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QUESTIONS AND ANSWERS

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 a *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:

- A) **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.
- B) **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.
- C) **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.
- D) **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.
- E) **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 refinancings.