Joseph P. Bort MetroCenter
101 Eighth Street
Oakland, CA 94607-4700
TEL 510.817.5700
TDD/TTY 510.817.5769
FAX 510.817.7848
E-MAIL info@mtc.ca.gov
WEB www.mtc.ca.gov

Memorandum

TO: BATA Authority

DATE: February 20, 2008

FR: Executive Director

RE: Update on BATA Financing Bond Insurers

The Authority will be updated on recent rating agency actions regarding bond insurers. Staff will be available at that time to respond to questions or comments on the presentation. Attached are the materials that were presented to the BATA Oversight Committee on February 13th.

Brian Mayhew and our banking team have been meeting frequently during the recent market turmoil caused by the sub-prime mortgage issue. They have been evaluating various options to restructure some of BATA's outstanding variable rate debt obligations, which are summarized on the final page of the attached presentation. If market conditions warrant, we may seek Authority approval at your meeting next week to begin to execute one or more of these options to protect BATA's financial interests.

If an action item is necessary for the February 27th Authority meeting, we will distribute a proposed resolution to you prior to the meeting for your review and consideration.

Steve Heminger

SH/pl
J:\COMMITTE\BATA Oversight\2008\b_February_2008\5_BATA Financing_Rev 2.doc

CREDIT UPDATE
February 2008

- **Since the discussions in January**
  - **No change in AMBAC status**
    - **Aaa/AAA/AA (negative outlook from all three credit rating agencies)**
  - **XL has been downgraded to A3 negative outlook (from Aaa)**
    - **Moody's also downgraded three BATA debt series to "SG" (speculative grade) impacting $290 million of BATA variable bonds**
  - **Variable rate bonds have been trading well over tax exempt rates**
    - **Problems with auction rate bonds are related to insurance**
    - **Problems with variable rate bonds are related to issues of industry standard documentation**
- **Further negative rating actions now seem likely**

Portfolio Breakdown

- **Current BATA debt portfolio is $5.4 billion**
- **$2.5 billion fixed rate debt is not impacted**
- **$2.9 billion variable rate debt**
- **The weighted cost of the entire "AA" portfolio is 4.20%**
- **BATA could not deliver the entire $12 billion toll construction program with a debt portfolio of 100% fixed rate with the $4.00 toll structure**

	Principal		Insured
Variable	$2,900	54%	$2,900
Fixed	2,500	46%	972
Total Debt	$5,400		$3,872
Swap-to-Fixed	$2,800	52%	$2,800

Bond Insurance

- The municipal bond insurance model depends on the highest credit ratings (Aaa/AAA/AAA) to assure bondholders of debt payments in the event of government default
- Since December 2007 the "monoline" insurance industry has been on "credit watch" as rating agencies evaluate their "subprime" exposure and "capitalization" models
- BATA utilizes five insurers between toll and BAIFA bonds
- AMBAC and XL combine to insure 87% of the BATA portfolio (including SPANS)

	Bonds	Fixed Rate	Variable Rate	Auction Rate	DSRF	Swap
AMBAC	$2,656	$89	$1,890	$510	$167	$2,200
XL Cap	764	217	290	210	47	
FGIC	491	491				
CIFG	36	36				
Assured	34	34				
Total	$3,981	$867	$2,180	$720	$214	$2,200

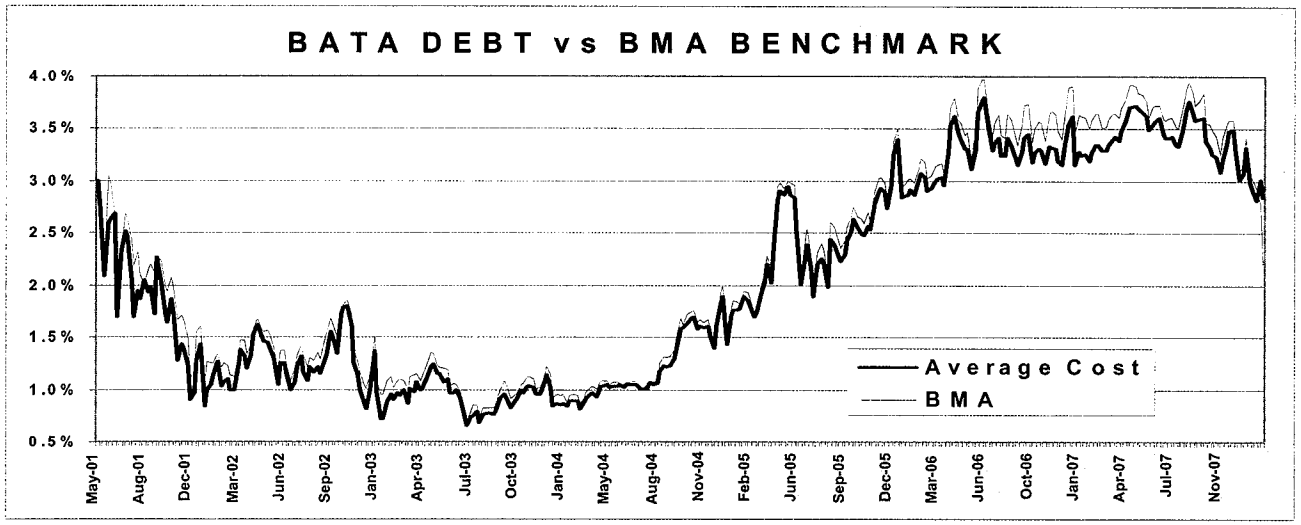
CREDIT ACTIONS

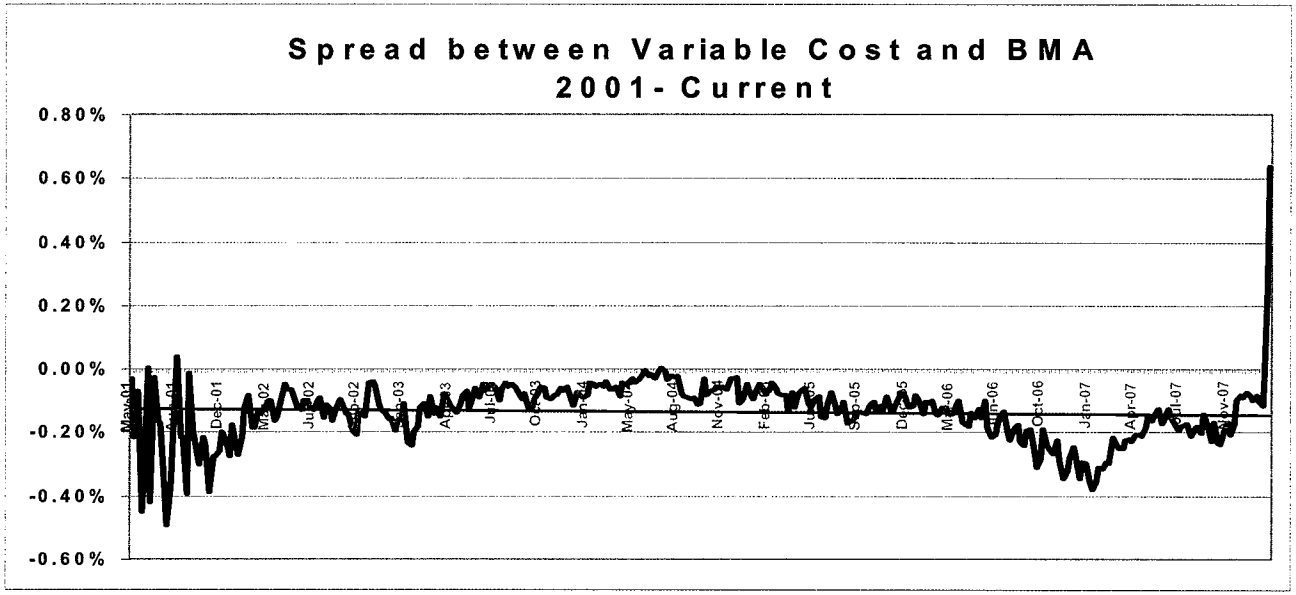
- Rating agencies started evaluating insurer CDO exposure in November 2007
- December 2007, AMBAC AAA "Affirmed/Stable" from Moodys - XL Negative Outlook
- January 2008, first downgrade – AMBAC to AA/negative by Fitch
- February 2008, XL downgraded to A3/Negative by Moody's
- Moody's also cuts short term ratings on XL insured bonds to "SG" (speculative grade)
- Moody's downgraded over 120 issues including BATA (three series), California ERB, EBMUD, LA, MTA NY, SF Airport and San Jose whose bonds are no longer money market eligible
- Moody's downgrade does <u>not</u> impact long term (Aa3) ratings or place issue on "Credit Watch"

	AMBAC (Moody's/S&P/Fitch)	XL	BATA
Nov. 2007	Aaa/AAA/AAA Stable/Stable/Stable	Aaa/AAA/AAA Stable/Stable/Stable	Aa3/AA/AA- Stable/Stable/Stable
Dec. 2007	Aaa/AAA/AAA A-S/Stable/Neg.	Aaa/AAA/AAA Neg./Stable/Neg.	Aa3/AA/AA- Stable/Stable/Stable
Jan. 2008	Aaa/AAA/AA Neg./Neg./Neg.	Aaa/AAA/AA Neg./Neg./Neg.	Aa3/AA/AA- Stable/Stable/Stable
Feb. 2008	Aaa/AAA/AA Neg./Neg./Neg.	A3/AAA/AA Neg./Neg./Neg.	Aa3/AA/AA- Stable*/Stable/Stable *(Speculative Grade)

MARKET IMPACT

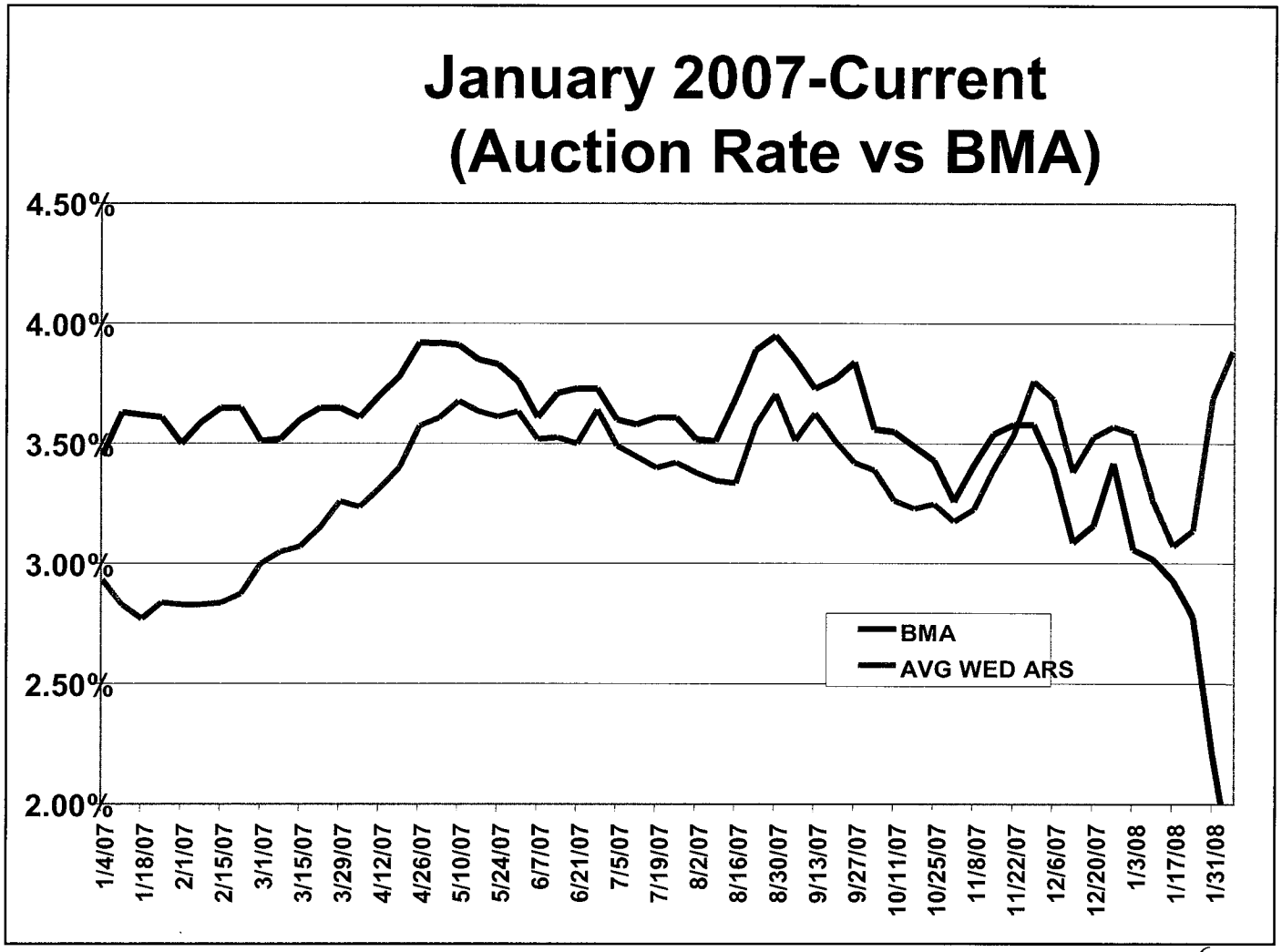
- Insurance was intended to enhance BATA's strong credit
- Over the years BATA has had success actually pricing variable rate debt below the tax exempt variable benchmark
- Insurance has become such a negative factor it now increases BATA's variable rate costs





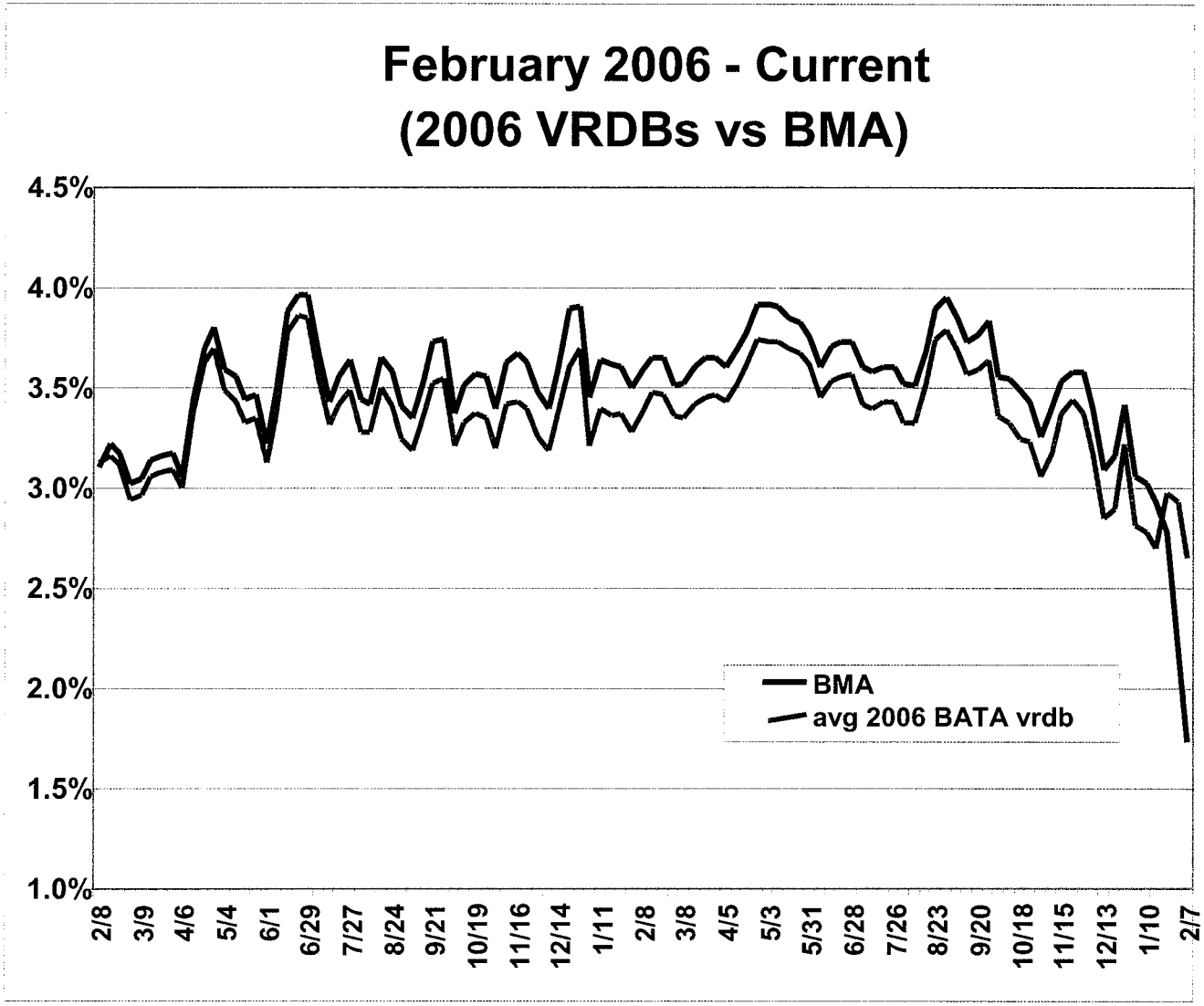
AUCTION RATE BONDS

- Auction rate bonds sell on the credit strength of the underlying credit (BATA) and the AAA strength of the insurance guarantee
- Since December BATA bonds have traded over the equivalent tax exempt rate



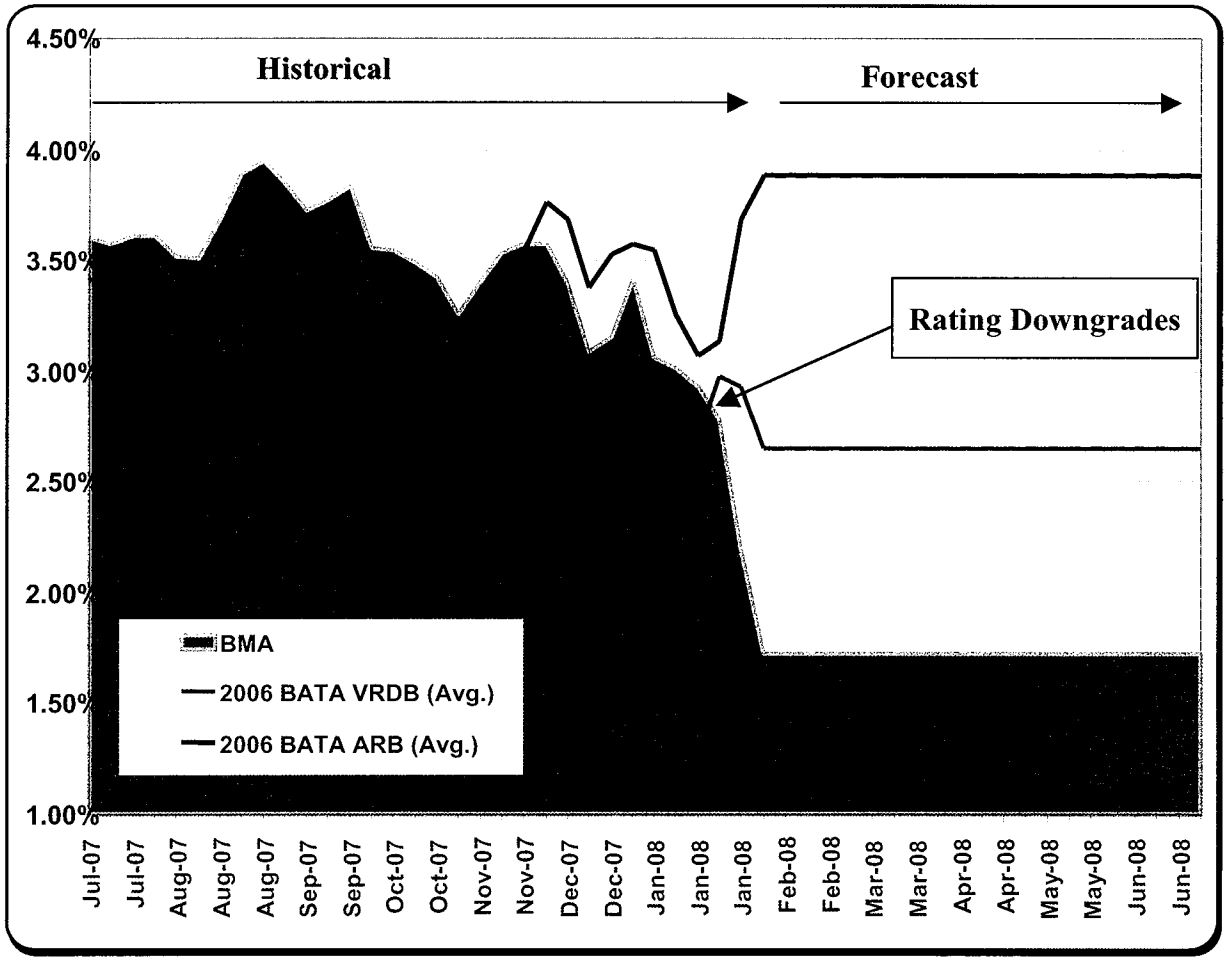
VARIABLE RATE DEMAND BONDS

- Variable rate demand bonds are priced every week and derive their value from the liquidity bank (remarketing agent), underlying credit (BATA) and ultimately the strength of the AAA insurance guarantee
- Downgrades in the insurance market have created serious pricing problems
- The result is interest rates in excess of the tax exempt benchmark



LONG TERM IMPACT

- BATA's strong credit quality has resulted in inexpensive insurance and liquidity rates
- Until the recent insurer issues BATA traded an average of .18% below the tax exempt index ($5.1m)
- Since January 2008 BATA has traded +172% to the BMA index
- If the trend continues BATA's annual debt cost would increase between $10mm and $36mm



FINANCING OPTIONS

- **BATA strong balance sheet has not changed and still has the financial strength and liquidity to consider a number of available financing options to deal with the credit market problem**
  - **Do nothing and hope the market will correct itself**
  - **Correct the standby agreement to remove the issues that caused Moody's to rate parts of the variable rate debt "speculative grade": $290 million**
    - **The cost of new agreements is expected to double the current cost of liquidity ($3.7mm)**
    - **This correction should bring the variable rate bonds closer to BMA levels but will not correct the auction rate bonds**
  - **Refinance the XL based bonds: $500 million**
    - **This action would improve overall market value for XL bonds but still leave us vulnerable if AMBAC slips as quickly**
  - **Refinance all XL based debt and all auction rate bonds: $1 billion**
    - **Still a remaining issue of continuing insurer (AMBAC) downgrades**
  - **Refinance the entire variable portfolio: $3 billion**
    - **The market for high grade / uninsured fixed and variable rate is at very low levels and may make it cost effective to refinance (bonds and swaps) at rates that would be approximate to the existing portfolio**
- **Staff expects to have more detail financial analysis and potential recommendations at the February 27 full BATA meeting**