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Dealing with a Dislocated Municipal Debt Marketplace

How to Survive the Storm

FOLEY & LARDNER LLP

The Current Market Environment

June 4, 2008

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Participants and Background

Presentation Participants

- Foley & Lardner LLP
  - David Bannard
- PFM Group
  - Chris Doyle
- Massachusetts Health & Educational Facilities Authority
  - Danielle Manning
- MassDevelopment
  - Jami Loh
- Fidelity Management and Research
  - Ben Schuler

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PFM Group

The PFM Group ("PFM"), including Public Financial Management, Inc. and PFM Asset Management LLC, was founded in 1975 with a staff of five.

Today PFM is the nation's leading provider of independent financial and investment advisory services with offices throughout the United States. PFM has been the nation's number one ranked financial advisor in the nation for four consecutive years.

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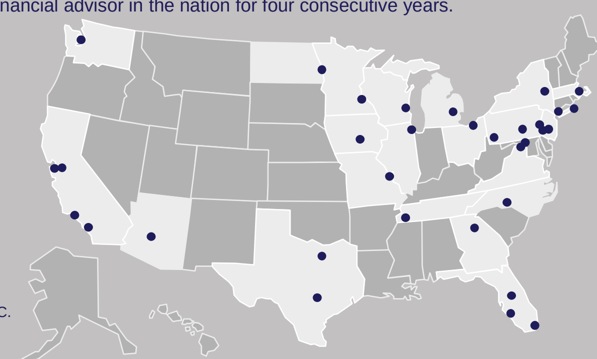

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- Foley is a highly regarded, national law firm providing client-focused, interdisciplinary services that result in high-value legal counsel for our clients.
- Our practice areas encompass the full range of corporate legal services, including corporate governance and compliance, securities, healthcare finance and restructuring, mergers and acquisitions, litigation, labor and employment, intellectual property and IP litigation, and tax. Our attorneys are recognized as insightful thought leaders on these and many other of today's most complex business issues.

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Foley & Lardner LLP (continued)

- Foley's Health Care Finance & Restructuring Practice is comprised of attorneys who have years of experience representing and counseling the public finance, commercial finance, and health care providers in the capital structures and needs of the health care industry. These attorneys understand that one of the primary objectives of the health care borrower or issuer of securities is to borrow money at the lowest cost possible yet with sufficient contractual and regulatory flexibility. We appreciate the challenges facing the health care executive and the institution's financial advisors and investment bankers in the current environment, and we are recognized as a leader in providing comprehensive services to the health care industry. Foley's Health Care Finance team has restructured over $14 billion in municipal auction and variable rate debt since the fall of 2007.

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Overview of Capital Markets:

The Impact of the Housing Crisis, Credit and Liquidity Crunch on Tax-Exempt Borrowing

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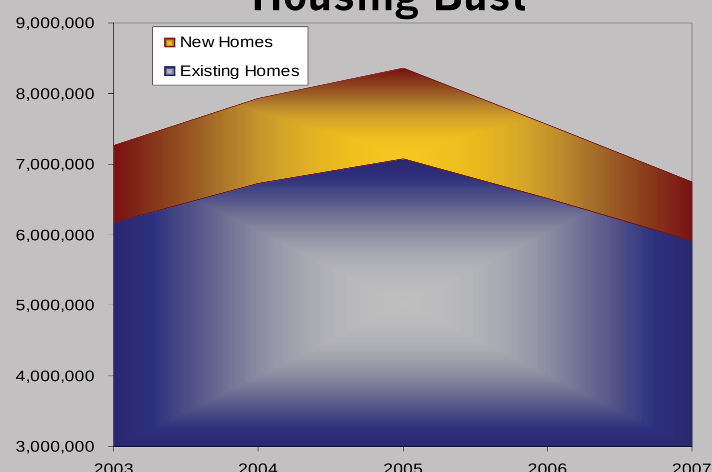
Existing and New Home Sales

Housing Bust

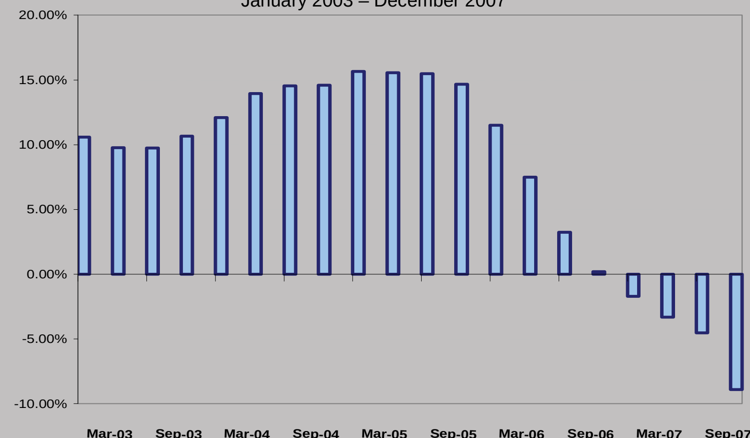


Source: Bloomberg

Housing Bust

Home Values

January 2003 – December 2007



Source: Bloomberg

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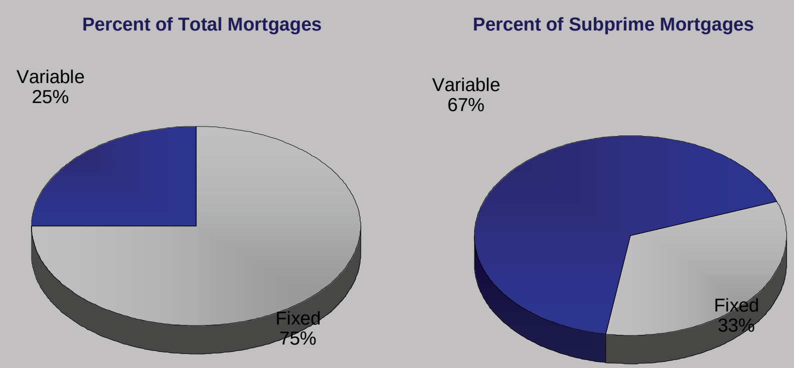
Subprime Lending

- Making loans to borrowers who do not qualify for best market rates because credit history is less than ideal.
  - Benefits – Gives credit to people who would not otherwise not have access to the credit markets
  - Downsides – Can likely lead to default, seizure of collateral and foreclosures

The Subprime Mortgage/ Variable Rate Connection



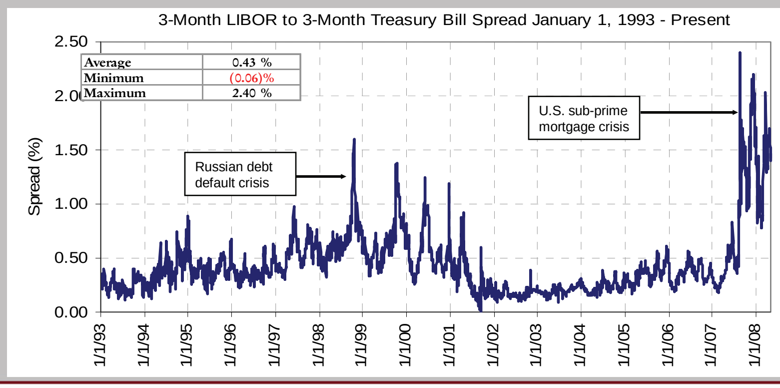
Source: Bloomberg and Bankrate.com

Asset-Backed Securities

- Linked to packages of mortgages – including subprime mortgages
- Pass through Securities – As mortgage payments are made they are passed through to investors
- Defaults in Mortgages causing problems for owners of these securities
  - Cash Flows have essentially dried up
  - SIV are defaulting or near default
  - Causing Financial Institutions to report huge losses

Credit Spreads Widen on Subprime Mortgage Woes

- Yield difference or spread between risk-free (Treasury bills) and risky (LIBOR deposits) assets historically widens during financial stress



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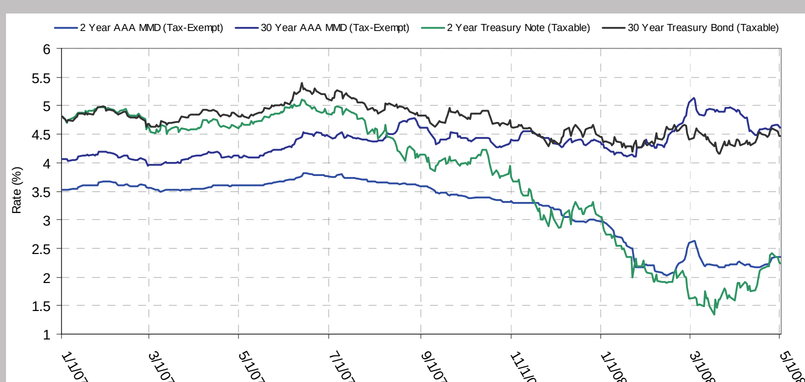

Index	% Rate Change (Jan. 2007 - Present)
2 Year AAA MMD (Tax-Exempt)	(1.17)
30 Year AAA MMD (Tax-Exempt)	0.54
2 Year Treasury Note (Taxable)	(2.57)
30 Year Treasury Bond (Taxable)	(0.35)

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Bond Insurance Turmoil

- Status of Bond Insurers (as of May 12, 2008)
  - FSA and Assured Guaranty are the only AAA insurers with stable ratings from all three agencies

Insurer	Moody's Investor Services	Standard & Poor's Rating Services	Fitch Rating Services
FSA	Aaa / Stable	AAA / Stable	AAA / Stable
Assured Guaranty	Aaa / Stable	AAA / Stable	AAA / Stable
Radian Asset Assurance	Aa3 / Negative	AA / Negative Watch	WD (5/2/08)
MBIA	Aaa / Negative	AAA / Negative	AA / Negative
Ambac	Aaa / Negative	AAA / Negative	AA / Negative
CIFG	Ba2 / Developing Watch	A+ / Negative	CCC / Evolving Watch
FGIC	Baa3 / Negative Watch	BB / Negative	BBB / Negative
XL Capital Assurance	A3 / Negative Watch	A- / Negative Watch	BB / Negative
ACA	Not Rated	CCC / Developing Watch	Not Rated

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Bond Insurance Trading Spreads

- FSA and Assured Guaranty only insurers without material impact on trading value
- Other bond insurers (MBIA, Ambac, FGIC, XL, CIFG, Radian) trading on underlying credit
  - Investors look past bond insurance

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Bond Insurance Market for New Deals

- Insurance premiums higher from FSA and Assured Guaranty
  - Focus on capital charges for the rating agency requirements
- FSA and Assured Guaranty likely to tighten underwriting conditions based on favorable market position
- Berkshire Hathaway just recently entered the market as AAA rated by all three rating agencies.

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Auction Rate Securities

- Long Term Debt with Periodic Interest Rate reset by Auction (typically 7, 28 or 35 days)
- No “put” right for holders – investor options limited to buy, hold or sell (if buyers exist)
- Ineligible for money market funds
- If insufficient buyers, all current holders retain bonds (“failed auction”)
- Most ARS wrapped by insurance

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Variable Rate Demand Obligations

- National long term debt with interest rate reset on periodic basis (typically 1 day, 7 days, monthly or up to 270 days)
- Bond holder has “put” right typically coincident with interest rate reset period.
- Generally backed by letter of credit or liquidity facility (“direct pay” vs. “stand by”)
- In the event of a failed remarketing, become “bank bonds” held by LOC bank

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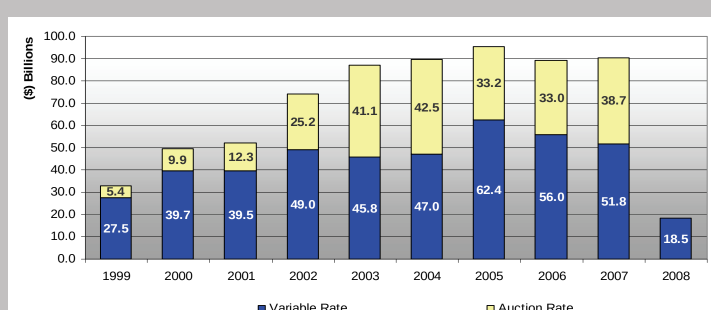
Growth in the Variable Rate Market

- Over 10 years variable rate market doubled -- most growth from ARS
- ARS attractive for borrowers because traded at lower rates than VRDOs and did not require liquidity support

VRDO vs. Auction Rate Issuance



10 Year Total:
Variable Rate
$437.2 Billion
Auction Rate
$241.3 Billion

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Deterioration of the Auction Rate Market

Deterioration of the auction rate market driven by several factors:

- Investor demand for liquidity
  - ARS do not have a put option for investors
  - Investors view ARS as illiquid
  - Turmoil with bond insurers that insure most ARS
- Capital pressure on broker-dealers limit their ability to support auctions

Failed Auctions

- ARS have priced more and more poorly through the fall and winter
  - Pricing changed from below SIFMA to far above SIFMA
- Week of February 11th -- widespread deterioration of auction market
  - Vast majority of ARS with "failed auctions" or auctions with very high rates
- "Failed Auction" is auction without enough orders to place the ARS
  - Failed auction interest rate can be high rate or formula rate (% of a market index), depending on the auction documents

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Future of Auction Rate Securities Market

- Consensus market view is that the auction rate market is defunct
  - Most borrowers refinancing or converting ARS to other instruments (VRDOs, fixed rate bonds, CP, and others)
  - Currently pressure on the traditional fixed rate markets with many institutions refinancing to a traditional fixed rate

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To Date Actions in Auction Rate Market

- As of April 29th, **Siebert Brandford Shank & Co. LLC** reported a total of $76.6 billion auction-rates and variable-rates have announced to be called since Feb. 1, 2008.
  - Tax-exempt auction-rate securities alone account for $54.4 billion through 950 cusips.
  - Tax-exempt variable rates account for $17.6 billion through 368 deals.
- Bloomberg has estimated total ARS market, minus taxables and student loans, at $166 billion on data compiled by **Moody's Investors Service** and **Bank of America**.
  - Based off these estimates, 32.7% of the muni, tax-exempt ARS market has been or is already on the way to be converted.

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Pressure in the Variable Rate Demand Market

- VRDO market has some difficulties too
- **Insured** VRDOs with external liquidity provider
  - Liquidity agreement usually has termination trigger tied to insurer rating
  - Downgrades of insurers cause flight from insured VRDOs.
- Insured VRDOs are trading at wide spreads to SIFMA
- Many examples of failed remarketing of insured VRDOs
- Supply of external liquidity is limited and pricing is increasing significantly.
- Generally VRDOs backed by a **Letter of Credit** (rather than an insurer) have been performing well and as expected

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Subprime Impact to Swap Markets

- Increased focus on counterparty risk as several counterparties have faced downgrades
  - Terms in the Credit Support Annex outline the situation in which swap counterparties must post collateral as credit protection
- In some instances of insured swaps a downgrade to the bond insurer may trigger a collateral event in which Institutions may need to post collateral to swap counterparties depending on the severity of insurer downgrade and provisions in the swap documents

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Potential Actions to Address ARS or Insured VRDOs

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Variables Impacting Restructuring Decision

- Identity of Insurer – Current Rating and Outlook
- Existence of Hedge - Is Swap Termination "Out of Money"?
- Availability of Letter of Credit or Credit Facility
- Provisions of Underlying Documents
- Budget & Cash Flow

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Notes from the Buy Side

- Current Volume Very High – Over 200 CUSIPs per week
- Avoid Unacceptable Remedies or Levels of Risk
- Requirements of Regulation 2(a)(7)
- Concentration, rating and other risks

Current Options to Consider

Options	Economic Implications	Risks	Swap Implications	Tax Implications	Legal Implications
Option 1: Take No Action	High interest rate expense immediately and potentially over the long-term	Problem doesn't self correct over the long-term	Basis risk whereby variable payments do not offset interest expense	None	None
Option 2: Traditional Fixed Rate Refunding	Likely a higher expected cost of funds than with variable rates	Potentially unfavorable fixed rate market at time of pricing	Fixed payer swap would be terminated and fixed-payor swaps are generally out of the money.	Refunding for tax purposes and arbitrage rebate calculation on prior bonds is accelerated	Probably need authorization for refunding
Option 3: Convert to Fixed Rate Bonds	Likely a higher expected cost of funds than with variable rates, preserve value of insurance	Potentially unfavorable fixed rate market at time of pricing	Fixed payer swap would be terminated and fixed-payor swaps are generally out of the money.		Need legal authorization for conversion

Current Options to Consider (continued)

Options	Economic Implications	Risks	Swap Implications	Tax Implications	Legal Implications
Option 4: Convert to VRDO with Letter of Credit (LOC) and Retain Insurer	Immediately improve interest rates as well as preserve potential future value of bond insurance.	-LOC credit risk -LOC renewal risk -LOC and Insurer may not agree on Intercreditor Agreement	Fixed-payer swap transferred to VRDOs	Deemed termination of swap. Because LOC provider is investment grade then probably no reissuance	If Intercreditor agreement, then insurer and LOC provider need to agree to how control rights are shared
Option 5: Convert to VRDO with Letter of Credit (LOC), without Insurance	Immediately improve interest rates, lose benefit of insurance	-LOC credit risk. -LOC renewal risk	Fixed payer swap could act as interest rate hedge for VRDOs (if swap was insured may need to change swap security)	Deemed termination of swap. Rebate calculation accelerated for prior bonds. Reissuance considerations depending on credit rating of LOC provider.	Insurer may ask issuer or conduit borrower for indemnity and opinion from legal counsel that documents permit the Insurer to be removed. If swap insured, Insurer may attempt to remove swap insurance.
Option 6: Temporary Term (e.g. 1 year)	Lower interest rate; put right and refinance risk	Ability to refinance after term	Likely mismatch with swap rate	Probably not a reissuance	Requires ability to set term under documents; security issues; inability to accelerate

Current Options to Consider (continued)

Options	Economic Implications	Risks	Swap Implications	Tax Implications	Legal Implications
Option 7: Bid on own ARS (at auction)	Immediately out of pocket to buy ARS	Bonds may be deemed retired; market manipulation claims	Depending whether bonds retired	See IRS Notices 2008-27 & 2008-41	Disclosure to market key issue – see 3/14/08 SEC letter
Option 8: Enter into a Trust	Immediately improves interest rates, preserve potential future value of bond insurance.	-Not viable as long-term solution, 3-5 year time horizon. -LOC credit risk	Fixed payer swap can be applied to newly issued bonds. Preserves swap insurance	Whether the Trust is a pure pass through vehicle not creating any tax implications to the Trust or the purchasers of the units in the Trust.	Insurer and LOC provider may need to negotiate control rights.

Disclosure Issues

- Downgrade of Insurer – Event Disclosure
- Issuer or Borrower bidding on own ARS
- Remarketing vs. Refunding – secondary vs. primary market disclosure
- Potential Impairment of Assets; calculation of "fair value" of investments when market is illiquid

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Questions ??

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