



**Comptroller of the Currency
Administrator of National Banks**

Washington, DC 20219

**Interpretive Letter #770
March 1997
12 U.S.C. 24(7)2A
12 U.S.C. 24(7)29A**

February 10, 1997

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Dear []:

This letter is written in response to your request of January 27, 1997, on behalf of [] (the "Bank"), [city, state], for an opinion as to whether a certain facility leveraged lease transaction would be permissible pursuant to 12 U.S.C. 24(Seventh) and the Office of the Comptroller of the Currency's ("OCC") newly revised 12 CFR Part 23. For the following reasons, and subject to the limitations discussed below, we conclude that the transaction, as described herein, would be permissible under 12 U.S.C. 24(Seventh).

Background

You have represented that the leveraged lease transaction will be structured as follows. A trust established by the Bank for its own benefit ("Owner Trust") intends to purchase, for the fair market value of approximately \$140 million, a petrochemical facility (the "Facility"), comprised of various equipment, fixtures and other personal property, from a multinational petrochemical company (the "Company"). This purchase will be financed in part by an equity investment of approximately \$30 million which will be placed into the Owner Trust by the Bank. The Owner Trust will raise, on the Bank's behalf, the remaining approximately \$110 million of the purchase price through a non-recourse debt offering. The Owner Trust will then purchase the Facility with these funds and lease it back to an affiliate of the Company pursuant to a net, full payout lease for a term of 20 years ("Facility Lease"). The Facility Lease will have an estimated residual value of less than 25% of the cost of the Facility. At the expiration of the lease, the affiliate will have the option to purchase the Facility.

The Bank, through the Owner Trust, will also lease from the Company various real property interests, including property, easements and rights-of-way (the "Site"), necessary for the operation of the Facility pursuant to a head ground lease ("Head GL"). The Owner Trust will then sublease these interests to the affiliate of the Company pursuant to a sub-ground lease ("Sub GL"). The rent obligation under the Head GL will be strictly contingent on, and exactly equal

to, the rent payment by the sublessee under the Sub GL and, thus, there will be no cost to the Bank associated with the real property lease. The Head GL is for a term of approximately 28 years.¹

The affiliate's performance of its obligations under both the Facility Lease and Sub GL is guaranteed by the Company. In addition, the Facility Lease and Sub GL are cross-defaulted so that a default under either agreement will give the Bank, through the Owner Trust, the opportunity to operate the Facility in place and in use.

The Bank has represented that it is taking an interest in the Site for the sole purpose of protecting its interest in the Facility in the event of a default. Although the Bank has stated that it could protect its interest in the Facility by requesting a mortgage on the underlying Site from the Company instead of taking a real property interest in it, it stated that to do so would put the Bank at a competitive disadvantage since other potential lease financiers would not be hampered by this regulatory restriction.

Discussion

a. Personal Property Leasing

Lease financing transactions are addressed in the OCC's leasing regulation, 12 CFR Part 23.² That regulation states that a bank may enter into lease financing transactions pursuant to two separate statutory authorities: 12 U.S.C. 24(Seventh) or 12 U.S.C. 24(Tenth). You have requested authority for this lease transaction under 12 U.S.C. 24(Seventh).

Section 23.3 of the OCC's leasing regulation defines the general requirements for a conforming personal property lease and provides that:

A national bank may acquire personal property for the purpose of, or in connection with leasing that property, and may engage in activities incidental thereto, if the lease qualifies as a full-payout lease and a net lease.

¹ The Facility Lease and Sub GL, which both are 20 years in duration, are 8 years shorter in duration than the Head GL. As a result, the Bank will bear the risk of the affiliate of the Company not exercising its option to purchase the Facility upon the expiration of the Facility Lease. The Bank has represented that it must take a longer durational interest in the Head GL to protect itself from this possibility. In order for the Facility to be resold or released and the Bank to recoup its investment, the Bank must be able to convey an interest in the Site to ensure the operability of the Facility. As mentioned earlier, the Bank is only obligated to pay rent under the Head GL if the sublessee pays rent under the Sub GL. Because the Sub GL terminates after 20 years and the Head GL terminates after 28 years, the sublessee will not be paying rent after year 20. Therefore, there will be no rent obligation under the Head GL for the remaining eight years that it exists.

² See 61 Fed Reg. 66554 (December 18, 1996).

12 CFR § 23.3. A “full-payout lease” is defined as a lease in which a national bank reasonably expects to realize the return of its full investment in the leased property and the estimated cost of financing the property over the term of the lease from rentals, estimated tax benefits and the estimated residual value of the property. 12 CFR §23.2(e). The “net lease” requirement means that the national bank will not, directly or indirectly, provide or be obligated to provide for, among other things, servicing and repairs on the leased property or the payment of insurance for the lessee. 12 CFR §23.2(f).

Subpart C of Part 23 further describes the rules governing a 24(Seventh) lease and provides that:

Pursuant to 12 U.S.C. 24(Seventh) a national bank may invest in tangible or intangible personal property . . . for the purpose of, or in connection with leasing that property, if the related lease is a conforming lease representing a noncancelable obligation of the lessee (notwithstanding the possible early termination of that lease).

12 CFR § 23.20(a). In addition, this subpart limits the estimated residual value of a lease authorized under 12 U.S.C. 24(Seventh) to a maximum of 25% of the original cost of the property unless the bank receives a guarantee for any excess residual value above that amount. 12 CFR § 23.21(a) and (b).

Based on your description of the proposed transaction, summarized above, as well as the supporting documentation with which we have been provided, we conclude that the Facility Lease is a conforming lease which complies with the above-mentioned requirements of 12 CFR Part 23.

b. Activities “Incidental to” Personal Property Leasing

Part 23, as recently revised, recognizes that a national bank may engage in activities that are “incidental” to permissible personal property leasing. In the preamble to the final rule, the OCC stated that it retained the authority to approve those activities on a case-by-case basis.³ In your letter, you request that the OCC find that the acquisition of an interest in real property, represented by the Head Ground Lease, is incidental to the Facility Lease.

You represent that the Bank’s obligation under the Head GL will not involve any real estate construction or the acquisition or leasing of real property for the purpose of speculation. Rather, the Bank is entering into the Head GL strictly in order to better protect the value and utility of the financed equipment. The Head GL allows the Bank to sustain the value of the personal property collateral in the event of default by ensuring the use of the Facility as a going concern rather than requiring the piecemeal liquidation of the Facility if such Ground Lease did not exist.

³ Id., at 66556.

Real property leasing as an “incidental” activity was contemplated in the promulgation of the Part 23 leasing rule. In the preamble to the final rule, the OCC discussed a typical facility leasing transaction⁴ and concluded that

... under some circumstances real estate leasing may be an incidental component of a personal property leasing transaction. Therefore, consistent with its decision to retain a case-by-case approach to activities incidental to leasing generally, the OCC will determine the permissibility of personal property lease financing transactions that have a real estate leasing component based upon the facts of a given lease financing transaction This will enable the OCC to review any safety or soundness or other supervisory concerns that particular transactions may present.

61 Fed Reg. 66554, 66556 (December 18, 1996).

The primary concern in permitting a bank to become a party to a real property lease is the restrictions imposed by 12 U.S.C. § 29 which states:

A national banking association may purchase, hold and convey real estate for the following purposes, and for no others:

- First** Such as shall be necessary for its accommodation in the transaction of its business.
- Second** Such as shall be mortgaged to it in good faith by way of security for debts previously contracted.
- Third** Such as shall be conveyed to it in satisfaction of debts previously contracted in the course of its dealings.
- Fourth** Such as it shall purchase at sales under judgments, decrees, or mortgages held by the association, or shall purchase to secure debts due to it.

But no such association shall hold the possession of any real estate under mortgage, or the title and possession of any real estate purchased to secure any debts due to it, for a longer period than five years except as otherwise provided in this section.

12 U.S.C. § 29.

⁴ The OCC also requested comments on the use of real property as incidental to personal property leasing, such as facility leasing, in its Notice of Proposed Rulemaking for Part 23. 60 Fed Reg. 46246, 46248 (September 6, 1995).

A threshold question raised by Section 29 is whether real property leasing was contemplated as being within the purview of the statute. For the purposes of this analysis only, we assume that a leasehold interest in real estate is subject to the restrictions of Section 29.⁵

The OCC has previously approved facility leasing transactions. However, our precedent in this area has been inconsistent.⁶ Therefore, the OCC clarified its position when it revised Part 23. As discussed above, Part 23 recognizes as permissible the incidental use of real property to secure a bank's interest in personal property that it is leasing, depending on the facts of a given case. This position is predicated on the real property interests being, in fact, incidental to the primary transaction - the personal property lease. The measure of what constitutes "incidental" will vary in each case depending on the facts.

In the proposed transaction, several factors indicate that the Head GL is incidental to the Facility Lease. First, the Bank need not advance any money for the Head GL because the Sub GL rent amount exactly equals the rent amount due under the Head GL. Because of these matched obligations, there is no cost to the Bank for the Head GL as compared to the substantial cost to it for the Facility Lease. Second, the Bank is under no legal obligation to pay rent under the Head GL unless the affiliate of the Company pays rent under the Sub GL. Further, the Bank, through its Owner's Trust, only has a leasehold interest in the real property - not legal title. Its interest in the real property is directly related to the amount of time it will take the Bank to recoup its investment in the Facility, at which point its leasehold interest will expire.⁷ Finally, the Bank has represented that its only purpose in entering into the Ground Lease is to ensure the value of the equipment being leased under the Facility Lease.

⁵ This proposed leasehold interest arguably is permissible under the actual wording of the statute. Section 29 says that no bank may hold "possession" or "title and possession" of real estate. In this case, the bank would have neither title to the property, nor actual possession of it during the term of the Facility Lease. At the point that the bank might take possession of the property, i.e. upon termination of the Facility Lease, the bank would be required to divest itself of its interest in the Head GL within 10 years.

⁶ See, Letter from Thomas DeShazo, dated July 8, 1974 (unpublished); Letter from Peter Liebesman, dated March 13, 1990 (unpublished). But see, Interpretive Letter No. 556 [1991-92 Transfer Binder] ¶ 83,306 (August 6, 1991).

⁷ Although the Head GL runs approximately 8 years longer than the Facility Lease, the Bank has indicated that the reason for this provision is to ensure the marketability of the Facility at the close of the Facility Lease term. If the remaining useful life of the Facility cannot be utilized because the real property on which it sits no longer is transferable, then the Bank will be unable to sell or release the Facility after the Facility Lease with the Company ends. As further evidence of its incidental nature, the Bank is under no obligation to pay rent on the Head GL if the Sub GL lessee does not pay, including after the termination of the Facility Lease.

The Head GL is not inconsistent with any of the purposes underlying the restrictions of Section 29.⁸ The bank's funds are not being removed from the channels of commerce because the Bank will not be obligated to pay rent unless the sublessee under the Sub GL pays rent. There is no speculation in the value of real estate because the amounts owing under the Head GL and the Sub GL are identical. Finally, no large mass of real estate will be accumulated or held by the Bank as the Bank is limited to a leasehold interest in the Site.

In addition, the proposed transaction proposes no immediate safety and soundness concerns. The payment of rent on the Sub GL is guaranteed by the Company. Further, as mentioned earlier, the Bank is under no obligation to pay on the Head GL unless the affiliate pays on the Sub GL. Finally, the Bank has built into the Facility Lease and the Head GL a cross-default provision which would allow the Bank to operate the Facility if there were a default under either agreement. This provision would insulate the Bank from the possibility of having to disassemble the Facility and liquidate it in the event of default.

Therefore, for the reasons already stated, and based on the representations made to us, as summarized herein, we conclude that this facility leveraged lease transaction is permissible under 12 U.S.C. 24(Seventh). However, the Bank must at all times comply with the conditions set out in 12 CFR Part 23, including the requirement to divest of any off-lease interests within the appropriate divestiture period.

I trust this has been responsive to your inquiry.

Very truly yours,

/s/

Julie L. Williams
Chief Counsel

⁸ For example, the Supreme Court in Union National Bank v. Matthews, stated that

[t]he object of [Section 29] was obviously threefold. It was to keep the capital of the banks flowing in the daily channels of commerce; to deter them from embarking in hazardous real estate speculations; and to prevent the accumulation of large masses of such property in their hands, to be held, as it were, in mortmain.

98 U.S. 621, 626 (1878).