Status Report by TPFA On

TWIA Class 1 Revenue Notes Taxable Series 2012

TPFA issued a $500 million Note for TWIA in August. The Note was privately placed with Merrill Lynch Pierce Fenner and Smith. The $500 million proceeds of the Note are on deposit in the Texas Treasury Safekeeping Trust Company. The Note has an interest rate of 1%, which rises to 2.5% if an “A” equivalent or better rating is not achieved by at least two rating agencies. There is a soft put date of February 1, 2013. If the Note is not paid off by February 1, 2013, the Note becomes a 3 year term note maturing on August 1, 2015, with an interest rate of 8% if the rating requirement has been achieved and at 10% if the rating requirement has not been achieved by the 60th day following closing, which was September 30, 2012.

TPFA made presentations to the three rating agencies. Below is the feedback that we received from the rating agencies:

- Due to the Note’s credit structure, all three rating agencies determined that state issuer based rating criteria were not appropriate for the credit, since the Class 1 revenue stream is not similar to a “assessment, tax or surcharge” as in Florida or Louisiana.
- Two of the agencies proposed use of the insurance company rating scale, and the third stated that it would need to establish new rating criteria to perform the rating.
- The use of private insurance company rating criteria requires the ability of the entity to pay claims and continue to operate following a 1/100 or more year storm. Including the $500 million in Note proceeds and the potential to issue post-event Class 2 and Class 3 bond, TWIA only has the ability to handle a 1/60 year storm currently.

As a result of this feedback, TPFA along with its advisors determined that the resulting rating was likely to be below the “A” rating required to receive the reduced interest rate on the notes, and therefore, there was nothing to be gained by pursuing the ratings and potential negative fall-out from such a rating. The deciding factors that we used in making this determination were the following:

- A published non-investment grade rating would be detrimental to future borrowing ability of TWIA. TWIA would have to overcome the stigma of this rating, even if the credit was enhanced in the future.
- A published non-investment grade rating could impact the market perception of other classes of debt that may need to be sold (e.g., Classes 2 & 3.)
- Moving forward with no credit rating on the Note is preferable when compared to potential for negative impact to issuer.
- It is more prudent to save the cost of rating, if a desirable outcome cannot be achieved.
- An “A” category rating from only one of the rating agencies would not prohibit the increased interest rate trigger on the Note.
- For at least one rating agency, the time needed to develop new rating would not offer the opportunity to achieve an interest rate reduction.

If there is no catastrophe, the Note proceeds in the TSCTC will be used to pay off the note on February 1, 2013. If there is a catastrophe, the Note proceeds will provide liquidity to pay claims, while TPFA goes to the market to sell post-event bonds. If the Note is needed to pay claims, after February 1, 2013, the interest rate on the outstanding Note principal will be 10% and the Note will mature on August 1, 2015. Three of the six debt service payments, which are required to be paid on the Notes by February 1, have already been set aside by TWIA.