Indianapolis Local Public Improvement Bond Bank

INTEREST RATE SWAP MANAGEMENT POLICY

DRAFT – December 7, 2006

1. Introduction

This Interest Rate Management Policy sets forth the basic criteria and guidelines under which the Indianapolis Local Public Improvement Bond Bank (the "Bond Bank"), as a financing conduit for the City of Indianapolis, Indiana, and other Qualified Entities will enter into various interest rate management and other derivative financial instruments and agreements.

The policy provides for security and payment provisions, and sets forth certain other provisions related to such interest rate management agreements and other derivative financial instruments, including, but not limited to, interest rate swaps, swaptions, caps, collars and floors, incurred in connection with the issuance of bonds, notes and other obligations, between the Bond Bank and qualified counterparties.

2. Authority

The Bond Bank is a body corporate and politic organized under the provisions of Indiana Code 5-1.4 (the "Act"). The Bond Bank, created by the Act and acting under the Trust Indenture (the "Indenture"), is authorized to issue Bonds and/or Notes, and to enter into financial derivative transactions as it deems fit in order to obtain lower costs of capital for Qualified Entities.

The Executive Director shall review this Interest Rate Swap Management Policy on at least an annual basis and recommend any changes to the Board of Directors for their consideration.

3. Purpose

The incurring of obligations by the Bond Bank involves a variety of interest rate payments and other risks that a number of derivative financial instruments are available to offset, hedge, or reduce. It is the policy of the Bond Bank to utilize interest rate swaps and other derivative financial instruments to better manage its assets and liabilities. The Bond Bank intends to execute interest rate swaps if the transaction can be expected to result in one or more of the following:

- Hedging to reduce interest rate exposure on a particular financial transaction.
- Reduction in interest rate risk in order to better manage the Bond Bank's overall asset/liability balance.

- Obtain a lower net cost of borrowing with respect to the Bond Bank's debt.
- Manage variable interest rate exposure consistent with prudent debt practices.
- Manage exposure to changing market conditions in advance of anticipated bond issues (through the use of anticipatory hedging instruments or rate locks).
- Achieve more flexibility in meeting overall financial objectives than could be achieved in conventional markets. For example, entering into a swaption with an upfront payment.
- Produce a specific benefit to the Bond Bank not otherwise available through traditional financing techniques.

The Bond Bank will not enter into financial product agreements for purely speculative purposes. As a result of executing any swap or derivative product transaction, the outstanding bond rating of the Bond Bank at the time of execution should not be impaired nor should the amount of credit enhancement capacity available to the Bond Bank be negatively affected. The Bond Bank will be open to innovative ideas for any proposed transaction as well as variations from these guidelines, provided that such variations shall be fully examined in consultation with the Bond Bank's advisors, and justified to the members of the Board of Directors, and shall be memorialized through a modification or amendment to this Interest Rate Swap Management Policy if necessary.

The Bond Bank must receive an opinion acceptable to the market from nationally recognized bond counsel that the agreement relating to the financial product agreement is a legal, valid and binding obligation of the Bond Bank and entering into the transaction complies with applicable Federal, state and local laws. In addition, the Bond Bank should receive a "fair market" pricing determination either through the use of a competitive bidding process or from the Bond Bank's Swap Advisor. The Bond Bank will consult with the rating agencies in developing a swap or hedged transaction so as not to impair its credit rating at that time as a result of entering into such transaction.

4. Swap Risk Factors

The Bond Bank recognizes that there are certain risks associated with derivative financial products that it will consider prior to entering into each transaction. Such risks include:

1) _Counterparty risk_ is the risk that the counterparty will not fulfill its obligations as specified under the contract. Failure of a counterparty to make required payments could result in an unplanned change in the expected costs of funds of a particular transaction that could increase debt service costs to the Bond Bank depending upon the interest rate environment when this occurred. In order to mitigate this risk, the Bond Bank will enter into interest rate swaps and other derivative financial transactions only with highly rated counterparties, and it will monitor exposure levels, ratings thresholds, and collateralization requirements.

   The Bond Bank will enter into derivative transactions only with qualified swap counterparties rated at least "A", or equivalent by any two of the nationally recognized rating agencies or a "AAA" subsidiary as rated by at least one nationally recognized credit rating agency. The nationally recognized rating agencies are Moody's Investors Services, Inc., Standard and Poor's Rating Services, and Fitch Ratings.

The Bond Bank shall endeavor to diversify its exposure to counterparties. To that end, before entering into a transaction, it will determine how the proposed transaction would affect its exposure. The Bond Bank will consult with its swap advisor in making this determination. The Bond Bank will limit its exposure to any one provider to 65% of its swapped or hedged instruments. For purposes of this Interest Rate Management Policy, any financial product agreement which reduces exposure on any outstanding financial product agreement will be considered an excluded agreement and not subject to the 65% limitation.

2) *Termination risk* is the risk that the transaction could be terminated by the counterparty due to any of several events, which may include issuer or counterparty ratings downgrade, covenant violation by either party, bankruptcy of either party, swap payment default by either party, or events of default under the Trust Indenture. In order to mitigate against these risks, the Bond Bank will consider maintaining strong collateral requirements and other protection measures. The Bond Bank will not enter into financial product agreements where the counterparty has any optional right of termination. The Bond Bank will review the use of swap insurance on any interest rate swap to protect against its own credit deterioration.

   The Bond Bank shall attempt to include in all financial product agreements provisions granting the Bond Bank the right to optionally terminate the transaction at any time over the term of the transaction. The Executive Director shall determine if it is financially advantageous for the Bond Bank to terminate a transaction. The Bond Bank's swap advisors and/or financial advisors will prepare an analysis indicating the costs or benefits.

   Termination Events: A termination payment to or from the Bond Bank may be required in the event of termination of a transaction due to a default or a decrease in credit rating of either the Bond Bank (or in the case of an insured swap, both the swap insurer and the Bond Bank) or the counterparty. The Bond Bank intends to incorporate an Additional Termination Event if the counterparty falls below Baa1 or BBB+ by Moody's and Standard & Poor's, respectively. It is the intent of the Bond Bank not to make a termination payment to a counterparty that does not meet its contractual obligations. Prior to making any such termination payment, the Executive Director shall evaluate whether it is financially advantageous for the Bond Bank to obtain a replacement counterparty or some other available remedy such as collateralizing to avoid making such termination payment.

   As part of any financial product agreement, the Bond Bank may require collateralization or other credit enhancement to secure any or all payment obligations of the counterparty. As appropriate, the Executive Director may require collateral or other credit enhancement to be posted by each counterparty under the following circumstances:

   - Each counterparty to the Bond Bank may be required to post collateral if the credit rating of the counterparty or parent falls at least below the "A" category by both S&P and Moody's.
   - The Bond Bank will determine reasonable collateral threshold levels and for increments of collateral posting thereafter. Additional collateral for further

decreases in credit ratings of each counterparty may be posted by each counterparty in accordance with the provisions contained in the credit support annex to the schedule to the master agreement with the Bond Bank.

- Collateral shall be deposited with a third party trustee, or as mutually agreed upon between the Bond Bank and each 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 agreement with each counterparty.
- The market value of the collateral shall be determined on at least a monthly basis and more frequently if possible.
- The Executive Director shall determine on a case by case basis whether other forms of credit enhancement are more beneficial to the Bond Bank.

3) *Basis risk* refers to a mismatch between the interest rate received from the swap contract and the interest actually owed on the Bond Bank's variable rate bonds in the case of a floating to fixed rate swap or between two indices in the case of a basis swap. Prior to the execution of any interest rate swap, the Bond Bank will undertake an analysis of both the starting basis risk match and the historical basis risk match in order to select an the appropriate level of payments and receipts of the swap or the underlying variable rate debt that most closely approximates or exceeds a zero basis risk profile, while still maintaining the economic advantages of the interest rate swap.

4) *Tax event risk*. All issuers who issue tax-exempt variable rate bonds that trade accept risk stemming from changes in marginal income tax rates– namely, a reduction in the top federal income tax rate could increase the Bond Bank's cost of funds relative to taxable debt. These risks are best mitigated by limiting the amount of variable rate debt as a percentage of the Bond Bank's total debt outstanding and by managing its exposure to payments based on a tax-exempt index such as the BMA Index.

5) *Rollover risk* is the risk that the swap contract is not coterminous with related bonds. The Executive Director shall determine the appropriate term for an interest rate swap agreement on a case-by-case basis. The slope of the swap curve, the marginal change in swap rate from year to year along the swap curve, and the impact that the term of the swap has on the overall exposure of the Bond Bank shall be considered in determining the appropriate term of any swap agreement. In connection with the issuance or carrying of bonds, the term of a swap agreement between the Bond Bank and a qualified swap counterparty shall not extend beyond the final maturity date of existing or anticipated debt of the Bond Bank, or in the case of a refunding transaction, beyond the final maturity date of the refunding bonds.

6) *Amortization risk* represents the cost to the issuer of servicing debt or honoring swap payments due to a mismatch between bonds and the notional amount of swap. The Bond Bank intends to always match the principal amount of bonds with the notional amount of the interest rate swap.

4. Selecting and Procuring Financial Products

A. Financing Team

The Bond Bank will retain the services of all necessary parties including legal, accounting and financial/swap advisors. In connection with an interest rate swap, the financing team will discuss integration for arbitrage purposes and planning.

B. Counterparty Selection

The Bond Bank may use either a competitive or a negotiated process to select a counterparty, whichever is in the best interest of the Bond Bank. To the extent that a negotiated process is used, all counterparties shall meet specific rating and capitalization criteria that will mitigate risk to the Bond Bank.

5. Review and Analysis

In evaluating a particular transaction involving the use of derivative financial products, the Bond Bank shall review long-term implications associated with entering into derivatives, including costs of borrowing, historical interest rate trends, variable rate capacity, credit enhancement capacity, opportunities to refund related debt obligations and other similar considerations.

Proposals submitted by a financial product(s) provider, for consideration by the Bond Bank, shall include a clear analysis which identifies both the potential benefits and risks associated with the proposed transaction. Eligible providers may be required to run additional analyses in light of the existing goals and objectives of the working group and establish the financial product's value in light of the Bond Bank's target benchmarks.

- The Bond Bank's swap advisor will provide independent analysis of the proposed financial product(s) transactions including termination matrices and indexing options, as appropriate.

- The Bond Bank's cost of the transaction and any ongoing costs, such as remarketing and liquidity fees, swap advisors, financial advisors, lawyers and other necessary costs will be included in the cost/benefit evaluations.

- A review of provisions required by bond and/or swap insurance providers and the cost/benefit of those provisions should be included in an evaluation of the transaction.

6. Legal Matters

Each interest rate swap executed by the Bond Bank shall contain terms and conditions as set forth in the International Swaps and Derivatives Association, Inc. ("ISDA") Master Agreement, including any schedules and confirmations. The agreements between the Bond Bank and each qualified swap counterparty relating to derivative financial products shall include payment, term, security, collateral, default, remedy, termination, and other terms, conditions and provisions as the Executive Director or such designee deems necessary or desirable. Subject to the provisions contained herein, the terms of any financial product agreement shall use the following guidelines:

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

2) Governing law will be New York or Indiana. The Bond Bank shall attempt to include provisions relating to the power and authority of the Bond Bank to enter into a Swap to be governed by and construed in accordance with law of the State of Indiana. Preference will be given to language providing that the counterparty will consent to jurisdiction in the United States District Court in the State of Indiana with respect to any suit, action or proceedings of the agreement.

3) The specified indebtedness related to credit events should be narrowly defined and refer only to indebtedness of the Bond Bank that could have a materially adverse effect on Bond Bank's ability to perform its obligations under the transaction. Debt should typically only include obligations within the same lien as the transaction obligation.

4) Collateral thresholds for the counterparty should be set on a sliding scale reflective of credit ratings. Collateral requirements should be established and based upon the credit ratings of the counterparty or its guarantor. The Trustee or an independent third party or the counterparty if so directed should hold collateral.

5) Termination value should be set by "second method" and "market quotation" methodology, unless the Bond Bank deems an alternate appropriate.

6) Events of default of a counterparty shall include the following:

   a) Failure to make payments when due
   b) Breach of agreement
   c) Credit support default
   d) Misrepresentation
   e) Default under specified transaction
   f) Cross default
   g) Bankruptcy

An event of default by the counterparty shall lead to termination of the agreement with the Bond Bank being the non-affected party for purposes of calculating the termination payment owed.

7. Forward Refundings and Synthetic Advance Refundings

The Bond Bank will consider synthetic advance refundings, which produce a meaningful economic benefit and will in no way impair the outstanding bond rating of the Bond Bank.

- The present value savings of the transaction must be quantifiable (based on reasonable expectations) and higher than that which could be achieved through the use of a traditional fixed rate refunding, achieve the target present value savings benchmarks set by the Bond Bank, and/or annual average debt service savings as approved by the Board of the Bond Bank.
- Proposals submitted by firms for consideration by the Bond Bank shall identify and address not only the benefits of the proposed transaction, but should include a balanced review of the impacts for the proposed transaction.
- Additional transaction costs such as bond counsel, trustee, independent auditors, liquidity providers, and swap advisor (when applicable) shall be included in the savings calculations.
- The Bond Bank's swap and financial advisors maybe asked to produce an independent analysis of the implications of paying a forward premium vs. waiting to the current call date of the bonds.

8. Reporting

Any financial product agreement entered into by the Bond Bank under this Interest Rate Management Policy shall be described in the Bond Bank's audit in accordance with applicable accounting standards currently directed by GASB Technical Bulletin No. 2003-1. The disclosure requirements include:

1. Objective of the Derivative
2. Significant Terms
3. Fair Value
4. Associated Debt
5. Risks

This Interest Rate Management Policy shall be reviewed on a no less than annual basis with the Bond Bank's auditor and any necessary changes shall be promptly implemented.