

BIDDING THE LEASE PURCHASE, OR, A CAVALIER ATTITUDE CAN BITE YOU IN THE ASSUMPTION.

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“Sign here, here, here and here. The equipment will be delivered next week. Thanks for the order! Bye!” This scene has been played at school districts since salespeople realized there was a market in education for their goods and services! One of the key lessons in sales training is overcoming objections. Once the need is identified and fulfilled with the functionality of their product, the major obstacle to a salesperson is “it’s not in our budget.” What happens next separates the enlightened from the uninformed school business administrator. This also determines whether or not you’ve unwittingly allowed some company to take funds that could have been put to better use in your district.

Lease purchase financing for equipment or a project with a term under five years *must* be bid. The fact that the equipment is on State contract, or the vendor has an attractive 0% financing promotion does not exclude the transaction from the bidding requirement! You are bidding for the utility of the funds. The criteria in determining the bid threshold is the amount of interest you will pay over the term of the lease and no, you cannot divide the payments per year to skirt around the threshold!

Many companies who sell to schools also sell to commercial accounts. In their enthusiasm to close a sale, a salesperson will invariably use the same closing techniques in the public education environment. It’s quick and easy, but for a school district it is not the wisest course of action.

Lease purchase financing for equipment is ubiquitous. It is permitted under N.J.S.A. 18A:18A-42 with bidding requirements and other requisite provisions to the documentation provided for in N.J.A.C. 5:34-3.1-4. There are points to a lease that must be included in the documents, among which is the provision for non-appropriations. If you are asked to sign a lease “here, here, and here” without a board resolution, without

your attorney reviewing the contract, and if the document says: “This is a NON-CANCELABLE Lease,” **DO NOT SIGN**, pure and simple. It is surprising how many leases like this are signed unwittingly. That is a commercial lease and the rates are higher commercial rates. Your district loses.

There are vendors who do the majority of their work with school districts, and in deference to them, they know better and do not adhere to these practices. However the lease purchase is still the accommodation that vendors use to overcome the ever present “there’s no money in the budget” objection. Again, it is easy to let them supply the financing.

The bid you put out may request that financing be supplied by the vendor. Here is one of the typical pitfalls of bidding. Many times a school district will structure a bid for equipment requesting terms for financing. The specifications for the equipment will, no doubt, be extensive. The obligatory attending documentation to the bid will be included, then comes the bid response form... *and folks, this is coming from a real bid for 50 computers...* “Total Monthly Payments” in one column followed by the second and last column, “Total Payments Over the 36 Month Lease Purchase Agreement.” That was what this bid requested, honest! How do you judge what is the best bid for the district? There are enough holes in this bid to really jeopardize the district’s acquisition of the computers! How much is being charged for the computers and how much they will pay in interest are important issues that are not addressed in this bid!

COMPONENT PARTS

The more information included in the response to the bid, the easier will be the task of evaluation. Simple questions should be answered:

- 1.) What is the cost of the equipment? If there are numerous stand-alone parts, list the price of those as well.
- 2.) What is the anticipated delivery date?
- 3.) What rate is being bid for the lease purchase of the equipment?
- 4.) Can you add other equipment into the financing or is it limited to just the vendor's product?
- 5.) How long will the rate be held for?

One of the most confusing issues is whether or not to request a bid and performance bond. The simple answer for a lease is "no." The lease is basically a *loan* to the school district. There are too many variables to be answered after the fact. What you are requesting is a quote. Normally a Lessor (lender) will caveat their proposal with the bid being subject to acceptable credit and documentation. There is the credit of the school district involved, along with the question of collateral for the lease (the equipment) and what will be in the documentation. Unless you furnish a full disclosure document similar to that prepared for a bond, along with the samples of the documents you wish to use to close the transaction, a bidder cannot comply with the request for surety.

When at all possible, break apart your bids – one section for the equipment, the other for the financing. Take the "Chinese Menu" approach. You want the best from "Column A" and the best from "Column B." Why should you preclude financial institutions from bidding a portion of the transaction because they don't supply equipment? The logical response is not to preclude them from bidding. By limiting respondents to only those equipment suppliers who have finance programs, you limit competition for the interest rate. Think of it as if you are buying two separate items. The first item is the equipment. You want to deal with someone who specializes in that sort of equipment so you will get the best buy and service. The second item you are buying is the money! Yes, it is all the same color green. Or is it? By limiting your bid to the equipment suppliers, you have excluded those who specialize in selling money. The logic that you applied to inviting qualified vendors of the equipment has gone out the window in selecting a supplier of capital! The strongest suppliers of money are cut out, thereby eliminating your chances of getting the lowest rates available.

ATTRACTING THE LOWEST RATES

Planning pays. Consider a typical singular transaction – one acquisition of a certain type of equipment which could be buses, computers, maintenance vehicles, etc. Each bid for equipment includes a separate lease. This can cause accounting nightmares, a great deal of time wasted supplying financial information, and unnecessary legal review costs. These issues, together with the fact that the transactions are for relatively small amounts with commensurate higher associated interest rates, combine to make the whole exercise a series of, mostly, time consuming burdens.

Every year a school district goes through the long and arduous task of preparing a budget for the next fiscal year. At that time the scene is set for the fiscal needs of the up coming year. By using that plan and pulling out those items that will need to be financed through lease purchase you can arrive at an estimated figure for anticipated acquisitions for the new fiscal year. At that time many school districts allocate "x number" of dollars for the lease purchase payments to be made from that portion of the budget.

The optimal situation is for a district to pool all of its anticipated lease purchases into one transaction. This pooling will attract lower interest rates due to the increased size of the issue. The lease purchase can have dissimilar types of equipment in it. In fact, a mix of equipment is often very helpful.

COLLATERAL BALANCE

When putting together a lease purchase financing remember that you are going to have to "sell" the package to a lender (lessor). In their eyes, this is no different than any other type of lending. They are lending your district money for equipment which will become collateral for the loan. The rates they bid will be predicated on how secure they feel with that collateral. Their only recourse in a "worst case scenario" is to take back the equipment. You can turn this into a plus for your district. By mixing hard collateral items such as school buses with softer items such as infrastructure computer wiring, and medium value items such as computers, you will be able to use the strength of the hard collateral to balance the weak. This strengthens the overall transaction and ensures the greatest number of respondents to the bid for the financing along with the most competitive rates.

ESCROW OF FUNDS

Ok, you know how much and what type of equipment will be needed. The next question raised is how does the school district get all of the equipment in at one time to put it on one lease. The answer is simple, *it doesn't*. The equipment can come in during the year at different times. This can be facilitated through the use of an escrow account.

All the funds for the different equipment being purchased throughout the year will be placed into escrow at the onset of the lease. The escrow account is interest bearing. All of the interest earned in this account goes to the school district. The district is paying for the utility of the money; they should enjoy its benefits. Also be aware that the escrowed funds should be domiciled in the State. This is similar to any other deposit the district holds with a financial institution. Please don't fall victim to bidders that use the interest income from the escrow account to "buy down" the interest rate they quote you. These earnings belong solely to the school district. The funds in the escrow account should be released when the various equipment is delivered and installed over the course of the year. This method gives your district the ability to establish benchmarks and release payments when these points are completed.

In establishing an escrow account you should make sure that your district has the ability to self direct the investment of the funds. As a school district you have investment tools available to you that commercial entities don't. Avoid the bidder who wants you to invest in a fund that is held in their bank and will not allow you to move it elsewhere. There may be a buried profit motive there and you owe it to the taxpayers in your district to get the best return for the money within prudent business practices.

DISCLOSURE

Without getting into all of the nitty gritty, you should state whether or not your district will be issuing more than ten million dollars in aggregate debt during the calendar year in which the lease will be written. This debt is for bonds, lease purchases, bond anticipation notes, and any other instruments. If you are issuing more than that amount, you will limit the potential bidders to nonbanks. If you are issuing less than ten million dollars in the calendar year, you will open up the potential bidders to banks as well. This is known as

"bank qualified." Congress created this distinction in 1986 to prevent the banking industry from sheltering their income in tax-exempt issues. The tax deduction that banks can enjoy is limited to public entities issuing less than ten million dollars. If you can time the issuance of bonds and lease purchases, you will see a better rate and be rewarded for your patience.

STRUCTURING REPAYMENT SCHEDULE

As business administrators, you know what your cash flow is, and what bonds are being paid off when. With a lease purchase you have the ability to structure the repayment schedule to one that best fits the fiscal needs of your district. Repayment can be structured to keep your tax rate even or meet with other anticipated revenues, and frequency of payment can also be established. The repayment stream can be set up to coincide with your receipt of revenues. Keep in mind, however, the sooner you repay a lease or any loan, the less interest you will have to pay out.

CRITERIA

All of the above information needs to be disclosed somewhere on the bid for case of analysis. The bid response form is the place for this. After the obvious bidder identification, you need an interest rate disclosed, the period that the lease rate will be held for (this should be no longer than thirty days, then the rate should be indexed to some instrument and fixed prior to closing), and an amortization schedule which should be appended to the bid sheet. The amortization schedule should be set to some amount close to that which you seek to obtain. This will be a confirmatory piece to review if the bidder understands and will comply with the repayment structure you requested. Be wary of aberrations in this amortization schedule. A nifty trick is to 'front end load' the principal repayment of the lease thereby lowering the overall interest you have to repay. You are the one making the decision, you want the best rate, and the repayment schedule should meet your needs.

CONCLUSION

The lease purchase is a powerful financing tool for school districts. If used properly it can help your cash flow, and make the acquisition of equipment and other projects easier to afford. Think before you sign. Ask

questions of your vendors, your professionals, and that of fellow administrators. Never assume. What you sign today, you may have to live with for five years.

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