As adopted by the Metropolitan King County Council on November 23rd by Motion 15984.

KING COUNTY DEBT MANAGEMENT POLICY

Section 1: Introduction

This document sets forth the policies that govern the issuance and management of debt by King County (hereinafter the "County"). Beyond being good business practice, the County periodically adopts a formal Debt Management Policy for two reasons. First, it satisfies the requirements of RCW 36.48.070. Second, the credit rating agencies have identified the adoption of a formal debt policy as a source of rating strength.

This policy updates the existing King County Debt Management Policy that was adopted by Motion 12660 in 2007 to reflect the many significant changes that have occurred in municipal finance since that time.

It is the intent that this updated policy will again be adopted by motion by the Metropolitan King County Council (hereinafter the "Council"). Following Council adoption, periodic amendments will be reviewed by the County's Executive Finance Committee (hereinafter the "EFC") and substantive policy changes, as determined by the EFC, will be submitted to the Council for approval.

This policy does NOT address the amount of debt that can be prudently issued on behalf of the different funds of the County. The subject of prudent debt levels and borrowing strategies, which will depend on factors such as the stability of associated revenue streams, should be addressed by the financial policies and plans for each of these funds.

Section 2: Policy Goals

The County's debt will be managed with an overall philosophy of taking a long-term approach to borrowing funds at the lowest possible cost, consistent with an acceptable level of risk.

The County's debt management practices are intended to achieve the following specific objectives:

- To minimize debt service costs, subject to preserving the County's flexibility to provide services and set rates and charges;
- To limit the exposure of the different funds of the County to interest rate risk and other risks to levels commensurate with their ability to absorb such risk;
- To preserve adequate capacity for the County to finance future capital needs with low-cost debt; and
- To contribute to the maintenance or enhancement of the County's current very strong bond ratings.

Section 3: Roles & Responsibilities in the Debt Issuance Process

3.1 King County Council
The Council is responsible for the adoption of legislation necessary for the issuance of all County debt.

3.2 Finance and Business Operations Division
The Finance and Business Operations Division (hereinafter the "Division") within the Department of Executive Services is responsible for identifying potential borrowing strategies, coordinating all of the work necessary for the issuance of such debt, and for the subsequent administration thereof, including ensuring the County's compliance with adopted post-issuance procedures required by the Internal Revenue Service (hereinafter "the IRS") and continuing disclosure undertakings.

3.3 King County Agencies
Individual County agencies, working through the Office of Performance, Strategy and Budget (hereinafter "PSB"), are responsible for providing adequate advance notification of the need for borrowing, responding to due diligence inquiries regarding such borrowings, and for providing information required by the Division needed for the issuance and the subsequent administration of such debt, including ensuring the County's compliance with adopted post-issuance procedures required by the IRS.

Each County agency bears responsibility for the accuracy of information provided to the Division.

3.4 Executive Finance Committee
The EFC is responsible for periodically reviewing the Debt Management Policy and recommending any substantive changes to the Executive and Council for adoption. The EFC also has the authority to amend the policy for non-substantive changes to clarify the intent of the existing policy and related practices.

The EFC is also responsible for the approval of all Inter-Fund Loans and County procedures relating to debt administration.

Section 4: Type of Debt Instruments

4.1 Bonds
The great majority of the debt issued by the County will take the form of fixed rate municipal bonds with terms ranging between 3 and 40 years to finance capital assets.

4.2 Notes
Shorter-term notes, defined as having a maturity of not more than 3 years, may also be issued to provide interim financing in anticipation of subsequent definite sources of revenues. Notes may also be used as interim financing during the construction of a project with the ultimate long-term financing occurring once the final project cost has been determined and the project has been placed into service. Examples of these financing instruments include Tax Anticipation Notes (hereinafter "TANs"), which are issued in anticipation of specific tax revenues, and Bond Anticipation Notes (hereinafter "BANs"), which will be repaid from the proceeds of a future bond issue.

4.3 Variable Rate Debt

The County may issue variable rate debt in order to lower the cost of borrowing and, in accordance with the principles of asset-liability management, to reduce the County's exposure to changes in interest rates.

There are several different forms of variable rate debt including, but not limited to, variable rate demand bonds (VRDBs), floating rate notes (FRNs), direct purchase bank loans and commercial paper (CP). The County will assess the comparative costs (both issuance and ongoing), trading differential, variation in risk exposure, required administrative effort and the ability to achieve other financing goals when determining the appropriate vehicle to be used for its variable rate debt issues.

4.4 Payment Agreements

If appropriate, the County may utilize payment agreements to produce synthetic fixed rate or variable rate debt instruments in order to either take advantage of market opportunities to potentially lower overall debt service costs or to manage exposure to changes in interest rates and other risks. As defined under state law, a "Payment Agreement" means a written agreement which provides for an exchange of payments based on interest rates, or for ceilings or floors on these payments, or an option on these payments, or any combination, entered into on either a current or forward basis. A typical form of payment agreement is an "interest rate swap" in which one party usually exchanges a variable rate for a fixed rate with another party.

The use of payment agreements exposes the County to various risks that are not present, or are present to a more limited degree, in relation to the issuance of standard County debt instruments. The risks include, but are not limited to, basis risk, tax risk, termination risk and counter-party risk. Due to these risks, the use of payment agreements will require the County to devote greater resources to their subsequent monitoring and administration.

In recognition of the added risk exposure, the use of a payment agreement will only be contemplated when it can be satisfactorily documented that the expected benefits compensate for the additional risks and administration costs by an appropriate margin.

The rationale for and the guidelines governing the execution and management of such payment agreements by the County are presented in detail, together with definitions of certain terms and risks, in Appendix A--King County Payment Agreement Policy.

4.5 Conduit Financing Vehicles

Although they will typically entail somewhat higher financing costs compared to the issuance of standard County debt, for certain projects the County may rely on alternative conduit financing vehicles such as 63-20 Bonds or Certificates of Participation (COPs) that are issued by third parties but are still secured by County revenues such as property lease payments.

The rationale for the use of such conduit financing vehicles is that they may provide other benefits to the County that more than offset the higher financing costs. Such benefits stem from the fact that the use of such conduit financing vehicles allows projects designed for the County's use to be constructed and owned by private parties. The private parties agree to accept the risks associated with construction costs and can usually maintain the facility at a lower annual operating cost.

Section 5: Security for Debt Instruments

5.1 General Obligation (GO) Debt
The lowest cost of funds will normally be obtained through the issuance of general obligation debt secured by the full faith and credit of the County. The two types of general obligation debt are:

- *Unlimited Tax General Obligation (UTGO) Debt* is payable from excess tax levies that are approved by the voters. Any proposition for UTGO debt must be approved by 60% of the voters casting a vote and the total number of ballots cast must be at least equal to 40% of the total number of voters voting in the last general election.

- *Limited Tax General Obligation (LTGO) Debt* is payable from regular general fund tax levies and revenues, and includes all types of obligations whether bonds, notes, lease-purchase financing contracts, loans or other payment obligations.

Although ultimately pledging general fund revenues, LTGO debt is also issued for the benefit of other County funds that can document sufficient future revenues to pay the debt service incurred. In cases in which the County pledges its full faith and credit in support of debt issued on behalf of other funds, the general fund may levy a charge on such funds as compensation for the provision of such credit enhancement. The criteria for such charges are determined by PSB in consultation with the Division.

Total GO debt -- limited and unlimited tax -- is subject to a statutory limitation of 5.0% of the County's assessed valuation. Of this amount, up to 2.5% may be used for County purposes and up to 2.5% may be used for metropolitan functions (currently Wastewater Treatment and Transit). Within these limits, total LTGO debt is subject to a statutory limitation of 1.5% of the County's assessed valuation without voter approval.

The County will attempt to maintain a substantial amount of unused debt capacity within these limitations in order to preserve future financing flexibility.

5.2 Revenue-backed Obligations
When both feasible and cost-effective, the County will finance capital assets by issuing debt secured solely by a pledge of certain revenues. Examples of such pledged revenues may include (but are not necessarily limited to) both the operating revenues of County Enterprise Funds or special dedicated taxes.

If general tax revenues are not pledged as security, the issuance of such obligations will not count against the County's GO statutory debt limitations and therefore the County's unused debt capacity will be preserved.

In order to provide greater protection for the holders of revenue-backed obligations, the issuance of such obligations will normally require the County to meet certain specific covenants. These covenants may include the establishment of a debt service reserve fund, additional reporting requirements, and the achievement of required debt service coverage ratios. Complying with such covenants may entail additional costs for the County.

While there may be no statutory limits to the amount of such revenue obligations that can be issued, there are limitations related to the County's ability to repay the debt. Prior to issuing new revenue-backed obligations, the County must satisfy an Additional Bonds Test. An Additional Bonds Test demonstrates that the current revenues pledged as security would be sufficient to meet required debt service coverage requirements on both the new obligations and any existing obligations issued on parity with the new obligations in each year that the new obligations are outstanding.

5.3 Double-barreled Obligations
Double-barreled bonds are general obligation bonds that are additionally secured by a pledge of certain revenues.

By issuing such double-barreled bonds, the County's general fund is effectively providing credit enhancement to other County funds. Bonds secured by the full faith and credit of the County are typically rated more highly by the credit rating agencies than revenue-backed obligations. As a result of the higher credit rating, the interest rates obtained on double-barreled bonds will normally be lower than interest rates for obligations backed solely by revenues.

Before issuing double-barreled bonds, the Division will take account of several factors including the estimated debt service savings, the risk to the County's general fund, the County's remaining debt capacity and the anticipated impact on the County's overall credit rating. Specifically, the County will review whether the anticipated savings in debt service costs are sufficient to justify using the full faith and credit of the County to provide additional credit enhancement to revenue-backed obligations. To maximize the benefits obtained from utilizing the County's finite capacity to issue double-barreled LTGO bonds over time, the Division will not only consider the absolute benefits available in terms of lower interest rates but also whether prevailing credit spreads (i.e. the differentials in interest rates for differences in credit ratings) are narrow or wide by historical standards.

Since double-barreled bonds are secured by a pledge of revenues, their issuance will normally require the County to meet the same, or similar, covenants as those described in Section 5.2. As they carry the pledge of the full faith and credit of the County, such bonds may be subject to the same general fund charge as compensation for the provision of such credit enhancement as described in Section 5.1.

5.4 Credit Enhancement & Liquidity Support
Instruments such as bond insurance or bank facilities may be used to provide additional credit enhancement or liquidity support for County debt when necessary for the completion of a transaction or when it can be demonstrated that the cost of such instruments is expected to be more than offset by the resulting reduction in debt service.

In order to avoid the often substantial fees for bank-provided facilities and to eliminate certain forms of risk associated with such facilities, such as rollover or market access risk (see Section 6.9 below), the County will consider the use of its own assets held in the King County Investment Pool as an alternative source of liquidity support for certain forms of its variable rate debt, so-called "self-liquidity".

Section 6: Guiding Principles of Debt Management

6.1 Purpose

Debt financing is primarily utilized to provide funding for the acquisition and construction of County capital assets. Debt financing for capital projects offers several important benefits vis-à-vis cash funding, including the following:

- allows the County to undertake capital expenditures prior to accumulating sufficient funds necessary for the completion of the entire project;
- preserves cash for other purposes, including notably the retirement or defeasance of previously-issued higher cost debt (so-called "cash optimization");
- allows the cost of such assets to be spread over future users of those assets, thereby providing greater inter-generational equity; and
- allows the County to benefit from the subsidy for municipal entities provided by the federal government through the ability to issue debt on a tax-advantaged basis.

The County has set a minimum threshold that a capital asset must have an expected useful life of at least 3 years to be considered for debt financing. Shorter-term notes, defined as having a maturity of not more than 3 years, may also be issued to provide interim financing in anticipation of subsequent definite sources of revenues such as taxes or the issuance of long-term bonds. Although use of such notes may be justified for a number of different practical reasons, notes shall NOT be used to postpone the issuance of bonds purely in expectation of future declines in the County's long-term borrowing costs.

Debt financing will NOT be used to finance current operations. However, for certain large, non-recurring expenses such as lawsuit settlements, the County may determine that it is prudent to fund such expenditures through the issuance of debt in order to amortize the payment of such expenses over an extended period. In addition, conditions may exist where the County would find it economically advantageous to pre-fund certain ongoing operating expenditures (e.g. pension or OPEB payments) through the issuance of debt.

6.2 Issue Size

The issuance of municipal debt involves certain transaction costs including, but not limited to, payments to underwriters, legal counsel, financial advisors and rating agencies. Such costs of issuance are typically lower, as a percentage of the principal amount, for larger debt issues. Accordingly, to take advantage of such economies of scale in issuance costs, when feasible, the County will attempt to combine the financing of several different projects into larger debt issues.

Combining the financing of several different projects into a larger issuance has the additional important benefit of helping to dilute any private use that may exist with regard to one or more of the projects.

6.3 Term of Financing

The term of any financing will not exceed the estimated useful life of the asset(s) being financed.

The term of financing will also not exceed the expected term of any revenue streams that are specifically dedicated to the payment of the debt service on the financing.

6.4 Debt Service Profiles

The County will generally structure its fixed rate bonds to produce approximately level annual debt service payments (comprised of both principal and interest) over the life of the debt.

An issue of GO bonds is often used to provide financing for a number of separate projects, each of which may have different useful lives. Such so-called "various-purpose" bond issues are essentially a composite of individual bond issues for each of the separate projects. As such, although debt service will usually be levelized on a project-by-project basis, the debt service profile for the bond issue in aggregate will normally exhibit a series of discrete declines as the principal for each of the projects is fully amortized.

Back-loading of principal, however, will be considered in certain circumstances. Such circumstances include when the benefits from the debt issuance can clearly be demonstrated to be greater further in the future; when such structuring is beneficial to the overall amortization schedule of a fund's capital structure; or when the structure will more closely match debt service to the anticipated repayment source.

6.5 Use of Inter-Fund Loans

Before pursuing short-term interim financing in the public markets for a project (e.g. anticipation notes or commercial paper), the issuance and interest costs shall be compared with the cost of meeting the cash-flow need through temporary borrowing via an inter-fund loan from the King County Investment Pool.

All Inter-Fund loan requests shall be submitted to the Division for review to ensure that suitable reimbursement language is included. Following Division review, the request will be submitted to the EFC for final review and approval.

6.6 Tax-Advantaged vs. Taxable Debt

Normally, the issuance of tax-advantaged debt will produce a lower cost of financing for the County. However, the County will compare the relative financing cost of tax-advantaged debt with that of issuing taxable debt, and, in making a selection between the two alternatives when the relative costs are close, will give some consideration to the costs of adhering to the post-issuance compliance procedures necessitated by the IRS for tax-advantaged debt. In the comparison of the alternatives, the County will consider both the projected difference in interest cost on the initial issuance, but also any difference in the projected value of the call options between the two alternatives.

For certain capital projects that include usage by private or non-profit entities beyond allowable limits, it may be advantageous for the County to issue some portion of the funding in the form of taxable debt in order to create "qualified equity". For some other capital projects or for expenditures that are not classified as capital, the County will only be able to issue taxable debt.

It may also prove advantageous to undertake a refunding using taxable debt when outstanding bonds are not close to their call date.

6.7 Refunding Transactions

The County will periodically refund (refinance) outstanding debt for the purpose of achieving debt service savings.

In most refunding transactions, the County issues new fixed rate bonds (the refunding bonds) with a life equal to the remaining life of the bonds to be refunded (the refunded bonds). The refunding bonds are sized so that the proceeds, which are deposited into an escrow account, together with any investment earnings thereon, will provide sufficient funds to pay the remaining debt service payments on the refunded bonds until they are called.

Municipal bonds are routinely issued with provisions that allow the bonds to be called (i.e. retired) any time after approximately ten years. The right of municipal issuers to call their bonds any time after 10 years is an option that has economic value. The value of this option will fluctuate significantly over the life of the bonds, and, as such, it is important that the County establishes threshold economic values that it will accept for exercising a call option.

The County is permitted by IRS regulations to issue tax-advantaged refunding bonds within 90 days of, or after, the first call date of the bonds to be refunded. Such an issuance is referred to as a “current refunding transaction”.

Once the initial call date has passed, the value of the call option declines as bonds approach their stated maturities. Because of this diminishing value, the target savings for a current refunding transaction shall take into account the remaining life of the refunded bonds. Unless otherwise justified, a current refunding will require graduated minimum net present value savings as follows:

Remaining life (years)	Present Value Savings
<=2	1%
>2 & <=4	2%
>4 & <=7	3%
>7 & <=10	4%
>10	5%

Depending on IRS regulations, the County may have one or more options to refund outstanding bonds earlier than 90 days prior to their call date if it wishes to take advantage of favorable interest rate conditions. These include issuing tax-advantaged refunding bonds, taxable refunding bonds or doing a forward refunding in which tax-advantaged bonds are sold currently but not delivered until a later date (which would be within the 90-day window for a current refunding). Collectively, such options are labelled as “advance refunding transactions”.

The most efficient of these options is the issuance of tax-advantaged refunding bonds since they will typically provide the lowest borrowing costs. In recognition of this, an advance refunding using tax-advantaged refunding bonds will be undertaken if it produces debt service savings with a present value of at least **5%** of the refunded bonds. Because the latter two options -- the issuance of either taxable refunding bonds or a forward refunding -- will involve higher borrowing costs, they will only be undertaken if they produce debt service savings with a present value of at least **10%** of the refunded bonds.

In addition, advance refunding transactions that would achieve these respective savings targets will NOT be undertaken if the resultant net present value of the debt service savings does not

exceed the value of the "negative arbitrage" that is incurred in the escrow established for the refunding transaction. This requirement is termed "50% escrow efficiency".

Further, based on guidance from the County's financial advisor, savings targets higher than these minimum thresholds may be appropriate for certain advance refunding transactions. Among the circumstances that may justify requiring such higher savings targets are the length of time remaining before the initial call date of the refunded bonds, the remaining life of the refunded bonds beyond the call date, the differential in the value of the call option included with the refunding bonds compared to the value associated with a standard tax-advantaged issuance, and higher-than-average coupon interest rates on the refunded bonds. Additionally, part of this analysis will be a comparison of the projected savings available from these advance refunding transactions with the projected savings available to the County from waiting to pursue a current refunding within 90 days of the call date on the refunded bonds.

Unless otherwise justified, the maturity of any refunding bonds will not extend beyond the remaining life of the original bonds and the transactions will typically be structured in such a way as to produce approximately equal or proportional debt service savings in each of the remaining years of the life of the original bonds.

The appropriate refunding savings targets will typically be monitored on a maturity-by-maturity basis, although on occasion other considerations may warrant inclusion of some maturities in a refunding transaction that do not meet such thresholds.

Instead of issuing fixed rate refunding bonds, on occasion the County may issue variable rate bonds and enter into an interest rate swap agreement to produce a fixed rate refunding bond issue. In recognition of the additional risks associated with such swap-based transactions, however, the County must achieve projected minimum present value debt service savings threshold targets that are both *at least 5%* higher than those identified above and at least *5%* higher than those that would be produced from fixed rate advance refunding transactions.

A refunding that does not meet the present value savings targets identified above may still be undertaken if there are other considerations such as the desire to eliminate burdensome covenant restrictions or to respond to other possible changes that affect the County's debt.

The County will NOT refund debt for the sole purpose of deferring debt service unless justified by unique circumstances.

6.8 Fixed vs. Variable Debt

The majority of County debt takes the form of fixed rate long-term debt. Such debt provides the benefit of stable and certain annual debt service payments. While fixed rate bonds offer long-term predictability for debt service costs, it is prudent for County funds of sufficient size to finance a portion of their capital program using variable rate debt for the following reasons.

- *Lower debt service costs.* One important advantage of issuing variable rate debt is that such debt typically produces lower debt service costs over time. This expectation is based on the historical experience that the normal shape of the yield curve is upward-sloping, meaning that short-term interest rates are lower than long-term interest rates, together with the evidence that forecasts of interest rates implied by the yield curve systematically tend to overstate future rates because investors value the liquidity of short-term debt instruments. In combination, these considerations mean that variable rate debt,

the rates on which reflect short-term yields, should result in a lower cost of borrowing over time than using fixed rate long-term bonds.

- *Reduced net exposure to changes in interest rates.* Another important advantage of using variable rate debt is that it would act as a natural "hedge" to the exposure of the different County funds to the impact of changes in short-term interest rates on their investment income. Most County funds have significant cash balances that are held in the County's Investment Pool. Since the Investment Pool is typically invested in relatively short-term instruments, changes in short-term interest rates will result in volatility in the total revenues of County funds. Because changes in the interest rates on variable rate debt are likely to be positively correlated with changes in the yield on the County Investment Pool, changes in the interest expense of variable rate debt will provide a natural offset to changes in the investment income as interest rates increase or decrease. Using variable rate debt to fund a portion of their capital structure would therefore reduce the exposure of County funds to changes in interest rates.

  Furthermore, the amount or percentage of variable rate debt to be incurred in order to hedge against volatility in a Fund's interest earnings on its investment balances does not require an exact matching of cash assets with variable debt liabilities. The reason for this is that changes in taxable interest rates, which are earned by the Investment Pool, are expected to result in smaller absolute changes in tax-exempt interest rates, which the County pays on its variable rate debt. (Note: Variable rate debt issued solely to act as a hedge against invested assets will henceforward be termed "hedged variable rate debt", while any additional amounts will be termed "unhedged variable rate debt").

- *Increased financing flexibility.* An additional advantage of issuing variable rate debt instruments is that it provides greater financing flexibility. While fixed rate debt is almost always sold with a ten-year call feature, variable rate debt can usually be redeemed at any time. This flexibility can be useful in restructuring the County's debt service pattern or if there is uncertainty regarding the timing of the revenues to be used to retire principal. Certain types of variable rate debt also incorporate an option for the County to convert the debt to fixed rate bonds. As opposed to relying on the potentially time-intensive process of issuing new bonds, the ability to exercise this option provides the County with greater flexibility to respond quickly to changes in financial market conditions if it is considered prudent to lock in long-term fixed rates.

The potential risk associated with issuing unhedged variable rate debt to take advantage of such lower expected lifetime borrowing costs is that increases in interest rates may cause significantly higher debt service costs that may be difficult for different County funds to absorb out of their available revenues. The prudent level of outstanding unhedged variable rate debt for each of the different County funds will therefore depend on several considerations such as the stability and/or controllability of their revenues. The County will solicit input from its financial advisor and review relevant rating criteria from the credit rating agencies regarding the appropriate amount of unhedged variable rate debt for each different fund.

6.9 Limited Renewal, Market Access and Rollover Risk

Although variable rate debt normally takes the nominal form of long-lived obligations, such debt usually exposes the County to so-called "renewal risk".

These obligations are generally either secured by bank credit or liquidity facilities or are sold to banks as direct loans (see Section 7.3 below). In all these cases, the banks are typically not

willing to make these commitments for a period that exceeds 5 years and, as such, the County must periodically renew or replace such arrangements. This entails a risk that such renewal or replacements may occur at a time when either a particular bank, or even the banking industry as a whole, is in a period of turmoil which may force the County to renew or replace such facilities on very disadvantageous terms. Indeed, in extreme market conditions, the County potentially may be unable to renew or replace these expiring arrangements, necessitating either the premature redemption of such debt or conversion to a potentially expensive fixed rate mode. This risk is referred to as renewal risk.

To limit such renewal risk, the County will attempt to enter into such arrangements with a well-diversified group of different banks, thereby limiting its exposure within its overall variable rate debt portfolio to any individual bank. Such diversification offers the additional benefit of limiting the County's exposure to negative news regarding one of its credit or liquidity support providers that would adversely impact the re-pricing of the interest rates that the County pays on its variable rate debt. (Such risk is sometimes referred to as "bank" or "headline" risk.)

The County will also attempt to limit renewal risk by staggering the expiration of such bank facilities so that a large number do not need to be renewed or replaced simultaneously. This limits exposure to a situation when the entire banking industry may be under pressure to raise their pricing or even withdraw from a particular line of municipal business.

A risk similar in nature to the above is intrinsic to the use of BANs to provide interim project financing since their issuance assumes that the County will be able to issue bonds or a subsequent BAN issue to provide the takeout financing when the BANs mature. However, such subsequent issuances may potentially be expensive or, in extreme market conditions, impossible. In the context of BANs, this risk is often referred to as "market access" or "rollover" risk.

Extreme market access and rollover risk may be partially mitigated by maintaining working relationships with several large banks which, even when accessing the public sale market is unfeasible, may be able to provide continued interim financing as a private placement (see below) on an expedited basis. This may allow the County to avoid paying off maturing BANs directly, which would preclude such projects from being eligible for later tax-advantaged bond funding.

The most significant basic safeguard against renewal, market access and rollover risk, however, is the County's maintenance of its excellent credit ratings since such risks are greatly magnified for lower-rated issuers. When market conditions have deteriorated in recent years, investors have demonstrated a marked preference for higher-rated credits. This has resulted in much wider credit spreads at such times and, to the extent that any credit is available in the municipal market, a definite bias in favor of the strongest credits.

6.10 Limited Market Timing

Except in unusual market conditions that are widely considered to be transitory in nature, the County will NOT attempt to structure and time its debt issues on the basis of interest rate forecasts.

Unless specific debt service or rate targets need to be met, County debt will be issued as expeditiously as possible to support the most advantageous financing schedules for County capital projects and to take advantage of available refunding opportunities. As a frequent issuer, the County will therefore issue debt in all market conditions, which will result in a blend of interest rates on its overall debt portfolio.

Section7: Debt Issuance Methods

7.1 Reliance on Professional Advisors

In selling debt, the County will place heavy reliance on its financial advisor, bond counsel, disclosure counsel and, in the case of negotiated sales, underwriter(s). Following are definitions of these roles and responsibilities:

- *Financial Advisor:* the primary role of the County's financial advisor is to identify the market opportunities for bond sales and ensure the County's financial interests are protected on any debt issuance. The financial advisor helps determine the structure and timing of the bond issue, evaluates bond sales, and assists in the closing of transactions;
- *Bond Counsel:* the primary role of bond counsel is to certify that the County has legal authority to issue the bonds. The bond counsel also works with the County to ensure compliance with all federal tax law constraints and statutory and procedural requirements;
- *Disclosure Counsel:* the primary role of disclosure counsel in the sale process is to help ensure, and then certify, that the County's offering documents provide all necessary and relevant information that potential investors would need to base their decision as to whether or not to purchase the bonds;
- *Underwriter:* the primary function of the underwriter is to purchase debt issues from the County and resell them to investors. In a negotiated sale, the underwriter provides expertise regarding the structure of the debt issue that will enhance its marketability. Underwriters also act as remarketing agents for certain forms of the county's variable rate debt.

Consistent with County procurement practices, the Division will periodically issue Requests for Proposals (RFPs) in order to enter multi-year contracts (or other arrangements) with such professionals. The preferred candidates will be selected on the basis of their experience, the proposed pricing of their services, and other considerations deemed appropriate.

7.2 Competitive Sales vs Negotiated Sales

The County prefers to sell debt by means of competitive sales.

In a competitive sale, the County solicits bids from underwriting firms to purchase its debt, and sells the debt to the firm offering the lowest interest cost bid. The County prefers this method because: (1) it ensures that the debt is sold at the lowest interest cost for the given issue structure and the prevailing market conditions; (2) the underwriting cost tends to be lower compared to negotiated sales; and (3) it promotes the appearance of an open and fair process.

Negotiated sales will be used, however, for certain debt issues for which a specific result is required and for more complicated debt issues for which closer underwriter input can provide added value in the structuring and marketing of the debt.

7.3 Private Placements

The County may also utilize private direct placements which are transactions that are neither competitive nor negotiated but placed directly with one or two investors, usually banks. Included in such category are various loan programs administered by the state or federal government.

7.4 Credit Enhancements

As mentioned, credit enhancement instruments such as bond insurance or bank credit and liquidity facilities will be used to provide additional security for County debt when necessary to complete a transaction and when it can be demonstrated that the cost thereof is expected to be more than offset by the reduction in debt service. (When sold competitively, the decision to insure bonds is made by the winning underwriter rather than by the County.)

Section 8: Debt Administration Duties

8.1 Investment of Proceeds

Each bond ordinance will provide for the establishment of funds and accounts, which will be designated in advance by the County. Each ordinance will identify the investing officer for the funds held by the County, and any investments will generally be made in accordance with the County's Investment Policy and procedures established by the County. For refunding transactions, proceeds will be invested in highly-rated securities such as those issued by the US Treasury, including State and Local Government Series (SLGS) securities, and other securities permitted under State law.

The County will consider investment agreements on a case-by-case basis and enter into agreements when appropriate through a process of competitive bidding that adheres to U.S. Treasury regulations and guidelines.

8.2 Post-Issuance Tax Compliance

The county will adhere to written procedures for post-bond issuance tax compliance with federal tax law as recommended by bond counsel and adopted by the EFC to ensure that bonds remain eligible for favorable tax treatment throughout their lifetimes.

The Division is <u>not</u> responsible for arbitrage and other tax law requirements for junior taxing districts for which the County serves *as ex officio* treasurer.

8.3 Financial Disclosure

The County is committed to providing full financial disclosure.

The Division will adhere to written disclosure procedures adopted by the EFC to ensure that the County complies with applicable securities law in providing full disclosure upon the issuance of all debt. The Division will serve as the focal point for compiling information provided by County agencies needed for inclusion in the official statements to be used in the initial offering of the County's debt.

The Division will adhere to written disclosure procedures adopted by the EFC to ensure that the County meets its continuing disclosure undertakings pursuant to the Securities and Exchange Commission Rule 15c2-12 and provides other financial information required by various covenant agreements in a timely manner. Filings required pursuant to the County's Rule 15c2-12 continuing disclosure undertakings will be submitted using the Electronic Municipal Marketplace Access ("EMMA") system maintained by the Municipal Securities Rulemaking Board.

The Division will serve as the focal point for responding to requests from bondholders, rating agencies, and other external parties. To facilitate such communication, the County will provide pertinent financial information on a website dedicated to the investor community (an "Investor Webpage").

APPENDIX A

KING COUNTY PAYMENT AGREEMENT POLICY

1.0 Introduction

This document sets forth the policies that will govern the execution and management of payment agreements. A "Payment Agreement" means a written agreement which provides for an exchange of payments based on interest rates, or for ceilings or floors on these payments, or an option on these payments, or any combination, entered into on either a current or forward basis. This Payment Agreement Policy is a subset of King County's Debt Management Policy.

A typical form of payment agreement is an "interest rate swap". An interest rate swap is a contract entered into by an issuer with a swap provider to exchange periodic interest payments. Normally, one party agrees to make payments to the other based upon a fixed rate of interest in exchange for payments based on a variable rate.

For example, the County may issue variable rate debt and simultaneously enter into an interest rate swap contract. The swap contract may provide that the County pay to the swap counter-party a fixed rate of interest in exchange for the counter-party making variable payments that are expected to be similar to the amount payable on the variable rate debt. In other circumstances it may prove cost-effective for the County to enter into an interest rate swap agreement to synthetically create variable interest rate exposure instead of issuing variable rate directly.

The size of the interest rate swap market (estimated in the tens of trillions of dollars) far exceeds that of the municipal bond market. Participants in the municipal bond market are primarily limited on one side to governmental and other tax-exempt issuers and, on the other, to investors who have a U.S. federal income tax liability. Participants in the interest rate swap market include both of these groups as well as corporations and investors of all types, both domestic and international. The sheer size of this market can produce efficiencies not seen in the municipal market. Furthermore, this diverse group of participants also means that there is likely a party whose goals for their borrowing or investment program are different than those of the County's (i.e., the County would like to reduce its risk exposure while the other party is more tolerant of risk). The interest rate swap market provides these parties with increased options for aligning their investing and borrowing outcomes more closely with their respective goals.

The County may be willing to enter into such an agreement if it results in the expectation of the County paying a lower net fixed or variable rate of interest than it would have to pay if it simply issued fixed or variable rate bonds. The benefits from using swaps depend on financial market conditions. For example, during the early 2000s the County could have consistently lowered its fixed-rate borrowing costs by at least 50 basis points had it been able to enter into such interest rate swaps instead of issuing fixed rate bonds. Since then, however, the use of such swaps by municipalities for such purpose has been greatly reduced.

Although the County may enter into an interest rate swap agreement with the expectation of paying an all-in lower amount than on a traditional financing, a "synthetic" structure often carries different risks than a fixed rate transaction. Although the expected payments may be lower, over time the costs of the synthetic transaction may prove excessive and there may also be acceleration

or termination provisions that could require substantial payments on a timeframe different from the expected payment schedule.

The purpose of this Payment Agreement Policy is to establish guidelines for the execution and management of the County's payment agreements, including interest rate swaps. This Policy confirms the commitment of the Executive, Council, staff, and advisors to adhere to sound financial and risk management practices, with the goal of achieving the lowest possible cost of capital within prudent risk parameters. It is expected that this policy will be updated periodically as necessary.

2.0 Philosophy Regarding Use of Payment Agreements

Payment Agreements may be executed when they achieve a specific objective consistent with the County's overall financial policies. The County will use payment agreements to produce an expected result not otherwise available in the cash market or to provide a higher level of expected savings, expected lower level of risk, expected greater flexibility, or other expected direct benefits related to the debt obligation with which the payment agreement is associated.

The County will not use payment agreements that it expects would: (i) create extraordinary leverage or financial risk; or (ii) provide insufficient price transparency to allow reasonable valuation.

Payment agreements will not be used for speculation. For policy purposes, speculation means taking additional risks, unrelated to the County's business, in an effort to increase returns.

Reasons to use payment agreements include, but are not limited to:

- Reducing expected interest expense;
- Hedging and actively managing interest rate, tax, basis, and other risks;
- Achieving an appropriate asset/liability match within a particular fund; and
- Achieving variable rate funding without utilizing the services of a remarketing agent and obtaining credit enhancement and/or liquidity agreements.

All payment agreements will conform to the requirements set forth in RCW 39.96, as amended, related to payment agreements.

The Council will be responsible for adopting legislation necessary for the County to enter into such transactions. Specific delegation from the Council will be obtained by the Division prior to entering into any payment agreements pursuant to such legislation.

3.0 Permitted Instruments

The County may use the following financial products after identifying the specific financial objective(s) and assessing the attendant risks:

- Interest Rate Swaps – Immediate or forward starting variable-to-fixed rate swaps may be used to capture current market fixed interest rates or attempt to minimize variable rate exposure. Fixed-to-variable rate swaps may be used to create additional variable interest rate exposure.

- Interest Rate Caps, Floors, and Collars – Financial contracts may be used to limit or bound exposure to interest rate volatility.

  An interest rate cap is an agreement entered into by the issuer of variable rate debt in which the counter-party agrees to pay any portion of the interest on an index that exceeds a specified interest rate. Absent any deterioration in the credit of the issuer and subject to counterparty and basis risk, such a cap creates an upper limit on the interest cost to the issuer of variable rate debt.

  An interest rate floor is an agreement whereby the issuer of variable rate debt agrees to pay a stated rate of interest based on an index even if the actual rate on the variable rate debt (after adjusting for any changes in the credit quality of the issuer) is lower. The issuer receives an upfront fee from a counter-party in exchange for the obligation to pay the difference between the interest rate floor and the actual rate on the index.

  A collar is a combination of a cap and a floor.

- Options on Swaps – Sales or purchases of options may be used to commence or cancel interest rate swaps.

  A swaption is an option held by one party that provides that party the right to require that a counter-party enter into a swap contract on certain specified terms.

- Basis Swaps – Variable-to-variable rate swaps may be used to manage basis or tax risk and change the basis on which variable cash flows are determined.
- Rate Locks – Rate locks may be used to hedge an upcoming fixed rate bond issue.
- Other financial products – These may be used with the approval of the Council.

4.0 Risk Analysis

The County will evaluate all permitted instruments with respect to the risks with which they are associated. A specific determination must be made that the expected benefits exceed the identified risks by an adequate margin over those available in the traditional cash market, if any.

The County will analyze and evaluate the potential risk involved by examining the factors listed below:

- Market or interest rate risk – Does the transaction hedge or create interest rate volatility?
- Risk of Uncommitted Funding – Does the transaction entail the risk of future refinancing needs?
- Legal Risk – Is the County authorized by its governing law to enter into the transaction, and does the proposed transaction conform to RCW 39.96?
- Reporting Considerations – Has the County consulted its accounting staff and auditors to determine the impacts such a transaction will have on the County's financial statements (including mark-to-market considerations)?
- Rating Risk – Does the proposed transaction pose undue risk to the County’s debt ratings? Has the proposed transaction been reviewed by the rating agencies?
- Termination Risk – Under what circumstances might the transaction be terminated? What is the probable range of termination values? How would a possible termination payment be funded?

- Counter-party Risk – What is the creditworthiness of the counterparty? (Ratings and rating outlooks)
- Basis Risk – Do the anticipated payments the County will receive match the payments it makes? If not, is the basis risk justified by the expected benefits?
- Tax Risk – Is the financial outcome of the transaction subject to change if there is a change in federal income tax policy?

Once a payment agreement has been executed (implying that the first five threshold items above have been satisfactorily addressed), the County would continue to face termination risk, counter-party risk and, depending on the index used, may also face basis risk and tax risk. The following discussion addresses each of these risks.

> *Termination risk* refers to the potential consequences for the County if the payment agreement has to be terminated earlier than scheduled. All payment agreement documents will identify events that trigger automatic termination. These can include credit-related events such as ratings downgrades, bankruptcy/insolvency of either party, and nonpayment of debt by either party. If a payment agreement is terminated, the County would face the reversion of its underlying debt to its original form and/or may be liable for potentially large payments if the termination occurs at a time of adverse market conditions.
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> *Counter-party risk* represents one source, albeit perhaps the most significant one, of termination risk since the default by a counter-party in a payment agreement and the consequent termination exposes the County to precisely the same potential consequences as those identified in the above paragraph. There are several strategies that the County will use to mitigate counter-party risk, including dealing only with providers that have very high credit ratings, diversifying its exposure across many providers, and requiring providers to post collateral when counter-party ratings dip below specified levels.
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> *Basis risk* arises when the variable rate payments an issuer receives under a payment agreement are not sufficient to cover the variable interest rates that it must pay on its bonds. This is often the result of basing the payment agreement on a different index. For example, while variable tax-exempt bond rates track the Securities Industry and Financial Markets Association (SIFMA) index, payments made to tax-exempt issuers on variable-to-fixed rate swaps are frequently based on a percentage of a short-term taxable index (historically, the London InterBank Offered Rate (LIBOR), but currently transitioning to the Secured Overnight Financing Rate (SOFR)). If the relationship between these indices changes during the life of the swap, the County may have to pay an additional amount to cover the payments on its variable rate debt over and above the fixed rate it would be paying under the payment agreement. Over and above the use of an index that does not exactly track the SIFMA index, an issuer would also incur additional variable rate payments on the underlying variable rate bonds if it or its credit support provider experiences any deterioration in credit during the term of the payment agreement.
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> *Tax risk* represents one source, albeit a very significant one, of basis risk. This is because a change in federal tax rates is one major factor that would have a significant impact on the relationship between the SIFMA index, which reflects the rates on tax-exempt debt, and a taxable short-term interest rate.

The rating agencies will need to be convinced that the County is fully cognizant of the above risks and that it has the financial flexibility to absorb the potentially higher payments that could result from various adverse developments.

5.0 Risk Limits

5.1 Value at Risk
The County shall measure, monitor, and limit its market risk on payment agreements. The County will calculate the net effect of a 100 basis point (1%) unfavorable change in interest rates on its payment agreement program at least quarterly. The value at risk will not be allowed to exceed the reasonable ability of the County to provide liquidity for a termination payment in the event of a termination event.

5.2 Other limits
Payment agreement terms may not exceed the expected term of the debt obligation associated with the agreement. The total notional amount of the payment agreement may not exceed the total par amount of the debt obligation(s) associated with the agreement (i.e. as the par amount of the debt obligation declines with amortization, the notional amount of the payment agreement must be reduced correspondingly).

6.0 Payment Agreement Procurement and Execution

The County will solicit and procure payment agreements by competitive bid when feasible. Only parties conforming to the minimum credit standards outlined in this Policy and that have agreed to terms and conditions acceptable to the County will be allowed to participate in a competitive transaction.

The County may procure payment agreements by negotiated methods if it determines that due to the size, complexity or timing considerations of a particular agreement, competitive bidding is undesirable, impractical or impossible and a negotiated transaction would result in the most favorable terms. The County will attempt to price the agreement based upon an agreed-to methodology, relying on available pricing data. The County will use a financial advisor to assist in price negotiations and the determination of the method of procurement.

Regardless of the method of procurement, the County will obtain a finding from the financial advisor that the payment agreement and the terms and conditions of the agreement are "commercially reasonable" pursuant to RCW 39.96.

The Director of the Finance and Business Operations Division or his or her designee may execute Council-approved payment agreements and other documents related to such transactions and may execute the documents related to similar transactions, if such documents result in a transaction consistent with this Policy. This authorization will extend to future termination or modifications of the initial documents, provided such terminations or modifications result in a structure and other parameters that are otherwise consistent with this Policy.

7.0 Counterparties Policy

The County shall execute payment agreements only with counter-parties with strong credit ratings. The County will attempt to do business with counter-parties with at least two ratings in the "AA" category or above as of the transaction date.

For lower-rated (below "AA" category) counterparties, the County will seek credit enhancement in the form of:

- Collateral;
- Guarantees; and
- Termination events (e.g., if the counterparty rating falls below investment grade).

When the counter-party and any counter-party guarantor is rated below the "AA" category (either at the time of creation of the payment agreement or while the payment agreement is in effect), then:

- The obligations of the counter-party will be 100% collateralized (and preferably 102% collateralized) by cash, direct obligations of the United States, or Agencies; and
- The cash or obligations will be deposited with the County or with an agent of the County; and
- The collateral obligations will be valued at least weekly.

The County will attempt to structure payment agreements to limit losses due to non-performance of its counter-parties using appropriate strategies, e.g. by using more than one counter-party for an agreement and having the explicit option to terminate an agreement.

The County will establish and review counter-party exposure limits, i.e., not-to-exceed amounts for a given counterparty.

8.0 Documentation

The County will use standard ISDA documentation, including the Master Agreement, Schedule to the Master Agreement, Credit Support Annex, and Confirmation.

9.0 Active Management

The County will seek to maximize the benefits it accrues and minimize the risks it bears by actively managing its payment agreements. This will entail periodic monitoring of market conditions (such as current interest rates, credit ratings of the parties to a transaction, and other relevant factors), in conjunction with the counter-party and the County's advisors, for emergent opportunities and risks. Active management may entail modifications of existing transactions including:

- Early termination of an agreement;
- Shortening or lengthening the term of an agreement;
- Sale or purchase of options; and
- Application of basis swaps.

Each proposed modification must be consistent with this Policy. With the approval and conditions set forth by the Executive Finance Committee, the Director of Finance and Business Operations will have delegated authority sufficient to provide flexibility to actively manage

existing payment agreements without additional Council approvals. Such delegated authority includes, but is not necessarily limited to, the authority to execute modifications to documents or to exercise actions permitted under the documents related to a transaction. The Finance Director will report all such modifications to the Executive Finance Committee.

10.0 Reporting and Disclosure

The Division will provide an annual report on the status of the County's payment agreements to the Executive Finance Committee. These reports will include market values, cash flows, value at risk and other performance measures, as well as evaluations of each transaction's performance relative to benchmarks or goals set forth for the transaction. The reports will also note all material changes to payment agreements or new agreements entered into by the County since the last report.

The County Executive will monitor and require compliance with this Policy as well as then-current accounting practices and federal and state regulations and requirements.

11.0 Rating Agencies

The County will advise the rating agencies of any proposed payment agreements as part of its overall rating agency strategy, and will provide updates to them on any changes.

12.0 Payment Agreement Management Plan

The County will prepare and maintain a payment agreement management plan. This management plan will contain a discussion of the details of the agreement, its risks, regards, and exit strategies. The following will be addressed in the plan:

- A discussion of why the agreement makes sense to the County, given its projected benefits and risks.
- Counterparty ratings and implications for the County.
- Impact on annual financial statements
- Discussion of senior management's awareness of basis risk, termination (or rollover) risk, and counterparty risk.
- The methods for handling basis risk, interest rate risk, termination risk, and counter-party risk.
- Events that may trigger an early termination under the agreement.
- Assessment of the possibility of involuntary termination due to an event of default or event of termination.
- Determination of how much an involuntary or voluntary termination would cost and how it would be paid.
- In the event of early termination, discuss how any variable rate exposure would be re-hedged.
- Identity of key personnel and/or positions involved in monitoring the terms of the agreement and counterparty creditworthiness.

13.0 Qualified Independent Representative

The County shall select and retain a consultant (the "Swap Advisor") to provide guidance with respect to swap transactions and to act as the County's "Qualified Independent Representative,"

as defined in the regulations of the U.S. Commodities Futures Trading Commission promulgated under the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Selection Criteria
To be eligible to serve as the Swap Advisor, an entity or person must:

- have substantial experience advising state and local governments with respect to swaps;
- be independent from any counterparty or proposed counterparty to any swap transaction, and not be recommended to the County by any such counterparty;
- not be subject to statutory disqualification under the Commodities Exchange Act or the Securities Act of 1933,
- disclose any material conflicts of interest that could affect its judgment with respect to its duties as the County's Swap Advisor, and
- comply with all applicable state and federal laws with respect to political contributions to public officials.

The County will review the performance of the Swap Advisor annually to ensure compliance with this Policy and the service provided by the Swap Advisor. In connection with this annual review, the Swap Advisor will represent, in writing, that it meets the above criteria and that it will at all times act in the best interests of the County.

The County will consult the Swap Advisor with respect to all proposed swap transactions, including any modifications, cancellations and options. The Swap Advisor will provide the County with its evaluation of such swap transaction, including:

- Suitability: whether the swap transaction meets the County's stated objectives, financial limitations and complies with this Policy.
- Fair Pricing: the Swap Advisor is not required to provide executable levels for pricing or price quotations, but will evaluate the price being offered and obtain quotations from other dealers as necessary.
- Risks: the Swap Advisor's evaluation of the risks of the swap transaction in accordance with this Policy

The Swap Advisor shall also consult with the County with respect to the management of the County's swaps outside of specific swap transactions including such matters as recordkeeping and legal compliance issues (but will not provide legal, accounting or tax advice to the County).