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Report on Innovative Financing Techniques for Transit Agencies

This report was prepared under TCRP Project J-5, "Legal Aspects of Transit and Intermodal Transportation Programs, "for which the Transportation Research Board is the agency coordinating the research The report was prepared by Mary A Collins James B McDaniel, TRB Counsel for Legal Research Projects, was the principal investigator and content editor

THE PROBLEM AND ITS SOLUTION

The nation's transit agencies need to have access to a program that can provide authoritatively researched, specific, limited-scope studies of legal issues and problems having national significance and application to their businesses The TCRP Project J-5 is designed to provide insight into the operating practices and legal elements of specific problems in transportation agencies.

The intermodal approach to surface transportation requires a partnership between transit and other transportation modes. To make the partnership work well, attorneys for each mode need to be familiar with the legal framework and processes of the other modes. Research studies in areas of common concern will be needed to determine what adaptations are necessary to carry on successful intermodal programs

Transit attorneys have noted that they particularly need information in several areas of transportation law, including

- Environmental standards and requirements;
- Construction and procurement contract procedures and administration;
- Civil rights and labor standards; and
- T ort liability, risk management, and system safety

In other areas of the law, transit programs may involve legal problems and issues that are not shared with other modes; as, for example, compliance with transitequipment and operations guidelines, FTA financing initiatives, private-sector programs, and labor or environmental standards relating to transit operations Emphasis is placed on research of current importance and applicability to transit and intermodal operations and programs.

APPLICATIONS

Transit agencies now have an enormous need for equipment and facilities, and the resources available from federal, state, and local governments cannot keep up with their capital needs. Transit agencies can no longer rely solely on funding from federal, state, and local governments, but must find optional methods to raise capital and increase cash flow These agencies are under pressure to use "innovative financing techniques" to meet that need

This publication explores the nature of "innovative financing techniques" and describes situations in which such techniques have been used It should be useful to transit administrators, attorneys, debt managers, capital programs managers, comptrollers, financial officers, planners, and project development officials.

TRANSPORTATION RESEARCH BOARD
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REPORT ON INNOVATIVE FINANCING TECHNIQUES FOR TRANSIT AGENCIES

By Mary A. Collins, Orrick, Herrington & Sutcliffe LLP, San Francisco, California

I--INTRODUCTION

For over a decade, transit agencies across the United States have been faced with the challenge of finding or maintaining revenues with which to meet their growing budgets for operations and capital costs relating to providing transit services to their constituents. In California alone, the Californians for Better Transportation estimates that the unfunded annual needs of public transit total over half a billion dollars. The traditional sources of funding for transit providers have been state and federal grants and fare box revenues, but due to budget restraints, both federal and state governments have been reluctant to continue the level of subsidies for transit that have been pervasive in the past. Recognizing this, the federal government has been encouraging new sources of revenue and innovative applications of existing revenues to support transit services. The Intermodal Service Transportation Efficiency Act of 1991 (ISTEA) encouraged revenue enhancement and more efficient management of public transit infrastructure through the creation of public/private partnerships.

On May 9, 1995, the Federal Transit Administration (FTA) published a notice regarding its innovative financing initiative in the Federal Register (60 Fed. Reg. 24682), in which FTA described innovative financing methods and asset management tools that may be used in connection with projects receiving assistance from the FTA in order to facilitate financing; leverage federal, state, and local funds; and otherwise increase the effectiveness of transit capital projects.

Using the FTA notice as a guide to the types of innovative financing methods in use, we conducted a survey to gather case studies of such techniques in operation. In March 1996 a questionnaire was mailed to 400 transit providers requesting them to identify innovative financing techniques they had used. Responses were received from 97 transit agencies, although many of those responding simply requested copies of the finished report. After reviewing the results of the survey, we contacted various transit agencies to attempt to determine appropriate case studies. For each financing technique we identified at least one or two agencies from which we could obtain the necessary information for a study. In discussions with agencies we sometimes identified appropriate case studies that were not initially identified in the survey response, such as examples of joint development.

This report describes the identified techniques that have been successfully employed or attempted by transit operators in order to increase revenues available for transit capital or operating needs or to provide development of transit assets in innovative ways. Learning by example is often the easiest way to learn and by studying the case studies set forth in this report, transit operators across the country can duplicate these techniques or expand on them with their own innovative financing techniques to produce revenues or transit assets for the commuting public.

Certain legal issues are raised with respect to any innovative financing technique that is employed. First, one has to examine any federal regulations or issues that are raised by using federally-funded assets in an innovative financing technique. FTA's policy of encouraging financing innovations has not necessarily trickled down to the regulations governing the use of federallyfunded assets. Amendments to regulations or special consents are often required. State laws must also be examined to determine whether the innovative financing technique runs afoul of state law prohibitions. Where there are public/private partnerships or the use of public assets by private entities, state laws may restrict such participation by private firms. Finally, federal tax law issues may be raised if tax-exempt financing has been involved in any of the assets under consideration for the financing technique. Tax-exempt financing also places limits on the private use of projects funded with tax-exempt funds. This report describes case studies where financings have been undertaken.

The case studies that we present here involve the following areas:

1. Certificates of participation or lease financing of transit assets,
2. Joint development,
3. Cross-border leasing,
4. U.S. leverage leases,
5. Fare box revenue bonds, and
6. State revolving loan funds.

Appendix A to this report contains addresses for the public entities involved in the case studies and identifies the counsel or other officer of the transit agencies familiar with the financing studied.

II--CERTIFICATES OF PARTICIPATION INVOLVING FTA 49 U.S.C. § 5307 ("SECTION 9") FUNDS

Introduction

One promising innovative financing technique for transit projects is the use of FTA Section 9 funds to subsidize principal and interest payments with respect to Certificates of Participation (COPs).[1] This chapter

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[1] On July 5, 1994, Public Law No 103-272 passed and codified federal transit laws under Chapter 53 of the United States Code. The law repealed the Federal Transit Act without substantive change. The original meanings of the Federal Transit Act provisions are unchanged even though the new language in some instances differs from that of the original

will include a general discussion of COPs and the use of FTA Section 9 funds to help finance the acquisition of transit-related capital projects through the sale of COPs

The Structure of a Certificates of Participation Transaction

COPs are securities that represent interests in a stream of payments from an underlying obligation, typically a lease or an installment sale agreement. The governmental entity's payments pursuant to this underlying obligation are assigned to a trustee who pays such moneys to the holders of the COPs. For transit finance purposes, this underlying obligation is usually a lease, since FTA Section 9 funds are available to pay a portion of such lease payments, as discussed below.

COPs in lease payments are a mechanism for governmental entities to finance capital projects without technically issuing long-term debt. The issuance of long-term debt is commonly subject to voter approval and other State constitutional and statutory requirements. Case law in various jurisdictions supports the proposition that leases do not constitute "debt" for these purposes because the governmental lessee is not obligated at the outset to make rental payments throughout the entire term of the lease, but is only required to pay rent each year to the extent the leased property is available for use during such year.[2]

In a typical COPs financing:

- An item of real or personal property with adequate annual fair rental value and useful life is identified as the asset to be subject to the Financing Lease. Such leased asset may be the property to be acquired or constructed with the proceeds of the COPs, in which case interest with respect to the COPs will need to be capitalized until the acquisition or construction of the property is complete. Alternatively, in an "asset transfer" or "asset strip" structure, such leased asset may be a preexisting item of property, which obviates the need for capitalized interest
- The identified item of property is leased to a second party (often for nominal consideration), which becomes the lessor entity under the Financing Lease.
- The property is then leased back to the governmental entity pursuant to a Financing Lease for rent that approximates the fair rental value of the property. These rent payments have designated principal and interest components that equal the principal and interest represented by the COPs. In addition to specifying the rental obligation, the Financing Lease typically calls for abatement of rent if the leased asset is damaged, destroyed, taken by eminent domain, or (for real property) subject to title defect. The Financing Lease also includes covenants to maintain insurance and specifies remedies for the failure to make rent payments. The right to receive rent payments and to exercise remedies under the Financing Lease is typically assigned to a trustee acting on behalf of the holders of the COPs.
- COPs are sold as securities to investors in both private placements and public offerings. The credit strength of COPs may be enhanced with bond insurance, letters of credit, or other guarantees. Because of the risks of abatement and nonappropriation of lease payments, an issuer's COPs are generally considered less creditworthy than its general obligation debt.

FTA Section 9 Funding

The link between FTA Section 9 funding and payments on COPs begins with Section 308 of the Surface Transportation and Uniform Relocation Assistance Act of 1987 (STURRA).[3] Section 308 authorized the use of Section 9 federal transit funds for leases of facilities and equipment at the 80 percent matching level in projects where leasing is determined to be more cost effective than purchase or direct construction. Previously, the interest portion of lease payments was treated as an operating expense and eligible for reimbursement at only a 50 percent matching ratio.

The FTA issued a Final Rule on Capital Leases to clarify the application of Section 308 on October 15, 1991.[4] The primary change reflected in the FTA's 1991 Capital Leasing guidelines is the ability to treat lease payments, including interest costs, as capital expenses eligible for reimbursement at the full, 80 percent federal matching level. Since COPs represent an interest in a stream of payments, including lease payments, the new FTA policy created a clear opportunity for transit agencies to use federal moneys in support of long-term financings.

The FTA's guidelines allow any asset eligible as a capital item to be leased. Moreover, the Department of Transportation's comments accompanying the rules state that the Senate Report language for Section 308 of STURRA envisioned application of federal transit leasing for such items as "computers, maintenance of way and other heavy equipment, maintenance of effort rail equipment, radio equipment, bus garages, property or structures for park and ride, and other buildings or facilities used for mass transit purposes."[5] Despite the variety of assets that may be leased, the typical FTA Section 9 supported COP has involved the acquisition of buses. The use of this financing mechanism versus a pay-as-you-go policy allows transit agencies (either separately or in a pooled transaction) to make larger purchases of bus assets sooner, thereby enhancing service.

Since FTA Section 9 funding is subject to congressional appropriation each year, there is no guarantee

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Act Section 5307 of Title 49 of the U S C replaced Section 9 of the Federal Transit Act, but the funds are still called "Section 9" funds in common parlance and are so called in this report.

[2] *See* Rider v City of San Diego, 18 Cal. 4th 1035, 959 P 2d 347 (Cal 1998)

[3] Pub L No. 100-17 § 308 (April 2, 1987) 101 Stat 226.

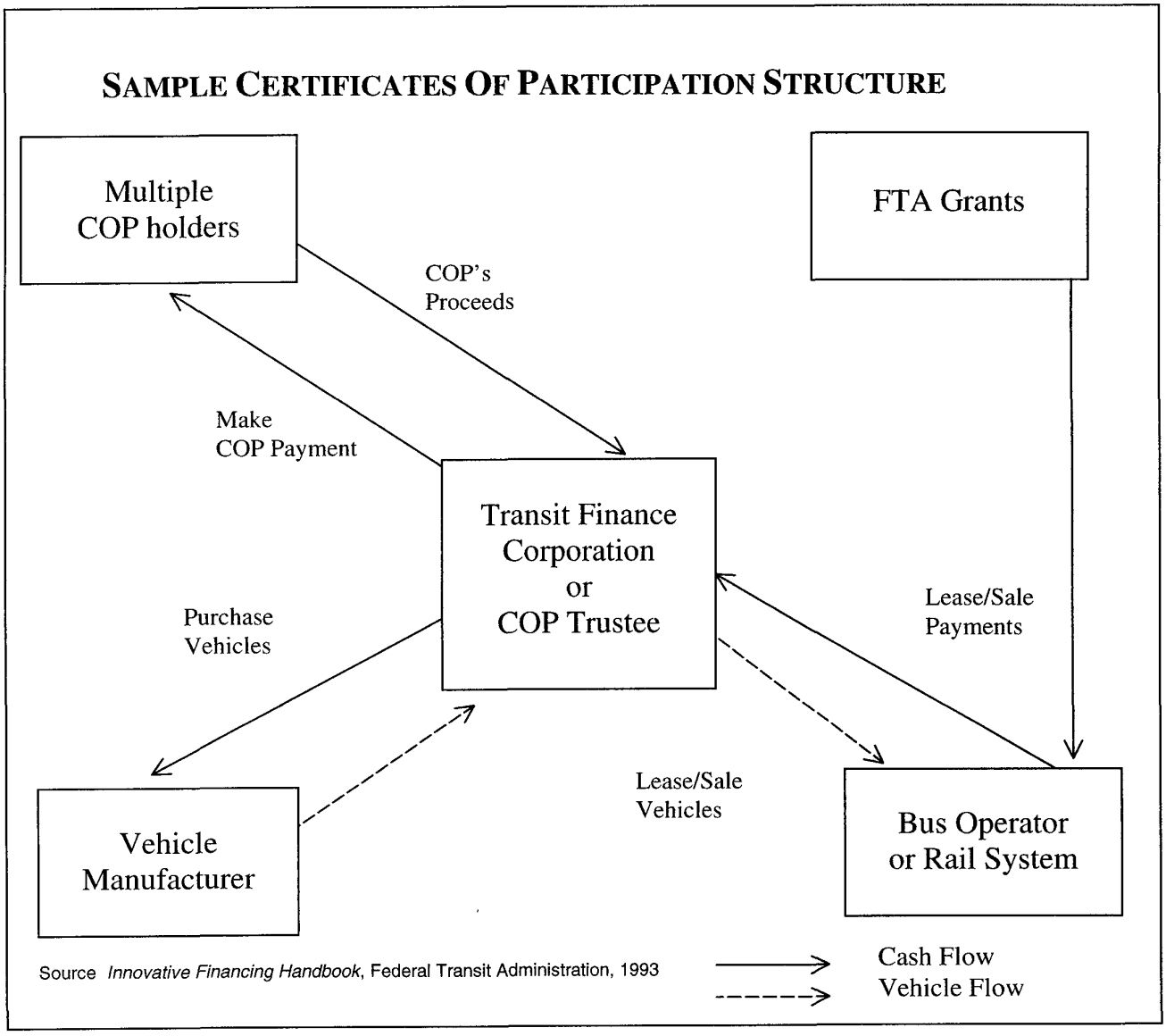
[4] 49 C F R Part 639.

[5] *See* 56 Fed Reg. 51786 (Oct 15, 1991)

that sufficient funds will always be available to pay the full 80 percent match of lease payments. Thus, rating agencies and capital market participants do not treat Section 9 funds as a guarantee, and the focus of any credit analysis is still on nonfederal revenues.[6] Moreover, the FTA's capital leasing guidelines impose a financial capacity test that requires that the lessee transit agency certify that it has the ability to meet future lease obligations in the absence of federal funding.

The FTA also requires that a determination of cost effectiveness be made in order to justify a lease structure instead of a traditional pay-as-you-go purchase arrangement The calculation is made by the grantee using the guidance set forth in FTA's Final Rule on Capital Leases and involves a self-certified net present value analysis of costs and benefits. The most common rationale for lease financing over a pay-as-you-go program is avoiding the cost inflation inherent with later purchases, as well as the economics of scale afforded by larger, one-time purchases.

Key Legal Issue: Under state law, the threshold legal issue is whether the lease or COP structure is permitted, without voter approval, under constitutional and statutory provisions. The key legal issue for FTA approval is the cost benefit analysis of the financing.



[6] JEFFREY A PARKER, How TO EVALUATE OPPORTUNITIES FOR CROSS BORDER LEASING AND CERTIFICATES OF PARTICIPATION 78 (1993)

Case Study--Sacramento Regional Transit District $32.44 Million California Transit Finance Corporation Certificates of Participation, 1992 Series A

In the spring of 1992, the Sacramento Regional Transit District of Sacramento, California, participated in the sale of $32.44 million COPs to finance the acquisition of approximately 75 buses, a fare collection system, and a radio system The COPs represented proportionate interests in the lease payments to be made by the District to the California Transit Finance Corporation (CTFC), a nonprofit corporation, for lease of the project. One of the sources of revenue supporting the District's lease payments is a FTA Section 9 capital grant.

The Parties

The **Sacramento Regional Transit District** is a legislatively created transit district that encompasses an area of 340 square miles, including the City of Sacramento and most of the urbanized area within Sacramento County. The City of Sacramento is the state capital of California located approximately 75 miles northeast of San Francisco The County of Sacramento has a population of over 1 million, approximately onethird of which live within the City of Sacramento. The District operates a fleet of 200 buses and an 18.3-mile light rail line.

CTFC is a nonprofit public benefit corporation created in 1990 by the California Transit Association to provide financing assistance to California transit entities. CTFC provides transit agencies with standardized lease financing documents for stand-alone and pooled COPs supported in part by FTA Section 9 capital grants The CTFC structure has been market tested by the major rating agencies as well as the public finance capital markets. Typically, CTFC transactions involve a preestablished financing team of financial advisors, bond counsel, underwriter, and underwriter's counsel. To date, CTFC has participated in at least six successful COP financings involving FTA Section 9 funds.

The Project

The project included three components: (1) Purchasing 75 heavy-duty transit buses, (2) Installing a fare collection system, and (3) Installing a new radio system The buses are approximately 40 feet long by 102 inches wide, equipped with natural gas engines, air conditioning, and front and rear doors with a wheelchair lift at the front door. Delivery of the buses was anticipated to take place over a period of 16 to 22 months. Cost of the buses was estimated at $21.5 million, which included acquisition and delivery costs.

The new fare collection system was for the District's bus fleet (now 200 buses). The fare collection system consisted of 200 registering fare boxes plus cash boxes, five receiver vaults, and a data collection system to record cash received onboard the buses. The onboard registration feature aids the drivers in determining whether proper fare has been received and also provides information that can be used to reconcile and audit cash receipts. The cost was estimated at $2.0 million.

The radio system replaced an aging 14-year-old, three-channel system that was experiencing frequent breakdowns and gaps in geographical coverage. The new system was to be a six-channel "trunk" radio system providing the necessary flexibility for bus, rail, and paratransit services over the next 12 years. The equipment procured consisted of three base stations, 300 mobile units, and a number of hand-held portable radios. The cost was estimated at $4.0 million.

The Financing

As indicated in the Official Statement dated April 8, 1992, proceeds of the Certificates were allocated as follows:

Acquisition Fund (1)	$25,194,696
Lease Payment Fund (2)	3,231,382
Reserve Fund (3)	3,213,601
Financing Fee (4)	496,332
Original Issue Discount	303,939
Total Principal Amount of Certificates	$32,440,000

(1) Includes Delivery Costs

(2) All of the interest accrued with respect to the Certificates from the date of execution and delivery of the Certificates through December 1, 1993, and a portion of the interest due on the Certificates from January 1, 1994 through April 1, 1994, was capitalized.

(3) Equal to 10% of principal amount of the Certificates, less original issue discount

(4) Includes Underwriter's discount and certain costs of issuance associated with the execution and delivery of the Certificates

The Lease Payment Fund was funded with COP proceeds sufficient to make all lease payments due prior to the expected completion date of the project.

Each Certificate represents a proportionate interest in the lease payments to be made by the District to the Corporation under the financing lease. The Corporation, pursuant to an assignment agreement, assigned its rights and remedies under the Lease Agreement (except certain rights to indemnity and reimbursement of expenses) to the trustee bank for the benefit of the owners of the Certificates, including its right to receive lease payments. Principal and interest due with respect to the Certificates is made from the lease payments payable by the District; insurance or condemnation proceeds pertaining to the project, to the extent that such proceeds are not used for repair or replacement; and interest or other income derived from the investment of the funds and accounts by the Trustee pursuant to the Trust Agreement. Lease payments are paid from revenues of the District.

The District applied for a Letter of No Prejudice from FTA, pursuant to ISTEA, for the reimbursement of a portion of the capital costs of acquiring the project. Prior to the closing of the financing, the District received a notification from FTA indicating FTA's preliminary

approval (subject to final review of legal documents) for the annual reimbursement to the District of 80 percent of the lease payments net of capitalized interest and the earnings on the reserve fund (the "Net Lease Payments").

The District included the following disclosure in its official statement for the financing:

> Although ISTEA provides federal funding for transportation purposes through the federal government's fiscal year ending September 30, 1997, receipt of funding by the District for any fiscal year beyond the current federal fiscal year is subject to future Congressional appropriation for transit purposes and future submittal of grant applications by the District with the FTA Receipt of funding by the District for any federal fiscal year beyond the federal fiscal year ending September 30, 1997 is subject to future Congressional authorization Furthermore, although ISTEA establishes the federal matching ratios for transit projects at 80%, no assurances can be made that the funding level for the FTA Project Grants at 80% of Net Lease Payments expected to be preliminarily approved by FTA under Section 9 for the FT Act (as hereinafter defined) will be continued in any future Congressional authorization
>
> The District expects to fund the remaining portion of Lease Payments which are not funded with the FTA Project Grants from Revenues, which include State and local funds and other legally available sources.

Due to the contingent nature of the federal grants, rating agencies rely on the ability of the District to make lease payments from other revenue sources in assigning a credit rating to the transaction. The District receives portions of the local sales tax and gas tax moneys levied pursuant to state law and a local sales tax initiative. This revenue, which is independent of fare box revenue, is used for the local match for the FTA grants. For this issue the District was assigned a rating of A-1 by Moody's Investors Service.

The lease payments were structured with equal principal payments of approximately $2,705,000 each year, resulting in a declining annual payment in order to approximate the depreciating value of the buses and to protect investors from a possible change in FTA funding.

The issuance of the COPs enabled the District to receive a favorable bid on a large bus order, resulting in more capital assets for less expenditure of funds. Economy of scale was also realized in the low issuance costs allocable to the remaining portions of the project.

The key legal issue as to what authority existed under state law to enter into the lease was determined by the District's special counsel. The FTA's approval or letter of no prejudice was the key factor in allowing the District to determine to proceed with the financing. The role of Agency counsel, as is true for most innovative financing techniques, is to render opinions that the Agency has the authority to engage in the transaction and to ensure that the proper procedural steps for the adoption of the required Agency resolutions have been followed by the Agency. Special counsel is customarily engaged to provide opinions to the investors in the COPs or to the counterparties involved in other innovative financing transactions.

Case Study-$9.66 Million California Transit Finance Corporation Certificates of Participation, 1996 Series A (City of Culver City, California)

On June 4, 1996, the City of Culver City, California and the CTFC participated in the sale of $9.66 million aggregate principal amount of COPs to finance a portion of the construction costs relating to the city's Transportation Administration/Maintenance facility. One of the sources of revenue supporting the Certificates is FTA Section 9 capital grants. This transaction involved a number of significant innovations, which are discussed in more detail below.

The Parties

The City of Culver City, California, is located about 8 miles west of downtown Los Angeles and 2 miles north of the Los Angeles International Airport, encompassing an area of almost 5 square miles. In 1994 the city had a population of approximately 38,793. The city operates the Culver City Municipal Bus Lines (CCMBL), the second oldest municipally owned bus agency in the State of California. CCMBL maintains a fleet of 33 buses, of which 30 are used in regular service.

The **CTFC** is a nonprofit public benefit corporation created in 1990 by the California Transit Association to provide financing assistance to California transit entities. CTFC provides transit agencies with standardized lease financing documents for stand-alone and pooled COPs supported in part by FTA Section 9 capital grants. The CTFC structure has been market tested by the major rating agencies as well as the public finance capital markets. Typically, CTFC transactions involve a preestablished financing team of financial advisors, bond counsel, underwriter, and underwriter's counsel. To date, CTFC has participated in at least five successful COP financings involving FTA Section 9 funds.

The Project

Prior to the financing, CCMBL provided bus maintenance services on a crowded 3.96-acre City Yard site shared with the city's Public Works, Parks Maintenance, and Purchasing Divisions. In order to provide more efficient and cost-effective service, CCMBL proposed a plan to the FTA that included (i) dedicating the entire City Yard site for public transit purposes, (ii) demolishing existing buildings and constructing a new parking structure and transit facility, including an administrative/maintenance building containing a fueling island, bus washer, eight bus bays, inspection area, and a welding shop, and (iii) purchasing a new site and remodeling an existing building to accommodate the displaced city divisions. The project described above would allow CCMBL to increase its bus fleet from 33 to 60 in anticipation of increased demand for public transit service. The FTA accepted and approved CCMBL's proposal

through their adoption of a Federal Highway Administration rule referred to as "functional replacement."

The total cost of the project was estimated at $23.8 million Certificate proceeds provided approximately $8.4 million, with the balance of the cost being paid by city contributions and FTA Section 9 capital grants (in addition to the Section 9 funds expected to pay debt service on the Certificates).

The Financing

The CTFC Certificates represent a proportionate interest in lease payments made by the city to CTFC under a lease agreement between the city and CTFC. CTFC assigned these lease payments to the trustee for the Certificates, as well as any insurance or condemnation proceeds relating to the property encumbered by the Lease Agreement, to the extent not required for the repair or replacement of such property. Payments under the Lease Agreement are payable only from "revenues" of the city, which are defined as (i) certain FTA Section 9 capital grant funds, (ii) the Local Transportation Fund portion of California Transportation Development Act funds, (iii) the city's share of State Transit Assistance Funds and (iv) the city's discretionary and local return portion of two 1/2 cent transportation sales taxes levied in Los Angeles County. General fund moneys of the city are not included in the definition of "revenues" and are therefore not available to make payments under the Lease Agreement. The Lease Agreement provides that the obligation of the city to make payments under the Lease Agreement solely from revenues is unconditional and not subject to abatement in the event of a casualty loss involving the leased facilities.

The Certificates are also secured by a reserve fund held by the trustee, funded at maximum annual debt service on the Certificates. Finally, the payment of principal and interest with respect to the Certificates is guaranteed by a municipal bond insurance policy issued by AMBAC Indemnity Corporation.

The Certificates represent a clear progression in the manner FTA Section 9 supported COPs have been structured The primary innovation is the use of real property instead of buses to serve as the asset encumbered by the Lease Agreement. This produces several financial benefits to the city. Since the city's Transportation Administration/Maintenance facility has a longer useful life than vehicles, the city was able to spread out its payments over a 20-year term, as opposed to the 12year term usually seen in bus financings. In addition, there will be sufficient rental value in the project to allow for level debt service instead of the declining payments that are associated with bus leases, again maximizing the benefits of tax-exempt financing.

FTA permitted the use of Section 9 capital grant moneys to support the financing costs of the project because the city's Transportation Administration/Maintenance facility is clearly transit-related. In addition, FTA allowed Section 9 funds to account for 100 percent of debt service on the Certificates, as opposed to the traditional 80 percent match. The rationale for this arrangement is that the city contributed approximately $3.9 million of land upon which the project will be located and further contributed $3.1 million in cash to finance the project. These up-front contributions satisfied the FTA's requirement of a 20 percent local match for FTA Section 9 projects.

Another innovative feature of the Certificates involves the lack of capitalized interest. Typically, the FTA requires interest payments on Section 9 lease financings to be capitalized for a period sufficient to allow the construction or acquisition of the asset encumbered by the lease. Until the asset is ready for use and occupancy, FTA Section 9 capital grants may not be used to pay debt service. This policy mirrors the practice of most bond counsel firms in California, which generally require capitalized interest prior to the construction or acquisition of the leased asset so that the initial lease payments will not violate the debt limit embodied in Article XVI, Section 18 of the California Constitution. The need to capitalize interest increases the amount of COPs required to be sold and increases the total debt service obligation of the governmental lessee.

Since the relevant lease payments consist of special revenues not subject to the State Constitutional debt limit, FTA policy for this transaction mirrored State law in this regard and permitted FTA Section 9 supported lease payments to be made prior to the completion of the city's Transportation Administration/Maintenance facility.

Another unique aspect of this transaction is the use of a bond insurance policy to enhance the rating of the Certificates to AAA/Aaa by Standard & Poor's Ratings Services and Moody's Investors Service, respectively. The premium for this bond insurance was less than the net present value of the marginally higher interest that would have been payable on an unenhanced issue. This is apparently the first new issue FTA Section 9 supported COP to have been enhanced by bond insurance.

The use of bond insurance and real property as the leased asset represents a logical extension of the COP structure inherent in these financings. So long as a governmental entity can demonstrate to the FTA a sufficient transit purpose, further financings can reflect various permutations, including "asset transfer" or "asset strip" structures, variable rate COPs backed by liquidity facilities, and other complex arrangements that are now commonplace for non-FTA supported COPs.

Bond counsel (or special counsel as they are sometimes described in COP financings) delivered the customary legal opinion in this transaction that the Lease Agreement was a valid and binding obligation of the city. Such opinion is customarily required on all publicly sold COP financings by an independent bond counsel firm. Bond counsel makes this determination based on case law or may require the issuing entity to file a

validation action or some other similar court proceeding to determine the validity of the transaction prior to proceeding with the transaction.

The authority for lease financing is very well developed in California.[7] In other jurisdictions, case law authority may not be as developed and in considering any lease financing, the threshold legal issues are whether there is authority to enter into the lease financing and whether there is any constitutional impediment to the lease transaction.

III--JOINT DEVELOPMENT

Introduction

Another promising method of innovative financing for transit projects is joint development projects. This chapter will include a discussion of joint development and the issues it raises.

The Structure of a Joint Development Transaction

Joint development involves a partnership or joint venture between a transit agency and a private developer to develop certain assets It can also mean a relationship whereby the transit agency receives revenues or transit facilities and the developer receives use of either real estate or some other asset owned by the transit agency. Joint development is seen as a method by which private funds are used to develop transit property resulting in profit for the private developer and a developed asset for the transit agency. Risks related to the development are either shared or borne by the transit agency or the private developer.

One of the chief assets that transit agencies commonly have that can be made available for development by a private developer is real estate. An example is where a transit agency has a surface park-and-ride lot and in exchange for a portion of the lot, the developer will agree to construct a parking structure on the remaining surface parking area. The increased development may mean greater residential density or commercial activity next to the transit facility, leading to increased ridership. Although real estate is the most common asset that a transit agency uses in order to participate in a joint development project, the right-of-way that a transit agency maintains is also an asset that can be used in a joint development scenario

Many different purposes are served by joint development and one of the issues to be considered by a transit agency when undertaking joint development is which policies it wishes to further. The most common policy is one of increased revenues. Through leasing or other use of transit property, revenues are sought to be generated. Another purpose of joint development is increased ridership. By creating a higher density of residential or commercial areas around a transit facility, joint development can lead to new ridership or use of the transit facilities. Another purpose may be to enhance the transit facility itself. By converting a bare park-and-ride lot to a transit village with both commercial and residential facilities, the transit facility is made a more attractive alternative with added security and conveniences. Whereas currently revenue generation is the primary focus of transit agencies in joint development projects, in the future, enhancement of transit facilities and increased ridership may take preeminence over revenue considerations.

Legal and Policy Authority for Joint Development

The authority for pursuing joint development is contained in a mix of congressional legislation, Executive Orders, and FTA policy initiatives. For example, Section 5309(a)(1)(E) of the Federal Transit Act, as amended, provided that the Secretary of Transportation may make grants or loans to assist in financing projects that (i) enhance the effectiveness of any mass transportation project and are physically or functionally related to such mass transportation project or (ii) create or enhance coordination between mass transportation and other forms of transportation, either of which enhance urban economic development or incorporate private investment.[8]

Grants under the Federal Transit Act can be made for property acquisition; demolition of existing structures; site preparation; utilities; building foundations, walkways, and open space; and the acquisition, construction, and improvement of facilities and equipment for intermodal transport facilities and transit malls, but generally may not be made to finance the construction of commercial revenue-producing facilities or those portions of public facilities not related to mass transportation.[9] The Federal Transit Act also permits federal participation in land acquisition, demolition of existing structures, and site preparation for mixed use projects.

Additional authority for joint development is embodied in ISTEA, which encourages more efficient management and enhancement of public transit infrastructure through the creation of public/private partnerships. Joint development also finds support in Executive Order 12893, "Principles for Federal Infrastructure Investments," signed by the President on January 26, 1994. Section 5C of Executive Order 12893 states:

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[7] In Rider v City of San Diego, 18 Cal 4th 1035, 959 P 2d 347 (Cal 1998), the California Supreme Court upheld a constitutional challenge to a lease financing and noted the long history of court cases upholding such financings

[8] Federal Transit Act Section 5309 (a)(1), 49 U S.C A 5309 (a)(1)(E), (1997, 1998 Suppl) By technical amendments made in the Transportation Equity Act for the 21st Century, Pub L No 105-178, 112 Stat 107, this language has been moved to 49 U S.C 5302 (a)(1)(G) *See* Sec 3003 of H.R. 2400 and p 146 of House Conf. Rpt. 105-550.

[9] Fed Transit Act Sec. 5309 (f), 49 U.S C A. 5309 (f) (1997) This section was repealed by TEA-21 and these criteria were placed in 49 U S C 5302 (a)(1)(G) (i) & (ii) *See* citation in footnote 8

> Federal agencies shall seek private sector participation in infrastructure investment and management Innovative public/private initiatives can bring about greater private sector participation in the ownership, financing, construction, and operation of infrastructure programs.
>
> Consistent with the public interest, agencies should work with state and local entities to minimize legal and regulatory barriers to private sector participation in the provision of infrastructure facilities and services

Moreover, the FTA in November 1994 issued its Livable Communities Initiative, which encourages userfriendly transit projects that effectively link residents with local and economic services and jobs. The Livable Communities Initiative endorses mixed use development and describes certain characteristics of successful "livable communities":

> Livable Communities involve careful coordination of transit planning with community development planning Livable communities are neighborhoods where housing, schools and parks are within easy walking distance of user-friendly transit opportunities that effectively link residents with local social and economic services and jobs In livable communities, transit service reflects the diverse needs of the community.
>
> Transit facilities [in Livable Communities] are designed to include space for day care centers, dry cleaners, and other enterprises that are useful to transit passengers.

Under the Livable Communities Initiative, the FTA may provide Section 5309 (formerly Section 3) and Section 5336 (formerly Section 9) capital grants for enhancements to transit stations; park and ride lots; transfer points incorporating community service and customer convenience facilities (such as health care centers, banks, retail services and the like); safety elements; sidewalks; skyways; access roadways; and other transit-related improvements.

The Livable Communities Initiative requires transit agencies proposing federally-funded projects to demonstrate that the projects are transit-related and promote the concept of livable community in the area adjacent to the project. The FTA requires a local match of 20 percent for all grants under the Livable Communities Initiative.

Finally, the FTA published its Innovative Financing Initiative on May 9, 1995,[10] which gives explicit support for joint development using Section 3 and Section 9 funding, as well as funding under the STP and Congestion Management Air Quality Programs. The Innovative Financing Initiative announced:

> [A]ssets previously acquired with FTA funds may be used for joint development purposes For example, land now used for station parking and no longer needed for transit purposes may be converted to use in a transit-related development project.. FTA program funds may be used for the overall planning of a transit-related project, including the commercial revenue-producing facilities, so long as such commercial facilities are part of an overall transit-related project

[10] 60 Fed Reg 24681 (May 9, 1995)

Private Use Issues

The FTA's stated policy is to review joint development proposals on a case-by-case basis.[11] It may be beneficial for a transit agency to use consultants to guide proposals through the FTA's approval process. The FTA's subjective approach may arise from the conflict between the private sector participation inherent in all joint development and long-standing federal policy that discourages undue private benefit from public agency grants.

This policy is evident in the complex and stringent Internal Revenue Service regulations regarding the private use of projects financed with proceeds of tax exempt bonds. Another example of this policy is the general rule that transit assets funded by federal grants must remain in mass transit service over the life of the asset. If the asset is removed from mass transit service during its useful life, then the prorated, depreciated federal share of the asset must be rebated to the federal government. This result can be mitigated, however, by transferring the federal interest in certain assets to other transit assets, in accordance with the FTA's guidelines.[12]

Key Legal Issue: Issues that are raised in joint development focus on the statutory authority of the agency to undertake the joint development activity (public bidding requirements may prohibit the structure); the limitation on any funding available for joint development, whether it be state, federal or local; and whether there are any tax law restrictions on the various funding mechanisms available for the joint development project.

Case Study--Vertical Mall Joint Development for Miami-Dade Transit Agency (Dade County, Florida)

The Miami-Dade Transit Agency (MDTA) recently completed construction on an ambitious joint development project adjacent to one of its heavy rail transit stations. The process began over a decade ago, and Miami-Dade's experience is illustrative of certain issues that can arise when undertaking a project involving joint development.

The Parties

The **Miami-Dade Transit Agency** is the transit operations agency of Miami-Dade County, Florida. Miami-Dade serves the greater Miami metropolitan area, operating approximately 600 buses as well as the 21-mile elevated rail line known as Metrorail.

The private developers involved in Miami-Dade's development project were the Green Companies, Jeff Berkowitz & Co., and Mark Millgram & Co., in a joint venture.

[11] FEDERAL TRANSIT ADMINISTRATION, INNOVATIVE FINANCING HANDBOOK (undated)

[12] FEDERAL TRANSIT ADMINISTRATION, INNOVATIVE FINANCING INITIATIVE, 60 Fed. Reg. 24681-84 (May 9, 1995).

The Project

The existing site upon which the project was constructed consisted of a 9.2-acre park-and-ride lot containing approximately 750 parking spaces, adjacent to Miami-Dade's heavy rail Dadeland North Station. Miami-Dade originally purchased this land with Urban Mass Transportation Administration (UMTA)[13] capital grant funds. Shortly before construction of the project, the State of Florida financed the construction of an above-ground parking structure with approximately 2,000 parking spaces adjacent to the Dadeland North Site. Phase 1 of the project itself involved a "vertical mall" containing approximately 315,000 square feet of retail space, at a construction cost of approximately $40 million. The developers of the vertical mall entered into a 90-year ground lease with Miami-Dade for the use of the Dadeland North Site.

The Financing

In 1981, Miami-Dade issued a Request for Proposals (RFP) for the Lease and Joint Development of the Dade North Metrorail Station Site. Pursuant to this RFP, Miami-Dade selected the Green Companies, and protracted negotiations followed for approximately 12 years. In 1994, under the threat of Miami-Dade issuing a new RFP to developers, the Green Companies, in a joint venture with Jeff Berkowitz & Co., and Mark Millgram & Co., negotiated a revised arrangement with Miami-Dade that included the following provisions:

> 1. Minimum rent to be paid to Miami-Dade for the use of the Dadeland North Site will not be less than $100,000 per year, plus 5 percent of gross revenues from the operation of the vertical mall Miami-Dade has projected this 5 percent portion to be approximately $1,500,000, which will generate an estimated $40,000,000 in additional revenue for Miami-Dade over the 25-year lease term
> 2. If Miami-Dade discontinues transit service to and from the Dadeland North Station, the parties agree to review the impact of such termination and make an equitable adjustment in the lease.
> 3. Construction plans shall include several "transit friendly" design features

While Miami-Dade's impasse with the developers was being resolved, a new hurdle arose-FTA approval. The federal government retained an interest in the Dadeland North Site because Miami-Dade's purchase of the land was financed with an UMTA capital grant. In 1989, UMTA approved a proposed lease between Miami-Dade and the Green Companies, but the parties could not agree on certain major business points. By the time Miami-Dade was able to reach agreement with the developers in 1994, the FTA (through its Region IV Office) had disapproved the project.

The FTA's Region IV Office noted that after project completion, the Dadeland North Site would technically no longer have a transit use. The Region IV Office made it clear if the project went forward, Miami-Dade would be expected to buy out the FTA's interest in the property. In support of their decision, the Region IV Office cited the provisions of Office of Management and Budget Circular A-102 (March 3, 1988), which requires the disposition of UMTA-financed property no longer used for a transit purpose.

Miami-Dade appealed this decision to FTA headquarters in Washington, DC. Miami-Dade argued that a strict interpretation of the OMB Circular would contradict several policy pronouncements promoting joint development. Miami-Dade stressed the transit purpose of the project as a whole and noted that all rental income from the project would be used only for public transit. Moreover, Miami-Dade predicted that the project would increase its ridership by at least 200,000 riders per year. Miami-Dade ultimately prevailed and on June 28, 1994, the FTA granted its formal approval of the project.

Case Study--Santa Clara Valley Transportation Agency--Almaden Lake Village

The Santa Clara Valley Transportation Authority (VTA), in partnership with the Almaden Lake Village Associates, is in the process of developing a highdensity rental community on the Guadalupe Corridor light rail system's Almaden park-and-ride lot. The building of the Almaden Lake Village is the first project of its type in the nation and is targeted at residents who are priced out of the housing market and/or those who choose the convenience and amenities of luxury apartment living with easy access to transit.

The Parties

The **VTA** is the transit agency for the City of San Jose and the other 14 cities located in the County of Santa Clara, which contains the largest population in the San Francisco Bay area and a thriving manufacturing and services section, including the famed Silicon Valley concentration of high-tech computer firms.

Almaden Lake Village Associates is a limited liability partnership established by the developer of the project.

The Project

Almaden Lake Village was completed in 1998. It is built on 7.1 acres (5.4 acres net) of VTA-owned land at the Almaden park-and-ride lot at Winfield Boulevard and Coleman Road in San Jose. The high-density, multi-residential complex includes 250 units, with a density of 47.2 dwelling units per net acre.

The purpose of the Almaden Lake Village Project and subsequent high-density residential projects is threefold. First, to allow VTA to generate a continuing revenue stream in order to defray operating and other expenses; second, to use high-density residential development in order to gain as many new riders as

[13] UMTA or Urban Mass Transportation Administration was the predecessor to the Federal Transit Administration.

possible for the transit system; and third, to enhance the environment at and around the park-and-ride lots and provide a sense of "place" and "community" at those locations

The Almaden Lake Village project is primarily a market-rate apartment development with 20 percent of the units available to low-income households. Subsequent projects could incorporate affordable housing units and, perhaps, a commercial/retail component into the design. The project cost $32 million and was built on property leased from VTA under a 75-year ground lease. The rental of the land for the project is the direct monetary benefit the agency receives from this joint development.

The Financing

VTA established a joint development program to identify and implement joint development opportunities at VTA-owned park-and-ride lots. The first step in implementing the program was to assess the benefits of and opportunities for joint development. Studies conducted ranked the Almaden light rail park-and-ride lot as the first most feasible location for a joint development project. Studies also found that the benefits of joint development (i.e., revenue production, increase in transit ridership, and enhancements to the environment around the transit facility) at this site would come from a high-density residential development.

VTA has long pursued strategies to increase ridership and seek out additional revenue sources. The Almaden Lake Village Joint Development project will help to meet these objectives. It will supplement fare box revenues and because of its higher than average densities and direct link to the station, increased ridership is expected.

Park Place, in Mountain View, a 370-unit project development by Prometheus featuring three-story buildings over a podium with subgrade parking, was selected as the best prototype for the project, since a design of its type would cost less to build and it commands the highest rents in Santa Clara County. The architect for Park Place, Fisher Friedman Associates, was hired to design a project for Almaden Lake Village modeled after Park Place.

The Almaden Lake Village 250-unit complex has two and three-story buildings on podiums over subgrade parking and features fully-secured main grounds and inner-courtyards with easy pedestrian access to the Almaden Transit Station and Guadalupe River Park. An East Block and a West Block are situated on either side of a connecting road that provides car and bus traffic with road access. The existing roadway was moved 100 feet to the west to accommodate this combined use and maximize the efficiency of the site.

Additional project amenities include a lap pool and spa, 3,300-square-feet recreation center with community lounge, meeting rooms, and a fully-equipped fitness center. Water features and landscaping are an integral part of the project.

The developer for the project was chosen by VTA following a request for proposal process. Financing for the Almaden Lake Village project is solely the responsibility of the project developer. VTA's board was firm in not assuming any risk with respect to the development and not subsidizing the development other than by providing the land and agreeing to subordinate the lease payments for the land to the financing required for the project. The developer initially sought a loan from the Department of Housing and Urban Development (HUD), but after a series of delays it was determined that the HUD loan was too problematic and the process too lengthy. Tax credits were next analyzed as a possible means of financing the project, but due to a rules change, the tax credit route was not considered feasible. Finally, financing the project through the issuance of tax exempt bonds as a multifamily housing project, containing 20 percent low-income units, was determined to be the most advantageous option.

The City of San Jose was instrumental in providing the bond financing, which requires an allocation of the state volume cap for private activity bonds. Support of the local government appears to be a key element in the success of the joint development project. Local zoning and permits need to be granted for the project to proceed in a timely manner. An aggressive campaign of community involvement and support in the project can be beneficial. It is possible for community activists to focus on the joint development project as a means of illiciting more amenities from the city, such as additional parks and landscaping.

Following the necessary bond approval and cap allocation from the state, bond financing allowed the construction to proceed. VTA anticipates receiving revenues from the project in the form of annual lease payments, which were set pursuant to a market rate based on an appraisal of the land. One of the advantages of the Almaden site was that the land was not purchased with federal transit funds so FTA approval was not required.

In the future, the VTA may be less risk adverse and seek to play a more active role in the development. This may include expanding the type of development to include commercial facilities as well as housing facilities. Correct assessment of the feasibility of a proposed joint development project may require that the VTA obtain analysis from a neutral third-party (not the developer) with expertise in the area. The Almaden Lake Village may prove to be a prototype for future developments of park-and-ride lots.

Various legal issues were raised in the development of the joint development project and were addressed by different counsels, as appropriate. The initial key legal issue was the legality of choosing a developer for the site through an RFP process, a modified public bidding process allowed under state law. This decision as to the legality of the RFP was made at the agency counsel level. Special counsel was involved in the financing, as well as attorneys for the City of San Jose.

Case Study--San Francisco Bay Area Rapid Transit District (BART) Telecommunications System

In 1994 BART solicited RFPs from private developers interested in installing, maintaining, managing, and marketing a fiber optic telecommunications system under a long-term license agreement that would provide revenue sharing to BART and at the same time meet BART's own telecommunication needs.

The Parties

BART is a legislatively-established voter approved transit district covering three counties in the San Francisco Bay Area. The BART system is a 39-station, 93 mile regional rail system currently serving approximately 2 9 million people in the three San Francisco Bay Area counties: Alameda and Contra Costa Counties and the City and County of San Francisco. The system began passenger operations in 1972. It is the principal commuting transportation system for residents of Alameda and Contra Costa Counties who work in the City and County of San Francisco, accounting for 57 percent of all transbay, home-to-work trips that terminate in the core part of San Francisco's central business district The District owns approximately 650 rail cars, which operate over 93 miles of double mainline tracks. Twenty-eight of those miles are in the subway, 24 miles are on an elevated structure, and 43 miles are at grade. An extension south of San Francisco through San Mateo County to the San Francisco International Airport is currently being developed. BART has some unique physical assets in that it has transit lines that run in the East Bay, a transbay tube that runs under San Francisco Bay to downtown San Francisco, and a line running through San Francisco that eventually will extend to the San Francisco International Airport. This system provides an asset in the form of a right of way upon which a fiber optic network may be installed.

The **Metropolitan Fiber System Network Technologies, Inc.,** (MFSNT) was chosen pursuant to the RFP process to develop the telecommunications system.

The Project

The MFSNT/BART contract and agreements provide for the development of a telesystem consisting of a commercial fiber optic telecommunications system and a fully integrated BART telecommunications system. A portion of the conduit system's capacity will be used to support the BART telecommunications system. The remaining capacity will be made available by MFSNT for commercial use, which will generate revenue for BART as described below. The BART telecommunications system will replace BART's existing telecommunications system with a new trunk radio system, a synchronous fiber-optic-based data transmission network, and the hardware and software to fully integrate the entire system for BART's use. The BART telecommunications system is a one-of-a kind system within the transit industry. Other transit properties have portions of the proposed improvements, but the BART telecommunications system is unique.

The BART telecommunications system was financed pursuant to a lease with MFSNT with principal components in the amount of approximately $45 million. MFSNT supplies all of the equipment for and provides engineering and construction management services to fully integrate the BART telecommunications system. Construction work associated with the installation of the BART telecommunications system (estimated at 10 percent to 20 percent of the cost of the BART telecommunications system) was competitively bid by BART. In the event that BART's competitive bid process results in a cost that exceeds the $45 million, MFSNT agreed to pay the difference. In the event that BART's competitive bid process results in a cost that is less than the $45 million, MFSNT agreed to reduce BART's financial obligation accordingly. BART entered into a 15-year Equipment Lease-Purchase contract with MFSNT for the telecommunications system. MFSNT retains ownership of the BART telecommunications system for the term of the contract. At the end of the term, ownership will transfer to BART. BART has an option to purchase the equipment during the term of the lease purchase contract.

MFSNT provides the materials for, owns, and operates the conduit system in BART's right of way for revenue generation under a 15-year Telecommunications License Agreement. Installation of the conduit system was competitively bid. In return, BART shares in the revenue generated from MFSNT's operation of the portion of the conduit system that is not required for the BART system. At the end of the term, ownership will transfer to BART. It was originally projected that revenues from the commercial operations would offset most of the cost of the financing for the BART telecommunications system.

The Financing

In the course of the joint development project with MFSNT, a number of legal issues had to be addressed. Among these were the public bidding requirements that control BART's ability to enter into the contract with MFSNT. Certain parts of the project, such as installation of the conduit that contains the fiber optics, were contracted pursuant to competitive bid. However, the major aspect of the acquisition of the equipment was accomplished through the RFP process.

California Public Contract Code Section 20229.1 authorizes the BART Board of Directors to direct the procurement of certain equipment, including electronic equipment, by competitive negotiation, upon a finding, by a two-thirds vote of the BART Board, that the purchase of equipment in compliance with the provisions of the Public Contract Code generally applicable to such purchases would not be adequate for BART's needs. Competitive bidding of a complex integrated system such as the one sought by BART did not meet BART's needs, as BART would be constrained in its ability to

evaluate the qualifications of proposers and the technical merit of the proposals. Furthermore, if competitive bidding procedures were used for procurement of the system, it would not be feasible for BART to consider adequately the revenue sharing offered by bidders or the merits of their financing packages. The RFP process used by BART to solicit proposals for the telecommunications system met the requirements for competitive negotiation.

Another issue that arose was that some of the right of way owned by BART had been purchased with state moneys provided by the California Department of Transportation (Caltrans). Caltrans' consent was therefore required in order to allow the joint commercial use of the right of way by MFSNT. In exchange for Caltrans' permission to allow BART to use such joint right of way for the revenue generating telecommunications network, BART agreed to allow Caltrans to use a portion of the fiber optics cable ability along BART's entire right of way. BART and Caltrans also agreed to consider revenue sharing in the future. BART's environmental compliance staff determined that the project would not have any significant effect on the environment and, therefore, that the project and its approval was exempt from the California Environmental Quality Act.

The joint development project was financed by a lease purchase agreement of BART under which the BART telecommunications system was purchased by BART pursuant to a tax-exempt financing. The financing required BART to make payments to the lender; however, payment could be deferred until the project was delivered. Based on certain projections, it was considered possible that revenues generated by the commercial use of the fiber optics system would be sufficient to offset a major portion of the payments required by BART to finance its own telecommunications system. BART, however, was taking a financial risk. If the revenues generated from the commercial use of the fiber optics system were not sufficient, BART's own general fund revenues would supply the funds to pay for the lease purchase financing.

Another legal issue that had to be addressed was whether the use by MFSNT of the right of way was prohibited by existing bond covenants of BART as portions of the right of way had been purchased with taxexempt bond proceeds. Bond counsel to BART determined that the use of the right of way by the fiber optic cable was incidental and would not adversely affect BART's outstanding tax-exempt bonds. BART has recently commenced operations of the telecommunications system. Revenues are just now beginning to be realized from the use of the system and it is too early at this point to determine whether sufficient revenues will be generated to offset the cost of BART's telecommunications system

Lessons Learned from Joint Development

Any joint development project is going to require a knowledge of state procurement laws or other restrictions on the use of transit property at the state level, as well as an understanding of FTA restrictions if FTA funded property is involved in the joint development. The policy behind many of these laws is to ensure that private entities do not benefit from the special use of public property without a fair selection process or just compensation. Obtaining the "best price" for a public asset at public bidding is seen as protection from potentially abusive influence by private interests. Because of the inherent public/private partnership in joint development, overcoming the public bidding laws is one of the more difficult hurdles. In the joint development projects studied here, the direct economic benefit to the different transit agencies, typically rent payments, appears minimal compared to the costs of the projects undertaken. Nonmonetary benefits such as economic development, community development, potential increased ridership, and a free flow of information may provide other justification for joint development. However, the potential for uncompensated or undercompensated exploitation of public assets by private firms that are unfairly selected is also a concern in any joint development project.

IV--CROSS-BORDER LEASES OF TRANSIT VEHICLES

Introduction

Cross-border leasing transactions are designed to enable a foreign entity to receive in its country the tax benefits associated with ownership of an item of equipment. These transactions are attractive to many transit agencies because the foreign entity, the "lessor" of the equipment, will pay the 'lessee" (the transit agency) between approximately 3 percent and 7 percent of the cost of the equipment for entering into the transaction. These revenues are then available to the transit agency for any purpose. The transaction is structured so that, for practical purposes, it does not materially affect the operations of the transit agency. These leases do not "finance" the vehicles being leased; rather, they generate unencumbered revenue to the transit agency from the foreign tax treatment associated with ownership of such vehicles. The decision of the transit agency is whether the revenues are sufficient for undertaking the risk of the transaction. Certain inherent or perceived risks of the transaction of concern to potential lessees can be minimized to acceptable levels by provisions in the agreement.

The following is intended to identify some of the common concerns of lessees in cross-border leases and to indicate how they can be reduced while maintaining a transaction acceptable to cross-border lessors.

The Structure of a Cross-Border Lease Transaction

Cross-border leases are very generally structured as follows:

- The foreign entity lessor borrows money from a bank on a nonrecourse basis;

• Next, the entity purchases the equipment either directly from the transit agency or from the manufacturer with the proceeds of the loan; and

• Finally, the foreign entity leases the equipment to the lessee transit agency. As security for the loan, the lessor assigns to the lender lease payments made by the lessee transit agency sufficient to repay the loan.

The cross-border lease appears to be a real lease. Often title is held by the foreign entity and the transit agency is a lessee. Economically, however, the cross-border lease puts the benefits and burdens of ownership of the equipment onto the transit agency lessee, not the lessor.

The foregoing structure is intended to place United States tax and commercial ownership with the lessee. Because various foreign jurisdictions are more formalistic in their approach to ownership for tax purposes, tax ownership under the laws of the lessor's country resides with the lessor. It is this difference in approach that allows cross-border leasing to work.

Cross-border leases can be defeased or nondefeased, depending on the jurisdiction involved and the financing needs of the lessee:

• In a defeased structure, the lessee will pay to an entity (usually a bank and frequently an affiliate of the lender) an amount equal to the amount the lessor borrowed from the lender. The defeasance bank will then assume responsibility for payment of all obligations to the lender. The lender will look only to the defeasance bank for payment, not the equipment.

• A nondefeased structure is very similar to a leveraged lease, except that the lessee has United States tax ownership of the equipment and, subject to the discussion below, is obligated only to repay the loan (and, if applicable, the equity investment of the lessor) in order to terminate all of the lessor's interests in the equipment.

Following are a listing of the key risks to a cross-border transaction and suggested approaches to minimizing such risks.

Risks To Lessees

The risk: Lease termination triggering stipulated loss payment obligation. Typically, leases may be terminated upon a default by the lessee, the destruction of equipment, or a change in tax laws. These termination events will give rise to the obligation of the lessee to make stipulated loss payments to the lessor.

Minimizing the risks:

Lessee Defaults--The obvious method of reducing the risks of default by the lessee is to reduce the lessee's obligations. Depending upon the degree to which the lessor's jurisdiction requires the lease to resemble a "true" lease for the lessor to receive tax benefits, it may be possible to draft the documents so that the lessee's obligations regarding insurance, maintenance, and taxes are the same as the lessee performs normally for similar equipment. In a defeased lease, the risk that a lessee will default in its lease payment obligation can be virtually eliminated through financial arrangements with the defeasance bank.

Destruction of Equipment--In a defeased transaction, destruction of an item of equipment harms the lessee and the lessor. The lessee must make a stipulated loss payment and the lessor loses the tax benefits associated with ownership of the equipment. The standards for determining whether an item of equipment has been destroyed should, therefore, be no more onerous than the applicable tax law definition of a casualty.

The risks to the parties arising upon destruction of the equipment can be further reduced if the lessor and lender will allow substitution of equipment.

Stipulated Loss Payment--The stipulated loss payment is always at least equal to the loan amount. In a defeased structure this amount is paid by the defeasance bank. In both a defeased and nondefeased transaction, the stipulated loss payment also includes an additional payment to the lessor. The exact amount of this payment will vary depending upon the circumstances giving rise to the termination, the period when the termination occurs, the bargaining strength of the parties, and the practices under the jurisdiction where the lessor is located.

The risk: Lessor bankruptcy. Bankruptcy of the lessor raises the risk that the bankruptcy trustee will treat the lease as a real lease and take control of the equipment for the benefit of the lessor's bankruptcy estate.

Minimizing the risks:

Reduce Bankruptcy Risk.--Lessor bankruptcy risk can be reduced by using a special purpose corporation or similar entity with a low bankruptcy risk. Additionally, most lessors are part of substantial organizations that have the tax appetite to allow them to receive the foreign tax benefits associated with cross-border transactions. It may, therefore, be possible to reduce the bankruptcy risk through a guaranty or other assurance from the lessor's parent organization.

Lease Termination--It may be possible for the bankruptcy of the lessor to give the lessee the right to terminate the lease. Upon such a termination, the stipulated loss schedule should require only a payment sufficient to repay the lender and the amount of the equity invested in the transaction. If the lease is defeased, this payment is made by the defeasance bank and no additional payment is made to the lessor. This forced sale by the lessor to the lessee, however, may not be enforceable against the lessor's bankruptcy trustee.

Structural provisions can be added to improve the enforceability of this forced sale. However, the availability and enforceability of each such device will vary depending upon the lessor's jurisdiction.

Lessee Has Title--Regardless of whether any of the foregoing are effective to cause the lessor (or its bankruptcy trustee) to reconvey title to the lessee, it may be possible to conclude, based upon the overall transaction, that for United States commercial law purposes, the lessee owns the equipment. If the equipment is in

the lessee's possession in the United States and the lessee performs its obligations under the lease, then it will probably be very difficult for the lessor's bankruptcy trustee to obtain possession of the equipment.

The risk: Defeasance bank bankruptcy

Unless the defeasance structure is a legal defeasance (in which the lessee is completely released from any of the obligations assumed by the defeasance bank), the lessee will be liable for the payments under the lease assumed by the defeasance bank if the defeasance bank does not pay.

Minimizing the risks:

Reduce Bankruptcy Risk--Most banks selected to act as defeasance banks are very highly rated; therefore, as a practical matter, the bankruptcy risk is quite low. However, because cross-border leases frequently have terms in excess of 15 years, a high credit rating may not be sufficient comfort.

Setoff Protection--Defeasance bank bankruptcy risk can be further reduced through a setoff arrangement. The lease will provide that it can be terminated upon a defeasance bank bankruptcy and that the lessee can assume the lessor's position under the loan in lieu of making the stipulated loss payment. Therefore, on a defeasance bank bankruptcy, after assuming the loan, the lessee may be able to set-off against the loan obligation the obligation the defeasance bank owes to the lessee under the agreement by which the defeasance bank assumed the obligation to pay the lease payments.

The risk: Retaining tax ownership. On its surface, the transaction is characterized as a sale and leaseback of the equipment. The lessee faces the risk that it will be forced to accept the form of the transaction for transfer and property tax purposes. If the lessee is forced to accept the form of the transaction, it may be exposed to transfer taxes (such as sales or use taxes) and local property tax exemptions may be lost. The lessee typically indemnifies the lessor against these risks. If the transaction is really in substance a loan or a sale of tax benefits, then these taxes can be avoided.

Minimizing the risks:

Place the Benefits and Burdens of Ownership on the Lessee--To ensure that the lease is characterized as a loan or a sale of tax benefits rather than a saleleaseback, it must be possible to conclude that during the lease term the benefits and burdens of ownership are retained by the lessee and in all events the lessee will own the equipment at the end of the lease term. In a cross-border lease the lessee essentially has all of the rights and responsibilities of ownership. Ensuring that the lessee will own the equipment at the end of the lease term is frequently accomplished through put and call provisions in the lease documents. These provisions require that the lessor and the lessee make economically irrational decisions in order for the lessee to not obtain title to the equipment at the end of the lease term. Lessees may want to obtain an opinion from their tax counsel or a ruling from the local tax authorities to be assured of the consequences of the transaction

Avoid Inconsistent United States Tax Positions With Lessor--The Internal Revenue Service is concerned about parties to a transaction taking inconsistent positions to the detriment of the United States government. To avoid this whipsaw risk, the lessor should agree with the lessee not to attempt to claim United States state or federal tax ownership of the equipment.

The risk: United States withholding tax. Cross-border lessees will generally indemnify lessors for United States tax law risks. This includes the risk that the payments to the lessor will be subject to a United States withholding tax.

Minimizing the risks:

Tax Treaties--Many of the countries with lessors most frequently involved in cross-border leasing (including Sweden, Germany, and France) have tax treaties with the United States that reduce the withholding rate on lease payments to zero. Japan's tax treaty reduces the rate to 10 percent. Even if these treaties are amended or abrogated, it should be possible to insert into the lease provisions that would allow the lessee to treat the lease payments as interest payments and avail itself of the statutory portfolio interest exemption.

Burdensome Buyout--To reduce the risk to the lessee of a change in the tax treaties, the lessor should be willing to allow the lessee to terminate the lease upon such an event by payment to the lessor of an amount that will fully compensate the lessor for the termination of the transaction.

Legal Defeasance--If the transaction is legally defeased, then the lessee can take the position that there are no payments being made by it to the lessor on which it must withhold.

The risk: Local tax consequences. The lessee will generally have responsibility for United States local tax law risks such as income tax, sales/use tax, and property tax.

Minimizing the risks:

Income Tax--State income tax rules generally follow the federal treatment of a transaction.

Sales/Use and Property Tax--Sales/use and property tax authorities are generally more formalistic on ownership questions and particular care must be taken in transactions involving property that has already been placed in service.

The risk: Foreign tax consequences. Lessees are justifiably unwilling to assume foreign tax law risks in the transaction due to their unfamiliarity with those laws.

Minimizing the risks:

Limited Liability--Lessors should generally be willing to assume the risk for changes in laws in their own jurisdiction. One way to accomplish this is to not give the lessor the right to terminate the lease upon a change of law in the lessor's country. In a defeased transaction, this also can be accomplished by allowing

the lessee to terminate the lease without any payments other than the defeased payments to the lender

Case Study--Regional Transportation District (Denver, Colorado) Cross-Border Lease

On December 22, 1994, the Regional Transportation District of Denver, Colorado (RTD), successfully closed a cross-border lease transaction with DB Export Leasing GmbH (DBX), involving 11 light rail vehicles.

The Parties

RTD is a political subdivision of the State of Colorado, authorized to develop, maintain, and operate a mass transportation system for the benefit of inhabitants of the district. RTD's boundaries generally encompass the greater Denver metropolitan area.

DBX, a wholly-owned subsidiary of Deutsche Bank AG, was the Lessor in this transaction.

CS First Boston (Nederland) N.V. (CSFB) acted as Accounts Receivable Purchaser for the transaction. As Accounts Receivable Purchaser, CSFB was essentially acting in the capacity of lender.

The Project

The property encumbered by this cross-border lease consisted of 11 light rail vehicles manufactured by Siemens Duewag Corporation. The equipment had a useful life of 20 years and an appraised value at closing of approximately $25 million. RTD's net benefit from the transaction amounted to approximately 2 percent of the value of the equipment.

The Financing

The first step in this transaction was RTD's sale of the equipment to DBX This sale was accompanied by an acknowledgment from Siemens Duewag Corporation, the equipment manufacturer, that despite the sale it would not seek compensation from DBX for claims or disputes relating to the equipment.

This transaction was structured as a leveraged lease, with DBX financing approximately 84.3 percent of the purchase price of the equipment. This financing did not consist of a bank loan. Instead, DBX entered into an Accounts Receivable Purchase Agreement with CSFB. Pursuant to this agreement, DBX sold to CSFB without recourse certain accounts receivable consisting of basic rent to be received by DBX under the Lease Agreement, stipulated loss value, and other amounts recoverable by DBX under the Lease Agreement. From CSFB's standpoint, this structure was superior to a conventional loan. Generally, lenders in leveraged lease transactions ultimately look to the lessee for repayment and treat the lessor as largely a pass-through entity. CSFB has a more direct creditor relationship with RTD as the holder of accounts receivable payable by RTD than as a lender to DBX, with the loan collateralized by a security interest in lease payments payable by RTD. This structure was possible because, under German tax law, this arrangement is viewed as a loan from CSFB to DBX, and the accounts receivable sale proceeds are not considered to be current income of DBX.

RTD then leased the equipment from DBX under the Lease Agreement, which grants RTD a purchase option at the end of its 18-year term. With the proceeds from the sale of the equipment, RTD paid its transactions costs, prepaid its lease obligations, and funded an escrow account to finance the purchase price of the equipment on the purchase option date, retaining approximately 2 percent of the proceeds as its net benefit from the transaction. The prepayment of lease payments is accomplished pursuant to an Assumption Agreement between RTD and CSFB. Under the Assumption Agreement, RTD paid an up-front sum to CSFB in consideration for CSFB's agreement to pay certain Specified Payments, which are defined to include basic rent and stipulated loss value under the Lease Agreement. By virtue of entering into the Accounts Receivable Purchase Agreement and the Assumption Agreement, CSFB became essentially both the obligor and the obligee on the same obligation.

The Lease Agreement was economically defeased by the Assumption Agreement, but RTD retained certain contingent liabilities, including payment of the purchase option price. Although RTD was not required to do so, RTD chose to defease this liability by depositing U.S. Treasury securities in an escrow account held by Colorado National Bank, which will have a maturity value at the end of the Lease term not less than the purchase option price.

RTD's tax indemnities to DBX represented another contingent liability. RTD was especially concerned about withholding taxes and German Value Added Taxes. Typically, lessees mitigate this indemnity risk with a burdensome buyout option. DBX would not agree to any provisions for a burdensome buyout, however, because the concept was not compatible with the analysis of German tax counsel. Ultimately, DBX chose to accept this risk and proceed with the transaction. At the time, another cross-border lease between DBX and the San Diego Metropolitan Transit Development Board was moving on a parallel track, with most of the same parties and substantially identical documentation. That transaction did not close, largely because of the absence of a burdensome buyout option.

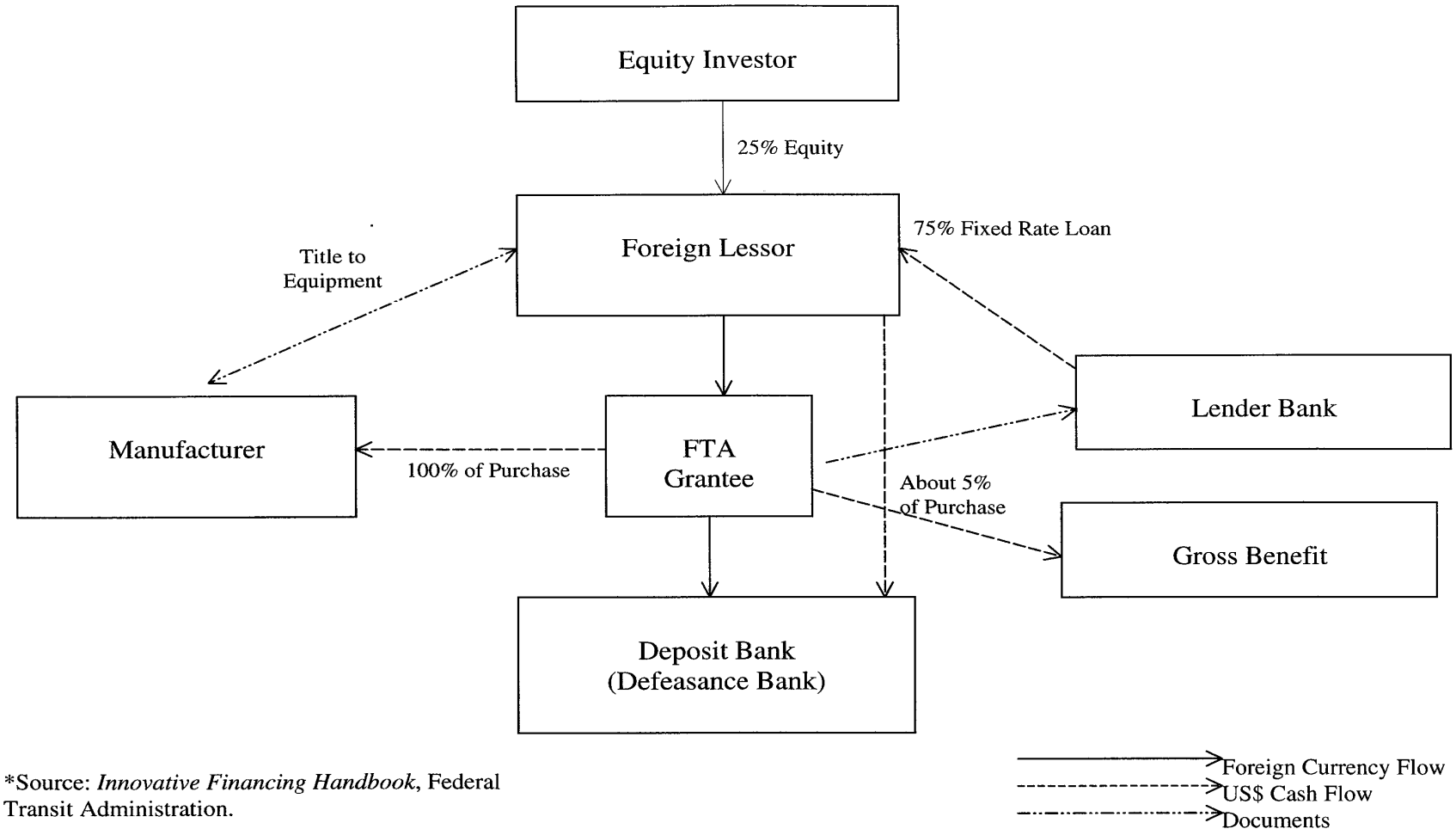
Case Study--San Diego Metropolitan Transit Development Board Cross-Border Lease Financing

In November 1995, the San Diego Metropolitan Transit Development Board (MTDB) entered into a cross-border lease financing in connection with the acquisition of 97 buses.

The Parties

The parties to the transaction were MTDB, as lessee, JL Coronado Lease Co., Ltd., as lessor, and the Dai-Ichi

SAMPLE CROSS-BORDER LEASE STRUCTURE



*Source: *Innovative Financing Handbook*, Federal Transit Administration.

Kangyo Bank, Ltd., New York Branch, as lender. The lessor in this situation was a corporation formed under the laws of Japan and the transaction was referred to as a Japanese leveraged lease.

The Financing

The arrangers prepared a summary of terms for the Japanese leverage lease, and this term sheet was negotiated among the parties. Upon agreement of the terms, the necessary documentation was prepared. This documentation included a Participation Agreement among the lessee, the lessor, the lender, and the lender's agent that set forth the general agreement and understandings between the parties; a Lease Agreement pursuant to which the lessor leases the buses to the lessee; a Loan Agreement between the lender and the lessor pursuant to which the lender agrees to loan to the lessor 73 percent of the costs of the acquisition price for the buses (the remaining costs are supplied by the equity deposit of the lessor); and various custodian and security interest agreements, including an interest exchange agreement, deposit agreement, debt funding agreement, deposit pledge agreement, and security agreement.

The lessor, pursuant to an assignment of the purchase agreement, received legal title to the buses and paid the purchase price of the buses to the vendor. The lessee then leased the buses from the lessor. One of the issues that had to be addressed by the parties was the ability to have title to the vehicle expressed in the name of the lessor and a valid security interest or lien on such vehicle given to the lender. The appraised value of the vehicles is an important ingredient in structuring the transaction, providing a basis for the security that the lessor gives for repayment of the loan to the lender. A valid appraisal is one of the items required to be submitted at the closing. Another item required to be delivered at closing is FTA approval of the financing.[14]

In the documents the lessee transit agency is required to make certain representations. Among them is the representation that the defense of sovereign immunity is not available to the transit agency with respect to obligations under the lease. This is a representation that may vary depending on the laws of the jurisdiction of the lessee Other heavily negotiated provisions of the documents are the tax indemnifications and the events of termination, all of which pertain to the relative risk sharing of the parties to the transaction.

[14] FTA review is concerned with the level of fees paid to facilitate a cross border lease vs the net present value benefit to the transit agency In reviewing fees, the FTA seeks to ensure that total fees paid are less than the expected net present value benefit to the transit agency FTA policy guidance for transit agencies considering cross border leasing of federally funded equipment is contained in FTA Circular C7020 1

Innovative Nature of the Financing

MTDB had participated in prior cross-border lease financings. What made this transaction unique was MTDB's economic defeasance of its lease obligation. Defeasance of MTDB's lease obligation was not required in this transaction. However, in order to minimize the risk of the financing to the lessee transit agency, MTDB desired to economically defease its lease obligation. The original term sheet for the proposed financing had specified that defeasance would be accomplished through the purchase of B-rated variable rate corporate bonds by MTDB. Concern over the legal authority for such an investment and a desire to have a more secure, higher rated investment caused MTDB to request its financial advisor to propose another method by which the defeasance of its lease obligation could be accomplished.

Asset Swap for Defeasance

MTDB chose an asset swap to defease its obligations under the cross-border lease. The provider of or "counterparty" to the asset swap was National Westminster Bank Plc, acting through its New York Branch (NatWest). The asset swap used a standardized International Swap Dealer Association, Inc., (ISDA) master agreement for a multi-currency cross-border swap. The obligation of MTDB under its cross-border lease consisted of a set principal repayment schedule with a variable 6-month LIBOR rate plus 30 basis points. By the asset swap, MTDB made an up-front payment derived from the lender portion of its cross-border lease. This payment of approximately $18.5 million contributed to the purchase of the assets to be held pursuant to the asset swap. The assets consisted of certain taxable municipal securities. These taxable municipal securities had ratings of AA or better and had principal and interest payments on a fixed basis. By entering into the swap, MTDB agreed to pay to NatWest the upfront payment ($18.5 million), principal and interest payments corresponding to the principal, interest payments on the underlying assets (the "Muni Bonds") and, upon conclusion of the swap, the proceeds from the sale of the Muni Bonds. In exchange NatWest, the swap party, made principal and interest payments equal to MTDB's obligation under its cross-border lease financing, that is the designated principal payments plus interest on the principal at the 6-month LIBOR rate plus 30 basis points. Through the swap, MTDB eliminated the risk of being able to invest the $18.5 million at a rate sufficient to pay a 6-month LIBOR rate plus 30 basis points. MTDB eliminated that variable rate risk and assumed the risk of the underlying credit on the Muni Bonds. This credit rating (AAA to a great extent) was much higher than the B-rated corporate bonds originally proposed for the defeasance. In addition, MTDB assumed risk associated with NatWest's credit strength or continued liability, as NatWest was its counterparty in the swap transaction. This risk in a swap is commonly referred to as "counterparty risk."

Although the lease defeasance asset swap that MTDB availed itself of to defease its cross-border lease was a unique instrument, transit agencies' use of the swap market can be very advantageous. The difficulty of taking advantage is the requirement that one have assets of a sufficient material value, such as the $18.5 million in MTDB's case study, to invest. In addition to eliminating the variable rate investment risk by accomplishing the lease defeasance asset swap, MTDB was able to alleviate the administrative burden of monitoring and tracking the investment of the sum involved. As transit agencies face continued economic pressures, a smaller staff is required to perform at the utmost level of efficiency. Freeing up administrative staff time for other purposes was an additional beneficial side effect to the defeasance.

V--U.S. LEASEHOLD INTEREST

In recent years there has been increasing interest among exempt entities in a leasing transaction commonly known as "leasehold interest" transactions. The transactions must comply with federal tax laws and regulations. The Internal Revenue Service released Revenue Ruling 99-14 on March 11, 1999, 26 C.F.R. 1.162-11, which may curtail, if not eliminate, the tax benefits to the equity investor in these transactions. If successfully completed, the transit agency can realize a benefit ranging from 4 percent to 10 percent or more of the value of the leased asset. This chapter describes the basics of the leasehold structure and sets out a checklist of issues to determine the feasibility of such a transaction.

The Structure of U.S. Leasehold Interest Transactions

In a typical leasehold structure for a U.S. lease:

- The transit agency as the owner of equipment or facilities (the "head lessor") leases the equipment or facilities (the "asset") to a trustee for the benefit of a U.S. Equity Investor (the "head lessee"). This lease is called the "head lease,"
- The head lessee then leases the asset back to the transit agency (the "sublessee"). This lease is called the "sublease,"
- The head lessee prepays the rent under the head lease in one or more installments. A substantial portion of the funds needed to make the prepayments is borrowed from a lender, and the balance represents the head lessee's equity investment in the transaction;
- The equity portion and the debt portion are repaid through sublessee payments under the sublease. Repayment of the equity portion is economically defeased through the purchase of U.S. Treasury securities to be held by the head lessee, and repayment of the debt portion is economically defeased through a deposit with an affiliate of the lender (the "payment undertaker");
- The difference between the amounts paid to the head lessor under the head lease and the sum of the equity defeasance and the debt defeasance represents the net benefit to the head lessor from the transaction; and
- At the end of the term of the sublease, the sublessee has an option to purchase the asset at a fixed price. Please see the attached charts for schematic diagrams of the leasehold structure and cash flows.

Key Legal Issues: The following issues must be addressed to determine the feasibility of the leasehold structure.

Is the owner of the asset:

- a nontaxpayer (e.g., U.S., state, or local governmental authority)?
- at least A-rated or willing and able to provide letters of credit from banks rated AA or better?

Does the asset have:

- a 20-year minimum remaining life?
- a minimum $50 million value?
- a fair market value, taking inflation into account, that increases or at least remains stable for at least 20 years?

Is the asset property that the head lessee could reasonably use or lease to a party unrelated to the asset owner? (i.e., leasing the asset back to the transit agency cannot be the head lessee's only commercially feasible use of the asset).

Does the existing financing of the asset include:

- a security interest in the asset? If so, the existing financing must be prepayable or capable of being incorporated into the leasehold structure.
- tax-exempt bonds? If so, it must be determined if the leasehold interest will cause the bonds to be taxable.

Do the existing contracts directly or indirectly transfer the value of the asset to another party?

The asset must have value to the owner. Otherwise the value of the leasehold interest will be small or minimal, eliminating the benefit of the transaction. Such a transfer of value might occur under an exclusive operating contract based upon a pass-through of all costs, with no profit potential.

Are there contractual or bond covenant restrictions on the head lessor's right to lease or sell the asset? Does local law restrict transfers and leasing or pledge of assets or require a public bid, voter approval, and other similar requirements?

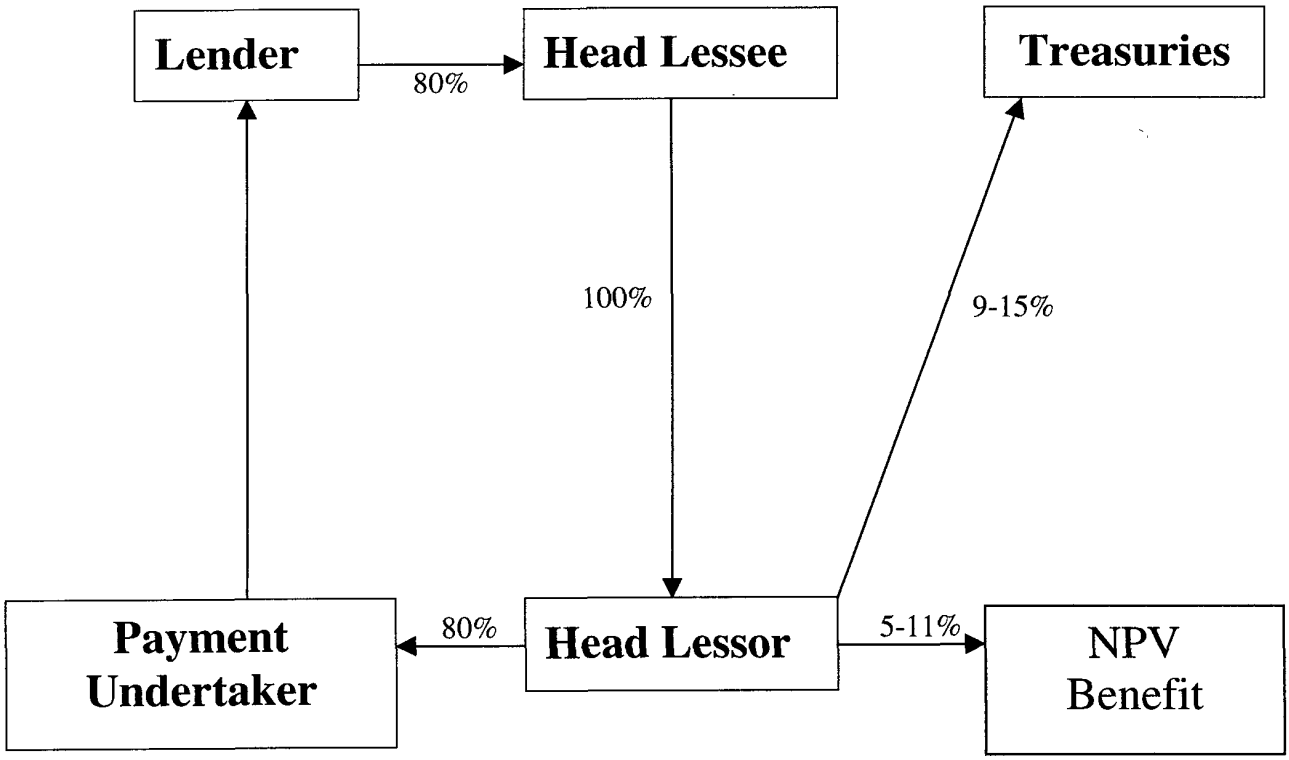
The transit agency must have the legal power and authority to lease the asset to the head lessee and to lease the asset from the head lessee.

The transit agency must have the legal ability to pledge assets to satisfy the security provisions of the structure, including the ability to grant security interest in the asset and in the deposits or payments of the payment undertaker, as well as the ability to indemnify the debt and equity participants in the transaction.

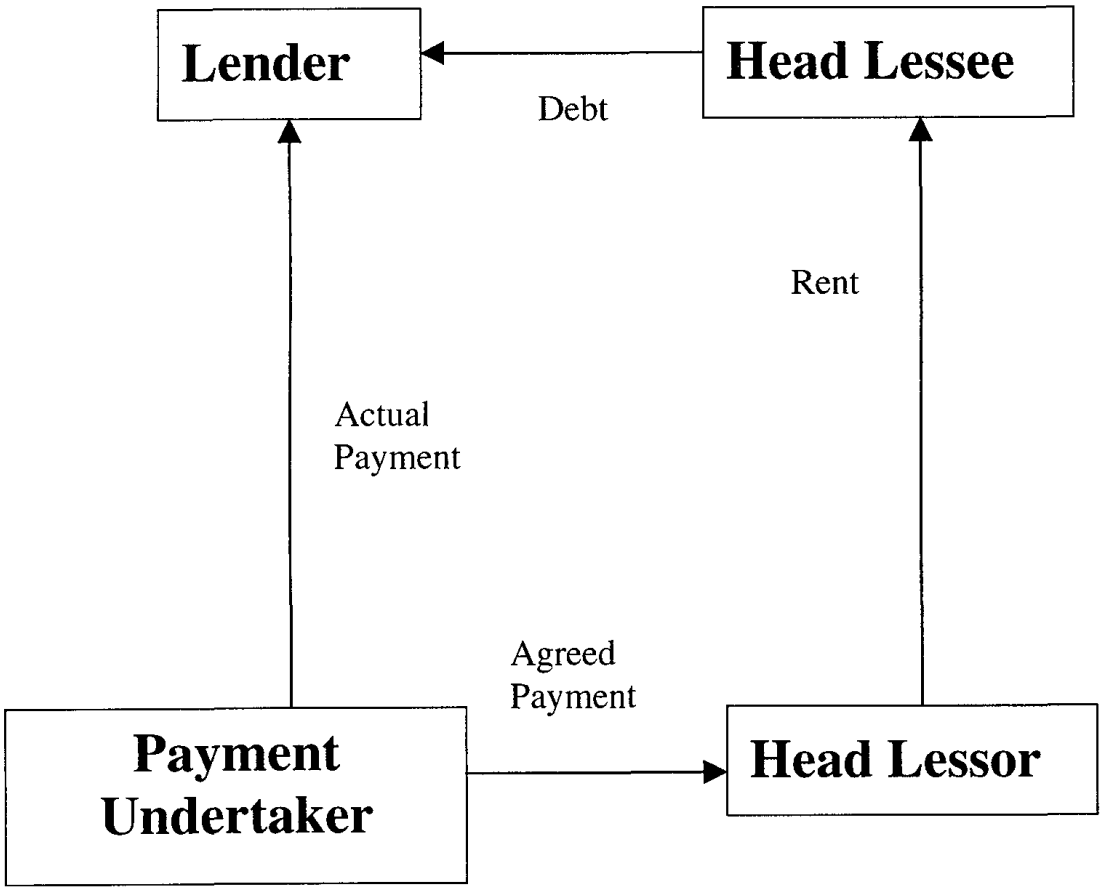
Each transaction is tailored to the needs of the equity investor to some extent and is not amenable to bid.

U.S. LEASEHOLD INTEREST

CASH FLOWS ON CLOSING

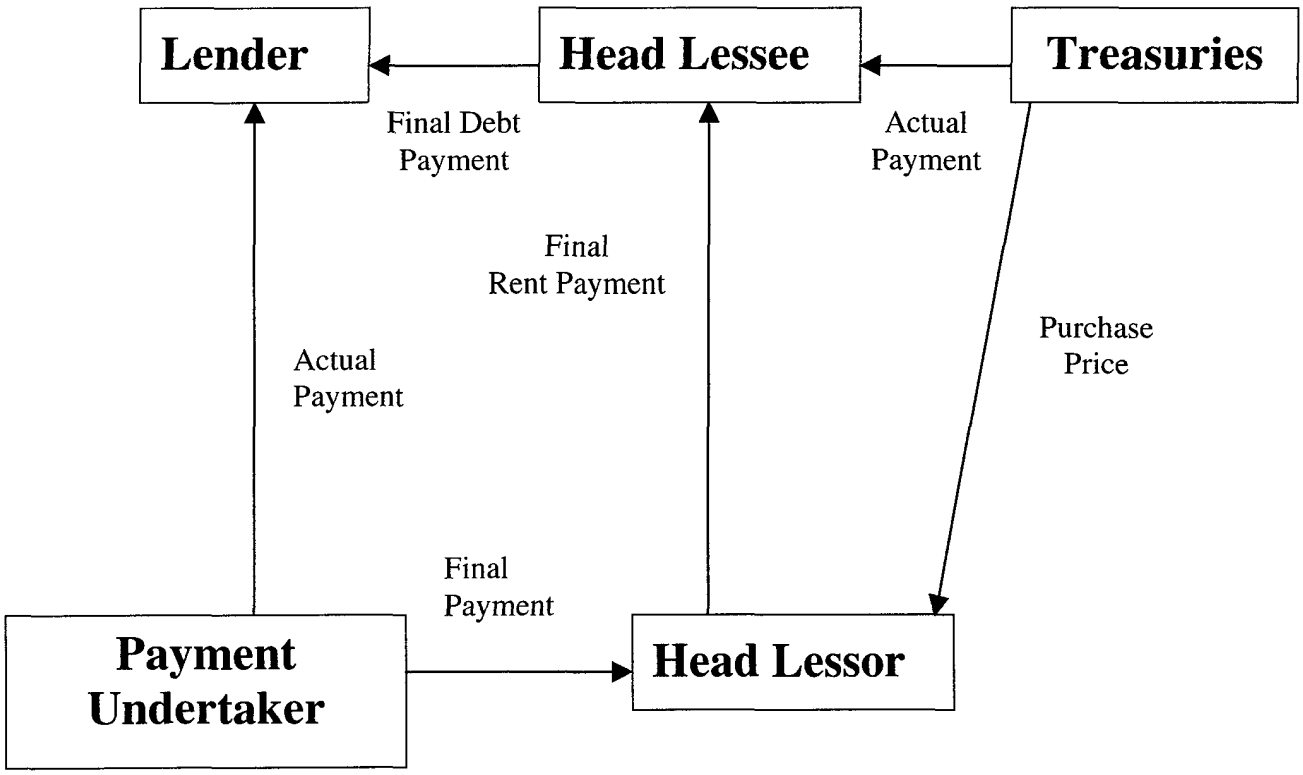


U.S. LEASEHOLD INTEREST
CASH FLOWS DURING TERM



U.S. LEASEHOLD INTEREST

CASH FLOWS ON PURCHASE



Public bidding requirements may prohibit the necessary negotiated nature of the transaction.

The transit agency must have authority to make the purchase of the defeasance securities and to enter into the payment undertaking.

Can the deal be structured around local use, sales, and property taxes? Who bears the broken deal risks? If there are changes in the tax law, such as if the Section 467 regulations are finalized, the leasehold transaction may not be doable. If the transaction fails to close, the transit agency could be required to pay substantial transaction costs. Substantial additional property tax issues are presented if the property involved is real property

Selected Indicative Issues

Payment Undertaker Risk-Typically, the structure of the transaction contemplates having the debt defeasance entity (the "payment undertaker") make the sublease payments owed by the transit agency through the entire term of the sublease. Any bankruptcy or other financial difficulty affecting the payment undertaker could trigger an event of default under the sublease with severe consequences for the transit agency. In order to mitigate this risk, only the most creditworthy entities are selected as payment undertakers. In addition, if the long-term senior debt obligations of the payment undertaker cease to be rated at least AA- by Standard & Poor's Ratings Services or Aa3 by Moody's Investors Service, the parties agreement typically contains provisions that call for the parties to the transaction to negotiate in good faith to select a new payment undertaker, in order to refinance the obligations of the former payment undertaker, and adjust the rent payments, default payments, and purchase option prices due under the sublease. Such refinance rights are not always available, depending upon the assumptions, analysis, and tax law framework.

Event of Loss-In order to attempt to mitigate the impact of an event of loss, the transit agency may elect not to include one or more of its rail cars in the transaction. Since the leases permit, under certain conditions, the substitution of leased equipment, holding such property in reserve potentially acts as an insurance policy against the payment of stipulated loss value and other unwind costs in the event any equipment is destroyed during the lease term. On the other hand, the transit agency also has to forgo the net benefit of including the additional rail cars in the transaction.

Every U S. leasehold interest transaction involves assumptions of certain risks by the transit agency These risks can be minimized by structural and drafting technique, but not eliminated. The transit agency must determine that the risks are acceptable when balanced against the economic benefit.

Case Studies

Although many of the major transit providers in the United States have successfully closed U.S. leasehold transactions, the agencies we contacted declined to be examined as case studies out of deference to their investors.

VI--FARE BOX REVENUE BONDS

Introduction

The following chapter addresses fare box revenue bonds. Fare box revenue bonds involve the issuance of debt by a transit agency, which is secured by a pledge of the revenues collected by operation of the transit system. Fare box revenue bonds are rare due to the simple fact that most transit systems operate at substantial deficits. Transit riders on average pay less than 40 percent of transit operating costs. Federal, state, and local subsidies are necessary to maintain operations.

The Structure of a Fare Box Revenue Transaction

For a traditional revenue bond, such as one for a water or sewer system, an issuer covenants to charge rates that will produce revenues sufficient to cover operating and maintenance costs and debt service. Such a covenant is called a "rate covenant." A "coverage factor" is also commonly desired in which the issuer will covenant to maintain revenues in excess of operations and maintenance expenses by a certain multiple of the annual debt service owed on its outstanding obligations. Factors of 1 10, 1.25, 1.5, or 2 times the coverage have all been used to seek investment grade ratings on revenue debt.

Transit systems are different:

- Because a transit system does not produce sufficient net fare box revenues to cover debt service, a gross revenue pledge is employed. A gross revenue pledge measures gross revenues to debt service and requires substantial coverage (3 or 4 times debt service).
- To evaluate the potential transaction, the viability of the system is analyzed to determine how creditworthy it is. The essentiality of the system to the local economy may be more important to a credit analysis than an impractical rate covenant. It will not be desirable to require an increase in rates by way of a rate covenant if the result of such increase is less riders and ultimately less revenues. What percentage of total commute trips are provided by the transit system?

Rate increases may also lead to less public and political support for subsidy payments What is the elasticity of the demand for the transit service? What are the alternatives to the transit system and the relative cost of the alternatives?

Large metropolitan systems with well developed routes and consistent ridership levels are most appropriate for fare box revenue borrowing. Even with such a transit system, other dedicated subsidy sources such as sales taxes or bridge tolls may be essential in order to obtain an investment grade rating on debt.

Key Legal Issue: Are fare box revenues sufficient security for a financing and does the transit agency have authority to issue fare box revenue bonds? The first part of this issue is a credit determination ultimately made by the ability to sell the bonds in the capital markets. The latter legal issue is governed by state law.

Case Study--New York Metropolitan Transportation Authority Transit Facility Revenue Bonds, Series 1998C

In December 1998, the Metropolitan Transportation Authority issued $317.245 million in principal amount of its Transit Facilities Revenue Bonds, Series 1998C. There are $2.282 billion aggregate principal amount of transit facility bonds of the Authority outstanding including the series 1998C Bonds.

The Parties

The **Metropolitan Transportation Authority,** a public benefit corporation of the State of New York, has responsibility for developing and implementing a unified mass transportation policy for The City of New York and Dutchess, Nassau, Orange, Putnam, Rockland, Suffolk, and Westchester counties (collectively with the city, the "Transportation District"). The Authority carries out these responsibilities directly and through its subsidiaries and affiliates, including the New York City Transit Authority, an affiliate of the Authority, and the Manhattan and Bronx Surface Transit Operating Authority (MaBSTOA), a subsidiary of the Transit Authority

The Project

The city's rapid transit system is by far the largest in the nation. Only a few cities in the world have a subway system comparable in physical size and ridership. The subway system has over 656 miles of mainline track extending 230 route miles. It operates 24 hours a day, 365 days a year. In calendar year 1998, approximately 1.2 billion revenue passengers used the subway. The Transit Authority employs approximately 25,000 workers in rapid transit. It currently has a fleet of approximately 5,800 subway cars, two major subway car repair shops, 14 maintenance shops, 23 subway car storage yards, and 468 passenger stations.

The Transit Authority and MaBSTOA presently operate bus service on approximately 230 local and express routes throughout the city. The majority of bus routes are designed to serve passengers traveling within a particular borough or to serve as feeders to the subway system. In calendar year 1998, approximately 625.5 million revenue passengers used the bus system. Together, this bus system employs approximately 13,000 persons and operates approximately 4,100 buses.

To assist the Transit Authority and MaBSTOA in carrying out its role, the Authority has been authorized to issue bonds, payable from certain revenues and operating subsidies of the Transit Authority and MaBSTOA, to fund a portion of the capital needs of the Transit Authority and MaBSTOA. The Series 1998C Bonds were issued by the Authority to refund other bonds issued for such purpose.

The Financing

The Series 1998C Bonds are special obligations of the Authority payable solely from and secured by a pledge of the items pledged under the Transit Facilities Special Obligation Resolution of the Authority, adopted October 14, 1982, as supplemented. These include the Revenue Fund into which there is to be deposited, pursuant to an agreement among the Authority, the Transit Authority, and MaBSTOA, dated July 1, 1982, as authorized by Title 9 of Article 5 of the Public Authorities Law, as amended (the Transit Authority Act), fares collected for use of the subway and bus systems operated by the Transit Authority and MaBSTOA, payments from concessionaires, and operating subsidies (not including federal operating subsidies). The operating subsidies include expense reimbursement payments from the State of New York, the city, and the Triborough Bridge and Tunnel Authority (TBTA), an affiliate of the Authority. The operating revenues and subsidies pledged under the Resolution are collectively referred to as the "pledged revenues" or "revenues."

The Series 1998C Bonds are on a parity as to the lien on pledged revenues with all bonds that are, and with all bonds and parity obligations that from time to time may be, issued and outstanding under the Resolution.

The financing agreement obligates the Transit Authority and MaBSTOA to fix or adjust the rates of fares, fees, rentals, and other charges for the use of the system at the level required by the Resolution, which obligates the Authority to cause the Transit Authority and MaBSTOA to adjust such rates as necessary to produce revenues, together with other lawfully available moneys, sufficient to pay debt service on bonds and parity obligations, maintain all debt service reserve funds at their required levels, and pay all operating and maintenance expenses and other obligations of the Transit Authority and MaBSTOA as they become due. This covenant is similar to a traditional revenue bond rate covenant with the added feature of including subsidy payments and other available revenues. Due to the lack of control the Authority has over the amounts of subsidies and other revenues, such amounts would not have been included in a traditional revenue debt analysis.

The Transit Authority and MaBSTOA have covenanted in the financing agreement that prior to the commencement of each fiscal year the Transit Authority and MaBSTOA will prepare inspection, maintenance, and repair programs and revise such programs, if necessary, in order to procure an Independent Engineer's Certificate stating that such programs are reasonable and appropriate. Such a certificate has been furnished for each fiscal year required. The Transit Authority and MaBSTOA have also covenanted to include

the cost of such programs in their annual operating budgets and, on or before the commencement of each fiscal year or 60 days following the receipt of the Independent Engineer's Certificate, whichever comes later, to fix or adjust fares or other charges required to generate revenues during the fiscal year sufficient, together with all other lawfully available moneys, to pay the debt service on bonds and parity obligations, operating and maintenance expenses included in such budgets, and all other obligations to become payable during the fiscal year.

The financing agreement further provides that if the actions by the Transit Authority and MaBSTOA to meet their obligations under the financing agreement are not sufficient to allow the Authority to meet its obligations to make payments to holders of bonds and parity obligations and to make all required deposits under the Resolution, the Transit Authority and MaBSTOA shall, and the Authority and the Trustee may, take such actions to require the Transit Authority and MaBSTOA to fix or adjust the rate or rates of fares, fees, rentals or other charges for the use of the system as shall be necessary to produce revenues that, together with all other lawfully available moneys, shall enable the Transit Authority and MaBSTOA to make the payments required under the financing agreement.

Additional bonds (other than refunding bonds) and parity obligations may be issued only if, in addition to other requirements, the Authority meets certain tests established under the Resolution, including the delivery of a certificate of an Independent Engineer stating that it is feasible that revenues can be derived from the operations of the system so that certain coverage ratios can be maintained during the current and each of the succeeding 3 fiscal years. The Independent Engineer's certificate must also state that certain historical revenues, adjusted on a pro forma basis as provided in the Resolution, provide four times coverage for adjusted aggregate maximum debt service.

Under the Authority's enabling legislation, the state pledges to and agrees with the holders of any notes, bonds, or lease obligations issued or incurred by the Authority, including bonds and parity obligations, that the state will not limit or alter the rights vested in the Authority to fulfill the terms of any agreements made by the Authority with the holders of its notes, bonds, and lease obligations, including bonds and parity obligations, or in any way impair the rights and remedies of such holders. The Authority's enabling legislation also prohibits the Authority from filing a petition in bankruptcy under Chapter 9 of the Federal Bankruptcy Code or such successor chapters or sections as may from time to time be in effect. The state has pledged that so long as any notes, bonds, or lease obligations of the Authority are outstanding, it will not limit or alter the denial of authority to the Authority to so file. Similar covenants apply to the Transit Authority and MaBSTOA.

The pledged revenues of the Transit Authority and MaBSTOA are receipts derived from a number of sources that may be grouped into seven principal categories: (i) fares; (ii) income from concessions and advertising; (iii) fare and service reimbursements from the city for certain costs incurred by the Transit Authority and MaBSTOA; (iv) operating subsidies provided by the state and the city from their general funds; (v) amounts derived from special tax-supported operating subsidies; (vi) amounts derived from TBTA's operating surplus; and (vii) income from investments and miscellaneous other sources.

Pledged revenues amounted to approximately $3.36 billion in 1998 (representing 21 times aggregate bond service for such year). Revenues derived from fares charged to users of the system in 1995 aggregated approximately $2.0 billion, or approximately 68 percent of operating disbursements.

The rate or rates of fares charged to users of the system are determined by the Transit Authority and MaBSTOA after reviewing and adopting operating expense budgets. After assessing the availability of governmental subsidies, the Transit Authority and MaBSTOA make a determination of the level of fares needed to operate on a self-sustaining cash basis. Due to the impact of fares on users of the system and on the regional economy, it is the policy of the Transit Authority and MaBSTOA to attempt to reduce costs or obtain additional revenues from other sources prior to increasing fares. Consequently, the amount and timing of fare increases are affected by the federal, state, and city financial conditions and budgetary and legislative processes.

The Authority relies on a mixture of federal, state, and local subsidies; TBTA operating surpluses; and dedicated special taxes to make up the operating deficit and fund capital costs. There is an inherent tension between the desires of the credit markets for a secure revenue bond with customary rate covenant and coverage and the reality of transit operations, which is one of providing a public service that, while in part is userbased through fee collections, is also subsidized as part of the Transportation District's infrastructure.

The Authority employs a rate covenant but adds to the fare box revenues other available revenue, including subsidies to determine compliance with the rate covenant. The Authority has a coverage test for the issuance of additional debt, but it is a gross coverage test of certain revenues at four times debt service. Therefore, the Authority's fare box revenue bonds have the trappings of traditional revenue bonds, but not the substance. A traditional revenue bond would require net revenues sufficient to cover debt service. Due to the subsidy required for Transit Authority and MaBSTOA operations, there are no net revenues from operations. The inability to declare bankruptcy is very unique and of great reassurance to investors in the deficit-prone operations. Investors have the assurance that operations will continue and the Authority's debt cannot be avoided.

There is no assurance that there is any level at which system fares would produce revenues sufficient to comply

with the rate covenant of the financing agreement in the event the level of collection of dedicated taxes, operating subsidies, and expense reimbursements presently provided for the system were to be discontinued or substantially reduced. As is generally the case with publicly operated mass transit systems in the United States, the system has been dependent upon aid and assistance to meet its capital and operating needs in the past, and it is anticipated that the system will continue to be so dependent for a substantial portion of such needs in the future.

Fare box revenue is not sufficient (and is never anticipated to be sufficient) to maintain operations and cover debt service and capital costs. The Transit Authority and MaBSTOA are dependent on governmental subsidies that can get mired in the legislative process (a delay in adopting the state budget can result in a delay in receiving certain subsidy payments and cash flow restraints), or vary depending on appropriations. In New York, where the transit system is vital to the economy and of a sufficient size to weather recession years and a downturn in ridership, a revenue based financing is deemed creditworthy. If the system was not as integrated into the Transportation District infrastructure or if it did not have the historical and institutionalized financial support that the Authority enjoys, its access to the credit markets would most likely be more limited.

The Authority as an issuer is unique in more than just the technique it uses to finance capital improvements. Having a system that generates approximately $1.9 billion a year in operating revenues and has a fare box recovery ratio of approximately 68 percent is unique. In addition to the Authority's issuance of transit fare box bonds, the Authority has issued dedicated tax fund bonds secured by certain state subsidies. TBTA has issued general purpose revenue bonds secured by TBTA bridge and tunnel tolls, special obligation bonds secured by regional mortgage recording taxes and by TBTA net revenues on a subordinate basis, and beneficial interest certificates secured on a subordinate basis on TBTA net revenues. In 1982 and 1987 the state agreed to permit the Authority to issue service contract bonds secured by the state's appropriation of debt service to finance Transit Authority and MaBSTOA capital needs. Being vital to a region, having a long historical existence in the infrastructure, and possessing accepted financial subsidies (such as the TBTA bridge and tunnel tolls) completes the unique nature of the Authority's financing alternatives.

Case Study--$169.5 Million Los Angeles County Metropolitan Transportation Authority General Revenue Bonds (Union Station Gateway Project) Series 1995-A

On January 19, 1995, the Los Angeles County Metropolitan Transportation Authority issued $169.5 million in principal amount of its General Revenue Bonds (Union Station Gateway Project) Series 1995-A. At the time, the Authority had nearly $2.2 billion of long-term sales tax revenue bonds outstanding, but this was its first experience with bonds secured by fare box revenues.

The Parties

The **Los Angeles County Metropolitan Transportation Authority** is a public agency created by the California Public Utilities Code with the responsibility for planning, financing, constructing, and operating the rapid transit system of Los Angeles County. The Authority provides bus service throughout the County of Los Angeles, as well as portions of neighboring Orange and Ventura Counties. In addition, the Authority operates a light rail system and a subway service within Los Angeles County. The Authority was formed in 1993 upon the merger of the former Los Angeles County Transportation Commission and the former Southern California Rapid Transit District.

The Project

After the merger of the Authority's predecessor agencies in 1993, the need for centralized office space became acute. A study undertaken by the Authority indicated that annual debt service on a tax-exempt financing to construct a new headquarters building would be less than the total annual occupancy costs, including rent and operating expenses, that the Authority would be incurring if it continued to occupy its current premises.

The Authority's new headquarters building, known as the Union Station Gateway Headquarters Building, is a 26-story office building designed to accommodate 1,900 employees. The Headquarters Building includes over 628,000 gross square feet of office space and approximately 800 parking spaces. It is located in the northeast portion of downtown Los Angeles, near Amtrak's Union Station depot. The Headquarters Building and adjacent public transit improvements to be constructed are expected to serve as a transportation hub for the region, connecting passengers of commuter rail, subway, light rail, bus, and Amtrak service.

The total cost of the Headquarters Building was approximately $145.5 million. Construction began in February 1993, approximately 2 years prior to the issuance of the bonds. The Authority financed a portion of this construction with $98 million of sales tax revenue commercial paper, which was retired with bond proceeds. The Authority took occupancy of the Headquarters Building in September 1995.

The Financing

The bonds are special, limited obligations of the Authority, payable from and secured by a prior lien on "pledged revenues" and "remaining sales tax." Pledged revenues are generally defined as all fare box revenues and advertising revenues, together with interest income thereon, derived from the facilities and properties maintained and operated by the Authority. Remaining

sales tax is generally defined as the net proceeds of the Authority's transportation sales tax levied in Los Angeles County, after the payment of debt service on obligations secured by such sales tax revenues on a basis senior to the bonds. If pledged revenues are insufficient to pay debt service on the bonds when due, the Authority has agreed to make such payments from any moneys available to it for use for any lawful purpose, including but not limited to remaining sales tax and the Authority's share of certain state and local transportation subsidies.

At the time the bonds were issued, the Authority's net available fare box revenues for the most recently ended fiscal year (1993-94) totaled approximately $207.703 million, with over 96.6 percent of that amount generated by the Authority's bus service. Remaining sales tax for the 1993-94 fiscal year amounted to approximately $439.886 million. At the same time, the Authority was facing a budget deficit of approximately $126 million

The bonds were structured as multi-mode variable rate securities, insured by Financial Security Assurance, Inc. The bonds were initially issued in a weekly interest rate mode, with liquidity support provided by a 3-year Standby Bond Purchase Agreement with Societe Generale. Due to this credit enhancement and liquidity support, the bonds were rated "Aaa/VMIG-1" and "AAA/A-1+" by Moody's Investors Service and Standard & Poor's, respectively. The Bonds received a SPUR (S&P Underlying Rating) of "A-", reflecting Standard & Poor's assessment of the Authority's stand-alone ability to pay debt service on the bonds.

To hedge a portion of its variable rate exposure, the Authority entered into interest rate swap agreements with Goldman Sachs Capital Markets, L.P., (GSCM) and GBDP, L.P., (an affiliate of Grigsby Brandford & Co. {GBDP)). The GSCM swap had a notional amount equal to 75 percent of the principal amount of the bonds and paid the Authority the actual interest rate borne by the bonds in exchange for the Authority's fixed payments. The GBDP swap had a notional amount equal to 25 percent of the bonds' principal amount, and paid the Authority a floating amount based on the PSA Municipal Swap Index. Both interest rate swap agreements were scheduled to terminate in 10 years; the remaining 20-year term of the bonds was unhedged. The Authority expected this partial synthetic fixed rate structure to achieve a lower overall cost of borrowing than the issuance of the bonds as fixed rate obligations.

At the time this transaction was being structured, the Authority was planning and constructing an ambitious and comprehensive rail rapid transit system for Los Angeles County. The capital needs for this system were being financed with a combination of federal and state grants and the proceeds of two countywide sales taxes levied for transit purposes. These sales taxes secured nearly $2.2 billion of the Authority's sales tax revenues bonds.

The Authority made a policy decision not to finance construction of the Headquarters Building with sales tax revenue bonds, in order to preserve financing capacity for planned rail improvements. The Authority's fare box revenues provided the best alternative security for the new financing and were the historical source for payment of office space leases.

Various aspects of the bonds, including sources of repayment and coverage tests for additional parity bonds, were formulated after lengthy discussions with the members of the Authority's financing team, the bond insurer, and, in particular, the rating agencies. A significant source of the Authority's nonoperating revenues consisted of state and federal grants, which by their terms could not be pledged to pay debt service or were too unpredictable to be included in the revenue pledge. Thus, FTA Section 9 funds are not part of the security for the bonds, and the Authority's state and local transportation subsidies are not pledged, but only made available to pay debt service to the extent pledged revenues are insufficient. Remaining sales tax is pledged to the payment of the bonds, but such revenues are not deposited with the bond trustee on a monthly basis, as is the case with the Authority's fare box and advertising revenues.

The Authority was willing to provide additional security for the bonds by granting a first mortgage on the Headquarters Building. The bond insurer ultimately rejected this collateral because of perceived difficulties in foreclosing against a governmental entity and the limited utility of such security in light of California's "one form of action" rule.

An important goal was to structure the Trust Agreement for the bonds like an enterprise revenue bond indenture, with the flexibility to issue additional series of parity and subordinate bonds secured by the same revenue sources. This would allow the Authority to exploit the maximum bonding capacity of its general revenues at the lowest overall cost.

Standing in the way of this goal was the fact that the Authority's transportation system was not a traditional "enterprise" in several key respects. Like most transit agencies, the Authority has never attempted to set bus and rail fares at levels high enough to cover the cost of providing the service-in fact, the Authority's operating deficit for the 1994-95 fiscal year exceeded half a billion dollars. This deficit was covered by federal and state transit subsidies and local sales taxes. Moreover, considering the MTA's operating deficit, elasticity of demand concerns, and potential political and legal considerations, the customary rate covenant found in most enterprise revenue bond indentures was determined to be inappropriate.

On the other hand, the Authority's fare box revenues had been fairly stable over the past several years. While the Authority's structural operating deficits would preclude a net revenue pledge, a gross pledge could still be worthwhile. Finally, the Authority's historical receipts of sales tax revenues, as well as federal, state, and local grants and subsidies (aggregating over $364.295 million in the 1994-95 fiscal year), suggested

that its transit operations would remain financially viable.

Ultimately, the structure, provisions, and general tenor of the Trust Agreement for the bonds reflected a hybrid of concepts from both enterprise revenue and unsecured financings. There was a gross pledge of fare box and advertising revenues, but no rate covenant. The Trust Agreement established various debt service accounts with different priorities, but the coverage ratio for additional parity bonds called for pledged revenues and remaining sales tax to be at least equal to 300 percent of maximum annual debt service. This unusually stringent test reflects the fact that transit revenues are volatile and not directly subject to the Authority's control. In this respect, the rating agencies and bond insurers appeared to view the bonds as somewhat less secured than general fund lease obligations, where acceptable "coverage" (to the extent the concept is applicable) for an investment grade stand-alone issue may indicate a general revenues to debt service ratio of 5 to 1, 10 to 1, or greater.

Postscript

After construction of the Headquarters Building was completed, the Authority reorganized certain executive positions and had a change in personnel. Subsequently, the new management consensus was that the remaining 20 years of variable rate exposure on the bonds was no longer a prudent risk. On August 20, 1996, the Authority issued $185.735 million in aggregate principal amount of its General Revenue Refunding Bonds (Union Station Gateway Project) Series 1996-A to refund the bonds and terminate the related swap agreements. The refunding bonds were issued as fixed rate obligations, again insured by Financial Security Assurance The Authority has not issued any additional General Revenue Bonds, but this borrowing capacity remains available as a financing source for future special projects.

VII--STATE REVOLVING LOAN FUNDS/STATE INFRASTRUCTURE BANKS

Introduction

This chapter will address State Revolving Loan Funds."[15] In response to states' requests for greater flexibility in transportation financing, Congress established a Pilot Program for State Infrastructure Banks (SIBs) through Section 350 of the National Highway System Designation Act of 1995 (NHS Act).[16] Section 350 authorized DOT to enter into cooperative agreements with up to 10 states for the establishment of SIBs or multistate infrastructure banks for making loans and providing other assistance to public and private entities carrying out or proposing to carry out projects eligible for assistance under the Section. The purpose of the Pilot Program was to help DOT proceed with the concept while simultaneously advancing projects. Of the 10 originally approved projects, nine signed agreements with FTA and FHWA.

Under provisions of the Appropriations Act of 1997 for the Department of Transportation,[17] DOT was authorized to enter into agreements with "more than 10 States." Under the NHS and Appropriations Act provisions, 39 states were approved by DOT for SIBs. Four of those states did not have enabling legislation that would allow the establishment of the banks, but 34 states have programs that are in some status of implementation.

The Transportation Equity Act for the 21st Century[18] (TEA-21) made several changes in the State Infrastructure Bank Pilot Program. Most significantly, Section 1151 (b)(1) of TEA-21[19] reduced the number of states that could enter into agreements with DOT to four specific states: California, Florida, Missouri, and Rhode Island. Other states, where SIBs were already established, may continue to operate those banks but there will be no additional federal funds under current law. Theoretically, since the banks operate with revolving loan funds, they could continue indefinitely. Further, the states may add funds from other sources.

Other changes made by TEA-21 allow the states greater flexibility in the amount of their federal highway or transit funds they may contribute to the SIB, rather than the 10 percent limit under the NHS Act. Further, TEA-21 provides that "second generation" payments or repayments from nonfederal sources be "considered to be Federal funds" and the requirements of Titles 23 and 49 of the U.S. Code shall apply to these repayments.[20] The NHS Act had no similar provision.

The Structure of a State Infrastructure Bank Transaction

An SIB is an infrastructure investment fund established to facilitate and encourage investment in eligible transportation infrastructure projects sponsored by public and/or private entities. Through an SIB, a state can use its initial capital, provided by its federal-aid highway apportionment, federal transit allocations, and nonfederal monies to make loans, provide credit enhancement, serve as a capital reserve for bond or debt financing, subsidize interest rates, issue letters of credit, finance purchase and lease agreements, provide debt financing security, or provide other forms of financial assistance for construction of projects qualified under the federal-aid highway program and transit capital projects.

The revolving loan fund allows pooled vehicle purchases that may help reduce acquisition costs. In addition, it provides a mechanism for states to make loans

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[15] No case studies are available for this innovation due to its recent introduction.

[16] Pub L No 104-59, § 350, (Nov 28, 1995) 109 Stat 618

[17] Pub. L No. 104-205, (Sept 30, 1996) 110 Stat 2959

[18] Pub L 105-178, (June 9, 1998), 112 Stat. 107

[19] Pub. L No. 105-178, Sec. 1511(b)(1), 112 Stat 251

[20] Pub L No 105-178, Sec. 1151(I)(2), 112 Stat. 254.

(with interest) or leases to transit operators who might not be able to finance transactions on their own. Because the interest and lease payments returned to a state's fund are considered "program income" they need not be returned to the U.S. Treasury. The SIB can make new financial assistance available to other eligible projects, continually recycling the initial monies, thus leveraging the initial funds available. Local grantees can use subsequent years' rural or urban grant funds to make loan or lease payments, including reasonable interest.

The SIB was expressly designed to provide states with new levels of financial flexibility to advance needed projects. There are numerous potential approaches to implementing an SIB under the Pilot Program. The chosen approach in each case will be influenced by state laws, the desire to employ capital markets for additional financing, the type of financial assistance the state seeks to provide the projects, the needs of the individual projects to be financed, and a variety of other factors. While we did not include a case study for this source of financing, transit agencies in states where they have been authorized or established under prior legislation should explore the potential offered by these programs.

VIII--CONCLUSION

From these case studies we can observe that innovative financing techniques can be utilized to bring additional revenues to a transit agency, accelerate the receipt of transit assets, or expand on a transit agency's contribution to the community. Certain steps are common to all the techniques:

Legal authority: Determination of state and federal legal authority or legal prohibitions on the proposed financing technique is the first job that a lawyer faces.

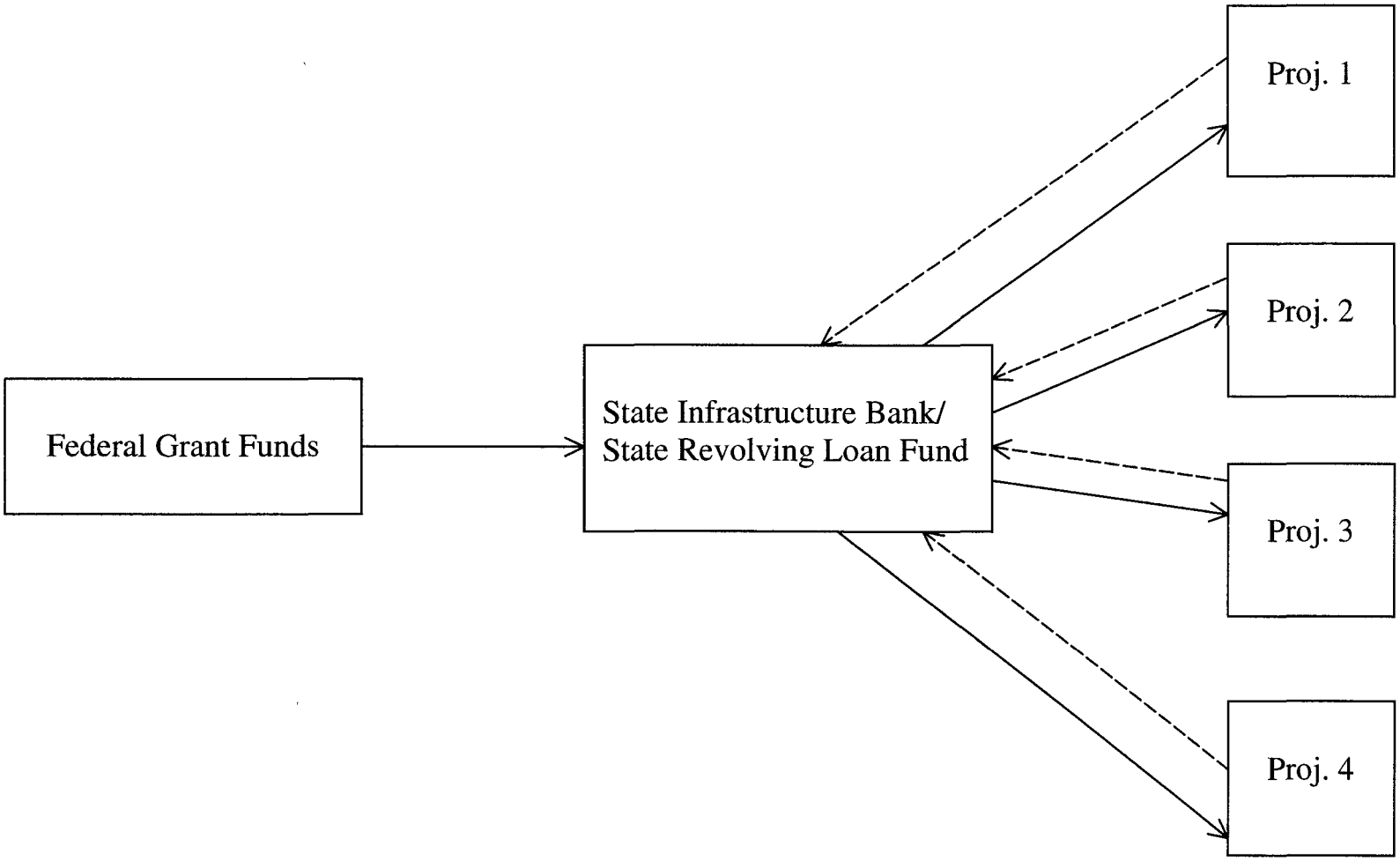
Many of the techniques are document intensive, requiring sophisticated analysis and strategies to minimize the risks involved in the transaction and to maximize the gain to the transit agency.

Risk Benefit Analysis: Every financing technique, whether it be novel, complicated, or customary, contains inherent risks that must be evaluated by the decision makers of the transit agency prior to proceeding with the financing. Legal advisors may be crucial in identifying the risks, describing appropriate ways to minimize the risks, and clarifying the options available to the transit agency.

It is important to have realistic goals in determining whether to proceed with an innovative financing technique. Such goals are not a lawyer's responsibility, but rather belong to the policy makers of the transit agency. Often the economic gains to be derived from a financing are dependent upon a number of future circumstances that are beyond the control of the agency. Other policy goals may benefit from or provide support for the innovative financing technique, such as low income housing, economic development, or acceleration of transit service delivery. Having a clear understanding of the policy makers' goals for the transaction assists those in structuring the deal to best achieve those goals.

The techniques described here are not ones that can be found in FTA regulations or case decisions. They are the product of transit officials with vision and innovative staff who have developed these transactions. This is appropriate in the public arena where the expenditure of public funds is involved. Most transit agencies are risk adverse and the undertaking of these innovative financings was done with careful consideration and an eye to minimizing the risks involved to the agency and its funds. Although glowing results are not always possible, the techniques can be refined, and the benefits that are available from these techniques may be obtained, where appropriate, in the transit community.

SAMPLE STATE INFRASTRUCTURE BANK/STATE REVOLVING LOAN FUND STRUCTURE



*Source of chart, Innovative Financing Handbook
Federal Transit Administration

APPENDIX A--LISTING OF AGENCIES INVOLVED IN CASE STUDY TRANSACTIONS

1. Sacramento Regional Transit District $32.44 million California Transit Finance Corporation Certificates of Participation, 1992, Series A
The Sacramento Regional Transit District
1400 29th Street
Sacramento, CA 95812-2110
Mark Gilbert, Chief Legal Counsel, 916-321-2973; Fax: 916-321-2975

2. $9.66 Million California Transit Finance Corporation Certificates of Participation, 1996 Series A (City of Culver City, California)
City of Culver City
9815 Jefferson Boulevard
Culver City, CA 90232
David R. Ashcroft, Transportation Director,
310- 2535851; Fax: 310-253-6513
9770 Culver Blvd
City Hall, 3rd Floor
Culver City, CA 90232
Carol Schwab, City Attorney,
310-253-5560; Fax: 310253-5664

3. Vertical Mall Joint Development for Metro-Dade Transit Agency (Dade County, Florida)
Miami-Dade Transit Agency
Miami-Dada Center
111 N.W. First Street, Suite 910
Miami, FL 33128-1999
Frank Talleda, Chief Joint Development & Leasing,
305-375-3013
Robert Cuevas, Assistant County Attorney, 305-3755151

4. Santa Clara Valley Transportation Agency--Almaden Lake Village
Santa Clara County Transportation Agency
3331 North First Street, Building B
San Jose, CA 95134-1906
James R. Lightbody, Manager
Planning & Development, 408-321-5550; Fax: 408-3217547
3331 North First Street, Building C
San Jose, CA 95134-1906
Suzanne Gifford, General Counsel, 408-321-5744; Fax: 408-321-9765
Almaden Lake Village Associates

5. San Francisco Bay Area Rapid Transit District (BART) Telecommunications System
San Francisco Bay Area Rapid Transit
P.O. Box 12688
Oakland, CA 94604-2688
Scott Schroeder, Director of Finance, 510-464-6070
Sherwood Wakeman, General Counsel, 510-464-6010

6. Regional Transportation District (Denver, Colorado) Cross-Border Lease
Regional Transportation District
1600 Blake Street
Denver, CO 80202
Salley Zack Wheller, Senior Manager-Human Resources,
303-299-2206; Fax: 303-299-2015

7. San Diego Metropolitan Transit Development Board Cross-Border Lease Financing
San Diego Metropolitan Transit Development Board
1255 Imperial Avenue, Suite 1000
San Diego, CA 92101-7490
Renee Wasmund, Director of Finance, (619) 557-4531
Jack Limber, Deputy General Manager & Legal Counsel, 619-557-4512

8. New York Metropolitan Transportation Authority Transit Facility Revenue Bonds, Series 1998C
New York Metropolitan Transportation Authority
347 Madison Avenue
New York, NY 10017
Kenneth C. Lind, Deputy General Counsel for Public Finance
212-878-7350; Fax: 212-878-1240

9. $169.5 Million Los Angeles County Metropolitan Transportation Authority General Revenue Bonds (Union Station Gateway Project) Series 1995-A.
Los Angeles County Metropolitan Transportation Authority
One Gateway Plaza
Los Angeles, CA 90012-2932
Michael J. Smith, Debt Manager, (213) 922-4042; Fax: (213) 922-4027
Joyce Chang, 213-922-2502; Fax: 213-922-2531

APPENDIX B--INNOVATIVE FINANCING TECHNIQUES--TRNSPORTATION RESEARCH BOARD QUESTIONNAIRE/RESULTS

Name of Transit Agency (State)	Cross Border Leases	U.S. Leasehold Interest	Fair Box Revenues	Taxable Debt	Revolving loan funds	Leases involving FTA funds	COPs	Joint Development Project	Other financing techniques	Techniques appropriate for case study
Alexandria Transit Systems (ATRANS) (LA)										X
Port Authority of Allegheny County (PA)	X									X
Amarillo City Transit (TX)										
Ann Arbor Transportation Authority (MI)										
Antelope Valley Transit Authority (CA)							X			
Bi-State Development Agency (MO)		X		X	X					X
Metropolitan Transit Authority of Black Hawk Co. (IA)					X					
Broward County Mass Transit (FL)						X				X
Cambria County Transit Authority (PA)										
Capital Area Transportation Authority (MI)										X
Central Arkansas Transit Authority (AR)						X				
Central Contra Costa Transit Authority (CA)										X
Clark County Public Transportation Benefit Area Authority (dba C-TRAN) (WA)										

Name of Transit Agency (State)	Cross Border Leases	U.S. Leasehold Interest	Fair Box Revenues	Taxable Debt	Revolving loan funds	Leases involving FTA funds	COPs	Joint Development Project	Other financing techniques	Techniques appropriate for case study
Greater Cleveland Regional Transit Authority (OH)										
Coast Transportation Building-UNH (NH)										
Dallas Area Rapid Transit (TX)									X	
Dial-A-Ride Transportation (DART) (AL)										
Durham Area Transit Authority (NC)										
Erie Metro Transit Authority (PA)										
Fayetteville Area System of Transit (NC)										
Five Seasons Transportation & Parking (IA)									X	X
Fresno Area Express (CA)										
GG&C Bus Co. Inc. (PA)					X					
Golden Gate Transit (CA)										
The Bus City of Greeley (CO)										X
Green Bay Transit (WI)						X				
Hillsborough Area Regional Transit Authority (HART) (FL)										X
Honolulu Public Transit Authority (HI)										
Intercity Transit (WA)										
Jacksonville Transportation Authority (FL)										

Name of Transit Agency (State)	Cross Border Leases	U.S. Leasehold Interest	Fair Box Revenues	Taxable Debt	Revolving loan funds	Leases involving FTA funds	COPs	Joint Development Project	Other financing techniques	Techniques appropriate for case study
Janesville Transit System (WI)										
Kitsap Transit (WA)										X
Lakeland Area Mass Transit (FL)										X
LakeTran (OH)										
Lane Transit District (OR)										
Lewiston Auburn Transit Committee (ME)										
Livermore/Amador Valle Transit Authority (CA)										
L.A. County Metropolitan Transit Authority (CA)	X		X	X		X	X			X
LYNX-Central Florida Regional Transportation Authority (FL)										
Madison Metro Transit (WI)										
Manatee County Area Transit										X
Maryland Mass Transit Administration (MD)	X									X
Mass Transportation Authority (MI)						X				
Massachusetts Bay Transportation Authority (MA)	X	X							X	
Memphis Area Transit Authority (TN)										
Metro-Dade Transit Agency (FL)								X		
Metropolitan Transit Authority (NY)	X	X	X							

Name of Transit Agency (State)	Cross Border Leases	U.S. Leasehold Interest	Fair Box Revenues	Taxable Debt	Revolving loan funds	Leases involving FTA funds	COPs	Joint Development Project	Other financing techniques	Techniques appropriate for case study
METRO (OH)										
MTA Long Island Bus (NY)										
Metro Transit (WA)	X									X
Milwaukee County Department of Public Works (WI)					X					
Montachusett Regional Transit Authority (MA)										X
Niagara Frontier Transportation Authority (NY)										
Northeastern Connecticut Transit District (CT)										
North East Transportation Co., Inc. (CT)										X
Northern Indiana Commuter Transportation District (IN)		X				X			X	
Ohio Valley Regional Transportation Authority (OVRTA) (WV)						X			X	
Orange County Transportation Authority (CA)		X	X				X			X
County of Orange, Department of Planning (NY)										X
PACE (IL)										
Panama City UZA (FL)										
Pee Dee Regional Transportation Authority (SC)										

Name of Transit Agency (State)	Cross Border Leases	U.S. Leasehold Interest	Fair Box Revenues	Taxable Debt	Revolving loan funds	Leases involving FTA funds	COPs	Joint Development Project	Other financing techniques	Techniques appropriate for case study
Peninsula Transportation District Commission (VA)					X	X				X
Pierce Transit (WA)						X	X			
City of Phoenix Public Transit Department (AZ)							X			
PVTA (MA)							X			
Regional Transportation District (CO)	X					X				
Regional Transportation Program (ME)										
Rhode Island Public Transit Authority (RIPTA) (RI)										X
Transit Authority of River City (KY)										X
Rochester-Genesee Regional Transportation Authority (NY)										X
Rockford Mass Transit District (IL)										
Rock Island County Metropolitan Mass Transit (IL)										
Sacramento Regional Transit District (CA)	X						X			X
Salem Area Mass Transit District (OR)										X
San Diego Metropolitan Transit Development Board (CA)	X	X					X			X
San Francisco (BART) (CA)	X									X
Sheboygan Transit (WI)										X

Name of Transit Agency (State)	Cross Border Leases	U.S. Leasehold Interest	Fair Box Revenues	Taxable Debt	Revolving loan funds	Leases involving FTA funds	COPs	Joint Development Project	Other financing techniques	Techniques appropriate for case study
Sioux City Transit System (IA)										
South Carolina Electric & Gas Company (SC)										X
Southeast Area Transit (CT)					X					
Southeastern Pennsylvania Transportation Authority (PA)	X			X						
Spokane Transit Authority (WA)										X
Tidewater Transportation District Commission (VA)						X				
Toledo Area Regional Transit Authority (OH)										
Utica Transit Authority (NY)									X	X
Valley Transit (WI)										X
Via Metropolitan Transit (TX)										
Washington Metropolitan Area Transit Authority (DC)			X							X
Greater Waterbury Transit District (CT)										
Waukesha Metro Transit (WI)						X				X
Wester Reserve Transit Authority (OH)										
Whatcom Transportation Authority (WTA) (WA)										
The City of Wichita (KS)										

Name of Transit Agency (State)	Cross Border Leases	U.S. Leasehold Interest	Fair Box Revenues	Taxable Debt	Revolving loan funds	Leases involving FTA funds	COPs	Joint Development Project	Other financing techniques	Techniques appropriate for case study
Winston-Salem Transit Authority (NC)										
York County Transportation Authority (PA)									X	

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TRANSPORTATION RESEARCH BOARD
National Research Council
2101 Constitution Avenue, N.W
Washington, DC 20418