

American Association of Ports Authorities

Current State of Port Financing Alternatives

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Presentation Topics

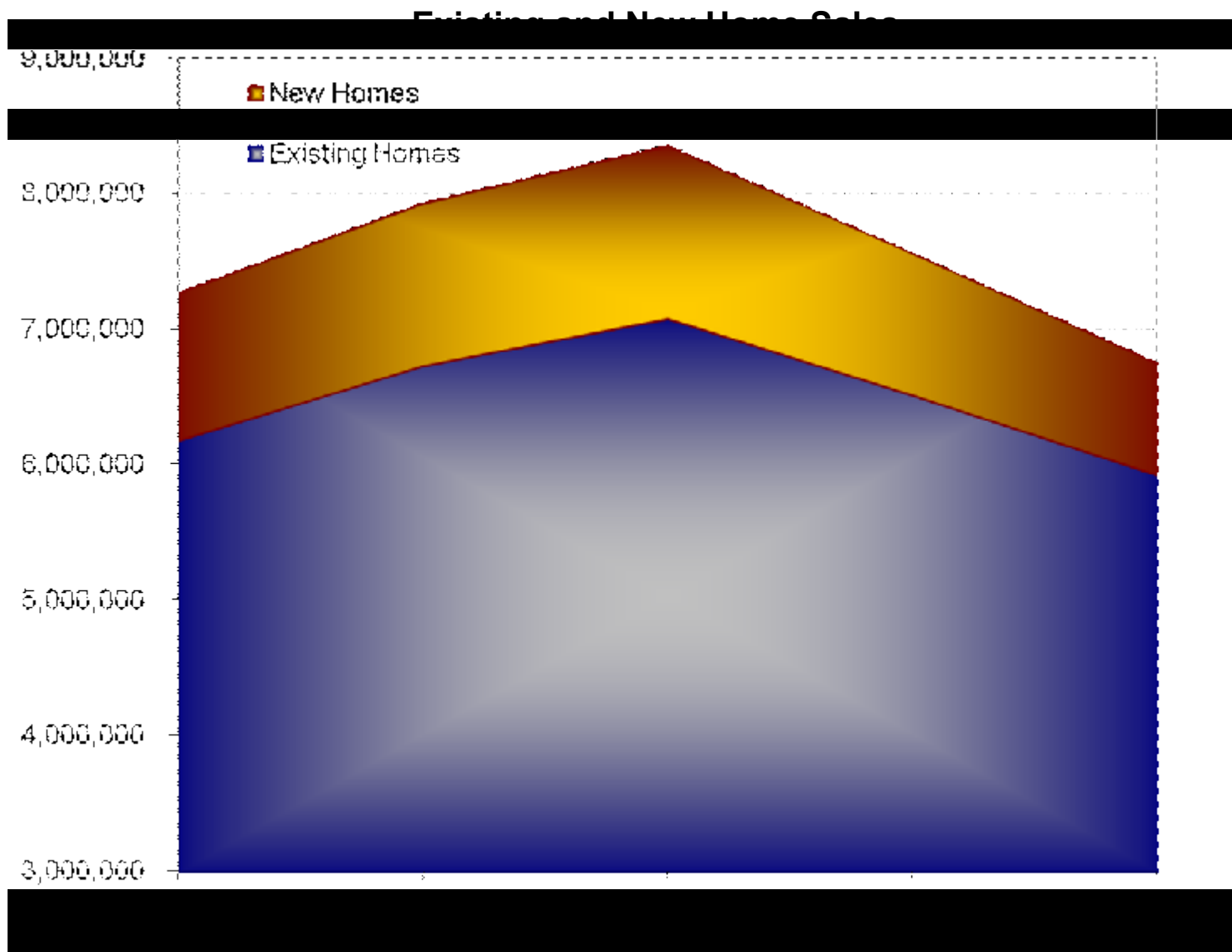
- Overview of Current Conditions in the Muni Market
- Impact of Credit Crisis on Tax-Exempt Borrowers
- Overview of Current Conditions in the Bank/P3 Markets
- Impact of Credit Crisis on P3 Transactions

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 have access to the credit markets
 - Downsides – Can likely lead to default, seizure of collateral and foreclosures



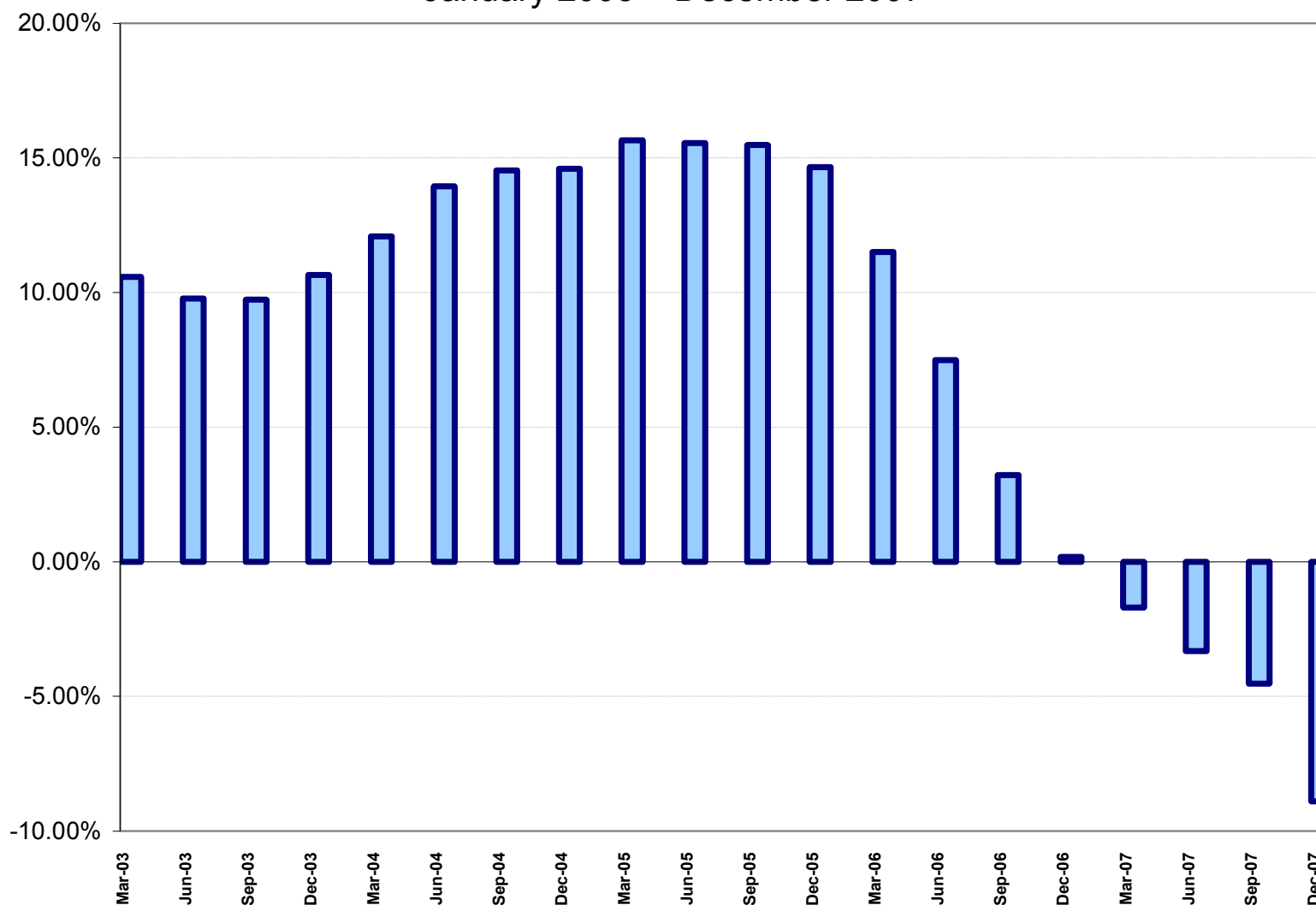
Housing Bust



Source: Bloomberg

Housing Bust

Home Values
January 2003 – December 2007



Source: Bloomberg

Credit Market Update

1. Consumers finance acquisition of real estate, auto, etc. by debt (mostly subprime, ALT/A, No Doc/Low Doc, etc.)

2. This paper is originated by brokers, mid/small/micro-cap banks, thrifts and others

3. This paper is sold primarily to 25 or so of the largest U.S. banks. Some selling banks rely on proceeds as a source of primary liquidity, some do not

4. The large banks bundled and “tranching” these assets into securities tailor-made and sold primarily to the hedge fund universe of buyers. Big banks rely on proceeds as primary sources of liquidity

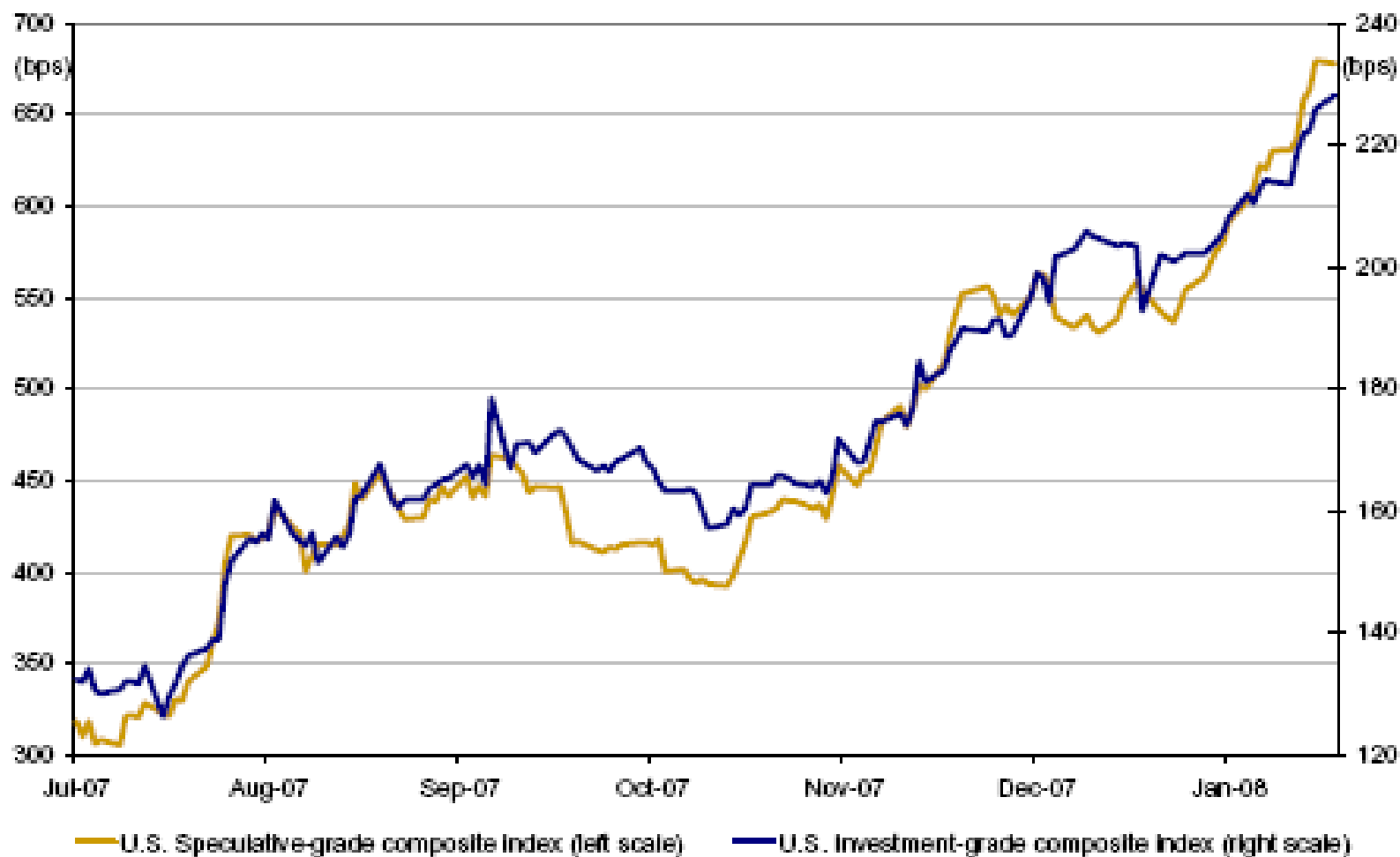
5. Hedge funds sell to limited partner interests to investors

6. Large banks and brokers also provide liquidity lines of credit to hedge funds on a margin or repo basis

- ◆ *Prices Decline*
- ◆ *Liquidity & Profits dry Up*
- ◆ *Exposure to falling asset prices*
- ◆ *Credit Freezes Up; Borrowing costs higher & terms “tighter”*
- ◆ *Less liquidity and leverage leads to further declines in asset values*
- ◆ *Downward de-leveraging spiral*

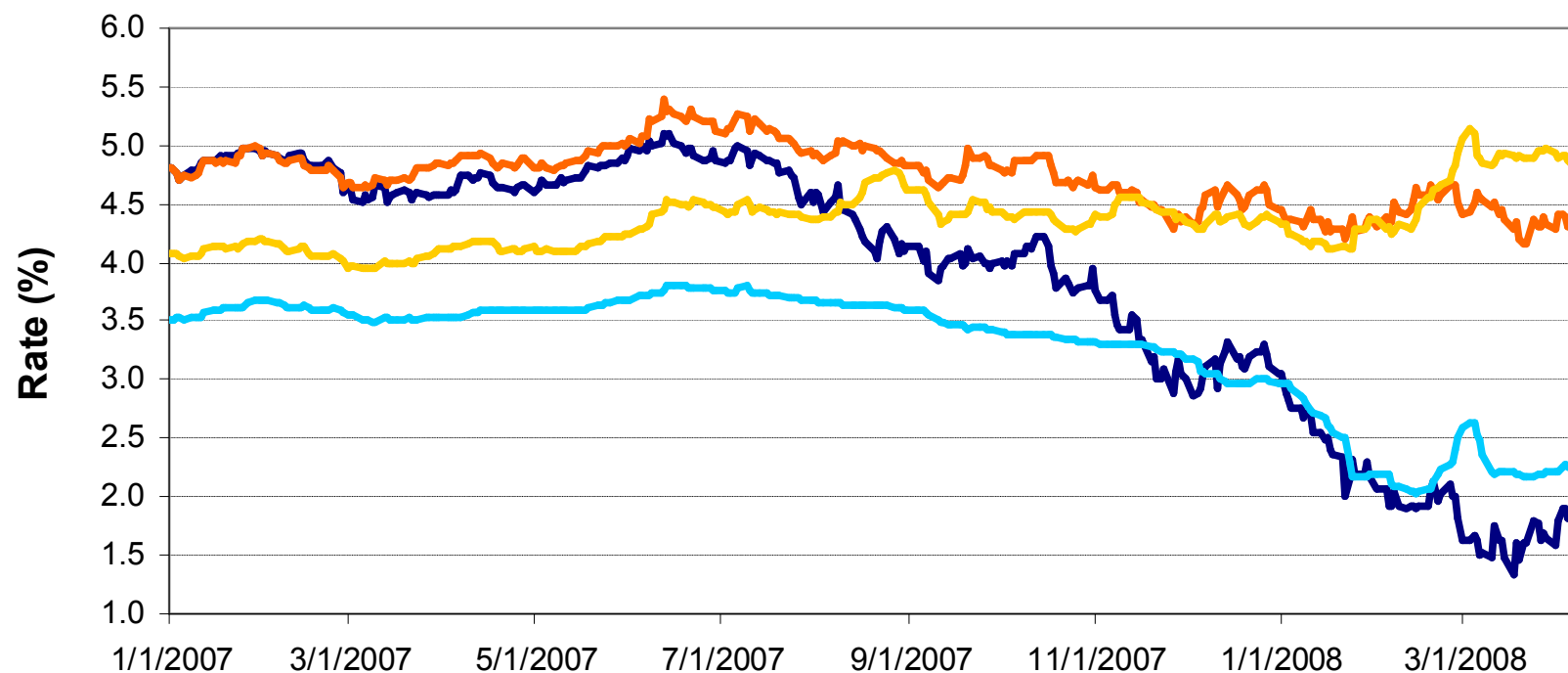
Muni Debt Market Update

Credit spreads are up, without regard to credit risk



Flight-to-Quality in U.S. Bond Market

Rate Changes (January 2007 - Present)



— 2-yr Treasury
— 30-yr Treasury

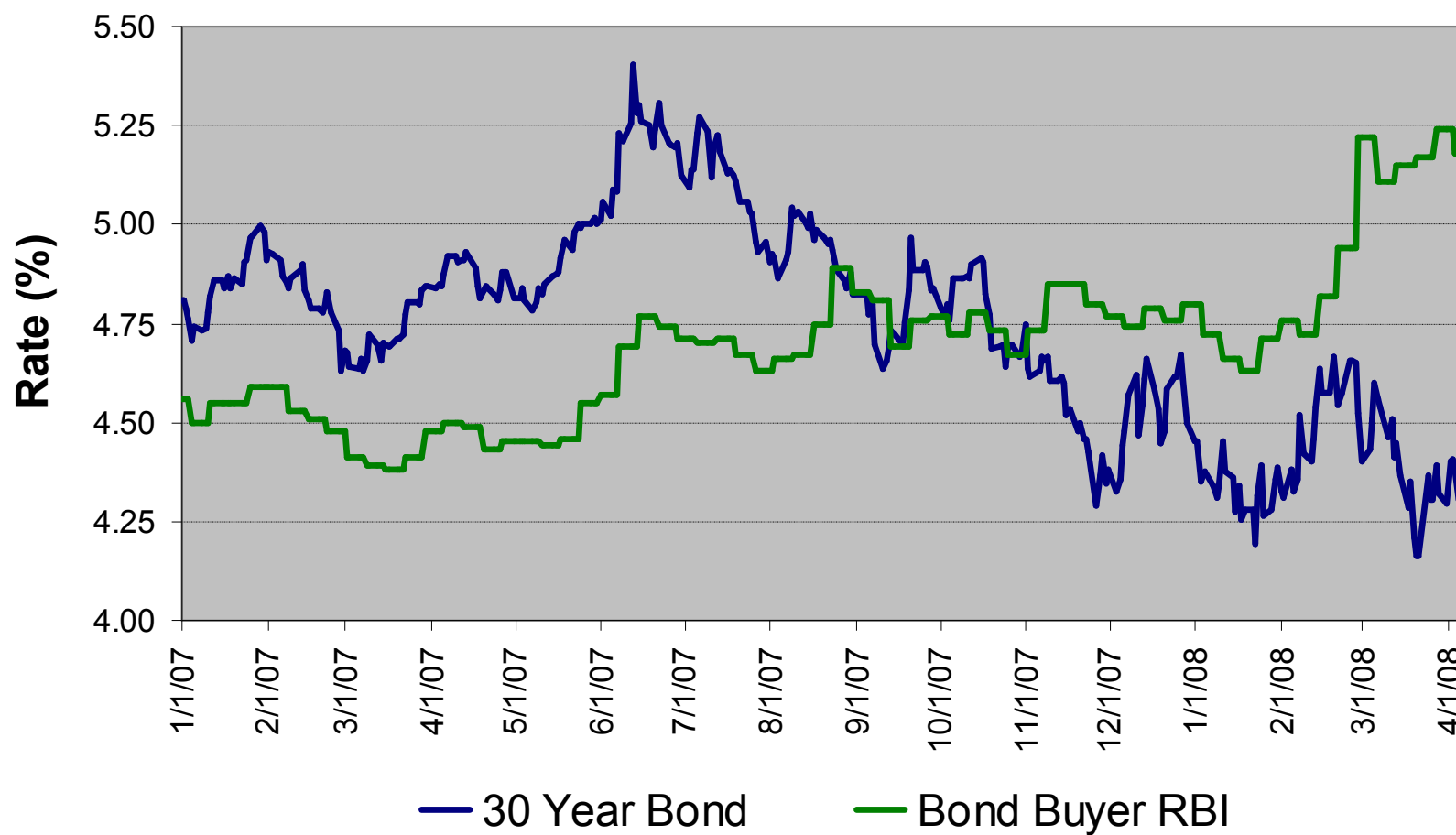
— 2-yr MMD
— 30-yr MMD

Change in Yields since January 1, 2007

2-yr Treasury	(299) bps
2-yr MMD	(130) bps
30-yr Treasury	(43) bps
30-yr MMD	63 bps

Flight-to-Quality in U.S. Bond Market

30 year TSY vs. Bond Buyer RBI



Bond Insurance Turmoil

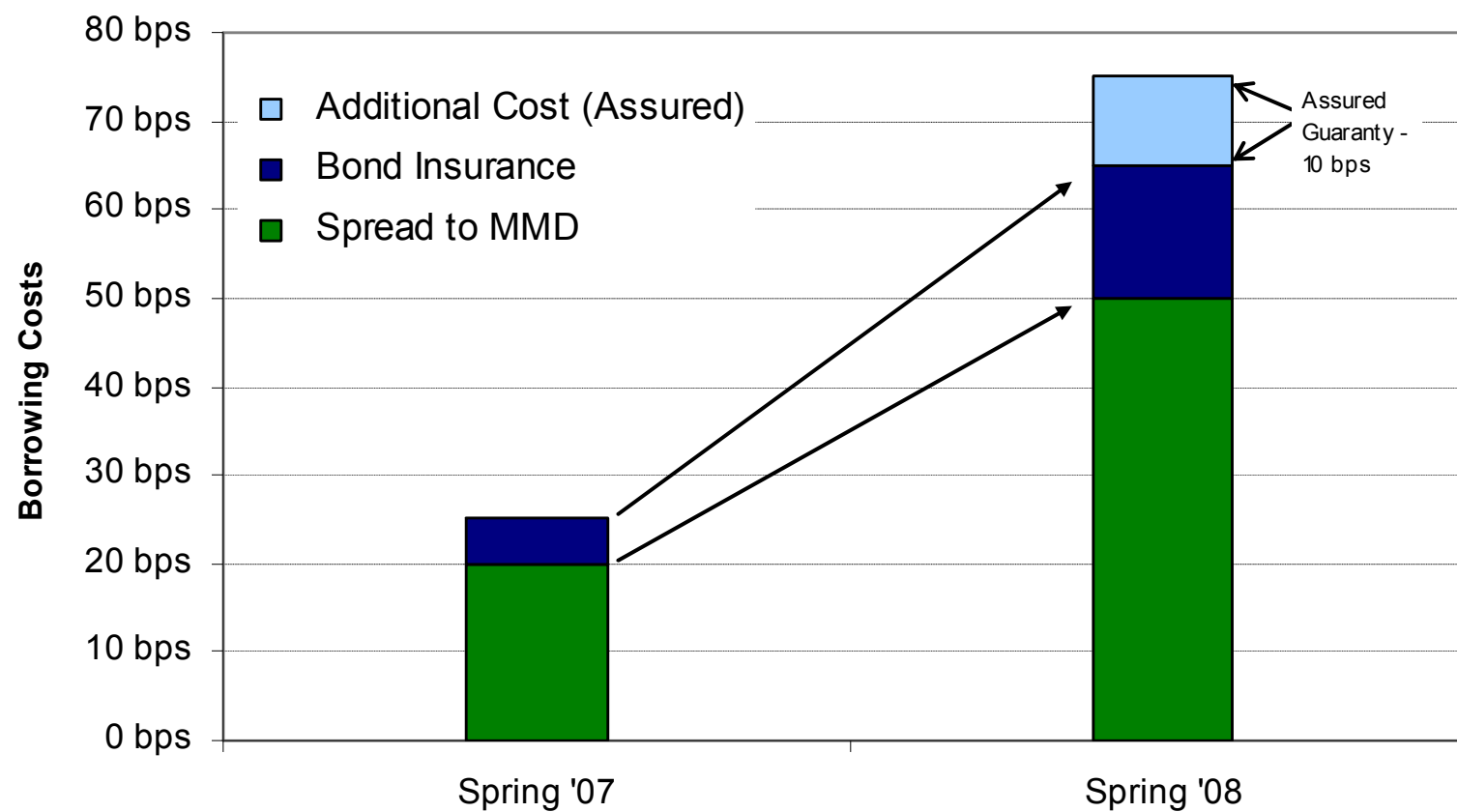
- Bond insurers – the same ones insuring muni bonds – insured much of the mortgage backed financial securities
- FSA and Assured Guaranty are the only AAA insurers with stable ratings from all three agencies

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
MBIA	Aaa / Negative	AA / Negative	AA / Negative
CIFG	Ba2 / Watch Developing	A+ / Negative	CCC / Evolving Watch
Ambac	Aaa / Negative	AA / Negative	AA / Negative
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

Bond Insurance Market

- FSA and Assured Guaranty only insurers without material impact on trading value
- Other bond insurers (MBIA, Ambac, FGIC, XL, CIFG, Radian) are trading on underlying credit of the Issuer.
 - Investors look past bond insurance in a credit review
- Insurance premiums are higher from FSA and Assured Guaranty than in the past.
 - Focus on capital charges for the rating agency requirements.
- FSA and Assured Guaranty will likely tighten underwriting conditions based on favorable market position.

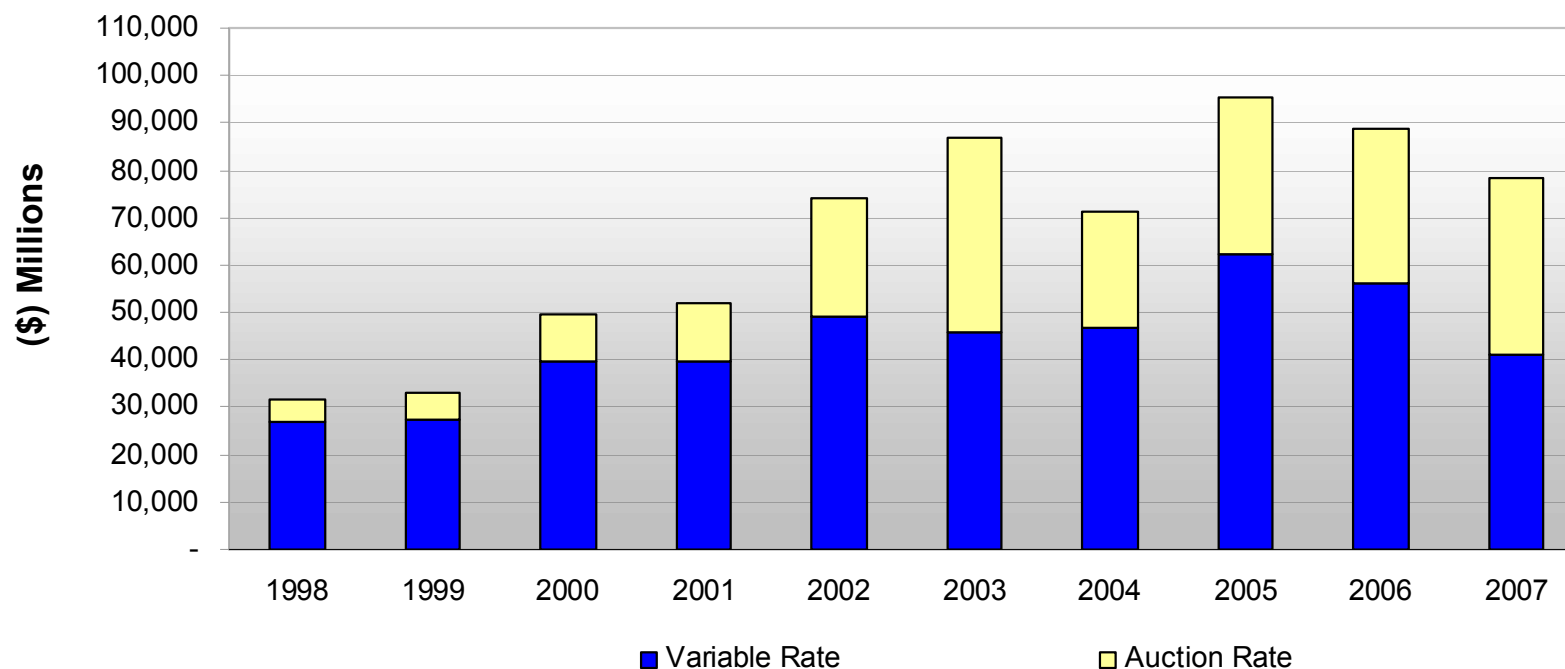
Bond Insurance Market for New Deals



Growth in the Variable Rate Market

- Over the past 10 years, the variable rate market doubled -- most of the growth from Auction Rate Securities (ARS)
- ARS were attractive for borrowers because they traded at lower rates than VRDO's and did not require liquidity support

VRDO vs. Auction Rate Issuance



Meltdown of the Auction Rate Market

- Meltdown of the auction rate market was driven by several factors
 - 1) Investor demand for liquidity
 - ARS do not have a put option for investors
 - Investors view ARS as illiquid
 - 2) Turmoil with bond insurers that insure most ARS
 - 3) Capital pressure on broker-dealers limit their ability to support auctions

Failed Auctions

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

ARS Conversion Options

Option	Description	Considerations	
		Bond Market	
		Advantages	Disadvantages
1.	Do nothing	<ul style="list-style-type: none"> Potential for return to normalized auction market without costs of conversion or refunding 	<ul style="list-style-type: none"> Higher current interest rates than other alternatives Near-term risk of failed auction due to either liquidity or insurer -related concerns Uncertain future letter of credit and insurance/liquidity facility costs upon potential future conversion or refunding
2.	Replace insurance and stay in auction mode	<ul style="list-style-type: none"> Reduce near-term volatility in setting auction rates Potential for return to normalized auction market 	<ul style="list-style-type: none"> Uncertainty about potential investors and the applicable interest rate Does not address illiquidity concerns Cost of new insurance would be "out of pocket" for the issuer if even able to obtain Only FSA and Assured Guaranty are viewed as considered "safe"
3.	Refund/convert to VRDOs	<ul style="list-style-type: none"> Eliminates illiquidity risk associated with auction reset securities Taps into broadest variable rate municipal market 	<ul style="list-style-type: none"> Additional costs (legal, consulting, etc.) associated with refunding/conversion Letter of credit will require renewal over the life of the transaction (will include evergreen provision to help minimize this risk)
4.	Refund with fixed rate bonds	<ul style="list-style-type: none"> Eliminates interest rate risk associated with variable rate obligations and renewal risk associated with letter of credit 	<ul style="list-style-type: none"> Additional costs (underwriting, legal, consulting, etc.) for refunding issue Requires a new bond insurance policy or could be sold uninsured Fixed interest rate for uninsured debt will be relatively high and eliminate savings expected from initial transaction

Future of Auction Rate Securities Market

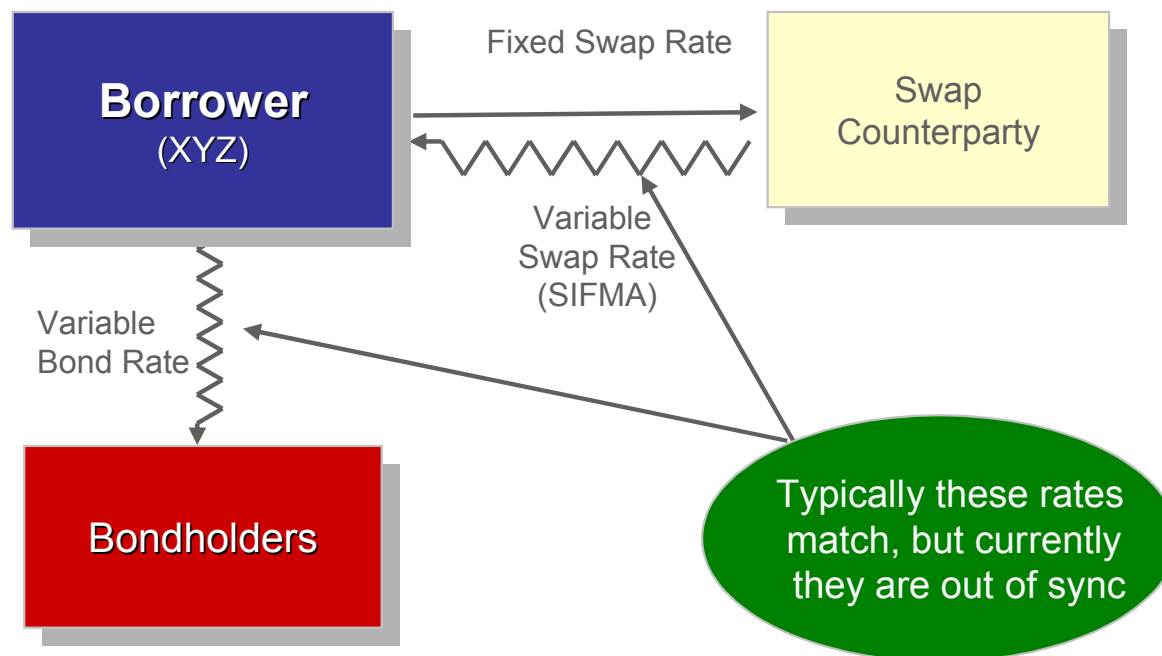
- Consensus market view is that the auction rate market is defunct
 - Most borrowers refinancing or converting ARS to other instruments, in particular to fixed put and VRDBs
 - Currently pressure on the traditional fixed rate markets with many institutions refinancing to a traditional fixed rate
 - See Prior Discussion of:
 - Higher Tax-Exempt Rates
 - Higher Insurance Costs

Pressure in the Variable Rate Demand Market

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

Subprime Impact to Swap Markets

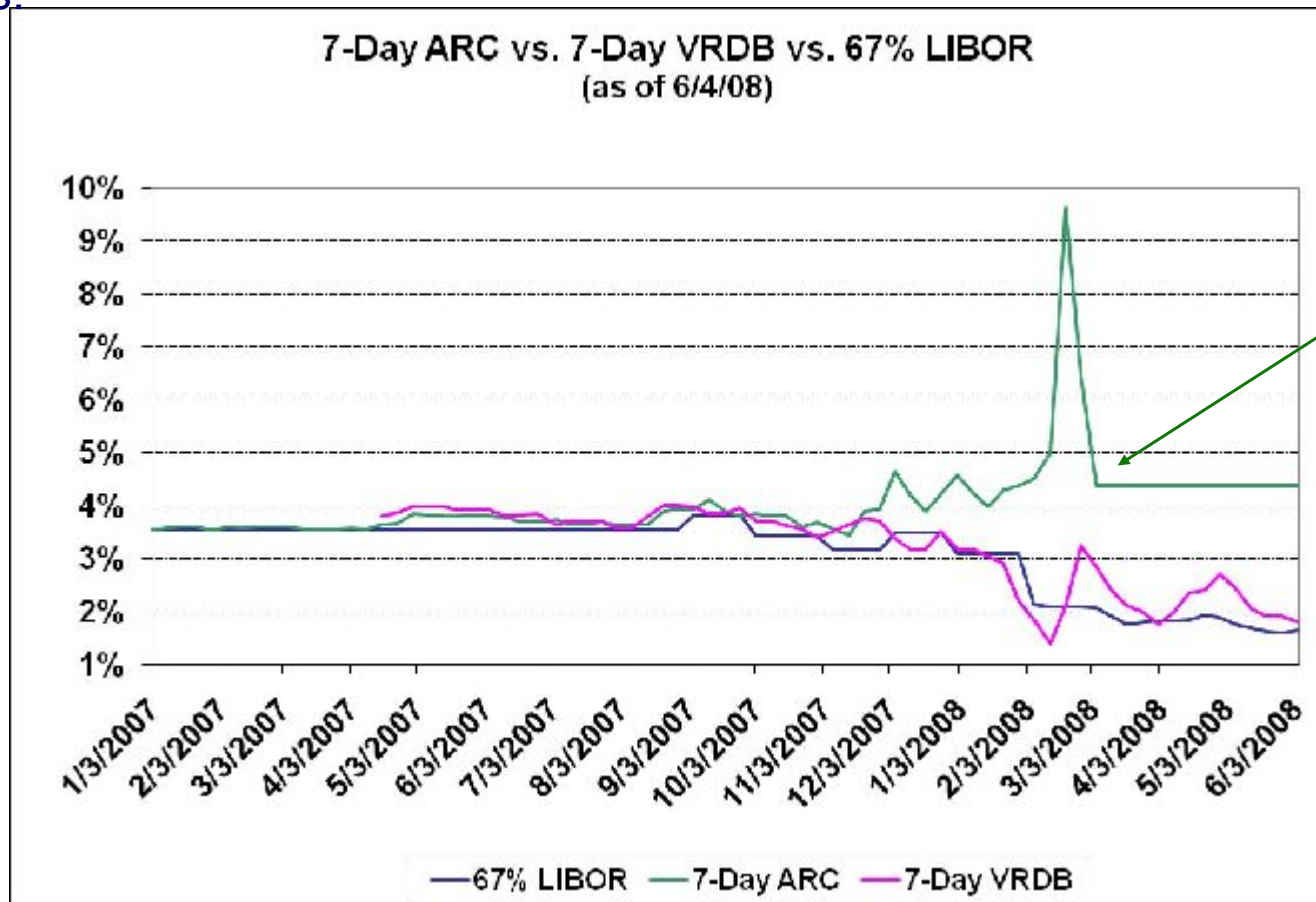
- Increased focus on counterparty risk as several counterparties have faced downgrades
 - Terms in the Credit Support Annex outline the situation in which swap counterparties must post collateral as credit protection
- In some instances of insured swaps a downgrade to the bond insurer may trigger a collateral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



Variable Rate Performance in the Market January 2007 to June 2008



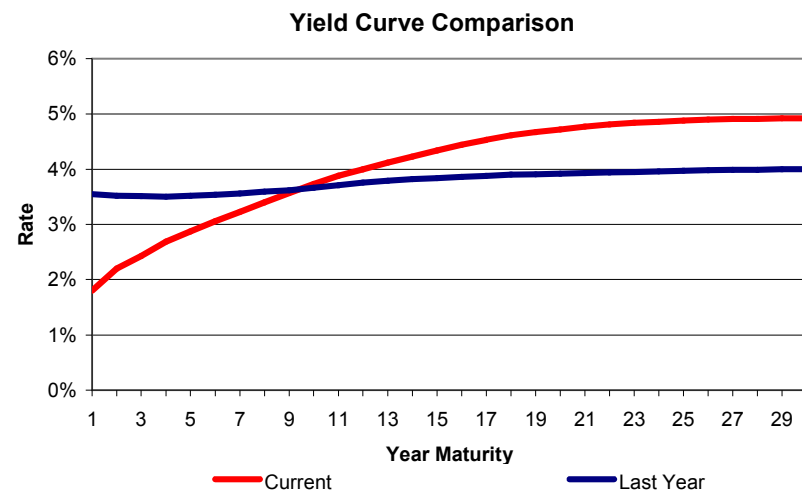
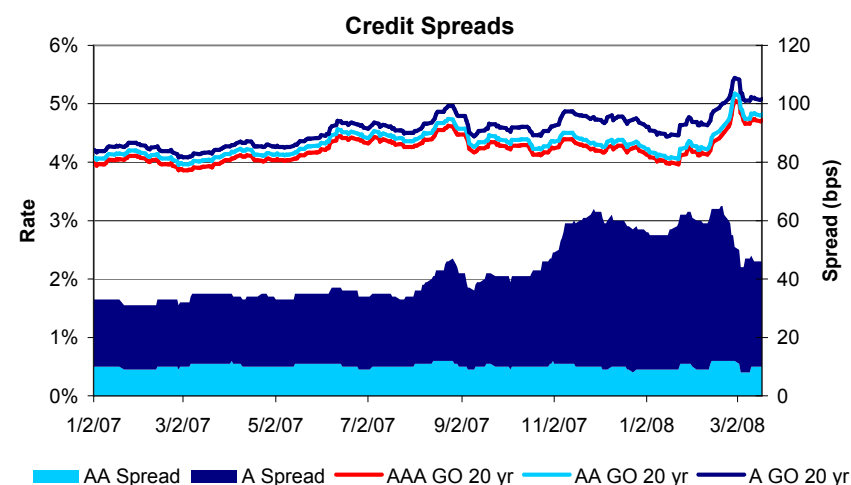
- The graph JaxPort's 2006 Bonds in the ARCs mode vs JaxPort's LOC backed 2007 Special Purpose Revenue Bonds in the VRDBs mode as well as 67% 1-month LIBOR.
- Clearly the market disruptions, including MBIA's negative credit outlook, caused interest rates on the Authority's 2006 Bonds in ARCs mode to have higher interest rates.



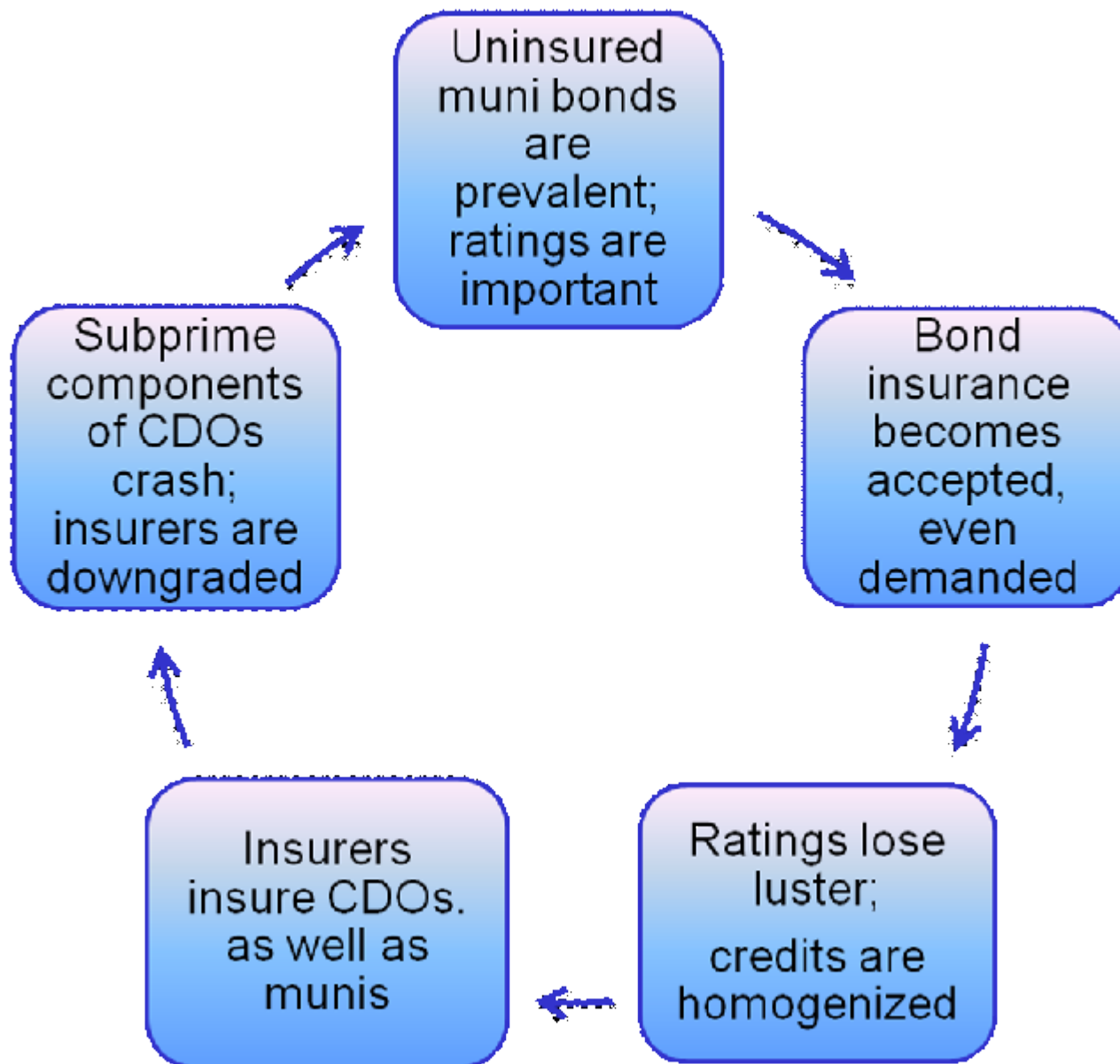
7-Day ARCs converted
to fixed-rate put bond
@ 4.375%

So What is the “Takeaway”

- Credit enhancement was cheap and accessible, so ratings were less important
 - The pendulum has swung back
- New Money
 - Credit rating matters – Credit spreads have widened
 - Insurance premiums have increased significantly
 - LOC providers have become very selective on their exposures
- Existing VRDOs & ARS
 - Increase in failed auctions
 - Reset rate approaching max rate
 - \$ 200/300 billion of ARS/VRDOs are currently in the process of being converted or refunded
 - Liquidity for VRDOs is difficult to obtain



Historical Perspective



Range of Port Financing Options

Financing Approach	Public Agency Tax-Backed	Public Agency Operating Revenues	Public Private Partnership	Private Concession
Operating Model	Public Operator	Public Operator/ Landlord	Long Term Landlord	Passive Landlord
Primary Management Control	Public	Public	Public-Private	Private
Typical Contracts & Lease Agreement	N/A for Grants & Tax Revenues	Multiple Tenants; Variable Contracts Discretionary Terms	Single Tenant; Long Term Must Cover Debt	Single Tenant; Longest Term to Cover Debt & Equity Return
Typical Facilities Financed	Public Use; Infrastructure such as Roads and Dredging	Private Activity; Docks, Wharves, Cranes, Warehouses, Buildings, etc.	Private Activity; Docks, Wharves, Cranes, Warehouses, Buildings, etc.	Private Activity; Docks, Wharves, Cranes, Warehouses, Buildings, etc.
Sources of Revenues and Security for Debt	Grants, Gov't Transfers, Taxes	Tariffs, Throughput Fees, Security Fees, Facility Lease Revenue, etc.	Corporate Rental Minimum Guarantee & Throughput Fees	Tariffs/Lease Revenue, etc. Received by Private Concessionaire
Type of Debt	Agency Revenue Bonds	Agency Revenue Bonds	Agency Special Purpose Conduit Bonds	Corporate Debt & Private Equity
Tax Status/ Term	Gov't Purpose & AMT Tax- Exempt 10-30 years	Gov't Purpose & AMT Tax- Exempt 10-30 years	AMT Tax-Exempt 20-40 years	Taxable Debt 50-99 years
Primary Private Partners	Shipping Company, Railroads, Private Haulers/Trucks	Shipping Company, Railroads, Private Haulers/Trucks, Terminal Operator	Terminal Operator/ Corporate Guarantor (likely operator parent and/or shipping co)	Private Equity Concessionaire

P3 Investors Fundamentally Differ from Bondholders

- **Bondholders are passive lenders**
 - Seek timely payment of principal and interest
 - Investment decisions are based on third-party evaluations and “done deals”
 - Rating agencies and credit enhancement are key

- **P3 investors are active business partners**
 - Interested in profit, in equity return, in risk allocation and in regulation
 - P3 investor will perform their own technical due diligence
 - The business structure creates the credit, which in turn defines the financing options

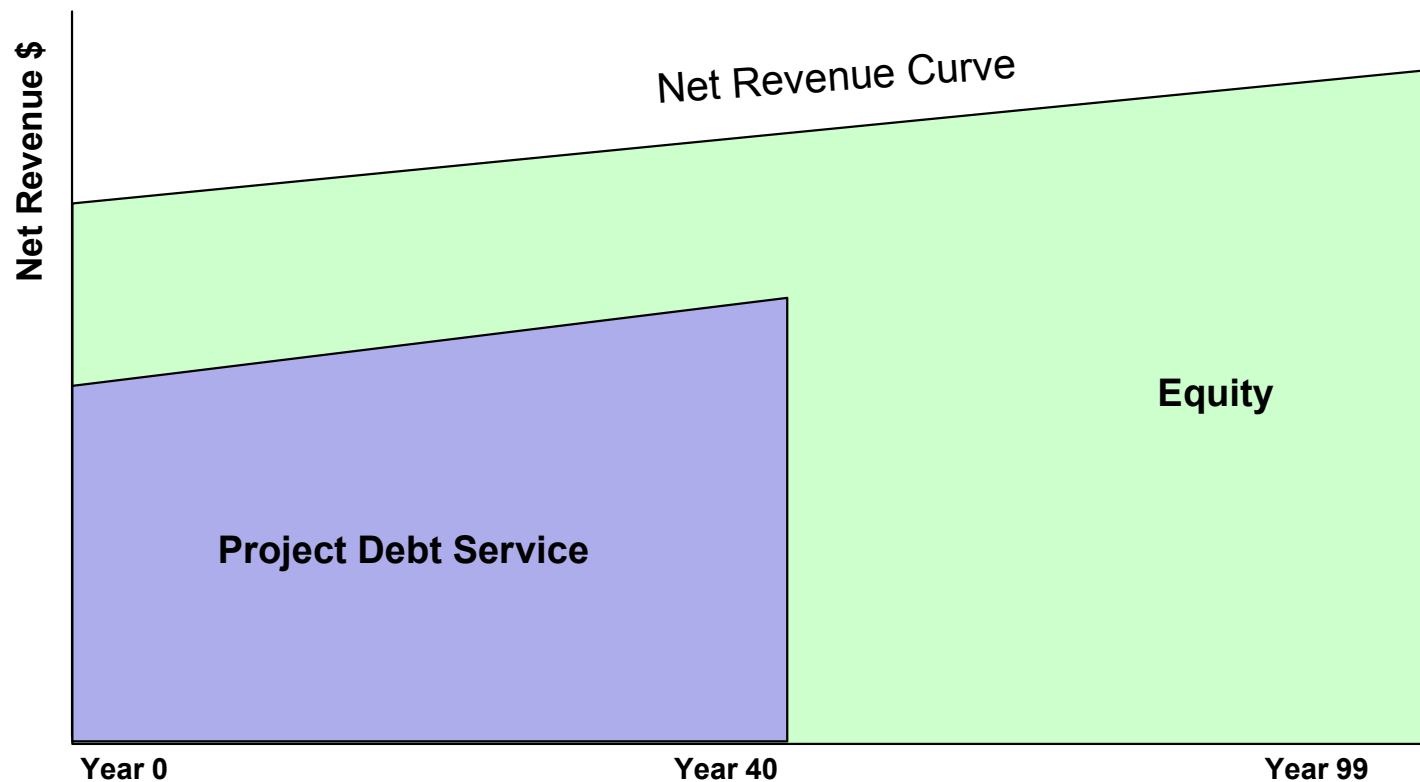
Typical P3 Financial Structures

- Generally taxable, in order to get benefit of tax ownership (interest deductions and depreciation)
- Initial equity 20-30 percent depending on strength of revenues;
 - Re-leveraged to maximize equity return
- Return on equity targets for “greenfield” projects in the mid-teens percent due to high project risks
 - Lower for mature “brownfield” projects
- Bank financing, not bonds, with construction loans flipping into tiered debt
- Maximum use of interest-only structures to get highest leverage possible

Typical P3 Financial Structures

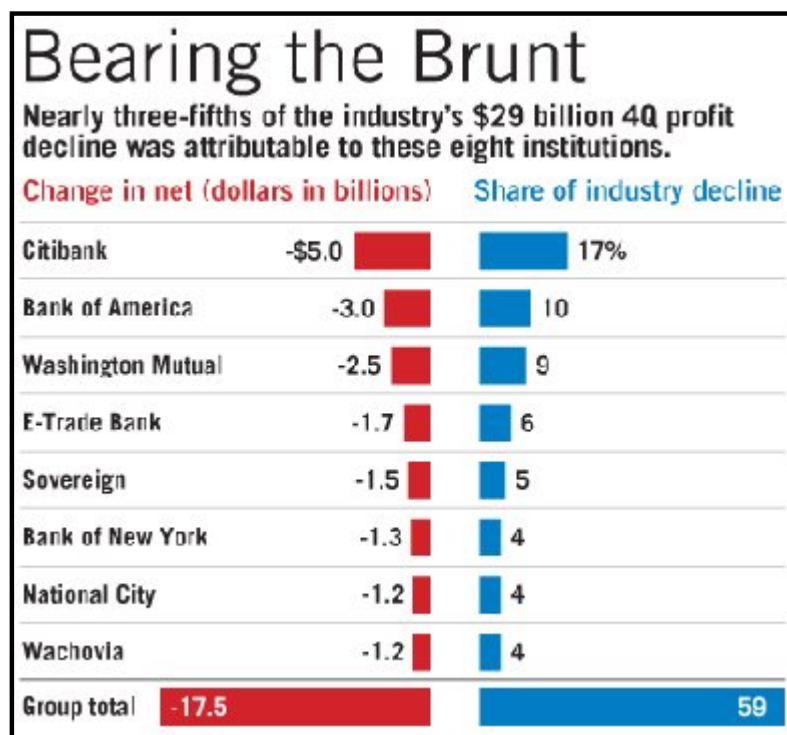


- Municipal bonds monetize 40 years of value. While equity investors will take risk to 99 years of cash flow, to enhance the present value payment.
- Municipal issuers get none of the advantages of tax-exemption with a P3 finance approach.
- Cash flows monetized by equity are typically discounted back at rates of 12% to 18% for a “greenfield” facility.



P3 Debt Market Update

- ◆ Large losses at large banks constrained industry profitability

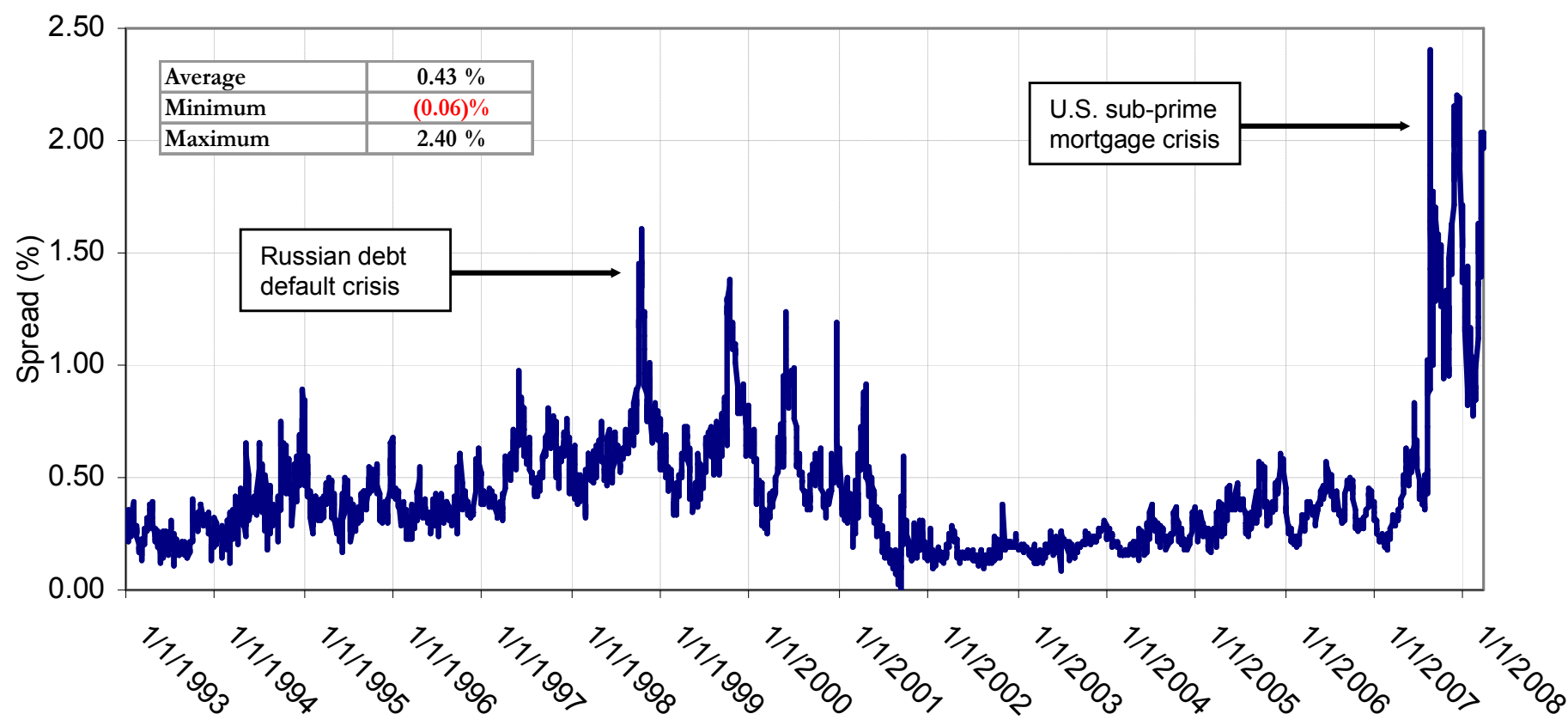


- The nation's 8 largest banks accounted for 60% of the industries spiraling decline in net income in the 4th quarter of 2007

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

3-Month LIBOR - 3-Month Treasury Bill Spreads (January 1, 1993 - Present)

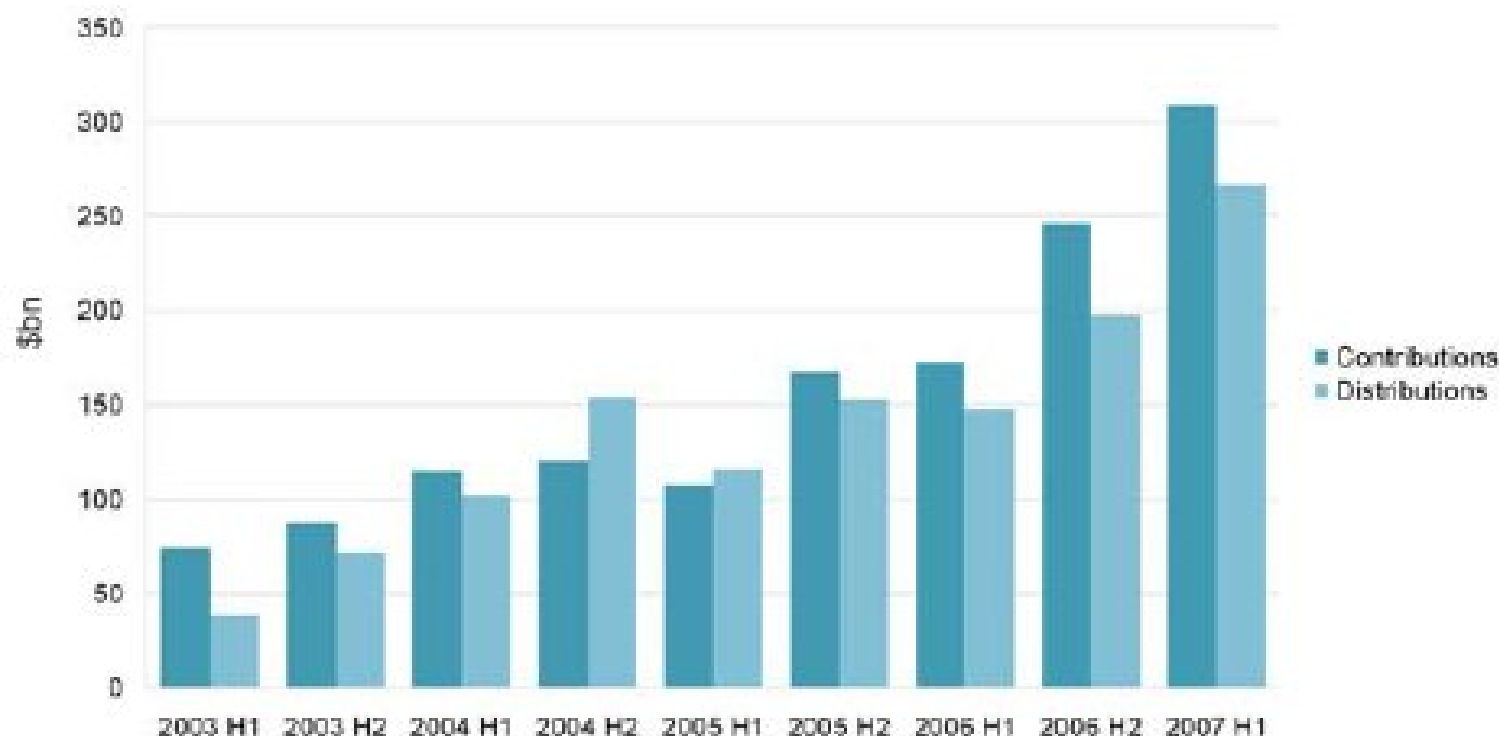


P3 Debt Market Update

- ◆ Below the largest institutions, banks are not burdened with substantial stranded “bad assets” from failed asset securitizations.
- ◆ Because banks in some states have not experienced a rapid decline in residential and commercial real estate values, the banks who compete in those states are much better off than peer banks in many other states
- ◆ Therefore, on the debt side of P3s, interest from mid-caps and small-cap banks located outside of problematic geographic markets is still strong
- ◆ Credit matters – investment grade is required – and the more stringent debt covenants reduce leverage
- ◆ Exotic debt structures and subordinate debt will be limited – again, less leverage
- ◆ More equity participation required

P3 Equity Availability

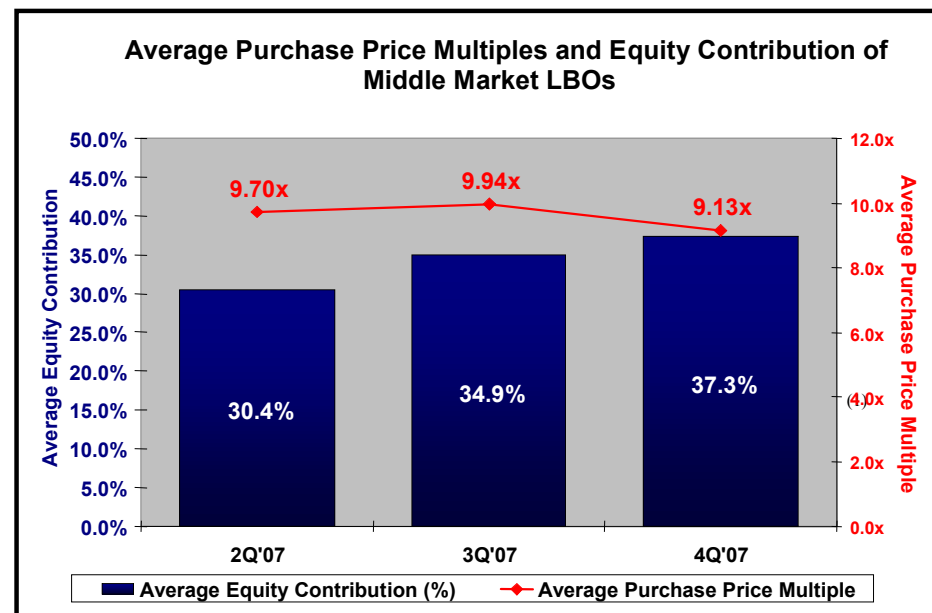
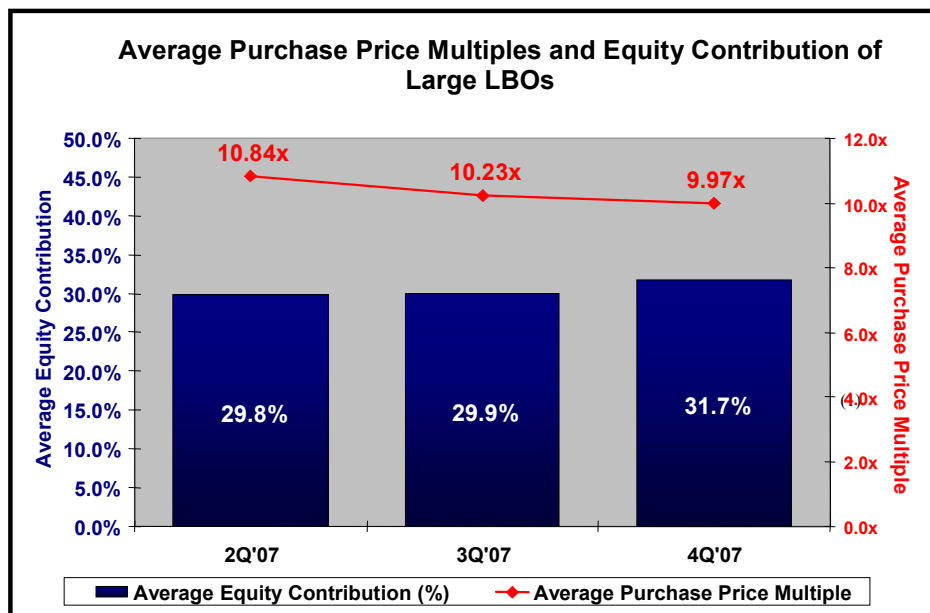
- There continues to be a tremendous amount of liquidity in the U.S. private equity markets waiting to be deployed
- Strong fundraising throughout 2007, despite turmoil in the debt markets



Figures show aggregate global cash calls made from LPs to private equity funds and cash distributions made back to them, taken across all types of private equity fund, with the exception of fund of funds.

P3 Market Update

Cumulative impact leading to lower purchase price multiples for deals and higher equity contribution rates, esp larger deals (41% for Penn Turnpike).



Note: Large defined as issuers with EBITDA of more than \$50 million and Middle Market defined as issuers with EBITDA of \$50 million or less

(1) Includes transaction fees and expenses

Source: Standard & Poor's

P3 “Takeaway”

- ◆ Increased credit spreads and diminishing bank debt mean that a focus on strong economic & credit fundamentals will be very important
- ◆ Market is still available for good projects but probably not at values as high as in the past, especially for larger projects
- ◆ Strategic maritime & intermodal industry participants will continue to look for investment opportunities
- ◆ Public ports should consider and compare the full range of project development and financing options

Questions??



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