The Basics of Municipal Leasing

David G. Roeder, LaSalle National Leasing Corp.
How do State & Local Governments Traditionally Pay for Capital Projects?

1. Cash on Hand
2. Assess or Raise Taxes
3. Assess or Raise Fees or User Charges
4. Create an Indebtedness
   a. General Obligation Bond
      1. Full Faith and Credit
   b. Revenue-Backed Bond
      1. Water & Sewer Revenues
      2. Sales Tax Revenues
The Other Alternative!!!: Municipal Lease-Purchase

- A hybrid tax-exempt structure with features similar to both a loan and a lease
  - **Like a Loan**: Customer has title to asset during term and gains free & clear ownership of asset at end of term
  - **Like a Lease**: Financing is subject to annual renewal or termination
  - Legally not a “Debt” from a constitutional perspective, because no multi-year obligation is created
  - Treated as a Capital Lease under GAAP accounting
Annual Appropriation Clause

- Lessee must appropriate lease payments into budget each year to renew or continue the financing
- Lessee may terminate the financing if insufficient funds are appropriated (a non-appropriation is said to have occurred)
- Upon termination, Lessee must return the asset, but has no further obligations under the financing
- The appropriation decision occurs each year during the lease term
What Can Be Lease-Purchased?

Personal Property Examples

- Vehicles,
  - such as Fire Trucks, Police Cars, Ambulances, Refuse Trucks & School Buses
- Telecommunications Equipment
- Computers & Software
- Copiers & Other Office Equipment
- Safety Equipment
- Energy Management Systems,
  - such as HVAC equipment
- Medical Equipment
- Modular Buildings
What Can Be Lease-Purchased?

Real Property Examples

- School Facilities
- Courthouses
- City Halls
- Fire Stations
- Hospitals
- Nursing Homes
- Correctional Facilities
- Public Utility Facilities
- Libraries
- Airport Facilities
- Recreational Facilities
- Port Facilities
**Who are Eligible Lessees?**

**Direct Issuers: (100,000 Nationally)**
- States
- Local Governments & Other Political Subdivisions
  - Such as:
    - Cities & Counties
    - Public School Districts
    - State Universities
    - Fire Protection Districts
    - Ambulance Districts
    - Public Utility Districts
    - Various Authorities
- Native American Tribal Governments (Sovereign)

**Requires On-Behalf of Issuer for Tax-Exempt Issuance:**
- 501(c)(3) Organizations
  - Generally includes:
    - Charitable, Religious & Educational Entities
    - Not-For-Profit Hospitals
    - Private Schools
- Certain Private Parties
  - Such as:
    - Manufacturers
    - Other Exempt Facilities
Who are Eligible Lessors?

(Almost Anyone!)

- Brokers/Packagers
- Vendors
- Investment Bankers
- Banks, as lenders
- Banks & Trust Companies, as trustees
- Captive Finance Companies
- Independent Finance Companies
- Other Governmental Entities
- Non-Profit Corporations
Who are the Investors?
(Or, Who’s Loaning the Money?)

- Banks
- Leasing Companies
- Corporations
- Mutual Funds
- Insurance Companies
- Individual Investors
- Grantor Trusts (Securitization)
- Investment Bankers
Why Use Lease-Purchase Financing?

• Conserves Cash on Hand

• Not classified as Debt, therefore:
  – No Voter Referendum
  – Not subject to Legal Debt Limitations

• No Encumbrance of Tax or Other Revenues, therefore:
  – Revenues are available to secure future Debt
  – Enhances borrowing flexibility

• More Structuring Flexibility
  – Match financing terms with expected useful life of asset
  – Less rigid terms vs. bonds

• Benefits vs. Public Bonds:
  – Easier Approval Process
  – Lower Transaction Costs
  – More Flexible Structures
  – Fewer Documents
  – No Ratings / Insurance
  – Less Complicated for Lessee
  – No Ongoing Reporting
Why Are Municipal Lease-Purchases Attractive to Investors?

1) Comparable Taxable Equivalent Yield vs. Commercial
   
   \[
   5.00\% \quad \text{(Municipal lease)}
   \]
   
   \[
   \div .650 \quad \text{(1 Minus the 35\% Corporate Tax Bracket)}
   \]
   
   \[
   = 7.69\% \quad \text{Taxable Equivalent Yield}
   \]

2) Favorable Credit Profile vs. Commercial Customers
   - More Essential Assets
   - Monopolistic Providers
   - Lower Default & Loss Rates
Typical Transaction Structures

- Lease-Purchase of Equipment or Real Property
  - Subject to Appropriation
  - Subject to Abatement (CA and IN)
  - Ground Lease / Facility Lease

- Lease Revenue Bonds

- Certificates of Participation (COP’s)

- 501(c)(3) Conduit Financings

- Industrial Development Revenue Bonds (IDRB’s)
Credit Considerations

1) Essentiality  
   A) Of Service Provided  
   B) Of Asset Financed

2) Source of Repayment  
   A) General Fund  
   B) Capital Fund  
   C) Specific Revenues

3) Financial Wherewithal  
   A) Unrestricted Liquidity  
   B) Debt Capacity  
   C) Debt Ratings

4) Demographic Analysis  
   A) Assessed Valuation  
   B) Population Trends  
   C) Major Employers & Taxpayers
Lease-Purchase Documentation

• Lease-Purchase Agreement
  - Equipment Description Schedule
  - Payment Schedule
• Escrow Agreement
• Delivery & Acceptance Certificate
• Title / Security Interest / Leasehold Interest / Lien
• Proof of Insurance

• Resolution of Governing Body
• Incumbency Certificate
• Bank-Qualified Certificate
• Essential-Use Certificate
• Opinion of Counsel
• IRS Form 8038-G
Documentation Considerations

- Resolution should approve the project & the financing
- Payment Schedule must include breakout of principal & interest
- Lease should be governed by state law of the lessee
- “Validity” Opinion should address whether the Lease is legal, valid, binding and enforceable
- Tax Opinion for complex structures & conduit structures
- IRS Form 8038-G should include correct Issue Cost, Yield & Maturity
- 8038-G should be filed according to IRS procedures
Documentation Considerations

• UCC-1 filing must contain exact name of customer

• Many states have not adopted Article 9 for Governmental Bodies

• Many governmental customers are self-insured or participate in pools

• Non-Substitution clause may render Lease invalid

• Assignment provision dictates whether Lessee consent is required

• Late-Payment fees may not be permitted by statute

• Liability claims may be capped by statute
# Common Municipal Leasing Terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Description</th>
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<tbody>
<tr>
<td>Bank Qualified</td>
<td>Lessee expects to issue $10 million or less during calendar year</td>
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<tr>
<td></td>
<td>“Qualified Tax-Exempt Obligation” designation</td>
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<tr>
<td></td>
<td>Section 265(b)(3) of IRS Code</td>
</tr>
<tr>
<td>Non-Bank Qualified</td>
<td>Lessee expects to issue more than $10 million during calendar year</td>
</tr>
<tr>
<td>Appropriation Lease</td>
<td>Repayment subject to the annual appropriation of funds</td>
</tr>
<tr>
<td>Abatement Lease</td>
<td>Repayment subject to usage of asset financed</td>
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<tr>
<td>Firm-Term Lease</td>
<td>Repayment is unconditional</td>
</tr>
<tr>
<td>Essentiality</td>
<td>A relative measure of the importance of the project to the lessee</td>
</tr>
<tr>
<td>Non-Substitution</td>
<td>Provision prohibiting customer from replacing project for a specified period of time following a non-appropriation</td>
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<tr>
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<td>Compels lessee to renew</td>
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<td>Contravention of Debt limitations</td>
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<td>May render lease-purchase agreement INVALID</td>
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| COP’s                 | - Certificates of Participation  
                          - Lease is certificated into fractional ownership & sold to investors  |
| Conduit Issuer        | - A governmental body that issues a tax-exempt obligation on behalf of another entity  |
| Red-Book Counsel      | - A nationally-recognized law firm  
                          - Listed in the Bond Buyer Municipal Marketplace (the “Red Book”)  |
| Statute               | - A law that authorizes and/or prohibits certain activities  |
| Private Activity      | - Over 10% of project will be used by non-governmental entity  
                          - Impacts tax-exemption of transaction  |
| Reimbursement Resolution | - Allows lessee to reimburse prior cash outlays from bond or lease-purchase proceeds  
                          - Resolution must be approved within 60 days of expenditure  |
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<td>Public Bidding</td>
<td>- Public projects require multiple bids (usually 3 or more)</td>
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<td>- Bids must be open to public inspection &amp; review</td>
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<td>- Helps ensure fairness and public approval</td>
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<tr>
<td>RFP</td>
<td>- Request for Proposal</td>
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<td>- Customer is seeking proposals for a specific project</td>
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<td>Award</td>
<td>- Customer notification to the winning bidder</td>
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<tr>
<td>Coupon Rate</td>
<td>- The tax-exempt interest rate paid by the Lessee</td>
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<td>- Indicated on payment schedule</td>
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<tr>
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<td>- Indicated on 8038-G (as Yield)</td>
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<tr>
<td>Buy Rate</td>
<td>- Discounting rate used by Investor to determine Purchase Price</td>
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<tr>
<td>Notice of Assignment</td>
<td>- Written notice to Lessee re: assignment by Lessor</td>
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<td>- Provides payment direction to Lessee</td>
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Basics of Municipal Leasing

- Q & A
- Enjoy the Conference!
- Presentation will be available on ELA website