City Hall
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Title: Lease In/Lease Out Termination; Financing of Capital Costs (B)

This item is in regards to the termination of the Lease In/Lease Out transaction in connection with Deerhaven Units 1 and 2.

Sponsors:

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Attachments: 1. 080805_presentation_20090219.pdf, 2. 080805a_Termination Agreement_20090219.pdf

Date	Ver.	Action By	Action	Result
2/19/2009	0	City Commission	Approved as Recommended	Pass

Lease In/Lease Out Termination; Financing of Capital Costs (B)

This item is in regards to the termination of the Lease In/Lease Out transaction in connection with Deerhaven Units 1 and 2.
Pursuant to City Commission authorization given on September 14, 1998, GRU staff negotiated entering into a LILO transaction in connection with the Plant. In accordance with that City Commission authorization, bids were taken for an equity provider, equity credit enhancer and debt provider for the transaction. These bids resulted in the selection of The Bank of New York (BNY), through a special purpose limited liability company, as equity provider and affiliates of Ambac Assurance Corporation (Ambac) as equity credit enhancer and debt provider.

As part of the LILO financing structure, the City entered into two "Head Leases" of the Plant to an owner trust formed on behalf of BNY, as equity investor. The owner trust prepaid a substantial portion of the rent under the Head Leases to the City in a lump sum at the closing, with proceeds coming from the equity provider and the debt provider. The trust then leased the Plant back to the City under a fairly conventional "net" lease for a shorter term (the Lease), which granted to the City an option to purchase back the remaining term of the Head Leases at the end of the Lease term for a fixed purchase option price.

The transaction was closed on December 10, 1998, and the net proceeds received by the City totaled $35.6 million. Of this amount, $5.1 million was transferred to the City's General Fund under the General Fund Transfer formula. The remaining funds were used to pay down generation debt of the Utility.

As provided in the Participation Agreement entered into in connection with the LILO transaction, the City is required to provide additional credit support for the benefit of the equity investor in the event of a downgrade in Ambac's credit ratings. On November 19, 2008, Standard & Poor's lowered its rating on Ambac from "AA" to "A." As a result of that downgrade, GRU had 30 days in which to provide the additional credit support under the Participation Agreement. BNY, as equity investor, has provided GRU with several extensions of time, allowing us to evaluate our options for securing additional credit support and/or to consider a buyout and termination of the LILO transaction.

GRU staff have been working closely with our Bond Counsel and our Financial Advisor, as well as an advisory firm specializing in this type of transaction. The team canvassed the market for replacement credit support providers and at the same time commenced negotiations with Ambac and BNY to determine the buyout price. The only bona fide proposal for credit support came from Berkshire Hathaway Assurance Company at an expensive rate that was equivalent to a present value cost of approximately $15.2 million. Based upon the additional expense and considering that GRU would retain ongoing credit exposure to Ambac if the LILO transaction continues under a guaranteed investment contract (GIC) that was entered into in connection with the LILO transaction for the payment of rent and funding of the City's fixed price purchase option under the Lease, GRU staff have determined that the termination of the LILO transaction is the most appropriate action.

GRU staff have negotiated with BNY to reduce the equity portion of the termination price from approximately $214 million (the stipulated "Termination Value" under the Lease) to $138.4 million, assuming that the buyout occurs in February of 2009. In addition, the value of the Ambac GIC has increased to approximately $125.2 million. The difference in these amounts, approximately $13.2 million, is an obligation of the City. The difference will need to be paid by GRU upon the closing of the LILO termination. Included in the buyout will be a pay-off of a loan provided originally by Ambac which was economically defeased by a separate deposit with another affiliate of Ambac. This loan, which has a current balance of approximately $58 million, will not require any additional payment from GRU upon the termination of the LILO transaction.

In order to provide for the termination of the LILO transaction, the City will need to enter into a Termination Agreement with, among others, the Delaware limited liability company that owns the Head Leases, BNY, Ambac and certain Ambac affiliates. The Termination Agreement, a draft of which is attached, will provide for the payment to the equity investor, discharge of debt, release of leaseholds, mortgages and security interests and termination of certain documents entered into by the City in connection with the LILO transaction. We recommend that the City Commission approve the form of the Termination Agreement attached hereto and authorize the General Manager to execute and deliver the Termination Agreement on behalf of the City, in substantially the form attached hereto and with such changes thereto as the General Manager approves as being necessary or desirable and in the best interests of the City, such approval to be evidenced conclusively by the execution thereof. In addition, the City will have to execute various other implementing releases and terminations of property interests and UCC termination statements. The City will retain liability under certain general and general tax indemnity provisions contained in the Participation Agreement and certain federal tax indemnity provisions contained in the Tax Indemnity Agreement entered into in connection with the LILO transaction with respect to circumstances or conditions occurring or existing on or prior to the effective date of the termination.

GRU staff, in consultation with our Financial Advisor and Bond Counsel, have evaluated different options to fund the termination payment and associated costs and expenses. Given recent and current market conditions, we recommend that the City Commission approve the financing of the termination payment and associated costs and expenses through the issuance of not to exceed $14,500,000 in aggregate principal amount of commercial paper notes, which is a form of variable rate debt. These notes are not currently experiencing problems in the market. The notes must be taxable given the current tax status of the LILO arrangement.

The Utility has maintained in effect since 2000 a taxable commercial paper program that currently permits the Utility, upon authorization of the City Commission, to issue up to $25,000,000 in aggregate principal amount of Series D CP Notes at any one time outstanding. There are no amounts currently outstanding under the Series D CP Note program. Since all of the documentation for that program already is in place, upon approval by the City Commission, staff will be able to move quickly to issue the Series D CP Notes and meet the deadline imposed by BNY. Given the current low variable interest rate environment, the debt service payments would be relatively low as compared with fixed rate debt.

If, at some point in the future, there is a need to issue long-term fixed rate debt for regular construction needs, staff may come back to the City Commission for authorization to refund the Series D CP Notes to be issued to finance the LILO termination payment and associated costs and expenses with fixed-rate debt, in order to bring certainty to the Utility's future debt service payments and to take advantage of the bond deal size.

Although a termination payment was not the desired outcome when the LILO transaction was entered into, a substantial portion of the net benefit from this transaction remains.

We also are recommending that Ordinance O-99-16, Item #980766 be repealed. This ordinance was enacted to facilitate the LILO transaction and, once the LILO transaction is terminated, should be repealed.

In addition, in conjunction with the authorization of additional Series D CP Notes to finance the termination of the LILO transaction, GRU staff have determined that it would be desirable that GRU staff be authorized to issue additional Series D CP Notes from time to time in order to fund other Utility capital projects that, under applicable federal income tax laws and regulations, may be financed only on a taxable basis. Accordingly, we also are recommending that GRU staff be authorized to issue additional Series D CP Notes from time to time in an aggregate amount not to exceed $25,000,000 at any one time outstanding, in order to finance the Cost of Acquisition and Construction (as defined in the City's Utilities System Revenue Bond Resolution) of capital projects that, under applicable federal income tax laws and regulations, may be financed only on a taxable basis; provided, however, that (a) such capital projects are included in GRU's then-approved capital budget and (b) [taking into account all material considerations that the General Manager determines to be relevant (including, without limitation, then-current market conditions, GRU's then-current and anticipated future financing requirements and GRU's then-current outstanding debt), the General Manager determines that the financing of such projects through the issuance of Series D CP Notes is consistent with Prudent Utility Practice (as defined in the Utilities System Revenue Bond Resolution) and advantageous to the City, which determination shall be confirmed by the firm serving as GRU's financial advisor at the time].

The Clerk of the Commission, the General Manger or other Authorized Officers of the City (as defined in the Utilities System Revenue Bond Resolution) may be required to take certain other actions and hire certain other professionals to proceed with the transactions described above. Therefore, we recommend that these officials be authorized to take such other actions as may be necessary or desirable to proceed with the termination of the LILO transaction and the issuance of Series D CP Notes in accordance with this City Commission authorization.

The City Commission: 1)Authorize (a) the termination of a "Lease In/Lease Out" (LILO) transaction previously entered into by the City in connection with Deerhaven Units 1 and 2 and shared common facilities (the Plant) and (b) the execution and delivery of certain documents in connection therewith, including the Termination Agreement described below; 2)Authorize the issuance of additional taxable Utilities System Commercial Paper Notes, Series D of the City (Series D CP Notes) in an aggregate principal amount to be outstanding at any time not to exceed $25,000,000 for the purposes of (a) financing the payment required to be made by the City in order to terminate the LILO transaction and associated costs and expenses and (b) subject to the limitations set forth below, financing certain other GRU capital projects; 3) Authorize the Clerk of the Commission, the General Manager and other Authorized Officers to execute such other documents as may be necessary to proceed with the transactions authorized above, and to take such other actions as may be necessary or desirable to proceed with such transactions in accordance with this City Commission authorization: and 4) Authorize the City Attorney to prepare and the Clerk of the Commission to advertise an ordinance repealing Ordinance O-99-16, Item #980766.

Projected debt service payments for the Series D CP Notes to be issued to finance the termination of the LILO transaction and associated costs and expenses will be covered within the FY09 budgeted dollars. Alternatives to the recommendation, while less expensive upfront, could prove to be much costlier in the future given current risks.

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