1

SPECIAL BOARD MEETING
OCTOBER 20, 2003

SUBJECT: DEFEASED LEASE TRANSACTION FOR QUALIFIED TECHNOLOGICAL EQUIPMENT

ACTION: APPROVE DEFEASED LEASE TRANSACTION

RECOMMENDATION

A. Authorize the Chief Executive Officer to negotiate the terms of and execute documents necessary to complete a defeased lease transaction covering the Qualified Technological Equipment ("QTE") listed on Attachment A with one of the following equity investors ("Equity Investor"): (a) CIBC Capital Corporation and/or their syndication partners ("CIBC"), or (b) SMBC Leasing and Finance ("SMBC"). (The terms of the proposed transaction are detailed on Attachment B.)

B. Authorize payment of fees and transaction expenses not to exceed $975,000, as detailed on Attachment C.

C. Approve the attached resolution authorizing the defeased lease transaction for Qualified Technological Equipment (Attachment D).

ISSUE

The proposed transaction will provide the MTA with substantial up front financial benefit without loss of operational control over the assets included in the transaction. The proposed transaction will be similar in structure to the defeased lease transactions previously approved by the Board for rail cars. The assets involved in this transaction make up that portion of the MTA's rail control, communications and information systems that qualify as Qualified Technological Equipment, or "QTE", under the U.S. Internal Revenue Code. In general, only the computer/microprocessor-based equipment forming a part of these systems qualifies as QTE. The proposed transaction is consistent with the MTA's Defeased Leasing Policy and meets FTA Guidelines for Innovative Financing.

OPTIONS

One option is to reject all bids received for the proposed transaction and reissue an invitation for bids to lease the QTE at a later date. This option is not recommended because both of the proposals under consideration are reflective of today's marketplace and were selected through a competitive bid process. Delaying this transaction in hopes of a stronger equity market response in the future would not provide assurance of a proposal superior to either CIBC's or SMBC's current proposal.

Another option is to reject all bids and not proceed with a defeased lease transaction of the proposed QTE assets at all. This option is not recommended because the anticipated benefits to be derived from the proposed transaction outweigh the risks.

FINANCIAL IMPACT

QTE-based defeased lease transactions receive special tax treatment under the U.S. Internal Revenue Code. As such, these transactions provide greater percentage benefit to both the equity investor and the owner of the QTE assets than is typically found in defeased lease transactions involving other assets. Based on a preliminary appraised value of $100 million for the QTE, this transaction is currently anticipated to generate approximately $8.5 million of net, up-front revenue to the MTA. However, the final benefit to the MTA is dependent on the specific Equity Investor selected, market interest rates at the time of closing, qualification of the proposed assets for QTE treatment under the Internal Revenue Code, the final appraised value of the qualifying assets, and final determination of transaction expenses, each of which could raise or lower the MTA's actual net benefit. An itemization of the MTA's and the Equity Investor's anticipated transaction expenses and a calculation of the MTA's anticipated net benefit are detailed on Attachment C.

In the event the proposed transaction does not close for reasons beyond the MTA's control, the MTA would be responsible for payment of its outside legal counsel and other miscellaneous expenses incurred by the MTA. This "broken deal" expense would not exceed $425,000. If the proposed transaction does not close through the fault of the MTA, the MTA could be responsible for "broken deal" expenses totaling up to $1,365,000. Staff is reasonably confident that the proposed transaction will close given that all of the previous seven defeased lease transactions entered into by the MTA have closed.

The proposed benefit is approximately 8.5% of the value of the QTE assets proposed for this transaction, which is within the anticipated 6-10% benefit range set forth in the February 2000 Board Report requesting approval of the Defeased Leasing Policy. The ten-year financial forecast assumes that leasing revenues will be available to partially fund transit operating costs.

BACKGROUND

The Board adopted the Defeased Leasing Policy in February 2000 and approved an update to the same in February 2003. The Defeased Leasing Policy covers the solicitation and execution of defeased leases entered into with institutional investors. The scope of the policy is limited to defeased leases of MTA assets and excludes any funded leases that are otherwise covered under the MTA's Debt Policy. The assets include rail cars, buses, maintenance facilities, QTE, rail stations and rights of way. To "defease" in this case, means to bank sufficient proceeds from the transaction to cover scheduled sublease payments as well as provide sufficient funds for the fixed purchase option at the end of the sublease term.

At the time the Defeased Leasing Policy was being developed, MTA staff conducted research with other transit agencies that had defeased-leasing programs. It was determined that the MTA could generate substantial income from pursuing defeased leasing. The MTA has contracted with Capstar/McCalley Consulting ("Capstar") to provide professional services in connection with the defeased leasing program.

The MTA has successfully completed seven defeased lease transactions to date. The subject assets include rail cars, buses, maintenance facilities and a parking structure. These seven transactions have generated $65.18 million in gross revenue benefit to the MTA.

Asset	**Date**	**Transaction FMV (in million)**	**NPV - %FMV**	**NPV (in million)**
Red Line HRVs	June 22, 2002	$182.88	8.39%	$15.33
Rail Maintenance Facilities	August 9, 2001	$285.56	5.00%	$14.28
LRVs Part I	September 25, 2001	$82.41	7.80%	$6.43
Parking Structure	June 20, 2002	$125.00	5.76%	$7.20
LRVs Part II	September 26, 2002	$71.25	7.57%	$5.39
CNG Buses	December 31, 2003	$395.24	2.04%	$8.07
LRVs Part III	July 18, 2003	$99.17	8.55%	$8.48
	Totals	**$1,241.51**		**$65.18**

The proposed transaction will provide the Equity Investor with a leasehold interest in the subject QTE. The MTA will sublease these assets back, and will maintain complete operational control over the assets during the sublease term. The sublease will provide the MTA with an option to purchase the assets back at the end of the sublease term for a fixed purchase price. At that time, defeased funds invested at the time of closing will be available to pay the full amount of the fixed purchase price.

Discussion of Equity Marketing Process

Capstar conducted a competitive process to attract an equity investor for the QTE transaction. As part of the process, Capstar issued an information memorandum to the financial community requesting investor proposals. Three proposers responded to the information memorandum: CIBC, Bank of New York, and Babcock and Brown (representing SMBC). The Bank of New York proposal was not financially competitive and was not pursued further. The CIBC and SMBC proposals were in the competitive range and Capstar has requested clarifications and best and final proposals from each. At present, Capstar is completing final evaluation and due diligence, and completion of this process is imminent. After consultation with Capstar, staff will select the most beneficial proposal for the proposed transaction.

CIBC and SMBC are both active equity investors and syndicators with substantial experience in the transit leasing market, and specifically in the QTE leasing market. Each has closed numerous defeased lease financing transactions.

Risks to the MTA

The risks of the proposed transaction are consistent with the risk parameters of previous MTA defeased lease transactions. The risks of the proposed transaction are as follows:

1. Sales and Use Tax Risk: This risk involves the possibility that the transaction could be taxed for sales tax purposes. If such taxes are assessed, the MTA will be liable for the same under the terms of the proposed transaction. Under current law, the transfers contemplated by the proposed transaction are exempt from sales and use taxes.

2. Withholding Tax Risk: Under current law, payments made pursuant to the proposed transaction are not subject to U. S. Income Tax withholding. Any withholding taxes that may result as a result of a change in the current law would be the responsibility of the MTA. Such a change is unlikely, however, and the transaction documents will provide a number of options to mitigate this exposure in such event.

3. Early Termination Risk: Entering into this transaction will require the MTA to keep the QTE assets covered by the transaction in service throughout the proposed 17 to 18 year sublease term, or replace them with similar assets if and when such replacement is needed (in the event of a casualty) or desired. If an asset is taken out of service and not replaced, substantial penalties could accrue to the MTA. This risk is minimal, however, given the nature of the assets and the relatively short sublease term. Further, the transaction documents will provide for an extended period to replace damaged assets or to partially terminate the transaction to preserve the benefit.

4. Interest Rate Risk: This is a near-term exposure affecting the size of the MTA's net benefit. As with all defeased lease transactions, the calculation of this benefit is subject to market interest rates at the time of closing.

5. Income Tax Risk: The equity investor will take all structural risk, change in tax law risk, and change in US tax rate risk associated with the transaction. For federal income tax purposes, the MTA will be required to make representations as to the use of the equipment.

6. Credit Risk: This is a remote risk, but would require the MTA to provide additional credit enhancement if the credit rating of the MTA, the defeasance provider or the defeasance securities drop below certain proscribed levels.

7. Broken Deal Risk: Broken deal risk is a near-term exposure involving liabilities resulting from failure to close the proposed transaction. This exposure is detailed in the Financial Impact section of this report.

NEXT STEPS

1. Select an Equity Investor.
2. Complete due diligence on the QTE assets to be included in the transaction, including qualifying the assets for QTE treatment and addressing funding-related issues.
3. Identify remaining principal parties such as lenders, possible syndication partners and defeasance providers;
4. Negotiate documents with principal parties;
5. Obtain QTE expert's report on asset qualification, final appraisal and transportation consultant's report (as necessary);
6. Obtain Federal Transit Administration approval of transaction;
7. Set final pricing and schedule closing; and
8. Execute final documentation, fund and close transaction.

ATTACHMENTS

A. List of Qualified Technological Equipment
B. Term Sheet
C. Estimated Transaction Expenses
D. Authorizing Resolution

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Terry Matsumoto
Executive Officer, Finance
and Treasurer

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Roger Snoble
Chief Executive Officer

Attachment A

LIST OF QUALIFIED TECHNOLOGICAL EQUIPMENT

Central Train Control Equipment –Central rail operations control equipment is located at CCF and includes central processing computers, software and related databases, command floor computer terminals and related software at the supervisor and operator stations, support functions (testing/development) that communicate with the central processing computer, monitors, large-scale projectors, printers and ancillary equipment associated with the rail operations control system.

Wayside Train Control Equipment – Wayside rail operations control and data feedback equipment is part of the rail control system connected to the Central Train Control Equipment noted above. QTE qualifying equipment is located along the Green and Gold Lines only, and consists of microprocessor based controllers that interface with track switching and signaling devices. (Red and Blue Line wayside control is not microprocessor based, and is thus not eligible for QTE treatment.)

Rail Communications Equipment – Rail communication equipment allows voice and data transfer between and among CCF, wayside equipment, rail cars and right of way personnel throughout the MTA's rail network. (The electronic components of this system should be eligible for QTE treatment.)

SCADA System – The SCADA system links CCF with rail station devices and equipment throughout the rail network, and provides central control and monitoring of the same. Equipment linked to the SCADA System includes access control, lighting, FLS equipment, HVAC, escalator and elevator control, and power/switchgear devices.

Passenger Information System – The passenger information system consists of the centrally controlled variable message sign and voice messaging systems located on the Green, Blue and Red Lines. (The Gold Line does not have such systems.)

Wayside Intrusion Equipment – Wayside intrusion equipment consists of the electronic components forming a portion of the Green Line's CCF-linked wayside intrusion system. (Wayside intrusion systems do not exist on other MTA rail lines.)

Attachment B

MTA QTE DEFEASED LEASE TRANSACTION SUMMARY

Head Lessor/Sublessee:	MTA
Equity Participant:	The equity investor (“Equity Investor”) will be either: (a) CIBC Capital Corporation and/or its syndicate investors, or (b) SMBC Leasing and Finance.
Head Lessee/ Sublessor/Trustee:	A statutory trust created by the Equity Investor with a California trust company (the “Trust”). The Trust is used in part to help insulate the MTA and other transaction parties from risks associated with a bankruptcy of the Equity Investor.
Transaction Structure:	This transaction will employ a typical defeased lease transaction structure, where the MTA will lease the QTE assets to the Trust under a Head Lease and the Trust will sublease them back to the MTA under a Sublease. The MTA will maintain operational control over the assets throughout the Sublease term and will have an option to purchase them back at a fixed purchase price (“Fixed Purchase Price”) at either the end of the Sublease term (if a lease to service contract structure is used), or at a specified early buy out date (if a service contract is not involved).
Head Lease Term:	The Head Lease term will be no more than 125% of the remaining useful life of the QTE assets, or approximately 37.5 years.
Sublease Term:	Approximately 17 to 18 years, if a lease to service contract structure is employed, or approximately 24 years if a service contract is not involved.
Service Contract Term (if applicable)	Approximately 6 to 7 years.
Early Buy Out (if applicable):	If a lease to service contract structure is not employed, the Sublease will provide MTA with an option to “buy out” of the Sublease early at the Fixed Purchase Price. The date that this option can be exercised will be approximately 17 to 18 years from the commencement of the Sublease.

Asset Value/Head Lease Prepaid Rent:	Approximately $100,000,000.
Sublease Rent:	A fully defeased amount to be determined.
Net Benefit to the MTA:	Estimated to be $8,500,000, based on an asset value of $100,000,000. The final benefit to the MTA is dependent on the particular equity investor selected for the proposed transaction, market interest rates at the time of closing, qualification of the proposed assets for QTE treatment under the Internal Revenue Code, the final appraised value of the qualifying assets, and final determination of transaction expenses, each of which could lower or raise the MTA's actual net benefit.
Minimum Gross Benefit of Transaction:	$9,595,000.
Loan:	A portion of the Trust's prepaid rent under the Head Lease will be financed with a loan (the "Loan").
Lender:	A specific lender ("Lender") has yet to be selected for the Loan, but a defeased lease lender, such as an affiliate of AIG, Ambac or FSA, will be selected based on price, experience, and lending terms and conditions.
Loan Payment Undertaker:	A financial institution ("Loan Payment Undertaker") will agree to make Sublease rent payments equal to debt service payments under the Loan in return for an up-front fee. The obligations of the Loan Payment Undertaker will be guaranteed by a AAA/Aaa rated entity such as AIG, Ambac or FSA.
Defeasance of Sublease Rental Obligations & Fixed Purchase Price:	The equity portion of the MTA's rental obligations under the sublease and the Fixed Purchase Price will be fully-defeased at closing using either U.S. Government Agency Securities (such as FNMA, FICO, REFCO, etc.) or a guaranteed investment contract issued by a AAA/Aaa rated entity (such as AIG, Ambac or FSA) collateralized with zero risk weighted government securities (the "Equity Defeasance").

Strip Coverage/Surety Bond:	A surety bond ("Surety Bond") may be purchased by the MTA from a AAA/Aaa rated insurer at closing, which coverage would, in the event of early termination of the Sublease, pay the Equity Investor an amount equal to the difference between the equity portion of the termination value (as set forth in the transaction documents) and the scheduled accreted value of the Equity Defeasance (the "Strip"). Purchase of the Surety Bond may be a transaction requirement or an option, depending on the specific equity investor selected for this transaction. If it is an option, the MTA may elect not to purchase such Surety Bond at closing, effectively saving the policy premium fee. If such coverage is not purchased at close, however, the MTA would be responsible for the Strip in the event of early termination of the Sublease, and a Material Adverse Change clause will be required as part of the transaction documents, which would require the MTA to purchase such coverage at a later date (for what would likely be a higher premium) on the occurrence of certain credit triggers.
Appraiser:	American Appraisal Associates, Inc.
QTE Expert:	Tyler & Company
Equity Investor Counsel:	To be determined.
MTA's Outside Counsel:	Orrick, Herrington & Sutcliffe LLP
Lender Counsel:	To be determined.
Closing Date:	December 15, 2003 is the target closing date for this transaction.

Attachment C

MTA QTE
Estimated Transaction Revenue and Expenses

Estimated Appraised Equipment Value	**$100,000,000**	
Proposed Gross Benefit as defined by the FTA	**$ 11,595,000**	**11.60%**
Transaction Expenses paid by Equity Investor		
Equity Investor Counsel	$ 400,000	0.40%
Equity Investor Local Counsel	$ 25,000	0.03%
Trustee	$ 30,000	0.03%
Trustee Legal Counsel	$ 15,000	0.02%
Optional Surety Policy	$ 400,000	0.40%
Lender Fees	$ 350,000	0.35%
Lender Counsel	$ 175,000	0.18%
Lender Local Counsel	$ 25,000	0.03%
Appraisal (American Appraisal Associates)	$ 150,000	0.15%
QTE Consultant (Tyler & Company)	$ 300,000	0.30%
Transportation Consultant	$ 150,000	0.15%
Miscellaneous	$ 100,000	0.10%
Total paid by Equity Investor	***$2,120,000***	***2.12%***
Gross Benefit Paid to the MTA	**$ 9,475,000**	**9.48%**
Transaction Expenses paid by the MTA		
Capstar Partners/McCalley Consulting	$550,000	0.55%
MTA Counsel	$375,000	0.38%
Miscellaneous	$50,000	0.05%
Total paid by the MTA	***$975,000***	***0.98%***
Net Benefit Paid to the MTA	**$ 8,500,000**	**8.50%**
FTA Transaction Expense Ratio (Total Expenses Paid/FTA Gross Benefit)		**26.69%**

Attachment D

Resolution
Authorizing the Defeased Lease Transaction for
Qualified Technological Equipment

WHEREAS, the Los Angeles County Metropolitan Transportation Authority (the "Authority") provides public transportation services with its buses and Metro Red Line, Blue Line, Gold Line and Green Line rail service; and

WHEREAS, at its meeting on February 24, 2000, the Board of Directors of the Authority (the "Board of Directors") approved and adopted a policy (the "Defeased Leasing Policy") governing defeased lease transactions of the Authority's fixed assets for the purpose of generating funds for the Authority; and

WHEREAS, at its meeting on February 27, 2003 the Board of Directors approved and adopted an update and amendment to the Defeased Leasing Policy; and

WHEREAS, a defeased lease transaction (the "Transaction") for the lease of the Qualified Technological Equipment described in Attachment A has been presented to the Board of Directors which, if carried out in accordance with the terms outlined on Attachment B (the "Transaction Summary"), will provide a substantial present value benefit to the Authority, the Authority's passengers and residents within the Authority's service area; and

WHEREAS, the Transaction meets the criteria and requirements of the Defeased Leasing Policy; and

WHEREAS, certain Transaction agreements will reduce the amount or duration of payment, rate or similar risk to the Authority of the Transaction or enhance the relationship between risk and return with respect to investments made pursuant to or in connection with the Transaction, as authorized under Section 5922 of the California Government Code; and

WHEREAS, the Board of Directors now desires to authorize the officers and staff of the Authority to take such further actions, including the negotiation, execution and delivery of such documents, agreements and certificates as shall be necessary and appropriate to implement the Transaction described in the Transaction Summary;

NOW, THEREFORE, THE LOS ANGELES COUNTY METROPOLITAN TRANSPORTATION AUTHORITY DOES HEREBY FIND, DETERMINE AND ORDER AS FOLLOWS:

Section 1. The above recitals are true and correct, and the Board of Directors so finds and determines the same.

Section 2. The Transaction as described in the Transaction Summary is hereby approved. The officers and staff of the Authority, under the direction of the Chief Executive Officer of the Authority, are hereby authorized and directed, for and in the name of and on behalf of the Authority, to negotiate and cause the preparation of the documents described in the Transaction Summary and such related documents as are necessary or proper to effect the Transaction (collectively, the "Transaction Documents"), provided that such Transaction Documents contain substantially the terms described in the Transaction Summary.

Section 3. The Chief Executive Officer of the Authority or his designee is hereby authorized and directed, for and in the name of and on behalf of the Authority, to execute and deliver the Transaction Documents to which the Authority is a party, in such form as the Chief Executive Officer and the Authority's general counsel may approve, such approval to be conclusively evidenced by the execution and delivery thereof.

Section 4. The officers of the Authority are hereby authorized and directed, for and in the name and on behalf of the Authority, to do any and all things and take any and all actions, including (without limitation) the execution and delivery of any and all certificates, filings, documents and agreements, which such officers may deem necessary or advisable in order to consummate the transactions described in the Transaction Summary and otherwise to give effect to the purpose and intent of this Resolution.

Section 5. This Resolution shall take effect from and after the date of its adoption.