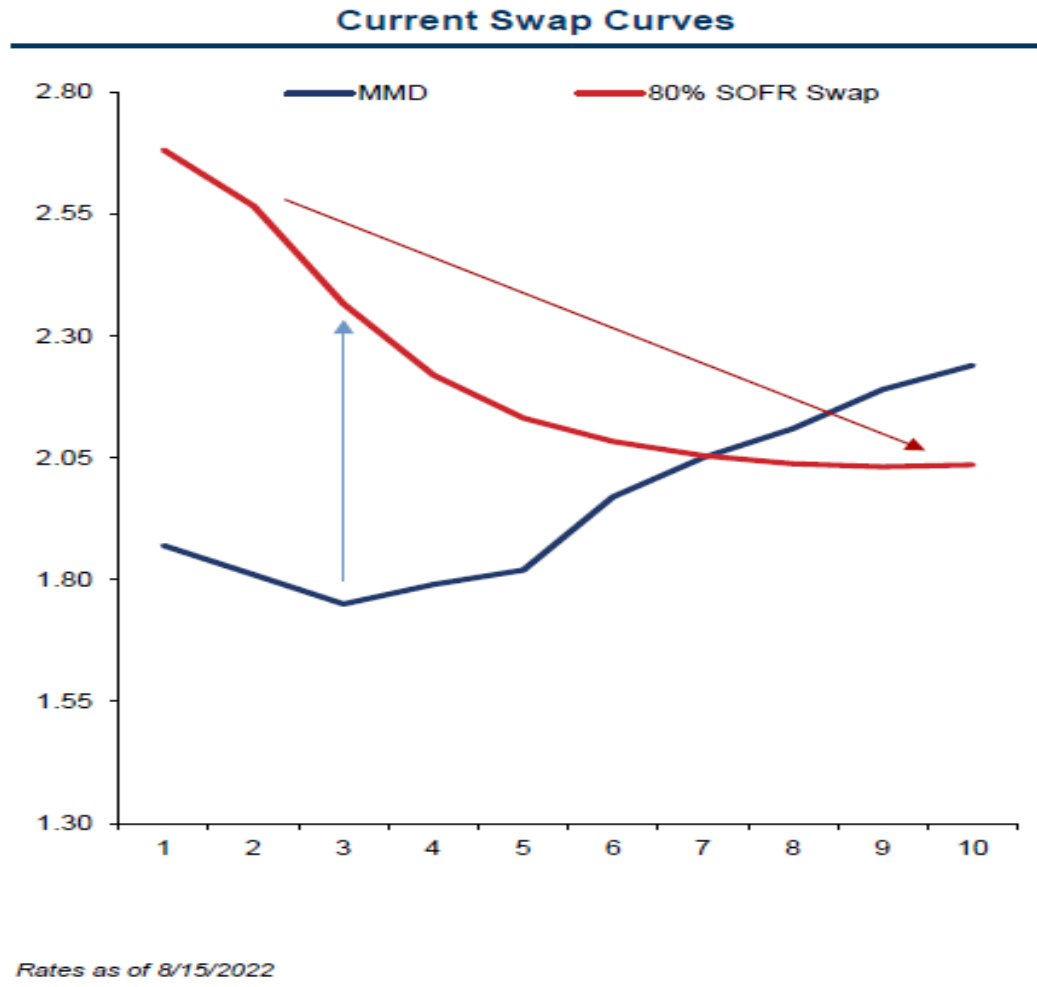


Swap Opportunities

October 6, 2022



Swap Opportunities



- The bond market reflects current interest rates while the swap market reflects the *expectation of future interest rates*.
- Dislocation has occurred recently between these two different markets.
- Bond market generally has an upward sloping yield curve as you move out in time.
- Conversely, the swap market curve is downward sloping - the further you go out in maturity, the rate decreases.
- This creates a **negative** forward premium.
- This displacement between the two markets has created some opportunities for GRU to both
 - Add certainty to future borrowings
 - Potentially realize savings in the near term.

Swap Opportunities

- Swap Amendments: monetizing mark-to-market levels on existing Series 2014 A and Series 2019 A forward starting swaps.
 - Impact: GRU would receive an upfront payment from the counterparties while retaining interest rate certainty for the future refundings of the Series 2014 A and 2019 A Bonds.
- Interest Rate Lock/Cash-Settled Forward Swap associated with a 2023 new money transaction.
 - Impact: GRU would lock-in the interest rate today for next years' bond transaction.
- Swap Amendment – Series 2017 B and Series 2020 B fixed to floating swaps.
 - Impact: GRU would receive an upfront payment and use this to defease debt.



Swap Opportunities

Monetizing Mark-to-Market Levels on Series 2014 A & Series 2019 A Swaps

- The City currently entered into two forward starting swaps related to the Series 2014 A and Series 2019 A fixed rate bonds in 2020..
- With these swaps, the City effectively locked in low interest rates for the future refunding of the Series 2014 A and 2019 A Bonds at those respective call dates (2024 and 2029)
- When the call date of each series approaches, GRU has two options:
 - Terminate the swap, 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 underlying series of bonds.
 - Enter the swap and issue new variable rate debt to refund the outstanding series of bonds so that the swaps effectively hedge this new debt with a fixed rate of interest.
- With these swaps, GRU effectively locked in future refunding savings:
 - 2014 A savings \$12.9M through 2044
 - 2019 A savings \$55.5M through 2047



Swap Opportunities

Monetizing Mark-to-Market Levels on Series 2014 A & Series 2019 A Swaps

- Since we entered into these transactions, interest rates have moved higher.
- This rising interest rate environment has created value in these swaps:
 - Series 2014 A \$ 3.6M*
 - Series 2019 A \$16.9M*
- GRU has the opportunity to monetize this value:
 - Amend the swaps
 - Results in upfront payments to GRU for a portion of the current mark-to-market values
 - Necessitates an increase to the current fixed rate payments the City is making to increase the current fixed rate payments the City is making (1.054% on the 2014 and 1.171% on the 2019)

* Based on current market rates. This will fluctuate until the transaction is executed.



Swap Opportunities

Monetizing Mark-to-Market Levels on Series 2014 A & Series 2019 A Swaps

- The new fixed rate paid by the City would be determined at the time of the amendment
- The City would be able to lock in the savings on the future refundings on the adjusted swap rates at the time of the amendment
- As the call dates of the bonds approach, this transaction would allow the City to retain the two refunding options described earlier.



Swap Opportunities

Interest Rate Lock/Cash-Settled Forward Swap

- As a five system municipal utility operation which includes power generation, GRU is a capital intensive operation.
- Requires that we access capital markets on a regular basis, usually every two to three years.
- Our next new money bond issue is projected for spring of 2023.



Swap Opportunities

Interest Rate Lock/Cash-Settled Forward Swap

- The difference in interest rates between the current market and the swap market can help GRU manage its future borrowing costs.
- 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.



Swap Opportunities

Interest Rate Lock/Cash-Settled Forward Swap Mechanics

- Executed based on current rates and terms.
- Structured to terminate on a pre-determined future 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.
 - Adjustments create value for the forward starting swap.
 - 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.



Swap Opportunities

Interest Rate Lock/Cash-Settled Forward Swap Mechanics (concluded)

- GRU would either make or receive a swap termination payment.
 - If rates rise, GRU would receive a termination payment offsetting higher interest rates.
 - If rates fall, GRU would make a termination payment. This termination payment would be incorporated into the 2023 transaction. 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 Opportunities

Swap Reversal Soft Put – Series 2017 B and Series 2020 B Bonds Swaps

- 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 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).



Swap Opportunities

Swap Reversal Soft Put – Series 2017 B and Series 2020 B Bonds Swaps

- Additionally, to manage variable rate 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.



Swap Opportunities

Swap Reversal Soft Put - Series 2017 B Bonds and Series 2020 B Bonds Swaps

- 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 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 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 swap agreements.



Swap Opportunities

Swap Amendments Series 2014 A and Series 2019 A

Delegation Parameters

- The fixed rate payable by the City shall be no 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 these interest rate changes shall be at least \$1,200,000 with respect to the Series 2014 A swap with Bank of America and at least \$5,100,000 with respect to 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.



Swap Opportunities

Interest Rate Lock/Cash-Settled Forward Swap

Delegation Parameters

- The notional amount of the 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 fixed rate payable by the City under the Forward Swap of not to exceed 6.00%
 - A floating interest rate based on the Secured Overnight Financing Rate index or such other comparable index as recommended by the City's Financial Advisor.



Swap Opportunities

Interest Rate Lock/Cash-Settled Forward Swap Delegation Parameters (concluded)

- 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 Opportunities

Swap Reversal Soft Put – Series 2017 B and Series 2020 B Bonds Swaps Delegation Parameters

- The upfront settlement payment to the City shall be at least \$1,300,000 with respect to the Citibank swap and \$2,700,000 with respect to the Goldman Sachs swap.
- 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 provider.
- The amendments shall be entered into by the City with a trade date on or before September 30, 2023.



Swap Opportunities

Recommendation

- The City Commission authorize the Mayor, Clerk, Chief Financial Officer, General Manager or their respective designee to negotiate and execute the listed transactions, subject to the specified delegation parameters, and approve the Resolution.

