



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Report

Office of the CFO

- Swap Quarterly Report

Summary

The attached quarterly report provides a summary of outstanding interest rate swaps

Purpose

In accordance with Resolution No. 8773, as amended, and Section 5922 of the California Government Code

Attachments

Attachment 1 – Swap Quarterly Report-For the period ending June 30, 2015



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Date: July 13, 2015
To: Finance and Insurance Committee
From: Gary Breaux, Assistant General Manager/Chief Financial Officer
Subject: Swap Quarterly Report-For the period ending June 30, 2015

This letter provides a summary of the interest rate swaps outstanding as of June 30, 2015. These transactions are consistent with board policy and Section 5922 of the California Government code, and have been executed to reduce debt service costs and reduce duration and interest rate risk.

As approved by the Board, Metropolitan has \$493.6 million in outstanding interest rate swaps. These transactions and their associated bonds have resulted in \$106.1 million in savings through the date of this report, including \$3.8 million, net present debt service savings, on the three swap termination transactions. The mark-to-market value plus the accrued interest of the swap portfolio is a negative \$83.2 million, reflecting interest rates, as of June 30, 2015, which were significantly lower than when these swaps were executed. Net exposure to all counterparties is within board-approved guidelines. As of June 30, 2015, Metropolitan had no collateral posted with any counterparties.

On June 9, 2015, Standard and Poor's Rating Services downgraded the credit rating of Deutsche Bank, AG, one of Metropolitan's swap counterparties, to BBB+. This rating level triggered an Additional Termination Event (an "ATE"), under Metropolitan's swap agreement with Deutsche Bank. Metropolitan has one outstanding, \$158,597,500, interest rate swap with Deutsche Bank. The ATE does not compel Metropolitan to take any action. However, the ATE provides Metropolitan with the right, but not the obligation, to terminate the swap agreement. Deutsche Bank is currently performing under the swap agreement.

Metropolitan is exploring alternatives including negotiating the novation, or transfer, of the swap to another, more highly rated, counterparty. Metropolitan expects to address the Deutsche Bank swap agreement in the next four-to-six weeks.

Staff will continue to monitor the market for opportunities and work with the committee on transactions that meet Metropolitan's policies and financial objectives.

A handwritten signature in black ink, appearing to read "Gary Breaux", is written over the printed name.

Gary Breaux

Outstanding Swaps By Counterparty

| <u>Swap</u> | <u>Amount Outstanding</u> | <u>Swap Counterparty</u> |
|--------------|---------------------------|--------------------------------------|
| 2004C | \$ 6,349,500 | Citigroup Financial Products Inc. |
| July 2005 | \$ 29,057,500 | Citigroup Financial Products Inc. |
| 2002B | \$ 28,371,600 | JPMorgan Chase Bank |
| 2003 | \$158,597,500 | JPMorgan Chase Bank |
| July 2005 | \$ 29,057,500 | JPMorgan Chase Bank |
| 2002A | \$ 75,838,400 | Morgan Stanley Capital Services Inc. |
| 2004C | \$ 7,760,500 | Morgan Stanley Capital Services Inc. |
| 2003 | <u>\$158,597,500</u> | Deutsche Bank AG |
| Total | \$493,630,000 | |

**Summary of Counterparty Exposure and Notional Amount
(\$ in Millions)
June 30, 2015**

| <u>Swap Counterparty</u> | <u>Notional Amount Outstanding (1)</u> | <u>Net Exposure (2)</u> |
|--------------------------------------|--|-------------------------|
| Citigroup Financial Products Inc. | \$ 35.4 | \$ (5.8) |
| JPMorgan Chase Bank (3) | 216.0 | (36.7) |
| Morgan Stanley Capital Services Inc. | 83.6 | (13.4) |
| Deutsche Bank AG (4) | <u>158.6</u> | <u>(27.3)</u> |
| Total | \$493.6 | \$(83.2) |

(1) Metropolitan's Master Swap Policy, adopted by the Board on September 11, 2001, states "*The sum total notional amount per swap counterparty may not exceed 25 percent of Metropolitan's total revenue bond indebtedness.*" As of June 30, 2015, Metropolitan's total revenue bond indebtedness was \$4.2 billion. No swap counterparty currently exceeds the limitation of \$1.04 billion.

(2) Shown from Metropolitan's perspective. Amounts in parenthesis (negative) mean that Metropolitan would pay the counterparty upon termination of all transactions. Positive amounts mean that the counterparty would pay Metropolitan. Includes mark-to-market fair value and accrued interest.

(3) Effective May 26, 2009, JPMorgan Chase Bank merged with Bear Stearns Financial Products, Inc. (BSFP) and assumed the obligations of \$269.1 million of Metropolitan's interest rate swaps with BSFP.

(4) Deutsche Bank AG replaced UBS AG as counterparty effective July 22, 2010.

Counterparty Credit Ratings As of June 30, 2015

| <u>Swap Counterparty</u> | <u>Credit Rating S&P/Moody's/Fitch</u> | <u>Prior Ratings</u> |
|--------------------------------------|--|----------------------|
| Citigroup Financial Products Inc. | A-/Baa1/A | A-/Baa2/A |
| JPMorgan Chase Bank | A+/Aa3/AA- | A+/Aa3/A+ |
| Morgan Stanley Capital Services Inc. | A-/A3/A | A-/Baa2/A |
| Deutsche Bank AG | BBB+/A3/A | A/A3/A+ |

Metropolitan is authorized to enter into interest rate swap transactions with qualified swap counterparties as outlined in its Master Swap Policy. Qualified swap counterparties must be rated at least "Aa3," or "AA-," or equivalent by any two of the nationally recognized rating agencies (Moody's, Standard and Poor's, and Fitch); or have a "AAA" subsidiary as rated by at least one nationally recognized credit rating agency.

Rating Agency Ratings

| <u>Standard & Poor's</u> | <u>Moody's</u> | <u>Fitch</u> |
|------------------------------|----------------|--------------|
| AAA | Aaa | AAA |
| AA+ | Aa1 | AA+ |
| AA | Aa2 | AA |
| AA- | Aa3 | AA- |
| A+ | A1 | A+ |
| A | A2 | A |
| A- | A3 | A- |
| BBB+ | Baa1 | BBB+ |
| BBB | Baa2 | BBB |
| BBB- | Baa3 | BBB- |

**Debt Service Savings
As of June 30, 2015**

| <u>Swap Transactions</u> | <u>Projected Savings To-Date</u> | <u>Actual Savings To-Date</u> |
|--|---|--------------------------------------|
| 2001 Series B | \$15.8 Million | \$ 8.7 Million |
| 2002 Series A-B | 9.2 Million | 13.8 Million |
| 2003 Series | 14.6 Million | 22.5 Million |
| 2004 Series | 12.1 Million | 14.8 Million |
| 2004 Series C | 7.3 Million | 9.5 Million |
| 2006 Series | 4.0 Million | 5.3 Million |
| 2006 Series A | <u>1.0 Million</u> | <u>1.2 Million</u> |
| Total | \$64.0 Million | \$75.8 Million |
| | | |
| NPV Savings (Swap Termination Transactions) | | \$ 3.8 Million ⁽¹⁾ |
| 2002 Receiver Swap | NA | 15.4 Million |
| 2004 Basis Swap | NA | 7.2 Million ⁽²⁾ |
| 2006 CMS Swap | NA | 0.3 Million ⁽³⁾ |
| 2005 Basis Swap | NA | <u>3.6 Million ⁽⁴⁾</u> |
| Total | | \$30.3 Million |
| Total Savings To-Date | | \$106.1 Million |

(1) Swap termination transactions of June 2012, March 2014, and August 2014.

(2) Includes impact of accumulated cash-flow savings and the \$1.05 million receipt for the 01/02/08 amendment of the JPMorgan 2004 Basis Swap.

(3) Includes accumulated impact of negative cash-flow and the \$1.05 million termination receipt of 12/17/07.

(4) Accumulated cash-flow savings and the \$2.7 million termination receipt of 1/11/07.

The Metropolitan Water District of Southern California- Swap Summary as of June 30, 2015

| Purpose of Swap (1) | Swap | Notional Amount Outstanding | Counterparty | S&P/Moody's/Fitch | Effective Date | Maturity Date | Type of Swap | Metropolitan Pays | Metropolitan Receives | Mark-to-Market Value and Accrued Interest | Change in Mark-to-Market (2) | Remaining Average Life | Collateral Posting |
|---------------------|------------|-----------------------------|--------------------------------------|-------------------|----------------|---------------|----------------------|-------------------|---|---|------------------------------|------------------------|--------------------|
| (A) | 2001 B | \$-0- | Deutsche Bank AG | BBB+/A3/A | 9/6/2001 | 7/1/2020 | Floating to Fixed | 4.219% | SIFMA minus 35 basis points | \$-0- | \$-0- | | |
| | 2001 B | -0- | JPMorgan Chase Bank | A+/Aa3/AA- | 9/6/2001 | 7/1/2020 | Floating to Fixed | 4.219% | SIFMA minus 35 basis points | -0- | -0- | | |
| (B) | 2002 A | 75,838,400 | Morgan Stanley Capital Services Inc. | A-/A3/A | 9/12/2002 | 7/1/2025 | Floating to Fixed | 3.300% | 57.74% of One Month LIBOR | (12,174,600) | 2,740,000 | 7.2 Years | No |
| | 2002 B | 28,371,600 | JPMorgan Chase Bank | A+/Aa3/AA- | 9/12/2002 | 7/1/2025 | Floating to Fixed | 3.300% | 57.74% of One Month LIBOR | (4,551,000) | 951,600 | 7.2 Years | No |
| (C) | 2003 | 158,597,500 | Deutsche Bank AG | BBB+/A3/A | 12/18/2003 | 7/1/2030 | Floating to Fixed | 3.257% | 61.20% of One Month LIBOR | (27,312,600) | 7,226,000 | 10.1 Years | No |
| | 2003 | 158,597,500 | JPMorgan Chase Bank | A+/Aa3/AA- | 12/18/2003 | 7/1/2030 | Floating to Fixed | 3.257% | 61.20% of One Month LIBOR | (27,312,600) | 7,226,000 | 10.1 Years | No |
| (D) | 2004 A | -0- | Morgan Stanley Capital Services Inc. | A-/A3/A | 2/19/2004 | 7/1/2023 | Floating to Fixed | 2.917% | 61.20% of One Month LIBOR | -0- | 0- | | |
| (E) | 2004 C | 7,760,500 | Morgan Stanley Capital Services Inc. | A-/A3/A | 11/16/2004 | 10/1/2029 | Floating to Fixed | 2.980% | 61.55% of One Month LIBOR | (1,174,500) | 381,000 | 11.0 Years | No |
| | 2004 C | 6,349,500 | Citigroup Financial Products Inc. | A-/Baa1/A | 11/16/2004 | 10/1/2029 | Floating to Fixed | 2.980% | 61.55% of One Month LIBOR | (952,500) | 311,000 | 11.0 Years | No |
| (F) | 2005 | 29,057,500 | JPMorgan Chase Bank | A+/Aa3/AA- | 7/6/2005 | 7/1/2030 | Floating to Fixed | 3.360% | 70.0% of Three Month LIBOR | (4,881,900) | 1,533,000 | 12.0 Years | No |
| | 2005 | 29,057,500 | Citigroup Financial Products Inc. | A-/Baa1/A | 7/6/2005 | 7/1/2030 | Floating to Fixed | 3.360% | 70.0% of Three Month LIBOR | (4,834,800) | 1,533,000 | 12.0 Years | No |
| (G) | 2006 | -0- | Deutsche Bank AG | A/A3/A | 4/4/2006 | 7/1/2021 | Floating to Fixed | 3.210% | 63.00% of Three Month LIBOR | -0- | -0- | | |
| | 2006 | -0- | JPMorgan Chase Bank | A+/Aa3/A+ | 4/4/2006 | 7/1/2021 | Floating to Fixed | 3.210% | 63.00% of Three Month LIBOR | -0- | -0- | | |
| (H) | 2006 A | -0- | Deutsche Bank AG | BBB+/A3/A | 4/4/2006 | 6/29/2012 | Floating to Fixed | 2.911% | 63.00% of Three Month LIBOR | -0- | -0- | | |
| | 2006 A | -0- | JPMorgan Chase Bank | A+/Aa3/AA- | 4/4/2006 | 6/29/2012 | Floating to Fixed | 2.911% | 63.00% of Three Month LIBOR | -0- | -0- | | |
| (I) | 2004 Basis | -0- | JPMorgan Chase Bank | A+/Aa3/AA- | 5/19/2004 | 7/1/2014 | Floating to Floating | SIFMA | 70% of One Month LIBOR plus 31.5 basis points | -0- | -0- | | |
| Total | | \$ 493,630,000 | | | | | | | | \$(83,194,500) | | | |

(1) See footnotes on Attachment 1, page 7
 (2) For payor swaps-change in mark-to-market as the result of a 50 basis point change in interest rates.

Purpose of the Swap Transactions:

- A. The 2001B swap was executed in conjunction with the issuance of the 2001 Series B variable rate bonds, to provide funds to refund portions of the 1992 Water Revenue Bond issue and the 1993 Series B Water Revenue Bonds. The transaction was expected to achieve debt service savings of \$25.7 million and net present value savings of \$15.0 million. On June 28, 2012 the entire 2001B swap was terminated with a payment \$36.2 million, representing the fair market value of the terminated 2001 swap. Debt service savings of \$8.7 million were realized, versus projected savings of \$15.8 million.
- B. The 2002A and 2002B swaps were executed in conjunction with the issuance of 2002 Series A and Series B Variable Rate Demand Bonds, to provide funds to refund portions of the 1992 Water Revenue Bonds, the 1995 Series A Water Revenue bonds and the 1999 Series A Water Revenue Bonds. The transaction was expected to achieve debt service savings of \$15.6 million and net present value savings of \$9.7 million. On July 28, 2014, \$16.56 million of the 2002A and 2002B swaps were partially terminated (maturities from 7/1/2015-7/1/2019) with a payment of \$1.4 million, representing the fair market value of the terminated 2002A and 2002B swaps.
- C. The 2003 swaps were executed in conjunction with the issuance of the 2003 Series C1- C3 variable rate bonds, sold on December 18, 2003, to provide funds to refund a portion of the 1996 Series C Water Revenue Bonds and the 1997 Series A Water Revenue bonds. The transaction was expected to achieve debt service savings of \$33.3 million and net present value savings of \$21.1 million. On July 28, 2014, \$7.97 million of the 2003 swaps were partially terminated (maturities from 7/1/2015-7/1/2019) with a payment of \$596,500, representing the fair market value of the terminated 2003 swaps.
- D. The 2004A swap was executed in conjunction with the issuance of 2004 Series A variable rate bonds, sold on February 19, 2004, to provide funds to refund a portion of the 1996 Series C Water Revenue Bonds, the 1997 Series A Water Revenue bonds and the 1999 Series A Water Revenue Bonds. The transaction was expected to achieve debt service savings of \$29.3 million and net present value savings of \$11.4 million. On June 28, 2012, \$60.43 million of the 2004A swap was partially terminated (maturities from 7/1/2013-7/1/2018) with a payment of \$ 6.3 million, representing the fair market value of the terminated 2004A swap. On February 12, 2014, \$15.3 million of the 2004A swap was partially terminated (maturities from 7/1/2019-7/1/2020) with a payment of \$ 1.5 million, representing the fair market value of the terminated 2004A swap. On July 28, 2014, the remaining \$79.185 million of the 2004 swap was terminated, with a payment of \$9.1 million, representing the fair market value of the terminated 2004 swap.
- E. The 2004C swap was executed in conjunction with the issuance of the 2004 Series C variable rate bonds sold on November 16, 2004. Proceeds were used to refund a portion of the 1996 Series B Water Revenue Bonds, the 1996 Series C Water Revenue Bonds and the 1997 Series A Water Revenue bonds. The transaction was expected to achieve debt service savings of \$14.4 million and net present value savings of \$11.0 million. On June 28, 2012, \$26.35 million of the 2004 C swap was partially terminated (maturities from 10/1/2013-10/1/2017) with a payment of \$ 3.1 million, representing the fair market value of the terminated 2004 C swap. On February 12, 2014, \$90.1 million of the 2004C swaps were terminated (maturities from 10/1/2018-10/1/2020) with a payment of \$9.3 million, representing the fair market value of the terminated 2004 C swaps.
- F. The 2005 swaps were executed to lock-in a fixed rate of 3.36% for approximately \$117.1 million of Metropolitan's variable rate debt. On July 28, 2014, \$58.98 million of the 2005 swaps were partially terminated (maturities from 7/1/2015-7/1/2024) with a payment of \$5.1million, representing the fair market value of the terminated 2005 swaps.
- G. The 2006 swap was executed with the issuance of the 2006 Series A1 and A2 variable rate bonds to provide funds to refund a portion of the 1996 Series B Water Revenue Bonds. The transaction was expected to achieve debt service savings of \$8.3 million and net present value savings of \$4.8 million. On June 28, 2012, \$20.49 million of the 2006 swap was terminated (maturities from 7/1/2013-7/1/2018) with a payment of \$1.6 million, representing the fair market value of the terminated 2006 swap. On February 12, 2014, the remaining \$41.4 million of the 2006 swaps were terminated, with a payment of \$.7 million, representing the fair market value of the terminated 2006 swaps.
- H. The 2006A swap was executed with the issuance of the 2006 Series A1 and A2 variable rate bonds to provide funds to refund a portion of the 1996 Series B Water Revenue Bonds. The transaction was expected to achieve debt service savings of \$1.0 million and net present value savings of \$610,000. The 2006A swap matured as scheduled, on June 29, 2012. Total debt service savings from the 2006A swap transaction was \$1.22 million.

- I. The 2004 basis swap was executed to achieve debt service savings, estimated to be \$400,000 to \$1.1 million per year, depending on actual tax-exempt to taxable ratios. The 2004 basis swap matured, as scheduled, on July 1, 2014.