

**FORMAL PROPOSAL  
TAX-EXEMPT MOTORCYCLE LEASE**

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Lessee: Municipality

Proposal Date: November 9, 2010

Equipment: Auto Moto Scooter Police Vehicle

**TERMS & CONDITIONS**  
*(Per Vehicle)*

|                           |            |                           |                      |
|---------------------------|------------|---------------------------|----------------------|
| <b>Acquisition Cost:</b>  | \$3,800.00 | <b>Term:</b>              | Sixty (60) Months    |
| <b>Documentation Fee:</b> | \$125.00   | <b>First Payment Due:</b> | One Month from Close |
| <b>Down Payment:</b>      | \$0.00     | <b>Payment Mode:</b>      | Monthly in Arrears   |
| <b>Principal Balance:</b> | \$3,925.00 |                           |                      |

**Payment: \$76.00**

All Equipment will be owned by Lessee at the end of lease term.

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The lease payments for this transaction were calculated at low, tax-exempt rates (interest earnings are exempt from federal income tax) as per Section 103 of the Internal Revenue Code. In order to qualify for tax-exempt rates, the following requirements must be met:

- ✓ A commitment to make all payments and therefore all payments must be listed on a Payment Schedule, and no "Termination for Convenience" language can be included in the documentation
- ✓ The Municipality is the title owner and therefore is responsible for all insurance, taxes, and registration fees
- ✓ Lessee's total amount of tax-exempt debt to be issued in this calendar year will not exceed the \$30,000,000 limit

**In the event this transaction does not qualify for tax-exempt status, the payment as quoted shall be considered void and the Proposal rescinded. Taxable rates are available upon request.**

This is a finance/ownership lease. No residual value risk has been assigned to the Lessor. Fixed interest rate for the term of the lease.

This is a proposal only and is not a commitment to finance. This proposal is subject to credit review and approval and proper execution of mutually acceptable documentation.

This transaction must be credit approved and lease documents must be properly executed and returned to Sparta Commercial Services or its assignee within thirty (30) days from the Proposal Date stated above or Lessor reserves the right to adjust and determine a new rate factor and payment amount.

Failure to consummate this transaction once credit approval is granted and the lease documents are drafted and delivered to Lessee will result in a documentation fee of \$350.00 being processed to the Lessee.

|                     |
|---------------------|
| Signature:          |
| Typed Name & Title: |

## **Lease Purchase Financing**

### **History**

In 1986 the IRS revised Section 150(e) of the IRS Code, making it possible for lenders to offer lease purchase agreements with tax-exempt rates to municipalities. In summary, the interest portion of the lease is exempt from Federal income tax, therefore producing an overall lower interest rate to the municipal organization.

### **Definition**

Lease purchase financing (LPF) is the purchase of an asset through installment lease payments. Payments on such a lease have to include both an interest and principal portion. This is commonly referred to as *tax-exempt financing*. Not to be confused with a car lease or rental, with a tax-exempt lease, the municipal organization will own the equipment/facility upon final payment.

### **Characteristics**

Qualifying Entity—identified by their possession of one of the three Sovereign Powers

- Direct Taxing Power
- Police Power
- Power of Eminent Domain

Non-appropriation Clause

- LPF is not considered debt in most states because the municipality must appropriate funds each fiscal year for the installment payments.
- No voter referendum is necessary in most states because the obligation is part of the municipality's operating expenses and not dependent upon increased tax revenues.

Ownership Intent

- Lessee takes title to equipment or deed to property at the beginning of lease and is responsible for the use, maintenance, and insurance on the equipment or property. Lessee owns equipment or property at the end of the lease term.

Installment Payments with Principal Reduction

- Purchase price of equipment is amortized over term of lease agreement.
- The agreement term is directly related to useful life of equipment financed.

Tax-exempt Interest Rates

- Rates on tax-exempt leases are lower than traditional financing options because the interest income to the Lender is exempt from Federal, and sometimes State income tax. Savings passed on to the Lessee are in the form of lower interest rates.

IRS Requirements

- For a lease to legally qualify as a municipal transaction, the Lender must file Form 8038 with the Federal government on each transaction.
- Failure to properly file with the government puts the tax-exempt status of the transaction at risk for the Lender and the Lessee.

### Lender Security Interest

- For the Term of the contract, the Lender will hold security interest in the equipment or property through UCC-1 filings, vehicle lien, base lease, or title commitment.
- Lender is also listed as additional insured and/or loss payee on insurance coverage for equipment or property financed under the agreement.

### Legal Opinion & State Statutes

- Legal Opinion from Lessee's legal counsel validates the Lessee's ability to enter into the agreement and validates the agreement meets all state and local laws governing the Lessee's ability to borrow funds.
- Statutes governing a Lessee's ability to finance purchases, vary from state to state. It is critical to ensure the lease purchase contract is compliant with state laws to preserve the tax-exempt status.

## **Financial Process**

### Basic Steps

- Obtain finance quote from qualified funding source
- Credit process (submission of credit application and financial information)
- Legal contract specific to transaction issued
- Lessee executes contract and returns to Lender with any additional items required
- Lender obtains dealer/contractor invoices and MSOs (where applicable), and verifies insurance coverage
- At equipment delivery, lessee 'accepts' equipment and authorizes Lender to pay vendor on their behalf
- Lender files appropriate UCC-1 or other instrument of security interest and files appropriate 8038 Form
- Lessee makes payments directly to Lender in accordance with payment schedule through contract maturity

### **Cost Analysis—Lease Purchase Financing vs. Other Procurement Options**

#### **Cash Payment**

- Reduces funds available for other expenditures
- Opportunity cost of choosing between competing essential needs
- Availability of funds
- Budget inconsistencies vs. level payments/budgeting

#### **Delay Purchase**

- Rising cost of materials can increase future purchase price of acquisition
- Financial and operating challenges of maintaining worn out or obsolete equipment
- Safety/Federal requirements may not be met

#### **Local Banks**

- Not specialized in municipal lending
- Contract issued may not be in compliance with legal tax-exempt requirements
- Limited knowledge about federal filing of required documents
- Repayment schedule may not match useful life of acquisition
- Limited financing terms and options available

## **Bond Issuance**

- Lengthy voter approval process
- Bond issuance requires a designated revenue source and count as debt of the lessee
- Lengthy documentation with varied maturities, call provisions, and multiple investors
- Ongoing credit review by potential investors
- Compounding of interest results in higher overall interest costs
- Additional costs: tax opinion, bond counsel, trustee fees, and rate risk from floating interest rate

## **Evaluating Competing Proposals**

What to watch out for when comparing Lease Purchase Proposals

Interest rate by itself is not always the most accurate guide for selecting the best proposal....

Consider the following:

- **Capped Fees**—Lender fees included as part of the financed amount increase the payments. This situation results in a low interest rate shown, with higher overall cost incurred by the department (SEE EXAMPLE)
- **Closing Costs or Doc Fees**—Disclosed or undisclosed
- **Structure**—Review payment due dates, down payment requirements, disbursement schedule and payment frequency. A difference in any one component can have an impact on the true interest rate

## **Lease Purchase Financing: The Financing Solution for the 21<sup>st</sup> Century**

Benefits & Flexibility of Lease Purchase Financing

- Quick solutions for overcoming budget constraints during fiscal year
- No voter approval needed
- No tax increase to constituents
- Customized financing for specific needs of lessee
- Rates on tax-exempt financing are comparative to bond financing without the expense and inconvenience of the bond process
- Financing term matches the useful life of the equipment
- Available for nearly all essential use acquisitions