

DrummondWoodsum

Basics of Borrowing and Lease Purchase Financing

NHGFOA – June 30, 2022

Topics

- Clarifications on terminology – “A bond by any other name”
- Why do I need a bond opinion?
- Developing the warrant article, including legal and political considerations
- Steps for voter approval (SB2 and traditional)
- Due diligence checklist
- Selection of a lender, including the Bond Bank
- Lease Purchase Agreements

A bond by any other name . . .

BOND

Loan

Borrowing

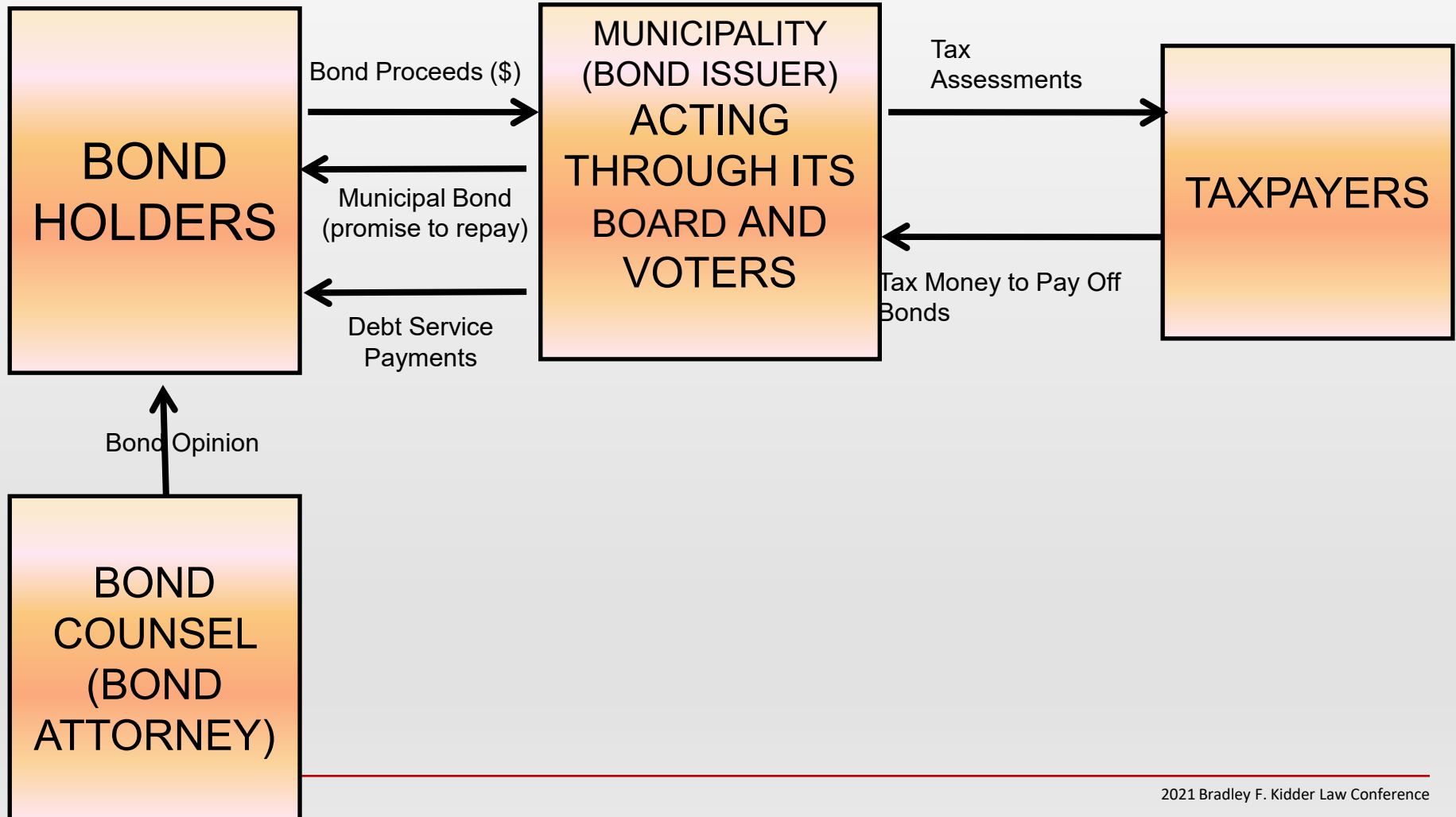
NOTE

Premissory Note

MUNICIPAL SECURITY

General Obligation

TYPICAL BOND TRANSACTION



NH Supreme Court
Smith v. Town of Epping, 69 N.H. 558 (1899)

“It is a general and fundamental principle of law that all persons contracting with a municipal corporation must, at their peril, inquire into the power of the corporation or its officers to make the contract.”

Article ##: Long Term Borrowing

To see if the [*name of municipality/school*] will vote to raise and appropriate the sum of \$_____ (gross budget) for the [*purpose*] (the “Project”), [*if not bonding the full amount, authorize the use other source(s) of Project funds*], and to authorize the issuance of not more than \$_____ of bond or notes in accordance with the Municipal Finance Act (RSA 33), and to authorize the [*governing body*] to issue and negotiate such bonds or notes and to determine the dates, maturities, interest rate, and other details of such bonds or notes; and to raise and appropriate an additional sum of \$_____ to pay debt service on such bonds or notes in the [*20__-20__*] fiscal year; [*and to authorize the [governing body] to apply for, obtain, and accept on behalf of the [municipality] any federal, state, or private funds that may become available in respect of the Project*]. (3/5 ballot vote required)

[*Governing Body*] recommends a “yes” vote [*tally, if required*]

[Budget Committee recommends a [“yes”/“no”] vote [*tally, if required*]]



Department of Revenue Administration

Municipal & Property Division – Municipal Bureau
P.O. Box 487
Concord, NH 03302-0487
(603) 230-5090

SB2 TOWNS & SCHOOLS ANNUAL MEETING (MARCH 2022) TIMELINE

Date*	Action	RSA §	Parameters*
Friday, January 7	Last day for petitioned bond articles over \$100,000	40:13, II-a (b), 33:8-a	"...the second Tuesday in January, provided however, that if a petitioned article proposes a bond governed by RSA 33:8-a, the deadline shall be the preceding Friday."
Tuesday, January 11	Last day to post notice of January 18 th budget hearing	40:13, II-a (a), 32:5, I	"...the second Tuesday in January..."
Tuesday, January 11	Last day to post notice of bond hearing	40:13, II-a (a), 33:8-a	"...the second Tuesday in January..."
Tuesday, January 11	Last day for petitioned warrant articles (schools and towns)	40:13, II-a (b), 39:3	"...the second Tuesday in January..."
Tuesday, January 11	Last day for negotiated cost items to be finalized	40:13, II-a (b), 273-A:1	"...the second Tuesday in January..."
Tuesday, January 18	Last day to hold at least one budget hearing	40:13, II-a (c)	"...on or before the third Tuesday in January."
Tuesday, January 18	Last day for bond hearing	40:13, II-a (c), 33:8-a	"...on or before the third Tuesday in January."
Thursday, January 27	Last day for budget committee to deliver budget and warrant article recommendations to the governing body for posting	40:13, II-a (c), 32:16, IV	"...the Thursday before the last Monday in January..."
Monday, January 31	Last day to post warrant, budget and default budget (schools and towns)	40:13, II-a (d), 39:5, 197:7	"...on or before the last Monday in January."

Due Diligence Items for Bond

- Signed and attested Warrant for annual meeting(s);
- Completed certificate of posting of Warrant;
- Minutes of annual meeting with results of bond warrant article vote (if non-SB2) and documenting that polling was open for at least one hour;
- Minutes of deliberative session (if SB2);
- Results of voting session (if SB2);
- Proof of publication of bond hearing notice;
- Minutes of the bond hearing; and
- Bond resolution adopted by governing body.

NH Municipal Bond Bank

Pros

Streamlined process; Bond Bank staff very helpful

Enhanced credit rating

Bond Bank bonds sold on the public bond market, yielding some benefits of a public sale without administrative burdens.

Bond Bank bonds aggregate multiple issuers; can produce better interest rates

Bond Bank will assist with temporary financing (bond anticipation notes)

Bond Bank will undertake refinancing to reduce debt service

Cons

No prepayment permitted

No certainty on interest rate at time of loan commitment

Local Bank

<u>Pros</u>	<u>Cons</u>
Can have prepayment option	Potentially limited lending capacity
Certainty on interest rate at time of loan commitment	Fixed interest rate sometimes not available for > 10 years
Can have favorable terms, especially if the municipality has deposit relationship	

Public Bond Market

<u>Pros</u>	<u>Cons</u>
Can produce excellent interest rates.	Municipality must provide updates to bond market of annual financials and occurrence of material events. This requires constant monitoring for the life of the bonds.
Good for municipality that borrow often.	
Sale can produce “bond premium” to either reduce the principal amount of the bonds and/or pay transaction costs.	Generally, no prepayment for first 10 years
	Higher transaction cost – municipal advisor, ratings agency fees, underwriter fees, etc.
	More administrative work preparing information for the bond sale

Topics to Cover

Lease Purchase Agreements

- Statutory authority in RSA 33:7-e
- Terminology
- Non-Appropriation Clause (“Escape Clause”)
- Legal Authorization
 - Initial
 - Ongoing
- Selecting a Lease Finance Company; Pitfalls
- Practical Steps

Statutory Authority

RSA 33:7-e Lease Agreements of Equipment

The **governing body** may enter into leases of equipment as required by the municipality.

Appropriations to fund lease agreements with nonappropriation clauses **may be approved by a simple majority vote** of the legislative body.

Lease agreements with nonappropriation clauses shall **not be treated as debt** under RSA 33:4-a.

For the purposes of this section, "lease" shall include lease-purchase, sale and lease back, installment sale, or other similar agreement to acquire use or ownership of such equipment as is from time to time required by the municipality.

For purposes of this section and RSA 382-A, **building or facility improvements related to the installation, purpose, or operation of such equipment shall be deemed to constitute equipment** and the costs of such improvements may be financed through lease agreements under this section.

Terminology

What is equipment?

- “Equipment” is not defined in RSA 33:7-e.
 - School buses, plow trucks, technology equipment, copiers, etc.
 - Boilers, HVAC equipment
- “Equipment” also includes “building or facility improvements related to the installation, purpose, or operation of such equipment”
 - 2014 amendment to RSA 33:7-e
 - Grey area between “equipment” and “renovation”

Terminology

What is a lease purchase agreement?

A.k.a. lease, lease financing, equipment lease, capital lease, municipal lease

“Lessor” the lease financing company (lender)

“Lessee” municipality/school (borrower)

Terminology

What is a lease purchase agreement?

- Distinguished from an operating lease
 - Not a landlord-tenant lease for real property
 - Not a rental lease – e.g., car leasing (lessor owns equipment)
- Distinguished from a bond or note
 - Not a general obligation; not a long term debt
- Best described as a financing based upon a conditional promise to pay
- Town/School (as lessee) owns the equipment and is responsible for insurance, taxes, maintenance. Option to purchase for \$1 at end of lease.

Terminology

What is a lease purchase agreement?

- Distinguished from a bond or note
 - It is not a general obligation; not a long term debt
 - Secured by lien on equipment, not the District's taxing power

However, like a governmental bond, a lease purchase agreement may be issued on a **tax-exempt basis** (the lessor does not pay income tax on interest paid by lessee). Lease payments must have principal and interest components.

Under federal law, a tax-exempt lease purchase agreement is treated like a governmental bond for purposes of reporting (Form 8038-G or -GC), and compliance with arbitrage and private activity regulations.

The Non-Appropriation Clause (“Escape Clause”)

The key feature of a lease purchase agreement is the **nonappropriation clause**. During the life of a lease, if the legislative body (annual meeting) does not appropriate sufficient funds to make lease payments due in the coming FY, then the lease will terminate and the lessor may repossess the equipment.

A lease without a nonappropriation clause is the same as a general obligation bond under NH law and requires the same approvals, including 3/5 legislative body approval (RSA 33:8; 33:8-a).

Features of Non-Appropriation "Right"

- Reserved to the legislative body that authorizes the annual budget (annual meeting)
- Exercise of nonappropriation is not a default under the lease; the lease agreement terminates and the equipment is returned
- Typically, nonappropriation is not easy to effectuate. In NH, however, the “No means no” law (RSA 32:10, I(e)) can be employed to nonappropriate funds for a specific purpose.

Lessor Protection from Non-Appropriation

- Security interest in equipment
- “Good faith effort” language
- Essential Use Certificate
- Payments in advance; not arrears
- Short amortization period
- Non-substitution clause
- Effect of non-appropriation on credit rating

Non-Appropriation

If members of the governing body (Board) are considering a lease purchase agreement with a view that the municipality/school can always get out of the lease through nonappropriation,

DO NOT ENTER INTO THE LEASE

Legal Authorization for Lease Purchase Agreements

RSA 33:7-e:

The **governing body** may enter into leases of equipment as required by the municipality.

Appropriations to fund lease agreements with nonappropriation clauses **may be approved by a simple majority vote** of the legislative body.

Two Authorizations required:

- 1.** Legislative body (annual meeting) approval of lease payments due in the coming fiscal year.
- 2.** Governing body (board) approval of lease agreement.

Legal Authorization for Lease Purchase Agreements

2 Authorizations required:

1. Legislative body (annual meeting) approval of lease payments due in the coming fiscal year.

Approval of lease payments in separate warrant article. OR

Approval of lease payments as part of annual operating budget.

Political considerations (initial and ongoing approvals)

2. Governing body (board) approval of lease agreement.

Legal Authorization for Lease Purchase Agreements

2 Authorizations required:

1. Legislative body (annual meeting) approval of lease payments due in the coming fiscal year.

Approval of lease payments in separate warrant article. OR

Approval of lease payments as part of annual operating budget.

Political considerations (initial and ongoing approvals)

2. Governing body (board) approval of lease agreement.

The board should take formal action to approve the lease and identify the person authorized to sign the lease.

Board action supports the legal opinion requested by lessor.

Legal Opinion for Lease Purchase Agreements

As with other loans or bonds, the lessor (lender) often requires a legal opinion from bond counsel, stating that:

1. The lease has been duly authorized and executed; and
 2. Interest payable on the lease is tax-exempt for the lessor.
- Without the legal opinion, the lease cannot close
 - Bond counsel's duty of care
 - Opinion given to the other party (lessor)
 - Bond counsel reaches determination and expresses independent legal opinion that transaction is valid and tax exempt
 - Potential liability of bond counsel to lessor

Practical Steps – Get Legal Counsel Involved Early

Consult with legal counsel early as to:

- Legality of equipment as subject of lease;
- Legislative body approval of lease payments;
- Form of the board vote.

Practical Steps – Select a Lease Financing Company

- Follow purchasing policy (call for quotes, formal bids)
- Benefit to using familiar leasing companies
 - Municipal Leasing Consultants (VT)
 - People's United Bank (NH)
 - TD Equipment Finance (ME)
 - Gorham Savings Leasing Group (ME)
- Does the lessor require a legal opinion?
 - Often, no opinion is needed if lease is <\$100,000

Practical Steps – Select a Lease Financing Company

Potential pitfalls

- Manufacturer's lease
 - Other lease finance options available; check for unreasonable terms
- Continuing lease
 - More like a rental agreement; can be required to make lease payments after the initial term
- True lease (fair market value lease)
 - A rental agreement where lessor owns the equipment
 - Muni/School is responsible to return equipment in good condition

Practical Steps – Lease Purchase Financing

- Plan for acquisition of equipment
- Get legislative body (annual meeting) approval of upcoming lease payments (in separate warrant article or as part of operating budget)
- Board vote to authorize the lease - have legal counsel draft or review the vote
- Coordinate execution and delivery of documents with legal opinion
- Funding of lease; acquisition of equipment
- For tax-exempt leases, file Form 8038-G or -GC.

Thank you

Greg Im

gim@dwmlaw.com