WEBINAR TRANSCRIPT

Legal Foundations and Strategic Structuring of Lease Financing
Part 2: *Risks, Realities, and Market Preferences of Lease Financing Decisions*

May 21, 2026 | 10:00 – 11:30 AM

The second session of this two-part series will focus on understanding the business and financing decisions agencies face in lease transactions, especially the features that may have been perceived as investor requirements that may no longer be so. Speakers will examine why these certain decisions, previously considered non-negotiable, may, in fact, not be as essential as previously thought, such as insurance requirements, asset selection, and remedies. Through practical insights and expert guidance, this session will help public agencies to make informed financing decisions when navigating their lease financings.

Editor's Note: This transcript has been prepared by the California Debt and Investment Advisory Commission (CDIAC) and it believes it to be a fair and accurate reproduction of the comments of the speakers. Any errors are those of CDIAC and not the speakers.

Slide 1 – Legal Foundations and Strategic Structuring of Lease Financing 00:00:00

ROBERT BERRY: Good morning, everyone. Welcome to the second session of our webinar series on the *Legal Foundations and Strategic Structuring of Lease Financing* produced by the California Debt and Investment Advisory Commission. Again, I'm Robert Berry, the Executive Director here at CDIAC. In today's session, our intention is to explore the risks, realities, and market preferences of lease financing decisions. You remember in our last session we enjoyed a tour through the history of leasings and built an understanding of how present-day lease financing has developed as a very important and consistently utilized public finance tool in California. We learned about the Supreme Court cases that ensconce the legal principles that formed the foundation of what we called the legal construct, or a legally valid exception, to the constitutional debt limit in California.

And our faculty explained how development and maintenance of the lease construct requires the inclusion of certain compulsory structural elements. But even in the discussion of compulsory elements, like fair rental value and abatement, we learned there's unsettled aspects and that conventions may guide financing decisions when the strict guidance of the law departs.

What our presenters conducted in session one was in effect the process of categorizing the structural elements of financing leases into those that are legally required and those that result from business decisions where the issuer has levels of discretion. In doing so, we're now in the position, in this session, to explore more deeply those discretionary elements and the various implications of different courses of action. So we're set up for a very interesting discussion that will challenge conventions born of our collective assumptions of what rating agencies and investors want to see and that age-old excuse of "well, we've always done it that way." This will not be a didactic session, but rather a Q&A discussion type program where our presenters will provide the benefit of their deep experience in lease financing to answer many of those questions that we didn't even know to ask. At the conclusion of this session, we hope to give you the confidence to challenge conventions and explore your options more fully to improve the overall value of your next lease financing transaction. So, before I introduce our faculty team, I need to again cover the standard webinar housekeeping items.

Slide 2 – Housekeeping 0:02:20

ROBERT BERRY: So again, the slides for this session and last session and links to our lease financing content series are posted to the event page on the CDIAC website. You can get that from our front page on our website or the link listed on the screen. Questions are submitted through Slido, again, on the Q& A tab. If you do not see the Slido app come up on your screen, there is a link in the chat that will allow you to access Q&A. So we're really hopeful that you will take part in this discussion by submitting questions anytime during the program. We'll also have a couple of polls today during the program, so use the polls tab in the Slido app to submit your responses to the poll questions as they appear.

If you'd like captioning, there's a captioning button in the lower left of the screen. If you participate in 70% of the webinar, we will send you a certificate of attendance. We'll also make a full replay available in our Education Portal in a couple of weeks. And then if you are having any technical problems, visit the link on the screen to Webex to solve some of those technical issues.

Slide 3 – Speaker Introductions 0:03:26

ROBERT BERRY: Now I will welcome and introduce our four distinguished faculty presenters for today's session. Each of these folks have been a longtime supporter of CDIAC, veterans of numerous educational programs for CDIAC, and contributors to our publications, and so we're really lucky to have them all with us here today. First, we have Margaret Backstrom, Managing Director and Co-head of Public Sector Banking for Morgan Stanley's Public Finance Department based in San Francisco with over 27 years of experience. As a public finance investment banker, Margaret is a recognized expert in a wide variety of bond structures and credits, having senior-managed more than $40 billion in financings for many of the largest public sector issuers in the western US. Also joining us is Melissa Shick, Municipal advisor at KNN Public Finance. Melissa's expertise has been built from 20 years of combined public sector, public finance investment banking, and municipal advisory experience. With KNN, Melissa advises a diverse mix of agencies across the public sector and is experienced in structuring and leading financing for various credit types including lease revenue bonds. Next, we welcome Anna Van Degna, Public Finance Director for the City and County of San Francisco. In her role, Anna oversees the issuance of all new debts secured by property taxes and general fund sources, initiates the City's debt policies and procedures, and provides technical expertise for the preparation and monitoring of the City's ten-year capital plan. Then returning as our moderator today is Dan Deaton, Partner with Nixon Peabody. Dan is in the public finance group of Nixon Peabody where he represents governmental agencies, nonprofits, underwriters, and others as disclosure and underwriters counsel in a wide variety of public finance transactions. So, Dan will get us started with a review of what we covered in session one. Dan?

Slide 4 – Summary And Discussion 0:05:23

DANIEL DEATON: Yeah, good morning, everybody, and thank you for joining us today. For folks who were not on the webinar or who were and now cannot remember what we talked about, about a week ago, Tuesday, David Brodsly, KNN, Melissa's colleague, John Palmer of Orrick, and I had a good conversation about the various legal parameters that we live in in terms of lease revenue bond financings and the lease exception itself under the California Constitution and how the Supreme Court has crafted that. And we discussed the evolution of that and how we basically have a Supreme Court-crafted, policy-crafted space for us to do our lease revenue bond deals and our lease deals that allows us to not worry about whether or not a city or a county or a school district or the state is violating the debt limit. And that lease exception, broadly stated as we talked about last time, requires there to be a leased asset that has what the courts referred to as fair rental value, and also ensures that there are provisions in the lease that ensure that if the use and occupancy of that asset is interfered with and that cannot be used, that rent on that is abated.

What we also talked a lot about last time is the evolution of this over time and how from the issuer's perspective, this moved from a very new thing, and trying to figure out how to kind of create something that hadn't been created before. And that particularly in the aftermath of Proposition 13, how this proliferated, and then after *Rider v. City of San Diego* really trying to make sense as to what the structure of this should look like from a legal perspective. But today what we want do is move to the other side of the lines where lawyers can't go, where lawyers can inform, lawyers can identify the issues, lawyers can share their experience, but in the end, today we want to talk about what's not legal. And what we mean by that is what are the financial decisions and the financial positions that local agencies need to be thinking through as they do lease revenue bond financings, COP financings that are based on the lease revenue exception, or even leases that they might enter into in one form or another. And I think that what we talked about last week was how we have this legal space that we have, but that what really has developed over the last call it 20 years has been change within the markets as to how these transactions are being affected within the market, number one. Learning, for example, the bankruptcy treatment of how this would work from the Stockton bankruptcy and what to be evaluating for that. And then at the end, really trying to sort of say, where do we as an industry stand today in terms of what are the right points of flexibility for local agencies that will still end up with appropriate market acceptance, getting deals done at the price levels that we want them to be done? How do we look at our lease assets in that regard; how do rating agencies and investors look at these products; and how do we understand the risks that we might encounter as we manage and maintain these programs and so on. And so, for that we have the group of folks that we have on today to discuss these issues. Trista, if you go to the next slide.

Slide 5 – What Are Some of the Challenges Issuers Face in Getting a Lease Financing Deal Done? 0:09:30

DANIEL DEATON: The first question that we really want to grapple with for a while, and this might be the longest question that we talk about today, which is what are some of the challenges that issuers face in getting a lease financing deal done? And for that, Trista, do we want to go to our first polling question?

Slide 6 – Polling Question #1 0:09:46

DANIEL DEATON: It's interesting that, and I think I would have to say, that this actually falls not that far off of what our preparations with what we were discussing in terms of what we were anecdotally experiencing ourselves. So it's an interesting ranking that the polling gives there. So Trista, if you go back to the last slide that would be great.

Slide 5 – What Are Some of the Challenges Issuers Face in Getting a Lease Financing Deal Done? 0:11:00

DANIEL DEATON: So let me let me start off with Melissa on this question in terms of leased assets. Melissa, could you just generally describe what are you encountering in terms of issuers, how often are they running into challenges getting enough assets to do their deals? What do they do when they face constrained assets when they do encounter those problems?

MELISSA SHICK: Yeah, thanks Dan. Yeah, I think that is certainly the biggest challenge as we think about lease financings. For the smaller agencies, they simply may just be asset constrained given the size of their organization and having less assets within a smaller city or smaller population. Whereas some of the larger issuers that we work with who have really active lease financing programs, they may have broad and diverse asset base and facility base, but it's a matter of many of those assets may already be encumbered on an existing frequent program. We typically work with our clients reviewing a list of assets within a city's, county's, or other governmental agency's portfolio determine which assets are encumbered, which assets maybe unencumbered, and then from there can consider things like the age of the asset and the asset life, and its ability to serve as a reasonable basis for a lease property on a transaction. Then we also look at essentiality and all of these topics we'll get into in more detail.

In the absence of asset availability or sufficient value to serve as the lease property on a transaction, we sometimes look to utilizing the project that's being financed through the issuance as an alternative mode for seeking value and having an asset assigned to the transaction. So Dan, I pulled up a number of topics in that response and I know we'll get into each of them in more detail but that's kind of broadly speaking in terms of how we start the asset discussion with our clients.

DANIEL DEATON: Yeah, and let me ask you a question. How often do you find that asset selection ultimately materially changes the financing structure and how often have people encountered, if they look in the next five years, is this going to have a good likelihood of changing financing structures for some issuers? How often does that happen, would you say?

MELISSA SHICK: I would say pretty frequently. First and foremost, in thinking about a transaction, the asset discussion ends up being the first item that we address because that does drive structure, Dan, and as assets existing assets may not be available, that is when a structure may change because we may have to use the project that's being financed which then implies a capitalized interest component on the structure. Some agencies have a master lease structure whereby there's a number of assets that are leased on a transaction which allows for the issuance of additional bonds to leverage the value of that pool of assets. But if, as that pool of assets is becoming more leveraged over time, that may then require an alternative structure. Adding additional assets or issuing under a separate lease structure. So certainly, things change over time. I will say, too, as an agency has a broader capital program and as they use lease revenue bonds to finance facilities and projects, once those facilities are financed and constructed, sometimes we replace or substitute those in on leases, so there tends to be kind of like a lag and a catch up. I know Dan will speak to some of the dynamics around substitution and replacement of assets further in the discussion.

DANIEL DEATON: Yeah, great. And Anna let me turn to you. How have you faced asset selection over time and how has it changed for you? What is it that are the challenges that you feel like you've faced when you have to choose different assets?

ANNA VAN DEGNA: Sure. I think one of the challenges that we face is just looking at the variety of assets that the City has and what the investors may deem as essential or non-essential, and also the rating agencies. So, I think essentiality is definitely a factor when we select our leased assets. We'll look at potentially what are the costs, costs are always a factor. But we've had a situation whereby for one particular lease revenue bond, the cost of property insurance was increasing over 20% per year for multiple years and it was just getting, for a very small transaction, to be a very high portion of the overall, not just base rental, but plus additional rental, very high. And so that was a situation in which we worked with our risk management division and our library department where we kind of went through the substitution process. The other times that we will maybe look to change leased assets is if we're embarking on a refinancing and it might be a refinancing of an asset that was a standalone two-tier lease revenue bond and we may look to bring that into our master lease, which, sometimes if we're looking at essentiality or thinking about essentiality, we can bring a less essential asset into a master lease and that might be another kind of choice in our structuring and choosing leased assets.

DANIEL DEATON: From your perspective, following the polling question, I think you just listed four out of five of the challenges as ones that you regularly are encountering as you have to make those decisions. How does playing the chess board down work for you as well? In other words, don't you have to look over some future period, understand the financing needs over that period, and be moving the assets around in a way that makes sure that you don't get boxed in in one form or another?

ANNA VAN DEGNA: Yes, so there's a list of leased assets along with our valuations that the real estate department maintains and we monitor and we're constantly looking at our future new money needs and looking to ensure that we've got proper lead time if we do want to bring one of those assets into the portfolio or if we know of certain transaction sizes that might be coming up in a year or two years, we'll look at that list of leased assets and think about the priorities of what to choose. We're lucky right now that we have a lot of leased assets to choose. The City might not always be in that situation.

DANIEL DEATON: Okay, great. And, Margaret let me turn it to you; what advice do you have for local agencies about how to look at leased assets from an investor's perspective and how is the investor perspective changed over time on this as best you can kind of describe it?

MARGARET BACKSTROM: Yeah, thanks. I would say that there are clearly a large variety of different types of leased assets that have been used by issuers in California. Everything from city hall to libraries, parks, undeveloped land, streets, convention centers. There is a precedent for a large variety. Investors do tend to look at the essentiality, and I actually think that the August 2025 CDIAC report that kind of gives this spectrum of different assets and their essentiality is pretty good in terms of what investors prefer and investors preferring things on the more essential side of that. Although I would say, and I know we're going to get into some of this conversation later, I would say that some of the assets that may be deemed less essential, like a park or undeveloped land or a corporate yard or something like that, may be less at risk for abatement and may have a lower insurance cost to them. So, I do think it's important for each issuer to look at the available assets and have a conversation with their municipal advisor and their underwriter and their attorneys and figure out what makes the most sense given that there are kind of pushes and pulls. An investor may want city hall, but if city hall is too expensive in terms of insurance, then it may make more sense to come together and bring some other assets into the mix, despite an investor preference.

DANIEL DEATON: Okay, great. And one last question in terms of this line of questioning. Melissa, we were talking about how to pick the leased asset with the financial objectives that are engaged but how are some ways that involving an asset into a deal can actually impact the operations of the government. In other words, what they do on an everyday basis, and I think an important consideration, how does this affect how they live their lives?

MELISSA SHICK: Yeah, I think that's a good question and sometimes that's not entirely apparent at issuance when we're putting the deal together. Remember, we're choosing a leased property at the time of issuance and the security structure. We issue 30-year bonds or 20-year bonds for longer-term capital projects. Ten years, twenty years down the road, the asset that we may have leased to the transaction may be needed for other purposes. I think as we think about the consideration of leasing an asset on a transaction, really looking at flexibility around the release and substitution of that asset is just super important. I have one client that I'm currently working on a release of an asset that had previously been leased to one of their lease revenue bond series, and that asset is part of a broader kind of campus redevelopment and a relook at a master plan of their facilities and ultimately that asset is going to be demolished and destructed for broader facility plans of this agency. They will have to release the asset and substitute it with another asset because they need it for other purposes. We've talked about this previously, but at the start of a transaction, I do think it's worthwhile to raise the question, is it appropriate to lease city hall? And do we need this for other purposes? And we'll get to relet and the discussion there, but I know Dan, you and I have had this discussion before with a mutual client. Assets at the start, knowing and understanding that it's a 30-year lease and we don't know what may come up over time, there is just the fundamental question at the start. Is this the asset that I want to encumber at this particular time? And is it a reasonable asset to do so? Sometimes the more essential the asset, the less flexible operationally that is for a city or a county – actually probably most times.

DANIEL DEATON: Yeah, and by the way, those are very awkward internal conversations that I've had before. If you include an asset into a lease revenue bond, you're not allowed to demolish it. And those have been awkward conversations. It is a rule. It's pretty important that you don't destroy the building. Anna, let me just kind of pick up on that a little bit. What from your perspective are assets that are just policy-wise off limit? I'm curious about how tone deaf is the municipal bond market about that. I think that's a key question. How tone deaf from, well, if there's no right of relet and if there's other types of deals, why does it matter if we lease the crown jewels of the city? What's off limits and how tone deaf are we as an industry about it?

ANNA VAN DEGNA: I started at the city eight years ago, and I remember when I started people mentioning to me "we don't talk about using city hall as a leased asset." I can't imagine going to the Mayor, the Board of Supervisors and suggesting a place where we come to work every day and that's just such an iconic part of San Francisco so certainly I think there's certain assets that are kind of just off the list unless maybe they really need to be for some reason.

DANIEL DEATON: I think it's important to keep in mind that, at the end of the day, it's the issuer itself that has to defend that. Meaning that one of the biggest problems that we can encounter as a municipal securities industry is that we can let the tail wag the dog and that, in the end, we're trying to get the best financing that we can for cities and counties, but we need to remember that cities and counties don't exist to do financing. They exist for their general welfare, the purposes that they're doing, and when that crosses that policy line, it needs to be the issuer that stands up and says, "this is essential to our mission and this facility is essential to our mission, and this is a line we cannot cross," or very extraordinary things need to be in that sense.

Margie, let me ask you about when you have assets that are uniquely exposed to earthquake risks, flood risk, or wildfire risks. There's been a lot of recent stuff over the last couple of years on this, as we've dealt with. How do you look at assets? How should local agencies look at assets that are exposed to these unique kinds of risks as they approach the investment community?

MARGARET BACKSTROM: We have been, as Californians, impacted by this over the years and investors' questions in my experience tend to vary a lot with the news cycle. In the last year, we've gotten more and more questions about wildfire risk than in my previous experience. Investors are very focused on these types of risks and what they might be exposed to. I think for the issuers, I think the important things are disclosing as much information as you can about the asset. Is it in a floodplain? What are some of the hardening measures that have been taken with respect to the asset? Because investors may ask those questions and obviously if it's not in your disclosure, then we can't communicate that information to them. But it also brings up, and I know we're going to talk a lot about insurance later, is what are the insurance requirements on that asset? I'm not aware of any, there might be one or two, but any clients who have earthquake insurance just given the cost of it. It's not a reasonable cost, so for an issuer to agree to provide. And so, it's finding that balance, explaining what the risks are to investors, what information you're aware of, but then also finding that balance with the insurance and the mitigating factors, I would say.

DANIEL DEATON: And how often have you experienced it where you felt like that risk actually led to a more expensive financing for the issuer? How often do you find that to occur?

MARGARET BACKSTROM: Yeah, that's a great question. It's hard to quantify because there may be investors that decide, for example, we were hearing that certain investors don't participate in lease financings after some high profile bankruptcies ten to fifteen years ago because those investors may have spent a lot of money in legal fees trying to fight it out to get paid on those lease revenue bonds. We are also finding that certain investors decided that they were not going to make any investments in lease revenue bonds in the entire Los Angeles basin. So, an eight-county or five-county area that they were just not comfortable. A lot of the times you're dealing with investors who are based not in these areas and so what they're exposed to is the news cycle. It's our job as underwriters to educate investors and let them know all the mitigating factors, all the insurance that our clients carry, and get them the best price available. We have very successful transactions, but does an investor deciding not to participate impact the cost? Well, probably not, but it's hard to say.

DANIEL DEATON: It sounds like most of your counsel with your experience would be don't necessarily exclude those assets but be prepared from a disclosure perspective and from an agreement perspective to be effective at answering those questions as opposed to excluding the asset themselves. Is that fair?

MARGARET BACKSTROM: Yes, I think that's absolutely fair.

DANIEL DEATON: Good. Anna, let me turn to you in terms of the next question that we have, which is the valuations. Can you describe how the City and County of San Francisco goes about coming up with its evaluation of fair rental value?

ANNA VAN DEGNA: Sure. For us in the Office of Public Finance, we work with the Director of Property in the Real Estate Division, so under the City's admin code, the Director of Property is responsible for determining the value of the City's assets. The Director may choose to work with a team in house or potentially outsource the work and work with a 3rd party appraiser. I've seen both since I've been here, but probably more frequently working with their own team of experts.

DANIEL DEATON: Let me ask you also a question, Anna. What are some challenges that you encounter by going about it in that way? In other words, what are some frustrations that you have in the process that you follow in that regard?

ANNA VAN DEGNA: I mean just generally, working in city government, you just want to make sure whoever you're working with has enough lead time to perform the work. We like to give folks as much advance notice as possible, whether we're working with our Risk Management Division or Real Estate Division or other departments in the city. Just making sure folks have enough lead time to do the work and think about it.

DANIEL DEATON: So it's a fair comment to say that, in your experience, the challenge that you have with valuations is not pondering the great metaphysical question about what the value is, but actually just doing the wood chopping of making sure that you have enough advanced notice to people so they can do the work that they need to do so you don't run into a problem with your financing schedule. Is that a fair way of putting it?

ANNA VAN DEGNA: Yes, and that’s why I mentioned just having the list of leased assets that we're periodically reviewing when we're planning for a future issuance.

DANIEL DEATON: Yeah, and that's consistent with my experience that for as much as people want to talk about the great metaphysical question, 90% of the time it comes down to just logistics. It really doesn't come down to some complex question. Melissa, how do other people approach valuations?

MELISSA SHICK: I'll say KNN has the benefit to work with the City and County of San Francisco and their approach is the super gold standard, but that's not always the case. This city's a large agency and with some of the smaller agencies we work with where they simply just don't have the resources of a broad real estate department.

Sometimes the path is reaching out to appraisers and getting a 3rd party opinion on valuations, but then some is just done in house in terms of being reliant on insured values, at what level they're insured at, and looking at valuations. We look at not only the value of the actual facility, but also the underlying land in which the facility is on. In that capacity, there can be different approaches to valuing the land, which is done either in house kind of a cost per square foot type of approach or looking at market comps in terms of the land value, but that also can be picked up in the 3rd party appraisals.

DANIEL DEATON: Great, and how often do you run into assets that are so unique and so weird that it's really hard to value them? How often do you run into that?

MELISSA SHICK: I would say maybe not as frequent, Dan, and maybe some of that would get chopped at Anna's level and working with your internal real estate department, but we do try in selecting assets to the extent there is a kind of a pool of available assets. We do try to kind of leverage the more straightforward assets, right? But even I'm thinking like a maintenance yard, right? The facilities or the buildings there may simply just not produce a lot of value, but the underlying land is what ends up really driving the value on the asset. So it could be tilted one way or another depending on the type of asset you're looking at.

DANIEL DEATON: Okay, great. Margie, what's the investor view on any of this? Like as a banker, what's your experience with these questions and what should issuers be thinking about from your perspective about valuation? How do you value these lease assets?

MARGARET BACKSTROM: Yeah, I would say investors don't focus a lot on the actual value. They rely on the fact that the law requires fair rental value in excess of the lease payment. My experience is that we don't get a lot of questions on actual valuations. We get more questions on what we've already discussed, which is essentiality and the risk profile of any given asset.

MELISSA SHICK: Dan, can we jump in? I think that's a super interesting point and I know, Dan, we've discussed this recently on issuer disclosure. And we do all the background work on valuation from a legal perspective, right? But as we think about issuer disclosure, at what point is the value that has been determined that of something that we should be disclosing to the market? I know you have an opinion on that.

DANIEL DEATON: Yeah, and I think putting the legal dimension of that to the side for this panel for a little bit because at some point you could have that. But let me redirect that to Margie and ask that question to her. When do investors want to see the value in the disclosure? In other words, we talked about the situation of master leases and other things. What disclosure considerations should they be thinking about as they think about that from an investor's perspective?

MARGARET BACKSTROM: Yeah, that's a great question. I mean, I've seen a variety of approaches, and I think that there are a lot of different ways that issuers have taken that and have approached it and have been accepted by the market. Again, in my experience working on these, I don't get a lot of questions about, this issuer decided not to disclose the detailed breakdown of value among the master lease components and I want that. That's not a question that I've ever received.

DANIEL DEATON: And if you did have assets that were exposed to wildfire risk or to flood risk or if we were disclosing that, that might be actually something that would be more important in those situations because you may receive the questions, but if you ended up with unique assets and people trying to figure out how big of this is, are these assets that are risky.

MARGARET BACKSTROM: Absolutely, absolutely. Yeah.

DANIEL DEATON: Okay, let us deal with two issues pretty quickly. We're almost done with this this topic, but I want to talk about title insurance and right to relet real quickly. Anna, could you just walk through the City's approach to dealing with title insurance on these transactions?

ANNA VAN DEGNA: For title insurance, typically that is a process that is initiated by our bond counsel. So as early on as we can in the process, bond counsel is going to engage with the title company so they can begin their work. We'll request a preliminary title report, which would then be reviewed with the City Attorney's Office and may involve us as well. Again, just wanting to make sure we have enough lead time if there's things that are unexpected that pop up that maybe we weren't aware of or things that we need to address. I think that's largely our process handled by bond counsel, whereas other things we may do in house.

DANIEL DEATON: Okay, great. Anna and Melissa: how expensive is title insurance in your experience?

MELISSA SHICK: Title insurance is an upfront cost of issuance, so it's due at closing, and it's typically driven as a percentage of the par amount of the issue. For smaller transactions, maybe that fee is more acceptable, but as you start thinking about larger transactions, larger issuances, it can be a meaningful component of the cost of issuance. I think you know some of the larger cities that we've worked with, the fee is kind of in and around 0.05% of par so that gets for a $10 million dollar transaction that's $5,000. But for a hundred-million-dollar transaction, that's $50,000 and it keeps going up. Dan, it can be a meaningful piece of cost of issuance, particularly for larger transactions.

DANIEL DEATON: Margie, do we even need to get title insurance? I know that this was a point that John Palmer and I asked. What if we just didn't get it? What would happen?

MARGARET BACKSTROM: That is a great question because, and I think you guys talked about this in your last session, but a lot of the municipal market is based on precedent. If every issuer is getting title insurance on every COP and every lease revenue bond, and you're the one who decides this time you're not going to get it, you're the issuer. I don't know what an investor is going to tell you. I do know that if you ask investors, are you ok? Would you buy this first lease revenue bond without title insurance? They're probably going to tell you no because their incentive is to get you to buy title insurance because it has some, even if it's marginal, level of protection for them. When they're not faced with an actual bond with actually no title insurance, you’re not putting their feet to the fire in terms of having to make an actual decision. It's a great question and I would say, if an issuer were to go without title insurance on a transaction, the key would be to disclose what you did instead of getting title insurance. There was research done by bond counsel or by the City Attorney or whoever the appropriate party is to do that research and determined that the title was clean. I'm not the right person for the terminology, but to determine that this is what we found out and these are the steps we took. The market has evolved on many other things. The markets evolved on reserve funds, which used to be absolutely on almost every lease revenue bond transaction and you can see that in some of the big master lease programs where they still have that debt service reserve fund and evolved away from that. So can it evolve away from title insurance, is a great question.

DANIEL DEATON: Yeah, and just to point out that with respect to title insurance, you would have to figure out how your due diligence, the title situation, so that you weren't running into some known major issue. I think that everybody would consider the due diligence component there. I don't quite know how you would do that and there may be ways of doing that we haven't followed, but it is an interesting thing that every single lease revenue bond deal has title insurance, and we don't know if investors would even impose any sort of penalty if it were gone. It's an interesting area. That doesn't mean we should stop doing it, but it is an interesting area of question. Particularly on various deals, is this expense to pay basically for due diligence in an unknown factor in the market worth it kind of thing. I think it's not something to suggest that we change it, but it's a good point to show that we are, to a certain extent, just doing it on every deal without asking the question. Sometimes asking the question is valuable in its own right, even if you keep doing the same thing. Let me move on and stay with you Margie with right of relet. First of all, for folks who are not familiar, what is a right of relet?

MARGARET BACKSTROM: A right of relet is – and Dan, you can correct me if I don't get the legal terms right – but a right of relet is basically if an issuer stopped paying, the trustee would have the right to take possession of the property and lease it to a different party and use that revenue, the money from that, the new party's lease payments, to pay the bond holders.

DANIEL DEATON: Right, and historically most deals had right of relet over time, a lot of them have not. Does an issuer have to agree to a right of relet in their documents?

MARGARET BACKSTROM: Yeah, so this is another area where we've seen a lot of movement away from the right of relet and some of it was issuers. Some of that was based on the assets. I've seen a number of transaction where the leased asset is like the streets of a city and obviously there's no ability for the trustee to take possession and relet those streets to a different party. So some of it's based on the asset. But there are some issuers highly rated, cities and counties in the state, that have just moved away from it. We disclose that to investors. We would need to ask them whether they thought that under any particular transaction whether there was any kind of penalty, but I think the market has now accepted that a right of relet is not required in a lease revenue bond transaction. Now, if it was a much lower rated entity, then that's still a certain type of asset that had a high value in terms of right of relet or an easier right of relet, not city hall, but now we're not a jail, right? You're unable to do that for a jail, but for a parking garage, would a right of relet improve your acceptance by the market? So, I think that there's been an evolution away from right of relet overall. But if you're talking about a lower rated issuer or a smaller transaction or a master lease that has – I mean, we're going to get into master leases later – but one of the challenges with a master lease is that you've set up everything at the beginning and the market evolved so that maybe you don't have to have a right of relet, it's baked into your documents.

DANIEL DEATON: Great, and just to make the point that John Palmer made in our last webinar, in the case of the Stockton bankruptcy, the existence of the right of relet meant the City lost the garage during the term of lease. And so right of relet can be significant. We say that the right of relet can't occur with respect to the jail, but the truth is legally we actually don't know what would happen. Could a court interfere with that use and occupancy as a result of that? We just don't know, right? I'm just interested from the local issuer's perspective, and I know city/county does not have the right of relet in its documents, but how would you from an internal perspective evaluate this discussion of should you have a right of relet or should you not in your documents in order to make sure that the investment community has what it needs, but also evaluating it from a local issuer perspective?

ANNA VAN DEGNA: In our more recent financings, we typically do not have the right to relet. In thinking about it, if you've got, let's say, an operational kind of revenue generating asset like a cruise terminal that you know needs to be in a certain place, realistically do you want the trustee coming in and taking that over? Our convention center? I think just you need to think about the business and operational needs. I already brought up city hall just in terms of assets that we would never ever think about that for.

DANIEL DEATON: And this could be, in the right circumstance, an incredibly traumatic event for a local agency. So it is something that I would just emphasize two things. It's a significant question. The decision belongs to the issuer. This is not a legal issue. This is a decision that belongs to the issuer to decide what it believes it should have. Running a little bit behind, so I want to speed this up just a little bit. Melissa, I wondered if you could talk a little bit about alternative structures and we've identified master lease programs, we've talked about them already. We've talked about, in our prep, lease revenue bond commercial paper programs and then project-based leased asset. I'm wondering if you could just talk a little bit about what are these different things and when should folks consider them? Then, hopefully we could get some color commentaries from Anna and Margie as well.

MELISSA SHICK: Starting with master lease programs and the lease revenue bond commercial paper programs, from our experience with our clients, it tends to be that the larger, more frequent issuers of lease revenue debt will be reliant on a master lease structure as well as a lease revenue commercial paper program. That's simply because each of those provide certain level of efficiencies in terms of execution either on the bond side or the project funding side. For example, a commercial paper program has been really valuable for a city and county like San Francisco in that they have very a large project lists and a lot of different types of projects that have different funding needs at different times. So commercial paper allows them to fund projects at different stages on a just-in-time basis. Then when there's been kind of a culmination of project costs, they take out the commercial paper with long term certificates of participation. So again, that just allows San Francisco a lot of flexibility and efficiencies in managing a more dynamic capital funding plan under their lease program. When it comes to the issuance of a long-term bond, there is like a single master lease structure that already has assets leased under the structure that allows for the issuance of additional bonds. So once again, it's not starting from scratch, and there's an existing framework that supports the issue at the long-term issuance of bonds. I think those two alternative structures we work with a lot, but mostly in the context of some of our clients that are larger, more frequent lease revenue bond issuers. For our other clients that have a single project that they finance every five years, a commercial paper program becomes less relevant and a master lease structure may be valuable, or it's just thinking about moving forward with a single lease for that particular project or that particular financing. And then, Dan, that's kind of where we get to a project-based lease asset approach is that, hey, I have this fire station that I need to finance. And by the way, that transaction that we did three years ago used all of our city's assets. What do I do in terms of financing the fire station today? And that's when we start thinking about, well, maybe we need to use the project that we're financing as the leased asset.

DANIEL DEATON: Great, and, Anna, what's your perspective on these different alternative structures?

ANNA VAN DEGNA: Starting with the commercial paper, the lease revenue bond commercial paper program, I've got an incredible team in the Office of Public Finance here that manages the day-to-day needs there. We might have 70 different critical repairs projects with a variety of different departments and there's frequent issuances and lots of tracks, so it's a valuable tool for that just-in-time financing and helps us really be able to plan when it's right to issue long term COPs or if our real estate department wanted to purchase an asset or buy some land, it can also be very useful to have a commercial paper program. For the master lease, we have one that's been around since 2009 that has grown quite large, so that is advantageous in that the market and the rating analysts are familiar with it. If you needed to change or wanted to change covenants, it would be more of an involved process over time. I mentioned earlier that it's been helpful in terms of, if we've got an asset that the market considers to be less essential. For example, the Moscone Convention Center, that was a standalone COP and we recently financed it, brought it into the master lease, and got an upgrade from Moody's related to that component just by doing that. I would say for frequent issuers, I also a lot of times find value in just a standalone non-master lease. We acquired a garage and Golden Gate Park. It, for business reasons, made sense to have that garage be the leased asset. It wouldn’t be something that we bring into the city-wide master lease. We also have a series of COP financings on Treasure Island to fund infrastructure there. You need to have a team of dedicated staff that know how to manage these programs and the liquidity renewals and the insurance, and all that. Finally for the project-based assets, we constructed an office permit center office building at 49 South Van Ness. There was a lot of equity in that building. We were able to use our commercial paper. That was something even though it was still the construction wasn't complete, it made a lot of sense to use that as the leased asset, instead of putting it under our master lease.

DANIEL DEATON: Great, and Margie let me turn to you particularly on the project-based leased asset. When do you think that makes sense for local agencies to consider?

MARGARET BACKSTROM: I would say similar to what Melissa said, it's really if there's not another asset or for some reason you want to isolate the risks associated with that project. So maybe there's some kind of a P3 involved where you're trying to basically put a box around the risks associated with that particular project because you are funding capitalized interest, and there are investors that do get very focused on the types of insurance, and whether the bond holders or COP holders are explicit beneficiaries of different types of insurance policies and that it does increase the cost of doing a project based lease structure. There are times when that's very appropriate given the specifics around a particular asset.

DANIEL DEATON: Okay, great. Trista, actually can we do the second poll question?

Slide 7 – Polling Question #2 1:02:50

DANIEL DEATON: Give this a couple seconds. I would say this is kind of a little bit different than I would have thought. I'm not surprised by the largest being none of the above, but I am surprised by how many have more than one above, which I think is kind of interesting. Okay, great. Now what we're going to do is we're going to move to the next topic, which is rating agencies.

Slide 8 – How Do Rating Agencies Approach Lease Revenue Bonds Differently from Other Bonds? 1:03:54

DANIEL DEATON: Let me start off, Anna, can you talk about what the rating process is from your perspective with lease revenue bonds and especially how is it different than other rating agency processes that you're used to?

ANNA VAN DEGNA: We frequently go to the rating agencies for our master lease COP program as well as our GO bonds. The disclosure we send them is the same Appendix A, although obviously the legal documents for a COP, whether it's a master lease or not, are going to be quite different. The rating analysts may have questions about essentiality and things like that. For Standard & Poor's, we always want to make sure we've got the earthquake seismic form filled out well in advance, because sometimes it's hard to track down the appropriate party to fill that out at the City. But I would say it's very similar for our more bread-and-butter general fund lease financings as it would be when we're going to them for our general obligation bonds.

DANIEL DEATON: Okay, great. And Melissa, can you generally describe how the different rating agencies approach these lease revenue bonds differently?

MELISSA SHICK: I think they each have a base case, as Anna described, where they're reliant on their local governmental criteria, each of which is different. But they begin with the issuer credit rating — that general obligation bond credit rating — and then from there they notch down, giving a lower rating based on the lease nature of the debt. That notching from the issuer's general credit rating to the lease rating can differ, particularly for Moody's. Moody's is focused on the essentiality of the asset serving as the lease property. So, for example, if the asset is city hall, that's deemed essential, but Moody's has lease commentary noting examples of non-essential assets, one of which is a convention center. Convention center debt by Moody’s is often notched two tiers lower than the issuer's general credit rating by Moody's. That's not the case with the other rating agencies, which tend to apply a single notch from the issuer credit rating to incorporate the lease nature of the credit.

Anna spoke about Standard & Poor's and their focus on the seismic analysis. That's a requirement — you conduct a seismic analysis and fill out a seismic form on any asset that will serve as the lease property on a transaction. That can be cumbersome, and for some of these larger organizations, finding the right person in the real estate department to fill out the form can be challenging. In fact, I have one client on one transaction that chose not to use Standard & Poor's simply because they didn't have the staffing bandwidth to get all the forms filled out. So for me, those are the two main differences, and kind of the bees in the bonnet that certain rating agencies have. Back in the day, Moody's was very focused on a debt service reserve fund for lease revenue debt; they're less focused on that now and more focused on asset essentiality.

DANIEL DEATON: That's great. Margie, what thoughts do you have for issuers to consider in terms of their rating agency approach?

MARGARET BACKSTROM: A couple of things. One is which rating agencies do have a relationship with on other credits or existing debt. A big point of interest for investors is when there's a shift — say you have Moody's on your existing debt but choose not to have them on a certain bond issue. Investors start digging a little deeper, because sometimes they assume there's a negative reason for that. But if it's a standalone transaction without a lot of precedent, then one thing I would say is that there's been a trend over the last 15 to 20 years where issuers utilize fewer ratings per bond issue. An issuer that used to have three ratings may use just two now, and an issuer that used to have two ratings may just use one rating now. There may be implications of that. And if an issuer is thinking about using insurance, certain agencies have relationships with the insurers, so that should all be taken into consideration. But I do think the trend toward fewer ratings may give issuers more flexibility to make changes over time. And there's always rating evaluation services up front, although it depends on what your objectives are in that process, so I would talk to your underwriter, municipal advisor, and attorneys about that one.

DANIEL DEATON: Okay, great. Trista, if we can move to the next slide.

Slide 9 – What Are Some of the Challenges Issuers Face in Maintaining a Lease Program? 1:10:35

DANIEL DEATON: Now let's move on to the next topic. Anna, you've done your deal and all the rest of us have abandoned you to comply with what we just put in place. Let's start with the overall ongoing management of your lease revenue bonds. What does that look like in the daily life of the City and County of San Francisco?

ANNA VAN DEGNA: One key thing is making sure we've got the right insurance for all of our leased assets. Each year we work with our risk management department to budget for the insurance and to ensure they have the information they need to procure it, especially if there are changes. There are also annual obligations — each year we need to obtain evidence of insurance and certifications from our risk manager that go to our trustees under the covenants. We also need to make the annual certifications that we're appropriating funds for the annual lease payments. And we want to monitor the leased assets and make sure the City still plans on having beneficial use and occupancy in the future, that there are no changes — for tax-exempt debt, that could impact our tax status, which is common for a variety of financings.

DANIEL DEATON: Okay, great. Let's start with what you mentioned first, which probably represents the most significant ongoing burden with respect to lease revenue bonds and is certainly distinct from other kinds of financings — the casualty and rental interruption insurance. In general terms, what are the insurance covenants the City and County of San Francisco has agreed to in its transactions?

ANNA VAN DEGNA: Typically, it's casualty, 24 months of business interruption, and we need to get title insurance if we're adding or substituting assets. The latter two are things we can't self-insure for and must procure from outside providers — but a lot of the standard things we've talked about here today.

DANIEL DEATON: And how has that expense changed over time? Going back to your prior experience and over the last 15 years or so, how expensive has insurance become relative to what it was before?

ANNA VAN DEGNA: I was a banker, so I can't speak to my days prior to joining the City. But post-pandemic, with the industry challenges I mentioned, there was a specific lease revenue bond financing where we were seeing 25 to 30% annual growth rates, and one case went through the substitution process, as I noted. What's interesting is that this year, in fiscal 26, our property insurance is almost across the board down from what it was in fiscal 25. So that's exciting for us.

DANIEL DEATON: That's great. And, Margie and Melissa, the vast majority of deals I've seen just copy and paste the insurance covenants. It seems virtually canon that you have to have 100% replacement value for casualty insurance, with a little bit of self-insurance that comes in — which is a slightly weird conversation about when it can and can't be used depending on what's happening — and then 24 months of rental interruption insurance, all handed down from on high. What if you didn't do it that way? What would happen from a market or rating agency perspective if you said you'd do half the replacement value? And let's not be crazy and get rid of insurance altogether — but let's ask the question: what if you did half the replacement value and 12 months of rental interruption insurance? What happens?

MARGARET BACKSTROM: That's a great question. One thing we know about the market is that we can't really predict its reaction to anything. So when something is as ingrained as rental interruption insurance, with two years being the standard, it's really hard to predict — because that is one of the things investors use to check a box. There are no more debt service reserve funds, but they make sure there's rental interruption insurance for the 24 months, just given the abatement nature of the lease. Now, looking at what other states do — other states that have lease programs don't have rental interruption insurance requirements, but they also don't have abatement. So I think it goes hand in hand with the abatement. I can't predict the market, but it's a really good question, and I think investors would have some serious questions.

MELISSA SHICK: On the rating agency side, I think we should absolutely have that dialogue. When I talked about rating lease revenue bonds, I talked about notching from the general credit rating, and it's not as if we're asked for checklists from the rating agencies — do you have this insurance, that insurance — in order for them to rate the lease transaction. Certainly when we're presenting the transaction we outline the standard insurance coverages, but I think it's worth asking the question with your rating analysts: if we had 12 months of rental interruption, would that materially impact our credit rating? I don't know the answer to that, but we should ask the question.

DANIEL DEATON: My only contribution to this conversation is that, as Anna noted, post-pandemic the insurance increases got positively scary. One thing people need to be thinking about from a financial perspective is: can I comply with this covenant? I'm fearful that copying and pasting these insurance covenants into lease revenue bond deals is leading people not to do a prospective assessment of whether they can really obtain the insurance they're agreeing to. I'm worried people are going to go into default if we end up in another round of inflation like that — which we all know is not outside the realm of reasonableness, particularly with inflationary concerns resurfacing over the last couple of months. This is an ongoing, potentially 30-year requirement to comply with this covenant, and the insurance market could move all around during that period. As Anna said, in the last six years it's gone all the way up and is now coming back down. The insurance market moves around over the total period, but the covenants don't change. So it's just about being thoughtful and realizing this isn't a legal requirement — none of these insurance requirements are legally required. They're there to make sure local agencies can get the best financing structure for them, and making sure they don't agree to something they can't comply with is the key piece. Melissa, can you talk briefly about how important release and substitution provisions in leases are, and when and how issuers use them?

MELISSA SHICK: We touched on this at the start, Dan, and I think they're super important. As I said, we're making a decision to lease an asset at the start of a transaction, but the debt is outstanding for anywhere from 20 to 30 years, and having that ongoing flexibility for future stakeholders and future management of a city, county, or other agency is super important. So in that context, we always look to ensure that as we establish a lease and the underlying legal parameters of that lease, we allow for the release and substitution of assets. Sometimes it's about ongoing management and operations, but there are times where, just for strategic reasons, release and substitution is important. An agency may be using an asset transfer structure to finance a project, but ultimately, once that project is built and constructed, they want to use the project as the leased asset, simply to keep everything in the same bucket. So we've presented a transaction to the rating agencies, as well as disclosed it in an official statement, to say, this is the lease property today, but once our project is constructed, it's our intent to release that property and replace it with the project. That's also a priority for clients and agencies — aligning the project with the debt service and the financing, as it may be helpful to the ongoing operations of an agency.

DANIEL DEATON: And Anna, when have you actually done substitutions or releases of property?

ANNA VAN DEGNA: I'd say in the last ten years there have been at least a couple of times — I mentioned the process with the library earlier. It comes up for various reasons, but not very frequently. Still, having that ability to substitute is key, so I greatly value having it.

DANIEL DEATON: And that's another area we're really good at copying and pasting. As Melissa was talking about, from the local agency perspective, it's a good set of provisions to own, because the question becomes: what's required, how do I know I can comply with it, who will do what, and how hard is it to do? The lawyers will draft it, but it ultimately represents a sizable amount of financial flexibility that the local agency needs to retain and own, in my opinion.

Slide 10 – What Is the Investor Base for Lease Revenue Bonds 1:23:27

DANIEL DEATON: Let me turn to the last question. For the last five or six minutes, could you discuss the investor base for lease revenue bonds — who are the typical investors, how has that base changed over time, and what are the typical and recurring questions, and how have those questions changed over time?

MARGARET BACKSTROM: Absolutely. The benefit of California lease revenue bonds is that they have a very broad and diverse investor base, which I think benefits issuers greatly. The dominant investors we've seen over the last few years have been California bond funds — tax-exempt bond funds that have to hold a certain percentage of their assets in California tax-exempt instruments. They're the most knowledgeable about California lease structures, abatement leases, and the various terms and conditions, and they tend to be the largest buyers. We've also seen an increase in separately managed accounts, or SMAs — some people call them professional retail investors — that have invested in California lease structures over time. That's been a growing base within the municipal market overall for tax-exempts, but especially in California, and we've seen a lot of those investors buy leases. That has been more of an education process, because a number of years ago those investors were dominant in essential service utility revenue bonds and general obligation bonds — the bonds they understood better — so it's been a focus of education over time, so they understand lease revenue bonds and COPs and are willing to invest in them. But we've seen that increase over time.

We also still see mom-and-pop retail investors being important, as well as insurance companies. Insurance companies tend to only invest in the very highest double-A and triple-A rated bonds, as well as taxable bonds, so they've been more restricted, and they've also decreased the amount of tax-exempt bonds they're buying overall.

As for what questions they're asking, the times we get the most questions are when there are unique features. If there's construction risk, we get a ton of questions about the insurance, the construction risk, and how much capitalized interest there is, whether there's a guaranteed maximum price contract, and they want to know the details of the contract — they get way into the weeds if there's construction risk. So if there's a desire to do a transaction where the project is the lease asset, you're going to get a ton of questions from investors about that.

DANIEL DEATON: Margie, could you speak to about 15 years ago — how was the investor base at that time, and how were deals done back then?

MARGARET BACKSTROM: Thinking back to 15 years ago, the vast majority of investors were bond funds. There was less of this professional retail, SMA, trust department, and privately managed money. Bond funds still comprise the largest chunk, but that amount has gone down over time. And insurance companies were probably a bigger participant back then — they can be cyclical in terms of their ability and the amount of assets they have to invest.

DANIEL DEATON: And I think most deals were covered by bond insurance back then too.

MARGARET BACKSTROM: Yes, pre-financial crisis. If you look pre-financial crisis, we were even getting insurance on double-A-plus rated transactions, which seems crazy now. But anything that wasn't a natural AAA, we would get bond insurance bids, and most of the time they were very inexpensive, so we insured everything. So there were a lot fewer questions about any of this, because investors really were looking at the underlying asset, but then right through to the insurance.

DANIEL DEATON: So it's dynamic, and issuers need to be aware of where they sit at whatever time they're going to market, to understand who that investor base is — it does change a lot over time. Well, thank you all. This was a great discussion. Let me turn it back to Robert.

Slide 11 – Questions **1:29:20**

ROBERT BERRY: Well, thank you, Dan. It was a great discussion, and we've run out of time. We haven't had any audience Q&A questions, but if you do have questions and would like us to follow up, go ahead and send those in to CDIAC and we'll follow up, reach out to our presenters, and answer your questions.

Slide 11 – Upcoming Events **1:29:39**

ROBERT BERRY: So that's going to close out our program for today. But before we sign off, of course, a huge thank you to Margaret Backstrom, Melissa Shick, Anna Van Degna, and Dan Deaton for all of your time preparing for this series. A great deal of time went into it, and thank you for sharing your experience in today's program.

I'd also like to quickly draw your attention to a few of our upcoming programs at CDIAC. First, *Municipal Debt Essentials*; this is our three-day flagship program on debt issuance and administration. It's a great opportunity, especially for new or less experienced members of your teams, or people in your agencies who are tangentially or infrequently involved in the debt issuance and administration process. In the email we sent with your certificate of participation in session one, we included a special discount code that will allow new registrants to receive the lowest price for this program. It's a multiple-use code, so you can use it for your staff, but it will expire on June 1. Then, the 25th Annual CDIAC Pre-conference to *The Bond Buyer's* California Public Finance Conference is October 14 in San Francisco. I'm currently working on developing the topic and agenda for that program, but I'm planning on another program that challenges public finance conventions, which I think should be very interesting. Full program details as they develop and registration information will be on the CDIAC website.

Finally, if you would, please spend just a few minutes completing our post-program evaluation and tell us what you think. Your feedback is very helpful and very much appreciated. On behalf of our presenters today and all of us at CDIAC, including our education team, Trista Zepeda and Anna Ramirez, thank you all very much for joining us, and have a great day.