



## City of Gainesville Agenda Report

---

**File #:** 2022-599

**Agenda Date:** October 6, 2022

**Department:** Gainesville Regional Utilities

**Title: Resolution Authorizing Amendments to Swap Transactions Between GRU and Wells Fargo Bank, NA and Bank of America, NA**

**Description:** Resolution No. 2022-599: Current financial market conditions have created potential opportunities for GRU to participate in certain financial transactions which can add certainty to future borrowings as well as realize near term savings. This agenda item requests that the City Commission authorize the Mayor, Clerk, Chief Financial Officer, General Manager or their respective designees to execute said transactions subject to certain delegation parameters.

**Explanation:**

In the wake of recent Federal Reserve actions raising the short-term interest rates, some dislocation has taken place between the swap and bond markets. The bond market's yield curve, while inverted in the first year, is generally upward sloping as one moves out the yield curve for longer maturities in time. The 10 year Secured Overnight Financing Rate (SOFR) swap curve, a representation of *future rates* is downward sloping – with rates decreasing the further you move out in maturity.

This difference between the two markets has created some opportunities for GRU that can add both certainty to future borrowings as well as potentially realize savings in the near term. Specifically, the following opportunities could be available.

Swap Amendments: Series 2014 A Wells Fargo and Series 2019 A Bank of America Forward Starting Swaps

GRU currently has two forward starting swaps associated with the Series 2014 A and Series 2019 A fixed rate bonds. These forward starting swaps were entered into during the Pandemic to take advantage of historically low interest rates for the forward market. Under these swaps GRU locked in then-existing (April 2020) swap rates for transactions whose cash flow exchanges would begin at the initial call dates of the bonds – 2024 for the 2014 Series A Bonds and 2029 for the 2019 Series A Bonds.

Under the current financial plan with these forward starting swaps, when the call date for the Series 2014 A and 2019 A bonds approaches, GRU would have two options:

- Terminate the swaps before the cash flow exchanges begin. GRU would make/receive a termination payment based on interest rate movements since the inception of the swaps, and issue new fixed rate debt to refund the outstanding 2014 Series A and 2019 Series A bonds. The termination payment would be incorporated into the transaction, either as a source of funds or a funding requirement.
- Continue the swaps and issue new variable rate debt to refund the outstanding fixed rate 2014 Series A and 2019 Series A bonds. The variable payments would be offset by the swap cash flows, basically transforming the variable rate debt into fixed rate debt.

Currently, as a result of the rising interest rate environment, both of these swaps have significant mark-to-market balances in favor of GRU. Potentially, GRU can monetize the positive valuation of these swaps with the respective counterparties. Specifically, GRU can amend the swaps and receive up-front payments from the respective counterparties.

Under the provisions of the existing swaps, GRU would make a fixed rate payment of 1.054% on the Series 2014 A swap and a fixed rate payment of 1.171% on the Series 2019 A swap. GRU can amend the swaps by agreeing to pay higher fixed rates to the counterparty in exchange for upfront payments of a portion of the current positive mark-to-market valuations of the two swaps. The new rate would be determined at the time of the amendment. Additionally, GRU would be able to lock in the savings on the future refundings at the respective call dates of the two series of bonds. This proposal would allow GRU to retain the option, as the refunding transactions approach, of either:

- Continuing the swap and issuing variable rate debt which is synthetically fixed with the modified swap rate, or
- Terminating the swap, make/receive a termination payment at time of termination and issue fixed rate debt.

With either option, GRU would effectively lock-in the refunding savings for these two series of bonds when the amendment is completed.

#### Interest Rate Lock/Cash-Settled Forward Swap for the 2023 New Money Transaction

As a five system municipal utility, including power generation, GRU is a capital intensive operation. Obtaining funds to acquire, construct and maintain our capital infrastructure requires that we access the capital markets on a regular basis, and historically we do this through a bond transaction every two to three years. GRU's next new money bond issuance is projected for spring of 2023.

As detailed above there is a difference in interest rates between the current market and the swap market that can help GRU manage its future borrowing costs. Specifically,

GRU can enter, in the near term, a forward or delayed-starting cash settled swap. This forward starting swap would allow GRU to set the interest rate today of the planned future 2023 borrowing. Given recent Federal Reserve actions, repeatedly raising interest rates, this forward starting swap would enable GRU to mitigate interest rate risk and provide certainty of the cost of the future borrowing. The mechanics of the forward starting swap are:

- The forward cash settled swap is executed based on current rates and terms.
- The forward cash settled swap is structured to terminate on a pre-determined date (Termination Date) that coincides with the planned 2023 bond transaction.
- As interest rates move over the next several months, the value of the swap will adjust. These interest rate adjustments create value for the forward starting swap. This valuation can be either positive or negative, depending on rate movements.
- When the Termination Date approaches, there will be a flow of funds between GRU and the forward starting swap counterparty. GRU would either make or receive a swap termination payment. If rates rise, GRU would receive a termination payment which would offset higher interest rates when we issue the bonds in 2023. Conversely, if rates fall, GRU would make a termination payment. The termination payment would be incorporated into the 2023 transaction and GRU would benefit from borrowing in a lower interest rate environment. The net effect of this transaction would be to set the interest rate of the 2023 borrowing when we enter into this transaction, effectively reducing future interest rate risk to GRU and our ratepayers.

#### Swap Amendment – Series 2017 B with Goldman Sachs and Citibank

In 2017 GRU issued \$150M in Series 2017 B Bonds. These bonds were a variable rate direct purchase, essentially a bank loan that financed a portion of the acquisition of Deerhaven Renewables. Over time, this \$150M was broken into two pieces between two different banks:

- \$105M with TD Bank (Now called the Series 2020 B Bonds).
- \$45M with Wells Fargo (the Series 2017 B Bonds).

Additionally, to manage variable interest rate risk, GRU entered into fixed-rate swaps for these bonds. The swaps are aligned with the respective series of bonds and the counterparties are:

- \$105M with Goldman Sachs.
- \$45M with Citibank.

Given interest rate movements, the swaps have a positive valuation in favor of GRU and the proposed transaction can extract this value. While complicated, the mechanics of this transaction involve the following:

- Eliminate the planned cash flows between GRU and the counterparties, for a period not to exceed four years from the date of the trade.
- GRU would then receive an upfront payment.
- With this upfront payment, GRU would refund a portion of the 2017 Series B Bonds and/or 2020 Series B Bonds.
- The remaining balance of the 2017 Series B Bonds and 2020 Series B Bonds would be refunded with fixed rate bonds, which are expected to be a direct purchase with a bank.
- GRU will review the specifics of this future direct purchase transaction with the City Commission as this transaction is executed.
- When this amendment terminates, the swap would resume. GRU would issue variable rate refunding bonds whose interest rate remains hedged by the existing interest rate swap agreements.

#### **Strategic Connection:**

Resilient Economy

#### **Fiscal Note:**

Execution of the proposed transactions is subject to the following delegation parameters.

#### Swap Amendments: 2014 A and 2019 A Forward Starting Swaps

The fixed rate payable by the City shall not be more than 2.50% with respect to the Series 2014 A swap with Bank of America and no more than 2.50% with respect to the Series 2019 A swap with Wells Fargo.

The upfront settlement payment to the City as a result of the foregoing change in the interest rates shall be at least \$1,200,000 for the Series 2014 A swap with Bank of America and at least \$5,100,000 for the Series 2019 A swap with Wells Fargo.

The swap amendments shall be entered into by the City with a trade date on or before December 31, 2023.

#### Interest Rate Lock/Cash-Settled Forward Swap for the 2023 New Money Transaction

The notional amount of the Forward Swap shall not exceed \$75,000,000.

The mandatory early termination date of the Forward Swap shall be no later than December 31, 2023 but may be terminated earlier at the option of the City.

The termination value of the swap shall be based on (a) a fixed rate payable by the City under the Forward Swap of not to exceed 6.00% and (b) a floating interest rate based

on the Secured Overnight Financing Rate index or other such comparable index as recommended by the City's Financial Advisor.

The termination payments shall constitute Subordinated Hedging Contract Obligations for purposes of the General Bond Resolution.

The Forward Swap shall be entered into by the City with a trade date on or before September 30, 2023.

Swap Amendment – Series 2017 B with Goldman Sachs and Citibank

The settlement payment to the City, as a result of the 2017 Amendments, shall be at least \$1,300,000 with respect to the Citibank Confirmation and \$2,700,000 with respect to the Goldman Sachs Confirmation.

The notional amount of the swap shall be reduced to zero dollars for a period not to exceed four years from the trade date of the amendment and during such time, except for the settlement payment referenced above, there shall be no recurring payments required to be made by either the City or the applicable swap counterparty.

The amendments shall be entered into by the City with a trade date on or before September 30, 2023.

**Recommendation:**

The City Commission authorize the Mayor, Clerk, Chief Financial Officer, General Manager or their respective designee to negotiate and execute the listed transactions within the prescribed execution parameters, and approve the Resolution.