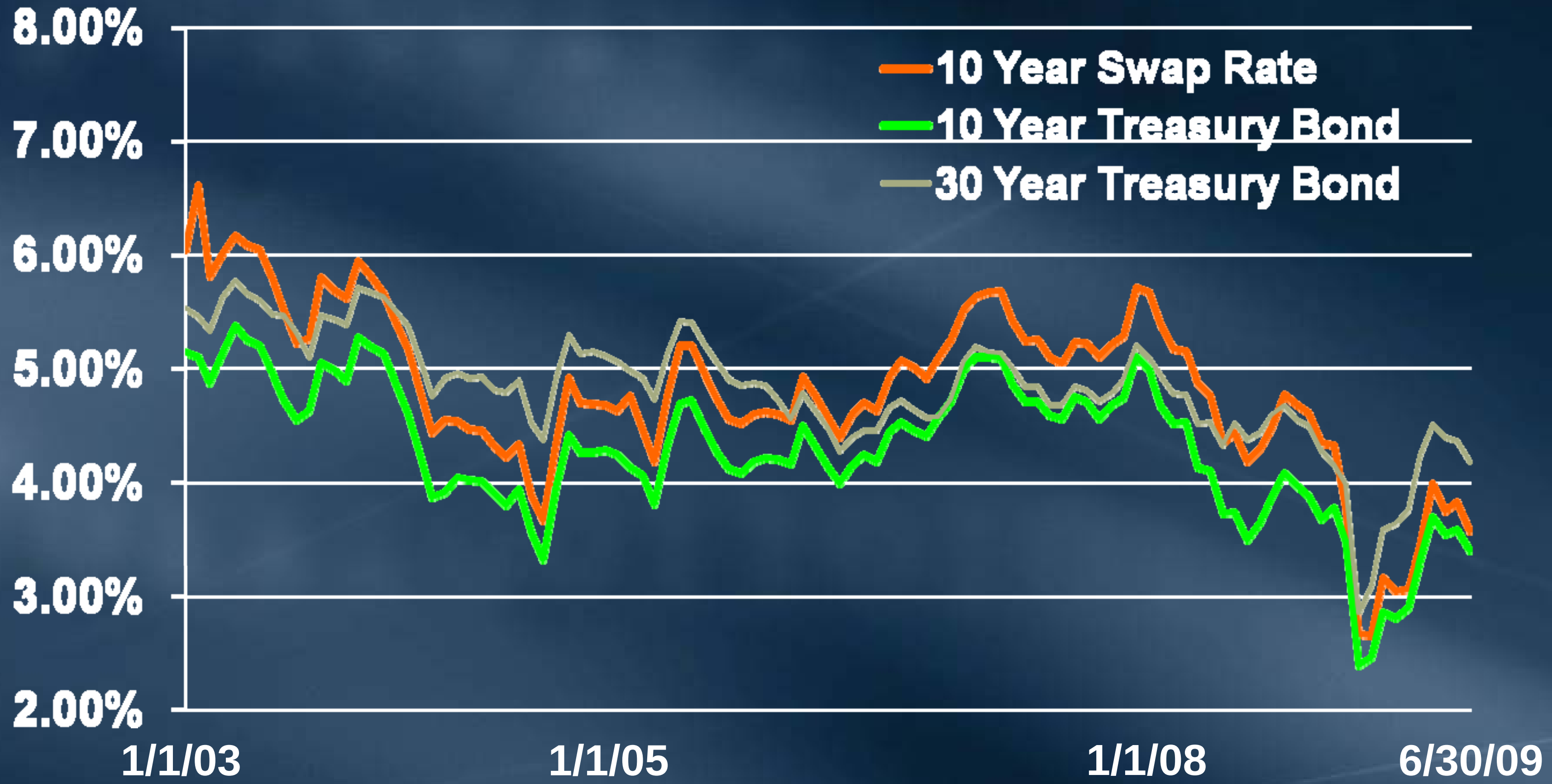


Comparison of Swap Rates and Current Market Swap Rates



US Treasury and Swap Market Rates
Interest rates trend down

2001 to 2009



Interest Rate Swaps: Disclosure

- GASB 53: effective for FY 2009/10
  - measurement, recognition, and disclosure
  - Metropolitan was a participant in field testing for GASB 53 requirements
- Fair value to swaps reflected on balance sheet and statement of net assets
- Most of Metropolitan’s swaps are effective hedges, no impact on net income
- Rules do not impact water rates and charges
- If Metropolitan terminates a swap, the gain or loss will affect rates

The Bottom Line

- Interest rate swaps are “marked-to-market” every month
- Disclosure of the position every month
- Debt service savings of $61 million since 2001
- Mark-to-market varies with interest rates – currently negative $127 million
- GASB 53 effective next fiscal year
- An important financial tool to enhance asset – liability management