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TFA Monthly Newsletter

February 2019

Hedging Your Risk: Derivative Logic Discusses Interest Rate Risk with TFA

In this month's newsletter, TFA's William Crader, CFA has a conversation with Rex Evans, Managing Director and Founder of Derivative Logic, about the current interest rate environment and insights on understanding the derivatives market and hedging strategies.

WC/TFA: In plain English, what does Derivative Logic do? And, how do they help Tribes?

***Rex/DL*:** In a similar way that TFA helps Tribes access capital efficiently, Derivative Logic provides Tribes transparent and efficient access to the financial derivative markets as they seek to manage interest rate risk. We pride ourselves on our ability to simplify the complex and to provide independent, objective advice to Tribes. It can be complicated and intimidating stuff to many, but we use programs like our Derivatives 101 seminars to educate. The more our clients understand about the opportunities and pitfalls offered by the fixed-income markets, the better we can help them achieve their goals.

WC/TFA: Your 2019 US Interest Rate Outlook provides three scenarios for interest rates this year. The most likely in your opinion is a modest Fed rate hike of 0.25% (range 2.50% - 2.75%) and medium- to long-term rates staying relatively stable, which translates to a "flat" yield curve. Recognizing that each Tribe has its own specific needs and goals, what in general does this mean for hedging strategies during 2019 and beyond?

Rex/DL: We strive to educate our clients to the point where they can appreciate a market opportunity to hedge when it presents itself, and then to have the confidence to act on that opportunity. What we seek to avoid is the Tribe making long-term financial decisions out of fear and misunderstanding, which usually translates into an unsuccessful outcome. That is why education comes first in our advisory process. Given the current interest rate environment, we believe it may be an opportune time to assess hedging long-

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IN THE NEWS

So Far So Good For Nebraska Tribe's Carter Lake IA Casino

1/14/2019 – WorldCasinoDirectory.com

Jamestown S'Klallam Tribe Ready To Break Ground On $40 Million Casino Expansion

1/16/2019 – Indianz.com

Committee Passes Casino Bill In Virginia

1/22/2019 – World CasinoDirectory.com

Bill In Arizona Restricts Sports Betting To Tribal Gaming Facilities

1/24/2019 – Indianz.com

Cherokee Nation Creates Its Own Film Office To Promote Filmmakers, Locations And Tribal Stories

1/25/2019 – TulsaWorld.com

One Size Does Not Fit All

1/27/2019 – GGBMagazine.com

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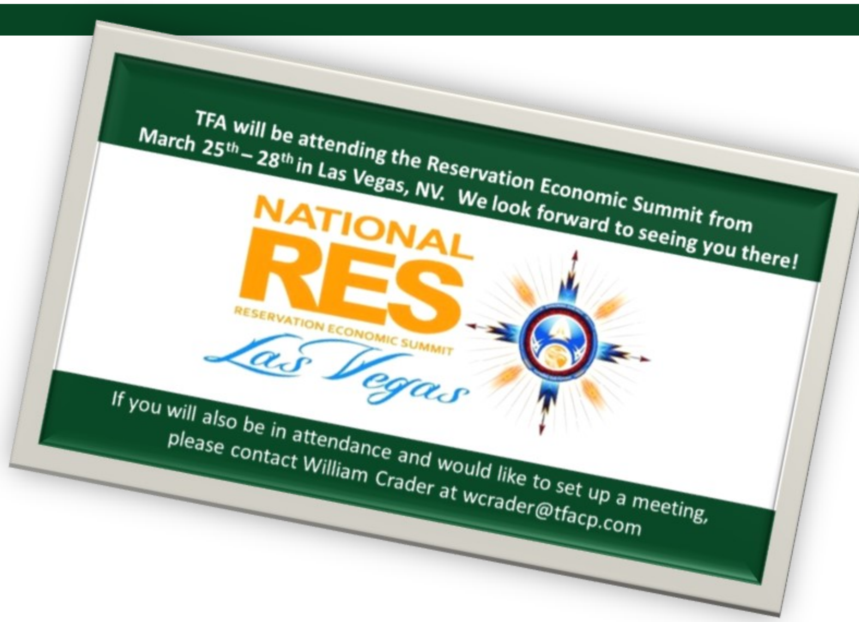
term interest rate risk. There are several cost-effective strategies at present that can be explored to accomplish this.

WC/TFA: Many Tribes with floating rates have been focused on rising short-term interest rates as they have increased significantly in the last few years. That said, compared to historic levels, short-term interest rates are still relatively low. What additional factors should Tribes be incorporating in their strategy to mitigate interest rate risk?

Rex/DL: One obvious strategy is having a focused debt repayment plan in place which not only includes required debt repayment, but also allows for use of excess cash flow to pay down debt. Tribes should have a solid understanding of how rising interest rates could impact the cash flow available for distribution to Tribal governments. This is where implementing a cost-effective hedging strategy can provide a Tribe with protection against changes in interest rates while mitigating the risk of a reduction in cash. Lastly, Tribes should asses their expectations of taking on debt in the future; is there a project under consideration that would increase the Tribe's debt two or three years from now?

WC/TFA: We've all heard that LIBOR - the common floating rate index inherent in most floating rate debt agreements – is set to be replaced in a couple of years. Real quick, should Tribes be concerned?



Rex/DL: Yes, without a doubt. It's probably the most pressing issue facing floating interest rate borrowers, as it could have a grave financial impact on them. All Tribes should be asking themselves: Do we have or are we contemplating taking on floating rate debt indexed to LIBOR? Do we have a firm understanding of what it will mean for our interest expense if LIBOR is replaced by something else? Do we have interest rate hedges (aka swaps) indexed to LIBOR? Will our hedge perform as expected if LIBOR is replaced?

WC/TFA: Last question, ISDA agreements . . . I know this is one of your favorite topics . . . should Tribes assume that ISDAs are non-negotiable?

Rex/DL: Absolutely not! The team at Derivative Logic prides itself on being able to assist Tribes in working through not only the hedging methods themselves, but also the definitive agreements that put them in place, like ISDA agreements. It's similar to how TFA assists Tribes in negotiating key debt agreements.

TFA and Derivative Logic will be attending the upcoming RES, NIGA and NAFOA conferences. We encourage any Tribe that would like a better understanding of hedging strategies to contact us to start a conversation.

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