

**Government**

**Lease – Financing**



**for**

**Cities - Counties - Schools**

# ***MUNICIPAL FINANCING***

## Overview

We would like to introduce you to our Tax-Exempt Municipal Lease Financing Program. With the increasing demand for services, public agencies have embraced tax-exempt leasing as an alternative means of acquiring needed **equipment, real property and facilities** construction or upgrade.

Municipalities may leverage annually appropriated funds from their budget by three or four times the annual amount available. They may, for example, turn an annual \$100,000.00 budget appropriation into a \$300,000.00 or \$400,000.00 equipment acquisition by borrowing at tax-exempt rates. These loans may be paid off early or re-financed in a forthcoming bond issue.

The process begins with you defining for us your need. It can be any essential equipment, project or real property. You decide what and how much it costs, and we stay out of the way. We *interface* rather than *interfere* in that process.

During the next stage, we offer a finance quote based on the cost, term and expected delivery date of the equipment. Upon acceptance of our quote, documents are prepared for your review and signature. Commencement of the lease begins once the equipment is delivered and accepted.

While this process is technically referred to as “Tax-Exempt Lease/Purchase” financing, it is in reality a series of one-year installment sale payments (including non-appropriations language in the contract), renewable each year for the duration of the payback period. Lease contracts may amortize over 2 to 10 years for equipment and 15 years, or longer, for real property.

To the municipality, this means:

- ⌚ Retention of your borrowing capacity (a Lease does not contribute to your debt ceiling)
- ⌚ Fully amortized payment schedule with no balloon payments at the end
- ⌚ Additional benefits as defined in the following pages

Attached to this summary page is an expanded overview of municipal leasing plus some possible applications where a Lease can be an effective tool.

## WHAT IS THE MEANING OF TAX-EXEMPT?

The following should clarify what is consistently upheld in 48 of the 50 states. Arkansas and New Mexico are the two exceptions.

Reciprocal Immunity Doctrine; Reciprocal immunity is the principal that neither the states nor federal government may tax income received from securities issued by the other. The doctrine provides the original, constitutional basis for the federal tax exemption on interest paid on municipal securities. Reference: Pollock v. Farmers' Loan & Trust Co., 157 U.S 429 (1895); National Life Insurance Co. v United States, 277 U.S. 508 (1928).

**“Tax-exempt” in this context means that the interest portion of each lease payment is excludable from Federal & State (where applicable) income tax of the Lessor, or owner of the lease.** The issue has nothing to do with sales, use, property taxes or status as in a not-for-profit corporation.

Why are lease payments not considered debt? Tax-exempt leases are structured as a series of one-year renewable obligations, subject to the agency's ability to appropriate funds to make the lease payments in subsequent years. As a result, payments constitute a current expense of the lessee. In the sole event that sufficient funds are not available for payment, the agreement is terminated and the equipment is delivered to the lessor.

Since payments are a “current expense” (meaning: due during the current fiscal year and renewable annually), they are not considered debt. This means two things: The lease does not require voter approval and, the amount financed does not count against a lessee's debt ceiling.

What mechanism permits the lessee to terminate the lease early without penalty? The lease contains a non-appropriation clause that enables the lessee to terminate the lease agreement at the end of the current fiscal year without further obligation or penalty and can be implemented only in cases where the lessee was unable to obtain funding for subsequent payments. **The non-appropriation clause enables the lessee to show the lease obligation as a current expense instead of debt.**



# WHAT CAN THE GOVERNMENT LEASE?

A Partial List ... from A to X

*(Equipment must be for an essential government purpose)*

Air Compressors	Food Service	Refuse Vehicles
Aircraft	Forklifts	School Buses
Airport Facilities	Fuel Dispensing	Scientific
Alarm Systems	Furniture	Scrapers
Ambulances	Graders	Scoreboards
Athletic Field Lighting	Hospital	Security Systems
Audio / Visual	Beds/Furniture	Sound Systems
Equipment	Ice Machines	Sweepers
Automobiles	Imaging	Telephone
Bleachers	Incinerators	Systems
Buildings –	Inflatable Domes	Theater
Jails/Hospitals	Lockers	Trash
Bulldozers	Mailing Systems	Compaction
Card Entry & Control	Medical	Two-Way Radios
Cash Registers	Microfilm	Utility Vehicles
Communication Base	Modular	Video Editing
Station	Classrooms	Voice Mail
Computers	Mowers	Systems
Computer Software	Musical	Water Filtration
Controls (HVAC)	Instruments	Water Purification
Copiers	911 Systems	X-Ray
Cranes	Office Furniture	<u>REAL</u>
Data Retrieval	Parking Meters	<u>PROPERTY</u>
Desktop Publishing	Playground	Waste Water
Dry Cleaning/Laundry	Police Vehicles	Lighting
Energy Management	Power Generators	Upgrades
Fax	Printing	Site
Fire Engines	Recycling	Improvements
Fitness	Containers	Synthetic Fields
	Refrigeration	School Buildings
	Resuscitation	Fire Station
		Multi-Purpose
		Building
		Recreation
		Facility

## **QUESTIONS AND ANSWERS**

Public borrowing in the form of installment lease/purchase agreements is a rapidly growing area of public finance. Total volume of municipal leases soared from \$700 million in 1980 to \$3.5 billion by 1984 and to over \$12 billion in recent years, according to the Association for Government Leasing and Finance.

### **What is a Municipal Lease/Purchase Agreement?**

A Tax-Exempt Municipal Lease/Purchase Agreement is essentially an *installment sale contract* that fully amortizes during the term of the Agreement. There is no balloon payment or purchase option at the end. The Lessee owns it from day one. The issuer (lessee) is able to acquire and utilize equipment or facilities and pay for them over a specified time period. If structured properly, the interest portion of the lease payment is exempt from federal and state income tax resulting in low *tax-exempt* interest rates to the borrower. However, care must be taken if the property has a private use or involves federal funds.

### **Why is a Municipal Lease/Purchase generally not considered debt?**

A Municipal Lease/Purchase Agreement is a yearly obligation renewable at the option of the lessee. The obligation is subject to the annual appropriation of funds by the borrower. If funds are not appropriated in a given year, the Municipal Lease/Purchase Agreement may be terminated. While voter approval is generally not required for a public agency to enter into a Municipal Lease/Purchase Agreement, terms of the transaction are fully disclosed in their annual audited financial statements. Due to a *non-appropriation clause* in the contract, payments are considered an operating expense rather than debt.

### **Who is eligible to utilize tax-exempt leasing?**

Basically, any municipality or political subdivision who can issue tax-exempt securities may utilize *tax-exempt* leasing. Examples: State & Local government agencies, special assessment districts, public hospitals, fire districts (including volunteer departments), public transit districts, school districts, etc. The interest can also be done at a taxable rate.

### **Why should Government Officials consider Lease/Purchase Agreements?**

Lease/Purchase Agreements should be used to compliment, rather than replace, traditional bond financing. Many times Lease/Purchase Agreements can be a more timely, efficient, and cost effective means of financing essential equipment and facilities. In addition to the low cost of issuance, uncomplicated financing documents save both administrative and legal expenses. For issuers expecting to do multiple transactions over a period of time, additional savings can be attained by use of an *Advance Payment/Purchase Agreement*.

### **What type of equipment should I consider leasing?**

Virtually any type of essential use equipment may qualify for a Lease/Purchase Agreement. In general, terms may be offered from *two to ten years* or more, depending on the useful life of the asset.

# **MUNICIPAL LEASING**

## **Advantages to the Lessee**

Municipal Lease/Purchase financing is designed to compliment, rather than replace bond financing. As governmental units have become cognizant of the advantages of Municipal Lease/Purchase Agreements over bonds, they have increased their utilization of this unique financing vehicle to satisfy many of their equipment and facility financing needs. The advantages of Municipal Lease/Purchase Agreements are as follows:

### **No Cash Down Payment**

These financings may provide for 100% of the equipment purchase price or facility construction cost plus related expenses. The governmental lessee only makes periodic lease payments. Substantial down payments may reduce interest rates charged.

### **Tax-Exempt Interest**

Properly structured, these transactions result in each payment representing some principal and some interest. The Internal Revenue Service has determined that interest paid in this manner is exempt from federal income tax. The interest may also be exempt from state and local income tax. Charter schools do not directly qualify for tax exempt financing.

### **No Public Debt Created**

Since the lease payments due in the transaction are subject to annual appropriation, the obligation created by the *lease is not subject to constitutional or statutory debt limitations in most states*. Since public debt is not created, voter approval for a Municipal Lease/Purchase transaction is not usually required.

### **Matching Cost with Revenue**

Payment obligations correspond more closely to the useful life of the asset(s) financed by the lessee. A full cash purchase charges one year's operating budget with the cost of an asset, which will be in use for several years. Lease/Purchase transactions can and should be designed to match the finance terms with the expected useful life of the asset, thereby spreading the cost over the budgets for all the years benefiting from the use of the asset. Amortization can be designed on a monthly, quarterly, semi-annual, or annual basis or even on a SKIP payment basis.

### **Flexibility**

Shorter lead time to arrange a financing, as the procedural aspects of traditional bond financing may be complicated by rigid constitutional requirements which serve capital project financing control, but are inflexible for asset acquisitions and future refinancing.



# A BRIEF COURSE IN PUBLIC FINANCING

## Everything you'll need to know about Municipal Leasing

### Purpose

To acquaint the reader with the most commonly used methods of financing utilized by municipal governments and when Leasing is the best option.

Public agencies have numerous available options to acquire needed resources – equipment and/or project financing. Of course, paying cash is the most preferable method. This being said, cash may not be the best use of funds because agencies often have multiple simultaneous needs and a finite amount of available cash in their current or, possibly, future budget years to accomplish their goals.

### Financing Options

- ⌚ Most common methods of financing are:
- ⌚ General Obligation Bonds
- ⌚ Revenue Bonds
- ⌚ Certificates of Participation
- ⌚ Lease/Purchase

### What is a bond?

In public finance, a bond is a piece of paper worth exactly \$5,000.00 (not including interest). Bond issues are divisible into \$5,000.00 units. A single \$5,000,000.00 bond issue has 1000 bonds (\$5,000,000.00 divided by \$5,000.00 = 1000 bonds) and permits the underwriter to sell the issue in parts to multiple investors. It could be challenging to sell a \$50,000,000.00 issue to a single investor.

Bonds have liquidity, which means they can be sold back to the underwriter by the original bondholder for an amount below their current par value, thus creating what's called a "secondary market." In other words, bonds are securities just like stocks and are subject to regulation by the SEC and NASD (National Association of Securities Dealers). Securities require full disclosure to prospective investors in the form of an Official Statement ("OS") prepared under the supervision of an attorney called "Disclosure Counsel." In addition a "Bond Counsel" is responsible for the authenticity and tax issues related the bond documents. Other underwriting costs include: paying agent (collects and disburses payments), printing costs of the OS and fees associated with the sale of the bonds. Bonds are "priced-to-market" the day the bonds are sold, meaning they are sold to investors at the prevailing interest rate on that particular day. Payments are due to bondholders every 6 months.

**General Obligation, or "GO" Bonds**, are exactly as the name implies – a general obligation of the city, county or state whose taxpayers approve the bond sale at the voting booth. All GO Bonds require voter approval. GO Bonds average 20 years in length, larger is size, rated by rating services such as Standard & Poor's, Moody's or Fitch's and bond proceeds are generally used to finance larger ticket capital projects. GO Bonds are not spontaneously conceived due to the time it takes to originate, sell the idea to the voters and hold an election – all of which is accomplished with public scrutiny. The process could take a year or more to complete and may or may not pass in the referendum.

**Revenue Bonds** have the same characteristics as a GO Bond with two exceptions: a) they do not require voter approval and, b) repayment is based on a defined source of revenue from the project being financed. A revenue bond would be approved by the board of the agency needing the funds after numerous meetings open to the public. Although the bonds are “revenue neutral” to the taxpayers, local input is encouraged for political and legal reasons.

Streets and sewers for a new housing development would be financed with revenue bonds since the repayment will be made by user fees charged to the local residents within the boundaries of the district. There are over 90,000 separate political subdivisions in the US, many being sewer and water / waste water related.

To mitigate possible investor risk, underwriters will likely arrange to have the bonds insured against default. An insured bond issue may then be rated to investment grade and receive an A or AA rating, making the issue a safe, conservative investment. The added cost of insurance is worth every penny to the borrowing agency since the bonds pay a lower rate of interest to the investor(s) and cost the borrower less over the term. By the same token, uninsured municipal bonds (not quite junk bonds) are sold at higher interest rates to entice more aggressive investors willing to take some risk for a higher yield on their money. These bonds can be very attractive to sophisticated investors who know what they are doing.

## **MUNICIPAL TAX-EXEMPT LEASES**

“**Tax-exempt**” in this context means the interest portion of each lease payment is excludable from federal and state income taxes to the lessor, or their assignee. The issue has nothing to do with sales, use or property taxes.

Only agencies with taxing authority can issue a tax-exempt lease. A non-profit corporation’s tax-exempt status does not qualify them since they don’t have the taxing authority reserved solely for public agencies.

Tax-exempt leases are, in most cases, installment *sales* containing “non-appropriation” language (also called “funding-out clause”) and enabling the lessee to terminate the lease at the end of the current fiscal year, without further obligation, when the lessee is unable to obtain funding for the next fiscal year and beyond. Technically the lease is structured as a series of one-year renewable obligations subject to the lessee’s ability to appropriate the money for payments due in future years. Cancellation for convenience is not implied by this provision.

Non-appropriation language permits the lessee to amortize the loan over a multiple year period. Without it included, leases would have to be fully amortized during the current fiscal year.

As a result, the payment constitutes a *current expense* of the lessee and is why the obligation is called a “Lease/Purchase” rather than a “Loan.” In the sole event sufficient funds are not available next fiscal year, the lease is terminated at the end of the current fiscal year and the equipment is delivered to the lessor with 90 days prior written notice. A current expense item is *not considered debt*; therefore tax-exempt leases *do not require voter approval*, nor do they count against the lessee’s debt ceiling, or borrowing limit. Being an installment sale, title to the equipment vests with the lessee *during* the lease term, and the lease will fully amortize to \$0.00 with the final lease payment.

**The two most common forms of a Tax-Exempt Lease are:  
Certificates of Participation (COP) and Lease/Purchase Agreements**

**COP's** are structured much like revenue bonds. They a) are sold to multiple investors in \$5,000.00 each certificates, meaning they are "securitized" and require full disclosure in the form of an Official Statement (OS), b) payments are made semi-annually and, c) they require a Paying Agent, or Trustee. The main difference between the two is that COP lease payments may be tied to a lessee's General Operating Fund rather than to a specific revenue source such as monthly utility fees. COP's may extend out 20 years and are of sufficient \$dollar size to warrant certificating them. Hence the name: "Certificates of Participation."

**Lease/Purchase Agreements** transactions are placed with a single investor, and generally limited to 10-12 years in length with an average maturity of about 5 years. Size runs from about \$10,000.00 to \$millions – depending on the *useful life* of the asset, transaction size and essentiality of the equipment. Vehicles and office equipment are typical items being financed.

Other advantages:

- ⌚ **100% financing** including delivery, installation and sales tax (where applicable).
- ⌚ **Cost effective** - Nominal associated origination costs, if any.
- ⌚ **Equipment and Real Property** may be financed on a Lease/Purchase Agreement.
- ⌚ **Flexible payments**: Monthly, Quarterly, Semi-Annual, Annual or Delayed Payments
- ⌚ **No Reserve Account** required
- ⌚ **Uncomplicated documentation**

## **MUNICIPAL LEASE VS. BOND COMPARISON**

<b>Financing Characteristics and/or Requirements</b>	<b>Public Bond Offering</b>	<b>Direct Source Financing</b>	<b>Why “No” is the Better Answer</b>
Compliance with SEC Rule 15c2-12	YES	NO	Disclosure rules do not apply
Exact Rates Unknown Prior to Closing	YES	NO	Rates quoted before funding Rate lock option available
Underwriter’s Fees	YES	NO	No additional fees
Rating Agency Fees	YES	NO	No additional fees
Printing Costs	YES	NO	No additional fees
Reserve Fund	YES	NO	Not required
Prepayment only on Call Dates	YES	NO	Prepayment options throughout term
Multiple Investors	YES	NO	Private placements
Semi-Annually Only	YES	NO	Payment schedule designed to meet your needs
Time Consuming Documentation Process	YES	NO	One simple process

Acquire the equipment you need *without* Disclosure. Beginning July 3, 1995, amended SEC Rule 15c2-12 governing disclosure obligations of municipal securities issuers and obligor went into effect. The new Rule is designed to protect investors by ensuring adequate ongoing disclosure of information relating to the financial health of the issuer and obligor. The Rule increases the complexity of debt issuance in the public market. **Direct source financing is not subject to disclosure requirements.**



# **BENEFITS OF TAX-EXEMPT MUNICIPAL FINANCING**

## **Advantages for the Government**

Lease/Purchase financing is designed to complement, not replace, bond financing. Leases afford government agencies the opportunity to acquire equipment during the current fiscal year instead of their having to wait until the next budgetary cycle. In addition, leases offer the following advantages to the government.

- ❖ 100% financing to include delivery and installation costs.
- ❖ Terms available up to ten years, sometimes longer (depending on the collateral).
- ❖ Tax-exempt interest. Lease payments include principal and an interest portion. The IRS has determined that interest paid in this manner is exempt from federal and state income tax. This means the government can take advantage of lower interest costs.
- ❖ No debt created. Lease payments are subject to annual appropriations, which means that the obligation is not subject to statutory debt limitations. Since no debt is created, municipal leases do not require voter approval.
- ❖ Budget enhancement. Leasing allows public agencies to acquire needed improvements now rather than wait until next FY or beyond.
- ❖ Leveraged dollars. Leases may be designed to match finance terms to the expected useful life of the asset and spread the cost over a multi-year period.
- ❖ Flexibility. Payments may begin upon installation or delayed until the next fiscal year. In addition, they may be made in monthly, quarterly, semi-annual or annual installments.
- ❖ Equipment and Real Property financed through a tax-exempt lease may be funded into escrow to facilitate project financing or progress payment requirements.
- ❖ Cost effective. Lease approval and documentation is very inexpensive to initiate.



# MASTER LEASE FINANCING

**Smart Finance Options, Inc.** has designed a Master Equipment municipal lease finance program that gives an agency *the ability to finance multiple projects and unrelated equipment needs - in one single Agreement.*

## THE OLD WAY...LEASE WITH OPTION TO PURCHASE

A conventional municipal lease agreement is most often called a *Lease with Option to Purchase*. This standard agreement is commonly used for single transactions according to a periodic need of an agency, and is perfectly suited for one-time purchases. In these cases, numerous Lessors and multiple billings will be the norm.

## MASTER AGREEMENT...THE BEST WAY!!

A Master Agreement makes it possible to *finance numerous projects using just one Lease Agreement*. Equipment Schedules may be added to the same Lease according to need and desired term. There may be one or ten schedules! Payments for all Schedules are made to one single Lessor. Master Agreements may be used for project financing, or possibly to replace obsolete Equipment.

A properly utilized Master Agreement will save time that is spent dealing with multiple lessors, separate billing statements, and money spent for multiple legal reviews of the lessor's documentation.

## MASTER AGREEMENT FEATURES:

### ⌚ **Staggered Maturity Dates**

*Each* equipment schedules to the Master Agreement may mature at different times

### ⌚ **Flexible Commencement Dates**

Commencement dates will vary according to the date equipment is accepted. Each schedule may be viewed as a mini-lease within the single Master Lease. Termination dates are independent from other schedules in force at the time.

### ⌚ **Escrow Funded**

Due to possible vendor progress payment requirements, escrow funding is available. Escrowed funds earn *daily-accrued interest* for the account of the Lessee based on the remaining balance in the account. Escrow set-up fees are nominal and often at no cost.

Additional unrelated Equipment schedules may be added to the Master Agreement as needed. New telephone system, computers, school buses or any other essential equipment, all acquired without necessitating a brand new lease every time an item of equipment or project is mandated. There is no maximum number of schedules.



## MUNICIPAL LEASE PROJECT FINANCING

Recently, a City was provided **project financing**: one that involved infrastructure improvements and expansion. The City had planned to finance with a bond but were turned down by the voters. They subsequently scaled back the project and arranged a multi-year Tax-Exempt Lease-Purchase financing to be re-paid from existing revenues.

*Some possibilities...*

- ⌚ Waste Transfer Station
- ⌚ Water Treatment Plant upgrades
- ⌚ A New City Hall
- ⌚ A New Fire Station
- ⌚ A New School Building
- ⌚ A New Synthetic Turf Soccer or Football field
- ⌚ Heating and Lighting upgrade

*To name a few...*

Municipal project financing provides public agencies with a whole new level of opportunity. Transactions are easier and faster to complete than traditional bond financing that often require voter approval.

For additional information please call our Government Finance Help Desk

**OFFICE 512.807.8159 or FAX 888.547.7993**  
**EMAIL: [info@smartfinanceoptions.com](mailto:info@smartfinanceoptions.com)**



# SMART FINANCE OPTIONS, INC.

## MUNICIPAL LEASE APPLICATION

### LESSEE INFORMATION

Legal Name of Lessee:	Phone Number:	Fax Number:	
Contact Person:	Title:	Email Address:	
Address:	City:	State/Province:	Zip/Postal Code:
Date municipal entity was established:	Federal Tax ID:		

### EQUIPMENT INFORMATION

Total Cost of Equipment: \$	Term in years:
Down Payment: \$	Anticipated Delivery Date:
Trade-in: \$	Payment Mode: <input type="checkbox"/> Monthly <input type="checkbox"/> Quarterly <input type="checkbox"/> Semi-Annual <input type="checkbox"/> Annual
Amount to Finance: \$	Payments made in: <input type="checkbox"/> Advance <input type="checkbox"/> Arrears
Is the equipment replacing existing 'like' equipment? <input type="checkbox"/> Yes <input type="checkbox"/> No	If yes, how many years has the current equipment been in use?
What is the reason for purchasing new equipment?	
Please <u>describe</u> the equipment being financed. <i>Also, please send an equipment or vendor brochure if available.</i>	

The equipment to be financed is: <input type="checkbox"/> New <input type="checkbox"/> Used	Vendor Web Site:
Please describe in <u>detail</u> why the equipment is essential and the use it will provide:	

### FUNDING INFORMATION

Please specify which fund the rental payments will be made from:	
The appropriations for this project have been: <input type="checkbox"/> Submitted <input type="checkbox"/> Approved	
Have you ever been in Default or Non-Appropriated on a Municipal Lease? <input type="checkbox"/> Yes <input type="checkbox"/> No	
Will you borrow <i>more</i> or <i>less</i> than \$10,000,000 in total new borrowing during this calendar year? <input type="checkbox"/> More <input type="checkbox"/> Less	
Person <i>signing</i> documents is:	Title of person <i>signing</i> documents:
Person <i>authorizing signatory</i> to execute documents is:	Title of person <i>authorizing signatory</i> : <input type="checkbox"/> Clerk <input type="checkbox"/> Secretary of the Board <input type="checkbox"/> President of the Board <input type="checkbox"/> Other (please specify)

Signature:

Date:

PLEASE FAX A COPY OF YOUR LATEST COMPLETED BALANCE SHEET AND INCOME STATEMENT ALONG WITH THIS COMPLETED APPLICATION TO 888-547-7993.