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CONFERENCE**

May 4-6, 2016 | Omni Charlotte Hotel



The Basics of Municipal Leasing AGL&F Annual Conference

**May 4, 2016
Charlotte, NC**

Jeff Sharp, Capital One Public Funding, LLC



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How do State & Local Governments Traditionally Raise Capital?

1. Levy (or raise) Taxes
2. Create an Indebtedness (Bonds, Notes, Obligations)
 - a. General Obligation
 1. Full Faith and Credit
 - b. Revenue Backed
 1. Water & Sewer
 2. Sales Tax
3. Fees and User Charges



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The Other Alternative!!!: Municipal Lease Purchase

- Developed in the 1960's to support the Office Technology boom.
- Legally not a debt. (Constitution)
- Considered Debt for GAAP Accounting & Credit Analysis.
- **Why: Non-Appropriation Clause**
Payments are not absolute, the funds must be appropriated each fiscal period.



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What is a Municipal Lease?

A Lease/Purchase Agreement, pursuant to which:

- The Lessee (*a/k/a* the “borrower”), which is a state or local government or political subdivision –
- purchases specific real or personal property from the Lessor (*a/k/a* the “lender”) –
- by making periodic lease payments over an established time-period, during which Lessee builds equity in the property (& gets ownership at end of term for \$1) – Conditional Sale
- subject to annual appropriation (or subject to an acceptance and rent abatement clause in CA & IN) –
- usually, interest portion of lease payment is tax-exempt.
 - ✓ Section 103 of the IRS code



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Credit Considerations – Municipal Leasing

1. Essential Purpose
2. Financial Capacity
 - A. General
 - I. Assessed Valuation
 - II. Demographic Trends
 - III. Legal/Statutory environment
 - B. Revenue Specific
 - I. Sources of Revenue
 1. Taxes (Sales, Hotel/Motel)
 2. Utility (Water, Gas, Electric, Broadband)
3. Documentation- Lease Agreement
 - A. Legal, Valid, Binding (at least 50 sets of rules)
 - B. Title/Security Interest
 - C. Mortgage/Base Lease (Ground Lease)
 - D. Tax Opinion



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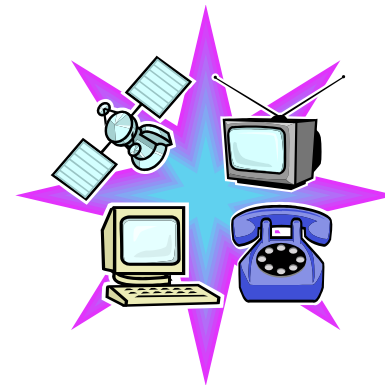
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What Can Be Leased?

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
- Substitute Collateral





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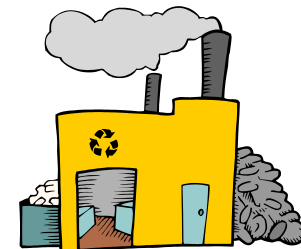
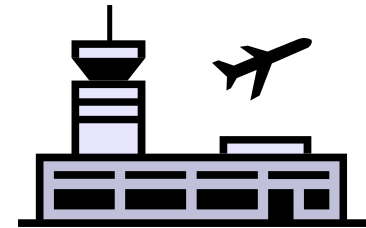
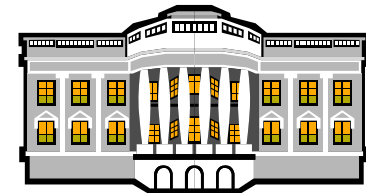
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What Can Be Leased?

Real Property Examples

- School Facilities
- Courthouses
- City Halls
- Fire Houses
- Hospitals
- Nursing Homes
- Correctional Facilities
- Public Utilities Facilities
- Libraries
- Airport Facilities
- Recreational Facilities
- Manufacturing Facilities
- Substitute Collateral





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Who are Eligible Lessees?

Direct Issuers: (100,000 Nationally)

- States
- Local Governments & Other Political Subdivisions
 - Such as:
 - Cities & Counties
 - Public Schools & Colleges
 - Fire Protection Districts
 - Ambulance Districts
 - Public Utility Districts
- Native American Tribal Governments (Sovereign)

Requires On-Behalf of Issuer for Tax-Exempt Issuance:

- 501(c)(3) Organizations
 - Generally includes:
 - Charitable, Religious & Educational Entities
 - Hospitals
 - Private Schools
- Certain Private Parties
 - Such as:
 - Manufacturers
 - Other Exempt Facilities



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Who are Eligible Lessors?

(Almost Anyone!)

- Brokers/Packagers
- Vendors
- Investment Bankers
- Banks, as lenders
- Banks & Trust Companies, as trustees
- Captive Finance Companies
- Independent Finance Co.
- Other Governmental Entities
- Non-profit corporations



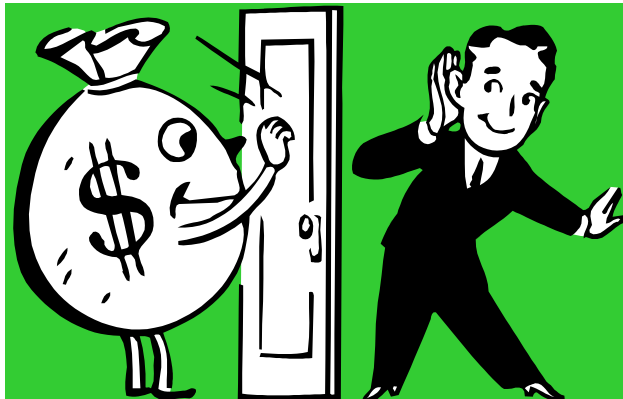
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Who are the Investors?

(Or, Who's Loaning the Money?)



- Banks
- Corporations
- Mutual Funds
- Insurance Companies
- Individuals
- Grantor Trusts
(Securitization)
- Investment Bankers



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Why Use Lease Financing?

- Alleviates cash flow burden that would be created by a lump sum capital expenditure.
 - A lease (unlike bonds) is not generally classified as “debt”, therefore –
 - No voter approval required, which allows for more timely financing.
 - Lease is usually not subject to legal debt limitations.
 - Lease does not encumber Lessee’s tax or other revenues, unlike a bond financing.
- More structuring flexibility than with bonds.
 - Can match separate lease terms with each asset’s expected useful life.
 - Benefits of a direct lease or a single-investor lease vs. a public offering of bonds:
 - Lower transaction costs
 - More flexibility in timing & structure
 - Fewer documents
 - Less complicated for Lessee



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Why Are Municipal Leases Attractive to Investors?

The Taxable Equivalent Yield

5.00 % (Municipal lease)

÷ .625 (Inverse of the 37 ½ % Corp. Tax
Bracket)

8.00 % Taxable Equivalent Yield



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Transaction Structures

- Lease-Purchase of Equipment or Real Property
 - Non-Appropriation
 - Abatement
 - Terms 1 – 20 Years (Sometimes Longer)
- Lease Revenue Bonds
- Certificates of Participation (“COPS”)
- 501(c)(3) Conduit Financings & Industrial Revenue Bonds



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The Municipal Leasing Market Today

Pre 9/11 and Economic Slowdown:

- Cash Rich borrowers (Sales Tax, Income Tax)
- Bond issues relatively easy to pass

Today

- Budgets are tight
- Bond Issues are more complex & expensive

The Answer: Municipal Leases

- Less cash required
- Flexibility of terms
- No voting requirements with adequate cash flow
- Real and personal property



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The Regulatory Environment

Dodd- Frank Changed Everything:

- SEC regulation of the Municipal Securities Market
- The role of a “Municipal Advisor” defined
- Municipal Lease vs. Municipal Security
- Broad definition of “Advice”
- A word of caution: Make sure you are seeking counsel about your role in the process when working with municipal borrowers and their advisors
- Significant potential consequences



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Common Municipal Leasing Terms

Bank Qualified:

- Must be for Governmental Purpose or 501 (c)3
- Does not reflect credit quality
- Lessee expects to borrow less than \$10 Million during that calendar year.**

Private Activity : Over 10% of the financed facility or equipment will be used by a private concern.

Non-Substitution: The borrower is not allowed to replace the equipment for a period of time following a non-appropriation.

--- **Court Decisions: Invalid**

Reimbursement Resolution: Allows a lessee to reimburse cash outlays from bond or lease proceeds (Must be done within 60 days of expenditure.)

Firm Term Lease : Not subject to annual appropriation



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Documenting the Master Lease Agreement

- The Agreement
- Schedule of Lease rental payments
 - (including prepayment schedule)
- Delivery and Acceptance
- Board Resolution (Municipal Certificate)
- Attorneys Opinion (Legal, Valid, Binding)
- UCC/Title
- 8038 G
- Escrow Agreement
- Arbitrage Certificate (Over \$1 million)
- Insurance Certificates
- Real Property: Title Ins., Phase I, Appraisal, Survey



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The Process

- Sign Up the Deal
- Structure the Transaction
- Submit the Deal
- Credit Review
- Approval
- Funding

Thanks And Good Luck!!