Build America Bonds: An Overview

Background

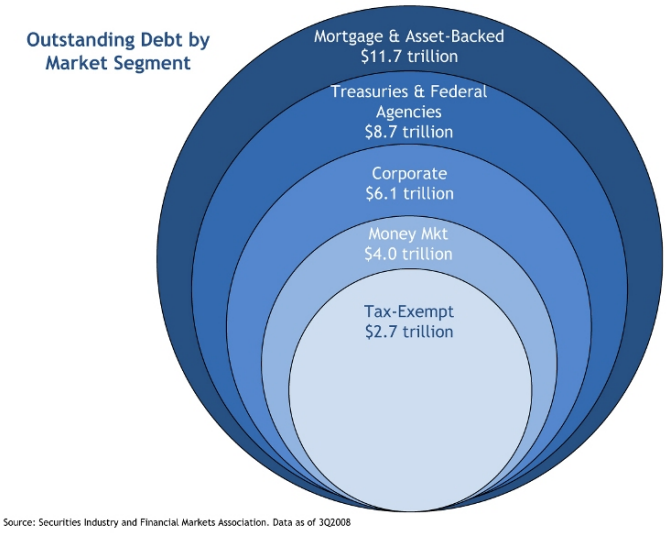
The Texas Department of Transportation's (TxDOT) main funding comes from traditional sources such as gas tax revenues, vehicle registration fee revenues and federal reimbursements. This enables TxDOT to pay for the construction and maintenance of nearly 80,000 centerline miles of roadway for which it is responsible.

Due to the large expense of funding infrastructure, TxDOT also has a variety of debt programs available to help pay for and advance projects, including the Texas Mobility Fund, General Obligation Bonds (Proposition 12) and State Highway Fund Revenue Bonds (Proposition 14). Borrowed money has helped the department maintain contracting levels in recent years.

Situation

Traditionally, the bonds TxDOT uses to fund transportation projects are sold in the tax-exempt market. This accounts for state and local governments being able to issue $2.7 trillion in the U.S. debt capital markets. By solely seeking investors from this sector, TxDOT's ability to secure cost effective financing for future infrastructure projects is somewhat limited, given the recent disruption in the capital markets.

One tool to help gain additional investors is in issuing taxable bonds, such as Build America Bonds, or BABs. The total debt issuance for all taxable bonds accounts for $11.7 trillion in the U.S. debt capital markets.



Source: Securities Industry and Financial Markets Association. Data as of 3Q2008

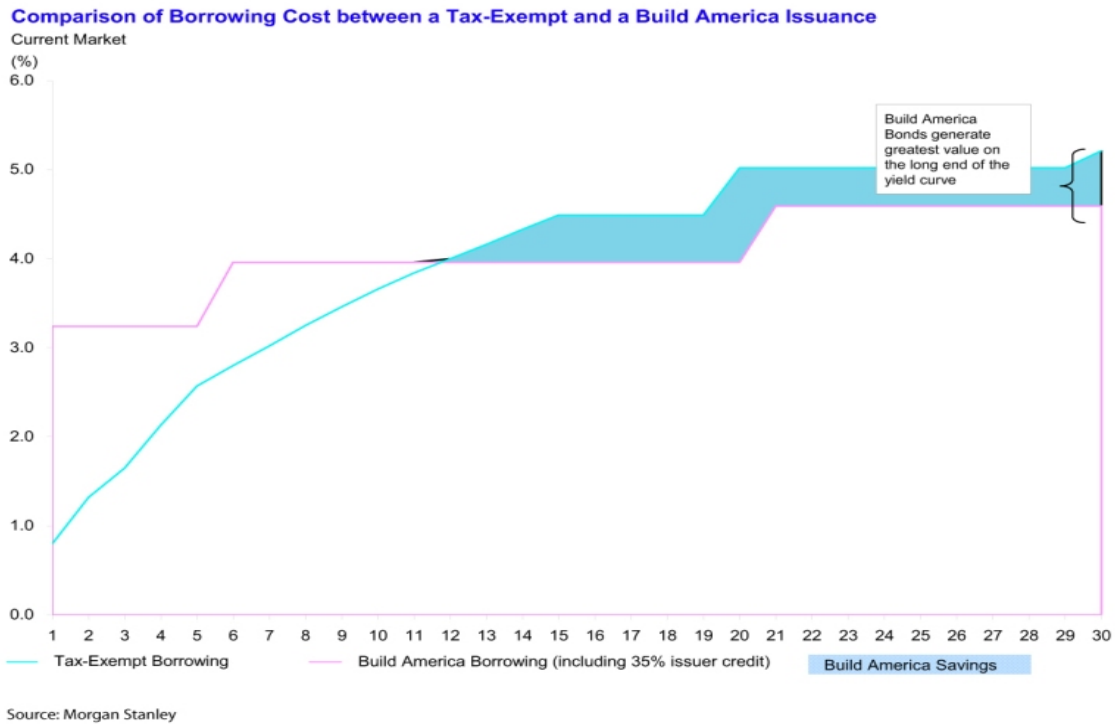
BABs provide TxDOT another option to access a broader investor base, as well as reduce borrowing costs. Since there are a lot more taxable investors than tax-exempt investors, TxDOT's utilization of BABs gives us access to these investors.

BABs explained

BABs are part of the American Recovery and Reinvestment Act federal stimulus plan. It allows governmental issuers to sell taxable debt until 2011 and receive an interest rate subsidy from the U.S. Treasury equal to 35 percent of all interest paid for the term of the debt. While a BAB could draw a higher taxable financing cost to the issuer than a tax-exempt bond, the 35 percent federal government payment may turn it into a lower overall borrowing rate.

In the current market, the Build America program provides TxDOT with interest cost savings over the life of the issue. Expanding TxDOT's universe of tax-exempt

investors mean larger size bond denominations can potentially be completed at a lower cost. These desirable characteristics can be structured into the Texas Mobility Fund financing program, resulting in a favorable response from investors.



BABs investors

The best candidates for BABs are medium to large, highly-rated (strong credit rating of 'A' or higher) issuers, like TxDOT. Major targeted investors in BABs include mostly domestic corporate investors, such as bond funds, insurance companies, and asset management companies.

BABs sale

TxDOT recently sold $1.2 billion of these bonds in the Texas Mobility Fund program. The preliminary official statement was released August 12, 2009. The bonds were marked and priced on August 19, 2009 and the closing date was on August 26, 2009. Prior to the sale, TxDOT received credit ratings for the Series 2009 Bonds:

- Standard & Poor's: AA+ (upgrade from prior AA)
- Moody's Investor Service: Aa1
- Fitch Ratings: AA+

These bond proceeds will be applied toward transportation improvement projects. The entire transaction was sold as fixed-rate taxable BABs with a 30 year maturity. The effective cost of borrowing after federal subsidy payments is 3.62 percent. Basically, this means the bonds will mature over 30 years and the interest rate is set, so TxDOT can accurately predict future bond payments.

Due to the very low cost of borrowing, the Texas Mobility Fund revenue is expected to be an adequate resource to make the bond payments.

2009 Texas Mobility Fund Bonds

Without the BABs program, the most TxDOT could have issued in tax-exempt bonds under the Texas Mobility Fund program would have been about $900 million. The $647 million of federal subsidy payments over the 30-year period enabled TxDOT to issue $1.2 billion in bonds. As compared to a similar tax-exempt bond issuance, the resulting present value debt service savings was $275 million.

The BABs option provided more debt capacity to fund existing transportation projects, while maintaining prudent debt service coverage levels. It also presented a much lower cost of borrowing, compared to a traditional tax-exempt issuance. The low fixed net cost received for these funds will be used to help TxDOT fund mobility projects across Texas.