Buffalo Fiscal Stability Authority

Interest Rate Swap Policy

The purpose of this Interest Rate Swap Policy (**"Policy"**) of Buffalo Fiscal Stability Authority ("BFSA**"**) is to establish guidelines for the use and management of all interest rate exchange transactions and other similar arrangements (each a "**Swap**" and collectively **"Swaps"**) incurred by BFSA, whether in connection with the incurrence of debt obligations or in furtherance of other non–speculative corporate purposes. This Policy sets forth the manner of execution of Swaps, provides for security and payment provisions, risk considerations and certain other relevant provisions.

The Conditions under which Swaps May Be Entered Into

Purposes

Swaps may be used for any one or more of the following purposes only:

- To achieve significant savings as compared to a product available in the bond market. Significant savings is to be calculated after adjusting for (a) applicable fees, including takedown, remarketing fees, credit enhancement and legal fees, and (b) call options that may be available on the bonds. Examples may include synthetic fixed rate debt and synthetic variable rate debt. Alternatively, significant savings may be deemed to occur if the use of Swaps helps to achieve diversification of a particular bond offering;
- To prudently hedge risk in the context of a particular financing or the overall asset/liability management of BFSA;
- Synthetically to create variable rate exposure within prudent guidelines through Swap transactions in which BFSA effectively exchanges with a Swap counterparty its fixed interest rate obligation on notes or bonds for an obligation to pay to the counterparty a variable interest rate;
- To lock in fixed rates in current markets for use at a later date, through the use of forward Swaps, swaptions, rate locks, options and forward delivery products;
- To access the capital markets more rapidly than may be possible with conventional debt instruments
- To manage BFSA's exposure to the risk of changes in the legal and regulatory treatment of tax–exempt bonds;

- To manage BFSA's credit exposure to financial institutions and other entities through the use of off–setting Swaps and other credit management products; and

- To achieve more flexibility in meeting overall financial objectives than can be achieved in conventional markets.

Legality

As a condition to the execution of any Swap transaction BFSA must receive an opinion acceptable to it from a nationally recognized bond counsel firm substantively to the effect that BFSA has the power and authority to execute the agreement(s) relating to the Swap, that the agreements are legal, valid and binding obligations of BFSA and that they and their execution and delivery are not inconsistent with applicable laws.

Speculation, Market Liquidity and Transparency

Swaps may not be used for speculative purposes or to assume risks that are not prudent in light of the purposes for which the Swap transaction is being done. BFSA may not enter into any Swap transaction for which there is insufficient market liquidity for its transfer or, upon its termination, insufficient price transparency to allow realistic valuation of its market value.

Methods of Soliciting and Procuring Swaps

BFSA will choose counterparties for entering into Swap agreements on either a negotiated or competitive basis. As a general rule, a competitive selection process will be used whenever reasonable, if (i) the product is relatively standard, (ii) it can be broken down into standard components, (iii) two or more providers have proposed a similar product to BFSA or (iv) competition will not create potential market pricing effects that would be detrimental to BFSA's interests. Negotiated procurement may be used (w) for original or proprietary products, (x) for original ideas of applying a specified product to an Authority need, (y) to avoid potential market pricing effects that would be detrimental to BFSA's interests or (z) on a discretionary basis in conjunction with other business purposes of BFSA. Consideration may be given in negotiated transactions to those counterparties who have demonstrated their willingness to participate in competitive transactions and have performed well. If it is determined that a Swap should be competitively bid, BFSA may employ a hybrid structure to reward unique ideas or special effort by reserving a specified percentage of the Swap to the firm presenting the ideas on the condition that the firm match or better the best bid. To provide safeguards on negotiated transaction, BFSA should generally secure outside professional advice to assist in the process of structuring, documenting and pricing the transaction, and to verify that a fair price was obtained. In any negotiated transactions, the counterparty will be required to disclose in the relevant confirmation for the transaction all payments to third parties, including lobbyists, consultants and attorneys, who had any involvement in assisting the counterparty in securing business with BFSA. In all transaction, whether competitively awarded or negotiated, BFSA should obtain from an independent third party with expertise in Swap transactions a verification or other written assurance with respect to the fair market value or pricing of the Swap.

Form and Content of Swaps

To the extent possible, each Swap transaction consummated by BFSA should contain the terms and conditions set forth in the International Swaps and Derivatives Association, Inc. (**"ISDA"**) Master Agreement, including schedule, credit support annex and confirmation. The schedule should be modified to reflect specific legal requirements and business terms desired and reasonably available to BFSA.

Optional Termination

BFSA should include in each Swap a provision that permits it to terminate the Swap at the market value of the agreement at any time at its option.

Events of Default and Termination Rights

The Swap agreement with a counterparty should provide that at least each of the following would constitute an event of default by the counterparty, which would give rise to BFSA's right to terminate the Swap:

- Failure by the counterparty to make any payment when due;
- Breach of a covenant or condition that remains uncured after notice and an opportunity to cure;
- A representation or warranty by the counterparty proves to have been incorrect in any material respect;
- The execution or performance of the Swap by the counterparty is or becomes illegal; and
- Failure to provide collateral security in accordance with the Swap agreements, including upon a reduction below specified levels, withdrawal or suspension of credit ratings.

In addition, the Swap agreements should give BFSA the right to terminate the Swap if the counterparty's credit ratings are reduced below specified levels or are withdrawn or suspended. Upon an early termination as a result of any counterparty event of default or termination event that gives rise to BFSA's right to terminate the Swap, the counterparty should be the "affected party" for purposes of calculating the termination payment owed, so that termination payments are determined giving BFSA the benefit of the bid/asked spread.

Aspects of Risk Exposure

Before entering into a Swap transaction, the risks inherent in the transaction are to be evaluated by BFSA. The risks to be evaluated should include counterparty risk, termination risk, rollover risk, basis risk (including tax risk) and amortization risk. Schedule I to this Swap policy includes definitions of the various risks associated with SWAPS and a table identifying risks to be evaluated and the actions to be taken by BFSA to assess and/or mitigate them.

Counterparty Selection

BFSA should endeavor to diversify its exposure to counterparties. To that end, before entering into a Swap transaction with a proposed counterparty or soliciting bids from a counterparty, it should determine its exposure to the relevant counterparty and determine how the proposed Swap transaction would affect the exposure. The exposure should not be measured solely in terms of notional amount, but may also take into account how changes in interest rates would affect BFSA's "Maximum Net Termination Exposure". For purposes of these limits, **"Maximum Net Termination Exposure"** equals the aggregate termination payment for all existing and projected Swap transactions with BFSA that would be paid by an individual counterparty. For purposes of this calculation, the aggregate termination payment is equal to: (i) the reasonably expected worst–case termination payment under all existing Swaps prior to the execution of any proposed transaction, plus (ii) the reasonably expected worst–case termination payment of the proposed transaction. BFSA recognizes that Maximum Net Termination Exposure, while a helpful measure, produces an inflated calculation of net exposure to any particular counterparty under normal market conditions and that in most circumstances payment of the worst–case termination payment is highly unlikely to occur. Maximum Net Termination Exposure is most useful when (a) the value of all existing and projected transactions with the counterparty have moved, in light of then current market conditions, completely in favor of BFSA, (b) the counterparty in question has not, or is not obligated to, post collateral to support its obligations under such transactions pursuant to industry standard credit support documents and (c) a disruption in the market has made it impossible for BFSA to replace any terminated transactions. In assessing exposure to any particular counterparty, BFSA may also consider other appropriate factors in measuring credit exposure, such as an assumed movement of rates of a specified number of basis points adverse to the counterparty rather than a worst case movement of rates or reducing any calculation of exposure to a counterparty by the value of collateral posted by the counterparty. In no event may the total exposure to a particular counterparty exceed a prudent level taking into consideration BFSA's financial resources and commitments.

BFSA may enter into a Swap transaction with a particular counterparty if (i) either (a) the counterparty has credit ratings from at least one nationally recognized statistical rating agency that is within the two highest investment grade categories, without distinction as to grade within the category or (b) the payment obligations of the counterparty will be collateralized, as described below, or unconditionally guaranteed by an entity with credit ratings that comply with clause (i)(a) above, and (ii) the counterparty has demonstrated experience in successfully executing Swaps. If after entering into an agreement the ratings of the counterparty or its guarantor or credit support party are downgraded below the ratings listed above by any one of the rating agencies, then the agreement should be subject to termination unless (x) the counterparty provides either a substitute guarantor or assigns the agreement, in either case, to a party meeting the rating criteria reasonably acceptable to BFSA or (y) collateralizes its obligations in accordance with the criteria set forth in the transaction documents, subject to an absolute rate threshold below which BFSA has the right to terminate, regardless of the posting of collateral.

Collateral Requirements

If the rating (a) of the counterparty, if its payment obligations are not unconditionally guaranteed by another entity, or (b) of the entity unconditionally guaranteeing its payment obligations, if so secured, does not meet or falls below the rating specified above under "Counterparty Selection", then the obligations of such counterparty to make a termination payment if there were an early termination of the Swap must be collateralized by obligations that constitute Eligible Investments, as that term is defined in BFSA's Indenture, valued at a percentage of their market value appropriate to the nature of the collateral. In all events, however, United States Treasury obligations that mature within a year should not be valued at more that 99% of their market value and all other obligations should not be valued at more than 98% of their market value. The obligation to post Collateral may be subject to differing threshold amounts depending on the counterparty's credit rating level. Collateral must be valued at regular intervals that are not less frequent than monthly. In addition, BFSA should have the right to independently value the Swap and the collateral. Collateral posted by the counterparty or its credit support party must be held either by BFSA or on behalf of BFSA by a mutually agreeable custodian

Long–Term Implications

In evaluating a particular Swap transaction, BFSA should review long–term implications associated with entering into the Swap, including the costs of borrowing, historical interest rate trends, variable rate capacity, credit enhancement capacity, opportunities to refund related debt obligations and other similar considerations.

Impact of use of Liquidity

BFSA shall consider the impact of any variable rate obligations issued in combination with a Swap on the availability and cost of liquidity support for other additional variable rate obligations that may be issued by BFSA in the future.

Call Option Value Considerations

When considering the relative advantage of using a Swap to synthetically create fixed rate bond obligation versus the issuance of conventional fixed rate obligations, BFSA should take into consideration the value of any call option on fixed rate obligations.

Swaps Associated with Tax–Exempt Debt

Prior to executing a Swap associated with tax–exempt debt, BFSA, in conjunction with its tax counsel, must review the effect the Swap is expected to have on the rebate of investment earnings to the United States Treasury and the tax status of the associated tax–exempt debt. Swap structures should be adopted within plans of finance, including mitigation strategies, that are designed to maintain the tax–exempt status of BFSA's debt.

Financial Statement Accounting

BFSA will reflect the use of Swaps on its financial statements in accordance with the generally accepted accounting principles applicable to it.

Monitoring and Reporting

Management of BFSA must report to BFSA's Directors at least once a calendar quarter and as requested by the Directors or their Chairperson. Each quarterly report must include the following:

- A summary of principal terms of the agreements, including notional amounts, interest rates, maturity and method of procurement.
- The marked–to–market value of each Swap.
- The name, description and credit ratings of each counterparty and the applicable guarantor or other credit support party.
- The amounts that were required to be paid and received, and any amounts that were actually paid and received.
- Listing of any credit enhancement, liquidity facility or reserves and accounting of all costs and expenses associated with the credit enhancement, liquidity facility or reserves.
- The aggregate marked to market value for each counterparty and relative exposure compared to other counterparties.
- A calculation of BFSA's Maximum Net Termination Exposure to each counterparty.
- Any posted collateral related to the transaction.

Schedule I

GLOSSARY OF TERMS

Amortization Risk – Amortization risk refers to a mismatch between the principal amount of hedged bonds and the notional amount of the associated hedging Swap at points in time.

Basis Risk – Basis risk refers to a mismatch between the interest rate received from the Swap contract and the interest actually owed on BFSA's related bonds. The risk, for example, in a floating to fixed rate Swap is that the variable rate interest payments will be less than the variable interest payments actually owed on the hedged bonds.

BMA Index – The Bond Market Association Municipal Swap Index. The principal benchmark for short–term, tax–exempt rates. A market basket index of over 200 actively traded, highly rated, non–AMT tax–exempt variable rate issues that reset their rates every Wednesday..

Confirmation – A contractual document executed for a specific Swap transaction and details the specific terms and conditions applicable to that transaction (fixed rate, floating rate index, payment dates, calculation methodology, amortization, maturity date, etc.).

Counterparty – A principal party to a Swap, as opposed to an agent such as a broker. BFSA and a Swap dealer would both be counterparties in a transaction.

Counterparty Risk – The risk that the SWAP counterparty will not fulfill its obligations as specified by the terms of the contract. Under a fixed payer Swap, for example, if the counterparty defaults, BFSA would be exposed to an unhedged variable rate bond position and the additional risk that the counterparty may be unable or fails to make an early termination payment that would compensate BFSA for the value of the lost hedge. One indicator of the creditworthiness of the counterparty is its credit rating.

Credit Support Annex – A contractual document that covers the posting of collateral, if required under the ISDA Schedule that is based on the net mark–to–market values of the cash flows in the Swap.

Forward Starting Swap – An interest rate Swap in which the Swap terms are set at the outset, but the start of the cash flow accruals and exchanges is delayed until some future date.

Hedge – A position taken in order to offset the risk associated with some other position. For example, a floating–to–fixed rate Swap can be a hedge of the interest rate risk of variable rate debt.

Interest Rate Risk – The risk that variable rates will increase or decrease. For example, an increase in interest rates results in an increase in variable rate debt service costs, which could and negatively impact cash flow margins.

Interest Rate Swap – An interest rate Swap is a contract between two parties to exchange cash flows over a predetermined length of time. Cash flows are calculated periodically based on a fixed or variable interest rate against a set "notional" amount (amount used only for calculation of interest payments). Principal is not exchanged.

ISDA – The International Swaps and Derivatives Association, Inc. The global trade association whose members are dealers in the Swap industry. Most Swap transactions are executed under standard documentation created by ISDA.

ISDA Master Agreement – The primary document for the terms and conditions governing the Swap market. The ISDA Master Agreement contains the terms for events of default, termination events, representations and covenants, early termination provisions and payment calculations.

LIBOR – The London InterBank Offered Rate. The rate at which banks will lend eurodollars to each other. The most active dollar–based taxable interest rate benchmark utilized globally.

Maximum Net Termination Exposure. An amount equals the aggregate termination payment for all existing and projected Swap transactions that would be paid by an individual counterparty. For purposes of this calculation, the aggregate termination payment is equal to: (i) the reasonably expected worst–case termination payment under all existing Swaps prior to the execution of any proposed transaction, plus (ii) the reasonably expected worst–case termination payment of the proposed transaction

Notional Amount – The stipulated principal amount for a Swap transaction. There is no transfer of ownership in the principal for a Swap; but there is an exchange in the cash flows for related, designated interest payments.

Swap Rollover Risk – The risk that the term of the Swap contract does not match the term of the related bonds being hedged. Upon the scheduled expiration of the Swap, the interest rate risk will be unhedged unless a new Swap is procured.

Tax Risk – A form of basis risk resulting from changes in marginal income tax rates and other changes in the Federal and state tax systems. Such changes will effect the relative value of tax–exempt debt. As marginal tax rates decline, the after tax value of tax–exempt income declines, which could cause tax–exempt rates to increase. Tax risk exists in all unhedged tax–exempt variable rate debt. Hedging tax–exempt variable rate debt with a LIBOR based Swap leaves an issuer exposed to the tax risk inherent in tax–exempt debt while hedging with a swap based on the BMA index would hedge the tax risk.

Termination Risk – The risk that the Swap could be terminated as a result of any of several events, which may include a ratings downgrade for BFSA or the Swap counterparty, covenant violation by either party, bankruptcy of either party, Swap payment default by either party, and default events under a bond resolution or trust indenture. BFSA could owe a termination payment to the counterparty or receive a termination payment from the counterparty, depending on how interest rates at the time of termination compare with the fixed rate on the Swap.

Schedule to the ISDA Master Agreement – A contractual document that supplements and may modify the terms of the Master Agreement. It also specifies which of a number of particular options available under the Master Agreement the parties have chosen to apply. The terms of the Schedule become part of the Master Agreement and will govern all Swap transactions consummated under the Master Agreement unless the Confirmation for a particular Swap transaction provides otherwise with respect to that Swap.

Swaption – A Swaption is an option on a Swap. The Swaption purchaser has the right to enter a specific Swap for a defined period of time. This option can be exercised on a specific exercise date or on any of a series of exercise dates depending on the specific terms of the Swaption.

Yield Curve – Refers to the graphical or tabular representation of interest rates across different maturities. The presentation often starts with the shortest–term rates and extends towards longer maturities. It reflects the market's views about implied inflation/deflation, liquidity, economic and financial activity, and other market forces.

Type of Risk	Description	Evaluation Methodology
Basis Risk	The mismatch between actual variable rate debt service and variable rate indices used to determine Swap payments.	BFSA should review historical trading differentials between the variable rate bonds and the index.
Amortization Risk	Refers to the cost of servicing debt or making Swap payments due to a mismatch between the principal amount of the bonds and the notional amount of Swap outstanding.	To the extent practicable and consistent with the purpose of the Swap the Swap's notional amount should match the bond amortization.
Tax Risk	The risk created by potential tax events that could affect the relationship between the Swap payments and the associated bond payments.	BFSA should review the tax events in proposed Swap agreements and evaluate the impact of potential changes in tax law on LIBOR indexed Swaps.
Counterparty Risk	The failure of the counterparty to make required payments.	BFSA should monitor exposure levels, ratings thresholds, and collateralization requirements.
Termination Risk	The risk that due to some event or exercise of a right the Swap may terminate or be terminated prior to its scheduled expiration which could result in a termination payment becoming payable by BFSA.	BFSA should compute its termination exposure for all existing and proposed Swaps at market value and under a worst–case scenario.
Swap Rollover Risk	The mismatch of the maturity of the Swap and the maturity of the underlying bonds.	BFSA should determine its capacity to issue variable rate bonds that may be outstanding after the maturity of the Swap.
Liquidity risk	The inability to continue or renew a liquidity facility.	BFSA will evaluate the expected availability of liquidity support for Swapped and unhedged variable rate debt.

Credit risk	The occurrence of an event modifying the credit rating of the issuer or its counterparty.	BFSA will monitor the ratings of its counterparties and insurers.