

**MEMORANDUM**

**To** Banking Committee  
**From:** Board Office  
**Subject:** Selection of Master Lease Provider  
**Date:** November 5, 2001

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**Recommended Action:** Approve the selection of Wells Fargo Brokerage Services, LLC for the financing for the Regents master lease program and authorize the Executive Director to enter into a contract with Wells Fargo within the parameters delineated in this memorandum.

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**Executive Summary:** Past practice of the Board has been to enter into a master lease agreement through the issuance of a Request for Proposals (RFP) process.

The master lease program has operated through Wells Fargo (previously known as Norwest Investment Services) as a result of RFP processes held in 1991 and 1996. The current agreement expires on December 1, 2001.

The Board Office distributed an RFP for the master lease program on July 23, 2001 to establish a two-year agreement with the possibility of three annual renewals for a total of five years.

The Board Office received proposals from the following firms:

- Wells Fargo Brokerage Services, LLC
- GE Capital
- US Bank

A screening committee comprised of representatives of the universities, Board Office, Regents bond counsel, and Regents financial advisor reviewed the proposals and determined that Wells Fargo submitted the most financially competitive, responsive proposal.

Further discussions were held to clarify some of the items in Wells Fargo's response and to discuss terms of a proposed contract.

Wells Fargo is:

- Willing to consider lowering its interest rates (the fixed increment to the Delphis Hanover Yield Curve Scale) in exchange for changes in the prepayment penalty; and
- Amenable to financing, under a new agreement, real and personal property up to an outstanding principal amount of \$20 million.

The universities are agreeable to these proposed changes and have had a good working relationship with Wells Fargo over the last ten years.

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## **Background:**

### Historical Context

Since July 1985, the Board has utilized a master lease concept to provide short-term financing (3 to 10 years) for real and personal property.

The Board's first utilization of the master lease concept was through an agreement between Iowa State University and Dougherty Dawkins, which ran through June 1988.

The use of master lease financing was made available to all Regent institutions in June 1988.

As a result of the Request for Proposal process, the Board entered into a master lease agreement with BancNew England Leasing Group (later acquired by Bank of Tokyo) from June 1988 through June 1991.

Since November 1991, the master lease program has operated through Wells Fargo (previously known as Norwest Investment Services) as a result of RFP processes held in 1991 and 1996; the current agreement is effective until December 1, 2001.

### Advantages

The master lease financing option offers certain advantages for financing necessary and essential property.

- Leases do not have the high origination costs of small bond issues that result from establishment of bond reserve funds, underwriter discounts, and issuance expenses.
- The negotiation of lease financing terms and amortization schedules allows lease payments to be better matched with available cash flows.

The Board approves each financing utilizing the Master Lease Agreement (Agreement) and Wells Fargo must agree to lease the property.

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**Analysis:**

Interest Rate  
Increment over  
Delphis

The respondents to the RFP were requested to submit their interest rate proposal as an increment over the "A" rated value from the most current daily Range of Yield Curve Scale published by the Delphis Hanover Corporation, which provides comprehensive municipal bond interest rate tables, for the specified lease term and average maturity.

Wells Fargo's proposal had the increments ranging from 1.78% over the Delphis for a three-year lease term to .82% over the Delphis for a ten-year lease.

These compare to a spread of 1.13% for a three-year lease and .58% for a ten-year lease under the current master lease agreement.

As a result of the events of September 11<sup>th</sup>, there have been disruptions to interest rate markets. As such, current Delphis scales are artificially low compared to the spread between treasury bonds and municipal rates are higher than when viewed on a historical basis.

According to Wells Fargo, the spread needs to be higher for it to earn an amount equal to the amount that was earned under the terms of the existing agreement.

Wells Fargo is willing to review increments on an annual basis and agrees to decrease the increments if market conditions warrant.

Wells Fargo has also agreed that the increments proposed in their response will not be increased regardless of market conditions that might occur during the length of the Agreement.

Total Amount of  
Lease Financing

The current agreement is valid only for up to a total of \$15 million of financings originated under the Agreement. The RFP indicated that the Board and its institutions were interested in the possibility of increasing the lease amount to \$20 million for the period of the next Agreement.

To provide additional flexibility, the next Agreement would be structured to allow, with Board approval, up to \$20 million of principal outstanding at any one time.

Wells Fargo is agreeable to this change.

The Board would continue to approve each financing utilizing the Master Lease Agreement and Wells Fargo must agree to lease the property.

This change would allow additional borrowings by the institutions as they repay earlier borrowings and could enhance the use of the Agreement.

Prepayment  
Penalty

The RFP stated that except for a non-appropriation, each lease would not be prepayable for the first 18 months. In addition, if the lease were to be prepaid before the midpoint of its term, an additional prepayment fee would be due in the amount of one-half of one percent of the outstanding principal.

If the no prepayment period were to be extended to two years or if a declining prepayment or refunding premium were included in the Agreement, Wells Fargo is willing to review and reduce the interest rate increment over Delphis from the levels included in its RFP response.

As provided by Springsted, the rationale for Wells Fargo's position is:

- If any of the leases which it writes are refinanced, Wells Fargo ends up making the holder of the lease "whole" by paying the holder the present value of the lost increment that occurs as a result of the prepayment. According to Wells Fargo, it does not receive any of the prepayment penalty.
- Since the investor's risk is covered, there is reduced risk in a lease that has a longer no prepayment period or a declining prepayment penalty, and the investor will accept a lower rate of return. This results in a lower spread over Delphis
- A change to the prepay provisions from those include in the RFP would allow Wells Fargo to undertake less risk of prepayment and would allow the firm to review and reduce the interest rate increment.

According to Springsted, the declining prepayment penalty is commonly used in lease financings.

It is recommended that both a 24 month no prepayment period and a declining prepayment or refunding premium be explored with Wells Fargo with the goal being to use the method which reduces, to the greatest extent possible, the interest rate increment.

Springsted believes that the proposed adjustments to the Wells Fargo Brokerage Services, LLC proposal in response to the Board's Master Lease Agreement RFP work to make the Agreement more flexible and useful to the Regent institutions.

If the Board approves these adjustments, Board Office and university staff with work with Springsted and Ahlers Law Firm to draft a new Master Lease Agreement to submit to Wells Fargo Brokerage Services, LLC., with agreement on a final document to be complete prior to the expiration of the current Agreement.