

Summary of Policy

The purpose of the Defeased Lease Policy is to establish guidelines for the use and on-going management of defeased leases. The policy covers the solicitation and execution of defeased leases entered into with institutional investors. Defeased leasing of capital assets is one of the innovative methods many of the major transit authorities use to earn additional revenue. To “defease” means to bank sufficient proceeds from the transaction to cover lease and loan requirements. Defeasance of the lease payments permits transit authorities to minimize currency and interest rate exposure as well as provide evidence to FTA of continuing control over federally funded assets.

The scope of the policy is limited to defeased leases on assets and the investment of proceeds gained from defeased leases. It excludes any funded leases that are otherwise covered under the Debt Policy. The assets include rolling stock, buses, maintenance facilities, train control systems, rail stations, and rights-of-way.

Defeased lease transactions include several transaction types, including sale/leaseback, cross-border lease, and lease/leaseback. The lease/leaseback, which is currently the most popular of the three transactions, allows the lease of equipment to a trust that is owned by an equity investor. The trust then subleases the equipment to us and gives us the option to purchase the equipment in the future. Sublease rent consists of debt service on the loan and a fixed-price-purchase option payment to the equity investor. The agency enters into defeased leases because they are a federally approved, innovative financing strategy that produces economic benefits.

In 2008, the meltdown of the financial markets, changes in law, and current regulatory actions, necessitated the policy to be updated. Prior to updating the policy in 2008, transactions in excess of certain monetary thresholds require Board approval. In the current highly volatile market place, it is not reasonable to expect financial terms to be held static for such a long time. The policy updates allow designated staff to act/react to changes under delegated authority, when it is in the best interest of the agency because of the highly volatile market.

The updated policy in 2008 added that the Chief Executive Officer, the Chief Financial Services Officer, the Treasurer and Assistant Treasurer, each, an "Authorized Signatory," is each individually authorized to take all reasonable actions necessary to administer the defeased leases on an ongoing basis, including such actions as amending terms and pricing, as well as terminating and replacing credit facilities, agreements, leases and other related documents, "Administrative Actions" when in the reasonable judgment of an Authorized Signatory such action will be beneficial to the agency and consistent with the original Board approved objectives for entering into the initial defeased lease transaction. The Board shall continue to approve any transactions involving a defeased lease, other than transactions involving Administrative Actions.

Historical Perspective

Before the adoption of this policy, staff relied on previously delegated executive authority to leverage its assets, but did little innovative financing like defeased leasing. The Board adopted this policy in February 2000 after staff had conducted research on other transit agencies' defeased lease programs and reported that

we could generate substantial income from pursuing defeased leasing. Since then, five transactions have been completed including rolling stock, maintenance facilities, and parking structures. These five transactions have generated \$48.0 million in gross revenue benefit.

The policy was updated in February 2003 to reflect organizational changes that had taken place since the first Defeased Lease policy was adopted in February 2000.

Last Board Action

October 23, 2008 – Defeased Lease

The Board

- A. approved the updated Defeased Lease Policy.
- B. authorized the Chief Executive Officer to execute letter to elected and other governmental officials in support of legislative or regulatory actions that would protect our financial interests and those of the public transit industry.

Attachment

Defeased Lease Policy

See Related

[Debt](#)

[Financial Stability](#)

[Interest Rate Swap](#)

[Investment](#)

DEFEASED LEASE POLICY

OCTOBER 2008

I. Introduction

The purpose of the defeased leasing policy is to establish guidelines for the use and on-going management of defeased leases.

From January 1997 through July 2003, we entered into a number of leveraged lease agreements including “lease/leaseback” agreements for heavy rail vehicles, buses, light rail vehicles, and various real property operating facilities. Under these agreements, we entered into a head-lease as lessor with an investor and simultaneously into a sublease agreement as lessee to lease the heavy rail vehicles back. We received upfront rent prepayments that we invested in fixed income deposits in an amount that, including interest income, will be sufficient to fund all scheduled payments through exercise of the early buyout option. We have realized \$64.7 million in net benefit after funding of defeasance investments and payment of \$13.2 million of transaction expenses.

For the above transactions, we were obligated to insure and maintain the facilities, buses and rail cars. The Lease Agreements provided for our right to continue to use and control the facilities, buses, and rail cars during the term of the sublease. We agreed to indemnify the investors against increased costs, and any new or increased taxes or fees imposed on the leased assets, and cash flows or income of the lease, other than changes to the income tax rate. We also agreed to maintain certain investment vehicles and credit facilities and replace them or provide replacement credit enhancement upon their credit rating downgrade below specified levels.

II. Scope and Authority

This Defeased Lease Policy shall govern the execution and management of defeased leases entered into with institutional investors. The scope of this Policy is limited to defeased leases on our assets and excludes any funded leases that are otherwise covered under our Debt Policy. The assets include rolling stock, buses, maintenance facilities, train control systems, rail stations and rights of way.

While adherence to this Policy is required in applicable circumstances, we recognize that changes in tax laws, the capital markets, agency programs, and other unforeseen circumstances may from time to time produce situations that are not covered by the Defeased Lease Policy and will require modifications or exceptions to achieve policy goals. In these cases,

management flexibility is appropriate provided specific authorization from the Board is obtained or is authorized in this policy. The Chief Executive Officer, the Chief Financial Services Officer, the Treasurer and Assistant Treasurer, each, an “Authorized Signatory,” are each individually authorized to take all reasonable actions necessary to administer the defeased leases on an ongoing basis, including such actions as amending terms and pricing, as well as terminating and replacing credit facilities, agreements, leases and other related documents when in the reasonable judgment of an Authorized Signatory such action will be beneficial to us and consistent with the original Board approved objectives for entering into the initial defeased lease transaction, “Administrative Actions.”

The Chief Executive Officer, the Chief Financial Services Officer and Treasurer are the designated administrators of the Defeased Lease Policy. The Treasurer shall have the day-to-day responsibility and authority for managing existing defeased lease transactions.

The Board shall approve any transaction involving a defeased lease, other than transactions involving Administrative Actions. We shall be authorized to enter into defeased lease transactions provided that after analysis it has been determined that there is sufficient benefit to compensate for the risk of the transaction. The proposed benefit to us will be presented to the Board at the time of each transaction. Each Authorized Signatory is individually authorized to make appropriate modifications so long as the criteria set forth in the Defeased Lease Policy are met.

III. Managing Defeased Leases

1. Optional Termination

In consultation with our counsel, financial advisor and/or lease advisor, we may terminate a lease if it is determined that it is financially advantageous, or will further other policy objectives, such as management of exposure to related parties.

2. Mandatory Termination

In the event a lease or component of the lease transaction is terminated as a result of a termination event, such as a change in law, default or a decrease in credit rating of either a counterparty or us, we will evaluate whether it is financially advantageous to obtain a replacement lease or component, or, negotiate with other parties to the transaction to keep the lease in effect. If we are unable to replace or amend the lease or it is otherwise economically advantageous to terminate the lease, we will make required termination payments.

3. Credit Support and Related Matters

In the event a credit support provider or investment provider is no longer acceptable pursuant to the documents related to a defeased lease transaction, we shall attempt to obtain an acceptable replacement or obtain a waiver from relevant parties, in consultation with our counsel and advisors.

IV. On-Going Administration

We will comply with all covenants and reporting requirements, including monitoring the financial condition and ratings of counterparties and provide the certificates and information as required under the terms of the defeased leases.

GLOSSARY OF TERMS

1. Defeased Lease-A lease in which the Lessee's, in this case, our rental obligations and purchase option payment are fully provided for at closing. We effectively prepay all of our obligations, including the exercise of the purchase option under the Sublease (as defined below).
2. Types of Defeased Leases:
 - a) Sale-Leaseback-A lease in which the Lessee sells the asset to the Trust which in turn leases it back to the Lessee with a repurchase right.
 - b) Lease-Leaseback – A lease in which the Lessee leases the asset to the Trust which in turn leases it back to the Lessee.
 - c) Cross-border Lease-A defeased lease to a U.S. based Lessee from a foreign based equity investor.
3. QTE- An asset that is classified as “Qualified Technological Equipment” under Section 168(i)(2) of the Internal Revenue Code. QTE assets may be depreciated on a straight-line basis over a five-year recovery period, thus providing enhanced tax benefits in a U.S. lease financing.
4. Trust-a special purpose entity that is created to hold title to or a leasehold interest in property for the benefit of an equity investor who is also known as the beneficiary. In a defeased lease, a trust is established for the benefit of the Equity Investor to receive the monies used to fund the transaction and administer the various transfers of funds that occur over the term of the lease. The Trust functions as the Lessor in a defeased lease transaction.

5. Equity Investor-A financial institution or corporation who, as a taxable entity, receives a combination of tax benefits and cash in return for its investment in a defeased lease transaction.
6. Cash Benefit-The net cash flow received by us for our participation in a defeased lease transaction.
7. Broken Deal-A transaction that fails to proceed once a term sheet has been signed and the Lessee has paid out on transaction expenses.
8. Head Lease-The lease from us to the Trust. A Head Lease is used instead of a sale. The Head Lease qualifies as a sale for federal income tax purposes.
9. Sublease-The lease from the Trust back to us.