STATE OF LOUISIANA
INTEREST RATE SWAP POLICY
APPROVED BY THE STATE BOND COMMISSION ON JUNE 15, 2006

I. INTRODUCTION

This interest rate swap policy (the "Swap Policy") is adopted by the Members of the State of Louisiana State Bond Commission ("Commission") on June 15, 2006. The Swap Policy is intended to provide general guidelines regarding the use, procurement and execution of interest rate swaps where the State Bond Commission is the issuer of the debt on behalf of the State. We expect the Commission, where the State Bond Commission is the issuer of the debt on behalf of the State, primarily to utilize interest rate swaps and the use of other financial hedges, such as options, caps, collars and related financial transactions are less likely to be employed. Therefore, the provisions of this Swap Policy are limited to the use of interest rate swaps.

This Swap Policy is intended to govern the use by the Commission, where the State Bond Commission is the issuer of the debt on behalf of the State, of the contractual exchange of different fixed and variable rate payment streams through interest rate swap agreements. No interest rate swap, or, for that matter, any financial hedge, may be executed by the State in connection with debt where the Commission is the issuer of the debt on behalf of the State. The Commission may make exceptions to any provisions of this Swap Policy (but failure to comply in any manner with this Swap Policy shall not result in any liability on the part of the State to any party). The Members of the Commission may hereby delegate the authority to approve the specific procedures supporting this Swap Policy to the Director of the State Bond Commission (the "Director"). In addition to the express terms of this Swap Policy, the Commission shall adhere to applicable governmental accounting treatment of interest rate swaps.

Barron's Financial Guidelines defines an interest rate swap as "an arrangement whereby two parties (called counterparties) enter into an agreement to exchange periodic interest payments." The payments are based on a fixed principal amount called the "notional" amount because no principal is actually exchanged; rather, only interest is exchanged (typically on a net basis). In a standard interest rate swap, one party pays interest calculated on the notional amount at a variable or floating rate which fluctuates periodically (e.g. weekly or monthly) according to a predetermined, published index. The other party normally pays interest at a rate that is fixed for the term of the swap. The swap fixed rate is determined at the time of trade execution by either competitive bidding or negotiation with an interest rate swap dealer(s). The dealers (or "providers"), generally known as "counterparties", who make markets in swaps, are large commercial or investment banks or other financial institutions. Swaps contracts are traded "over the counter" (as opposed to an exchange) and the terms can be customized to incorporate a variety of features and maturities from three months to thirty years or longer. Swaps may include an exchange of a fixed rate and a floating rate, the exchange of two floating rates or the exchange of two fixed rates.

II. SCOPE OF THE POLICY

This Swap Policy applies to any interest rate swap or related transaction, undertaken by the Commission. It is hereby determined to be the policy of the Commission that interest rate swaps, or for that matter, any financial hedge may only be entered into in compliance with the terms set of this policy unless the Commission affirmatively votes otherwise.

III. AUTHORIZATION AND APPROVALS; COMPLIANCE WITH BOND DOCUMENTS

Prior to the Commission entering into any interest rate swap, approval must be obtained from the Commission for the maximum notional amount and the maximum duration of such interest rate swap. Such approval may be accomplished through a specific Commission vote or as part of a bond resolution. The Attorney General's office and Bond Counsel (if, applicable) shall determine whether a proposed interest rate swap complies with all applicable provisions of State law and the State's bond resolutions and agreements with respect to the State's outstanding debt. The State is authorized under La. R.S. 39:1429 to enter into interest rate swaps and other financial hedges.

IV. APPROACH AND OBJECTIVES

Interest rate swaps can be appropriate interest rate management tools that can help meet the State's financial objectives. Properly used, such instruments can increase financial flexibility, provide opportunities for interest rate savings, and help manage the balance sheet through better matching of assets and liabilities. Interest rate swaps should be integrated into the State's overall debt management program and may not be used for speculation.

Interest rate swaps are appropriate when they achieve a specific financial objective consistent with the State's overall debt management program. The Commission may execute an interest rate swap only if the transaction can be reasonably expected to achieve one or more of the following objectives:

- result in a lower cost of borrowing with respect to the State's debt;
- reduce exposure to changes in interest rates or improve asset-liability matching of assets with liabilities; or
- manage credit exposure.

In structuring an interest rate swap, the Commission will also insure that both of the following conditions are met:

- The sizing of any particular interest rate swap will be tied to the then current view of the rating agencies as to the appropriate parameters for entities in the rating category of the State's general obligation bonds; and
- The advice of the State's Financial Advisor will be sought with respect to the terms of the interest rate swap with the goal of maintaining or improving the State's ratings.

V. CONDITIONS FOR THE USE OF INTEREST RATE SWAPS

A. General Usage

The Commission may use interest rate swaps to lock-in a fixed rate or, alternatively, to create additional variable rate exposure. In connection with the use of any interest rate swap or other financial hedge, the Commission, through the Director, shall make a finding that the authorized interest rate swap or other financial hedge will be used to alter interest rate risk and/or alter the cost of borrowing in a beneficial manner, and when used in combination with new or outstanding bonds, will enhance the relationship between risk and return, or achieve other policy objectives of the State.

B. Maximum Notional Amount

The Commission will limit the total notional amount of outstanding interest rate swaps and other financial hedges based on criteria set forth in this Interest Rate Swap Policy regarding the proper management of risks and calculation of termination exposure.

C. Liquidity Considerations

The Commission shall consider the impact of any variable rate bonds issued in combination with an interest rate swap on the availability and cost of liquidity support for other State variable rate programs. The Commission recognizes that there is a limited supply of letter of credit or liquidity facility support for State variable rate bonds, and the usage of liquidity support in connection with an interest rate swap may result in higher overall costs. It is recognized that auction rate bonds do not require liquidity support.

D. Call Option Value Considerations

When considering the relative advantage of an interest rate swap to fixed rate bonds, the Commission will consider the value of the call option on fixed rate bonds. Typically, in connection with debt where the Commission is the issuer of the debt on behalf of the State, the Commission sells bonds that are callable after 10 years and could be refunded at that time in exchange for paying a higher interest rate to investors. Similarly, interest rate swaps may also have a call provision.

VI. PERMITTED INSTRUMENTS

The Commission may utilize any or all of the following financial hedge products consistent with this Interest Rate Swap Policy: interest rate swaps, forward delivery agreements, basis swaps, rate locks, interest rate caps, floors or collars or any other similar or related transaction and futures or contracts providing for payments based on levels of or changes in interest rates, contracts and exchange of cash flows on a series of payments or contracts, including, without limitation, options, puts or calls to hedge payments, rate, spread or similar exposure. Should new financial hedging products become available in the future, not presently contemplated, or if a specific circumstance arises, the Commission may authorize a particular transaction not contemplated hereby when such transaction is consistent with the needs of the State and is permitted under State law. It may be necessary to develop separate policies in conjunction with the use of such new products.

VII. INTEREST RATE SWAP FEATURES

A. Interest Rate Swap Agreement

The Commission will use terms and conditions as set forth in the International Swap and Derivatives Association, Inc. (“ISDA”) Master Agreement. The swap agreement between the State and each counterparty shall include payment, term, security, collateral, default, remedy, termination, and other terms, conditions, provisions and safeguards as the State, in consultation with the Attorney General’s office, Bond Counsel (if applicable) and the Financial Advisor, deems necessary or desirable.

Subject to the provisions contained herein, the terms of any interest rate swap agreement shall use the following guidelines:

i. Downgrade provisions triggering termination shall in no event be worse than those affecting the counterparty.

ii. Governing law for interest rate swaps and other financial hedges will be Louisiana to the extent provided by law; however, the choice of law may be bifurcated for the State and the counterparty.

iii. The specified indebtedness related to credit events in any swap agreement should be narrowly defined and refer only to indebtedness of the State that could have a materially adverse effect on State’s ability to perform its obligations under the swap and have an appropriate lien that considers the lien of the swap obligation.

iv. Collateral thresholds for the swap provider should be set on a sliding scale reflective of credit ratings.

v. Eligible collateral should generally be limited to Treasuries and obligations of Federal Agencies where the principal and interest are guaranteed by the United States and should be valued no less often than weekly. At the discretion of the Commission, and if authorized by Louisiana law, through the Director, with the concurrence of the Financial Advisor, other high-quality obligations of Federal agencies, not secured by the full faith and credit of the U.S. government, may be used as collateral.

vi. The interest rate swap agreement should contain the right for the Commission in connection with debt where the Commission is the issuer of the debt on behalf of the State to optionally terminate a swap agreement at “market,” at any time over the term of the agreement.

vii. Termination value should be set by a “market quotation” methodology, unless the Commission, through the Director, with the concurrence of the Financial Advisor, deems an alternate appropriate.

B. Qualified Interest Rate Swap Counterparties

1. Credit Criteria

The Commission shall enter into interest rate swaps and other financial hedges only with qualified financial hedge counterparties whose: (1) long-term, unsecured and unsubordinated obligations shall be rated not lower than A2 or A by Moody's Investors' Service ("Moody's"), and Standard and Poor's Ratings ("S&P"), respectively, or (2) obligations under the agreement and any credit support annex are unconditionally guaranteed by a bank or non-bank financial institution the long-term, unsecured and unsubordinated obligations of which are rated as described in (1) above at the time of execution of the agreement. In addition, the counterparty must have a demonstrated record of successfully executing interest rate swaps and, if applicable, other types of financial hedges.

The Commission shall structure interest rate swap agreements to protect itself from credit deterioration of counterparties, including the use of credit support annexes or other forms of credit enhancement to secure counterparty performance. Such protection shall include any terms and conditions, which, in the State's sole discretion, are necessary or appropriate or in the State's best interest. The Commission will seek credit enhancement in the form of:

i. Contingent credit support or enhancement;

ii. Collateral consistent with the policies contained herein;

iii. Ratings downgrade triggers;

iv. Guaranty of parent, if any.

In addition, qualified swap counterparties must have a demonstrated record of successfully executing interest rate swap transactions, and, if applicable, other types of financial hedges.

2. Counterparty Termination Exposure

In order to diversify the State's counterparty credit risk and to limit the State's credit exposure to any one counterparty, the State will compute the "Maximum Net Termination Exposure" prior to executing a swap in connection with debt where the Commission is the issuer of the debt on behalf of the State

"Maximum Net Termination Exposure" is the aggregate termination payment for all existing and projected interest rate swap transactions that would be paid by an individual counterparty. For purposes of this calculation, the aggregate termination payment is equal to: (i) the termination payment based on the market value of all existing swaps as of the first day of the month prior to the execution of any proposed transaction, plus (ii) the expected worst-case termination payment of the proposed transaction. The expected worst-case termination payment shall be calculated assuming interest rates, as measured by the Bond Buyer Revenue Bond Index, increase (or decrease) by two standard deviations from the sample mean over the last 10 years.

The following chart provides the Maximum Net Termination Exposure to a swap counterparty given the lowest credit rating.

Credit Rating	Maximum Collateralized Exposure	Maximum Uncollateralized Exposure	Maximum Total Termination Exposure
AAA	Not applicable	$300 million	Not applicable
AA	Not applicable	$200 million	Not applicable
Below AA	Limited/TBD	None	Limited/TBD

C. Term and Notional Amount

The term of the swap agreement shall not extend beyond the final maturity date of the related bonds. The total “net notional amount” of all swaps related to a bond issue should not exceed the amount of outstanding bonds. For purposes of calculating the net notional amount, credit shall be given to any fixed versus variable rate swaps, variable versus variable rate swaps or other strategies that offset for a specific bond transaction.

D. Collateral Requirements

Additional collateral for decreases in credit ratings of each counterparty shall be posted by each counterparty in accordance with the provisions contained in the collateral support agreement to each counterparty with the Commission. Threshold collateral amounts shall be determined on a case-by-case basis. The Commission will determine the reasonable threshold limits for the initial deposit and for increments of collateral posting thereafter. Collateral shall be deposited as mutually agreed upon between the Commission and the counterparty. A list of acceptable securities that may be posted as collateral and the valuation of such collateral will be determined and mutually agreed upon during negotiation of the swap agreement with each swap counterparty. The market value of the collateral shall be determined on a weekly basis. Collateralization of interest rate swaps by the State is not expected to be necessary under conventional terms in the near future.

E. Security and Source of Repayment

To the extent allowed by State law, where the Commission is the issuer of the debt on behalf of the State, the Commission will to the extent allowed by law generally use the same security and source of repayment for interest rate swaps as is used for the bonds that are hedged or carried by the swap, if any, but shall consider the economic costs and benefits of subordinating the State’s payments under the swap and/or termination payment.

VIII. PROHIBITED USE OF INTEREST RATE SWAPS

There are financial risks involved in the use of interest rate swaps and other types of financial hedges. Interest rate swaps shall only be entered into by the State in accordance with this Interest Rate Swap Policy. When used improperly, interest rate swaps or other financial hedges could expose the State to undue or insufficiently compensated risk. The use of interest rate swaps and other types of financial hedges shall be prohibited:

- When the use of interest rate swaps or other types of financial hedges is for *speculative* purposes, such as potential trading gains, rather than for hedging interest rate risk in connection with the State's debt program;
- Where the State does not have sufficient liquidity to terminate an existing interest rate swap or other type of financial hedge at current market values (i.e., excessive leveraging that could impact adversely on the State's cash flow); and
- Where there is insufficient price "transparency" to permit the State or its Financial Advisor to reasonably value the interest rate swap or other type of financial hedge; for example, as a result of unusual embedded structures or terms.

IX. BENEFIT EXPECTATION

The Commission, through the Director, shall consider the array of benefits available from each proposed interest rate swap transaction, including portfolio composition, debt management, mitigation of interest rate risk, lowering the cost of debt service, or expected changes in interest rates, and include an analysis of such benefits in the evaluation of the proposed interest rate swap that is presented to the Commission.

X. IDENTIFICATION AND EVALUATION OF FINANCIAL AND OTHER RISKS

Prior to seeking the Commission's authorization to implement any proposed interest rate swap or other type of financial hedge, the Director, with the assistance of the Financial Advisor, shall undertake an identification and evaluation of the financial benefits and risks involved in the interest rate swap or other transaction and summarize them clearly and concisely for the Commission along with any measures that will be taken to mitigate those risks, recognizing that the significance of the various risks may vary from transaction to transaction. As part of this evaluation, the Director shall compute the Maximum Net Termination Exposure to the proposed swap counterparty. The summary should include an evaluation of the following risks:

- **Market or Interest Rate Risk:** The State's exposure to interest rate fluctuations under the proposed interest rate swap or other type of financial hedge..
- **Tax Risk**: The State's exposure under the proposed interest rate swap or other type of financial hedge to higher interest expense, lower investment earnings, extraordinary payments, termination or other adverse consequences as a result of an actual or anticipated future change in Federal income tax law or policy. As part of the evaluation process, the State will review the tax events in proposed swap agreements and will evaluate the impact of potential changes in tax law on indexed swaps.
- **Termination Payment Risk:** The State's exposure under the proposed interest rate swap or other type of financial hedge to an involuntary termination, including the magnitude of any potential termination payment and the impact of such a payment on the State's liquidity. A computation will be made of termination exposure to the State for all existing and proposed swaps and hedges at market value and under worst case scenarios.
- **Financing or Market Access Risk:** The proposed interest rate swap's or other type of financial hedge's dependence on the successful completion of a future bond issuance.
- **Legal Authority:** Legal authorization of each party to enter into the proposed interest rate swap or financial hedge.
- **Counterparty Credit Risk:** The creditworthiness of the transaction's counterparty(s) and any provisions in the interest rate swap or financial hedge contract that mitigate potential credit risk (e.g., collateral requirements, assignment provisions). The evaluation

will include a monitoring of exposure levels, rating thresholds and collateralization requirements.

- **Credit Ratings Risk:** The estimated potential impact of the proposed interest rate swap or financial hedge on the State's current or future ratings by the nationally recognized credit rating agencies. Continual monitoring of counterparty and/or insurer ratings will be made.
- **Basis Risk:** Quantification of any potential mismatch between the rate on the underlying bonds or investments and the rate on the proposed interest rate swap or financial hedge. As part of the evaluation process, the State will review the historical trading differentials applicable to the proposed interest rate swap.
- **Variable Rate Exposure:** The proposed interest rate swap's or financial hedge's potential for increasing the State's level of variable rate debt beyond the thresholds either adopted by the Commission or recommended by the Director of the State Bond Commission, and, in either case, also sanctioned by the nationally recognized rating agencies which rate the State's general obligation bonds, either through unhedged debt or through forward debt instruments.
- **Tax-Exemption Risk:** Determination of any impact of the proposed interest rate swap or financial hedge on the tax-exempt status of the State's outstanding bonds.
- **Accounting Risk:** Impact of the proposed interest rate swap or financial hedge on the State's financial statements and on the required accounting treatment for the proposed interest rate swap or financial hedge transaction.
- **Administrative Risk:** Operational requirements and estimated incremental additional costs for the State to adequately administer and monitor the proposed interest rate swap or financial hedge.
- **Assumptions Risk:** Any assumptions that the proposed interest rate swap or financial hedge depends on to generate its expected benefits.
- **Rollover Risk:** The mismatch of the maturity of the hedge and the maturity of the underlying bonds. An evaluation will be made as to the capacity to issue bonds that may be outstanding after the maturity of the hedge.
- **Liquidity Risk:** The inability to continue or renew a liquidity facility. An evaluation of the availability of liquidity support for hedged and unhedged variable rate debt will be made.

XI. COUNTERPARTY EXPOSURE LIMITS

The Commission may not enter into an uncollateralized interest rate swap or other type of financial hedge with any counterparty unless the current exposure, as well as the potential exposure provided by the proposed hedge, as marked-to-market with the counterparty, as of the commitment date of the proposed hedge, does not exceed prudent limits as are acceptable to the rating agencies, as determined from time to time by the Director of the State Bond Commission in consultation with the Financial Advisor in conjunction with discussions with the rating agencies. In evaluating counterparty exposure, the Commission will take into account not only current and proposed interest rate swap or other type of financial hedge, but also any relevant investment agreements and other contractual relations.

These limits will be reviewed periodically by the Commission through the Director. If it is determined that the exposure limit for a specific counterparty exceeds, or with the addition of an additional hedge will exceed, a prudent level, the State, in consultation with the Attorney General's office, Bond Counsel (if applicable) and its Financial Advisor, shall explore strategies to mitigate this exposure.

XII. PROCUREMENT OF INTEREST RATE SWAPS AND RELATED TRANSACTIONS

While the Commission has a strong preference for bidding interest rate swaps and other types of financial hedges, the Commission may directly negotiate the procurement of such instruments with one or more counterparties. The benefits of competitively bidding versus direct negotiation will be assessed on a case by case basis. Factors to be considered are whether the proposed hedge is non-proprietary or generally available in the marketplace or if it has customized or specific attributes designed on the State's behalf that would make it difficult or impracticable to competitively bid. For both competitively and negotiated procurements, the execution of any hedge should require an independent review and written analysis by the State's Financial Advisor that concludes that the terms and conditions reflect a fair market value of such Financial Hedge as of the date and time of its execution.

XIII. TERMINATION PROVISIONS

In general, a decision to terminate an interest rate swap or other type of financial hedge should produce a benefit to the State (in connection with debt where the Commission is the issuer of debt) either through the receipt of a payment from termination or, if the termination payment is made by the State, in conjunction with a conversion to a more beneficial debt position by the State, as determined by the Director in consultation with the Financial Advisor. Any payment due from the State to a counterparty to terminate an interest rate swap or financial hedge shall be made from available State monies, subject to State law, subordinate to the debt service payments due on any outstanding State general obligation bonds, and reported to the Commission at its next meeting. Potential termination payments for all interest rate swaps and other financial hedges may be subordinated to debt service payments on the State's outstanding general obligation bonds.

XIV. REPORTING

The Director of the State Bond Commission together with the Financial Advisor will provide a written report to the Commission regarding the status of all interest rate swaps and other types of financial hedges at least on a yearly basis and shall include the following information:

- Highlights of all material changes to interest rate swaps or financial hedges entered into by the State since the last report.
- The estimated mark-to-market value of each of the State's outstanding interest rate swaps or other types of financial hedges.
- For each hedge counterparty, the State shall provide the total notional amount and the remaining term of each hedge. The State will include its non-financial hedge exposure to each counterparty, including investment agreements and any other contractual relations.
- The long-term unsecured and unsubordinated credit rating of each counterparty, guarantor and credit enhancer insuring hedge payments, if any.
- Actual collateral posted by each hedge counterparty, if any, under each agreement and in total by that hedge counterparty.
- Information concerning any default by a counterparty under an interest rate swap or hedge agreement with the State, and the results of the default, including but not limited to the financial impact on the State, if any.
- A summary of any interest rate swaps or other types of financial hedges that were terminated.

- Any other information relating to any interest rate swap or other type of financial hedge prepared for disclosure per the advice of the Attorney General's office, Bond Counsel (if applicable) and/or the Legislative Auditor.

XV. ACCOUNTING TREATMENT

With respect to each interest rate swap or other type of financial hedge, the Commission shall adhere to applicable Governmental Accounting Standards Board (GASB) guidelines for the accounting treatment of interest rate swaps and financial hedges.