Chapter 2: Terms and Funding of Credit Instruments

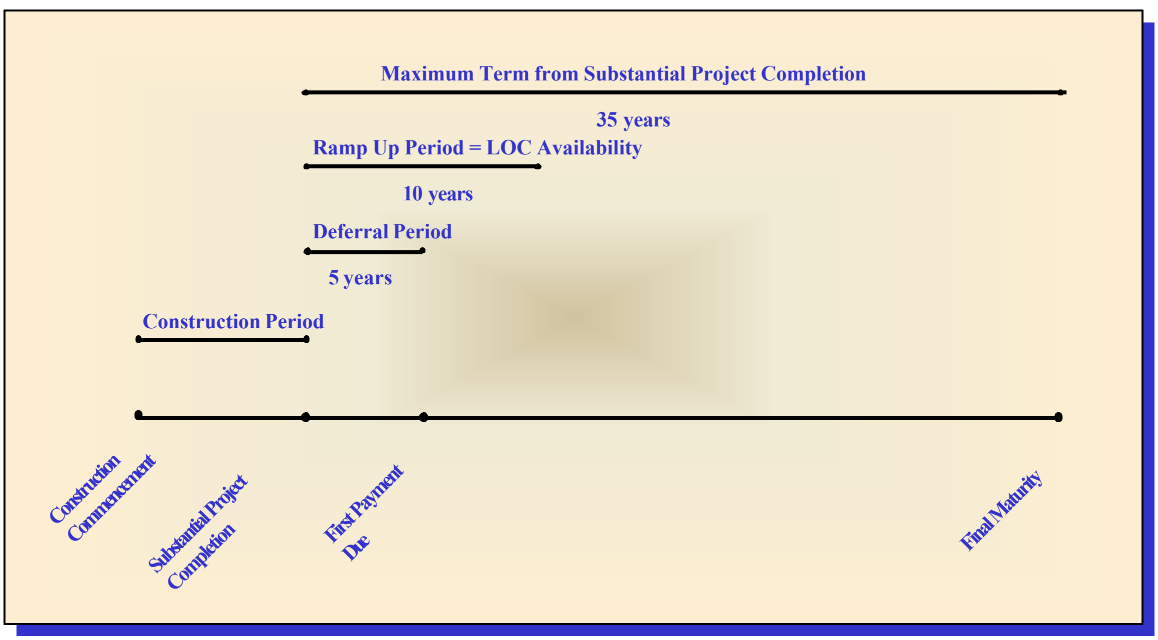
The TIFIA program's secured (direct) loans, loan guarantees, and standby lines of credit may offer more flexible repayment terms and more favorable interest rates than would be available from other lenders. This chapter summarizes the required terms that apply generally to TIFIA credit assistance and describes the major features of each credit instrument. A section on loan repayment and prepayment structuring provides information on financing structures and related repayment issues that may arise during negotiations. The chapter also provides an explanation of the dual funding controls that govern the amount of credit assistance available under the TIFIA program.

Section 2-1

Summary of Basic Terms for TIFIA Credit Assistance

Certain features of TIFIA credit assistance are the same regardless of whether the credit instrument is a secured loan, loan guarantee, or line of credit. For example, the maximum maturity of all TIFIA credits is 35 years after a project's substantial completion. Exhibit 2-A provides an illustrative TIFIA payment structure for any of the three credit instruments.

Exhibit 2-A: Illustrative TIFIA Payment Structure as Permitted by Statute



It is anticipated that, in many cases, the TIFIA credit instrument will be junior (i.e., subordinate) to the project's capital markets debt in its priority claim on the project's cash flow. However, in the event of bankruptcy, insolvency, or liquidation, the DOT must have a parity claim with respect to other creditors on the project's pledged security. The credit agreement will clearly specify the DOT's interest in the pledged security relative to the interests of any other creditors.

The TIFIA statute places two other important limits on the government's exposure to credit risk. First, TIFIA assistance must not exceed 33 percent of total eligible project costs. This is to ensure that the DOT shares the credit risk with other participants. Second, a project's senior debt obligations must receive an investment-grade rating (Baa3/BBB-or higher) as a condition for disbursement of TIFIA funds. Chapter 3 provides further details on eligible project costs and rating opinions.

Section 2-2
TIFIA Credit Instruments

A summary of the main features of TIFIA secured loans, loan guarantees, and lines of credit follows. These features are established by statute. This section also addresses the rules that govern how interest rates are set and funds are disbursed and repaid.

Secured Loans

A TIFIA secured loan is a debt obligation involving the DOT as the lender and a non-federal project sponsor as the borrower. Actual terms and conditions for a secured loan must be negotiated between the DOT and the project sponsor, but in general, the characteristics will include:

- Use of Proceeds. The proceeds of a secured loan must be used either to finance eligible project costs or to refinance interim construction financing of eligible project costs. In the latter case, the DOT loan may refinance existing debt no later than one year following substantial completion of the project.

- Amount. The principal amount of a secured loan, in combination with any other TIFIA credit assistance, may not exceed 33 percent of the reasonably anticipated eligible project costs.

- Interest Rate. The interest rate on a secured loan will be equal to or greater than the yield on marketable U.S. Treasury securities of comparable maturity on the date of execution of the credit agreement. The DOT identifies the U.S. Treasury rates through use of the daily rate tables published by the Bureau of the Public Debt for State and Local Government Securities (SLGS). Adding five basis points to the published SLGS rates produces Treasury's average estimated yields on its securities. The SLGS daily rate tables can be found at the Bureau of the Public Debt's website at http://www.publicdebt.treas.gov/. Interest accrual on TIFIA proceeds begins immediately upon disbursement of funds from the DOT.

- Timing of Disbursements. The DOT will disburse funds as often as once monthly, on a reimbursement basis, as costs are incurred for eligible project purposes. The credit agreement will specify an annual draw schedule, which can be amended as necessary.

- Maturity. The final maturity date of a secured loan must be no later than 35 years after the date of substantial completion of the project.

- Repayment Terms. Scheduled repayments must commence no later than five years after the date of substantial completion of the project. Level debt service is not required for project financings where pledged revenues are projected to increase over time. Debt service payments should be scheduled at least semi-annually.

- Deferrals. In the event revenues are insufficient to meet scheduled TIFIA loan payments within 10 years after substantial completion of the project, the DOT, at its sole discretion, may allow payment deferrals. Any such deferrals shall be contingent on the project's meeting criteria established by the Secretary, including standards for reasonable assurance of repayment. There can be no assurance that the Secretary will exercise this authority to reschedule debt service with respect to any particular project. Thus, borrowers should negotiate a debt service schedule they are confident they can meet.

- Prepayment Conditions. A secured loan may be prepaid in whole or in part at any time without penalty.

- DOT Lien Priority. Although the TIFIA claim on project revenues can be subordinated to those of senior lenders it cannot be subordinated in the event of bankruptcy, insolvency or liquidation of the obligor. In such an instance, the TIFIA lien would rise to parity with senior creditors. This provision may be effected through a master trust agreement, an inter-creditor agreement, or other agreement entered into at the time of execution of the secured loan.

Loan Guarantees

A TIFIA loan guarantee is any guarantee or other pledge by the DOT to pay to a third-party lender all or part of the debt service on a loan or other debt obligation of a project sponsor. The DOT will seek recovery from the sponsor of all funds paid to the guaranteed lender pursuant to a reimbursement agreement executed simultaneously with the loan guarantee agreement.

By statute, the guaranteed lender must be a "non-federal qualified institutional buyer" as defined in section 230.144A(a) of title 17, CFR, including qualified retirement plans and governmental plans. Prospective applicants and lenders should contact the DOT with any questions about what constitutes a "non-federal qualified institutional buyer."

Characteristics of a guaranteed loan include:

- Use of Proceeds. The proceeds of a guaranteed loan must be used either to finance eligible project costs or to refinance interim construction financing of eligible project costs. In the latter case, the guaranteed loan may refinance existing debt no later than one year following substantial completion of the project.

- Amount. The principal amount of a DOT loan guarantee, in combination with any other TIFIA credit assistance, may not exceed 33 percent of the reasonably anticipated eligible project costs.

- Interest Rate. The interest rate on a guaranteed loan will be negotiated between the guaranteed lender and the borrower, subject to consent from the DOT. Interest payments on a guaranteed loan are subject to federal income taxation.

- Maturity. The final maturity date of the guaranteed loan must be no later than 35 years after the date of substantial completion of the project.

- Repayment Terms. Scheduled repayments to the guaranteed lender must commence no later than five years after the date of substantial completion of the project. Level debt service is not required for project financings where the pledged revenues are projected to increase over time.

- Deferrals. In the event that revenues are insufficient to meet scheduled loan payments within the first 10 years after substantial completion of the project, the DOT may consent to payment deferrals and a rescheduling of the guaranteed debt service. Approval of any such payment deferrals shall be contingent on the project's meeting criteria established by the Secretary, including standards for reasonable assurance of repayment. There can be no assurance that the Secretary will exercise this authority to permit the rescheduling of debt service with respect to any particular project. Thus, borrowers should negotiate a debt service schedule they are confident they can meet.

- Prepayment Conditions. The prepayment features on a guaranteed loan will be negotiated between the guaranteed lender and the borrower, subject to consent from the DOT.

- Default Feature. In the event of an uncured borrower payment default, the guaranteed lender will receive payment from the DOT for the guaranteed payment due. The DOT will seek recovery from the borrower of all funds advanced pursuant to a reimbursement agreement executed simultaneously with the loan guarantee agreement.

- DOT Lien Priority. Although the TIFIA claim on project revenues can be subordinated to those of senior lenders it cannot be subordinated in the event of bankruptcy, insolvency or liquidation of the obligor. In such an instance, the TIFIA lien would rise to parity with senior creditors. This provision may be effected through a master trust agreement, an inter-creditor agreement, or other agreement entered into at the time of execution of the loan guarantee.

Lines of Credit

A TIFIA line of credit provides a contingent loan that may be drawn upon after substantial completion of the project to supplement project revenues during the first 10 years of the project's operations. The DOT will disburse funds only under certain conditions, which will be specified in the credit agreement.

Characteristics of a line of credit include:

- Use of Proceeds. The proceeds from a draw on a line of credit may be used only to pay debt service on project obligations (other than a TIFIA credit instrument) issued to finance eligible project costs, extraordinary repair and replacement costs, operation and maintenance expenses, and/or costs associated with unexpected federal or state environmental restrictions.

- Amount. The total principal amount of a line of credit, in combination with any other TIFIA credit assistance, may not exceed 33 percent of the reasonably anticipated eligible project costs.

- Annual Limitation on Draws. A maximum of 20 percent of the total principal amount of a line of credit may be drawn in any year. This 20 percent amount shall be calculated on the basis of the total principal amount of the line of credit on the date the line of credit is obligated.

- Condition Precedent for Draws. A draw may be made only if revenues from the project are insufficient to pay the costs enumerated above in "Use of Proceeds."

- Availability. A line of credit may be available for a period of 10 years following substantial completion of the project.

- Interest Rate. The interest rate on a secured loan resulting from a draw on a line of credit will be equal to or greater than the yield on a 30-year marketable U.S. Treasury security on the date the line of credit is obligated. The DOT identifies the U.S. Treasury rate through use of the daily rate tables published by the Bureau of the Public Debt for State and Local Government Securities (SLGS). Adding five basis points to the published SLGS rates produces Treasury's average estimated yields on its securities. The SLGS daily rate tables can be found at the Bureau of the Public Debt's website at http://www.publicdebt.treas.gov/. Interest accrual on TIFIA proceeds begins immediately upon disbursement of funds from the DOT.

- Maturity. The final maturity date of a secured loan resulting from a draw on a line of credit must be no later than 35 years after the date of substantial completion of the project.

- Repayment Terms. Scheduled repayments of a draw on a line of credit must commence no later than five years after the end of the 10-year period of availability and be fully repaid no later than 25 years after the end of the 10-year period of availability. Level debt service is not required. Debt service payments should be scheduled semi-annually.

- Prepayment Conditions. A secured loan resulting from a draw on a line of credit may be prepaid in whole or in part at any time without penalty.

- DOT Lien Priority. Although the TIFIA claim on project revenues can be subordinated to those of senior lenders it cannot be subordinated in the event of bankruptcy, insolvency or liquidation of the obligor. In such an instance, the TIFIA lien would rise to parity with senior creditors. This provision may be effected through a master trust agreement, an inter-creditor agreement, or other agreement entered into at the time of execution of the secured loan.

Section 2-3
Loan Repayment and Prepayment Structuring

The TIFIA statute gives the DOT broad discretion to negotiate a deferral of loan interest for the construction period and up to five years[1] after substantial completion. The DOT also has substantial flexibility to permit additional, but partial, deferral of interest and deferred repayment of principal.

1. Scheduled TIFIA Debt Service. Projects are not automatically entitled to the maximum statutorily permitted deferral. Rather, in the exercise of its discretion, the DOT evaluates the economics of each project to determine an appropriate debt service schedule. Factors in this assessment include:

   - *Availability of revenues for debt service.* Some projects are not true "project financings," but rely on tax or other revenues, which may be available for debt service even before the project is completed. In such cases, the DOT likely will require commencement of debt service upon substantial completion, although it may consider commencement of debt service during the construction phase. Projects most likely to be allowed significant interest deferral and heavy backloading of principal are those where project revenues support the financing and project sponsors anticipate a long ramp-up period.

   - *Amortization of senior debt.* When the plan of finance includes other debt senior to TIFIA, the DOT expects that the capitalized interest period for the senior debt likely will end before the capitalized interest period for the TIFIA loan. Thus, the DOT will agree to continue deferring an appropriate amount of its loan interest to ensure that revenue is adequate to pay full interest on the senior debt. However, the DOT will not increase its investment in a project by deferring interest when other creditors are withdrawing their investment. Therefore, the DOT will not permit any amortization of senior debt until all current TIFIA interest is being paid.

   - *Returns on equity*. Just as the DOT will defer commencement of its return on investment in favor senior debt, so equity investors, who will be subordinate to TIFIA, must defer commencement of their return. The DOT will not permit any return on equity until interest deferral has ceased and all currently accruing TIFIA interest is being paid. The DOT will negotiate, on a project-by-project basis, the priority and relationship of TIFIA repayment and equity payouts.

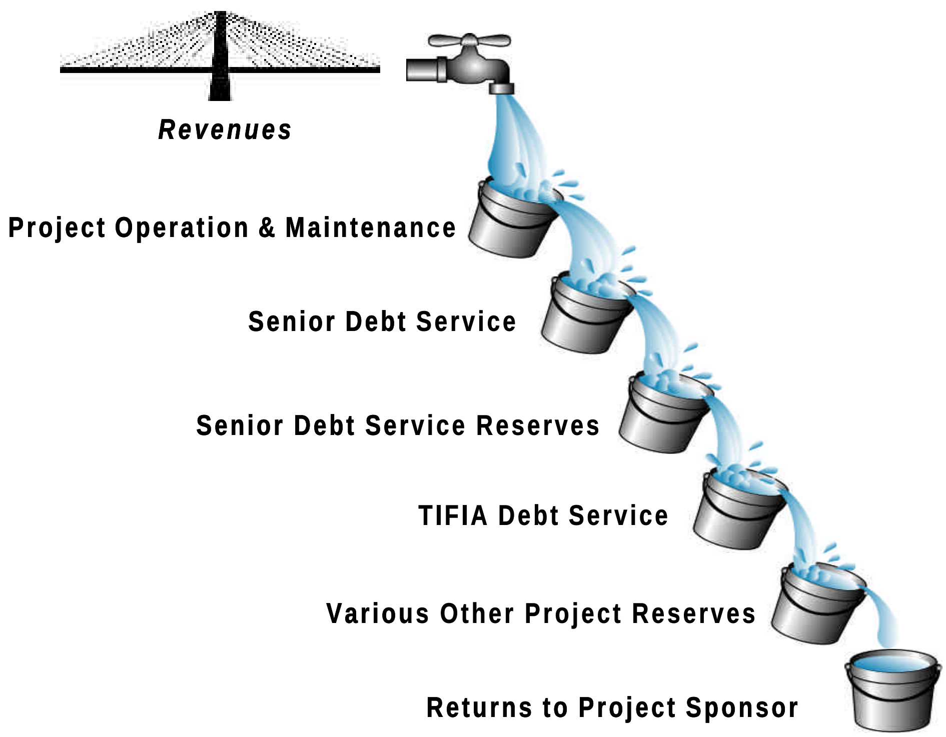
2. Prepayment and Refinancing. Although TIFIA provides long-term financing, the DOT does not intend that TIFIA become part of a project's permanent capital structure where a strong revenue stream and vigorous project economics permit prepayment or substitution of the TIFIA credit instrument. The DOT will negotiate a debt service schedule that provides a high probability of repayment and avoidance of default. In return, the DOT will require that excess revenues – not needed for project purposes – be applied to prepayment of the TIFIA loan. The DOT also will seek to structure the

[1] Note that the TIFIA statute requires the commencement of debt service itself, not commencement of the period when scheduled debt service first starts accruing, no later than five years after substantial completion.

financing in ways that encourage borrowers to replace the TIFIA loan with capital markets debt at such time as project economics support refinancing.

Exhibit 2-B shows a typical flow of funds for a project that includes both senior and subordinate TIFIA debt. The chart demonstrates how senior debt service (as well as reserve accounts for the benefit of senior bondholders) generally accumulates revenues ahead of TIFIA debt service.

Exhibit 2-B: Example of Project Flow of Funds



Section 2-4

Taxation Issues

With regard to the TIFIA program, the TEA 21 Conference Report states:

> "The Conference recognizes that the Congress enacted the Deficit Reduction Act of 1984 provision prohibiting the combination of Federal guarantees with tax-exempt debt, because of concerns that such a double-subsidy could result in the creation of a 'AAA' rated security superior to U.S. Treasury obligations. Accordingly, any project loan backed by a loan guarantee as provided in TIFIA must be issued on a taxable basis….
>
> "...The Conferees are aware that present Federal income tax law prohibits the use of direct or indirect Federal guarantees in combination with tax-exempt debt (section 149(b) of the Internal Revenue Code of 1986). The TIFIA provisions of the conference agreement do not override or otherwise modify this provision of the Code."

The DOT urges all applicants, and particularly those intending to use tax-exempt bonds in connection with TIFIA loans or lines of credit, to consult with the Internal Revenue Service, the Department of the Treasury, or their bond counsel.

Section 2-5
TIFIA Program Funding

Congress has placed dual controls on the amount of annual TIFIA funding available. First, it established a limit on the annual credit assistance (i.e., the principal amount) that may be committed in the form of secured loans, guaranteed loans, and lines of credit. For fiscal year 2003, this amount is $2.6 billion. It will not be available in subsequent years if not obligated by September 30, 2003.

Similar to all other federal credit assistance programs, the TIFIA program is governed by the Federal Credit Reform Act of 1990 (FCRA), which requires the DOT to establish a capital reserve, or “subsidy amount,” to cover expected credit losses before it can provide TIFIA credit assistance. Congress also places limits on the total annual subsidy amount available. For fiscal year 2003, this amount is approximately $70 million, or 2.7 percent of the total credit assistance available.

The amount of budget authority available in a given year to fund capital reserves for TIFIA credit instruments is subject to several factors, as described below.

- Federal-aid Highway Obligation Limitation. This obligation limitation pertains to most of the programs funded from the Federal Highway Trust Fund (as is the TIFIA program) and is determined through the appropriations process each year.

- Program Administration Expenses. The TIFIA statute authorizes the DOT to use up to $2,000,000 of the authorized budget authority in each of fiscal years 1999 through 2003 to administer the TIFIA program.

- Future-year Reservations. As discussed later, in Chapter 6, the DOT may in rare circumstances make future-year contingent commitments of budget authority. The DOT would make a future year reservation of funds only when the project seeking such commitment had met all TIFIA eligibility requirements and been partially funded out of the current fiscal year’s program. In this case, a portion of future-year budget authority would be administratively reserved for the project. To ensure additional projects’ access to the program in future years, the DOT would never reserve more than 50 percent of the amount of budget authority authorized for a single fiscal year.

- Carry-over Resources. Any budget authority made available but not consumed in previous fiscal years may carry over and increase the amount of budget authority available in a given fiscal year.

Section 2-6
Additional Information on Funding

Appendix B provides more detail on the funding mechanics and budget scoring for the TIFIA program. The appendix also contains information on the DOT's approach to measuring credit risk for individual TIFIA credit instruments.