



Bond Basics

March 24, 2011

Topics

- Definition and types of bonds
- Key features of bonds
- Measuring yield
- Assessing risk
- The bond process

Definition and Types of Bonds

- A bond is a debt security used to borrow funds from investors, which are repaid pursuant to the terms of the bond covenants

- **Bond issuers may be**
 - Governments (Tollway) and corporations
 - Special purpose trusts
 - Non-profit organizations

- **Security for bonds**
 - General obligation
 - Revenue bonds
 - Asset-backed



Reasons to Issue Bonds

- **Fund capital expenditures/new programs**
- **Fund capitalized interest and debt reserve**
- **Refinance existing debts**
 - Reduce debt service
 - Reduce risk related to existing debt
 - Exit bond limitations/modify covenants

Key Features of a Bond *(Definitions in Appendix)*

- Par value
- Coupon interest rate (fixed, synthetic fixed, variable)
- Maturity
- Default risk
- Premium or discount
- Price and yield
- Call provision (ability to pay off bonds early)
- Taxability of interest



Bond Value

■ Risk and return *(Definitions in Appendix)*

- Risk-free rate (Treasury securities)
- Credit risk
- Tax risk
- Liquidity risk

Anything else that affects the risk of the cash flows to bondholders will affect the returns required by investors

Illinois Tollway Bonds

Type	Government (municipal) bond
Security	Revenue bonds – senior lien
Maturities	1 - 25 years
Interest	Fixed – 68%, synthetic fixed – 32%
Ratings	Aa3 (Moody's)/ AA- (Fitch)/ AA- (S&P)

Interest exempt from federal income tax, but taxable by the state



Bond Ratings

- Assigned by credit rating agencies
- Indicate level of payment risk

	<u>Investment Grade</u>				<u>Non-Investment Grade</u>				
Moody's	Aaa	Aa	A	Baa	Ba	B	Caa	Ca	C
Fitch	AAA	AA	A	BBB	BB	B	CCC	CC	C D
S&P	AAA	AA	A	BBB	BB	B	CCC	CC	C D

- **Additional modifiers** - 1/2/3 for Moody's and +/- for Fitch and S&P
- **Outlook** - Indication of possible change in rating during the next 1-2 years



Current Yield and Spread – Muni Bonds

	<u>March 21, 2011</u>		<u>July 1, 2008</u>	
	<u>Yield</u>	<u>Spread to AAA</u>	<u>Yield</u>	<u>Spread to AAA</u>
AAA - 20 yr.	4.24%		4.48%	
AA - 20 yr.	4.50%	0.26%	4.58%	0.10%
A - 20 yr.	5.19%	0.95%	4.97%	0.49%

- **Impact of rating downgrade** – a downgrade from “AA-” to “A+” on the amount of \$100 million would cost the Tollway an estimated \$300,000 annually

Note - 0.01% is equivalent to 1 basis point or 1bp

Source: JP Morgan



Credit Risk and Bond Ratings - Factors

■ Financial performance

- Debt ratio
- Coverage ratios, such as debt service coverage
- Budget/financial management

■ Asset condition and management

■ Bond contract provisions

- Secured versus unsecured debt
- Senior versus subordinated debt
- Guarantee provisions
- Sinking fund provisions
- Debt maturity



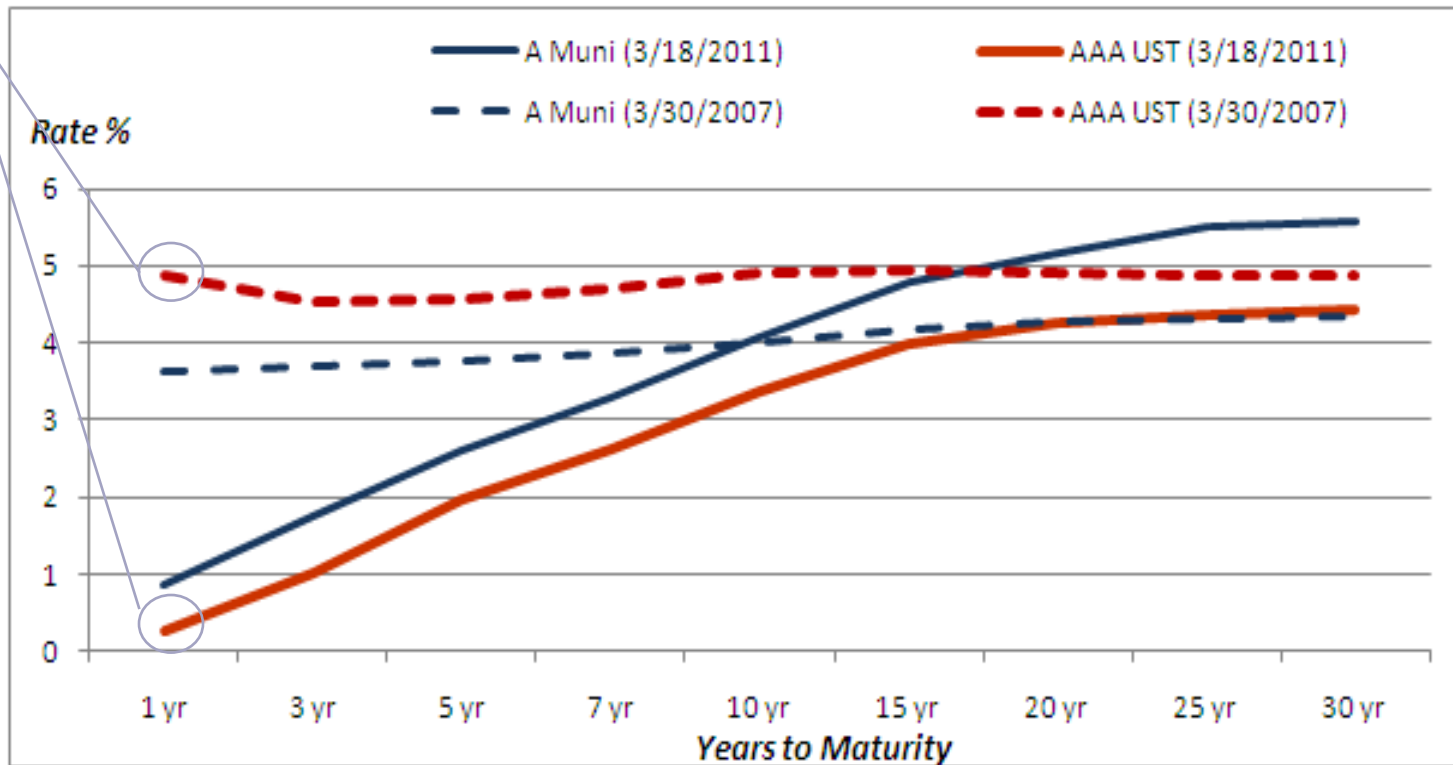
Credit Risk and Bond Ratings – Other Factors

- Income stability
- Regulatory environment
- Potential liability
- Accounting policies



Yield Curves – March 2011 vs. March 2007

Most Tollway investments
are one year or less



Source: JP Morgan



Principal Members of Financing Team

■ Financial Advisor(s):

- Advise with structuring plan of finance
- Assist with credit presentation materials
- Assure fair value at pricing

■ Bond Counsel

- Interprets laws and assists in the legal structuring of bond issue
- Drafts bond documents and Board resolutions
- Opines that bonds are legally issued

■ Trustee

- Receives proceeds of bond issue
- Invests and disburses funds as set forth in bond documents
- Monitors continuing disclosure and administers repayment of debt

■ Senior Managing Underwriter

- Leads bond marketing process to investors
- Coordinates sale orders from syndicate of co-managers
- Provides secondary market support for bonds

■ Remarketing Agents (Variable rate)

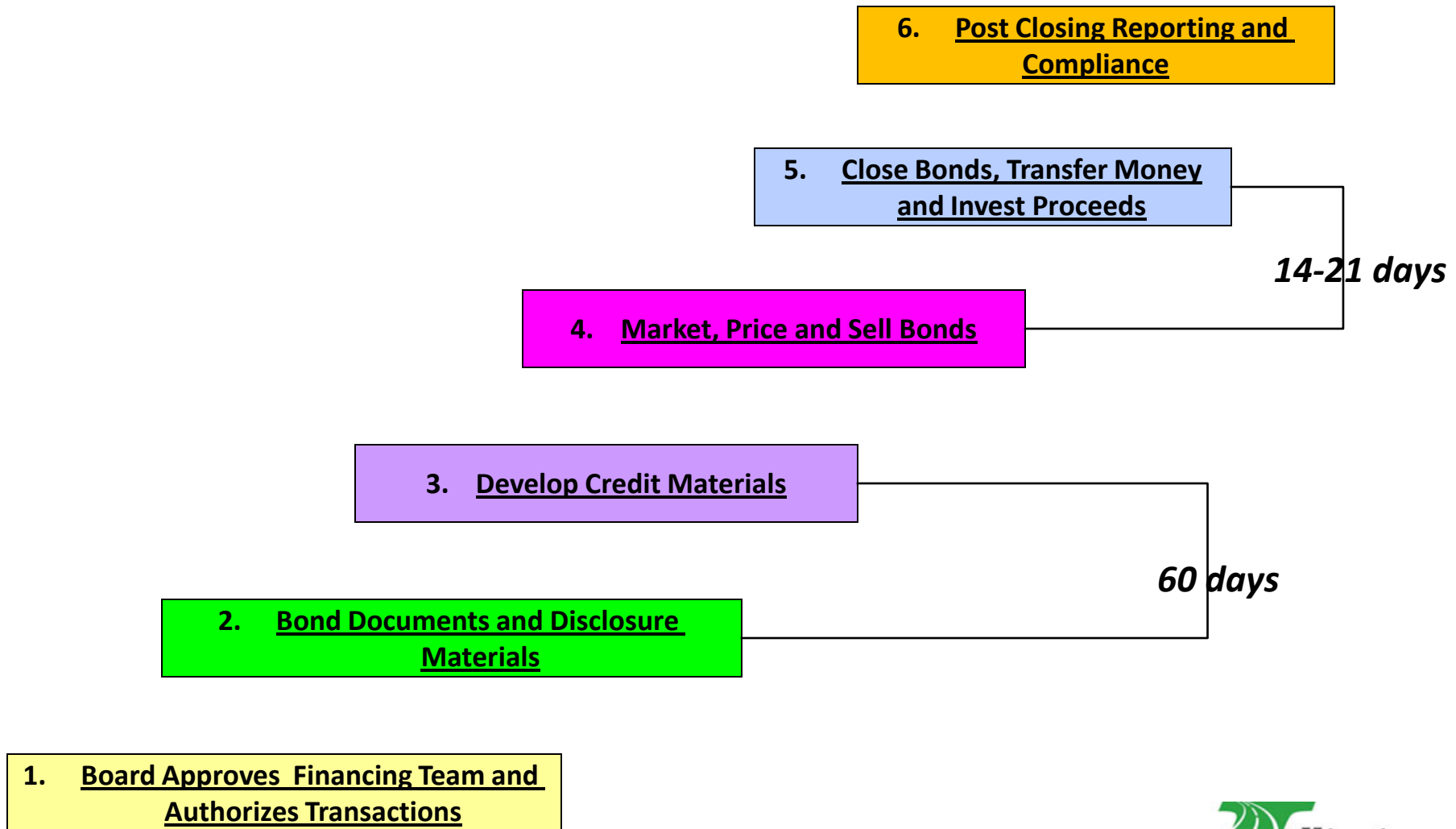
- Set interest rate for the variable rate bonds
- Remarkets bonds tendered by investors

■ Liquidity Banks (Variable rate)

- Obligated to purchase bonds when remarketing agents fail to locate new investors for tendered bonds (a “failed remarketing”)
- Letter of Credit - pays principal and interest and Tollway reimburses
- Standby Letter - only purchases bonds upon a failed remarketing



Time Schedule (90 days or less)



APPENDIX

Definitions

Par value: Face amount of a bond; paid at maturity

Coupon interest rate: Rate of interest applied to the par value

Maturity: Years until bond becomes due; payable to the bond holder

Bond price: Amount paid for a bond

Premium: When the bond price is more than its par value

Discount: When the bond price is less than its par value

Yield : Annual rate of return on a bond, based on the bond price, its rate and the length of time the bond is held

Taxable interest: Interest from a bond that is not exempt from federal and/or state income tax

Call provision: Provision for the Issuer to redeem a bond before the stated maturity at a specified price, usually at or above par



Definitions (continued)

Default risk: Risk that issuer fails to make interest or principal payments on a bond

Risk-free interest rate: Interest or rate of return of a bond with zero risk over a given period of time, e.g. U.S. Treasury bills

Credit risk: The bond holder weighs the risk of the issuer's failure to meet the bond obligation

Tax risk: Risk that the value of a bond can be impacted by changes to the tax code

Liquidity risk: Risk that a bond cannot be traded quickly enough in the market to prevent a loss or make the required profit

Sources: Municipal Securities Rulemaking Board (MSRB)





THANK YOU