

Bond Case Briefs

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Let's Talk Municipal Finance - Municipal Lease Purchase Agreements.

In the last installment of Let's Talk Municipal Finance, I discussed municipalities and governmental entities that issue bonds, a form of municipal debt. An alternative to incurring municipal debt and less onerous option for a municipality that is, for example, looking to purchase a new piece of equipment, is a municipal lease purchase agreement.

Like ordinary lease purchase agreements, municipal lease purchase agreements require payments for a set number of years to lease a piece of equipment. While some agreements are strictly lease agreements with no option to purchase, more commonly the agreements provide an option to purchase the equipment outright for a nominal price at the end of the term. While a municipality may enter into a lease purchase agreement without a vote of the residents, the allocation to pay the annual lease payments is included as a line item on the annual budget approved by the residents. In addition to the annual appropriation, the agreement must also be duly authorized by the municipality, which commonly means certain resolutions or ordinances must be adopted by the municipality's governing body authorizing entrance into the agreement by certain officers of the municipality.

Since payment of the lease is subject to annual appropriation in the municipal budget, municipal lease purchase agreements must contain a provision allowing for termination in the event that the residents fail to approve the appropriation for the following year's annual principal and interest payments. This allows the municipality to terminate the lease without penalty. Lending institutions are willing to enter into municipal lease purchase agreements because interest on the annual lease payments is tax exempt as a result of factors such as the municipality's status as a governmental unit and the use of the equipment being purchased for a municipal or public purpose.

Municipalities must also consider, however, that the administrative costs of issuing a municipal lease purchase agreement are often greater than those of issuing a bond, primarily because the process is less standardized. The municipality must negotiate individually with a lending institution. Further, the municipality's legal counsel must review and draft documents and governing body authorizations that are acceptable to the municipality's chosen lending institution and necessary to issue the opinion of legal counsel, which opines on issues such as due authorization and tax matters. For these reasons, if you are considering entering into a municipal lease purchase agreement, it is best to retain legal counsel at the very beginning of the process to ensure each of the documents and authorizations conforms to the necessary requirements.

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