

Leases and Other Alternative Financing Structures

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The Essentials

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Topics to be Covered

Reasons Why Non-Traditional Financing Tools May Be Used

Leases and Installment Payment Contracts

Certificates of Participation (COPs) and Other Common Non-Traditional Financings

Pooled Financings

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Pros and Cons of General Obligation Bonds

Common Elements

Generally backed by full faith and credit

Payable from taxes, usually property taxes

Benefits

Low default risk for investors; therefore, low interest rate

Usually simpler documentation

Pros and Cons of General Obligation Bonds – cont'd

Limitations and Disadvantages

Uses of proceeds

May require voter approval

Amounts may be limited by constitution/statute/charter

Requires use of property taxes for repayment

Capital Leases/Installment Payment Contracts

Common Elements

- Lessee is state or local governmental entity
- Installment payments with a specified interest component
- Acquiring the use of, and title to, real or personal property
- In most jurisdictions, does not constitute “debt” for state law purposes

Benefits

- Do not constitute “debt” for state law purposes or debt limits
- No tax levy in most cases
- Sometimes simpler documentation (e.g., direct equipment leases)

Capital Leases/Installment Payment Contracts (cont.)

Challenges

- Often state statutes do not clearly authorize lease financings or lack clarity
- Higher interest rates than general obligation debt
- Property rights and lien issues, including UCC lien issues, can be challenging

Financing Leases vs. True Leases (for federal tax purposes)

Financing Leases

- Involves the transfer of title to the real or personal property to the state or political subdivision at the end of the lease.
- Lessee is deemed the owner of the property for tax purposes.

True Leases (a/k/a Operating or Tax- Exempt Use Leases)

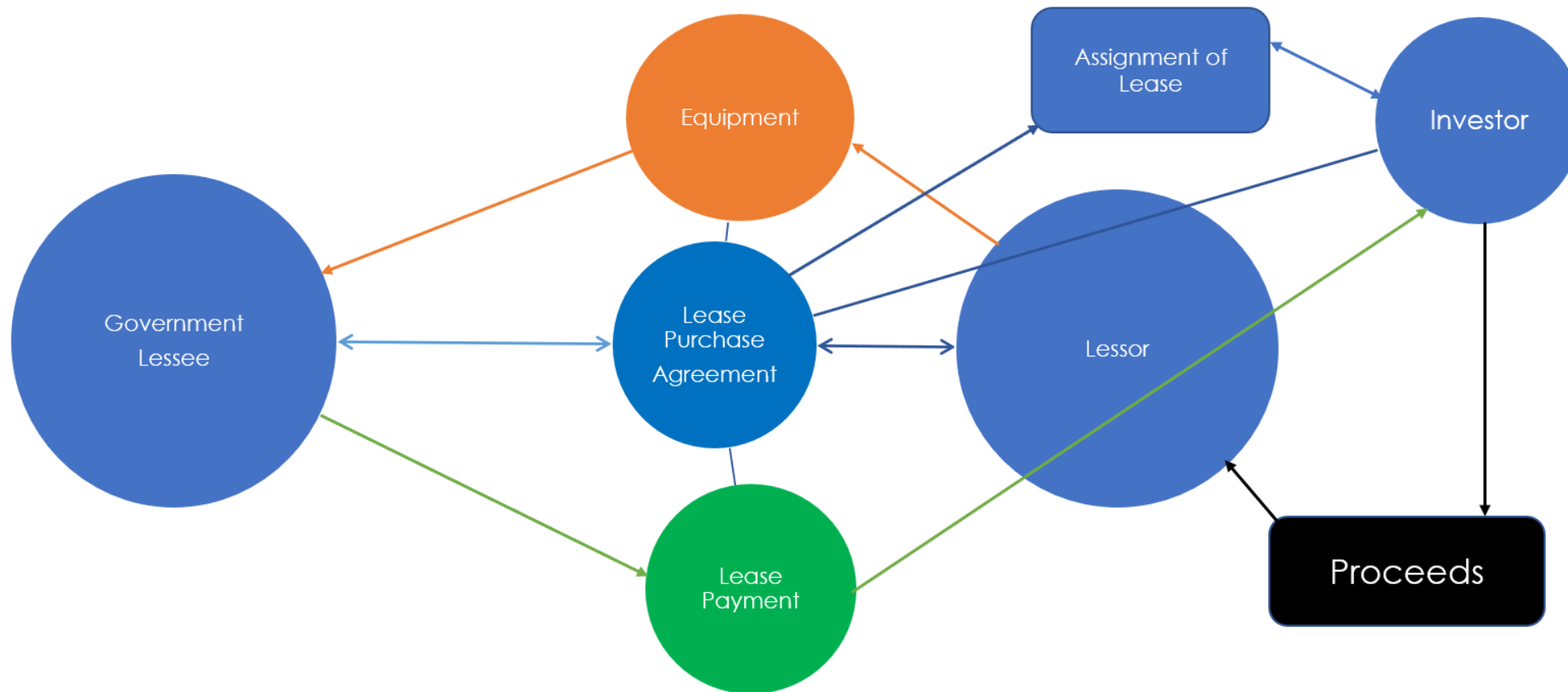
- Involves no transfer of title to the property to the state or political subdivision at the end of the term.

Applicable Debt Limitation Exceptions for Common Non- Traditional Financings

Just like Leases, Non-GO Financings have different effects on debt limits and may not impact debt.

- Special Fund Doctrine and Revenue Obligations
- Contingent Obligation Exception
- Service Contracts
- Moral Obligations
- Short-Term Borrowings
- Involuntary Obligations
- Nonrecourse Obligations

Basic Lease Structure



Most Common Forms of Tax-Exempt Leases

Annual Appropriation Leases

- Legal liability is limited to annual appropriations.
- Extent of commitment to appropriate is an essential issue.
- Some jurisdictions limit to revenue sources other than ad valorem (property taxes)

Abatement Leases

- Vesting of title at end of term.
- Rents subject to abatement if leased property is not available to local government to be used yet.

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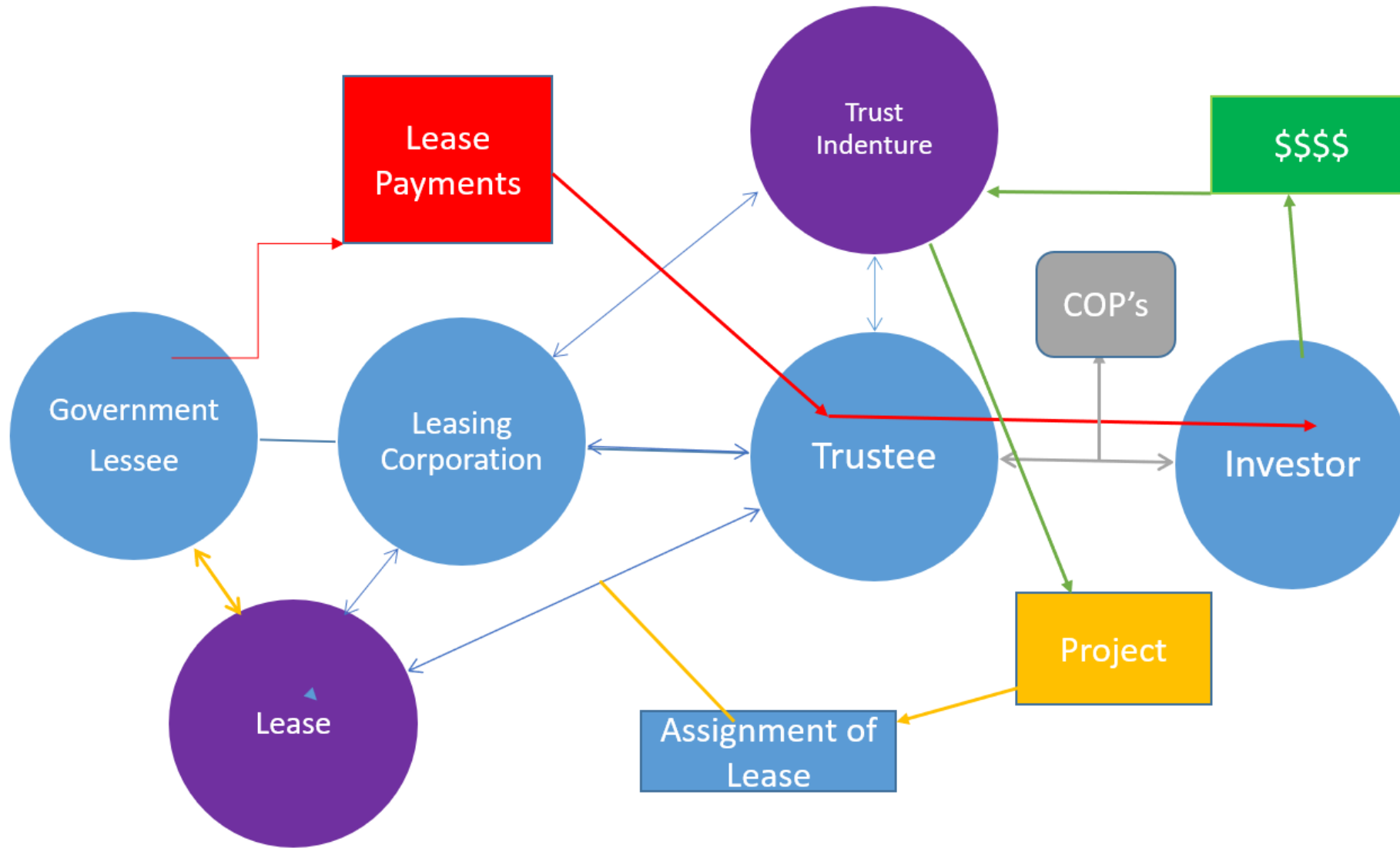
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Categories of Lessors

- Private entities, financial institutions and insurance companies
 - Direct Lease
 - Certificates of Participation ("COPs")
 - Lease Revenue Bond
- "On Behalf Of" Lessors
 - Constituted Authorities
 - 63-20 Corporations

COPs Transaction Structure



COPs Transaction Issues

Lessee approves, but is not a party to the Trust Agreement

Specific legislation analysis

COP Opinions

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Basic Lease Concerns

Is the Lease Valid/Authorized by State Law?

- Statutory Authority Analysis – Is a lease permitted?
- Debt Analysis – Does the lease constitute a “debt”?
- Usury Law Analysis – Does the interest rate exceed limits?
- Proper Authorization Analysis – What issuer action must be taken?
- Valid Procurement Analysis – Are there requirements?

Basic Lease Concerns (cont.)

Are the Owners'/Investors' Interests Adequately Protected?

- Essentiality Analysis
- Title/Ownership/Possession Analysis (Jurisdiction Specific – Who is going to own the property during the term of the lease?)
- Perfection of Security Interest Analysis (no UCC or Mortgage?)
- Payment/Budget Analysis – If subject to appropriation, is that a moral obligation for budget and appropriation?
- Abatement Analysis – When does the government get use of the property?
Capitalized Interest period?

Basic Lease Concerns (cont.)

Federal or State Securities Laws Issues – They still apply!

- Securities/Exempt Securities Analysis
 - Banks or Institutional Buyers?
 - COPS – Sold on public market with POS/OS
- Initial/Continuing Disclosure Analysis
- Rule 15c2-12 “Financial Obligation”
- Dodd-Frank Act Analysis

Basic Lease Concerns (cont.)

Federal Income Tax Issues

- State or Political Subdivision Analysis
- Capital Lease/True Lease Analysis (as mentioned)
- Interest Component Analysis
- Registered Form Analysis
- Private Activity Bond Analysis

Basic Lease Concerns (cont.)

Federal Income Tax Issues (cont.)

- Federal Guarantee Analysis
- Arbitrage/Rebate Analysis
- Form 8038-G Reporting
- “Bank Qualification” Analysis

Other Common Alternative Financing Structures



Revenue Bonds—obligations payable solely from one or more sources of specific revenues



Double-Barreled Obligations—obligations secured both by full faith and credit and revenues from a particular project or a specified source



Bond Anticipation Notes (“BANS”)—short-term obligations used as a means of interim financing until a long-term bond can be issued



Revenue and Tax Anticipation Notes (“RANS” and “TANS”)—short-term obligations used to level cash flows to match revenue and expenditure patterns during the fiscal year

Other Common Alternative Financing Structures (cont.)

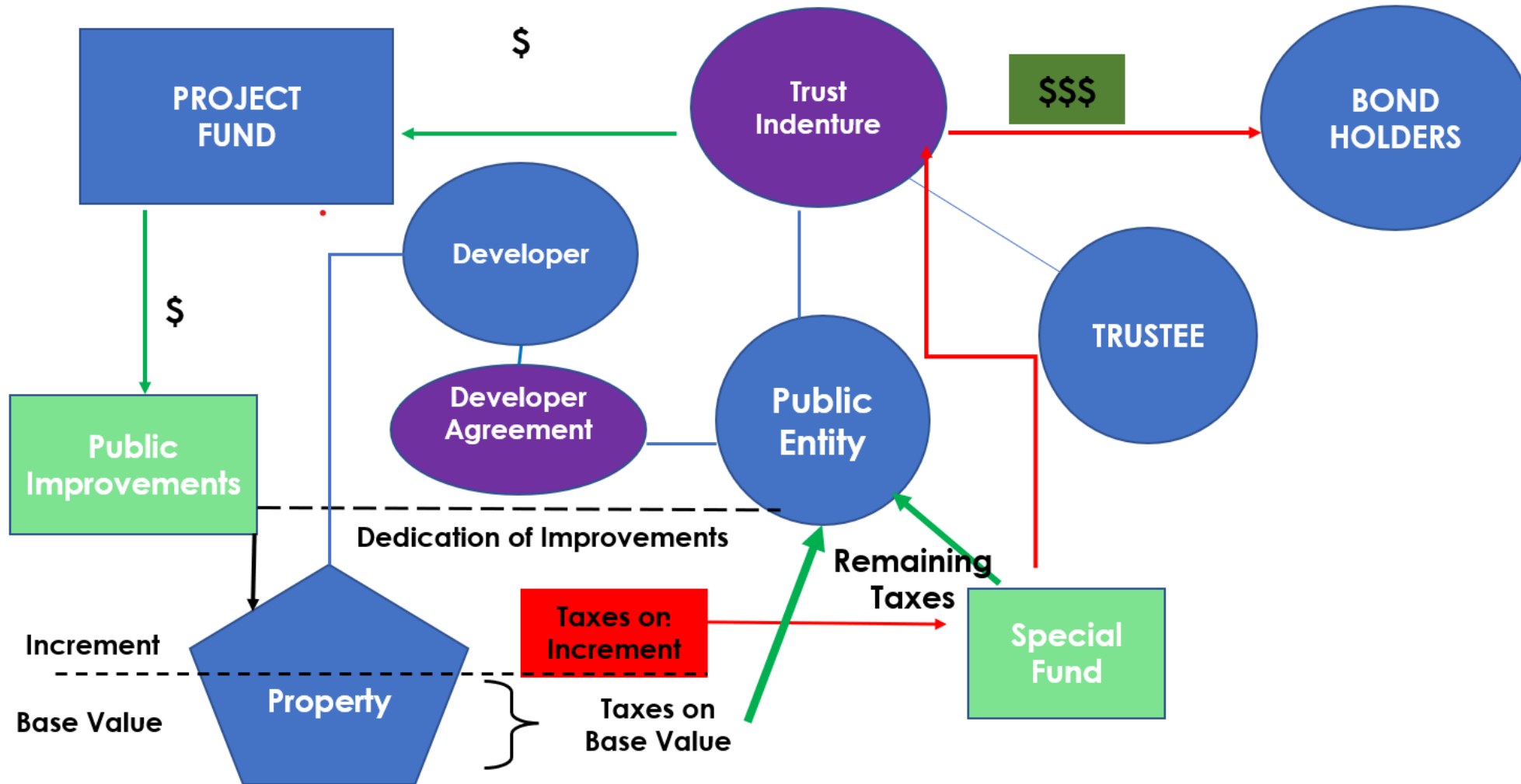
Grant Anticipation Revenue Bonds (“GARVEES”)—bonds issued in anticipation of federal highway or other grants used as a source of repayment for the bonds

Assessment Financings—obligations secured by assessments against the individuals or properties receiving the benefits from the improvements

Tax Increment Financings—obligations secured by general increases in taxable valuations or incremental increases in tax revenues paid by users of developed property within the tax increment area

Special District Financings—obligations issued by a special statutory entity that provides both governmental services and financing and secured by special tax levies/assessments within the district separate from the municipality

TIF Financing Structure



Tax Issues Unique to Tax Increment and Special Assessment Financings

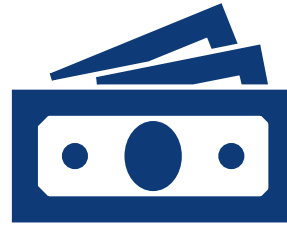
- No impermissible private activity agreements with developer or property owners are allowed for tax increment financings unless issued as taxable obligations.
- Special assessment financing must be for essential government purpose and special assessment must be apportioned on an proportionate/equitable basis upon benefit received.
- Developer guaranties can be problematic for private use and private financing tests.

Pooled Financings



Definition

Section 149(f)(6)(A) of the Code states, in general, the term “pooled financing bond” means any bond issued as part of an issue more than \$5,000,000 of the proceeds of which is reasonably expected to be used to make or finance loans to two or more ultimate (conduit) borrowers.



Issuer borrows money from the markets to lend to smaller borrowers

- Proceeds used to make loans that themselves may or may not be tax-exempt.
- Tax-exemption is derived from the top down, *i.e.*, the overall issue fails the private activity bond and loan tests and may or may not qualify for a rebate exception.

Advantages/Disadvantages of Pooled Financings

Advantages:

- Economies of Scale
- Diversification of Credit Risk

Disadvantages:

- “Weakest Link” Theory
- Competition with Other Pool Issuers
- Private activity – no control over small Borrowers and difficult to monitor
- Tax certificate for both issuer and pool members
- “Qualified Tax-Exempt Obligation” Elimination (BQ - \$10MM limit)

Securities and Tax Issues Relating to Pooled Financings

Securities Law Issues – Who is the Obligated Person?

- Continuing disclosure issues
- Involvement of underlying of borrowers in disclosure

Federal Tax Law Issues:

- Expenditure expectations relating to blind pool proceeds (demand survey)
- Complexity of multipurpose allocations
- Unspent proceeds
- Each borrower files Form 8038 and report as a pooled financing

Questions

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