18

Metropolitan
Transportation
Authority

One Gateway Plaza
Los Angeles, CA
90012-2932

(213) 922-2000

FINANCE AND BUDGET COMMITTEE
OCTOBER 17, 2002
REVISED

SUBJECT: DEFEASED LEASE TRANSACTION FOR UP TO 1,162 BUSES

ACTION: APPROVE DEFEASED LEASE TRANSACTION

RECOMMENDATION

A. Authorize the Chief Executive Officer to negotiate and execute a defeased lease transaction for up to 800 NABI Buses and up to 362 New Flyer Buses (collectively, the "Buses") with Philip Morris Capital Corporation ("PMCC") as the equity investor as outlined in the attached term sheet (Attachment A).

B. Authorize payment of fees and transaction expenses not to exceed ~~.65~~.66% of the appraised value of the vehicles (Attachment B).

C. Approve the attached resolution authorizing the lease to service contract defeased lease transaction for up to 1,162 Buses (Attachment C).

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. The lease to service contract is anticipated to generate a net benefit of 2% of the appraised value of the vehicles, approximately $~~8~~7.5 million, but in no event less than the FTA's maximum allowable transaction cost-to-gross-benefit ratio of 50%.

OPTIONS

An option is to reject PMCC's bid and reissue an invitation for bids to lease the Buses in the first quarter of calendar year 2003. This option is not recommended due to pricing and timing parameters associated with leasing the Buses. Due to Federal income tax considerations, a fourth quarter closing provides the equity investor with a greater tax incentive that they offer to share with MTA. Delaying this transaction until 2003 will cause approximately one third of the Buses to become ineligible for a lease transaction and reduce the benefit to MTA and provides no assurance that more or better bids will be submitted.

FINANCIAL IMPACT

Based on an estimated appraised value of $~~400~~375 million, this lease is currently anticipated to generate approximately $~~8~~7.5 million of revenue, net of $~~2.6~~2.5 million in expenses for the MTA. The estimated transaction expenses to be paid by the MTA, as well as the expenses paid by the equity investor, are identified in Attachment B. Transaction value and final benefit to the MTA are dependent on interest rates at closing, final appraisal, and actual transaction expenses. The anticipated benefit, approximately 2% of the equipment cost, is within the estimated benefit range under the Defeased Leasing Policy approved by the Board in February 2000. The ten-year financial forecast assumes that leasing revenues will be available to partially fund the operation of the transit system.

BACKGROUND

The Board adopted the Defeased Leasing Policy 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.

The MTA has successfully completed five transactions to date. The subject assets include rolling stock, maintenance facilities and parking structures. These five transactions have generated $48.0 million in gross revenue benefit to the MTA.

Asset	Date	Transaction FMV (millions)	NPV - %FMV	NPV (millions)
Red Line HRV's	June 2000	$182.9	8.4%	$15.3
Rail Maintenance Facilities	August 2001	285.6	5.0%	14.3
LRV's Part I	September 2001	82.4	7.6%	6.3
Parking Structure	June 2002	125.0	5.8%	7.2
LRV's Part II	September 2002	71.3	6.9%	4.9
	Totals	**$747.2**		**$48.0**

Discussion of Equity Marketing Process

Capstar conducted a competitive process among the financial community to attract an equity investor. 25 potential equity investors were solicited. Two proposers responded to the information memorandum; one proposer was determined to be non-responsive to the proposed requirements. Two experienced bus investors who did not respond, Comerica Leasing Corporation and Wells Fargo Equipment Finance, Inc., indicated that they have exposure issues to the MTA since they have recently invested in prior MTA transactions.

PMCC is a wholly owned subsidiary of Philip Morris Companies Inc., a diversified Fortune 500 company and the global leader in branded foods and non-alcoholic beverages. PMCC is an experienced investor with available capacity to close MTA's bus transaction volume. PMCC has closed a number of U.S. municipal transactions including New York MTA, New Jersey Sports Authority, New Jersey Transit, Oglethorpe Power Company, Big Rivers Electric Corporation, Michigan Waste Energy, Inc. and Seminole Electric Cooperative, Inc.

PMCC just closed a $500 million rolling stock transaction for the New York MTA in September 2002 and a similar bus transaction for New Jersey Transit (NJT) for $300 million covering 800 buses. The economics of PMCC bid for MTA are consistent with those of the NJT transaction.

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 and is consistent with the risk parameters of MTA's previous lease transactions.

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 partially terminate the transaction to preserve the benefit.
3. Interest Rate Risk: As with all defeased lease transactions, the economics are subject to movement in interest rates prior to closing. PMCC has agreed to index their yield which offsets some of this volatility, but there is still significant exposure to rate movements as shown in the chart below.

INTEREST RATE	NET BENEFIT (%)	NET BENEFIT ($millions)
4.9%	1.3%	~~5.3~~4.9
5.0%	1.5%	~~6.0~~5.6
5.1%	1.7%	~~6.6~~6.4
5.2%	1.8%	~~7.3~~6.8
5.3%	2.0%	~~8.0~~7.5
5.4%	2.2%	~~8.6~~8.3
5.5%	2.3%	~~9.3~~8.6
5.6%	2.5%	~~10.0~~9.4
5.7%	2.7%	~~10.7~~10.1

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. Broken Deal Risk: If the transaction fails to close for any reason the MTA may be liable for transaction costs incurred. Those costs are primarily for legal counsel for all of the parties and are estimated at a maximum of $500,000.

NEXT STEPS

1. Identify remaining principal parties such as lenders and defeasance providers;
2. Negotiate documentation with principal parties;
3. Obtain final appraisal and transportation consultant's report;
4. Obtain Federal Transit Administration approval of transaction;
5. Set final pricing and schedule closing; and
6. Execute final documentation, fund and close transaction.

ATTACHMENTS

A. Term Sheet
B. Estimated Transaction Expenses
C. Authorizing Resolution

Terry Matsumoto
Executive Officer, Finance and Treasurer

Roger Snoble
Chief Executive Officer

ATTACHMENT A

US LEASE TRANSACTION SUMMARY

PARTICIPANTS AND KEY DETAILS

Sublessee:	Los Angeles County Metropolitan Transportation Authority
Equity Participant:	Philip Morris Capital Corporation ("PMCC")
Head Lessee or Owner/ 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:	The Series A Lender will lend to the Trustee approximately 80% of the loan portion of the Trustee's prepayment of the Head Lease rentals or payment for acquiring the equipment. Defeased lease lenders such as AIG or FSA will be selected based on experience, terms and conditions as well as price.
Series B Lender:	The Series B Lender will lend to the Trustee approximately 20% of the loan portion of the Trustee's prepayment of the Head Lease rentals or payment for acquiring the equipment. This lender will be selected competitively based on terms and conditions as well as price.
Series A Loan Payment Undertaker:	A financial institution will agree to make Series A Loan debt service payments in return for an up-front fee. The obligations of the Series A Loan Payment Undertaker will be guaranteed by a subsidiary of the chosen Series A Lender.
Series B Loan Payment Undertaker:	Either U.S. Government Treasury or Agency Securities (such as FNMA, FICO, REFCO, etc.) or a financial instrument with an underlying credit rating of not less than AA.
Equity Payment Undertaker	Either U.S. Government Treasury or Agency Securities (such as FNMA, FICO, REFCO, etc.) or a financial instrument with an underlying credit rating of not less than AA.
Strip Coverage:	Strip coverage may be purchased from a AAA/Aaa rated insurer, in an amount equal to the difference between the equity portion of termination value, the value of the securities or financial instrument used for the Series B Loan defeasance, and the scheduled accreted value of the securities or financial instrument used for equity defeasance. PMCC does not require such coverage at closing and the MTA may elect not to purchase strip coverage, effectively saving the policy premium fee. If strip coverage is not purchased at close, it is anticipated that a Material Adverse Change ("MAC") clause will be required by PMCC, which may require the MTA to purchase strip coverage at a later date on the occurrence of certain credit triggers.

Head Lease Prepaid Rent or Sales Proceeds:	Approximately $~~400,000,000~~375,000,000
Appraiser:	Ernst & Young, LLP
Rail Expert:	R.L. Banks & Associates, Inc.
Basic Lease Term:	Up to 13 years
Service Contract Term:	Approximately 7 years
Equity Counsel:	Hunton & Williams
Sublessee Counsel:	~~To be determined.~~Orrick, Herrington & Sutcliffe
Series A Lender Counsel:	To be determined.
Series B Lender and Surety Bond Counsel:	To be determined.
Other	All other terms and conditions consistent with prior transactions as approved by County Counsel.

Attachment B

LACMTA Buses

Estimated Transaction Revenue and Expenses

Estimated Appraised Equipment Value	**$~~400,000,000~~375,000,000**	
Proposed Gross Benefit as defined by the FTA	**$~~14,440,000~~13,537,500**	**3.61%**
Transaction Expenses paid by PMCC		
Lessor Counsel	400,000	~~0.10~~0.11%
Series A Lender Fee	~~800,000~~700,000	~~0.20~~0.19%
Series A Lender Counsel	175,000	~~0.04~~0.05%
Optional Surety Policy	1,000,000	~~0.25~~0.27%
Series B Lender Fee	~~650,000~~475,000	~~0.16~~0.13%
Series B Lender Counsel	175,000	~~0.04~~0.05%
Appraisal	150,000	0.04%
Transportation Consultant	150,000	0.04%
Trustee/Custodian	40,000	0.01%
Trustee Counsel	10,000	0.00%
Residual Value Insurance	50,000	0.01%
Lessor Local Counsel	50,000	0.01%
Lender Local Counsel	25,000	0.01%
Miscellaneous	~~165,000~~175,000	~~0.04~~0.05%
Total paid by PMCC	~~3,840,000~~3,575,000	~~0.96~~0.95%
Gross Benefit Paid to MTA	**~~10,600,000~~9,962,500**	**~~2.65~~2.66%**
Transaction Expenses paid by MTA		
Capstar Partners/McCalley Consulting	~~2,200,000~~2,062,500	0.55%
Lessee Counsel	350,000	0.09%
Miscellaneous	50,000	0.01%
Total paid by MTA	~~2,600,000~~2,462,500	~~0.65~~0.66%
Net Benefit Paid to MTA	**$~~8,000,000~~7,500,000**	**2.00%**
FTA Transaction Expense Ratio (Total Expenses Paid/FTA Gross Benefit)		**44.60%**

Attachment C

Resolution
Authorizing the Lease to Service Contract Defeased Lease Transaction for 1,162 Buses

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

WHEREAS, at its February 2002 meeting, the Board of Directors of the MTA (the "Board of Directors") approved and adopted a policy (the "Defeased Lease Policy") governing defeased lease transactions of the MTA's fixed assets for the purpose of generating funds for the MTA; and

WHEREAS, a defeased lease transaction (the "Transaction") for the lease of up to 1,162 Buses, 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 MTA, the MTA's passengers and residents within the MTA'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 MTA 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 MTA 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 MTA, under the direction of the Chief Executive Officer of the MTA, are hereby authorized and directed, for and in the name of and on behalf of the MTA, 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 MTA or his designee is hereby authorized and directed, for and in the name of and on behalf of the MTA, to execute and deliver the Transaction Documents to which the MTA is a party, in such form as the Chief Executive Officer and the MTA's general counsel may approve, such approval to be conclusively evidenced by the execution and delivery thereof.

Section 4. The officers of the MTA are hereby authorized and directed, for and in the name and on behalf of the MTA, 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.