Lunch & Learn at the League:
Lease Purchase Financing
March 8, 2013

Speakers
Speakers (in speaking order)
• Ken Guckenberger – Kutak Rock
• Georgeann Becker – Peck Shaffer
• Alex Brown – Alex Brown Consulting
• Erick Stowe – CDFC
• Steph Chichester – North Slope Capital Advisors

Financing Lease w/Option to Purchase and Certificated

Rent Payments

Entrance to Accept & Lease Project

Lease

Trustee

Indenture of Trust/Assignment of Lease

COP Proceeds

Certificates of Participation

Investors

LEASING V. OTHER TYPES OF FINANCING
• Why Lease?
  • Leasing can be a convenient and appropriate financing method for certain borrowings
  • Common Examples: Equipment, vehicles
  • Long history of governmental entities executing lease purchase transactions in Colorado: cities, towns, counties, school districts and special districts
  • If subject to annual appropriation, then leases will typically fall outside the scope of TABOR; voter approval not required

LEASING IN COLORADO
• Pre-TABOR, leasing in Colorado was fairly common
• Colorado statutes authorize municipalities to lease both real and personal property (C.R.S. §31-15-101(d))
• Home Rule charters typically permit leases
• Not required to be approved by voters
• Statutory towns may be subject to election if lease involves sale of land under C.R.S. §31-15-713(a); so more typically see a lease-lease back situation in those situations

LEASING IN COLORADO POST-TABOR
• After the passage of TABOR (Colo. Const. Art. X, Sect. 20) in 1992, governmental leasing was quickly reaffirmed in a series of cases:
  – County of Boulder v. Dougherty, 890 P. 2d 199 (Colo. App. 1994) (affirming lease purchase of road grader by county without election where lease was subject to annual appropriation since such debt was not a multiple-fiscal year obligation under TABOR).
LEASING IN COLORADO POST-TABOR

In re Submission of Interrogatories on HB 99-1325, 970 P.2d 549 (Colo. 1999) (Colorado Supreme Court affirming conclusion of Dougherty decision that lease-purchase permitted under TABOR without voter approval because it did not entail the borrowing of funds or pledging of credit).

LEASING IN COLORADO POST-TABOR

See also Colorado Criminal Justice Reform v. Ortiz, 121 P.3d 288 (Colo. App. 2005) (lease payments for prison subject to annual appropriation of legislature not subject to TABOR); City of Golden v. Parker, 138 P.3d 285 (Colo. 2006) (multi-year payments to developers for economic development that were subject to annual appropriation are not multiple fiscal year obligations); Bruce v. Pikes Peak Library District, 155 P.3d 630 (Colo. App. 2007) (exception for multiple-fiscal year financial obligations for which adequate present cash reserves were pledged irrevocably and held for payments in all future fiscal years).

LESSORS

• Non-profit organizations
• Capital leasing corporations
• Other non-profits (CDFC)
• Leasing companies
• Trusts/Trustees

COMMON COMPONENTS OF COLORADO LOCAL GOVERNMENT LEASES

• The Lease is a series of 1-year terms
• Initial term through fiscal year-end
• Renewal term made through annual appropriation in budget
• The Lessee MUST have the right to NOT appropriate
• Implications of failure to appropriate
• Surrender the collateral (may or may not be the equipment/property leased)
• Lessor must be able to compel return of property

ECONOMIC COMPULSION REAL WORLD CONCERNS

• The lease must be of a nature that the Lessee can really walk away – that there is no economic “compulsion”. See Gude v. City of Lakewood, 636 P.2d 691, 700 n.8 (Co. 1981) (in upholding lease purchase financing of City Hall, the Court noted that there is showing that the lease rentals exceed a reasonable amount so that the City was under a practical compulsion to exercise its renewal options to protect its investment).

ECONOMIC COMPULSION REAL WORLD CONCERNS

• Transaction must be of a nature that lessee can really walk away and Lessor can repossess the leased property collateral. Ex: lease purchasing water system equipment. Can there be a meaningful repossession of such equipment? Is it situated in a way that prevents effective repossession? Is there a health and safety or police power issue if repossession takes place? Are there alternative for Lessee?
LEASE PAYMENTS TURNED INTO CERTIFICATES OF PARTICIPATIONS

• The purchaser has a participation in a stream of lease payments
• Lease payments are allocated in the lease to principal and interest
• Typically a trust indenture is used as the mechanism to split the larger stream of lease payments into smaller participations (the “COPS”) closely resembling bonds
• Still subject to annual appropriation
• Lease payments are treated as an “obligation” of a state or political subdivision and are thus excluded from gross income for federal tax purposes

Certificates of Participation

• Certain Vendors/Lessors Take Whole Lease Into Own Portfolio
  - May assign or participate interest in lease
  - May “bundle” or “pool” with other leases and/or syndicate
  * * *
• Lessor Assigns Lease to Trust
• Trustee Executes and Delivers COPs to Investors

COPs Continued

• COPs Represent a Participation Interest in (Right to Receive) Base Rentals
• Tax-Exemption based on Lease with (constituting installment sale to) state or political subdivision as lessee

Securities Laws re: Municipal Lease Financing

• Private Investor Lease Arrangement
  - Not “security” at all or
  - Private placement with sophisticated investor
• COP (or 63-20) Lease Arrangement
  - Exempt from registration with SEC
  - Not exempt from “anti-fraud” provisions (Rule 10b-5)
  - Not generally exempt from “continuing disclosure” (Rule 15c2-12)

SEC Rule 10b-5 (1933)

• Antifraud – Unlawful to make a material misstatement or omit to state a material fact
• Primary Offering/Initial Disclosure
• Materiality
  - Substantial likelihood that a reasonable investor would consider it important to an investment decision
  - Determined in context of all facts & circumstances; guidance primarily from court decisions and SEC enforcement cases

SEC Rule 15c2-12

• Continuing Disclosure (1988)
  Requires underwriters in a negotiated offering to obtain from the issuer and obligated persons a Continuing Disclosure Undertaking, which requires the filing with the Electronic Municipal Market Access (“EMMA”) system of (1) annual financial and operating data and (2) event notices
Continuing Disclosure Undertaking

- A contractual commitment from the Issuer and/or other "obligated persons" to provide disclosure of
  - Annual Financial Information
  - Events
- Electronic Municipal Market Access (EMMA)
- Annual Financial Information
  - Audited Financial Statements
  - Financial Information/Operating Data by date certain in CDU (often put into CAFR)

Events (Effective Date 12-1-2011)

- Listed Events Whether or Not Material
- Disclosure within 10 business days after occurrence
- 14 Listed Events (Selected Events Below)
  1. Principal and interest payment delinquencies
  2. Non-payment related defaults, if material
  3. Unscheduled draws on reserves to support payment of base rentals due under lease reflecting financial difficulties
  4. Adverse tax opinions and other events affecting the tax-exempt status of the COPs
  5. Modifications to rights of the Owners of the COPs
  6. Notice of optional or unscheduled (material) redemptions or tender offers of COPs

Events Continued

6. Adverse tax opinions and other events affecting the tax-exempt status of the COPs
7. Modifications to rights of the Owners of the COPs
8. Notice of optional or unscheduled (material) redemptions or tender offers of COPs

Events Continued

9. Defeasance of COPs or any portion
10. Release, substitution or sale of property securing repayment of COPs, if material
11. Rating changes
12. Certain bankruptcy events
   * * *

Structure and Market Issues

- Essentiality of the asset
- Ability to take security interest in asset
  - Asset Transfers
  - Assignment of Purchase or Construction Contract
- Source of payments
  - General Fund
  - Enterprise Fund
  - Special Tax
  - PILOT Payments

Structure and Market Issues

- Rating on COPs
- Rating consequences to nonappropriation
- Refinancing
Federal Tax Compliance

- Arbitrage restrictions apply —
  - Expenditures of “proceeds”
  - Investment Limitations
  - Issue Price
  - Placement Agent
  - Lease Broker

Federal Tax Compliance

- Rebate provisions generally apply unless:
  - No reserve fund & all proceeds spent within 6 months, or, in some cases, 18 months or 2 years; or
  - “Small issuer rebate exception” applies
    - Lessee issues no more than $5 million tax-exempt (plus an additional $10 million for schools, if for school construction) in calendar year
    - Lessee has general taxing power

CDFC Lease Program

- Participant Benefits
  - Creates a new option for funding this class of capital expenditure.
  - Simplified participation process.
  - Lease agreements will be execution ready upon receipt.
  - Reduced disclosure requirements.
  - A program motivated to include participation, not “cherry pick” credits.
  - Offers economy of scale for small transactions.
  - Extends debt planning financial advisory services to membership.