File No. 111003

Committee Item No. 5
Board Item No. _____

COMMITTEE/BOARD OF SUPERVISORS

AGENDA PACKET CONTENTS LIST

Committee: Budget and Finance Committee **Date:** October 12, 2011

Board of Supervisors Meeting **Date** _____

Cmte	Board	
☐	☐	**Motion**
☒	☐	**Resolution**
☐	☐	**Ordinance**
☐	☐	**Legislative Digest**
☒	☐	**Budget & Legislative Analyst Report**
☐	☐	**Ethics Form 126**
☐	☐	**Introduction Form (for hearings)**
☒	☐	**Department/Agency Cover Letter and/or Report**
☐	☐	**MOU**
☐	☐	**Grant Information Form**
☐	☐	**Grant Budget**
☐	☐	**Subcontract Budget**
☐	☐	**Contract/Agreement**
☐	☐	**Award Letter**
☐	☐	**Application**

OTHER **(Use back side if additional space is needed)**

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Completed by: Victor Young **Date:** October 7, 2011
Completed by: Victor Young **Date:** _____

An asterisked item represents the cover sheet to a document that exceeds 25 pages. The complete document is in the file.

[Termination Agreement(s) - Breda Light Rail Vehicle Leveraged Lease Transactions]

Resolution authorizing the Municipal Transportation Agency to enter into one or more consensual termination agreements with the equity investors and other parties that participated in the leveraged lease transactions executed in 2002 and 2003 with respect to the San Francisco Municipal Transportation Agency's Breda light rail vehicles, provided that there is no net financial cost to the City/San Francisco Municipal Transportation Agency for the terminations.

WHEREAS, In 2002 and 2003, the City and County of San Francisco (City), through the Municipal Transportation Agency (SFMTA), and with the approval of the Board of Supervisors, entered into Lease Transactions with various financial institutions with respect to the majority of the SFMTA's Breda light rail vehicles (LRVs); and

WHEREAS, Subsequent developments have led to a situation in which it might be beneficial for the City to enter into termination agreements for some or all of the Lease Transactions; and

WHEREAS, The benefits to the City of an early termination include (1) elimination of the risk of a technical default under its lease documents in the event that the financial guarantor of the transactions, Assured Guaranty, is downgraded by the rating agencies below "Aa3/AA-" and is not replaced by the City in accordance with the requirements of the lease documents; (2) simplification of the SFMTA's financial statements and elimination of a contingent liability; (3) removal of restrictions on the LRVs imposed by the lease documents; and (4) elimination of certain filing and reporting requirements; and

WHEREAS, Due to fluctuations in the financial market and the need to move forward quickly when favorable circumstances allow, staff seeks prior authorization to terminate any Lease Transaction, based on certain parameters; and

WHEREAS, The parameters are: (1) there shall be no net cost or liability to the SFMTA (excluding provisions that would otherwise survive at the end of the acceleration of the purchase option); (2) any termination agreement shall have been reviewed and approved by the City Attorney's Office; and (3) staff will report on any terminations as soon as practicable after they occur; and

WHEREAS, On June 21, 2011, the SFMTA Board of Directors approved a resolution authorizing the Executive Director/CEO to enter into one or more consensual terminations with the financial institutions and other parties that participated in the Lease Transactions executed in 2002 and 2003 with respect to the SFMTA's Breda LRVs under the parameters listed above, and subject to approval by this Board; now, therefore, be it

RESOLVED, That the Board of Supervisors authorizes the SFMTA to enter into one or more consensual terminations with the financial institutions and other parties that participated in the Lease Transactions executed in 2002 and 2003 with respect to the SFMTA's Breda LRVs, provided (1) there shall be no net cost or liability to the SFMTA (excluding provisions that would otherwise survive at the end of the acceleration of the purchase option); (2) any termination agreement shall have been reviewed and approved by the City Attorney's Office; and (3) staff will report on any terminations as soon as practicable after they occur; and, be it

FURTHER RESOLVED, That the Board of Supervisors authorizes the SFMTA to take any other actions required to effectuate the termination of the Lease Transactions, including, but not limited to, acceleration of the purchase option for the LRVs.

Item 5 File 11-1003	Department(s): San Francisco Municipal Transportation Agency (SFMTA)

EXECUTIVE SUMMARY

Legislative Objectives

The proposed resolution would authorize the SFMTA to enter into one or more future consensual termination agreements with the equity investors and other parties that participated in the lease transactions executed in 2002 and 2003 with respect to the SFMTA's Breda light rail vehicles, provided that there is no net financial cost to the City or SFMTA for the terminations.

Key Points

- In order to generate revenues, in 2002 and 2003, the SFMTA proposed entering into tax-advantaged lease transactions with equity investors, which transferred tax ownership of 139 Breda light rail vehicles from SFMTA to the equity investors. The equity investors sought certain Federal tax benefits from the transfer of tax ownership of the 139 Breda light rail vehicles from SFMTA. The equity investors made lump sum payments to SFMTA in 2002 and 2003, totaling approximately $40.6 million.
- Under the lease transactions, the equity investors formed seven statutory trusts (referred to collectively as the "trust"). The trust entered into a head lease with SFMTA to lease the Breda light rail vehicles from SFMTA for approximately 80 to 85 years. The trust then leased the Breda light rail vehicles back to SFMTA for 24 to 27 years. SFMTA has the option to purchase the remaining head lease interest in the Breda light rail vehicles at a predetermined price at the expiration of the lease terms in 24 to 27 years, or 2026 to 2030.
- The existing lease transactions were structured so that investments in Federal securities made at the outset of the lease transaction would mature in amounts and at times sufficient to fund the City's purchase option in 2026 to 2030. The existing lease transactions require a surety from a bond insurer that would pay to the equity investors any loss incurred if the lease transactions terminated, in part or in whole, before the termination dates in 2026 to 2030, when the Federal securities mature. Under the existing lease transaction, the bond insurer must maintain a credit rating of at least AA-/Aa3.
- SFMTA is now requesting the authority to enter into future consensual early termination of the lease transactions to eliminate the risk of a technical default in the event that the bond insurer's (Assured Guaranty Municipal Corporation, or AGM) credit rating is downgraded below the threshold required by the lease transactions. Since 2008, the credit ratings of formerly "Aaa/AAA" rated bond insurers have been downgraded by the rating agencies due to their exposure to the subprime mortgage market. According to Ms. Sonali Bose, SFMTA Chief Financial Officer, AGM is the only bond insurer with qualifying ratings. Currently, AGM has credit ratings of AA+/Aa3, but has been assigned a "negative outlook" by both Standard and Poor's and Moody's.

- The proposed resolution would authorize SFMTA to enter into future consensual early termination agreements with the equity investors without obtaining further approval by the Board of Supervisors if the early termination agreement resulted in no financial cost or liability to the City or SFMTA. As noted above, the existing lease transactions were structured so that investments in Federal securities made at the outset of the lease transaction would mature in amounts and at times sufficient to fund the City's purchase option in 2026 to 2030. For the SFMTA and the equity investors to enter into a termination agreement earlier than 2026 to 2030, the SFMTA and the equity investors would need to agree that the purchase price for the Breda light rail vehicles would equal the market value of the Federal securities at the time of the purchase. Equity investors may have an incentive to agree to an early termination of the lease transactions if low interest rates result in higher Federal security values. According to SFMTA's July 18, 2011 memorandum to the Board of Supervisors: "If the SFMTA were to reach agreement with an equity investor, then seek legislative approval, an intervening rise in interest rates could negate the benefit of a termination to the equity investor and cause it to decline to move forward".

Fiscal Impact

- According to the proposed resolution, the parameters to enter into future consensual early termination agreements include "(1) there shall be no net cost or liability to the SFMTA (excluding provisions that would otherwise survive at the end of the acceleration of the purchase option); (2) any termination agreement shall have been reviewed and approved by the City Attorney's Office; and (3) staff will report on any terminations as soon as practicable after they occur".
- Under the terms of the existing lease transactions, termination costs include: (1) transaction costs to terminate the lease transactions, (2) payment of loans that were part of the lease transactions, and (3) SFMTA exercising the purchase option of the remaining head lease interest in the 139 Breda light rail vehicles at a predetermined price.
- According to Ms. Bose, any early termination agreement would require the equity investors to (1) pay transaction costs, (2) cancel any existing loan balances, and (3) set the purchase price for the 139 Breda light rail vehicles equal to the sale proceeds of the Federal securities purchased at the outset of the lease transaction.
- Under the existing lease transactions, the City indemnifies the equity investors and other transaction parties, such as financial institutions, against future claims that are asserted after the termination of the lease transaction in 2026 to 2030, but are based on events that occurred during the term of the lease transaction. Under the proposed resolution, any early termination agreement would include the same indemnification terms as in the existing lease transactions. The future early termination agreements would continue to indemnify the equity investors and other transaction parties for claims which may be asserted in the future against the City or SFMTA for events that occurred during the term of the lease transaction from the origination date in 2002 or 2003 to the early termination date.

Conclusion

- The proposed resolution would authorize the SFMTA to enter into one or more consensual termination agreements with equity investors and other parties that participated in the lease transactions executed in 2002 and 2003, provided that "there is no net financial cost to the City/SFMTA for the terminations". The Budget and Legislative Analyst recommends amending page 1, line 6 of the proposed resolution to specify that "there is no net financial cost or liability to the City/SFMTA for the terminations".
- The proposed resolution states on page 2, line 1 that "there shall be no net cost or liability to the SFMTA." The Budget and Legislative Analyst recommends amending the resolution to specify that "there shall be no net cost or liability to the City or the SFMTA" and to require that "Any early termination agreement that requires out of pocket costs to the City or the SFMTA requires prior approval of the Board of Supervisors".
- The proposed resolution on page 2, line 4 states that "staff will report on any terminations as soon as practicable after they occur". The Budget and Legislative Analyst recommends amending the resolution to specify that the SFMTA is required to submit a written report to the Board of Supervisors no later than 30 days after the SFMTA enters into any future termination agreements with equity investors.
- Because the proposed resolution would authorize the SFMTA to enter into future early termination of the lease transactions without obtaining further approval of the Board of Supervisors, the Budget and Legislative Analyst considers approval of the proposed resolution to be a policy matter.

Recommendations

1. Amend page 1, line 6 of the proposed resolution to specify that "there is no net financial cost or liability to the City/SFMTA for the terminations".
2. Amend page 2, line 1 of the proposed resolution to state that "there shall be no net cost or liability to the City or the SFMTA" and to require that "Any early termination agreement that requires out of pocket costs to the City requires prior approval of the Board of Supervisors".
3. Amend page 2, line 4 of the proposed resolution to require SFMTA to submit a written report to the Board of Supervisors no later than 30 days after the SFMTA enters into a termination agreement with an equity investor.
4. Approval of the proposed resolution, as amended, is a policy matter for the Board of Supervisors.

MANDATE STATEMENT/ BACKGROUND

Mandate Statement

San Francisco Charter Section 9.118 requires that all agreements over $10,000,000 be subject to Board of Supervisors approval.

Background

SFMTA operates 151 Breda light rail vehicles, which were purchased and placed into service from 1998 through 2001. As of 2002, the 151 Breda light rail vehicles had a total asset value of $500,479,777 or approximately $3,314,435 per vehicle.

In order to generate revenues, in 2002 and 2003, the SFMTA proposed entering into tax-advantaged lease transactions (also known as "sale in lease out" transactions) with equity investors, which transferred tax ownership of 139 Breda light rail vehicles from SFMTA to the equity investors. The equity investors sought certain Federal tax benefits from the transfer of tax ownership of the 139 Breda light rail vehicles from SFMTA. The equity investors made lump sum payments to SFMTA in 2002 and 2003, totaling approximately $40.6 million.

In April 2002, the Board of Supervisors authorized SFMTA to enter into lease transactions for up to 118 of the 151 Breda light rail vehicles (File 02-0410). In September 2003, the Board of Supervisors authorized SFMTA to enter into a lease transaction for an additional 21 Breda light rail vehicles (File 03-1499). Therefore, 139 of the 151 Breda light rail vehicles were authorized for lease transactions and 12 Breda light rail vehicles were held back from the agreements, as shown in Table 1 below.

Table 1
Breda Light Rail Vehicles Included in Lease Transactions

Tranche	Equity Investors	Number of Breda Light Rail Vehicles	Asset Value
2002-1	Australia and New Zealand Banking Group (ANZ)	29	$98,745,000
2002-2	CIBC Capital Corporation	24	80,400,000
2002-3	CIBC Capital Corporation	6	18,930,000
2002-4	Comerica Leasing Corporation	26	84,448,000
2002-5	Comerica Leasing Corporation	5	16,005,000
2002-6	Wells Fargo Bank Minnesota	28	89,628,000
2003-1	Wells Fargo Bank Minnesota	21	72,555,000
Total Included in Lease Transactions		**139**	**460,711,000**
Held Back from Lease transactions		12	39,768,777
Grand Total		**151**	**$500,479,777**

Under the lease transactions, the equity investors formed seven statutory trusts (referred to collectively as the "trust"). The trust entered into a head lease with SFMTA to lease the Breda light rail vehicles for approximately 80 to 85 years. The trust then leased the Breda light rail vehicles back to SFMTA for 24 to 27 years. SFMTA has the option to purchase the remaining head lease interest in the Breda light rail vehicles at a predetermined price at the expiration of the lease terms in 24 to 27 years, or 2026 trough 2030.

The equity investors prepaid the head lease payments of $460,711,000 from the following funding sources:

(1) $114,167,895 in equity contributions from the equity investors; and

(2) $346,543,105 in aggregate loans to the trust from a private lender (FSA Global Funding Limited).

Of the $460,711,000, SFMTA deposited $416,126,696 (see Table 2 below) into debt and escrow accounts, as follows:

(1) $69,583,591 were deposited into escrow accounts. These funds were invested in Federal securities (Resolution Funding Corporation securities, or REFCORPs, and Fannie Mae securities). These Federal securities mature in amounts and at times that will be sufficient to fund SFMTA's option to purchase the head lease interest in the Breda light rail vehicles, if exercised. These Federal securities are held in trust by U.S. Bank National Association on behalf of SFMTA and the equity investors.

(2) $346,543,105 were deposited with a debt payment undertaker, Premier International Funding (Premier), formed by Financial Security Assurance (FSA). Payments by Premier are sufficient to meet SFMTA's periodic lease payments, which, in turn, are used to repay the loan from FSA Global Funding Limited. Payments made by Premier are guaranteed by FSA or its successor (Assured Guaranty Municipal Corporation, or AGM).

As a result of these transactions, SFMTA benefitted by receiving the net additional revenues of $40,647,518 as lump sum payments in 2002 and 2003, as shown in Table 2 below.

Table 2
Lump Sum Payments to SFMTA from Equity Investors

	2002 Tranche	2003 Tranche	Total
Equity Investors			
Equity Investors' Equity Contribution	$98,844,562	$15,323,333	$114,167,895
FSA Global Funding Limited Loan	289,311,438	57,231,667	346,543,105
Total Payments from Equity Investors' Trust to SFMTA	**388,156,000**	**72,555,000**	**460,711,000**
SFMTA			
Escrow Account	(59,273,752)	(10,309,839)	(69,583,591)
Debt Account	(289,311,438)	(57,231,667)	(346,543,105)
Total SFMTA Deposits	**(348,585,190)**	**(67,541,506)**	**(416,126,696)**
Net Transaction Expenses	(3,569,000)	(367,786)	(3,936,786)
Net Lump Sum Payment to SFMTA	**$36,001,810**	**$4,645,708**	**$40,647,518**

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would authorize the SFMTA to enter into one or more future consensual termination agreements with the equity investors and other parties that participated in the Breda light rail vehicle lease transactions executed in 2002 and 2003 between the SFMTA and the

equity investors, provided that there is no net financial cost either to the City or SFMTA by entering into the future consensual termination agreements.

SFMTA is now requesting the authority to enter into future consensual early termination of the lease transactions to eliminate the risk of a technical default in the event that the bond insurer's (Assured Guaranty Municipal Corporation, or AGM) credit rating is downgraded below the threshold required by the lease transactions, as discussed on page 7 below. Because SFMTA may not be able to replace AGM, the City and SFMTA could be liable to pay early termination costs in accordance with the lease transaction documents. As of June 30, 2011, these scheduled termination costs were approximately $109.2 million.

Authorization for SFMTA to terminate lease transactions without obtaining further Board of Supervisors approval

According to SFMTA, because any early termination agreements depend on low interest rates, which can fluctuate, delays in approving the early termination agreements may result in the equity investors withdrawing from the agreements. Therefore, the SFMTA is requesting authorization to enter into early termination agreements without submitting the final agreement to the Board of Supervisors for approval to avoid legislative delays.

The existing lease transactions were structured so that investments in Federal securities made at the outset of the lease transaction would mature in amounts and at times sufficient to fund the City's purchase option in 2026 to 2030. For the SFMTA and the equity investors to enter into a termination agreement earlier than 2026 to 2030, the SFMTA and the equity investors would need to agree that the purchase price for the Breda light rail vehicles would equal the market value of the Federal securities at the time of the purchase. Equity investors may have an incentive to agree to an early termination of the lease transactions if low interest rates result in higher Federal security values. According to SFMTA's July 18, 2011 memorandum to the Board of Supervisors states:

> "If the SFMTA were to reach agreement with an equity investor, then seek legislative approval, an intervening rise in interest rates could negate the benefit of a termination to the equity investor and cause it to decline to move forward"

Internal Revenue Service (IRS) rules and bond insurers' credit ratings

IRS rules

Subsequent to the 2002 and 2003 lease transactions between SFMTA and the equity investors, Federal legislation in 2004 prohibited tax-advantaged leveraged lease transactions between public agencies and private investors with certain specified exceptions. In addition, the IRS entered into settlement agreements with most equity investors that participated in leveraged lease transactions, including lease transactions with SFMTA. These settlement agreements, which are confidential, are reported to have resulted in the loss of tax benefits to be derived from the lease transactions. As a result, the equity investors now have on their books unrealized net losses associated with the initial investments in the lease transactions. According to Ms. Sonali Bose,

SFMTA Chief Financial Officer, these investment losses will be incurred solely by the equity investors and not by SFMTA.

Bond insurers' credit ratings

As noted above, the existing lease transactions were structured so that investments in Federal securities made at the outset of the lease transaction would mature in amounts and at times sufficient to fund the City's purchase option in 2026 to 2030. The existing lease transactions require a surety from a bond insurer that would pay to the equity investors any loss incurred if the lease transactions terminated, in part or in whole, before the termination dates in 2026 to 2030, when the Federal securities mature.

Under the existing lease transaction, the bond insurer must maintain a credit rating of at least AA-/Aa3. The lease transaction documents require SFMTA to replace the existing bond insurer, AGM, if the bond insurer's credit is rated less than AA-/Aa3 by Standard and Poor's and Moody's respectively. Currently, AGM has credit ratings of AA+/Aa3, but has been assigned a "negative outlook" by both Standard and Poor's and Moody's. SFMTA is at risk of technical default of the lease transactions if AGM's credit rating falls below AA-/Aa3.

Since 2008, the credit ratings of formerly "Aaa/AAA" rated bond insurers have been downgraded by the rating agencies due to their exposure to the subprime mortgage market. According to Ms. Bose, AGM is the only bond insurer with qualifying ratings. Ms. Bose states that some public transit agencies that entered into similar lease transactions have experienced technical defaults associated with the downgrade of the bond insurer providing the surety. Several of these transit agencies have restructured or terminated their lease transactions with equity investors. Ms. Bose states that Santa Clara Valley Transportation Authority, Washington Metropolitan Area Transit Authority, Metropolitan Atlanta Rapid Transit Authority, and the Dallas Area Rapid Transit District have terminated and/or restructured their lease transactions with equity investors.

SFMTA's reasons for consensual early termination of lease transactions

Avoidance of a potential technical default

According to Ms. Bose, SFMTA is requesting the authority to enter into future consensual early termination of the lease transactions to eliminate the risk of a technical default in the event AGM's rating is downgraded below AA-/Aa3. If Standard and Poor's or Moody's were to downgrade AGM's credit rating below the required threshold of AA-/Aa3, the equity investors could issue a notice of default to SFMTA. Because SFMTA may not be able to replace AGM, the City and the SFMTA could be liable to pay early termination costs in accordance with the schedule established in the lease transactions in the event of a technical default. As of June 30, 2011, these scheduled termination costs were approximately $109.2 million.

According to Ms. Bose, if the Board of Supervisors were to authorize SFMTA to enter into future consensual early termination agreements, the SFMTA and equity investors could structure the early termination agreement to avoid the payment of early termination costs, as discussed on page 9 below.

Other reasons for consensual early termination of the lease transactions

According to Ms. Bose, SFMTA would achieve other benefits from the future consensual early termination of the lease transactions. These benefits include:

- Simplification of SFMTA's financial statements. The SFMTA's financial auditors include a footnote in the annual audited financial statement on the lease transactions, which describes (a) SFMTA's potential liability due to an early termination, (b) the total amount of deferred revenue under the lease transactions recorded in 2002 and 2003, and (c) the amount of deferred revenue amortized in the current fiscal year. These footnotes would be eliminated if the lease transactions were terminated.

- Removal of liens and restrictions on operating and maintaining the Breda light rail vehicles. Under the lease transactions, SFMTA must maintain the 139 light rail vehicles during the term of the agreement. According to Ms. Bose, early termination of the lease transactions would provide SFMTA flexibility in operating or removing the Breda light rail vehicles from services.

- Elimination of reporting and filing requirements. If the lease transactions were terminated, SFMTA would no longer have to file reports with the Secretary of State or meet other reporting obligations of the lease transactions.

Status of discussions between SFMTA and the equity investors regarding early termination

According to the July 18, 2011 SFMTA memorandum to the Board of Supervisors:

> "In January/February 2010, SFMTA staff, recognizing that the market value of the REFCORPs and Fannie Mae securities had increased, approached each of the four Equity Investors to discuss its interest in a potential consensual early termination of its Lease Transaction(s). None of the Equity Investors expressed an interest to terminate at that time. The SFMTA recently resumed discussions with some of the Equity Investors, who are now more open to a consensual early termination."

FISCAL IMPACTS

The proposed resolution would authorize SFMTA to enter into future consensual early termination agreements with the equity investors without obtaining further SFMTA Board of Directors or Board of Supervisors approval.

As noted above, the City and SFMTA face financial risk under the existing lease transactions if the credit rating of AGM, the bond insurer, is downgraded below the threshold required by the lease transactions. If SFMTA were in technical default of the lease transaction because of the downgrade, the City and SFMTA could be liable to pay early termination costs in accordance

with the lease transaction documents. As of June 30, 2011, these scheduled termination costs were approximately $109.2 million.

As noted below, if the SFMTA enters into consensual early termination agreements with the equity partners to terminate the existing lease transactions, the SFMTA and equity partners would structure the agreements so that there would be no financial cost or liability to the City.

According to the proposed resolution, the parameters to enter into future consensual early termination agreements include that "(1) there shall be no net cost or liability to the SFMTA (excluding provisions that would otherwise survive at the end of the acceleration of the purchase option); (2) any termination agreement shall have been reviewed and approved by the City Attorney's Office; and (3) staff will report on any terminations as soon as practicable after they occur".

As noted on page 6 above, the equity investors may have an incentive to agree to an early termination of the lease transactions if the low interest rates result in higher Federal securities values, resulting in higher returns to the equity investors.

Impact of early termination to the City and SFMTA

Termination expenses. Costs for early termination include legal fees, financial advisor fees, and other expenses associated with each lease transaction participant, including SFMTA, equity investors, trustees, lenders, and surety providers. Ms. Bose states that the estimated termination expenses are approximately $100,000 to $150,000 and would be paid fully by the equity investors. Ms. Bose states that the City and SFMTA would incur no costs for the termination expenses.

Payment of the loan. The existing lease transactions include loans, totaling $346,543,105, from FSA Global Funding Limited, which were deposited with Premier International Funding. According to Ms. Bose, any future consensual early termination agreement would include provisions, in which outstanding loan balances would be cancelled. According to the Attachment, provided by Ms. Bose, "the remaining loan balance will be extinguished as part of the termination". Ms. Bose states that the City and SFMTA would incur no costs or liability for repayment of the loan to FSA Global Funding Limited.

Purchase option of the Breda light rail vehicles. Under the existing lease transactions, SFMTA has the option to purchase the head lease interest in the 139 Breda light rail vehicles at a predetermined purchase price at termination of the lease transaction. As noted above, the existing lease transactions were structured so that investments in Federal securities made at the outset of the lease transaction would mature in amounts and at times sufficient to fund the City's purchase option in 2026 to 2030. For the SFMTA and the equity investors to enter into a termination agreement earlier than 2026 to 2030, the SFMTA and the equity investors would need to agree that the purchase price for the Breda light rail vehicles would equal the market value of the Federal securities at the time of the purchase.

According to the Attachment, "the termination agreement will entail the accelerated payment of the SFMTA's purchase option, which currently is scheduled to arise in 2026 or 2030, depending

on the equity investor. The purchase price will, in effect, be the market value of the Federal securities (REFCORPs or Fannie Maes) that are in the relevant escrow deposit account, less the transaction costs that will be paid from proceeds generated by the sale of such Federal securities. This option price paid at early termination will supersede the much larger scheduled option price that SFMTA otherwise would pay in 2026 or 2030". Ms. Bose states that SFMTA would incur no additional costs or liability for exercising the purchase option early, even though the value of the Federal securities will be less than the value in 2026 or 2030.

Excluding provisions that would otherwise survive at the end of the acceleration of the purchase option

The proposed resolution states that "there shall be no net cost or liability to the SFMTA (excluding provisions that would otherwise survive at the end of the acceleration of the purchase option)". The "provisions that would otherwise survive at the end of the acceleration of the purchase option" are indemnification clauses currently contained in the existing lease transactions. Under the proposed resolution, these indemnification clauses would be included in any early termination agreements between the SFMTA and the equity investors.

- Under the existing lease transactions, the City indemnifies transaction parties for claims that may be asserted in the future based on events that occurred during the term of the lease transactions, which terminate in 2026 to 2030.

- Under the proposed resolution, early termination agreements would continue to indemnify the equity investors and other transaction parties for claims which may be asserted in the future against the City or SFMTA for events that occurred during the term of the lease transaction, which terminate at an earlier date to 2026 to 2030.

According to Mr. Mark Blake, Deputy City Attorney, such claims would generally be based on actions that were within the City's or SFMTA's control, such as (a) audit claims based on misrepresentation of information by the City or SFMTA, (b) liability claims due to accidents or other events related to a Breda light rail vehicle included in the lease transaction, (c) environmental claims related to a Breda light rail vehicle included in the lease transaction, (d) copyright infringements for materials displayed on the Breda light rail vehicles included in the lease transaction, or (e) property or other taxes assessed on the Breda light rail vehicles during the term of the lease transaction.

According to Mr. Blake, the transaction partners would have little incentive to terminate the lease transactions early if provisions indemnifying the transaction partners in the existing lease transaction were voided in an early termination agreement.

CONCLUSION

The proposed resolution would authorize the SFMTA to enter into one or more consensual termination agreements with equity investors and other parties that participated in the lease transactions executed in 2002 and 2003, provided that "there is no net financial cost to the City/SFMTA for the terminations". The Budget and Legislative Analyst recommends amending

page 1, line 6 of the proposed resolution to specify that "there is no net financial cost or liability to the City/SFMTA for the terminations".

The proposed resolution states on page 2, line 1 that "there shall be no net cost or liability to the SFMTA." The Budget and Legislative Analyst recommends amending the resolution to specify that "there shall be no net cost or liability to the City or the SFMTA", and to require that "Any early termination agreement that requires out of pocket costs to the City or the SFMTA requires prior approval of the Board of Supervisors".

The proposed resolution states on page 2, line 4 that "staff will report on any terminations as soon as practicable after they occur". The Budget and Legislative Analyst recommends amending the resolution to specify that the SFMTA is required to submit a written report to the Board of Supervisors no later than 30 days after the SFMTA enters into a termination agreement with an equity investor.

Because the proposed resolution would authorize the SFMTA to enter into future consensual early termination of the lease transactions without further approval of the Board of Supervisors, the Budget and Legislative Analyst considers approval of the proposed resolution to be a policy matter.

RECOMMENDATIONS

1. Amend page 1, line 6 of the proposed resolution to specify that "there is no net financial cost or liability to the City/SFMTA for the terminations".

2. Amend page 2, line 1 of the proposed resolution to state that "there shall be no net cost or liability to the City or the SFMTA" and to require that "Any early termination agreement that requires out of pocket costs to the City requires prior approval of the Board of Supervisors".

3. Amend page 2, line 4 of the proposed resolution to require SFMTA to submit a written report to the Board of Supervisors no later than 30 days after the SFMTA enters into a termination agreement with an equity investor.

4. Approval of the proposed resolution, as amended, is a policy matter for the Board of Supervisors.

MEMORANDUM

DATE: October 6, 2011

TO: Severin Campbell
Budget Analyst's Office

FROM: Sonali Bose
Chief Financial Officer

SUBJECT: Termination of Leveraged Lease Transactions – Cost and Liability Impact to SFMTA

The San Francisco Municipal Transportation Agency (SFMTA) is seeking Board of Supervisors approval to enter into consensual termination agreements with the equity investors involved in the SFMTA's leveraged lease transactions that were entered into in 2002 and 2003. Any decision by the SFMTA to go forward and enter into any such consensual termination agreement is dependent on market conditions, the agreement of the equity investor and the requirement that the SFMTA not incur any costs as a result of the termination.

One of the conditions for entering into such consensual termination agreements is that there be no additional cost or liability to the SFMTA. To that end, each equity investor with whom the SFMTA will execute a consensual termination agreement will agree to pay all transaction costs, including the fees and expenses of counsel to each transaction party, including, but not limited to, the SFMTA's counsel and financial advisor, equity investor counsel, trustee counsel and counsel to the various other financial counterparties.

The termination agreement will entail the accelerated payment of the SFMTA's purchase option, which currently is scheduled to arise in 2026 or 2030, depending on the equity investor. The purchase price will, in effect, be the market value of the Federal Securities (REFCORPs or Fannie Maes) that are in the relevant escrow deposit account less the transaction costs that will be paid from proceeds generated by the sale of such Federal Securities. This option price paid at early termination will supersede the much larger scheduled option price that the SFMTA otherwise would pay in 2026 or 2030.

Following the execution of a termination agreement, the SFMTA will no longer be liable for the payment of early termination costs or stipulated value costs that are contained in the schedules attached to the relevant Sublease Agreement and Supplement. Those costs are the costs that the SFMTA would be required to pay on any given date in the event of a future default or the loss of Breda vehicle. The early termination of the lease transaction, then, would preclude such future exposure. In addition, the remaining loan balance will be extinguished as part of the termination.

We note that the termination agreement will contain a paragraph that certain provisions of the lease transaction documents will survive lease termination. This "survival" provision is also contained in the original lease transaction documents and, to our knowledge, is a standard provision that exists in every termination agreement. The essence of this provision is to make clear that if there were a pre-existing requirement to indemnify a transaction party for something that happened prior to termination, that requirement is not extinguished by virtue of the termination. As the SFMTA lease transactions have been in existence for more than nine years and the SFMTA has not been required to make such an indemnification payment, the SFMTA has a high degree of confidence that no such latent liability will arise after the termination of a lease transaction. The SFMTA is also unaware of any transit agency having to make such a payment following a termination of its lease transaction.

Please contact me if you need further information on the requested termination authority.

SAN FRANCISCO
MUNICIPAL TRANSPORTATION AGENCY
BOARD OF DIRECTORS

RESOLUTION No. 11-079

WHEREAS, The City, through the SFMTA, entered into leveraged lease transactions (each, a "Lease Transaction") in 2002 and 2003 with respect to the majority of the SFMTA's Breda light rail vehicles; and,

WHEREAS, Recent developments have led to a situation in which it would be beneficial for the City to enter into termination agreements for some or all of the Lease Transactions; and,

WHEREAS, The benefits to the City of an early termination include (1) elimination of the risk of a technical default under its lease documents in the event that the financial guarantor of the transactions, Assured Guaranty, is downgraded by the credit agencies below "Aa3/AA-;" (2) simplification of the SFMTA's financial statements and elimination of a contingent liability; (3) removal of restrictions on the LRVs imposed by the lease documents; and (4) elimination of certain filing and reporting requirements; and,

WHEREAS, Due to fluctuations in the financial market and the need to move forward quickly when favorable circumstances allow, staff seeks prior authorization to terminate any Lease Transaction, based on certain parameters; and,

WHEREAS, The parameters are: (1) there shall be no net cost or liability to the SFMTA (excluding provisions that would otherwise survive at the end of the acceleration of the purchase option); (2) any termination agreement shall have been reviewed and approved by the City Attorney's Office; and (3) staff will report on any terminations as soon as practicable after they occur; and,

WHEREAS, If approved by the SFMTA Board, this authorization request will be submitted to the Board of Supervisors for approval; now, therefore, be it

RESOLVED, That the San Francisco Municipal Transportation Agency Board of Directors authorizes the Executive Director/CEO to enter into one or more consensual terminations with the financial institutions and other parties that participated in the Lease Transactions executed in 2002 and 2003 with respect to the SFMTA's Breda light rail vehicles, provided (1) there shall be no net cost or liability to the SFMTA (excluding provisions that would otherwise survive at the end of the acceleration of the purchase option); (2) any termination agreement shall have been reviewed and approved by the City Attorney's Office; and (3) staff will report on any terminations as soon as practicable after they occur; and, be it further

RESOLVED, That the SFMTA Board authorizes the Executive Director/CEO to take any other actions required to effectuate the termination of the Lease Transactions, including, but not limited to, acceleration of the purchase option for the LRVs; and be it further

RESOLVED, That the SFMTA Board recommends this matter to the Board of Supervisors for approval.

I certify that the foregoing resolution was adopted by the San Francisco Municipal Transportation Agency Board of Directors at its meeting of JUN 21 2011.

R. Boomer

Secretary to the Board of Directors
San Francisco Municipal Transportation Agency

MEMORANDUM

DATE: July 18, 2011

TO The San Francisco Board of Supervisors

FROM: Debra A. Johnson
Acting Executive Director/CEO

SUBJECT: Termination Agreements related to Leveraged Lease Transactions

Summary

On June 21, 2011, the San Francisco Municipal Transportation Agency (SFMTA) Board of Directors authorized the Executive Director/CEO to enter into one or more consensual termination agreements with the financial institutions and other parties that participated in the leveraged lease transactions executed in 2002 and 2003 (each a Lease Transaction) with respect to the majority of the SFMTA's Breda light rail vehicles (LRVs). Recent developments have led to a situation in which it would be beneficial for the City to enter into termination agreements for some or all of the Lease Transactions. Due to fluctuations in the financial market and the need to move forward quickly when favorable circumstances allow, SFMTA staff is seeking prior authorization to terminate any such Lease Transaction, based on certain parameters. These terminations will result in no net financial cost to the City/SFMTA, including legal and advisor fees, which will be absorbed by the financial institutions.

Background

In 2002 and 2003, with the encouragement and approval of the Federal Transit Administration (FTA), the City entered into Lease Transactions (also known as "sale in lease out" transactions or SILOs) with various financial institutions, referred to as "Equity Investors."[1] Under these Lease Transactions, tax ownership of 139 Breda LRVs was sold to single-purpose statutory trusts (each, a Lessor) formed on behalf of each Equity Investor. In each Lease Transaction, the original purchase price was funded in part with debt and in part with equity. The City leased back the LRVs under a sublease agreement (Lease Agreement), which provided the City with an

1 The SFMTA's Equity Investors are Wells Fargo, an American bank, Comerica, an American bank, CIBC, a Canadian bank and ANZ, an Australian/New Zealand bank. See attached chart.

option to purchase the LRVs at the end of the each sublease term (2025 and 2026). The Lease Transactions were structured to enable the Equity Investors to take certain tax deductions that the City could not enjoy as a public agency. In turn, the SILOs generated net upfront cash payments of over $40 million to the SFMTA. Almost every major transit system in the United States entered into similar leveraged lease transactions with respect to their railcars or other items of equipment.

The City's payment obligations under each Lease Transaction were provided for (economically "defeased") at the outset through certain deposits. One set of deposits was made with Premier International Funding Co. (Premier), formed by Financial Security Assurance (FSA). Premier's scheduled payments, which are guaranteed by FSA, are made in amounts and at times that satisfy the City's payment schedules under the Lease Transactions.

Another series of deposits was invested in Federal securities that are held in trust by U.S. Bank National Association on behalf of the City and the Equity Investors. These Federal securities mature in amounts and at times sufficient to fund the City's purchase options, if exercised at the end of the Lease terms. In 2002, the City purchased Resolution Funding Corporation securities (REFCORPs) and in 2003, it purchased Fannie Mae securities.

In addition to these deposits, FSA provided surety bonds to guarantee full payment to the Equity Investors in the event that the Lease Transactions are terminated prior to the scheduled maturities, in whole or in part for any reason. In June 2009, Assured Guaranty Corporation acquired FSA and assumed its obligations under the Lease Transactions.

The Lease Transaction documents assume that the LRVs would remain in, or be available for, revenue service throughout the term of the respective Lease Transaction. To that end, the City agreed to certain operating, maintenance and insurance covenants with respect to the LRVs that were consistent with the City's practices and FTA grant agreements that funded the LRVs. In addition, the City cannot sell, lease or transfer the LRVs to other agencies during the term of the Lease Transactions.

The Lease Transaction documents also assume that the financial participants would retain a high degree of creditworthiness. The City is required to replace Assured Guaranty, as successor to FSA, if its ratings are downgraded below certain thresholds: "Baa1/BBB+" with respect to Assured Guaranty's role as debt payment guarantor, and "Aa3/AA-" with respect to Assured Guaranty's role as surety provider. Assured Guaranty's current ratings are "Aa3/AA+."

The Lease Transaction documents include schedules that identify the cost of an early termination due to an event of default or the loss of an LRV. These costs are in the nature of liquidated damages. In addition, the Equity Investors could agree to a consensual termination under different terms than provided for under the Lease Transaction documents.

Recent Developments

Since the City entered into its Lease Transactions, several developments have occurred that have affected SILO and other leveraged lease transactions in general.

- After federal legislation in 2004 prohibited further SILO transactions (except certain "grandfathered" transactions), the U.S. Treasury Department (IRS) waged an aggressive campaign to disallow the tax benefits associated with SILOs and their predecessor structure ("lease in and lease out" transactions or LILOs). This effort culminated in settlement agreements with most of the equity investors in these transactions. The effect of these settlement agreements is to disallow the purported tax benefits to be derived from such lease transactions. These settlement agreements produced investment losses to those equity investors – which are realized upon termination of their lease transactions. This tax risk was borne ***solely*** by the equity investors and not the transit agencies.

- The financial guarantors (originally rated "Aaa/AAA") involved in many SILO and LILO transactions – notably AIG and Ambac – experienced significant rating downgrades due to their sub-prime loan exposure during the recent recession. Such downgrades caused technical defaults in the affected SILO and LILO transactions and, in many instances, resulted in the need for transit agencies to restructure or terminate such transactions because they were unable to replace the affected financial guarantors with institutions with acceptable credit ratings. As examples, Washington Metropolitan Area Transit Authority, Metropolitan Atlanta Rapid Transit Authority, Dallas Area Rapid Transit District and Santa Clara Valley Transportation Authority each terminated SILO transactions with equity investors. Because the ratings of Assured Guaranty remain at or above the relevant thresholds, the City did not experience these difficulties and the Lease Transactions remain in compliance.

- A positive development for transit agencies is that interest rates have plummeted since 2002 and 2003. This decline in interest rates has caused the market value of Federal securities, purchased in a much higher interest rate environment, to increase. Some equity investors have seen the increased value of these Federal securities as an opportunity to offset the

unrealized losses that they are currently carrying with respect to SILO transactions.

In January/February 2010, SFMTA staff, recognizing that the increased market value of the REFCORPs and Fannie Mae securities had increased, approached each of the four Equity Investors to discuss its interest in a potential consensual early termination of its Lease Transaction(s). None of the Equity Investors expressed an interest to terminate at that time. The SFMTA recently resumed discussions with some of the Equity Investors, who are now more open to a consensual early termination.

Benefit of an Early Termination

The early termination of the Lease Transactions would benefit the City/SFMTA in many ways, including:

- ***Early termination would eliminate the risk of a technical default under its documents in the event that Assured Guaranty is downgraded below "Aa3/AA-."*** Assured Guaranty's current ratings of "Aa3/AA+" are on the cusp of falling below the thresholds under the Lease Transaction documents. As rating agencies are considering a change in the rating criteria applicable to bond insurers, the risk of a future downgrade has grown. If a downgrade below the thresholds were to occur, the SFMTA either would need to replace Assured Guaranty, restructure the Lease Transactions, or terminate them under terms likely to be less favorable. Other transit agencies that have experienced technical defaults have found the replacement option infeasible due to the absence of viable alternatives. In a worst case scenario, a non-consensual termination cost under the SILO documents would expose the City to a significant termination cost.

- ***Early termination would simplify the SFMTA's financial statements and eliminate a contingent liability.*** Each year, the SFMTA prepares an extensive footnote that describes the status of the Lease Transactions and its theoretical financial exposure if an early, non-consensual termination occurred under the documents. Terminating Lease Transactions would free SFMTA of that responsibility.

- ***Early termination would remove restrictions on the subject LRVs.*** This would provide the SFMTA with the flexibility to keep the LRVs in operation, remove them from service and/or transfer them to another transit agency without limitations imposed by the existing Lease Transaction documents. The SFMTA, however, would remain subject to the terms and conditions of the original Federal Transit Agency grant agreements.

- ***Early termination would eliminate reporting and filing requirements.*** If the Lease Transactions were terminated, the SFMTA would no longer have to make periodic filings with the Secretary of State as required under the Uniform Commercial Code or continue with its reporting obligations under the Lease Transaction documents.

Timing of a Potential Consensual Early Termination; Parameters

The SFMTA's ability to terminate a Lease Transaction at no cost depends on interest rates and the resulting value of the Federal securities that are held by U.S. Bank and Trust Company. If the SFMTA were able to reach agreement with an Equity Investor then seek legislative approval, an intervening rise in interest rates could negate the benefit of a termination to the Equity Investor and cause it to decline to move forward. Accordingly, SFMTA staff seeks prior approval to terminate its Lease Transactions, subject to certain parameters, so as to capture any opportunities as they might arise. SFMTA staff suggests the following parameters:

- The termination does not involve any out-of-pocket costs or liability to the SFMTA – including its counsel and advisor fees (excluding provisions that would otherwise survive at the end of the acceleration of the purchase option);

- Any documentation evidencing such termination must be reviewed and approved as to form by the City Attorney's Office; and

- SFMTA staff will report to the SFMTA Board of Directors on any terminations as soon as practicable after they occur.

Documentation

Other transit agencies that have terminated transactions have entered into a Termination Agreement containing the following provisions:

- The election to terminate is made by accelerating the end of lease term purchase option;

- All liens are released among the parties to the transaction;

- The obligations of all parties under the transaction documents would be considered discharged;

- Certain indemnity provisions in the operative documents would survive;

- The Equity Investor or other party would pay all transaction expenses, including the costs of attorneys and advisors; and

- Each party agrees to provide further assurances of cooperation.

SFMTA staff anticipates that the City would need to approve a Termination Agreement with similar terms. It would not execute any such Termination Agreement, however, without the prior review of the City Attorney's Office and any outside counsel to be retained by the City Attorney's Office.

Thank you for your consideration of this Resolution and for your continued support for the SFMTA.

cc: SFMTA Board of Directors
Deputy City Attorney Julia Friedlander

Attachment

San Francisco Muni

Transit Agency							
Tranche Name	2002-1	2002-2	2002-3	2002-4	2002-5	2002-6	2003-1
Investor	ANZ	CIBC Capital	CIBC Capital	Comerica Leasing	Comerica Leasing	Wells Fargo Bank MN	Wells Fargo Bank MN
Subject of Lease	29 Breda LRVs	24 Breda LRVs	6 Breda LRVs	26 Breda LRVs	5 Breda LRVs	28 Breda LRVs	21 Breda LRVs
Date	4/18/2002	4/18/2002	4/18/2002	4/18/2002	4/18/2002	4/18/2002	9/25/2003
Asset Value	$98,745,000	$80,400,000	$18,930,000	$84,448,000	$16,005,000	$89,628,000	$72,555,000