Agenda Item No.	Board Meeting Date	Open/Closed Session	Information/Action Item	Issue Date
9	02/28/11	Open	Action	02/21/11

Subject: Approving a Restructuring Agreement for RT's Leveraged Lease Transactions

ISSUE

Whether or not to approve a restructuring agreement for RT's 2005, 2006, and 2007 Leveraged Lease Transactions (SILOs) and authorize the General Manager/CEO to execute the agreements. needed to accomplish such restructuring.

RECOMMENDED ACTION

Adopt Resolution No. 11-02-_____ Approving a Restructuring Agreement for RT's 2005, 2006, and 2007 Leveraged Lease Transactions (SILOs), and Authorizing the General Manager/CEO to Execute the Agreements.

FISCAL IMPACT

Budgeted:	No	This FY:	$200,000
Budget Source:	Operating	Next FY:	$0
Funding Source:	LTF; STA; Measure A	Annualized:	$N/A
Cost Cntr/GL Acct(s) or Capital Project #:	23 - 630003	Total Amount:	$200,000
Total Budget:	$ 200,000		

DISCUSSION

The purpose of this report is to 1) provide background on the nature and history of RT's SILO transactions; 2) summarize RT's proposal to The Fifth Third Leasing Company ("Fifth Third"), the equity investor on RT's three SILOs, to restructure all three transactions; and 3) discuss the expected costs and benefits of the proposed action.

Background:

A SILO (Sale In - Lease Out), transaction allows a public agency to "sell" the tax ownership of certain capital assets (in RT's case, 50 rail cars) to a for-profit investor (the "Equity Investor") and then lease them back over a long period of time (30 years), after which the agency can exercise a purchase option to re-acquire such leased assets.

With the encouragement and endorsement of the Federal Transit Administration (FTA), RT undertook 3 SILO transactions in 2005, 2006, 2007 with the Fifth Third Leasing Company as the Equity Investor. The SILOs involved, among other parties, AIG Matched Funding Corp., AIGFP-Special Finance, each guaranteed by American International Group, Inc (AIG) and Ambac Assurance Corp. (Ambac) . The net proceeds to RT totaled approximately $11 million in flexible

Approved:	Presented:
FINAL 2/23/11	
General Manager/CEO	Chief Financial Officer

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funding which was used to partially fund the Amtrak-Folsom project and to augment operations at the onset of the fiscal crisis in 2007.

In a SILO transaction, approximately 93% of the financed value of the assets is placed on deposit with the various financing counterparties at rates of interest that will fund the public agency’s annual payment obligations and its purchase option at the end of the lease term. Approximately 5% of the value of the assets is returned to the public agency as proceeds to use for operating or capital purposes. The equity investor receives its benefit over time in the form of the ability to use depreciation on the acquired assets to offset profits in its financial statements. The net effect (and benefit) for the investor was to reduce corporate income taxes. After the close of the transactions, no further action to annually make or receive payments is required by the public agency or the investor, assuming the financial counterparties perform as required by the SILO documents and remain creditworthy. All payments in connection with the SILO are made from funds on deposit, received and guaranteed by the counterparties to the transactions.

Leveraged Lease Transactions with “Grandfathered” Status

In 2003, the Internal Revenue Service (IRS) determined that SILO transactions were illegal tax shelters and that investors could not use the tax benefits to offset profits. Legislation was enacted to codify the IRS position. That legislation, however, specifically exempted transactions that were “in the pipeline”, thereby “grandfathering” those transactions and, in effect, allowing their investors to take the tax benefits from such SILO transactions. All three of RT’s transactions are “grandfathered” transactions.

Discussion of RT’s Transactions and the Restructuring Proposal

Each of RT’s three transactions was structured the same and involved the same parties. AIG Matched Funding provided a collateralized Equity Payment Undertaking Agreement (EPUA) which was guaranteed by AIG. Another AIG affiliated entity, AIGFP-Special Finance, provided a Debt Payment Undertaking Agreement (DPUA) which was also guaranteed by AIG. Ambac provided a surety, or secondary back up insurance. The agreements require RT to replace Ambac and AIG within 60 days in the event their ratings are downgraded below these triggers: “Aa3/AA-” in the case of Ambac and “A2/A” in the case of AIG as EPUA guarantor and ”A3/A-“ as DPUA guarantor.

As a result of the financial crisis that began in 2008, the ratings of both entities fell below the applicable thresholds. Both AIG and Ambac had been rated “Aaa/AAA”. AIG is now rated “Baa1/A-”, with the most recent Moody’s downgrade occurring in January 2010; Ambac is now rated in the “Caa” category by Moody’s and no longer carries a rating by Standard & Poors (S&P.)

From the time that the ratings first fell below their minimum thresholds in September 2008, Fifth Third has willingly provided RT with letter agreements in which it agreed to forbear from taking an action under the SILO documents for a period of time. With each expiration, Fifth Third provided a new letter. To date, Fifth Third has issued 11 such temporary forbearance letters – each at no cost apart from legal fees. However, Fifth Third made it clear that the forbearance process could not continue indefinitely and that a more permanent solution would eventually need to be found.

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RT has maintained regular contact with Fifth Third throughout this process. Working with RT's Financial Advisor, RT has discussed and analyzed numerous potential solutions, including the replacement of Ambac and AIG; the posting of additional collateral, and the termination of the SILOs. For a variety of reasons, none of these solutions were feasible.

In December 2010, Fifth Third advised RT that another transit agency had approached them with a restructuring strategy and that details would be forthcoming after the amendment to the transaction had closed. In January 2011, RT received the following details of the approach that had been accepted by Fifth Third from another other transit agency:

Fifth Third agreed to:

- Reduce the rating trigger for the AIG EPUA from "A2/A" to "Baa3/BBB-", provided that AIG continued to collateralized the EPUA as required under that document.
- Reduce the rating trigger to the AIG DPUA to "Baa3/BBB-"
- Keep Ambac in place, but eliminate the requirement to replace it
- In the event that the AIG revised rating trigger is hit, extend the time frame for replacement to the greater of: (1) one year after notice of the downgrade or (2) 180 days after direction from Fifth Third.

The Transit Agency agreed to:

- Pay $200,000 plus legal fees.

RT later learned the transit agency involved in the deal was MARTA in Atlanta. RT staff subsequently learned that a similar restructuring was agreed to by Fifth Third with DART in Dallas. RT and its financial advisor have since discussed their restructuring agreements with staff from those agencies. After much internal discussion on the variables of the other restructuring agreements accepted by Fifth Third, RT's transaction size and structures, and the pros and cons of various potential offers, the following conceptual proposal was made by RT to Fifth Third:

RT's Proposal to Fifth Third:

Fifth Third agrees to:

- Reduce the rating trigger for the AIG as the EPUA and the DPUA Guarantor from "A2/A" and "A3/A-" to "Baa3/BBB-".
- Keep Ambac in place, but eliminate the requirement to replace it
- In the event that the AIG revised rating trigger is hit, extend the time frame for replacement to (1) one year after actual knowledge or notice of the downgrade.

RT agrees to:

- Pay $150,000 or $50,000 per SILO (plus legal fees currently estimated at $50,000)

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In discussing RT’s proposal to Fifth Third with AIG, which would need to consent to the arrangement as a party to the RT’s SILO transactions, a refinement to RT’s proposal emerged. That refinement entails AIG providing a pool of Treasury Securities in lieu of continuing to serve as an Equity Payment Undertaker Guarantor under a collateralized EPUA. This approach, if agreed to by Fifth Third, would improve RT’s proposal by eliminating AIG’s ongoing participating as Equity Payment Undertaker Guarantor and, thus, eliminating the potential risk that it could be downgraded below “Baa3/BBB-“.

Benefits of RT’s Proposal:

Besides moving out from under the cloud of uncertainty regarding the cost and timing of the potential liability of having to pay an early termination cost of approximately $32 million, virtually on demand, the proposed restructuring is cost effective and will improve the District’s financial status.

The restructuring is a comprehensive fix, covering both Ambac and AIG, and provides a more realistic time frame to fix a subsequent downgrade problem.

The restructuring is comparatively inexpensive, unlike the alternative of replacing AIG and Ambac in the transactions. The lowest pricing that had been suggested for a replacement surety for Ambac was 20 bp/annum by Assured Guaranty. This annual cost equates to a net present value cost of more than $1 million. The cost of RT’s substituting Treasury or Agency securities for the AIG EPUA ranged from $2.4 million up to $6 million, depending on the market conditions in which this approach had been analyzed.

If Fifth Third agrees to AIG’s pledge of Treasury Securities in lieu of an EPUA, then RT’s exposure to the risk that AIG is downgraded below “Baa3/BBB-“ would be limited to the DPUA. In the DPUA, the risk of an early termination, potentially requiring a $32 million payment due to a ratings downgrade, will end on December 30, 2012 when the debt portion of the third and final SILO is fully paid.

Enhancements to RT’s Financial Profile:

The restructuring will improve RT’s financial reporting. RT will no longer have to include disclosures on the potential loss through early termination of the transactions in the notes to the financial statements.

It will also improve RT’s credit position by eliminating a major potential liability and demonstrating pro-active management. In all likelihood, Standard & Poor’s will change its outlook on RT from “negative” to “stable”. The result should lead to a more favorable interest rate should RT go to market for future financings as planned for the South Line project. As little as a 10 basis point improvement (e.g, from 5% to 4.9%) in the interest rate on a $70 million financing over 30 years would save $1.5 million in interest costs, or approximately $750,000 in net present value savings.

The restructuring will improve RT’s banking relations and provide an additional potential for savings; RT will no longer be required to seek forbearance from Wells Fargo Bank for its line of

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credit and will have the flexibility to take its banking services, including the line of credit, to market through the RFP process to seek more favorable terms for its banking business.

It will also eliminate potential legal costs related to the threat of litigation to oppose an early termination action brought by the investor on these transactions. This risk would be put off indefinitely, or could be considered effectively eliminated by the lowered replacement triggers and lengthy replacement period in the restructuring agreements.

Finally, the restructuring will improve RT’s case for continued financial stability with regulatory agencies monitoring RT’s financial performance. FTA is predominant among those as it continuous to assess RT’s financial capacity in conjunction with the request to enter final design on South Line.

Staff recommends adoption of a resolution approving a restructuring agreement for RT’s 2005, 2006, and 2007 Silos and authorizing the General Manager/CEO to execute the agreements.

RESOLUTION NO. 11-02-_____

Adopted by the Board of Directors of the Sacramento Regional Transit District on this date:

February 28, 2011

APPROVING A RESTRUCTURING AGREEMENT FOR RT'S 2005, 2006 AND 2007 LEVERAGED LEASE TRANSACTIONS (SILOs), AND AUTHORIZING THE GENERAL MANAGER/CEO TO EXECUTE THE AGREEMENTS

WHEREAS, in 2005, 2006, and 2007, RT entered into three leveraged lease transactions (SILOs) with The Fifth Third Leasing Company (Fifth Third) with respect to a total of 50 rail cars with an aggregate value of approximately $223.8 million; and

WHEREAS, the SILOs involved AIG as an Equity Payment Undertaker guarantor and a Debt Payment Undertaker Guarantor, and Ambac as a surety provider; and

WHEREAS, the SILOs contain a requirement for RT to replace AIG as Equity Payment Undertaker Guarantor if its credit rating fell below "A2/A", AIG as Debt Payment Undertaker Guarantor if its credit rating fell below "A3/A-" and Ambac as surety provider if its credit rating fell below Aa3/AA-; and

WHEREAS, in September 2008, AIG's rating fell below the ratings threshold as Equity Payment Undertaker Guarantor, in 2009 Ambac's rating fell below the ratings threshold as surety provider, and in January 2011, AIG's rating fell below the ratings threshold as Debt Payment Undertaker Guarantor; and

WHEREAS Fifth Third has consistently agreed to forbear the requirement to replace both AIG and Ambac until either replacements or a solution to the requirement was found, and

WHEREAS RT and Fifth Third have mutually agreed upon the terms described in Exhibit A, which provide the resolution to the requirements to replace AIG and Ambac within the SILOs, by lowering the ratings triggers on AIG and/or allowing for the pledge of a pool of Treasury Securities; eliminating reference to a minimum ratings requirement for Ambac; and extending the replacement time period in the event AIG's rating falls below the replacement level.

THEREFORE, BE IT HEREBY RESOLVED BY THE BOARD OF DIRECTORS OF THE SACRAMENTO REGIONAL TRANSIT DISTRICT AS FOLLOWS:

THAT, the General Manager/CEO is hereby authorized to execute all documents necessary to execute the Agreements consistent with the terms reflected in Exhibit A.

____
DON NOTTOLI, Chair

A T T E S T:
MICHAEL R. WILEY, Secretary

By: ______________________________
Cindy Brooks, Assistant Secretary

EXHIBIT A

Sacramento Regional Transit District (RT)

The Fifth Third Leasing Company (FT)

US Lease Financings – RT 2005-FT, RT-2006-FT and RT-2007-FT (the "Lease Transactions")

Agreement with Respect to Rating Triggers and Cure Periods

1. Purpose	To amend the applicable rating triggers in the Lease Transactions
2. Transaction Overview/Current Status	
Aggregate Transaction Size	$223,880,000
Final Lease Term	2035
Rail Equipment	10 Siemens light rail cars 40 CAF light rail cars
Aggregate Debt Portion	90%"Looped" Debt Portion: $164,608,896.31 10% "Real" Debt Portion: $18,289,877.37 Status: Debt associated with 2004 and 2005 tranches is repaid; Debt associated with 2007 tranche is due on December 30, 2012
Aggregate Equity Portion	$40,981,226.32
Debt Payment Guarantor	AIG – currently rated Baa1/A- vs. minimum rating of A3/A-; replace within 60 days of actual knowledge or notice
Surety Bond (Strip Collateral) Provider	Ambac – currently rated Ca2/NR vs. minimum rating requirement of Aa3/AA-; replace within 45 days of actual knowledge or demand
Equity Structure (Lease Collateral)	Collateralized EPUA with AIG – AIG rated Baa1/A- vs. minimum rating requirement of A2/A; replace within 60 days of actual knowledge or notice
RT's Ratings	A1/A-
3. Proposed Revision to Debt Payment Guarantor Rating Requirement (Section 21(b) of the Participation Agreement)	Amend Section 21 (b) to reduce rating trigger to replace Debt Payment Guarantor to Baa3/BBB- with period for replacement increased to 1 year following actual knowledge or notice.
4. Proposed Revision to Surety Bond Provider Rating Requirement (Section 21(d) of the Participation Agreement)	Amend Section 21 (d) to eliminate reference to minimum rating requirements and requirement to replace Surety Bond Provider and Surety Bond
5. Proposed Revision to Equity Payment Undertaker Guarantor Rating Requirement (Section 21(e)(iv) of the Participation Agreement)	Amend Section 21 (e) (iv) to reduce rating trigger to Baa3/BBB- with period for replacement increased to 1 year following actual knowledge or notice, or Eliminate a rating trigger if AIG pledges a sufficient amount of Treasury Securities maturing in accordance with the schedules associated with the EPUA.
6. RT Consideration	Payment of $150,000 to Fifth Third (for all three SILOs), plus legal fees currently estimated at $50,000.