

STAFF REPORT

SOUND TRANSIT MOTION NO. M2000-84

Lease/Leaseback Transaction for Commuter Rail Cars and Locomotives

Meeting:	Date:	Type of Action:	Staff Contact:	Phone:
Finance Committee	9/7/00	Discussion/Possible Action to Recommend Board Approval	Eric Mendelsohn Legal Department	206-398-5224
Board	9/14/00	Action		

PROPOSED ACTION

The proposed Motion authorizes the Executive Director to enter into a lease/leaseback contract with Amtrak to lease Sounder Commuter Rail cars and locomotives to benefit from Amtrak's tax exemption. Sound Transit expects to realize \$10 million to \$12 million in savings through this transaction. A memorandum of understanding between Amtrak and Sound Transit is attached as Exhibit A.

KEY FEATURES

Highlights:

- ◆ Under a lease/leaseback transaction, Sound Transit would lease its existing fleet of Sounder Commuter Rail cars and locomotives to Amtrak. Amtrak would lease the cars to BNSF. BNSF then provides service and rolling stock to Sound Transit. Sound Transit expects to benefit by receiving a State sales tax exemption.
- ◆ Sound Transit would retain title and control over the vehicles. Under the contract, Sound Transit would be required to maintain insurance on the cars and keep them in good working order.
- ◆ This lease with Amtrak is separate from the similar lease to service contract for Sounder vehicles with a private institutional investor that is under development by staff. The two transactions, while involving the same vehicles, are separate and distinct.

DISCUSSION OF PROPOSED ACTION

Under this agreement, Sound Transit would lease its existing fleet of Sounder Commuter Rail cars and locomotives to Amtrak. Amtrak would lease the cars to BNSF. Amtrak would repair, maintain, and service the rail cars at Amtrak's maintenance facility as previously approved by the Sound Transit Board in Resolution No. R99-10, and will require Amtrak to jointly undertake certain obligations contained in the operating agreement between Sound Transit and the

Burlington Northern & Santa Fe Railroad (BNSF) (previously approved by the Sound Transit Board in Resolution No. R99-22). The transaction is not subject to state or federal taxes, resulting in a potential \$12 million net reduction in the cost of the rail cars to Sound Transit. The transaction presents no increased risks to Sound Transit.

Thus far, staff has received conditional assurances from the Washington State Department of Revenue that the proposed structure is sales tax exempt, negotiated deal points with Amtrak with regard to use of funds generated from this transaction, and obtained FTA approval for the transaction in total. The only remaining issue is final approval from the Washington State Department of Revenue.

The transaction would be structured so that Sound Transit would retain title and continue to have uninterrupted use of the Sounder cars and locomotives or equipment of equal value and utility over the term of the lease. Sound Transit would maintain control and use of the assets. However, Sound Transit would be required to maintain insurance for the vehicles and keep them in good working order.

How Does the Transaction Work?

In a lease/leaseback transaction, Sound Transit would lease its current fleet of Sounder Commuter Rail cars and locomotives to Amtrak. Amtrak would in turn lease the assets to BNSF, who would provide service and rolling stock to Sound Transit. Sound Transit would then qualify for a "resale certificate" to be issued to the Department of Revenue.

What Are the Benefits of the Transaction?

Sound Transit expects the total sales tax exemption proceeds to be \$10 million to \$12 million. The net savings will be placed into an escrow account that will be used to benefit Northwest rail services and projects of mutual benefit to Amtrak and Sound Transit.

Potential issues

Placing the net proceeds into a joint escrow account for purposes of funding the mutually agreed upon track and related improvements would place the funds outside of the sole control of Sound Transit. Both parties have agreed to use current dispute resolution methods to avoid any conflicts.

BUDGET

If Sound Transit were to successfully execute this transaction, all costs would be covered by transaction proceeds (benefits). If Sound Transit were to undertake a transaction and be unable to successfully close a deal, there may be as much as \$75,000 in transaction related costs as well as the opportunity costs of lost staff time.

ALTERNATIVES

The Board could choose not to implement a lease/leaseback transaction at this time.

CONSEQUENCES OF DELAY

Successful execution of these types of transactions depends on a wide variety of factors, including tax law and political goodwill. The savings diminish as the equipment becomes used. A lease/leaseback transaction is currently viable for Sound Transit assets, but a delay in beginning work on the lease/leaseback risks changes in tax law and political conditions that will eliminate this transaction from possible execution.

REGIONAL PARTNERSHIP AND COOPERATION

The proposed transactions would involve only Sound Transit assets. However, the Federal Transit Administration (FTA) has encouraged Sound Transit to proceed with this transaction. Therefore, the FTA will need to be consulted prior to undertaking any transaction. In addition, BNSF, which has a separate agreement with Sound Transit regarding the operation of the vehicles, has pledged cooperation with Sound Transit to complete the transaction. Amtrak has worked diligently on this transaction to bring it to fruition.

PUBLIC INVOLVEMENT

In the course of its work on this project, Sound Transit has discussed this transaction extensively with the Department of Revenue and the Governor's office. A letter from Governor Gary Locke is attached as Exhibit B.

LEGAL REVIEW

The Legal Department has participated in the transaction and has prepared the motion and background material.

Approved as to form:
EM 8/30/00

SOUND TRANSIT

MOTION NO. M2000-84

A motion of the Board of the Central Puget Sound Regional Transit Authority authorizing the Executive Director to enter into a lease/leaseback contract to lease Sounder Commuter Rail cars and locomotives to Amtrak.

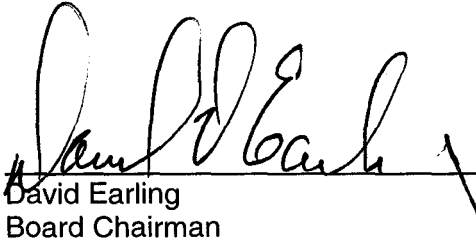
Background:

Sound Transit is now in a position to achieve additional efficiencies in the purchase of its rail car rolling stock assets. In this transaction, Sound Transit will lease an asset (rail cars) to Amtrak. The transaction will require Amtrak to repair, maintain, and service the rail cars at Amtrak's maintenance facility (previously approved by the Sound Transit Board in Resolution No. R99-10) and will require Amtrak to jointly undertake certain obligations contained in the operating agreement between Sound Transit and the Burlington Northern & Santa Fe Railroad (previously approved by the Sound Transit Board in Resolution No. R99-22). BNSF will leaseback and provide service to Sound Transit. The transaction is not subject to state or federal taxes resulting in a potential \$12 million net reduction in the cost of the rail cars to Sound Transit. The transaction presents no increased risks to Sound Transit.

Motion:

It is hereby moved by the Board of the Central Puget Sound Regional Transit Authority that the Executive Director is authorized to execute all necessary contracts and agreements to complete a lease/leaseback contract with Amtrak for Sounder Commuter Rail cars and locomotives. The term of the lease/leaseback contract shall not exceed 40 years.

APPROVED by the Board of the Central Puget Sound Regional Transit Authority at a regular meeting thereof on the 14th day of September 2000.


David Earling
Board Chairman

ATTEST:



Marcia Walker
Board Administrator

Exhibit A

MEMORANDUM OF UNDERSTANDING Relating to the Funding Generated by Sales Tax Exemption and Sale-Lease Back Transaction

THIS MEMORANDUM OF UNDERSTANDING is entered into this ____ day of July, 2000, by and between the National Railroad Passenger Corporation (“Amtrak”) and Central Puget Sound Regional Transit Authority (“Sound Transit”) to set forth the understanding of the parties regarding (i) the legal structure for Sound Transit’s acquisition of 58 coaches and cab cars and 11 locomotives (the “Rolling Stock”) for the Lakewood-to-Everett Commuter Rail Project and the exemption from Washington State sales and use taxes resulting from such legal structure, (ii) the potential for a future sale-lease back transaction with respect to the Rolling Stock, and (iii) the principles by which Amtrak and Sound Transit will allocate funding generated by such sales tax exemption and sale-lease back transaction, (iv) risk and cost allocation provisions; (v) other miscellaneous matters.

A. Legal Structure for Acquisition of Rolling Stock

Sound Transit wishes to enter into a lease/sublease transaction with Amtrak and Burlington Northern Santa Fe Railway (“BNSF”) so that Sound Transit’s acquisition of the Rolling Stock will be exempt from Washington State sales and use taxes in accordance with 49 USC §24301(k). Application of this Federal statute to a lease transaction is described in a February 16, 2000 letter to Claire Hesselholt from Preston Gates & Ellis LLP, attached hereto as Attachment A.

Subject to further discussions between the parties related to the effect of a bailment issue and simplifying the lease structure, Sound Transit and Amtrak agree that the legal structure for such leasing transaction shall be substantially as follows:

Lease and Sublease of Rolling Stock. Sound Transit will lease the Rolling Stock to Amtrak for a nominal rental. Under the Lease, Amtrak will have a lessee’s usual duties to maintain, repair and insure the Rolling Stock. (The maintenance and repair obligations of Amtrak set forth in the current form of the Maintenance Agreement between Amtrak and Sound Transit will be set forth instead in the Lease.) Amtrak will be permitted to sublease the Rolling Stock to BNSF. Amtrak will enter into a sublease with BNSF pursuant to which the Rolling Stock will be subleased by BNSF.

Operating Agreement between Sound Transit and BNSF. The Operating Agreement between BNSF and Sound Transit provides that BNSF will provide commuter rail service for Sound Transit in the central Puget Sound area. Consistent with the leasing structure given tentative approval by the Department of Revenue, Sound Transit will assign to Amtrak Sound Transit’s (i) rights under the Operating Agreement to receive commuter rail service and (ii) its obligations under the Operating Agreement to pay for such service.

Service Contract. Amtrak will enter into a Service Contract with Sound Transit, pursuant to which Amtrak will provide for Sound Transit the commuter rail services that BNSF has agreed to perform under the Operating Agreement that has been assigned to Amtrak. Under this Service Contract, Sound Transit will pay Amtrak for such services specified and (in accordance with the payment schedule set forth in the Operating Agreement). Additionally, Sound Transit will pay Amtrak's costs to maintain, repair and insure the Rolling Stock used in providing those services in accordance with the Maintenance Agreement. These payment obligations ensure that Sound Transit, pursuant to the Service Contract, will be paying the costs of maintenance, repair and insurance that the lease gives to Amtrak.

Also in the Service Contract, Sound Transit will have the right to require Amtrak to delegate to a third party designated by Sound Transit the maintenance and service functions after a period that coincides with the term under the current draft of the Maintenance Agreement. In connection with such delegation, Sound Transit would agree that Amtrak would have no liability for acts or omissions of the third party service provider designated by Sound Transit, and Sound Transit would make all necessary payments to such third party.

The transaction documents will provide that in the event of termination or expiration of the maintenance and operating responsibilities of Amtrak and BNSF, the Lease will be terminated.

B. Future Sale-Lease Back

Sound Transit has reserved the right to enter into a sale-lease back or similar financing agreement with respect to the Rolling Stock in the future. Amtrak agrees to cooperate with Sound Transit as may be reasonably necessary to accomplish such a financing transaction.

C. Use of Funds

The Parties hereby understand and agree that any funds generated from the sales tax exemption described in Section A will be used for projects that mutually benefit Pacific Northwest intercity rail passenger service, except as specifically set forth in Attachment B. Upon completion of the acquisition of Sound Transit Rolling Stock, Sound Transit shall immediately deposit into an Escrow Account all proceeds equal to the total sales and use tax savings generated by the use of Amtrak's tax exemption. The expenditure of funds generated in accordance with the transactions described in Sections A and B, above shall be in accordance with Attachment B hereto or subject to mutual agreement of the parties. In addition to completing the documents outlined in Section A above, the parties will agree in writing on a procedure for identification and mutual agreement of projects which will receive funding from the Escrow Account, the amount dedicated to each project, the project schedule, and cash flows.

D. Transaction Costs and Expenses

Sound Transit agrees to bear all costs associated with activities related to documenting the legal structures described in Sections A and B of this Memorandum of Understanding, including, but not limited to, Amtrak's transactional costs and legal fees. Sound Transit shall pay such costs and expenses whether or not the transactions contemplated under Sections A and B are finalized. Sound Transit shall reimburse Amtrak for such costs within thirty (30) days of receipt of an invoice from Amtrak.

E. Risk Allocation

1. Sound Transit agrees to defend, indemnify and hold harmless Amtrak, its officers, directors, employees, agents, servants, successors, assigns and subsidiaries, irrespective of any negligence or fault on their part, from and against any and all losses and liabilities, penalties, fines, forfeitures, demands, claims, causes of action, suits, costs and expenses incidental thereto (including the costs of defense and attorneys' fees), which any or all of them may hereafter incur, be responsible for or pay as a result of (1) injury or death of any person or damage to or loss (including loss of use) of any property, including property of the parties hereto, arising out of or in any degree directly or indirectly caused by or resulting from the services outlined in the BNSF Operating Agreement with Sound Transit to be assigned to Amtrak as described in Section A, above; and/or (2) violation of any Washington State sales and use tax laws resulting in a tax liability to Sound Transit or Amtrak; and/or (3) any adverse interpretation or change in Washington State sales and use tax laws which occur after execution of the final documents outlined Sections A and B above which result in a tax liability to Sound Transit or Amtrak.

2. Sound Transit agrees to provide Amtrak with either a letter of credit, and/or insurance protection, and/or some other form of guarantee acceptable to Amtrak to back up its indemnification, payment and other obligations provided hereunder and contemplated by the various legal structures set out under Sections A and B of this Memorandum of Understanding.

F. Board Approval

Amtrak's participation in any transaction outlined in this Memorandum of Understanding is subject to approval by Sound Transit and Amtrak's Board of Directors and formal approval by the Washington State Department of Revenue.

IN WITNESS WHEREOF, the parties hereto have set their hands as of the date above set forth.

**Central Puget Sound Regional
Transit Authority**

National Railroad Passenger Corporation

By:

By:

Title:

Title:

ATTACHMENT B

Proceeds from the sales tax exemption and any interest earned thereon will be expended as follows:

1. Immediately upon the deposit of funds from the sales tax exemption into the Escrow Account, Amtrak will withdraw an amount of \$2,000,000 to cover the following operating costs incurred by Amtrak West SBU:

a. King Street Yard Miscellaneous Maintenance Projects	\$250,000
b. King Street Station Miscellaneous Maintenance Projects	\$100,000
c. Service Facilities (Seattle Yard)	\$300,000
d. Tacoma, Edmonds & Everett Station Maintenance Projects	\$150,000
e. Training Development – Mechanical Right & Ready	\$100,000
f. Training Development – Service Standards – Stations	\$100,000
g. On-time Performance Enhancement (Tacoma to Everett)	\$500,000
h. Track Maintenance (Tacoma to Everett)	\$250,000
i. Switch Locomotive #565 – Maintenance and Repair	\$ 50,000
j. Station Staffing Enhancements (Tacoma, King Street, Edmonds & Everett)	<u>\$200,000</u>

Total Investment Costs (Operating) – PNW Corridor \$2,000,000

2. The balance of funds generated from the tax exemption, the future sale/leaseback transaction, and interest thereon will be used for track and signal improvements, capital and operating projects along Amtrak West and Sound Transit lines as mutually agreed by the parties, including, but not limited to the following four projects:
 - a. Partially fund additional costs associated with property acquisition, design, and additional pile driving due to soil conditions at the King Street Maintenance Facility.
 - b. Partially fill the funding gap in the King Street Station project to allow completion of final design and begin construction.
 - c. To backfill the money originally approved by the Amtrak Board of Directors to assist in the design and construction of Tukwila station in partnership with Sound Transit.
 - d. Partially fund additional costs for construction of a dual-track, grade separated project at the Tacoma Dome.