City of Rochester
City Administrator's Office

Memo

To: Mayor and City Council

From: Gary Neumann G. N.

Date: September 16, 2003

Re: ALLCO Lease and Lease-Back Proposal

At the September 22 Committee meeting the Council will be reviewing a proposal from the ALLCO company to lease the City water and sanitary sewer systems with a lease-back to the City under which the City continues to operate those systems.

There is a volume of attachments that explain this proposal. It is essentially a transaction in which ALLCO arranges the sale of depreciation tax credits with large investors. Under this process the City could obtain an estimated 3% to 4% of the value of those utility assets in cash in excess of the amount needed to be deposited (the remaining 96% to 97%) to make the lease payments. At the end of the 30 year term the City could get full title to its utilities back. During the 30 year lease period the City would continue to operate and maintain the utilities as it does now.

This matter has been reviewed in some detail by the City staff and the LMC staff. Many communities have gone from initial skepticism to support for this concept. The ALLCO company is currently out obtaining bids for utility systems in the larger communities of North Dakota. The LMC has also attempted to check out this approach by talking to the EPA and to the State Department of Revenue. Information from those agencies is included in the attachments. I will list the attachments for your ease of review.

1. Summary of Lease and Lease-Back Program.
2. League of Minnesota Cities/ALLCO Ventures Presentation
3. September 5,2003 from Jim Miller LMC Executive Director
4. Sample City Letter of Agreement
5. Emails from LMC Staff Kevin Frazell relating to EPA and Dept of Revenue

Summary
of
Lease and Lease-Back Program

The League of Minnesota Cities ("LMC") has received a proposal that it participate in a lease and lease-back program (the "Program") for the benefit of Minnesota cities. LMC has requested that Kennedy & Graven, Chartered ("K&G") prepare a summary analysis of the proposal made by Allco Finance ("Allco"). This document provides a short synopsis of the Program based on information provided to us by Allco and its counsel (Dorsey & Whitney LLP). A more detailed investigation of the Program will be appropriate if the LMC determines that it has an interest in participating in the Program. It should be noted that if the LMC elects to participate in the Program, the structure of the Program will likely evolve in response to financial and legal constraints and opportunities that arise during the development of the Program.

General

Under the Program, a Minnesota city (the "City") would lease its water treatment and distribution system or its wastewater treatment system (the "System") to a for-profit entity (the "Entity") under a long-term lease of 50 to 99 years (the "Lease"). The City would receive a single lease payment (the "Lease Payment") from the Entity equal to the appraised value of the leasehold estate acquired by the Entity in the System. Simultaneously, the City will enter into a sublease (the "Sublease") with the Entity for a shorter term of 30 years. Under the terms of the Sublease, the City is required to make periodic payments through the term of the Sublease and is provided the opportunity at the end of the Sublease to make a single option payment (the "Option Payment") to acquire the remaining leasehold interest held by the Entity under the Lease and terminate the transaction.

The Lease Payment received by the City upon execution and delivery of the Lease is applied as follows:

(a) A portion of the proceeds pays the expenses of the Program. These expenses include the appraisal that establishes the fair market value of the leasehold estate in the System to be acquired by the Entity, the fees of attorneys, accountants, financial advisors, and others incurred with respect to the transaction, the fee of Allco, and other costs.

(b) The largest portion of the Lease Payment is deposited into a defeasance account (the "Defeasance Account") and is invested in a guaranteed investment contract (the "GIC") or in several GICs. The principal and the interest derived from the GIC or GICs are withdrawn over the term of the Sublease in amounts sufficient to pay all periodic payments due under the Sublease and at the end of the term of the Sublease the amounts remaining in the Defeasance Account are applied to the payment of the Option Payment.

(c) The remaining portion of the Lease Payment is retained by the City (the "City Funds"). Allco estimates that the amount of the City Funds will be equal to three to four percent (3% - 4%) of the total Lease Payment. The City Funds are available to the City for any of its corporate purposes (although there may be some constraints imposed by the Program on the use of such funds).

Although the City may decline to pay the Option Payment at the end of the term of the Sublease and retain such funds for its own purposes, the Lease will remain in effect and, under its terms, the Entity will require the City to enter into a service contract that will provide for the operation of the System in a

manner that will produce an acceptable return to the Entity over the remaining term of the Lease. Needless to say, the City would likely find it preferable to pay the Option Payment and terminate the Lease since the Option Payment is fully funded from the Defeasance Account and such payment will prevent any interference by the Entity in the operation of the System. (In fact, the two options available to the City at the end of the Sublease are principally incorporated into the transaction to satisfy an income tax requirement applicable to the Entity. It is not expected that the City would ever elect to take any other action other than to pay the Option Payment and terminate the transaction.)

Why is this transaction attractive to the City? The major incentive for the City to participate in the Program is the receipt by the City of a substantial amount of unrestricted cash. Furthermore, the City is not required to give up ownership or control of the System during the term of the Sublease and the Lease. During the term of the Sublease and the Lease, title to the System will remain with the City and the City will continue to operate the System in the same manner as prior to the execution of the Lease and Sublease. The City retains the authority to set rates and collect and expend System revenues without any limitations imposed by the Entity. The City retains both the authority and the obligation to operate and maintain the System as if the City was not a participant in the Program. Although the City is exposed to some risks as a participant in the Program (see "City Risks" below), the risks can be minimized (although not eliminated) and the City may well determine that the rewards for participation in the Program exceed the risks.

Why is this transaction attractive to the Entity? Under applicable federal income tax law, the Entity is entitled to amortize or depreciate its investment in the System. This tax benefit is the principal motivation for the participation by the Entity in the Program. (The City does not guarantee any tax benefits. The risk that such tax benefits will be denied by the Internal Revenue Service are entirely those of the Entity.)

In addition, the Program minimizes the financial risks to the Entity. The funds to make the Lease Payment to the City are obtained by the Entity from an equity investment of approximately fifteen percent (15%) of the Lease Payment and from the proceeds of a loan (the "Loan") for the remaining eighty-five percent (85%) of the Lease Payment. A portion of the Lease Payment is paid to the City, a portion is applied to the costs of the transaction, and the remainder is deposited in the Defeasance Account and invested in a GIC or in several GICs. Absent a financial catastrophe (see "City Risks" below), the Defeasance Account investments will generate sufficient cashflow to pay the periodic payments due under the Sublease and to pay the Option Payment at the end of the term of the Sublease. Therefore, the Entity is virtually guaranteed to receive sufficient revenues under the Sublease to pay the principal of and interest on the Loan in full. Although the Entity is exposed to some risks as a participant in the Program, the risks are apparently acceptable to the Entity and, in any event, the City has no responsibilities with respect to such risks.

Other Significant Issues

The minimum amount of assets required by the Program is $250,000,000. As a result, it may be necessary for several cities to participate together in this transaction. The largest cities of Minnesota may have sufficiently large water treatment and distribution systems or wastewater treatment systems to participate in the Program individually. The other cities of Minnesota will be eligible to participate in the Program only if they join with others to provide the minimum assets. (Allco is presently structuring a program in the State of South Dakota in which the largest fourteen cities are participants.)

If the participating cities have received financing from the United States Environmental Protection Agency (the "EPA") or from the Minnesota Public Facilities Authority (the "PFA") for their water treatment and distribution systems or their wastewater treatment systems (this would likely include

all such participants), it will be necessary for such cities to obtain approval from the EPA and from the PFA to proceed with the Program. The grant and loan documentation employed by the EPA and the PFA likely contain provisions prohibiting the lease or other conveyance of the water treatment and distribution systems or the wastewater treatment systems. Allco is proposing that a joint application be made to the EPA by all participating cities. Allco has apparently engaged in discussions with the EPA regarding similar transactions and the EPA has indicated that it supports the concept. (There was some concern expressed by counsel to Allco that the EPA may put pressure on the participating cities to use the City Funds for System improvements rather than for other city purposes.

City Risks

GIC Default. Perhaps the major risk to cities participating in the Program is the risk of a GIC default. The Sublease is not a revenue obligation of the participating cities. Therefore, if there is a default on a GIC by the GIC provider (the "GIC Provider") and, as a result, the Defeasance Account does not have sufficient investment proceeds to pay the lease payments under the Sublease, the participating cities will remain contractually liable for such lease payments. In the event of a default by a city, it would be subject to a legal claim for the lease payments. Allco is proposing several actions that could be taken to minimize (but not eliminate) this risk.

> First, the Program will require that the GIC Providers constitute highly-rated insurance companies or other organizations with substantial assets. (This may also be a legal necessity since the provisions of Minnesota Statutes, Chapter 118A, as amended ("Chapter 118A"), are applicable to the Defeasance Account investments and, therefore, the GICs must be legal investments under Chapter 118A.)
>
> Second, to further reduce investment risks, the Program may also require diversification of the investments by utilizing as many as three GIC Providers.
>
> Third, the GIC Providers will be closely monitored to detect any financial weakness. If a GIC Provider does not appear to meet the strict standards of the Program, the GIC from that GIC Provider would be replaced with an investment from another source.

Notwithstanding the foregoing, it is important for the participating cities to understand that regardless of steps taken to minimize the risk, there will always remain a possibility (albeit small) that a GIC Provider may default on a GIC.

Tax-exempt Bonds. The lease of a city's water treatment and distribution system or its wastewater treatment system to a nongovernmental person raises the possibility that the "private business tests" of Section 141(b) of the Internal Revenue Code of 1986, as amended (the "Code"), or the "private loan financing test" of Section 141(c) of the Code, have been satisfied with respect to the outstanding bonds of the city that financed such system. If, upon closer analysis, this proves to be the case, interest on the outstanding bonds may no longer be excludable from gross income for federal income tax purposes or the city may be required to take certain "remedial actions" authorized by Treasury Regulations, Section 1.141-12, to ensure that the interest on such bonds continues to be excludable from gross income for federal income tax purposes. (Such remedial actions might include the redemption and prepayment of the outstanding bonds and/or the application of the proceeds derived from the lease to certain governmental facilities that do not satisfy the private business tests or the private loan financing test.)

In addition, if it is finally determined that the private business test or the private loan financing test would be satisfied by the lease of such system to the Entity, the city may be precluded from issuing tax-exempt bonds in the future to made repairs or improvements to the water system or the wastewater

system. In such case, future bond issues would be required to be issued as taxable bonds and tax-exempt financing would not be available to the city for the leased system during the term of the Sublease. (This limitation would not apply to bonds of the city issued for other purposes.)

Other Legal Issues.

Real Property Taxes. Under Minnesota law relating to real property taxation, it is generally the case that property owned by a governmental entity (and, as a result, exempt from real property taxes) will become subject to real property taxes if it is leased to a nongovernmental entity. If that law applies to the Program then the Entity would receive a real estate tax statement each year from the county or counties in which the lease system is located. Such taxes would likely be substantial. It will be necessary to work with the Commissioner of the Minnesota Department of Revenue and the counties to obtain a determination that the leased system is not subject to real property taxes or, if that determination cannot be obtained, to request an exemption from the Minnesota Legislature.

Legal Authority to Lease and Sub-lease. It will be necessary to make a determination that each participating city has the statutory authority to lease the water system or the wastewater system that will be included in the Program and that there are no charter limitations or statutory limitations that will preclude such leasing. (Dorsey & Whitney LLP, as counsel to Allco is confident that there is sufficient statutory authority for Minnesota cities to act as lessor and sub-lessee under the Program.)

Debt Limitations. The parties to the Program assume that the Sublease will not constitute a debt obligation under Minnesota law. Because the Sublease will not contain an interest component, it should be clear that the lease obligations of the participating cities will not constitute debt obligations of such cities. Nevertheless, it will necessary to confirm this legal conclusion as part of the structuring of the Program.

Other Legal Issues. The Entity may request title insurance on the water system or the wastewater system. The parties will need to negotiate the necessity for this title insurance requirement. The Entity may request additional liability or property insurance with respect to the water systems or the wastewater systems that are proposed to be included in the Program. This also will need to be negotiated between the parties. Finally, in the event that assets that are part of any System become worn or obsolete, the city may discard the asset but only if the asset is replaced with an asset of equal or greater value. This limitation would remain in place for the term of the Sublease.

The Role of the LMC

Although Allco has not precisely delineated the activities to be undertaken by the LMC with respect to the Program, it is likely that such activities would include the following:

(1) Organize the transaction and participate in the structuring of the Program, inform the members of the LMC about the Program, and act as a source of information for the Minnesota cities that are considering participation in the Program.

(2) Create a special purpose entity to manage the transaction.

(3) Monitor the GICs and the GIC Providers that are participating in the Program in order to minimize the risk of a default by a GIC Provider.

Conclusion

This summary is intended to provide a general review of the Program and some of the significant issues associated with participation in the Program. However, as is often the case in complicated transactions such as the Program, the "devil is in the details." It is likely that some of the legal and financial issues referenced above will be quickly resolved. Other issues may be more difficult to resolve and new legal and financial issues will arise as the Program is negotiated and structured.

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League of Minnesota Cities/ Allco Ventures

Presentation on Potential Lease/Leaseback Financing Program for Municipal Water and Wastewater Systems

Long-Term Lease / Leaseback Transaction

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CONCEPT OVERVIEW

- The purpose of a Long-Term Lease/Leaseback transaction is to allow a tax-exempt entity such as a municipality or other political sub-division, to enter into a transaction whereby they lease to a private entity, such as a very large bank or insurance company, an asset, and then immediately leaseback the asset.

- Through this lease and leaseback transaction, the tax-exempt entity receives a significant cash benefit (typically 3%-4% of fair-market-value of the asset) at execution of the agreement, and retains operating control of the system. The private entity receives the benefit of the depreciation on the asset over the life of the lease and transaction costs.

We are in the process of closing a transaction for the top 14 cities in South Dakota. Our estimates are the cities will realize over $40 million cash benefit at the time of closing a transaction on their wastewater system assets.

AN EXAMPLE

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- A city, (through the assistance of Allco) leases certain qualified assets (such as wastewater treatment and collector system assets) to a large bank (referred to as the "lessor") for approximately 98-99 years (referred to as the "head-lease"), and then immediately leases the assets back on a "leaseback" of approximately 30 years.

- Through the transaction, the municipality receives at the execution of an agreement, cash from the bank as the 100% up-front "Long-Term Lease payment" on the assets.

- Approximately 96%-97% of this cash is immediately placed by the municipality into an account. These accounts, known as "defeasance agreements", typically are guaranteed-investment-contracts backed by highly rated banks or other financial institutions. The defeasance agreements automatically make the "Leaseback" payments to the bank over the 30-year lease.

- The remaining 3%-4% up-front cash received by the municipality on the closing date is the cash benefit realized.

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BUSINESS AS USUAL

- There are no out-of-pocket expenses incurred by the city in entering into the transaction.
- During the lease period, title to the assets remains with the city.
- The lease is not regarded as debt, and current or future tax-exempt bonds are not adversely affected.
- The city continues to operate the assets, deliver services, set the rates, and collect the fees as they typically would as if the transaction had never occurred.
- The city retains full control to operate and maintain the system, and to make all upgrade and expansion decisions.

During the leaseback period, the City continues to operate the system ***Business as Usual.***

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NO IMPACT ON REVENUE

- There are no out-of-pocket expenses incurred by the city in entering into the transaction. All transaction costs are paid by the equity investors.
- All of the city's financial obligations under the lease and the sub-lease are pre-funded from the funds they receive when they lease the assets to the equity investor; therefore again, no on-going out-of-pocket expense to the city.
- The city continues to keep all system revenues, and the revenues are <u>not</u> pledged as collateral. The equity investors are subordinate to current and future tax-exempt debt and SRF Loans.
- The city is free to pledge any on-going revenues to bondholders for future additions or improvements to the system.
- At the end of the lease, the final payment from the defeasance accounts (at the option of the city) collapses the head-lease, and terminates the transaction
- The equity investors assume all the risks associated the investor's tax benefits of the transaction.

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BACKGROUND

- Transactions Completed Over The Past Two Decades In The United States
- Western Europe Over The Past Decade
- Two Years Ago – Domestic Infrastructure (Wastewater/Water)
- The South Dakota Experience
- Dorsey Whitney - Legal, Tax and Regulatory Review
- League of Minnesota Cities

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TYPICAL EQUITY INVESTORS

- AIG
- Ameritech
- Amsouth
- Banc One
- Bank of America
- Bank of New York
- Bank of Tokyo Mitsubishi
- Bell Atlantic (Verizon)
- Branch Bank and Trust
- CIBC
- CIT
- Con Edison
- Dana Commercial Credit
- Edison Capital
- GATX
- GE Capital
- Fifth Third Bank
- First Hawaiian Bank
- First Union National Bank
- Fleet Bank
- ICX Corporation
- John Hancock
- Key Bank
- Metlife
- Michigan National Bank
- Mitsubishi Trust
- Pacific Century
- Philip Morris Capital
- Pitney Bowes
- PNC Bank
- Potomac Capital
- Prudential
- PSEG
- Southern Energy
- State Street Bank and Trust
- Sumitomo Leasing
- Suntrust
- US Bank Corp
- Wachovia Bank
- Wells Fargo

Many well-known insurance companies, financial institutions and other companies invest in structured lease transactions.

U.S. STRUCUTED LEASE FINANCINGS

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Massachusetts Bay Transportation Authority (Boston)
Metropolitan Transportation Authority (New York)
Southeastern Pennsylvania Transportation Authority
Connecticut Department of Transportation
New Jersey Transit
Port Authority of Allegheny County (Pittsburgh)
Washington Metropolitan Area Transit Authority
Miami-Dade Transit
Metropolitan Atlanta Rapid Transit Authority
Greater Cleveland Regional Transit Authority
Metra (Chicago metropolitan area)
Chicago Transit Authority
Bi-State Development Agency (St. Louis transit)
Metropolitan Transit Authority (Houston)
Dallas Area Rapid Transit
Regional Transportation District (Denver)
Utah Transit Authority (Salt Lake City area)
Los Angeles County Metropolitan Transportation Authority

Metropolitan Transit Development Board (San Diego)
North County Transit District (San Diego area)
Southern California Regional Rail Authority
California Department of Transportation
Santa Clara Valley Transportation Authority
Peninsula Corridor Joint Powers Board (Silicon Valley/San Francisco regional)
San Joaquin Regional Rail Commission
Bay Area Rapid Transit District (San Francisco)
San Francisco Muni (bus, streetcar, cablecar transit)
Sacramento Regional Transit District
San Mateo County Transit District
Tri-County Metropolitan Transportation District of Oregon (Portland area)
Sound Transit (Seattle area)
Tennessee Valley Authority
Old Dominion Electric Cooperative
Oglethorpe Power Corporation
City Public Service of San Antonio

Nearly every major metropolitan area has executed a long-term lease/leaseback transaction on some their subway system.

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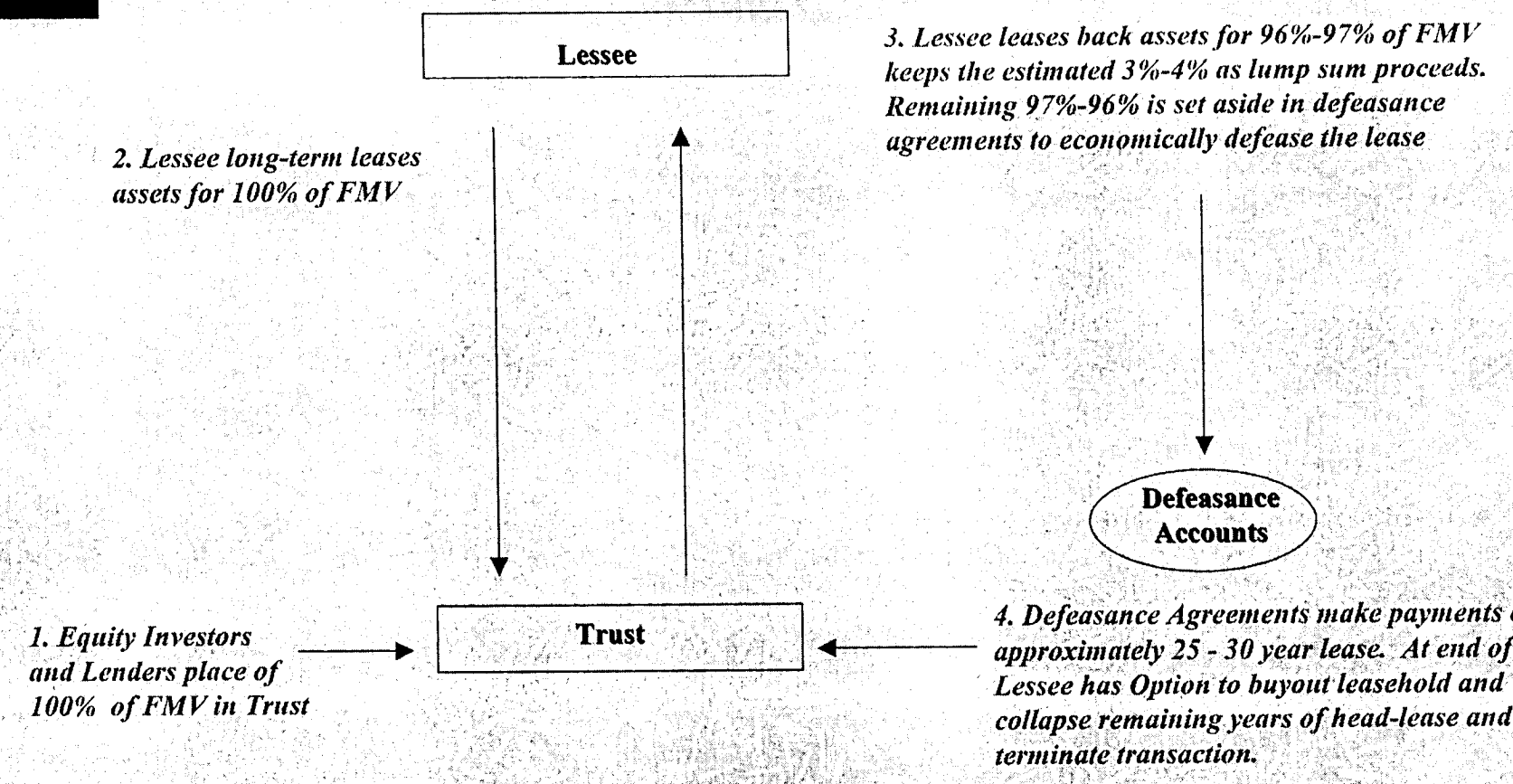
LONG-TERM LEASE / LEASEBACK



A step-by-step view of the transaction

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ABOUT ALLCO

- Allco is an investment banking firm specializing in structured lease finance products for large-ticket capital assets such as commercial aircraft, railroad rolling stock and infrastructure - including power facilities, drinking water and wastewater infrastructure assets and certain high technology infrastructure assets.

- Allco has closed in excess of $25 billion of domestic and cross-border transactions, including over $5 billion involving water assets.

- Allco is the market leader in applying lease finance products to water assets.

Allco's sole focus is on is on assisting municipalities and other tax-exempt entities in long-term lease/leaseback transactions.

NEXT STPES

- Initial introduction to Transaction
- Detailed Review of Transaction in LMC Offices
- Execution of LOU
- System Appraisal for Fair-Market-Value
- Bond Analysis for each City
- Market Transaction / Bid Solicitation to equity community
- Close Transaction and disperse funds to Cities

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EXAMPLE LIST OF *ALLCO* TRANSACIOTNS

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US Domestic and Cross-Border Leases			
Year	*Lessee*	*Equipment*	*US$ Million*
2003	*South Dakota*	*Wastewater Facilities*	*1,3000*
2002	*City of Cologne*	*Freshwater Facilities*	*1,200*
2002	*Duisburg*	*Wastewater Facilities*	*1,000**
2002	*Lippeverband*	*Wastewater Facilities Association*	*400**
2002	*Eifel Ruhr*	*Wastewater Facilities Association*	*800**
2002	*City of Berlin*	*Wastewater Facilities*	*1,250**
2002	*AZV Pinneberg*	*Wastewater Facilities*	*300**
2002	*Erftverband II*	*Wastewater Facilities Association*	*500*
2001	*Ruhrverband*	*Wastewater Facilities Association*	*180*
2001	*Erftverband*	*Wastewater Facilities Association*	*177*
2001	*Emschergenossenschaft*	*Wastewater Facilities*	*477*
2001	*Ruhrverband*	*Wastewater Facilities Association*	*743*
2001	*City of Duesseldorf*	*Wastewater Facilities*	*530*
2001	*City of Bonn*	*Wastewater Facilities*	*536*
2000	*City of Bonn*	*Wastewater Facilities*	*520*
2000	*City of Cologne*	*Wastewater Facilities*	*1,100*
2000	*City of Cologne*	*Wastewater Facilities*	*800*
2000	*City of Dresden*	*Wastewater Facilities*	*350*
1999	*City of Dusseldorf*	*Wastewater Facilities*	*600*
1998	*Rijnlanden/Friesland/Vallei en Em*	*Wastewater Facilities*	*600*
1997	*Regge and Dinkel, the Netherlands*	*Wastewater Facilities*	*439*

** Mandated - Scheduled to close in the near future*

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US Domestic and Cross-Border Leases			
Year	*Lessee*	*Equipment*	*US$ Million*
2002	*City of Cologne*	*Rolling Stock*	*180**
2002	*City of Erfurt*	*Rolling Stock*	*90**
2002	*WMATA*	*Rolling Stock*	*300**
2002	*DFS*	*Air Traffic Control Equipment*	*1,500**
2002	*Peninsula Corridor, JPB*	*Rolling Stock*	*76*
2000	*City of Stuttgart*	*Rolling Stock*	*70*
2000	*SNCF French Rail*	*Rolling Stock*	*210*
2000	*SNCF French Rail*	*Rolling Stock*	*230*
2000	*Peninsula Corridor, JPB*	*Rolling Stock*	*64*
2000	*SNCF, French Rail*	*Rolling Stock*	*500*
2000	*Queensland Rail*	*Rolling Stock*	*500*
2000	*Austrian Rail*	*Rolling Stock*	*230*
2000	*State of California Dept. of Transportation*	*Rolling Stock*	*238*
1999	*SNCF, French Rail*	*Rolling Stock*	*500*
1999	*SJ, Swedish Rail*	*Rolling Stock*	*160*
1999	*Washington Metropolitan Area Transit Auth.*	*Rolling Stock*	*320*

** Mandated - Scheduled to close in the near future*

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US Domestic and Cross-Border Leases

Year	Lessee	Equipment	US$ Million
1999	City of Munich	Rolling Stock	250
1999	Deutsche Bahn	Rolling Stock	495
1998	Deutsche Bahn	Rolling Stock	230
1998	City of Darmstadt	Rolling Stock	104
1998	City of Kassel	Rolling Stock	95
1998	City of Nuremberg	Rolling Stock	205
1998	Westrail	Rolling Stock	240
1998	Santa Clara Valley Transit Authority	Rolling Stock	107
1998	San Joaquin Regional Rail Commission	Rolling Stock	22
1998	Washington Metropolitan Area Transit Auth.	Rolling Stock	220
1998	SNCF, French Rail	Rolling Stock	280
1998	SJ, Swedish Rail	Rolling Stock	850
1998	NS/Dutch Rail	Rolling Stock	50
1998	NS/Dutch Rail	Rolling Stock	168
1998	Cathay Pacific	1 x 777	135
1998	Cathay Pacific	1 x 777	135

* Mandated - Scheduled to close in the near future

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US Domestic and Cross-Border Leases

Year	*Lessee*	*Equipment*	*US$ Million*
1998	*Dresden*	*Rolling Stock*	*70*
1998	*Hannover*	*Rolling Stock*	*150*
1998	*Wurzberg*	*Rolling Stock*	*100*
1998	*Westrail*	*Rolling Stock*	*70*
1997	*NS/Dutch Rail*	*Rolling Stock*	*130*
1997	*City of Essen*	*Rolling Stock*	*100*
1997	*City of Dortmund*	*Rolling Stock*	*155*
1997	*City of Hannover*	*Rolling Stock*	*105*
1997	*City of Bielefeld*	*Rolling Stock*	*130*
1997	*SNCF French Rail*	*Rolling Stock*	*180*
1997	*Denver, CO RTD*	*Bus and Rail Facilities*	*80*
1997	*Denver, CO RTD*	*Rolling Stock*	*35*
1997	*SNCF French Rail*	*Rolling Stock*	*400*
1997	*Port of Allegheny County, PA*	*Rolling Stock*	*100*
1997	*New South Wales - Mount Piper*	*Power Generation*	*470*
1997	*SJ/Swedish Rail*	*Rolling Stock*	*145*

** Mandated - Scheduled to close in the near future*

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US Domestic and Cross-Border Leases

Year	Lessee	Equipment	US$ Million
1997	New South Wales - Mount Piper	Power Generation	526
1997	ÖBB/Austrian Rail	Rolling Stock	154
1997	SJ/Swedish Rail	Rolling Stock	149
1997	Dresden	Rolling Stock	240
1997	ÖBB Austrian Rail	Rolling Stock	302
1997	Stuttgarter	Rolling Stock	327
1997	NS Dutch Rail	Rolling Stock	257
1997	SBB/Swiss Rail	Rolling Stock	400
1997	SJ/Swedish Rail	Rolling Stock	252
1997	Qantas Airways Limited	3 x 747-400 1 x 767-300	400
1997	New South Wales - Mount Piper	Power Generation	443
1997	Queensland Railways	Rolling Stock	159

** Mandated - Scheduled to close in the near future*

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League of Minnesota Cities
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Date: September 5, 2003

To: Cities Considering Participation in the Allco Lease/Leaseback Transaction

From: Jim Miller, LMC Executive Director James F. Miller

For the last six months, the League has been in active discussion with Allco and others to learn about the concept and better understand the Allco proposal. We have determined that Allco is a recognized "aggregator" with experience in this kind of transaction. We have checked with several other public entities that have worked with Allco and we are satisfied that they are a reputable firm.

In addition to our discussions with Allco, we have consulted with others, both in Minnesota and nationally, and have retained Kennedy & Graven, a noted Minnesota bond counsel, to advise the League. We also anticipate shortly retaining other outside professional expertise to assist in structuring the agreements between Allco and the League and Allco and the participating cities, as well as to help structure other critical transaction components.

We have met with Minnesota Finance Commissioner Dan McElroy to alert him to this proposal. He had no major concerns and promised to share the information with his department and the Revenue Department. A similar meeting was held with the State Public Finance Agency. We have received no negative reactions. I will be meeting with House Tax Committee Chair Ron Abrams soon to discuss the proposal with him as well.

Based on our analysis to date, the League believes that this proposal, at least for some cities, can be an appropriate means to generate considerable one-time funds. As with any investment transaction, there is risk, but the League will be working to mitigate that risk to the extent possible. Cities will clearly understand those risks before final approval.

At this time, there are still issues that need to be resolved, including with the letter agreement you previously received. Therefore, if you are interested in proceeding to the next step, you may want to ask the city council for conceptual approval with authority to the Mayor or other proper signatory to execute the letter agreement when in final form. LMC General Counsel Tom Grundhoeffer has suggest that you consider having your council pass a motion along the following lines:

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Motion authorizing staff to continue to work with Allco Financial Corporation (Allco) in the evaluation and structuring of a possible lease/leaseback transaction for city wastewater and drinking water assets; and authorizing (insert appropriate city official for your city), subject to city attorney review and approval, to enter into a letter of agreement with Allco for purposes of evaluating the feasibility of such a lease/lease back transaction.

Approval of the letter agreement does not commit the city to final approval of the transaction. It does express the city's intent to work with Allco to determine if a transaction can be completed.

In the interest of full disclosure, I want you to know that the League will be compensated if this transaction does occur. You have my strongest assurance that the League's actions, however, have been and will be to make the best recommendations in the interest of participating cities. Ultimately, that could mean recommending that cities not proceed with the transaction if all outstanding issues are not clarified and resolved.

I hope this letter is helpful in your evaluation. Please do not hesitate to contact me if you have any questions.

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Exhibit A

[Sample Letter of Agreement]

_____ __, 2003

[Name & Title]
[Address]

Re: Long-term lease/leaseback proposal

Dear M__. _____:

Over the past several months, Allco Finance Corporation (hereinafter "Allco") has been working with the League of Minnesota Cities (hereinafter "LMC") to develop a ***'long-term lease/leaseback financing program'*** (defined as the lease/leaseback of a defined set of Assets in a single closing or multiple closings, hereinafter "Transaction") for Minnesota cities. We have specifically focused on wastewater and drinking water system assets (hereinafter "Assets") owned and operated by Minnesota municipalities.

In our investigation, we have retained the counsel of Dorsey & Whitney LLP to assist in the investigation of the legal, regulatory and tax implications of the Transaction from a city perspective. In summary, Dorsey & Whitney has concluded, that if properly structured, including certain approvals at the State and Federal level, a Transaction as contemplated could be executed.

Allco is now prepared to commence the next phase of the process. Upon acceptance of this Letter of Agreement, Allco will begin the process of arranging the Transaction, with the goal of delivering a Transaction with acceptable terms and conditions to the city.

The city's ultimate decision as to whether to enter into a Transaction arranged by Allco is specifically contingent upon: 1) Allco delivering to the city a Transaction with terms and conditions deemed appropriate and acceptable to the city; 2) the negotiation of documentation acceptable to the city; and 3) the receipt of all necessary city approvals.

In its role as arranger of the Transaction, Allco shall, at its sole expense:

1. Engage expert appraisers to establish a fair market valuation of the Assets.

2. Engage engineering experts as necessary to perform due diligence tasks and support.

3. Pay the cost of "nationally recognized bond counsel " (hereinafter "Joint City Bond Counsel"), retained by participating cities to lead negotiations on behalf of participating cities. The Joint City Bond Counsel will represent the participating cities and report to

the cities' Utility Directors, Finance Officers, and City Attorneys. The role of the Joint City Bond Counsel will include the responsibility to review and comment on, and assist in the negotiation of, the Transaction documentation; provide general guidance to the cities as to the impact of the Transaction on outstanding tax-exempt bonds and flexibility to issue new bonds, and advise as to compliance with Minnesota law authorizing the execution and delivery of the Transaction documents.

It is acknowledged that Allco agrees to underwrite the expenses associated with the Joint City Bond Counsel (whether or not a Transaction is consummated), provided that the Participants each agree work exclusively with Allco, and participate with other cities contemplated in the Transaction, in the selection of no more than four acceptable bond counsel firms provided that the bond counsel firms agree to work cooperatively and in an effort to minimize redundant expenses. Allco, after consultation with the LMC, shall have the exclusive right to determine that any bond counsel is not working cooperatively and in an effort to minimize expenses and, accordingly, Allco may discontinue compensation, in whole or in part, of such bond counsel firm's future fees. Allco's financial responsibility for said legal expenses will not extend beyond payment of fees of the Joint City Bond Counsel related specifically to the Transaction.

4. Reimburse the city for the reasonable costs, with respect to the Transaction, of the city's outside city attorney, if any, whether or not a Transaction is consummated. The city will provide Allco with a billing statement on a monthly basis. Allco, upon receipt of the billing statement, will send payment to the city within thirty (30) days.

5. Assist the city in identifying the potential benefits of the Transaction.

6. Assist the city in structuring the Transaction.

7. Prepare offering materials, and market the Transaction to the investment community.

8. Solicit interest from equity investors to participate in the proposed Transaction and inform city of the status of the solicitation on a periodic basis.

9. Assist in the preparation of all Transaction documents.

10. Assist in the closing and funding of the Transaction.

Once all the cities participating in a Transaction have executed this Letter of Agreement, Allco will make a good faith effort to have the appraisal process completed within six (6) months. Upon completion of the appraisal process, Allco will immediately thereafter market the Transaction to the equity investor community. Once bids have been submitted, Allco will immediately thereafter commence with the Transaction documentation. All Transaction costs will be paid either by Allco or by the equity investor and such costs will be disclosed to both the city and the LMC.

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In consideration of the services cited above, the city grants Allco the exclusive right to arrange a Transaction for the city's Assets for a period of twenty-four (24) consecutive months commencing on the date of acceptance and agreement of this letter, or until the contemplated Transaction has closed.

If one party to this Letter of Agreement fails to meet its obligations, in any material respect, the other party may choose to terminate this Letter of Agreement. It is agreed that upon any such termination, the financial obligations established under this Letter of Agreement shall continue until satisfied in accordance with this Letter of Agreement.

If this proposal is acceptable to you, please sign and return a copy of this letter to us.

If you have any questions, please do not hesitate to call.

Sincerely,
ALLCO FINANCE CORPORATION

By:_____
Its _____

ACCEPTED BY:

City of _____, Minnesota

Date _____, 2003

By: _____
Its Mayor

By: _____
Its City [Administrator] [Manager]

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Neumann, Gary

From: Frazell, Kevin [KFrazell@LMNC.ORG]

Sent: Thursday, August 21, 2003 4:01 PM

To: 'DHahn@ci.plymouth.mn.us'; 'tom.hansen@ci.burnsville.mn.us'; 'jimm@ci.owatonna.mn.us'; 'DianeD@ci.brooklyn-park.mn.us'; 'JBodway@cityhall.luminet.net'; Winson, Mark; 'skotchevar@edenprairie.org'; 'bderus@ci.st-michael.mn.us'; 'dlarson@cfalls.net'; 'FChristiansen@ci.maple-grove.mn.us'; 'leconomy@ci.bloomington.mn.us'; 'michael.redlinger@ci.moorhead.mn.us'; 'legg@ci.coon-rapids.mn.us'; Neumann, Gary; 'gvanoverbeke@cityofeagan.com'; 'tdankert@ci.austin.mn.us'; 'jnorman@ci.stcloud.mn.us'; 'tberg@ci.faribault.mn.us'; 'todd.hurley@ci.stpaul.mn.us'

Cc: 'hedtke.andrea@dorseylaw.com'; 'sscofield@svtv.com'; Miller, Jim; Grundhoefer, Tom; Frazell, Kevin

Subject: LMC Board Action on Allco Leaseback

At it's meeting today, the LMC unanimously passed the following motion:

"A motion to conceptually approve an agreement with Allco Ventures, and to authorize retention of Public Financial Advisors to assist LMC in negotiating that agreement and structuring the transaction, both subject to Executive Committee approval."

Since our last correspondence, LMC has been in contact with the public finance consulting firm of Public Finance Management (PFM), which used to be Evenson-Dodge. Wayne Burgraff, their local contact, put us in contact with Alex Burnett of their San Francisco office. Alex has expertise in leveraged leasing, and addressed our Board of Directors via conference call. We were impressed by Alex's knowledge, and are retaining PFM to help us put together the best possible arrangement for participating cities.

We expect that all of the documents, including the final letter of agreement between individual cities and Allco should be ready within the next two weeks. In the meantime, those of you who are interested in moving forward should probably be scheduling discussions with your city council. The final documents will be e-mailed to you when they are prepared.

We will keep you updated via e-mail. If we have not yet heard from your city as to whether you plan to proceed, we would appreciate getting a return e-mail as soon as possible. Also let us know if you need Allco or LMC representation at any staff or council meetings.

A couple of cities have contacted LMC to say they will not be participating in the initial pilot project, but would likely be interested in future transactions. From what we are hearing from PFM and other sources, the market capacity to absorb these transactions is limited so if you wait, there is some real possibility that there might not be another offering for some time.

Below is the language Jay Lindgren of Dorsey-Whitney promised on the issue of allowability under IRS code and regulation:

Internal Revenue Code discussion

In completing a lease/leaseback transaction the equity investors rely upon high level legal opinions from their tax counsel (typically, large law firms with a number of practitioners who specialize in leasing) to the effect that the transaction as structured complies with current federal tax law. The lawyers analyzing the transactions are in turn relying upon many years of developed case law, IRS

regulations and rulings on leasing, as well as certain key sections of the internal revenue code, including section 168 (governing, among other things, the depreciation available to the investors) and section 467 (governing, among other things, how the rentals in the lease are structured) and the case law, regulations and rulings that have evolved around those sections. The means that the investor and its counsel must go through a very complicated tax analysis that draws on various aspects of a large body of law that has developed over time. The result, not surprisingly, is that each investor in the marketplace has its own particular twists on how it structures its transactions. From the point of view of the asset user, luckily, the risk that the structure does or does not comply with the federal tax law, and thus the risk that the investor will get the benefits it anticipates from the transaction, is borne by the investor.

Kevin Frazell
Director of Member Services
League of Minnesota Cities
145 University Ave. W.
St. Paul, MN 55103
651-281-1215
651-281-1296 (fax)
kfrazell@lmnc.org

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Neumann, Gary

From: Frazell, Kevin [KFrazell@LMNC.ORG]
Sent: Monday, August 25, 2003 9:59 AM
To: Neumann, Gary
Subject: RE: Your Response on the Allco Lease/Leaseback

Great! When would be a good time for me to give you a call.

Kevin

-----Original Message-----
From: Neumann, Gary [mailto:gneumann@ci.rochester.mn.us]
Sent: Sunday, August 24, 2003 10:18 AM
To: Frazell, Kevin
Subject: RE: Your Response on the Allco Lease/Leaseback

Kevin,

Rochester is very interested on a preliminary basis. Sometime the week of the 25th I would like to talk to you about having the Allco rep attend a meeting in Rochester with the Mayor, City Council President, City Administrator, Finance Director and myself.

Thanks Gary

-----Original Message-----
From: Frazell, Kevin [mailto:KFrazell@LMNC.ORG]
Sent: Wednesday, August 20, 2003 3:55 PM
To: 'tom.hansen@ci.burnsville.mn.us'; 'dlarson@cfalls.net'; 'legg@ci.coon-rapids.mn.us'; 'gvanoverbeke@cityofeagan.com'; Neumann, Gary; 'todd.hurley@ci.stpaul.mn.us'
Subject: Your Response on the Allco Lease/Leaseback
Importance: High

We haven't yet heard from the six of you regarding your continuing interest in the Allco program. The LMC Board meets at 11:30 Thursday, and it would be great to be able to let them know how many cities want to keep moving forward. For you convenience, I've reprinted another copy of my e-mail of last Thursday below.

Please send a Reply e-mail at your earliest convevience.

Thanks,

Kevin

August 14 E-mail:

Thanks, once again, for your interest in the LMC/Allco lease/leaseback proposal. We hope many of your questions were answered at the August 13th meeting.

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The purpose of this e-mail is to:

- **determine which cities intend to present the proposal, including the Letter of Understanding, to their governing bodies for consideration;**
- **provide the information you will need for that presentation; and**
- **find out which cities would like a representative of Allco and/or LMC to be present at the council meeting.**

I am attaching several pieces of information regarding the Allco proposal. Much of this is material you have already received, but this will provide you with an electronic copy you can easily use to produce council information.

The attachments are:

- The PowerPoint presentation Scott Scofield used both for the July 30 Webex conference and the August 13th meeting.
- The letter from EPA Region 8 office to the State of South Dakota concerning certain aspects of that program.
- Most importantly, the Letter of Understanding with Allco that your city would be asked to approve in order to continue pursuing a possible transaction.

<<Allco Tansaction Presentation (SS).PPT>> <<EPA response Jul-03.pdf>>
<<Sample letter of agreement with ALLCO.doc>>

EPA Region 8 Letter to South Dakota

The EPA letters are complex and confusing! The "bottom line" in the Region 8 EPA response, however, is that the lease/leaseback arrangement would not preclude participating cities from receiving federal grant funds (provided they continue to hold fee title to the facility), the segmentation of federal grant funds from tax-exempt bond funds by the South Dakota SRF program is acceptable, and that permitting and NPDES compliance requirements will continue to be primarily the responsibilities of the cities. Minnesota is NOT in Region 8, but this gives some indication of how EPA views the issue.

IRS Code Citation

Some of you asked for the IRS Code citations that would support the lease/leaseback program. Jay Lindgren of Dorsey and Whitney will be providing that next week and we'll send it to you with the follow up e-mail (see below) following the LMC Board meeting.

Conversation with Finance Commissioner Dan McElroy

LMC staff members Jim Miller, Kevin Frazell, and Tom Grundhoeffer, along with Dave Kennedy of Kennedy and Graven met with Commissioner McElroy on Thursday, August 14th, to explain the lease/leaseback concept. Our purpose was merely educational and to solicit his feedback.

The meeting was quite cordial. Commissioner McElroy was already familiar with the concept of lease/leaseback from a proposal that was made to the State during his time as a legislator. While he shared the same concern as many others about tax deduction benefits and the cost to the federal treasury, he didn't raise any

immediate issues from the State standpoint. He committed that he would have the staff at Finance and Revenue take a further look for any concerns. We told him candidly that the participating cities are concerned that there not be a negative backlash from State officials. His advice was that it be carefully cast as one time money that cities can use for particular projects and purposes, and that they (cities) are still working creatively to control city costs in the face of revenue shortfalls.

ACTION REQUIRED

The LMC Board will be considering whether to enter an agreement with Allco at its meeting this coming Thursday, August 21st. It would be very helpful to the Board to know how many cities would like to move forward.

PLEASE SEND A REPLY E-MAIL to me by Wednesday, August 20th, indicating:

1. **Whether your city would like to continue pursuing the program;**
2. **When your council will be considering the matter;**
3. **Who you would like to attend that council meeting - i.e. Allco, LMC staff.**

We look forward to getting your response.

After Thursday's LMC Board meeting we will send a follow up e-mail confirming their action. If the Board approves the agreement with Allco, we will also send a letter, signed by Jim Miller, that indicates LMC's participation in the program.

Give me a call if you have any questions or concerns.

Kevin

Kevin Frazell
Director of Member Services
League of Minnesota Cities
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St. Paul, MN 55103
651-281-1215
651-281-1296 (fax)
kfrazell@lmnc.org

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