First Southwest Company
Statement Regarding
Harris County Tollroad Authority Interest Rate Swaps

KTRK-TV has inquired about three interest rate swaps executed by the Harris County Toll Road Authority ("HCTRA") in 2006 and 2007. The 2006 swap was undertaken to reduce HCTRA's interest rate risk associated with the remarketing or refunding of municipal bonds in 2009. The two identical 2007 swaps, and the concurrently associated issuance of floating rate notes, took advantage of interest rates available at that time in the floating rate index bond market and the interest rate swap market, which were lower than rates that existed in the traditional fixed rate municipal tax exempt bond market. In spite of unprecedented credit events occurring in the fixed income markets since 2007, which resulted in new legislation and new accounting rules, the net interest rate paid by HCTRA on the swaps and associated variable rate bonds was lower than what would have been paid using traditional fixed rate municipal bond alternatives. In other words, the interest expense paid by HCTRA to the interest rate swap counterparties and bondholders was less than what would have been paid to fixed rate municipal bondholders.

The 2006 Interest Rate Swap:

Harris County issued bonds for the toll road authority in 2004 at a fixed yield of 3.02% through August 15, 2009 (the bonds mandatory tender date), after which the County would have to remarket or refund the bonds (which have a final maturity in 2021). The 2004 refunding bonds financed a refunding that saved HCTRA approximately $28MM in interest expense, which was $8-9 million more than the savings that could have been achieved through traditional fixed rate municipal bonds. The County, in accordance with its plan of finance and consistent with its debt policy and with rating agency guidelines regarding variable rate bonds, issued a portion of the 2004 refunding bonds in a variable rate format after 2009.

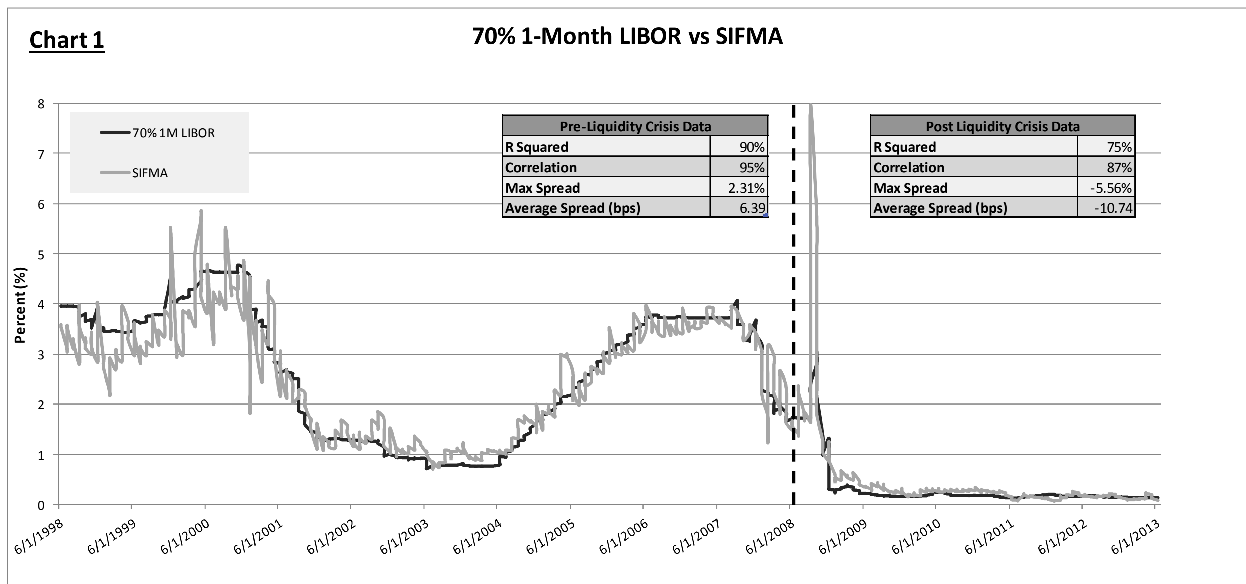
Two years after the 2004 refunding bonds were sold, the County decided to mitigate interest rate risk associated with the 2009 required remarketing by entering into the 2006 interest rate swap. At the time that the 2006 swap was executed, prevailing market fixed interest rates were at lows that had not been seen in the municipal market in over 30 years. Taking into account debt remarketing and other support costs, by entering into the 2006 interest rate swap, the County locked in interest expense of approximately 4% through the life of the swap. The 2004 bonds had to be remarketed in 2009 or a default would have occurred, regardless of the prevailing market conditions at that time. Thus, HCTRA was exposed to interest rates that could have been as high as 15%. By entering into the 2006 swap, the County protected HCTRA from any potential increase in interest expense above 4%. Data from a representative index of municipal revenue bonds shows that every day from 1996 to 2006 the index exceeded 4%. Furthermore, disregarding credit anomalies, which cannot be hedged using interest rate swaps, the 2006 interest rate swap hedged cash flows from the 2004 refunding bonds on a dollar for dollar basis.

The 2007 Interest Rate Swaps:

The two 2007 interest rate swaps are virtually identical, and they were entered into to take advantage of a market opportunity that existed for a short time in 2007 and that enhanced the present value savings associated with the 2007B refunding bonds. The swaps were entered into at the same time that the County sold HCTRA bonds bearing interest based on the London Interbank Offered Rate ("LIBOR"). The LIBOR-based cash flows from the 2007 interest rate swaps offset, dollar for dollar, the LIBOR-based interest amounts due on the 2007B refunding bonds. The economic result of the 2007 interest rate swaps provided HCTRA with a lower net interest expense than could have been achieved by selling bonds in the traditional fixed rate bond market at that time.

Further Information:

At the time the 2006 and 2007 interest rate swaps were entered into, a number of different potential transactions were analyzed from numerous perspectives. Each potential transaction was analyzed from within the context of the total economic situation facing HCTRA, including, but not limited to: the short term nature of its investments; the percentage of HCTRA's debt that was already in variable rate mode (including commercial paper); the rating agency criteria regarding acceptable limits on outstanding variable rate debt; the restrictions on financings imposed under the laws, rules and regulations that govern the issuance of tax exempt securities; as well as the statistical metrics establishing a relationship between the expected bond cash flows and the expected swap cash flows. Please see **Chart 1** depicting the long-term relationship between LIBOR and the Securities Industry Financial Markets Association Municipal Swap Index ("SIFMA"). Given the goals established by HCTRA, we believe that the interest rate swap transactions have hedged interest rates as designed, and they have provided subsequent opportunities to further reduce risk and total financing expenses for HCTRA.



On all three swaps, HCTRA and its swap counterparties, from time to time, depending on current interest rates, may be required to post collateral to ensure the financial performance of each swap

contract. By requiring collateral posting in its swap contracts, the County is attempting to protect itself from a failure, or non-performance, by its swap counterparties. Because interest rates have declined since the County entered into the swaps, the County is required to post collateral. If interest rates increase sufficiently, then the swap counterparties will post collateral for the benefit of the County and HCTRA. In either case, during the holding period, interest on collateral securities flows through to the party posting the collateral, and once the swaps are terminated (or as collateral posting requirements decrease) collateral is returned to the party who posted it.

We have tried to limit our statements to general information stated as simply as possible, however, as you have come to appreciate, these are complex financial transactions. At the time that the swaps were executed and based on the data available at that time, we believe that the swaps were reasonable transactions designed to mitigate interest rate risk. Third party evidence of this view includes the low risk assessment (where a lower value equates to a more favorable view) provided by Standard & Poor's. We have offered, and we will continue to offer, to meet with you and the professor that you have contacted in an effort to lay out, in detail, the facts and address any concerns. We look forward to an opportunity to brief you and your team regarding these matters.