metro

Washington
Metropolitan Area
Transit Authority

600 Fifth Street, NW
ashington, DC 20001
202/962-1234

By Metrorail:
diciary Square—Red Line
allery Place-Chinatown—
Red, Green and
Yellow Lines
By Metrobus:
Routes D1, D3, D6, P6,
70, 71, 80, X2

A District of Columbia,
Maryland and Virginia
Transit Partnership

October 28, 2008

U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Sir or Madam:

Re: Development of a Guarantee Program for Troubled Assets

The Washington Metropolitan Area Transit Authority (WMATA) is the largest mass transit provider in the Washington, D.C. metropolitan area and the second largest subway and fifth largest bus system nationally. On average, we provide 720,000 rail trips, 439,000 bus trips, and 4,400 paratransit trips every weekday.

Serving the nation's capital, WMATA was created primarily to serve the federal government, and nearly half of all Metrorail stations are located at federal facilities. More than 120,000 federal employees ride Metro to work, and federal workers comprise approximately 40% of peak ridership. WMATA's transit zone consists of the District of Columbia, the suburban Maryland counties of Montgomery and Prince George's and the Northern Virginia counties of Arlington, Fairfax and Loudoun and the cities of Alexandria, Fairfax and Falls Church. WMATA is pleased to provide the following comments in response to the notice and request for comments on the development of a guarantee program for troubled assets published on October 16, 2008 (at 73 Fed. Reg. 61452).

Background on transit agency leveraged leasing transactions

For some twenty years (until November 2003), the Urban Mass Transit Administration, then the Federal Transit Administration (FTA), encouraged public transit agencies to use "innovative financing mechanisms" to generate additional revenues, including "lease/leasback transactions" or "cross border leases." FTA listed "cross border leases," a type of leveraged leasing, in its "Innovative Financing Handbook" and in an industry notice (at 60 Fed. Reg. 24683) and both promoted and approved such financial transactions for transit agencies across the country.

WMATA, like more than 30 of the nation's largest transit agencies, has used leveraged leasing transactions to finance assets such as rail cars. With the encouragement of the FTA, WMATA entered into a number of these transactions, whereby it sold or leased an asset to an investor, typically a large financial institution. WMATA then leased the asset back from the investor.

WMATA's transactions, like those of other transit agencies, contained provisions that would require the transit agency to make the investor whole should the transit agency default on its obligations. The payment undertaking arrangements were designed to foreclose any practical possibility of default, and the FTA reviewed each transaction involving federally-assisted assets to ensure the assets were safe, i.e., that the transit agencies demonstrated "satisfactory continuing control" of the assets.

The transit agency contracted with entities such as AIG to act as payment undertakers. While the debt portions typically involved a deposit with an affiliate of the lender, the equity portion of lease payments were funded at the initiation of the transaction through the purchase of US Treasury obligations by the payment undertaker and were designed to create the necessary income stream to fund all rental payments throughout the life of the transaction. These securities were entrusted to the custodian on behalf of the equity payment undertaker, and an aspect of the agreements required the equity payment undertakers to maintain minimum credit ratings of their own.

The benefit from these transactions to transit agencies like WMATA was realized as an upfront payment for the assets. The benefit to the investor has always been the regular stream of payments from the transit agency, along with the ability to depreciate the asset for tax purposes. Under normal circumstances, investors very likely might waive replacement of the equity payment undertaker even if that entity fell below the minimum credit rating trigger, given their security interest in the underlying Treasuries. However, in recent years, the Internal Revenue Service (IRS) has acted against the investors, determining the investors took insufficient risk and that the transactions lacked economic substance. As a result, investors have seen their ability to take advantage of depreciation and other deductions--as well as their profit potential--severely limited.

Current crisis threatens transit agencies and state/local funders

With the recent turmoil in the financial markets and the credit rating downgrade of AIG and similar companies, WMATA and other transit agencies are required to replace AIG or others as the equity payment undertaker or other letter of credit provider for their transactions and a failure to do so results in a default on the part of the transit agencies. Replacing AIG and other similar companies has proved virtually impossible to accomplish in the current market since the equity payment undertaker must typically maintain a "AAA" rating.

In the event of default by the transit agency, the large banks that serve as investors can collect millions of dollars from the transit agency. In fact, the banks have an incentive to declare a default: The IRS has moved to disallow most of the tax advantages anticipated by the investors when they entered into the transactions, but in the event of a default, the investors can recover a penalty from the transit agency equal to the cash rents plus a cash payment reflective of anticipated tax benefits. Investors stymied by the IRS are seeking to recover anticipated profits at the expense of public transit. WMATA has already received a notice of default on one of its transactions requiring $43 million to be paid to a large foreign bank by Friday, October 31.

WMATA, like other transit systems, would find it a significant challenge to reimburse AIG or other similar companies for such a payout. Transit agencies are not for profit and provide a public service. They run significant operating deficits and, therefore, do not have cash on hand. Consequently, WMATA and other transit agencies could face cuts to service, as well as delayed or canceled capital maintenance and improvement projects, as they struggle to meet these demands.

In addition, a default could trigger a material adverse change, which would negatively impact future bond programs in the market, as well as have an adverse effect on other financing arrangements. The inability to issue bonds to fund capital improvements would be a serious blow to transit agencies and transit riders in the nation's capital and around the country.

Transit agencies, including WMATA, receive funding from state and local governments, so allowing investors to proceed to default in these leasing transactions would invite financial disaster for these governments and further disrupt their ability to obtain credit. In the case of WMATA, costs would be borne by taxpayers in the District of Columbia, State of Maryland, the Northern Virginia counties of Arlington, Fairfax and Loudoun and the cities of Alexandria, Fairfax and Falls Church and these government entities, which already face serious budget crises, would be negatively affected.

Urgent need to use Guarantee Program to assist transit agencies

It is imperative that the Treasury Department construct the Guarantee Program in a manner that provides relief to public transportation agencies at risk of default under leveraged leasing transactions. Transit agency cuts to service and/or capital projects and financial risks to state and local governments could be avoided without significant cost or risk to the Guarantee Program. We strongly urge the Department of Treasury to use its authority through the Guarantee Program to allow the Department to take over the role of "payment undertaker" and letter of credit provider from AIG or similar firms.

Because the rental payments are currently on deposit and currently being made on behalf of WMATA, the value of the guarantee made by the Treasury Department would be measured as a very low-risk solution. We believe that if the Treasury Department does not exercise authority under the Guarantee Program, the firms currently providing various letters of credit that secure the termination values or otherwise acting as payment undertaker would face potentially hundreds of millions of dollars in payments between now and the end of the year, and public entities, such as transit agencies and the cities and counties which fund them, would be destabilized as they attempted to raise these funds in credit markets which are all but frozen.

We appreciate the opportunity to comment on the development of this important program.

Sincerely,

Sarah Kline

Sarah Kline
Director, Office of Policy & Government Relations