



## Motion No. M2023-27

### Lease-to-Service Transaction for Commuter Rail Cars and Locomotives Amendments

Meeting:	Date:	Type of action:	Staff contact:
Finance and Audit Committee Board	03/16/2023 03/23/2023	Recommend to Board Final action	Mary Cummings, Chief Administrative Officer John Henry, Chief Financial Officer <b>Jeff Clark, Deputy Executive Director – Financial Operations</b>

### Proposed action

(1) Authorizes the chief executive officer to negotiate and execute a Standby Letter of Credit Side Letter, and (2) delegates to the chief executive officer authority to implement the Standby Letter of Credit Side Letter, including pledging up to \$4,000,000 as additional collateral, and executing amendments to agreements and other documents necessary to cure Sound Transit's technical default under the Lease-to-Service Transaction for Commuter Rail Cars and Locomotives caused by American International Group, Inc.'s credit rating slip and the bankruptcy of AIG Financial Products Corp.

### Key features summary

- In 2001, through Motion No. M2001-22, Sound Transit leased up to \$77 million in Sounder commuter rail cars and locomotives to FHL SPC One, Inc. (First Hawaiian) and American International Group, Inc. (AIG) in exchange for an up-front cash benefit to Sound Transit.
- In 2008, AIG's credit rating slipped below limits established in the transaction. Sound Transit negotiated temporary standstill agreements with the transaction participants to maintain the transaction and avoid technical default. These standstill agreements have been extended multiple times to reach the present day.
- This action is needed to cure a technical default caused by the credit rating slip of AIG and its subsidiaries below those permitted in the standstill agreements and extensions.
- AIG, through a non-bankrupt subsidiary, will issue a new standby letter of credit and Sound Transit will pledge additional collateral of up to \$4,000,000, which represents the exposure to First Hawaiian as owner participant and lessor in this transaction. Future AIG credit ratings will no longer trigger technical defaults. No additional temporary standstill agreements will be required.
- First Hawaiian's interest in the additional collateral will cease upon the expiration of the lease in 2027.
- Letter of Credit Side Letter parties include FHL SPC ONE, INC. (Owner Participant); ST 2001 FH-1 STATUTORY TRUST (Letter of Credit Beneficiary); AIG Financial Products Corp (Original Letter of Credit Issuer); AIG Matched Funding Corp. (Substitute Letter of Credit Issuer).

## Background

In 2001, Sound Transit entered into a transaction to lease 22 rail passenger cab and coach cars and 5 locomotives (the "Headlease") to a private investor and simultaneously subleased the vehicles back (the "Sublease"). Under this transaction, Sound Transit received a net upfront payment and maintained the right to continued use and control of the vehicles. At the time of the transaction, the vehicles had a fair market value of \$61.3 million.

On the closing date, Sound Transit received a prepayment of the Headlease obligations totaling \$61.3 million. From those proceeds, \$50.4 million was deposited with AIG-FP Special Finance Ltd (the "Debt Defeasance") to satisfy the debt portion of the lease payments and \$5.7 million was deposited with AIG Matched Funding Corporation (the "Equity Defeasance") to satisfy the portion of lease payments due to the lessor. AIG collateralized its obligations under the Equity Defeasance by posting US government securities in a custodial account for the benefit of Sound Transit. The remaining \$4.9 million (net of closing costs) was retained by Sound Transit.

The lease documentation established minimum credit levels to protect the Debt and Equity defeasance deposits. At the time these transactions closed, AIG was rated "AAA" by S&P and "Aaa" by Moody's. However, in 2008, AIG's credit rating slipped below limits established in the transaction, which put Sound Transit in technical default. At that time, Sound Transit negotiated standstill agreements with the transaction participants on the default requirement of Sound Transit having to replace the debt defeasance, equity defeasance, and AIG letter of credit. These standstill agreements from 2008 and 2009 have been extended multiple times to reach the present day.

In November 2022, AIG notified Sound Transit that its credit rating had slipped below the lower credit rating limits established in the temporary waiver agreement. In December 2022, AIG advised Sound Transit that AIG Financial Products Corp., the AIG subsidiary issuing the standby letter of credit for this transaction, had filed for bankruptcy.

As a result of the credit downgrades, and under the terms of the waiver agreements, Sound Transit must replace both the debt and equity defeasance arrangements as well as replace the AIG letter of credit. First Hawaiian has proposed an alternative that is satisfactory to Sound Transit: AIG will issue a new standby letter of credit from a different AIG subsidiary, and Sound Transit will deposit additional cash collateral of up to \$4,000,000 to benefit Wilmington Trust Company, as the letter of credit beneficiary, and FHL SPC, the Owner Participant. The additional \$4 million in collateral represents a portion of the early termination damages Sound Transit will be liable for if this transaction fails. If the parties do not cure the default now and waive future AIG credit rating slips, Sound Transit would be responsible for early termination damages of approximately \$8 million dollars. The \$4 million collateral can only be tapped in the event of a default and only to the extent of the damages specified in the agreement.

The additional collateral agreement will cease upon the expiration of the lease in 2027.

## Fiscal information

The economics of the original transaction are not changed by the cure of Sound Transit's default under the Lease-to Service Transaction. The budget appropriately reflects the fiscal impact of the transaction. This action does not have an associated fiscal outlay and therefore does not impact the long-range financial plan. There is no impact to affordability.

**Public involvement** - Not applicable to this action.

### **Time constraints**

Execution of the required agreements and other documents will cure Sound Transit's technical default in the transaction and its current obligations with regard to the default.

### **Prior Board/Committee actions**

Motion No. M2009-48: Authorized the chief executive officer to execute a contract amendment for a one-year contract extension with GSF Advisors to provide financial advisory services for Sound Transit's lease-leaseback transaction for a total authorized contract amount not to exceed \$210,000.

Motion No. M2001-22: Authorized the Executive Director to execute a lease-to-service contract for up to \$77 million in Sounder Commuter Rail cars and locomotives.

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**Environmental review** – LS 3/6/23

**Legal review** – JW 3/7/23



## Motion No. M2023-27

A motion of the Board of the Central Puget Sound Regional Transit Authority (1) authorizing the chief executive officer to negotiate and execute a Standby Letter of Credit Side Letter, and (2) delegating to the chief executive officer authority to implement the Standby Letter of Credit Side Letter, including pledging up to \$4,000,000 as additional collateral, and executing amendments to agreements and other documents necessary to cure Sound Transit's technical default under the Lease-to-Service Transaction for Commuter Rail Cars and Locomotives caused by American International Group, Inc.'s credit rating slip and the bankruptcy of AIG Financial Products Corp.

### Background

In 2001, Sound Transit entered into a transaction to lease 22 rail passenger cab and coach cars and 5 locomotives (the "Headlease") to a private investor and simultaneously subleased the vehicles back (the "Sublease"). Under this transaction, Sound Transit received a net upfront payment and maintained the right to continued use and control of the vehicles. At the time of the transaction, the vehicles had a fair market value of \$61.3 million.

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The lease documentation established minimum credit levels to protect the Debt and Equity defeasance deposits. At the time these transactions closed, AIG was rated "AAA" by S&P and "Aaa" by Moody's. However, in 2008, AIG's credit rating slipped below limits established in the transaction, which put Sound Transit in technical default. At that time, Sound Transit negotiated standstill agreements with the transaction participants on the default requirement of Sound Transit having to replace the debt defeasance, equity defeasance, and AIG letter of credit. These standstill agreements from 2008 and 2009 have been extended multiple times to reach the present day.

In November 2022, AIG notified Sound Transit that its credit rating had slipped below the lower credit rating limits established in the temporary waiver agreement. In December 2022, AIG advised Sound Transit that AIG Financial Products Corp., the AIG subsidiary issuing the standby letter of credit for this transaction, had filed for bankruptcy.

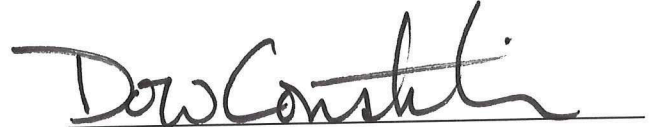
As a result of the credit downgrades, and under the terms of the waiver agreements, Sound Transit must replace both the debt and equity defeasance arrangements as well as replace the AIG letter of credit. First Hawaiian has proposed an alternative that is satisfactory to Sound Transit: AIG will issue a new standby letter of credit from a different AIG subsidiary, and Sound Transit will deposit additional cash collateral of up to \$4,000,000 to benefit Wilmington Trust Company, as the letter of credit beneficiary, and FHL SPC, the Owner Participant. The additional \$4 million in collateral represents a portion of the early termination damages Sound Transit will be liable for if this transaction fails. If the parties do not cure the default now and waive future AIG credit rating slips, Sound Transit would be responsible for early termination damages of approximately \$8 million dollars. The \$4 million collateral can only be tapped in the event of a default and only to the extent of the damages specified in the agreement.

The additional collateral agreement will cease upon the expiration of the lease in 2027.

## Motion

It is hereby moved by the Board of the Central Puget Sound Regional Transit Authority that (1) the chief executive officer is authorized to negotiate and execute a Standby Letter of Credit Side Letter, and (2) authority is delegated to the chief executive officer to implement the Standby Letter of Credit Side Letter, including pledging up to \$4,000,000 as additional collateral, and executing amendments to agreements and other documents necessary to cure Sound Transit's technical default under the Lease-to-Service Transaction for Commuter Rail Cars and Locomotives caused by American International Group, Inc.'s credit rating slip and the bankruptcy of AIG Financial Products Corp.

APPROVED by the Board of the Central Puget Sound Regional Transit Authority at a regular meeting thereof held on March 23, 2023.



Dow Constantine  
Board Chair

### Attest:

  
Kathryn Flores  
Board Administrator