



THE ILLINOIS STATE TOLL HIGHWAY AUTHORITY

Interest Rate Risk Management Guidelines

August 2005

Introduction

The purpose of this Interest Rate Risk Management Guidelines (the “Guidelines”) is to establish procedures for the analysis, use, execution and management of interest rate risk management tools, including interest rate exchange agreements, forward purchase agreements, variable rate debt and other products, agreements or transactions executed by the Tollway to manage or hedge interest rate risk, credit risk, tax risk or other risks associated with the borrowing and investment of capital.

The use of interest rate risk management strategies is constrained and/or governed by the Amended and Restated Trust Indenture, as amended and supplemented by each Supplemental Indenture, the Toll Highway Act of the State of Illinois, 605 ILCS 10/1 through 10/35, the 1970 Constitution of the State of Illinois and other applicable laws.

Scope and Authority

These documents shall guide the Tollway’s use of all interest rate risk management tools related to outstanding debt and debt projected to be issued by the Tollway in the future. The Tollway expressly recognizes that changes in the financial markets, changes in Tollway finances and legal authorizations, and other unforeseen developments may produce situations that are not adequately covered by the Guidelines. In that situation, the Tollway may need to make changes to the Guidelines to more fully achieve its goals. In such circumstances, management of the Tollway will make every effort to amend the Guidelines and present its recommendations to the Audit Committee of the Board of Directors for its review.

The Chief of Finance is designated as the administrator of the Guidelines. In that role he or she is responsible for (a) compliance with the Guidelines ; (b) periodically reviewing the Guidelines and making recommendations on amendments that may be required; (c) establishing procedures to assure compliance with the Guidelines throughout the life of each interest rate risk management contract or strategy, including proper training and redundancy of Tollway staff and (d) reporting to the Board on compliance with the Guidelines. The Guidelines should be reviewed and updated periodically as deemed necessary by the Chief of Finance or Audit Committee.

The Board of Directors of the Tollway shall approve all transactions involving interest rate risk management strategies as contemplated in these Guidelines. The Tollway shall enter into such transactions only with counterparties deemed to have the financial strength necessary to protect the Tollway's financial interests in the transaction.

Purpose and Form of Interest Rate Risk Management Agreements

The Tollway may use interest rate risk management agreements for various purposes including managing certain risks related to debt, achieving efficient access to capital, and better matching of Tollway assets and liabilities.

The Tollway shall enter into written agreements documenting each interest rate risk management agreement with the counterparty. The Tollway expects such contracts will be based on the International Swap Dealer Association, Inc ("ISDA") Master Agreement (the "Master Agreement") and any schedules to the Master Agreement including a credit support annex with collateral requirements.

The Tollway will monitor market developments regarding the standard form of agreements and related practices, and modify its market agreement standards as appropriate for governmental issuers.

Risk Assessment

The following is a brief discussion of the types of risk that will be assessed with each contemplated interest rate risk management agreement.

1. Interest Rate Risk. The rate of interest paid may increase on direct variable rate bonds or floating payer interest rate risk management agreements.
2. Liquidity Risk. When holders of variable rate bonds have a "put" option allowing them to tender their bonds back to the Tollway in exchange for cash, and those bonds cannot be immediately remarketed, the Tollway may pay a higher rate of interest to the financial institution that provides liquidity for the tendered bonds.
3. Rollover Risk. Liquidity provider agreements range from one to ten years, typically shorter than the amortization term of the variable rate bonds for which such facility is required. Two risks exist: (a) the Tollway may incur higher renewal fees when new agreements are negotiated and (b) the liquidity bank market constricts such that it is difficult to find a financial institution willing to provide liquidity at any interest rate.
4. Termination Risk. Termination risk is the cost of replacing the counterparty to an interest rate risk management agreement under unexpected circumstances including: a rating downgrade on the part of the Tollway or the counterparty, a covenant violation or default as defined in the Tollway's bond indenture or counterparty bankruptcy.

Termination risk may be reduced with collateral requirements, or through the purchase of termination risk insurance to cover the cost related to replacing the counterparty.

5. *Tax Risk.* Tax risk arises from tax-exempt rates increasing relative to Federal taxable rates, as would result from a decrease in the marginal rate of corporate and/or personal income tax rates.
6. *Basis Risk.* The risk of having insufficient receipts from a floating receiver interest rate risk management agreement to pay interest due on the underlying variable rate debt issued by the Tollway. The mismatch of receipts and payments can also occur to the Tollway's benefit.
7. *Amortization Risk.* The risk that interest rate risk management agreements with declining notional value could become mismatched versus the amortization of a particular series of fixed or floating rate bonds around which the contract was structured.
8. *Counterparty Risk.* The risk that the counterparty does not perform pursuant to the terms of the interest rate risk management agreement.
9. *Operational Risk.* The risk that the Tollway or the counterparty may not have adequate systems, polices and monitoring thereof, to avoid potentially costly mistakes involving the legal confirmation of transaction details, cash flow exchanges and collateral provisions.

Term of Agreements and Leverage

In general, the Tollway shall not enter into an interest rate risk management agreement for a term longer than the actual or projected life of related debt, taking into account future refunding and restructuring considerations.

Monitoring, Reporting and Disclosure

At the end of each fiscal year, the administrator of the Guidelines shall report to the Audit Committee of the Board of Directors on the risk position of the Tollway as it relates to the use of interest rate risk management agreements. Such report shall include the following:

1. Summary of interest rate risk management agreements
2. Profile of credit exposure by counterparty, along with ratings for each counterparty
3. Material events related to any counterparty
4. Termination value for each transaction

5. Other information as requested by the Board of Directors.

The Guidelines administrator shall also maintain as part of the Tollway's records all information required for: (a) financial reporting under GASB as well as other reporting and disclosure requirements, and (b) all necessary information related to interest rate risk management agreements that is required for reporting and disclosure purposes for all interest rate risk management agreements in force during the year.

Variable Interest Rate Position

The Tollway shall attempt to manage and constrain its unhedged variable rate exposure to no more than 30% of the currently outstanding debt of the Tollway plus any Board authorized borrowing program debt yet to be issued. For purposes of this limitation, unhedged variable rate exposure shall include both the principal amount of direct issue variable rate debt and the notional amount of synthetic variable rate debt, less:

1. The amount of direct variable rate debt for which variable interest rate exposure has been eliminated or reduced through an interest rate risk management agreement or other hedging tool; and
2. The amount of cash and cash equivalent investments and the market value of other investments with maturities of 30 days or less.

Liquidity Facility

The Tollway will consider the following factors when determining whether to use a liquidity facility, as well as what firm and terms to accept:

1. Form of the Liquidity Facility. The Tollway will evaluate different forms of liquidity in order to balance the protection offered against the economic costs associated with each structure. The forms of liquidity facility include direct pay letters of credit, standby letters of credit and standby purchase agreements.
2. Credit Ratings. The ratings of the liquidity provider may prevail over the Tollway's own short or long-term credit ratings because investors have the right to be repaid in full by that provider. Thus, the Tollway will seek out liquidity providers that have a combination of high short term ratings and the most favorable contractual terms to the Tollway as represented in the negotiated Reimbursement Agreement.
3. Trading Values. Before awarding liquidity facility provider contracts, the Tollway will seek input from market participants on anticipated trading levels and general market acceptance of bonds secured by credit facilities.
4. Costs. The Tollway shall consider all cost components when selecting and structuring a liquidity facility, including the commitment fee, draw fees (if any) and interest rates charged when a draw or purchase of bonds occurs.

5. Maturity. The Tollway shall consider the duration of the liquidity facility offered by providers, and seek stability in its liquidity facilities.