

**Pam Clayton**

Director

Higher Education

Wells Fargo Securities

212-214-6525

*pam.clayton@wellsfargo.com*



WELLS  
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SECURITIES

# Application of Strategic Financial Analysis

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July 14, 2014

2014 TASSCUBO Summer Conference

Together we'll go far



# Disclaimer

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The following slides present a floating rate bond or loan and the use of net swap receipts from Wells Fargo to offset interest expense on such bond or loan. Because the bond or loan and swap are separate contracts, if there is any change to the bond or loan, such change will not change the terms of the swap, including swap payments, but overall interest expense may increase or decrease, accordingly. Also, if the floating rate for the bond or loan is defined or determined in a way that differs from the way in which the floating rate for the swap is defined or determined (e.g., definition or periodicity of the rate, payment or reset dates, fallbacks if the rate is unavailable, or other provisions), the floating rate payments on the swap and the bond or loan could diverge (which divergence could be significant).

## Assessing the institution's ability to repay debt and rationale for creditworthiness

1. How are ratings used?
  - To sell bonds
  - To provide information to board members
  - To educate donors
  
2. What factors are considered in a rating assignment?
  - Qualitative factors
    - Policies and Practices
    - Management
  - Quantitative factors
    - Student demand
    - Operating performance
    - Debt burden
    - Liquidity
  
3. What types of university debt are common?
  - Fixed rate and Variable Rate
  - Tax-Exempt and Taxable
  
4. What happens after the debt is issued?

Recent Texas Public University Bond Sales



**September 2013**  
**\$334,330,000**

**Aaa/AA+/AA+**



**January 2014**  
**\$240,340,000 (PUF)**

**February 2014**  
**\$221,580,000 (PUF)**

**April 2014**  
**\$259,135,000 (RFS)**

**Aaa/AAA/AAA**



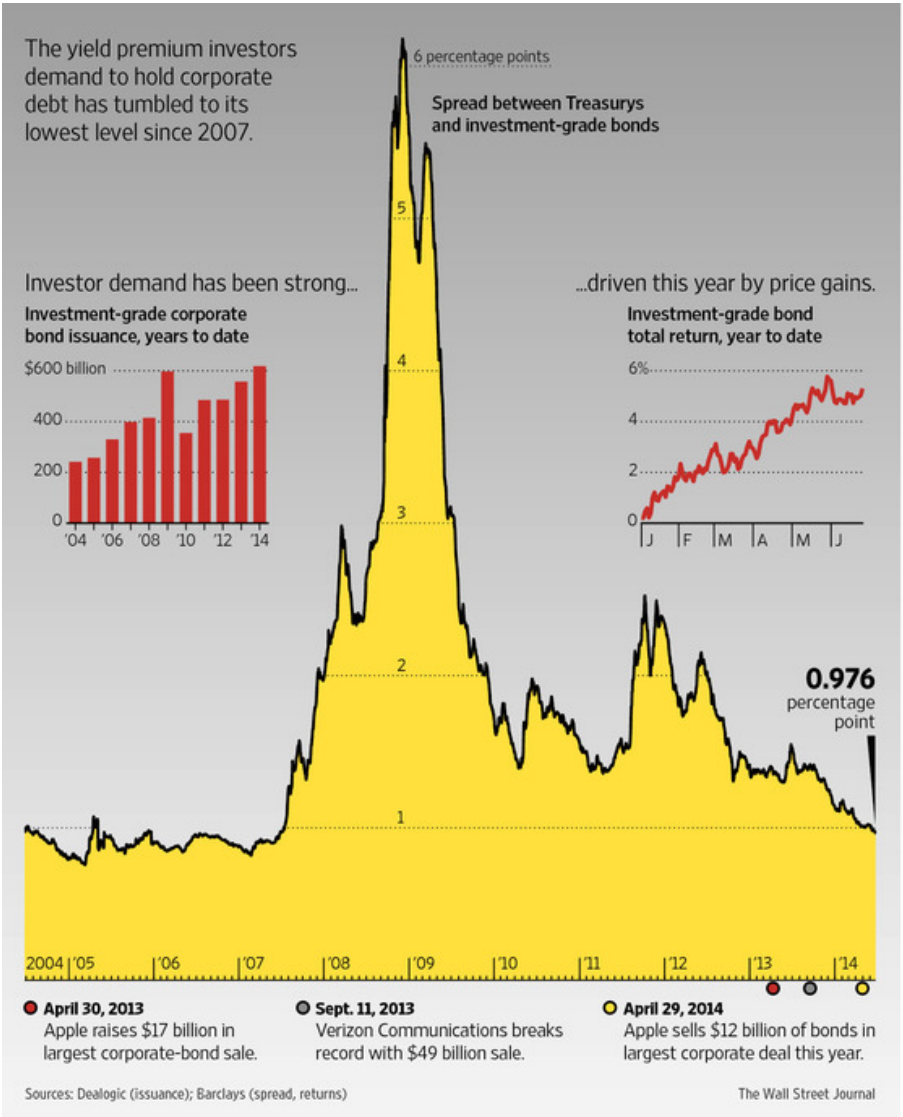
**June 2014**  
**\$88,415,000**

**Aa2/--/AA**

Source: EMMA, Ipreo

## Ratings are the Primary Driver of the “Spread”

- The spread reflects the yield “premium” that investors demand to hold a university’s bond compared to holding a ‘AAA” U.S. Treasury obligation (taxable) or the a “AAA” general obligation tax-exempt bond
- The higher the university’s rating, the lower the premium.
- Spreads fluctuate (widen or tighten) for reasons other than the rating.



# Spread's Impact on Yield or Price of the Bond

## Comparison of Spreads for AAA and BBB+ University

- For tax-exempt bonds, the rating impacts the spread to the “AAA” MMD Yield Curve
- The first table reflects a college with ratings of Aaa/AAA while the second table reflects a college with ratings of Baa1/BBB+.
- The column “spread to MMD” for each table reflects the extra yield that is required to sell the bonds when compared to a “AAA” general obligation MMD scale.

Sample "AAA" Tax Exempt Pricing					
Maturity (June 1)	MMD <sup>1</sup>	Spread to MMD	Coupon	Yield	Yield to Maturity
2015	0.11%	0.00%	3.00%	0.11%	
2016	0.28%	0.02%	4.00%	0.30%	
2017	0.56%	0.04%	4.00%	0.60%	
2018	0.89%	0.07%	4.00%	0.96%	
2019	1.20%	0.09%	5.00%	1.29%	
2020	1.47%	0.12%	5.00%	1.59%	
2021	1.72%	0.10%	5.00%	1.82%	
2022	1.95%	0.13%	5.00%	2.08%	
2023	2.13%	0.14%	5.00%	2.27%	
2024	2.26%	0.15%	5.00%	2.41%	
2025	2.38%	0.15%	5.00%	2.53%	2.77%
2026	2.48%	0.16%	5.00%	2.64%	3.02%
2027	2.57%	0.18%	5.00%	2.75%	3.20%
2028	2.65%	0.18%	5.00%	2.83%	3.34%
2029	2.73%	0.18%	5.00%	2.91%	3.48%
2030	2.80%	0.18%	5.00%	2.98%	3.60%
2031	2.87%	0.18%	5.00%	3.05%	3.70%
2032	2.93%	0.18%	5.00%	3.11%	3.80%
2033	2.99%	0.18%	5.00%	3.17%	3.89%
2034	3.04%	0.18%	5.00%	3.22%	3.96%
2039	3.24%	0.18%	5.00%	3.42%	4.19%
2044	3.28%	0.18%	5.00%	3.46%	4.29%

1. MMD Rates as of 6/30/2014. Subject to change.  
Assumes "AAA" category underlying ratings

Sample "BBB+" Tax Exempt Pricing					
Maturity (June 1)	MMD <sup>2</sup>	Spread to MMD	Coupon	Yield	Yield to Maturity
2015	0.11%	0.45%	2.00%	0.56%	
2016	0.28%	0.55%	4.00%	0.83%	
2017	0.56%	0.60%	4.00%	1.16%	
2018	0.89%	0.65%	5.00%	1.54%	
2019	1.20%	0.70%	5.00%	1.90%	
2020	1.47%	0.75%	5.00%	2.22%	
2021	1.72%	0.80%	5.00%	2.52%	
2022	1.95%	0.83%	5.00%	2.78%	
2023	2.13%	0.85%	5.00%	2.98%	
2024	2.26%	0.88%	5.00%	3.14%	
2025	2.38%	0.90%	5.00%	3.28%	3.40%
2026	2.48%	0.90%	5.00%	3.38%	3.59%
2027	2.57%	0.90%	5.00%	3.47%	3.74%
2028	2.65%	0.90%	5.00%	3.55%	3.87%
2029	2.73%	0.90%	5.00%	3.63%	3.98%
2030	2.80%	0.90%	5.00%	3.70%	4.08%
2031	2.87%	0.90%	5.00%	3.77%	4.16%
2032	2.93%	0.90%	5.00%	3.83%	4.23%
2033	2.99%	0.90%	5.00%	3.89%	4.29%
2034					
2035	3.09%	1.00%	4.25%	4.09%	4.16%
2039	3.24%	0.90%	5.00%	4.14%	4.53%
2044	3.28%	0.90%	5.00%	4.18%	4.59%

2. MMD Rates as of 6/30/2014. Subject to change.  
Assumes "BBB+" category underlying ratings

Rating Differential	
Moody's	S&P/Fitch
Aaa	AAA
Aa1	AA+
Aa2	AA
Aa3	AA-
A1	A+
A2	A
A3	A-
Baa1	BBB+
Baa2	BBB
Baa3	BBB-

# Spread's Impact on Yield or Price of the Bond

## Comparison of Debt Service for AAA and BBB+ University

- For the "AAA" bond, the all in true interest cost is 3.87% which translates to annual debt service of \$5.71 MM per year for 30 years.
- For the "BBB+" bond, the all in true interest cost is 4.28% which translates to annual debt service of \$5.99 MM per year for 30 years.
- Annual difference in debt service - \$285k for 30 years
- Total difference in debt service over the 30 years - \$8.495 MM

"AAA" Bond Statistics	
Par Amount	\$87,735,000
Premium	\$12,876,893
Project Fund	\$100,000,000
Dated Date	9/15/2014
Final Maturity	6/1/2044
Arbitrage Yield	3.07%
True Interest Cost (TIC)	3.85%
<b>All-In TIC</b>	<b>3.87%</b>
Average Life (Years)	18.7
Total Debt Service	\$169,630,328
Average Annual Debt Service	\$5,709,323

"BBB+" Bond Statistics	
Par Amount	\$92,765,000
Premium	\$7,860,024
Project Fund	\$100,000,000
Dated Date	9/15/2014
Final Maturity	6/1/2044
Arbitrage Yield	3.81%
True Interest Cost (TIC)	4.26%
<b>All-In TIC</b>	<b>4.28%</b>
Average Life (Years)	18.7
Total Debt Service	\$178,125,685
Average Annual Debt Service	\$5,995,255

### Assumptions:

Market conditions as of 6/30/2014. Subject to change.  
 30-year amortizing level debt service structure  
 \$300k COI / \$3.50 UWD

## Multiple Factors Determine Rating

2014 Sector Challenges			
Challenge	Moody's	Fitch	S&P
Financial Stability	✓	✓	✓
Heightened Competition	✓		✓
Declining Government Funding	✓	✓	✓
Increased Political Scrutiny + Regulation	✓		
Changing Demographic		✓	
Affordability	✓	✓	✓
Facility Maintenance	✓		✓
Leadership Turnover			✓
Investment Performance			✓



## Multiple Factors Determine Rating

- Qualitative Factors
  - Debt Policy
  - Investment Policy
  - Capital Improvement Plan
  - Strategic Plan
  - Management team
  
- Quantitative Factors
  - Student Demand
  - Operating Performance
  - Debt Burden
  - Liquidity

### Fall Headcount Enrollment Forecasts - Texas Institutions of Higher Education

	<b>Actual 2000</b>	<b>Actual 2005</b>	<b>Actual 2010</b>	<b>Actual 2012</b>	<b>Projections</b>		
					<b>2013</b>	<b>2015</b>	<b>2020</b>
Public Universities	414,626	484,999	557,550	576,965	584,190	600,158	630,034
Public Two-Year Colleges	447,998	566,071	743,252	738,981	750,211	772,463	822,048
Independent Universities	108,315	114,984	122,894	121,336	122,389	124,065	127,200
<b>Total</b>	<b>970,939</b>	<b>1,166,054</b>	<b>1,423,696</b>	<b>1,437,282</b>	<b>1,456,790</b>	<b>1,496,686</b>	<b>1,579,282</b>

Source: Texas Higher Education Coordinating Board, Enrollment Forecast 2013-2020, as of January 2013.

Select Ratio Comparison

MOODY'S



Texas A&M  
University System

Texas State  
University System

Texas Tech  
University System

University of  
North Texas System

University of  
Texas System

Aaa/AA+/AA+

Aa2/--/AA

--/AA/AA

Aa2/--/AA

Aaa/AAA/AAA

Operating margin (%)

2.3%

2.6%

2.6%

(3.5%)

2.5%

MADS to operations (%)

8.4%

8.0%

3.5%

5.5%

4.1%

Expendable financial resources-  
to-comprehensive debt (x)

2.10x

0.52x

1.99x

0.67x

1.49x

Expendable financial resources-  
to-operations (x)

1.47x

0.42x

0.79x

0.41x

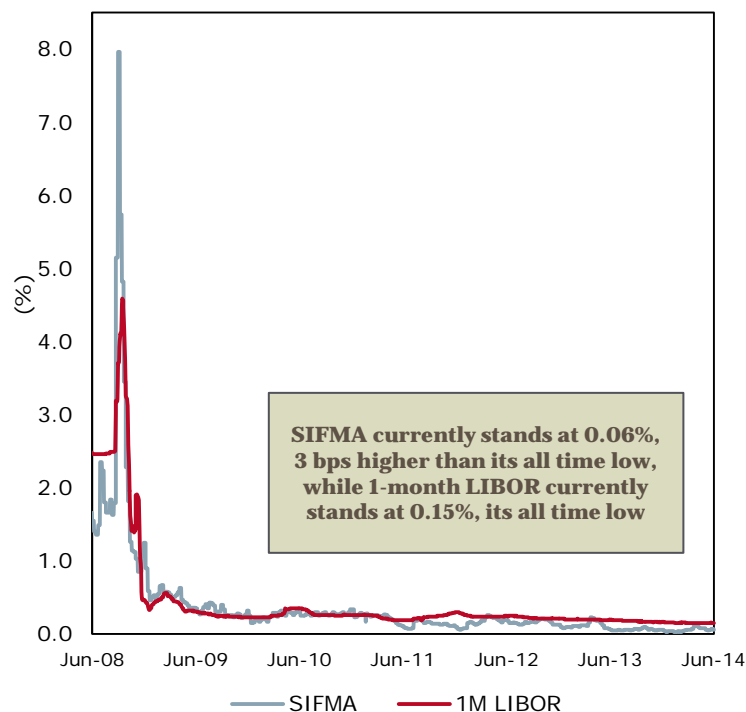
0.85x

Source: Moody's Municipal Financial Ratio Analysis FY 2013 data.

# Types of Debt: Fixed Rate and Variable Rate

- Variable rate debt today is considerably less costly than fixed rate debt
- Variable rate debt presents risks that fixed rate debt avoids

## Short-Term Interest Rates Remain Compressed



## Long-Term Tax-Exempt & Taxable Fixed Rates (30-Year)



Sources: TM3 and Bloomberg, as of 6/25/2014.

# Fixed Rate Versus Variable Rate Debt

## Comparison of Debt Service for a AAA university

- For the “AAA” fixed rate bond, the all in true interest cost is 3.87% which translates to annual debt service of \$5.71 MM per year for 30 years.
- For the “AAA” variable rate bond, the all in true interest cost is 1.79%\* which translates to annual debt service of \$4.13 MM per year for 30 years.
- Annual difference in debt service - \$1.58 MM for 30 years
- Total difference in debt service over the 30 years - \$47 MM

Fixed Rate Bond Statistics	
Par Amount	\$87,735,000
Premium	\$12,876,893
Project Fund	\$100,000,000
Dated Date	9/15/2014
Final Maturity	6/1/2044
Arbitrage Yield	3.07%
True Interest Cost (TIC)	3.85%
<b>All-In TIC</b>	<b>3.87%</b>
Average Life (Years)	18.7
Total Debt Service	\$169,630,328
Average Annual Debt Service	\$5,709,323

Variable Rate Bond Statistics	
Par Amount	\$100,370,000
Premium	\$0
Project Fund	\$100,000,000
Dated Date	9/15/2014
Final Maturity	6/1/2044
Arbitrage Yield	1.67%
True Interest Cost (TIC)	1.78%
<b>All-In TIC</b>	<b>1.79%</b>
Average Life (Years)	16.3
Total Debt Service	\$122,678,477
Average Annual Debt Service	\$4,129,044

### Assumptions for fixed rate:

Market conditions as of 6/30/2014. Subject to change.  
 “AAA” category underlying ratings.  
 30-year amortizing level debt service structure  
 \$300k COI / \$3.50 UWD

### Assumptions for variable rate:

Market conditions as of 6/30/2014. Subject to change.  
 Assumes 10-year average SIFMA rate (1.36%) for 30-year period.  
 Assumes 30bps letter of credit fee and 10bps remarketing fee.  
 30-year amortizing level debt service structure  
 \$200k COI / \$1.00 UWD

# Product Comparison: Fixed Rate versus Variable Rate

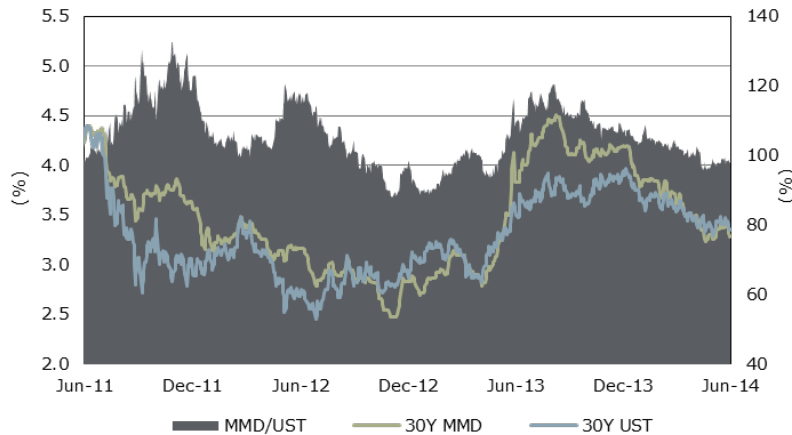
		Capital Markets					
Product		LOC-Backed CP	LOC or SBPA-Backed VRDB	Self-Liquidity VRDB	Public Market FRN	Fixed Rate Notes Put Bonds	Fixed Rate Bonds
Description		Ability to draw from program when needed; self liquidity or bank liquidity back-stop	Variable rate, reset weekly or daily by remarketing agent; trades on strength of bank provider	Variable rate, reset weekly or daily by remarketing agent; trades on strength of issuer	Floating rate note reset at fixed spread or fixed rate	Short-term note issued in anticipation of future bond sale	Long-term bonds issued at fixed rate
Periodic Rate Reset Period		Up to 270 Days	Multi-Modal	Multi-Modal	Wkly/Mthly	n/a	n/a
Facility/Note Length		1-5 Years <sup>(3)</sup>	1-5 Years <sup>(3)</sup>	n/a	Up to 5 Years	Up to 7 Years	Up to 30 Years
Purchaser		----- Public Market Investor -----					
Interest Rate		Term Dependent Set by Dealer	SIFMA + Spread	SIFMA + Spread	Index + Spread	Fixed	Fixed
Additional Support Costs		LOC + Remarketing + Legal Fees		----- Takedown + Legal Fees -----			
Considerations							
<b>Bank Risk</b>	<i>Spread over index increases due to investor discomfort with bank credit</i>	X	X	✓	✓	✓	✓
<b>Remarketing Risk</b>	<i>Spread over index is a function of a remarketing agent's capital strength and performance</i>	X	X	X	✓	✓	✓
<b>Systemic Put Risk</b>	<i>Investors refuse to hold VRDBs or Index Notes as an asset class</i>	✓	X	X	✓	✓	✓
<b>Bank Renewal Risk/ Market Access Risk</b>	<i>Facility is not renewed or pricing increases dramatically upon renewal</i>	X	X	⟷	X	⟷	✓
<b>Interest Rate Risk</b>	<i>Variable rates may rise unexpectedly resulting in higher debt service</i>	X	X	X	X	⟷	✓
<b>Prepayment Flexibility</b>	<i>Ability to call the bonds prior to the call date/mandatory tender date</i>	⟷	✓	✓	X	X	⟷
<b>Bank Terms/ Financial Covenants</b>	<i>Issuer commits to bank covenants</i>	X	X	✓	✓	✓	✓
<b>Disclosure Required</b>	<i>Investors require updated OS, audit and Appendix A</i>	X	⟷	⟷	⟷	⟷	⟷
<b>SIFMA Tax Risk</b>	<i>Interest rate index limited to SIFMA</i>	✓	✓	✓	⟷	N/A	N/A
<b>Basel III Exposure</b>	<i>Standard documents include adjustment to fees upon implementation of Basel III</i>	X	X	✓	✓	✓	✓

X Higher risk/concern      ⟷ Moderate risk/concern      ✓ Limited or low risk/concern

# Types of Debt: Tax-Exempt and Taxable Market Movements Since January 2011

- Tax-exempt bond proceeds cannot be used for private activity (some exceptions)
- Because of the tax-benefit to investors of tax-exempt bonds, tax-exempt bond yields should be lower than taxable bond yields (not always the situation)

## Short-Term Interest Rates Remain Compressed



	30Y MMD	30Y UST	MMD/UST
Min	2.47%	2.45%	87.9%
Max	4.51%	4.39%	132.5%
10Y Avg	4.15%	4.14%	100.3%
Current	3.28%	3.36%	97.6%

## Long-Term Tax-Exempt & Taxable Fixed Rates (30-Year)



Sources: TM3 and Bloomberg, as of 6/25/2014.

# Tax-Exempt Versus Taxable Debt

## Comparison of Debt Service for AAA University

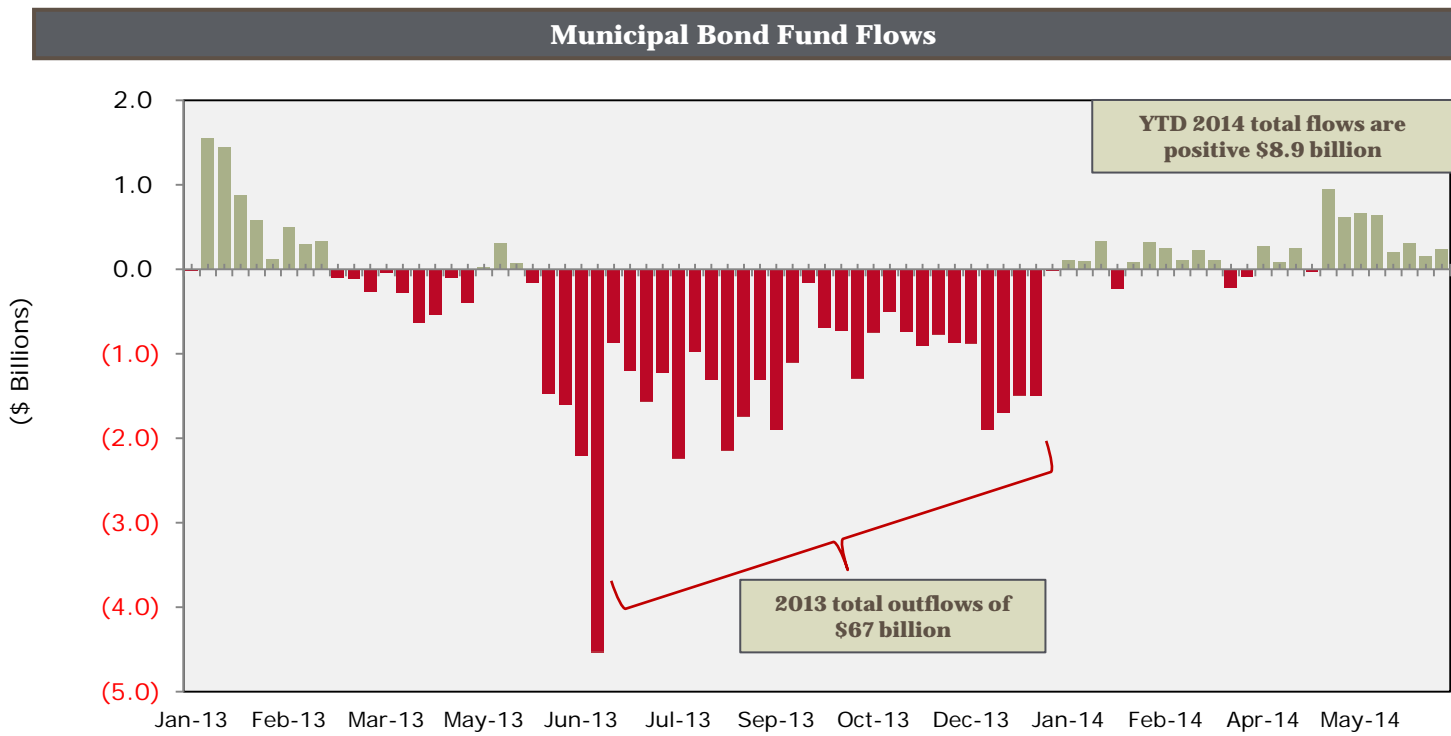
- For the “AAA” tax-exempt bond, the all in true interest cost is 3.87% which translates to annual debt service of \$5.71 MM per year for 30 years.
- For the “AAA” taxable bond, the all in true interest cost is 4.08% which translates to annual debt service of \$5.86 MM per year for 30 years.
- Annual difference in debt service - \$149k for 30 years
- Total difference in debt service over the 30 years - \$4.443 MM

Tax-Exempt Bond Statistics	
Par Amount	\$87,735,000
Premium	\$12,876,893
Project Fund	\$100,000,000
Dated Date	9/15/2014
Final Maturity	6/1/2044
Arbitrage Yield	3.07%
True Interest Cost (TIC)	3.85%
All-In TIC	3.87%
Average Life (Years)	18.7
Total Debt Service	\$169,630,328
Average Annual Debt Service	\$5,709,323

Taxable Bond Statistics	
Par Amount	\$100,655,000
Premium	--
Project Fund	\$100,000,000
Dated Date	9/15/2014
Final Maturity	6/1/2044
Arbitrage Yield	4.03%
True Interest Cost (TIC)	4.06%
All-In TIC	4.08%
Average Life (Years)	17.9
Total Debt Service	\$174,073,071
Average Annual Debt Service	\$5,858,854

Assumptions:  
 Market conditions as of 6/30/2014. Subject to change.  
 “AAA” category underlying ratings.  
 30-year amortizing level debt service structure  
 \$300k COI / \$3.50 UWD

# Demand for Municipal Bonds



Source: Lipper, A Thomson Reuters Company, as of 6/25/ 2014. Represents only funds that report weekly.



## After the Bond Sale: Continuing Disclosure

- **SEC Rule 15c2-12** – Requires underwriters of municipal securities, to ensure that the state or local government entity issuing a primary offering of bonds or an entity contractually obligated for debt service on the bonds enters into a continuing disclosure agreement to provide certain information to the Municipal Securities Rulemaking Board about the securities on an on-going basis.
- **Recent SEC enforcement actions:**
  - July 29, 2013: SEC took enforcement action against City Securities Corp and West Clark Community Schools (WCCS) for WCCS' failure to provide disclosure that was required by continuing disclosure agreement and City Securities' failure to perform appropriate due diligence.
    - In 2005, WCCS sold bonds to the underwriter and executed continuing disclosure agreement.
    - In 2007, WCCS sold bonds to the underwriter and made a statement that it had never failed to comply with any previous undertaking.
    - WCCS had not made any continuing disclosure filings on the Series 2005 bonds.
    - WCCS agreed to provide required disclosure and to adopt written disclosure policies and procedures.
    - Underwriter's violation of 15c2-12 and other violations resulted in censure, order to cease and desist from future securities law violations, comply with on-going undertakings, and disgorgement of approximately \$300,000 of profits and a fine of approximately \$300,000.

**SEC 15c2-12 compliance important to the university and investors**

# What Are Some Of The Basic Items That Are Required To Be Disclosed?

## Robust, Accurate and Timely Ongoing Disclosure Practices

Investor Benefits	Institutional Benefits
Facilitates accurate bond pricing	Fosters development of a greater pool of prospective investors
Provides secondary market liquidity	Enhances market access and re-access

Financial Information Disclosure	
Financial information and operating data	
Audited financial statements	
Event Notice Disclosure	
Always	If Material
Principal and interest payment delinquencies	Non-payment related defaults
Unscheduled draws on debt service reserves reflecting financial difficulties	Modifications to rights of security holders
Unscheduled draws on credit enhancements reflecting financial difficulties	Bond calls
Substitution of credit or liquidity providers, or their failure to perform	Release, substitution or sale of property securing repayment of the securities
Adverse tax opinions or events affecting the tax-exempt status of the security	Merger, acquisition or sale of all or substantially all of the assets of an obligated person or the termination of a definitive agreement relating to such action
Tender offers	Appointment of successor or additional trustee or change of name of trustee
Defeasances	
Rating changes	
Bankruptcy, insolvency or receivership, or similar event of the obligated person	
Failure to file annual financial information when required	

## Ongoing Disclosure – What Are Some Of The Key Areas That Need To Be Improved?

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- Post financial data, student demand statistics and MD&A in an easy to find place on your institutional website.
- **Appoint a point person who can speak to all organizational facets.**
- Make sure all relevant security and financial covenants are disclosed in the preliminary offering statement through accurate summary of the financing documents in “Plain English”, with all defined terms identified directly in the offering document.
- Post Consolidating Financial Statements, Comparison to Prior Year and Budget. Identify one time items, unrealized from realized gains.
- Debt Service Coverage after Pledged Revenues and Debt Service Coverage after Expenses.
- **Post timely self liquidity reports, collateral postings, compliance calculations and certifications to EMMA.**
- Post interim notices regarding new debt: i.e., bank loans, short term borrowings, “off-balance sheet” loans, etc.
- **Board approved Capital Improvement Plan including the timing and funding sources.**
- **Draft of a meaningful comprehensive MD&A.**
- Partial Information is better than no information:
  - Draft Audit
  - Entering Fall and Mid-Year demand statistics

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Before entering into any transactions described in the Materials, you should consider whether they are appropriate for you in light of your objectives, experience, financial and operational resources, legal capacity and authority, and other relevant circumstances. While these transactions may be used as hedging tools to reduce or eliminate certain risks associated with your assets or liabilities, this presumes holding these hedges to maturity and not disposing of the asset or liability during the term of the hedge. If the transaction is terminated early, or if you dispose of the asset or liability before the derivative matures, you may incur a substantial loss. You may also incur a substantial loss if you enter into the transaction in anticipation of hedging an asset or liability that does not materialize. You should understand that significant potential amounts could become payable for modifying the transaction or terminating it early, depending upon then existing market conditions. You should also consider that prepaying your loan or disposing of an asset or liability does not relieve you of your obligations under the transaction, which may be terminated early only in accordance with the terms of the derivatives contract (such as an ISDA Master Agreement) or otherwise by mutual consent, which may require payment of an early termination fee, which may be substantial. Whether you use them for hedging or another purpose, you should satisfy yourself that you understand these and other risks relative to the benefits you are seeking to achieve with the transaction.

Although the Materials describe how a transaction may be used to hedge against increases in the interest expense of an existing or future loan or other financing, the transaction would be a separate and independent obligation and would not be contingent on whether or not any loan or other financing closes, is outstanding or is repaid, in whole or in part, at any time, subject to any requirement of the transaction documents to terminate and settle the transaction early upon prepayment of the loan or for other loan-related events. In addition, if you provide any existing or future collateral or other credit support to secure the transaction and any exiting or future loan or other financing, then you would be entitled to the release of such collateral or credit support only if certain conditions contained in the related collateral agreement or credit support document are completely satisfied for both the transaction and any such loan or other financing. Alternative structures may be available that could achieve your interest rate risk management goals without entering into a swap and the related swap documentation.

