

# Hunterdon County Educational Services Commission



Lease Purchase Bidding and Advisory Services

## **UNDERSTANDING EQUIPMENT LEASE PURCHASE FINANCING for NEW JERSEY SCHOOL DISTRICTS**

By: Dennis R. Balodis  
*Financial Services Manger*  
*Hunterdon County Educational Services Commission*  
*NJ State Approved Cooperative Pricing System 34 HUNCCP*

Hope R. Blackburn, Esq.  
*General Counsel*  
*Jersey City Board of Education*  
*Jersey City, NJ*

## **Understanding Equipment Lease Purchase Financing for NJ School Districts**

There is a right and a wrong way to do things when it comes to lease purchase financing equipment for your school district. Let's face it; it isn't something you do every day. But with today's limits on budget growth the need for this financing tool has become very relevant. Here are some of the basics that you should keep in mind when considering using a lease purchase to finance your district's essential equipment needs. Prior to releasing any funds, the banks require an opinion of counsel providing both tax representations and attesting to certain conditions, including that your procedures complied with State law. Care should be taken from the beginning to make sure counsel is involved and that your procedures and documentation are accurate so that you don't have to start over.

### **Public School Contracts Law and Department of Education Regulations**

Although there is a statute that specifically governs Lease Purchase Financing, (*N.J.S.A. 18A:20-4.2(f)*) for facilities and equipment, when entering into lease purchase transaction you have to keep in mind that you also have to comply with the Public School Contracts Law to obtain **BOTH** the financing itself **AND** the equipment to be purchased. In addition, even though you are just buying equipment, Lease Purchase financing agreements are governed by the Facilities regulations (*N.J.A.C. 6A:26-10*).

This means that the equipment you purchase and the financing you obtain must follow the same procedures for any school district purchase: from the determination of the appropriate procurement methodology (bid, competitive contract, State, General Service Administration/Federal Supply Schedule) to the actual contract documents themselves. As such, unless you are using an exception to the public bidding law and obtaining the lease purchase finance through a purchasing cooperative or governmental sublease, you start with the publishing of Public Notice, and releasing the specification on the date the official notice.

The bid package or packages must have all the required documents including, A Non Collusion Affidavit, Stockholders/owners disclosure, political contribution disclosure, and any others that may be unique to your district. The respondents must also furnish you with the New Jersey Business Registration Certificate (prior to contracting) and either the Employee Information Report or an AA-302 application along with a copy of their check evidencing that they have applied for the EIR or a federally approved affirmative action plan.

The Public School Contract Law must also be adhered to when issuing any revisions or addenda to you bid. There is a definite difference between a clarification and addenda. A clarification does not make any material changes to the bid offering. The release of information that will materially change the bid must be done with addenda. The addenda must have a formal public notice published in the newspaper of record seven days prior to opening and must be sent to everyone who has picked up a bid packet. Remember, *"Failure of a board of education to advertise for the receipt of bids or to provide proper notification of revision or addenda to advertisement or bid documents related to bids as prescribed by this section shall prevent the board of education from accepting the bids and require the re-advertisement for bids pursuant to subsection a. of this section..."* (NJAC 18A: 18:A-21 (d)).

Lease Purchase Finance Bids are opened at the time and place provided in the solicitation and are awarded by Board resolution to the lowest responsible bidder.

### **Credit, Collateral and Current Budget**

Lease purchase also presents unique twists which you must keep in mind when considering this type of financing and in crafting your bid specifications. Each individual district's financing needs and credit present a unique transaction. This is different from a bond offering where the full faith and credit of a school district can be distilled down to a rated credit and sold as bonds to investors who know that come hell or high water they will receive their payments. No, a lease purchase is more like a commercial loan transaction.

Your lease purchase payments come from your annually appropriated budget and like all multi year leases must have a clause making them subject to annual appropriations sufficient to meet the required payments or must have an annual cancellation clause. A lender cannot rely on the commitment of future boards that they will receive payment for the funds lent under a lease purchase. So what do lenders rely on when making a decision to submit a bid for lease purchase?

Think worst case scenario: a lender does as a basis of their credit decision. "What will my bank do if the school district stops making their lease purchase payments?"

The lender relies on the equipment that is being financed. This is the collateral for the loan. When doing your budget planning examine your needs for the upcoming year, look to the different types of things you will be purchasing. Buses, technology upgrades, new tablets and computers, software textbooks, band uniforms, boilers, grounds equipment, maintenance trucks, all of these and more are what you are expected to evaluate and prioritize the need and what you can afford for your district.

You have a finite amount of money to fulfill the needs of district. You can't pay for everything outright so you intend to lease purchase some the items on your needs list. What and how you structure your lease purchase bid can save your district thousands of dollars over the term of the lease.

The equipment that you are financing in the lease purchase must be essential to the operation of your school district. When preparing your bid specification keep in mind that commercial bankers are going to respond to your bid. Since the lease purchase is only collateralized with the items on the bid the equipment description and amounts for each type of equipment should be disclosed. Do not assume that by stating you are looking for financing of "essential use equipment" that a banker will be satisfied with that as a description.

Think like the worst case scenario banker! The collateral make up and term of your lease purchase request will determine the interest rate you obtain in the market. The banks credit departments will assume that you will default on their loan and that they will have to rely on the resale of the equipment leased to recoup

their losses. What you consider as essential to your district may not be considered with the same essentiality by the bankers.

Take for instance textbooks, you have the ability to finance textbooks, textbooks are essential to the operation of your school district. The worst case scenario thinking banker will normally pass on bidding a lease purchase for a transaction that consists solely of books. In his mind's eye, all he can envision, if the district defaults on the lease is the impossibility of reprocessing the textbooks located throughout the district.

Your school buses and vehicles have a defined useful life with a secondary market that the bankers are familiar with. This is hard collateral for a lender. They know that they can get a predetermined price for the buses over the years of the transaction if they have to repossess. There is a softer secondary market for technology and computers that transcend the public and private sectors of business. Striking the proper blend of equipment with stronger collateral value to that with perceived lesser collateral value is the first half of putting your lease purchase bid together.

### **Term and Schedules**

The second important element in putting together your lease purchase bid is the selection of your lease term. This is a balancing act between what is allowed under *N.J.S.A. 18A: 18A-42(f)* and what bankers will think are the optimal terms for leases of different types of equipment. The statute allows lease terms for a period of not to exceed five years with the exceptions for school buses which have a ten year term limit. The regulations require that the Board of Education be able to refinance the lease at any time during the leased period, and as provided, above, statute and regulation mandate that the lease must have a clause making repayment subject to annual appropriation of sufficient funds to meet the required payments or have an annual cancellation clause

There is nothing that prevents you from using a shorter term than allowed by law, for those considering using the longest term allowed understand that bankers will take a practical look at the terms that they are willing to extend on a lease. Remember that the equipment is the only form of collateral securing this transaction. As the term lengthens the useful life of the equipment diminishes.

When crafting your bid specifications to optimize the competition amongst potential bidders you should consider using different repayment terms for different equipment types. These repayment schedules should not exceed seventy-five percent of the useful life of the equipment. For vehicles other than school buses use five years. For technology, you can go out five years, when you want to include copiers you probably shouldn't go out past three years. School buses are allowed to be financed for a period not to exceed ten years; however from the bankers credit analysis view point the majority are hard pressed to exceed six or seven years often citing that the buses will require more repairs with the advancing age and have less value. There is nothing that prohibits you from including different term repayment schedules in the same bid.

Keep in mind that in offering separate schedules for equipment with different repayment terms you are making life easier for yourself down the road. Remember that the equipment listed in the lease purchase is

the security for the transaction. If you craft a bid specification with only one repayment schedule for the longest term without designating the equipment you anticipate paying off in a shorter term the bank will cross collateralized all the equipment included in this transaction for the full and longest term of the contract. This will necessitate your remembering to request that the bank release its lien on shorter termed equipment should you want to sell it or replace it before the longer termed equipment.

A good example is for a lease purchase including buses and technology. You anticipate the buses having a seven year term and repayment for the technology of only four years. For expediency you blend in the technology with the price of the buses, thinking that you will allocate the principal repayment of the technology over a four year term and generate an internal amortization schedule. In year five of the bus and technology lease you want to dispose of the outdated technology. This technology still has a bank lien on it because the original bid did not disclose that the technology was to only be financed for four years.

### **Lease Purchase Documents, Tax-Exempt and Counsel**

As a public school district board of education you are a governmental entity. The interest you are paying to the bank or financial institution for this lease purchase is like a bond and is exempt from federal and state income taxes. The IRS views the lease purchase as a tax-exempt issue since it considers it a loan to a government entity.

A good number of lease purchase financings done by school districts in the state are under one million dollars in size. The winning bidder will furnish your district with documents that will need to be reviewed by board counsel to insure that public bidding laws were followed in the acquisition of the equipment being financed via the lease purchase. The officials named in the documents and resolution of your governing body duly authorizes them to execute the documents on behalf of the board. The documents of the transaction constitute a legal, valid and binding agreement. The last point is that the transaction will be considered exempt from federal taxes under the IRS Code.

Normally for transaction that do not involve ground leases, the banks will be satisfied with a “mini tax opinion” which is one or two paragraphs included in your counsels opinion letter. The banks are relying on your attorney that the interest you are paying to them in this transaction they are entering into with you is indeed exempt from taxes.

Many of the school solicitors do not have a problem providing an opinion for equipment lease purchase since they have a qualified tax attorney on staff. Please check with your attorney before bidding if they are comfortable opining to a tax-exempt lease purchase. If the answer is no then you should involve special counsel or bond counsel from the start. This will only enhance the competitiveness of larger, more complex transactions and reduce the possibility for any future problems

## **Summation**

Given the limitations in increasing the tax levy by a New Jersey school districts lease purchase financing has become an even more important tool to today's business administrator. The lease purchase gives you the capital to maintain and replenish the equipment necessary to provide education with the minimum year to year tax impact. The proper planning and design of a bid specification that meets your fiscal needs and that is attractive to potential bidders will result in your district savings thousands of dollars in unnecessary interest and fees.

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