Frequently Asked Questions About Tax-Exempt Municipal Leasing

1. What is a tax-exempt lease?

A tax-exempt lease or lease-purchase agreement is an installment purchase, conditional sale or lease with an option to purchase for nominal value. It may also be referred to as a municipal lease.

2. Who qualifies for tax-exempt financing?

The issuer of a tax-exempt obligation, including a tax-exempt lease, must be a State or possession of the U.S., the District of Columbia, or a political subdivision thereof. Political subdivisions include cities, towns, counties and other municipalities. They may include other state entities such as school districts, special purpose districts (fire, parks, utility, water, etc.), hospitals, agencies, authorities, boards and commissions.

Not-for-profit organizations created under Section 501 (c) (3) of the Internal Revenue Code do not qualify directly as issuers of tax-exempt obligations but may be eligible with a sponsoring governmental unit. Not-for-profit organizations benefiting from tax-exempt leasing include:

- Health Care (Hospitals, Clinics, Nursing Homes, Life Care Centers)
- Education (Colleges and Universities, Preparatory Schools)
- Museums
- Research Centers

3. What are some of the benefits of tax-exempt leasing?

The benefits of a tax-exempt lease include:

- Preservation of capital dollars for other projects for which leasing is not an option
- Preservation debt limitations does not create long-term debt on the entity’s books
- Enables improvement of cash flow
- Incorporates flexible structuring to meet budget needs
- Low rates resulting from tax-exempt basis
- Offers an alternative financing option without voter approval
- Provides project financing (including soft costs)
- Spreads out the cost of an asset over the useful life of that asset or project.

4. What can be financed on a tax-exempt basis?

Tax-exempt financing is typically utilized for equipment acquisitions. It may also be used for other capital expenditures, e.g., purchasing property, implementing of a specific project, or expanding existing facilities. Both personal property and real property can be leased. This includes personal property such as:

- Telecommunications Systems
- Computers
- Vehicles
- Energy Management Systems
- Recreational Equipment
- Emergency Services Equipment
Medical Equipment
Software
Modular Buildings

and real property such as:

- Schools
- Courthouses
- Correctional Facilities
- Central Offices
- Recreational Facilities
- Environmental Facilities.

Equipment may include:

- Hardware
- Installation
- Training
- Infrastructure wiring
- Maintenance
- Video & multimedia equipment
- Software applications

5. **How are tax-exempt leases structured?**

Tax-exempt leases are structured as a series of one-year renewable obligations that are subject to the governmental entities ability to appropriate funds for the continuation of lease payments. Payments constitute a current expense of the lessee and, in the event that sufficient funds are not available for payment, the agreement is terminated and the equipment is delivered to the lessor.

6. **What is a non-appropriation clause?**

A non-appropriation clause enables the lessee to terminate the lease agreement at the end of the current appropriation period without further obligation or penalty. This may be done only in cases where the lessee was unable to obtain funding for future payment obligations on the lease. Typically, the clause will contain a 'best efforts' requirement whereby the lessee must use its best efforts to obtain the necessary appropriation for the lease payments. The non-appropriation clause enables the lessee to account for the lease obligation as a current expense instead of debt.

7. **What is a non-substitution clause?**

A non-substitution clause maintains that if a lease is terminated for non-appropriation, the lessee may not replace the leased equipment with equipment that performs the same or similar functions.
8. **Who owns the equipment under a tax-exempt lease?**

Title may either be retained by the lessor until all payments have been received or may be granted to the lessee at lease inception. In this case, the obligation is secured by a 'perfected' first security lien on the equipment. In most cases it is preferable to pass title up front to avoid any potential tax issues.

9. **Who is responsible for maintenance, insurance, property tax and other operating expenses?**

A tax-exempt lease is a 'net lease,' which means that the lessee is responsible for these types of expenses. However, the lessee may contract with the equipment supplier to provide maintenance and other services. These costs may be included in the financing.

10. **What is the maximum finance term?**

The term of the lease may not exceed 120% of the average reasonable expected economic useful life of the property or project being financed.

11. **What factors should be considered in deciding when to use a tax-exempt lease?**

For any asset acquisition decision, the principal financial objective is to obtain the use of the asset for the lowest possible total cost, as measured over the period the asset is to be used. Other factors affecting the selection of a financing option which should be considered by a governmental entity include:

- Availability of cash at the time of procurement;
- Competing demands on capital resources;
- Essentiality of the asset to the basic functions of the entity;
- Useful life of the asset;
- Desirability of matching costs and benefits over time
- Ability to improve bargaining positions with vendors; and
- Political attitudes toward debt financing.

or a variety of needs and circumstances, tax-exempt lease financing provides a governmental entity with an alternative to purchasing an asset with cash, acquiring its use for a period of time through a true lease or issuing bonds.

Source: Association for Governmental Leasing & Finance