METROPOLITAN WASHINGTON AIRPORTS AUTHORITY
POLICY ON DERIVATIVE FINANCIAL PRODUCTS

AUTHORITY	Metropolitan Washington Airports Authority
PURPOSE	Establish guidelines to be used when considering non-traditional or derivative financial products, including the use, evaluation criteria, procurement and reporting processes by which the Metropolitan Washington Airports Authority (the Authority) may issue such products to finance facilities at the Authority's airports and to refinance outstanding debt obligations. These guidelines govern the issuance of such products (i.e. the incurring of liabilities) to hedge interest rate risk or for other qualified purposes (see "POLICY—Purpose" below); these guidelines do not govern the use of such products in the Authority's investment of funds.
SCOPE	Non-traditional or derivative financial products are products other than traditional long-term fixed rate debt obligations and traditional short-term variable rate products (including variable rate demand obligations, commercial paper and auction rate notes). Such non-traditional financial products include, but are not limited to, "swaps", "swaptions", "municipal warrants" and "caps."
DEFINITIONS	***Interest rate swap*** – contract between the Authority and a counterparty binding both parties to make net payments from one to the other. (The exchange could be fixed rate payments for variable rate payments or variable rate payments for variable rate payments.) ***Swaption*** – contract between the Authority and a counterparty granting one party the right to obligate the other party to enter into a swap contract on and after a certain date in the future. ***Municipal Warrants*** – provides an investor (i.e. the purchaser of the warrants) with the option to require the Authority to issue a specified type of bond at a specified price on and after a future date. ***Interest Rate Cap*** – an option that obligates the seller to pay the Authority the difference between actual floating rates and the strike price when actual rates are greater than the strike price. (The Authority's maximum floating rate obligation is

"capped" at, or limited to, the strike price.)

POLICY

The Authority, pursuant to this Derivatives Policy, may use non-traditional or derivative financial products to finance facilities at the Authority's airport system and to refinance outstanding debt obligations.

Purpose – Derivative products may be used if it is reasonably determined that the proposed transaction is expected to achieve one or more of the following objectives:

- Accomplish a financial objective not otherwise obtainable using traditional financing methods (e.g., synthetic advance refunding of private activity (AMT) bonds)
- Produce interest rate savings, including minimizing the potential negative arbitrage associated with the investment of bond proceeds
- Limit or hedge future interest rate risk
- Alter the pattern of debt service payments
- Provide better asset/liability matching
- Provide greater financial flexibility

Speculation **–** Derivatives shall not be used for speculative purposes outside of prudent risks that are appropriate for the Authority to take.

Legality **–** The Authority must receive an opinion acceptable to the market from a nationally recognized bond counsel firm that the agreement relating to the derivative product is a legal, valid and binding obligation of the Authority and entering into the transaction complies with applicable state and federal laws.

DOCUMENTATION

A. Form of Documentation

To the extent possible, the derivatives entered into by the Authority shall contain the terms and conditions set forth in the International Swap and Derivatives Association, Inc. ("ISDA") Master Agreement, including any schedules and confirmation. The schedule should be modified to reflect specific legal requirements and business terms desired by the Authority. If possible, the Authority should attempt to negotiate the master agreement and schedule with qualified counterparties to facilitate the use of derivatives in situations in which their use is desirable.

B. Terms

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

***Optional Termination* –** The Authority shall consider including a provision that permits it, at its option, to terminate the agreement at the market value of the agreement at any time. In general, the counterparty shall not have the right to optionally terminate an agreement.

***Payment of Termination Amount* –** In the event that the Authority is required to pay a termination amount to the counterparty, such obligation shall be, in general: (a) subordinate to the payment of debt service on outstanding and future bonds; and (b) payable over a reasonable period of time.

Collateral – If the ratings of the counterparty or its guarantor do not meet or fall below the ratings required herein ("ELIGIBLE COUNTERPARTIES – Credit Criteria"), the counterparty would be required to post collateral in an amount sufficient to maintain the required rating levels of the transaction (subject to minimum threshold amounts specified by the Authority). Eligible collateral shall include direct obligations of the United States or any agency thereof. In general, the Authority will not be obligated to post collateral.

Mark-to-market – The market value of the agreement and the collateral, if any, should be determined no less than monthly. Preferably, the collateral, if any, would be marked-to-market no less than weekly.

Events of Default (Counterparty) – Events of default of a counterparty shall be consistent with market standards.

An event of default by the counterparty shall lead to termination of the agreement with the counterparty being the Affected Party for purposes of calculating the termination payment owed.

Events of Default (the Authority***)*** – In general, events of default of the Authority shall be no more extensive than those provided in bond documentation.

EVALUATION OF RISK EXPOSURE AND EXPECTED ECONOMIC BENEFIT

A. Evaluation of Risks

Consideration of the potential economic benefit of using a derivative product requires an evaluation of various associated risks including, but not limited to: counterparty, basis, tax, liquidity renewal, remarketing and termination risks.

For example, in reviewing proposed or possible interest rate swaps, the Authority shall consider at a minimum each of the following types of risks, as applicable:

1. *Counterparty Risk* – The risk that the swap counterparty is not able to meet its obligations under the swap agreement.
2. *Basis Risk* – The risk that the payments that the Authority receives from the counterparty are not sufficient to completely offset the debt service payments on the underlying bonds.
3. *Tax Risk* – The risk that future tax law changes or trading relationships lead to an increase in the ratio of tax-exempt to taxable yields (e.g., the Authority pays a higher interest rate on its underlying bonds while the interest rate it receives from the counterparty remains unchanged). This is a special form of basis risk.
4. *Letter of Credit/Liquidity/Remarketing Risk* – The risk that the Authority cannot secure a cost-effective renewal of a Letter or Line of Credit or suffers a failed auction or remarketing with respect to its underlying variable-rate bonds.
5. *Termination/Market Valuation Risk* – The risk that in the event the swap is terminated prior to maturity, the Authority may owe a make-whole payment to the counterparty that could be substantial.

B. Risk Exposure to Counterparties

The Authority shall endeavor to diversify its exposure to counterparties. To that end, before entering into a transaction, it should determine its exposure to the relevant counterparty or counterparties and determine how the proposed transaction would affect the exposure. The exposure should not be measured solely in terms of notional amount, but should also consider how changes in interest rates would affect the Authority's exposure ("Value at Risk"). The Value at Risk should be based on all outstanding derivative transactions by the Authority.

C. Expected Economic Benefit

Expected levels of savings should be based on conservative assumptions regarding future interest rates and trading relationships, based on historical information as well as a consideration of future probability.

In addition, non-traditional or derivative financial products are generally non-callable. Therefore, one appropriate benchmark for evaluation purposes may be a comparison to non-callable traditional long-term fixed rate bonds.

For refundings using non-traditional financing products, including interest rate swaps, the Authority should use conservative assumptions in the calculation of expected savings and consider higher savings thresholds than for traditional financings to: (a) account for the fact that, in general, non-traditional financing products are non-callable instruments, (b) compensate it for additional risk and additional administrative work and (c) account for the variability of the expected savings.

D. Long-term Implications

In evaluating a particular transaction involving the use of derivatives, the Authority 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.

E. Prior to Execution

Prior to entering into an agreement, the Authority should (a) define a clear objective for its use, (b) acknowledge the existence of the applicable risks, (c) determine if any mitigating strategies may be appropriate and (d) carefully consider the underlying assumptions to be used in determining expected savings.

ELIGIBLE COUNTERPARTIES

Qualified counterparties must have a demonstrated record of successfully executing transactions similar in nature to the transaction contemplated by the Authority. The Authority will require the clear disclosure or identification of the counterparty and guarantor, if any.

A. Credit Criteria

The Authority will make its best efforts to work with qualified counterparties that have, or are guaranteed by a guarantor that has, a long-term senior unsecured credit rating of at least "Aa3" or "AA-" by one of the nationally recognized rating agencies and is not rated lower than "A3" or "A-" by any nationally recognized rating agency.

For counterparties rated below "Aa3/AA-", the Authority will seek credit enhancement such as in the form of collateral consistent with the policies contained herein ("DOCUMENTATION – Terms").

B. Downgrade Trigger

Subsequent to entering into the agreement, if the ratings of the counterparty or guarantor should fall below the minimum credit thresholds established above, the Authority should have the ability to (a) require the posting of additional collateral and/or (b) terminate the agreement at the market.

METHOD OF SOLICITING/ SECURING COUNTERPARTIES

A. Competitive Bids – In general, the Authority should consider competitive bidding when appropriate to ensure efficient execution.

B. Negotiated Bids – The Authority should maintain the ability to award trades on a negotiated basis under a set of pre-defined circumstances such as:

1. Due to the size and/or complexity of a particular trade (including the use of proprietary products)
2. To promote interest on the part of counterparties by rewarding innovative ideas
3. To negotiate specific or customized business terms to be included in the underlying legal documentation ("DOCUMENTATION – Form of Documentation")

C. Matching Bids – In order to achieve certain goals and objectives, the Authority should maintain the ability to allow for Matching Bids (i.e. allowing the second, and sometimes third, place bidders to match the winning bid and securing a portion of the trade). If the Authority determines that this strategy is advantageous, it should establish clear parameters and mechanics in the bid solicitation.

ACCOUNTING TREATMENT AND FINANCIAL STATEMENTS

Prior to execution of an agreement, the Authority will consult with its internal and external auditors to determine the appropriate accounting treatment for the product being considered. The Authority shall reflect such financial product on its financial statements in accordance with generally accepted accounting principles.

DISCLOSURE

Prior to execution of an agreement, the Authority will consult with its Disclosure Counsel to determine the appropriate disclosure strategy consistent with generally acceptable market practice.

MONITORING AND REPORTING

The Authority shall issue a report to its Board at least once per year and as requested by the Board. Such report shall include the following:

1. A summary of key terms of the agreements, including notional amounts, interest rates, maturity and method of procurement.
2. The periodic mark-to-market value of each agreement.
3. The full name, description and credit ratings of each counterparty or the applicable guarantor and any changes over the course of the previous year.
4. The amounts that were required to be paid and received, and any amounts that were actually paid and received (i.e. a review of the system(s) in place to monitor cashflows).
5. 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.
6. The aggregate marked-to-market value for each counterparty and relative exposure compared to other counterparties.
7. Discussion of other risks associated with each transaction.

This Policy shall be reviewed annually and amended as deemed appropriate.