FINANCE AND BUDGET COMMITTEE
JUNE 21, 2001

Metropolitan
Transportation
Authority

One Gateway Plaza
Los Angeles, CA
90012-2952

SUBJECT: DEFEASED LEASE TRANSACTION FOR 67 LIGHT RAIL VEHICLES

ACTION: APPROVE DEFEASED LEASE TRANSACTION

RECOMMENDATION

A. Authorize the Chief Executive Officer to negotiate and execute a lease to service contract defeased lease transaction and other documents for the 15 Sumitomo Light Rail Vehicles (LRV's) and 52 Siemens' LRV's with Fleet Capital Leasing (Fleet) as the syndicator for the equity investors as outlined in the attached term sheet (Attachment A). The lease to service contract is anticipated to generate a gross benefit of 10.32% (estimated to be $26 million) but in no event less than 6% (estimated to be $15.5 million) of the appraised value of the vehicles.

B. Authorize payment of fees and transaction expenses not to exceed .8% of the appraised value of the vehicles estimated between $1.7 million and $2 million.

C. Approve the attached resolution authorizing the lease to service contract defeased lease transaction for the 67 light rail vehicles (Attachment B).

D. Authorize the CEO to negotiate and execute a memorandum of understanding between the Southern California Regional Rail Authority (SCRRA) and the MTA to define the terms and conditions of the two agencies joint participation in the defeased lease transaction.

ISSUE

The proposed transaction is consistent with the February 2000 Board adopted policy for defeased leasing, meets FTA Guidelines for Innovative Financing, and provides additional revenues for the MTA.

OPTIONS

One option considered was to delay leasing of the LRV's until all the Siemens' cars had been received. This option was not recommended because we expect the leasing market to be flooded with new rail cars during the next three years. As more transit agencies purchase new rail cars and pursue leasing opportunities, the available pool of equity investors will be spread thinly, which will decrease the opportunities for the transit agencies.

FINANCIAL IMPACT

Based on an estimated appraised value of $259 million, this lease is anticipated to generate approximately $21 million of revenue net of $1.7 million in expenses for the MTA. The transaction expenses to be paid by the MTA, as well as the expenses paid by the equity investor, are identified in Attachment C. Transaction value and final benefit to the MTA are dependent on then current market rates, final appraisal, and transaction expenses that could affect the results of the transaction. The gross revenue benefit is approximately 8.9% of the equipment cost, which is in excess of the estimated benefit range under the Defeased Leasing Policy approved by the Board in February 2000. The ten-year business plan assumes that leasing revenues will be available to partially reduce the operating deficit.

BACKGROUND

The Defeased Leasing Policy was adopted by the Board in February 2000. The Defeased Leasing Policy covers the solicitation and execution of defeased leases entered into with institutional investors. The scope of the Policy is limited to defeased leases on MTA assets and excludes any funded leases that are otherwise covered under MTA's Debt Policy. The assets include rolling stock, buses, maintenance facilities, train control systems, rail stations and rights of way. To "defease" in this case, means to bank sufficient proceeds from the transaction to cover scheduled lease payments as well as provide for sufficient funds for the fixed purchase option at the end of the lease term.

MTA staff conducted research with other transit agencies that have a defeased leasing program. It was determined that the MTA could generate substantial income from pursuing defeased leasing. MTA contracted with Capstar/McCalley Consulting (Capstar) to provide professional services in connection with the defeased lease program and with Orrick, Herrington & Sutcliffe, LLP, to provide tax and legal counsel.

Capstar recommended that the MTA pursue a lease to service contract on its 67 unleased light rail vehicles. A lease to service contract is a defeased lease in which at the end of the lease term, if the lessee does not exercise the fixed purchase option, the lessor can require it to provide for a third party to operate and maintain the equipment under a service contract. Under the terms of the defeasance arrangements, there will be sufficient funds for the MTA to purchase the equipment.

Selection Process

Capstar conducted a competitive process among the financial community to attract an equity investor. Three proposers responded to the information memorandum; one proposer was determined to be non-responsive to the proposed requirements. Further questions and clarifications were sent to the remaining two proposers. The Fleet proposal provides the MTA with $1.2 million more in up-front benefit than the CIBC proposal. After considering all risks and benefits, MTA staff selected Fleet because their proposal offered the MTA the greatest economic benefit.

Risks to the MTA

The risks of the proposed lease to service contract fit within the risks description originally outlined to the Board when the defeased leasing policy was adopted in February 2000.

1. Sales and Use Taxes: The transaction will be structured so as to minimize the risk of any additional taxes being imposed on the MTA or the equity investor.
2. Early Termination for Casualty Event: Should the asset become unsuitable for commercial use, the documents will provide for an extended period to replace or post collateral.
3. Credit Rating of Surety Bond Provider: The transaction will use AAA rated defeasance providers and MTA will have to replace these parties if their respective ratings fall below AA-/Aa3.
4. Tax Risk: The equity investor will take all structural risk, change in tax law risk, and change in US tax rate risk. For federal income tax purposes, MTA will be required to make representations as to the use of the equipment.
5. General Indemnity: MTA will be expected to protect the investor against any 3rd party claims that may arise out of the operation and maintenance of the rail cars so long as they are under MTA's care, custody, and control.
6. Early Termination for Obsolescence: Termination Value will be based on a fixed schedule of agreed upon values leaving no uncertainty as to cost if MTA wants to collapse the lease for obsolescence of the equipment.

Delivery Process

The financing will be closed in two separate transactions to accommodate MTA's expected delivery schedule for the Siemens LRV's. The first tranche which is anticipated to close by the end of August 2001 would include the 15 Sumitomo LRV's and up to 26 Siemens LRV's. The estimated fair market value for the first tranche is $150 million. The second tranche, which is expected to close in the first or second quarter of 2002, will be for up to 26 Siemens LRV's at a fair market value of up to $109 million. The timing of the second closing will depend on the delivery of the last LRV.

SCRRA Participation

The SCRRA has requested to combine their 28 bi-level commuter coaches and 4 passenger locomotives valued at $67.8 million with MTA's lease assets. The advantage to the MTA of including the SCRRA in our transaction is that some of the expenses will be shared between the two agencies. The SCRRA has agreed that the MTA will be the lead agency in negotiating the transaction. The SCRRA has also agreed to use the MTA's leasing advisor and outside counsel to evaluate and negotiate the transaction. The SCRRA will request approval from their Board to proceed with the leasing transaction on June 8, 2001.

NEXT STEPS

1. Negotiate documentation with syndicator and other equity investors, as identified, lender, debt payment undertaker, equity payment undertaker, and GIC provider;
2. Obtain final appraisal and transportation consultant's report;
3. Obtain Federal Transit Administration approval of transaction;

4. Set final pricing and schedule closing; and
5. Execute final documentation, fund and close transaction.

ATTACHMENTS

A. Term Sheet
B. Resolution Authorizing the lease to service contract defeased lease transaction for the 67 light rail vehicles
C. Estimated Transaction Expenses

Michelle Caldwell
Deputy Executive Officer
New Business Development

Terry Matsumoto
Executive Officer, Finance
and Treasurer

Richard Brumbaugh
Chief Financial Officer

Allan G. Lipsky
Office of the Chief Executive Officer

ATTACHMENT A

US LEASE TRANSACTION SUMMARY

PARTICIPANTS AND KEY DETAILS

Sublessee:	Los Angeles County Metropolitan Transportation Authority
Equity Participant:	Fleet Capital Leasing as syndicator (other participants TBD).
Head Lessee/ Sublessor/Trustee:	A grantor trust created by the Equity Participant with a California trust company. A trust is used in part to help insulate other Transaction Parties from risks associated with a bankruptcy of the Equity Participant.
Series A Lender:	AIG-FP Funding (Cayman) Limited. The Series A Lender will lend to the Trustee 90% of the loan portion of the Trustee's prepayment of the Head Lease rentals.
Series B Lender:	Dexia Public Finance Bank, New York Agency. The Series B Lender will lend to the Trustee 10% of the loan portion of the Trustee's prepayment of the Head Lease rentals.
Series A Loan Payment Undertaker:	AIG-FP Special Finance (Cayman) Limited. The obligations of the Series A Loan Payment Undertaker will be guaranteed by American International Group, Inc., a AAA/Aaa rated company.
Series B Loan Payment Undertaker:	AIG Matched Funding Corp. The obligations of the Series B Loan Payment Undertaker will be guaranteed by American International Group, Inc., a AAA/Aaa rated company.
Equity Payment Undertaker	To be Determined. The Equity Payment Undertaker will be guaranteed by a AAA/Aaa rated company, or guaranteed by a AAA/Aaa rated company and may be collateralized with specified securities, including Freddie Mac's and Fannie Mae's.
Strip Coverage:	Strip coverage will be provided by Financial Security Assurance, Inc. ("FSA"), a AAA/Aaa rated insurer, in an

	amount equal to the difference between the equity portion of termination value, the value of the Series B Payment Undertaking Agreement, and the scheduled accreted value of the Equity Payment Agreement.
Head Lease Prepaid Rent:	Approximately US$259,200,000
Appraiser:	Ernst & Young, LLP
Rail Expert:	Mercer Management Consulting, Inc., a subsidiary of Marsh McLennan or other qualified consulting firm.
Basic Lease Term:	Up to 28 years
Service Contract Term:	Approximately 14 years
Equity Counsel:	King & Spalding
Sublessee Counsel:	Orrick, Herrington & Sutcliffe LLP
Series A Lender Counsel:	O'Melveny & Myers LLP
Series B Lender and Surety Bond Counsel:	White & Case LLP

Attachment B

Resolution
Authorizing the Lease to Service Contract Defeased Lease Transaction for the 67 Light Rail Vehicles

WHEREAS, the Los Angeles County Metropolitan Transportation Authority (the "Authority") provides public transportation services with its buses and Metro Red Line, Blue Line and Green Line; and

WHEREAS, at its meeting on February 24, 2000, the Board of Directors of the Authority (the "Board of Directors") approved and adopted a policy (the "Defeased Lease Policy") governing defeased lease transactions of the Authority's fixed assets for the purpose of generating funds for the Authority; and

WHEREAS, a defeased lease transaction (the "Transaction") for the lease of up to 67 light rail vehicles, as described in Attachment A (the "Transaction Summary"), has been presented to the Board of Directors which, if carried out in accordance with its terms, will provide a substantial present value benefit to the Authority, the Authority's passengers and residents within the Authority's service area; and

WHEREAS, the Transaction meets the criteria and requirements of the Defeased Lease Policy; and

WHEREAS, certain agreements described in the Transaction Summary will reduce the amount or duration of payment, rate or similar risk to the Authority of the Transaction or enhance the relationship between risk and return with respect to investments made pursuant to or in connection with the Transaction, as authorized under Section 5922 of the California Government Code; and

WHEREAS, the Board of Directors now desires to authorize the officers and staff of the Authority to take such further actions, including the negotiation, execution and delivery of such documents, agreements and certificates as shall be necessary and appropriate to implement the transaction described in the Transaction Summary;

NOW, THEREFORE, THE LOS ANGELES COUNTY METROPOLITAN TRANSPORTATION AUTHORITY DOES HEREBY FIND, DETERMINE AND ORDER AS FOLLOWS:

Section 1. The above recitals are true and correct, and the Board of Directors so finds and determines.

Section 2. The Transaction as described in the Transaction Summary is hereby approved. The officers and staff of the Authority, under the direction of the Chief Executive Officer of the Authority, are hereby authorized and directed, for and in the name of and on behalf of the Authority, to negotiate and cause the preparation of the documents described in the Transaction Summary and such related documents as are necessary or proper to effect the Transaction (collectively, the "Transaction Documents"), provided that such Transaction Documents contain substantially the terms described in the Transaction Summary.

Section 3. The Chief Executive Officer of the Authority or his designee is hereby authorized and directed, for and in the name of and on behalf of the Authority, to execute and deliver the Transaction Documents to which the Authority is a party, in such form as the Chief Executive Officer and the Authority's general counsel may approve, such approval to be conclusively evidenced by the execution and delivery thereof.

Section 4. The officers of the Authority are hereby authorized and directed, for and in the name and on behalf of the Authority, to do any and all things and take any and all actions, including (without limitation) the execution and delivery of any and all certificates, filings, documents and agreements, which such officers may deem necessary or advisable in order to consummate the transactions described in the Transaction Summary and otherwise to give effect to the purpose and intent of this Resolution.

Section 5. This Resolution shall take effect from and after the date of its adoption.

ATTACHMENT C

Estimated Transaction Revenue and Expenses

Estimated Appraised Equipment Value	**$259,200,000**	**100.00%**
Proposed Gross Benefit as defined by the FTA	**$26,744,490**	**10.32%**
Transaction Expenses paid by Fleet		
*Lessor Counsel	$350,000	0.14%
Trustee Counsel	$10,500	0.00%
Custodian Counsel	$10,500	0.00%
*Lender Counsel (AIG)	$175,000	0.07%
Lender Jersey Counsel (AIG)	$10,000	0.00%
Lender Cayman Counsel (AIG)	$10,000	0.00%
Surety/Lender B Counsel (FSA/Dexia)	$200,000	0.08%
Trustee	$55,500	0.02%
Custodian	$50,250	0.02%
Lender Fees	$933,120	0.36%
Lender B Upfront Fees	$200,000	0.08%
Surety Policy	$1,244,160	0.48%
*Appraiser	$60,000	0.02%
*Transportation Consultant	$190,000	0.07%
California Counsel	$22,500	0.01%
Miscellaneous	$150,000	0.06%
Total paid by Fleet	$3,671,530	1.42%
Gross Benefit Paid To MTA	**$23,072,960**	**8.90%**
Transaction Expenses paid by MTA		
Lessee Advisor (Capstar/McCalley)	$1,425,600	0.55%
*Lessee Counsel	$275,000	0.11%
Miscellaneous	$299,400	0.12%
Total paid by MTA	$2,000,000	0.77%
Net Benefit To MTA	**$21,072,960**	**8.13%**
FTA Transaction Expense Ratio (Total Expenses Paid/FTA Gross Benefit)		**21.21%**

Please note that these estimates are for pricing evaluation purposes only and are subject to change.
* These expenses may be reduced due to potential cost sharing opportunities with the SCRRA.