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FINANCE AND BUDGET COMMITTEE
OCTOBER 14, 2009

SUBJECT: DEFEASED LEASING

ACTION: APPROVE RESTRUCTURING OF FIRST HAWAIIAN RAILCAR TRANSACTION

RECOMMENDATION

Authorize the Chief Executive Officer and designees to negotiate and execute the documents necessary to restructure the First Hawaiian railcar transaction in accordance with the Restructuring Term Sheet, Attachment 1.

RATIONALE

We are in a technical default situation under our defeased lease transaction with First Hawaiian Bank ("FH") as a result of the credit rating downgrade of American International Group ("AIG") and the unavailability of an acceptable replacement payment undertaker. In this transaction, AIG provides the defeasance for end-of-term purchase option through a guaranteed investment contract ("GIC"). Under the GIC, we made a one-time, initial, non-refundable payment to AIG to fund the GIC. AIG agreed to pay the amounts to FH on the dates specified in the transaction. AIG was required to collateralize its obligations under the GIC at inception.

Financial Security Assurance ("FSA") provides the defeasance for the debt portion of lease rents in addition to a surety bond that insures our obligation to pay liquidated damages in the event that we are in default under the transaction. Currently, FSA's credit ratings meet the minimum threshold for both the defeasance and the surety bonds roles but both Moody's and Standard & Poor's have issued "negative" watch warnings and a further downgrade by Moody's would place FSA's credit below the replacement threshold.

The proposed restructuring will remedy this situation and allow the transaction to remain in place for the balance of its original term. We will open an escrow account that will contain cash or acceptable U.S. government securities in the initial amount of approximately $15 million that will be pledged to FH. A summary schedule of our collateral requirement over the remaining term of the transaction is shown in Attachment 2. On the purchase option date, assuming AIG performs as obligated under the GIC, these funds will be released back to us. Because the federal government is an 80% owner of AIG and AIG has collateralized its defeasance obligations under the GIC, we feel that our exposure to AIG is manageable. FH will waive the current and future replacement requirements that would be triggered by downgrades of FSA's credit ratings that could lead to a similar technical default as noted above.

The assets necessary to fund the escrow account are available from our workers' compensation/general liability self insurance reserves. The reserves totaled approximately $298 million on June 30, 2009. Because this reserve is fully funded and we annually budget additional monies to the reserve at 100% of our estimated annual expense, we believe that the reserve balance will remain sufficient to cover virtually any unforeseen occurrence over the remaining term of the lease.

DISCUSSION

We closed this transaction for the rail cars on September 29, 2002. The rail cars were valued at $71.3 million and we received an upfront benefit of $5.4 million.

Last fall, AIG's credit ratings were downgraded below the Aa3/AA- (Moody's/Standard & Poor's) credit triggers for replacing the GIC. Failure to successfully replace AIG on a timely basis constitutes an "event of default" under the lease documents. The penalties for default are substantial and could be approximately $14.2 million for this deal. Our total exposure is approximately $165.7 million for the seven transactions that are affected by the AIG downgrade.

FINANCIAL IMPACT

Funding of $1,000,000 has been included in the FY10 budget in cost center #0521 and project #100002 for the costs required to maintain and finalize the restructuring of leasing transactions.

The $15 million deposit into the escrow account has no budget impact and "no cost" because the assets remain our property as long as we remain in compliance with the FH documents and AIG fulfills its obligation to make the end-of-term payments to us. As shown on Attachment 2, the collateral requirement grows over time before final payments are made. In the event that interest earnings on the initial $15 million deposit are insufficient to meet the stated requirements, approval of the proposed restructuring also allows us to deposit additional funds from our self insurance reserves into the escrow account to meet the collateral requirement as necessary. Any additional deposits will also have no budgetary impact. The funds will be returned to the workers' compensation/general liability reserves after successful conclusion of the lease.

Impact to Bus and Rail Operating and Capital Budget

The sources of funds for the execution of the documents are Prop A, Prop C, and TDA Administrative funds. These funds are not eligible for bus and rail operating and capital expenditures.

ALTERNATIVES CONSIDERED

After AIG's downgrade last year, FH initially indicated that they wanted to terminate the deal and demanded a fee of $15,000 per month that we have been paying to temporarily waive the default provision. However, after preliminary negotiations, we determined that their exit price was in excess of the high price of purchasing an acceptable replacement for AIG. This option is not recommended.

We attempted to identify suitable replacements for AIG but found that there were few, if any, creditworthy parties and, if a replacement GIC might be available, it would have been prohibitively expensive. This option is not recommended.

BACKGROUND

It is estimated that the major transit agencies across the country executed over $15 billion of these transactions up to 2003 when Congress specifically changed the tax code to make future transactions uneconomic. AIG was a major player in this market and is involved in a substantial percentage of these transactions.

A coalition of these transit agencies was successful in having bills introduced in both the House and the Senate that would impose a 100% excise tax on the tax benefit portion of any liquidated damages received by investors to deter investors who might seek to take advantage of the technical defaults created by the credit downgrade.

On September 17, 2009, the United States 7th Circuit Court of Appeals handed down a decision in a case (the so-called "Hoosier Case") involving a similar lease transaction involving a rural electrical co-op in Indiana. The lessee in the Hoosier Case had obtained a preliminary injunction against the equity investor that temporarily enjoined the equity investor from exercising its remedies after the lessee was required to replace a surety bond provider following such provider's downgrading (similar to our replacement requirements in the FH lease transaction). However, in the 7th Circuit's decision, the court indicated that the lessee could not indefinitely forestall the lessor from exercising its remedies, going so far as to note that the lessee would either need to replace the downgraded surety bond provider by the end of the year or the lessor would be permitted to draw on the surety bond.

We executed 10 defeased lease transactions through 2003 and earned $65 million for our participation. One transaction not involving AIG was terminated in March 2009 at no cost to us other than minor legal expenses.

ATTACHMENTS

1. Restructuring Term Sheet
2. Collateral Requirements

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Chief Financial Services Officer and Treasurer

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Chief Executive Officer

Attachment 1
First Hawaiian Restructuring Term Sheet

1. Custodial Account: MTA will establish a securities custodial account (the "Custodial Account"). MTA will be the beneficial owner of the account but the Custodial Account will be pledged to First Hawaiian ("FH"). FH will release its existing lien and right to receive payment under the AIG payment undertaking agreement, the "GIC".

2. Funding of Custodial Account: On the funding date, MTA will be responsible for transferring Acceptable Collateral into the account with a fair market value equal to 104% of the "Accreted Value" under the lease (the "Collateral Requirement"). See Attachment 2 for schedule of the remaining Collateral Requirements.

3. Acceptable Collateral: Acceptable Collateral will consist of cash or US government and government agency securities.

4. Custodial Account Maintenance Requirement: MTA will be required to maintain and post additional collateral (or may withdraw collateral) such that, on a quarterly basis, the aggregate FMV of the Acceptable Collateral is equal to the Collateral Requirement on that date.

5. Existing First Hawaiian Collateral: The existing AIG GIC will remain in place but will be payable to MTA upon AIG's or MTA's default rather than to FH. The posting of Additional Collateral would satisfy MTA's obligations under the Participation Agreement to replace the AIG GIC.

6. FH will waive the minimum credit ratings requirements for FSA with respect to both the debt defeasance and the surety bond for the remainder of the transaction.

Attachment 2
Collateral Requirements

Date	Collateral (in $ millions)
November 2009	15.0
November 2010	15.8
November 2011	16.6
November 2012	17.5
November 2013	18.3
November 2014	19.3
November 2015	20.3
November 2016	21.3
November 2017	22.4
November 2018	23.6
November 2019	24.8
November 2020	26.1
November 2021	27.4
November 2022	28.9
November 2023	30.3
November 2024	31.9
November 2025	33.6
November 2026	35.4
November 2027	37.2
November 2028	13.7
January 2029	0.0