

S B

154

SENATE COMMITTEE REPORT

FURTHER

FIN

DATE TURNED INTO OFFICE

3/16/90

5/4/89

Mr. President:

L&C

Committee considered

SB 154

relating to equipment lease-financing and authorizing a master equipment lease-financing project; efd

and recommended

[x] replace with CS SB 154 (L+C) [x] same title
[] or adopt CS [] new title

[] attached amendment(s) and [] technical title change (HB only)

[x] Senate letter of intent adopted (letter of intent to follow)

[x] do pass

[] do not pass

[] no recommendation

[] individual recommendations

[] further referral to Dept of Admin 3/16/90

FISCAL NOTE(S) [x] zero [x] fiscal impact [] appropriation no FN
[] new Ak State Housing 12/27/88 [] updated [x] previous
[] same as previous fiscal note(s) published

MEMBERS SIGNING DO PASS

OTHER RECOMMENDATIONS

Handwritten signatures of committee members.

Chair signature and recommendation

[] Committee Backup attached

LETTER OF INTENT
FOR
CS SB 154 (Finance)

It is the intent of the Legislature that Alaska State Housing Authority and the Department of Administration place first priority on refinancing existing equipment leases under any master lease-financing program established pursuant to this Act, and that the Department of Administration identify in the report required pursuant to AS 36.30.080(d) the amount of equipment lease-financing provided under this Act for refinancing existing equipment leases as opposed to financing new equipment that replaces existing equipment.

FISCAL NOTE

REQUEST:

Revision Date: 3/16/90 Agency Affected: Department of Administration
Title: An Act relating to State equipment, BRU: General Services
including equipment lease--financing . . .
Sponsor: Rules Components: Purchasing
Requestor: Senate Labor & Commerce

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 91	FY 92	FY 93	FY 94	FY 95	FY 96
PERSONAL SERVICES	41.8	43.1	44.0	44.9	45.8	46.7
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	5.0	2.0	2.0	2.0	2.0	2.0
SUPPLIES	1.5	1.6	1.7	1.8	1.9	2.0
EQUIPMENT	0	7.0	0	0	0	0
LAND & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS (PHONE)	.6	.6	.7	.7	.8	.8
TOTAL OPERATING	55.9	47.3	48.4	49.4	50.5	51.5
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND	55.9	47.3	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	48.4	49.4	50.5	51.5
TOTAL	55.9	47.3	48.4	49.4	50.5	51.5

POSITIONS:

FULL-TIME	1	1	1	1	1	1
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary)

There would be no fiscal impact to the FY 90 budget. Potential financial savings should be reflected in the Department of Revenue fiscal note. We project a General Fund increase in year one and two in administrative expense due to the requirement to coordinate several hundred accounts in order to make one payment under the third party equipment lease plan to Alaska State Housing Authority, and to compile the required reports to the legislature. See attached for analysis. The requirement for General Fund would be replaced year three onward with I/A receipts to be transferred from the affected agencies.

Prepared by: Robert J. Link, Director Phone: 465-2250
Division: General Services and Supply Date: 03/16/90

Approved by Commissioner: Frank S. Baxter Date: 3/16/90
Agency: Department of Administration

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

CONTINUATION of FISCAL NOTE ANALYSIS

For CSSB 154 (L&C)

FISCAL NOTE ANALYSIS

Operating costs are based on the following assumptions:

Personal Services cost: One permanent, full-time Accounting Technician II, Range 14, Step B through J based on current contract.

Contractural: Estimated cost of \$5,000.00 for Professional Services contract for computer programming in FY 91, \$2,000.00 for support each year thereafter.

Supplies: Estimated cost of paper, desk supplies, etc., minimal increases each fiscal year in anticipation of inflated costs.

Equipment: Reflects purchase of personal computer. Costs needed to connect to mainframe (Alaska Statewide Accounting System [AKSAS]), printer and basic software. Costs are based on current State contract.

Miscellaneous: Estimated cost of long-distance telephone service. Escalated in third and fifth fiscal years to cover anticipated inflation.

Position Title Accounting Technician II		No. of Positions 1	Range/Step 14B	Barg. Unit GGU
Time Status FT	Staff Months 12	Location Juneau		Election District
		Justification		
Type of Expenditure		Amount		
1	2	3		
Salary	29.2			
Benefits	12.6			
Premium Pay				
Other				
Total Personal Services		41.8		
Travel				
Contractual		5.6		
Commodities		1.5		
Equipment		7.0		
Other				
Total Cost		55.9		
Funding Source for Total Cost				
Federal Receipts	1002			
G. F. Match	1003			
General Fund	1004	55.9		
I-A Receipts	1006			
CIP Receipts	1061			
Other				

There is currently no staff available to perform the duties mandated by this legislation. The required job duties and responsibilities are most associated to the class specifications of an Accounting Technician II. One full-time staff person would be responsible for reviewing several hundred accounts, determining which accounts would be refinanced, calculating account expenses, transferring funds and making one payment to the Alaska State Housing Authority. A report to the legislature would be compiled annually indicating the amount of interest to be saved by each agency during the next fiscal year as a result of participating in the master lease program.

4/11B1/060602-9

**Request For
New Position**

Administration
 Agency _____
 BRU _____
 Component _____
 General Services and Supply
 Purchasing

Page 3 of 3
 Revised Date

FY 91

FISCAL NOTE

REQUEST:

Revision Date: _____ Agency Affected: State Bond Committee
 Title: Authorizing master lease-financing
for state equipment BRU: _____
 Sponsor: Senate Labor & Commerce Components: _____
 Requestor: Senate Labor & Commerce

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 91	FY 92	FY 93	FY 94	FY 95	FY 96
OPERATING						
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LANDS & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	(2143.5)	136.4	98.5	479.3	1381.8	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	(2143.5)	136.4	98.5	479.3	1381.8	0
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND	(2143.5)	136.4	98.5	479.3	1381.8	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: attach a separate page for analysis.
Fiscal effect for FY 90 is zero.

Prepared By: Milt Barker *MB*
 Division: Treasury
 Approved by Commissioner: Milton B. Barker for
 Agency: Department of Revenue

Phone: 465-2350
 Date: March 15, 1990
 Date: 3-15-90

Distribution (by preparer):
 Legislative Finance
 Legislative Sponsor
 Requestor
 Office of Management and Budget
 Impacted Agency(ies)

Fiscal Note Analysis

The projected annual savings on refinancing State equipment leases are estimated in the table below. This estimate is from a detailed analysis of State equipment leases prepared in June 1987 by Shearson Lehman Brothers.

The savings from a master lease refinancing of State equipment leases would accrue to individual agency budgets. As presently envisioned, the State Bond Committee would make the lease payments on the master lease, but these payments would be funded by Reimbursable Services Agreements (RSA's) from the agencies that purchased the equipment. Information developed from implementation of the program should permit identification of specific lease costs and savings in specific agencies which could be deleted and replaced with a single appropriation to the State Bond Committee.

The present value of the savings shown in the table from a master lease refinancing of State equipment leases is \$424,000 or 6.3 percent of the amount of the refinancing. Please see the attached letter of January 27, 1989 from John Andrews for more information on the master lease program.

Lease-Financing Costs (Savings)

<u>Fiscal Year</u>	<u>Equipment Lease Refinancing</u>
1991	\$(2,143,460)
1992	136,406
1993	98,534
1994	479,273
1995	<u>1,381,766</u>
Total	\$ (47,480)



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

154

February 3, 1989

The Honorable Tim Kelly
President of the Senate
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

Dear Mr. President:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill relating to lease-financing for state equipment.

The main purposes of the bill are to:

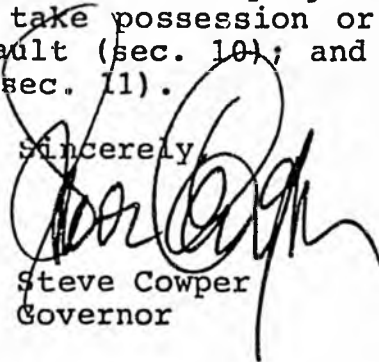
1. provide general statutory authority for the Alaska State Building Authority (ASBA) to finance and acquire equipment for lease to the state (sec. 3 of the bill);
2. specifically authorize ASBA to acquire and finance new equipment, or acquire and refinance equipment already on lease to the state, under a master lease program (secs. 12 and 13); and
3. specifically authorize, in accordance with the State Procurement Code, the Department of Administration to enter into lease-financing agreements with ASBA for the master lease program (secs. 14 and 15).

The approach to financing state equipment embodied in this bill offers potentially significant savings in interest costs on state equipment financing compared to interest rates charged by equipment vendors. The master lease program would be administered by the Department of Administration and available to all state agencies.

The second amendment of AS 18.55.100(d) in sec. 4, regarding legislative approval of equipment projects, raises a constitutional issue under the separation-of-powers doctrine, as does the current wording of that subsection. However, knowing of the legislature's concern about the overall debt management of the state, I believe that it might be helpful to set out this procedure in the statute, as a courtesy to the legislature.

Aside from the immediate-effective-date provision (sec. 16), the remaining sections of the bill consist of amendments that add references to state equipment lease-financing in various ASBA statutes relating to housing or public building projects of ASBA. These include corporate purpose (sec. 1 of the bill); prohibition of ASBA members or employees from acquiring an interest in projects (sec. 2); securing bonds with lease payments (sec. 5); validity of bonds and notes (sec. 6); bond covenants to limit disposition of projects (sec. 7); establish rates and fees for projects (sec. 8); vest in a trustee the right to take possession in the event of default on a project (sec. 9); grant bondholders rights to take possession or appoint a receiver for projects in default (sec. 10); and acceptance of federal aid for projects (sec. 11).

Sincerely,

A large, stylized handwritten signature in black ink, appearing to read 'Steve Cowper', is written over the typed name and title.

Steve Cowper
Governor

Hand delivered
from Cmsn
Hugh Malone

3/5

RECEIVED

MAR 6 1990

JAN FAIKS
SENATE OFFICE

Jan

SB 154 (State equipment
leasing in L+C) is
one of those "housekeeping"
bills that, actually well, as
at least allows, some efficiency
in government.

Right now state agencies after
lease expensive equip when they
don't have bucks to buy outright

Problem is — they have to
pay retail credit rates, which
raises the cost of acquisition.

That's also a hassle for some vendors,
since the vendor has to arrange
financing.

SB 154 would just allow
a "master" equipment leasing
program which the agency
managers would have option
of participating in.
This would allow them to
stretch their budgets.

I want to emphasize that
the master lease concept only
reduces equipment lease costs.
It means that source dollars
are released at agency or
appropriation level for
other uses.

I could use your help on
this, please. I'd be glad
to discuss the idea if you'd
like to give me a call.

Thanks

Hugh



January 30, 1989

The Honorable Tim Kelley
President of the Senate
Alaska State Legislature
P. O. Box V
Juneau, AK 99811

Dear Senator Kelley:

The assistance of the Alaska State Building Authority ("ASBA") has been requested by the Alaska Department of Administration to provide financing or refinancing of State equipment purchases under a master lease program. The program is more fully explained in Commissioner John Andrews' letter to you of January 27, 1989.

Legislative authorization for ASBA to undertake this program pursuant to amendments to AS 18.55.100 proposed by the Governor is requested. The authority would be a natural conduit for such financing since it is already statutorily mandated to serve as lessor for public buildings leased to the State.

Sincerely,

ALASKA STATE BUILDING AUTHORITY

Ray Price
Executive Director

mg:c:\wp5\admin\rp-tk.1

Enclosures

STATE OF ALASKA

DEPARTMENT OF REVENUE

TREASURY DIVISION

STEVE COWPER, GOVERNOR

ELEVENTH FLOOR
STATE OFFICE BUILDING
P.O. BOX SB
JUNEAU, ALASKA 99811-0400

April 18, 1989

The Honorable Pat Pourchot
Chairman
Senate State Affairs Committee
Alaska State Legislature
P. O. Box V
Juneau, Alaska 99811

Dear Senator Pourchot:

At a Senate State Affairs Committee hearing on Senate Bill 154, relating to equipment lease-financing, committee members expressed concern that authorization of master lease-financing would either

1. increase State equipment purchases; or,
2. produce budget savings for State agencies that would be spent on other agency budget items rather than used to reduce agency budgets.

If agencies don't lapse any savings, certainly one of the above results must occur. However, I would like to dispel any illusion that may remain that lease-financing somehow opens the door to unlimited or significantly greater means for agencies to acquire equipment. It does not.

Equipment acquired under the proposed master lease-financing program must be paid for out of state agency budgets and is limited as a result. In fact, payment of interest means that agencies would be acquiring less equipment over time than if they pay cash. Lease-financing allows purchase of more equipment now, but less later on by spreading the cost of purchase over time.

Equipment purchasing does not run amok. It is controlled by the generally small amounts available for discretionary spending in agency budgets. For example, there would be no prohibition on the State acquiring a new ferry vessel under the master-lease authorization in SB 154. However, no agency has the money in their budget to make the lease payments that would be required. This is the control point for lease-financing. The legislature holds the purse strings for equipment purchases, be they for cash or over time, just as it does for every other item of expenditure.

As you know, lease-financing is currently available to and used by State agencies from vendors or other parties. Agencies expend money from their operating budgets for interest on equipment lease-financing all the time. Master lease-financing does not change this item on the menu of possible State purchases, it just makes it a little cheaper.

Back to the ferry example. If appropriations were to be made to a State agency to purchase a ferry through lease-financing, the State would most assuredly want the master lease option available. The higher interest on financing from other sources would otherwise cost the State dearly.

Aside from outside legislative and budgetary control, equipment purchase decisions in most cases are probably determined by program needs, not the cost of financing.

Master lease-financing would reduce that cost of financing. I suspect the overall result would be that a small portion of the savings would be lapsed, a small portion would be spent on additional equipment, and most of the savings would be spent on other agency items. I think this is particularly likely given the squeeze agencies are facing on their budgets in order to bring State spending into balance with State revenues. This pressure is more likely to intensify than abate.

If the control of the disposition of the savings to assure that they lapse is of concern, the following amendment to SB 154 would address that concern:

Page 5, line 5: insert a new section to read:

"* Sec. 12. AS 36.30.080 is amended by adding a new subsection to read:

'(d) If the department enters into a lease-financing agreement with the Alaska State Building Authority for the financing or refinancing of equipment purchases by the State under a master lease program, the department shall report to the legislature by January 30 of each year the amount of interest to be saved by each State agency during the next fiscal year as a result of participation in the master lease program. The savings shall be calculated as the difference between the total payments to be made to the department by the agency under the program during the fiscal year and the total lease payments that would be required if the equipment were purchased under the same terms except at a true interest cost equal to

- (1) the rate charged by the vendor for financing purchase of the equipment; or,
- (2) if no vendor financing is available, the prime rate charged by banks on short-term business loans at the time of purchase."

and renumber succeeding sections.

With this information, the legislature could reduce agency budgets by the amount of the savings. This would prevent any increase in agency expenditures for equipment purchases or any other budgetary item over what would otherwise occur and would provide funds for the legislature to appropriate for other programs or priorities. There would be a danger with this amendment of losing the incentive for agencies to avail themselves of master lease-financing if there's nothing in it for them. If it is felt to be necessary to deal with the incentive problem, use of the master lease program for any agency lease-financing could be made mandatory. The following amendment to SB 154 would do that:

Page 5, line 5: insert a new section to read:

"*Sec. 13. AS 36.30.080 is amended by adding a new section to read:

'(e) An agency may finance or refinance the purchase of equipment only through a master lease program if the department has entered into a lease-financing agreement that provides financing or refinancing under a master lease program for such equipment."

and renumber succeeding sections.

The Honorable Pat Pourchot
April 18, 1989
page 3

In cases where an agency only had enough funds to pay for a master lease but not a vendor lease, reduction of the agency budget by the amount of the calculated savings could bite into the agency's program and altogether deter lease-financing that might be desirable. Such situations could probably be addressed in budget hearings on the agency's program.

One other suggestion. If the committee desires, it could authorize master lease-financing only for refinancing existing leases. In fact, it could conduct an ongoing program on this basis, each year authorizing refinancing of prior year lease-purchases. However, an ongoing refinance program would diminish the savings, due to payment of vendor rates for some period of time before the refinancing takes place and due to paying twice for some costs of financing -- legal, administrative, etc.

The following amendment to SB 154 would limit the bill to authorizing refinancing of estimated current equipment leases:

Page 5, line 5: amend section 12 to read:

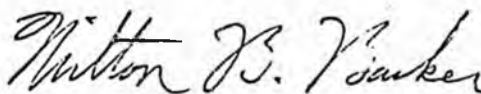
"*Sec. 12. The Alaska State Housing Authority may acquire equipment on lease to the State at the time of its acquisition by the authority, for lease to the State under a master lease program, and may provide refinancing up to a total of \$50,000,000, for such acquisitions."

Page 5, line 12: amend section 14 to read:

"*Sec. 14. The Department of Administration may enter into one or more lease-financing agreements with the Alaska State Housing Authority for the refinancing, up to a total of \$50,000,000, under a master lease program, of equipment purchased by the State."

The estimated amount of possible refinancing contained in the amendments is based on information from the State's accounting system (AKSAS) that indicates lease payments on equipment are running at approximately \$10 million during FY 89 (\$6,597,319 through March 23, 1989). Equipment lease payments totaled \$9,702,709 during FY 88. Assuming an average term of five years and an interest rate of 10 percent, \$10 million in annual lease payments would be the payment on \$48,780,000 of equipment purchases.

Yours truly



Milton B. Barker
Deputy Commissioner

MIB/ph

cc: State Bond Committee
Alaska State Housing Authority
Department of Transportation and Public Facilities
Alison Elgee, Director, Division of Budget Review

89-117

MEMORANDUM

State of Alaska

Department of Law

TO: Milt Barker
Deputy Commissioner
Department of Revenue

DATE: September 17, 1987

FILE NO: 663-88-0094

TELEPHONE NO: 465-3600

THRU:

SUBJECT: Equipment lease
purchase
Your file no.: 9095H

FROM: Robert M. Maynard *RM/ML*
Assistant Attorney General
Governmental Affairs-Juneau

You have asked for our opinion on the applicability of AS 36.30.080(c), which requires approval by law of lease-financing by the Department of Administration with annual rents exceeding \$1 million (effective January 1, 1988), to equipment financing or refinancing. In particular, you are contemplating a proposal whereby the various equipment leases now spread throughout state government would be consolidated under one or more new (or replacement) "master leases" through a particular vendor.

As we read your request, you are asking two questions. First, whether equipment-lease financing falls within the procurement code, and second, whether the provisions of AS 36.30.080 relating to legislative approval applies to equipment, rather than simply space, leases. The answer to both questions is that equipment-lease financing is covered by the new procurement code and the statutory requirement of legislative approval.

AS 36.30.850(b) provides that "[t]his chapter applies to every expenditure of state funds irrespective of their sources" except for some carefully worded exceptions that do not apply here. Since the new master lease will involve some expenditure of state funds (even though that expenditure, in some instances, may be less than would otherwise be the case), the provisions of AS 36.30 apply.

Second, although AS 36.30.080(a) is limited by its terms to space leasing, that limitation does not appear in either subsections (b) or (c). The only two potential sources for implying that limitation would come either from the use of the term "rent" in subsection (c), or, as you inquire, by the identification of leases by the "department" as applying to only the Department of Administration (which is presently responsible for space leasing).

Milt Barker, Deputy Commissioner
Department of Revenue
663-88-0094

September 17, 1987
Page 2

Although most commonly used in connection with land or space leases, "rent" is also a term applying to lease payments for other types of property. One may, for example, "rent" a car. Wells v. Allstate Ins. Co., 327 F. Supp. 622, 631 (D. S.C. 1971). Given the broad coverage of the state procurement act, we see no reason to imply a limitation to only real property rents that is not expressed.

Second, the indication that it is leases of the "department," meaning Department of Administration, does not imply a limitation on the type of leases covered by that section. With the effective date of the new procurement code, all leases, not just space leases, will be the responsibility of the Department of Administration. AS 36:30.005(a). Although this authority may be subsequently delegated to other agencies (AS 36.30.015(a)), the identification of the Department of Administration in AS 36.30.080(b) and (c) does not imply a limitation on the type of leases covered by those sections.

You have not asked, nor do we address, the question of the constitutionality of the requirement of legislative approval in AS 36.30.080(c). We would note, however, that the position of the Department of Law has consistently been that such requirements of legislative approval are unconstitutional as a violation of the doctrine of separation of powers. On the other hand, the consistent practice of administrations has been to respect the Legislature's desire to be involved in major transactions (which lease financings with annual payments of over \$1,000,000 would certainly be). Thus, as a matter of comity in these types of situations, administrations have as a matter of contract made legislative approval a requirement. Since lease-financing arrangements require a high degree of certainty that all applicable laws have been followed, the provisions of AS 36.30.080(c) will likely be followed in any event in order to eliminate potential uncertainties.

We would further note, in response to your inquiry, that the provision for legislative approval applies only where a particular lease, master lease, or contract exceeds \$1 million in annual rent. If the department enters into two separate master leases with a \$500,000 annual payment each, then legislative approval is not required (as long as a separate procurement in conformance with the Code is done for each agreement).

If you have any questions, please do not hesitate to call.

RMM:jf

STATE OF ALASKA

STEVE COWPER, GOVERNOR

DEPARTMENT OF ADMINISTRATION

POUCH C (MS 0200)
JUNEAU, ALASKA 99811
PHONE: (907) 465-2200

OFFICE OF THE COMMISSIONER

January 27, 1989

The Honorable Tim Kelly
President of the Senate
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

Dear Mr. President:

In compliance with AS 36.30.080(c), I wish to inform the Legislature that the Department of Administration intends to enter into one or more lease-financing agreements for the financing or refinancing of State equipment purchases. Enclosed is an Attorney General's opinion of September 17, 1987 indicating that equipment lease-financing is subject to AS 36.30.080(c).

The project or projects would involve the consolidation of individual lease-purchases from any or all State agencies into one or more "master leases." All equipment purchases under a given master lease would be financed in a single transaction. The enclosed memorandum of September 28, 1987 from Government Finance Associates, Inc. describes the project in more detail.

The main advantage in using a master lease is a significant reduction in interest cost. The average interest rate on State equipment leases outstanding as of July 1, 1987 was 13.86 percent. Interest costs on a master lease-financing would currently be expected to be in the range of 6 percent to 7 percent. Vendor financing on current equipment purchases could be expected to be in the range of 9.5 percent.

The refinancing of outstanding State equipment leases is estimated to require issuance of financing obligations in the amount of approximately \$10 million with annual rental payments of approximately \$2.85 million assuming a 6.5 percent interest cost and four year final maturity. The amount of outstanding State equipment leases as of July 1, 1987 was \$6,617,494. The estimated \$10 million financing would allow for some increase in outstanding leases prior to the refinancing, a possible reserve fund, and other costs of issuance.

The enclosed proposal of Shearson Lehman Brothers estimated in June of 1987 that refinancing equipment leases would produce present value savings of \$424,000 which would be 6.3 percent of the amount of the refinancing. The State Bond Committee has used a 3 percent savings as its guideline for endorsing refinancings.

The Honorable Tim Kelly

Page 2

The financing of new equipment purchases during fiscal year 1990 could require issuance of financing obligations up to the amount of approximately \$30 million, resulting in annual rental payments of approximately \$8.75 million assuming a 6.5 percent interest cost and four year final maturity. The amount of potential financing includes \$23.8 million for equipment purchases contained in the Governor's proposed fiscal year 1990 capital budget, as well as allowance for possible reserve funds and issuance costs.

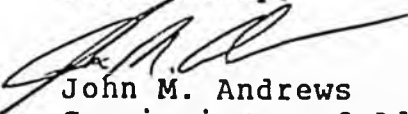
The dollar amount of \$30 million is undoubtedly a high estimate. The capital budget figure is the total for all line items which include equipment. Many line items include purposes other than equipment. Enclosed is a listing of the items in the capital budget with those which include equipment underscored.

The availability of a master lease program will save money for the State where equipment has been or would otherwise be purchased through vendor or other lease-financing. Where the equipment would otherwise be purchased for cash, the master lease would create additional State costs for interest and increase total State indebtedness.

The \$30 million financing amount for new equipment is based on proposed appropriations for cash purchases. Undoubtedly, many such purchases would be consummated for cash. However, in some cases, agencies might want to use a master lease program. To the extent this occurred, fiscal year 1990 appropriations might be lapsed, to be replaced by increased contractual services appropriations in subsequent years.

Because lease-financing that is used in place of cash purchases raises concerns about increased debt loads and increased future budgetary obligations, the Administration will carefully consider implementation of any master lease program for new equipment purchases. Availability of master lease financing may be restricted in those cases where appropriations for cash purchases are available, except for overriding concerns that might arise, such as a cash shortage in the general fund. Thus, far less than \$30 million would actually be expected in master lease financing for new equipment purchases.

Yours truly,



John M. Andrews
Commissioner of Administration

JMA/MB/ph

SHEARSON
LEHMAN
BROTHERS

June 16, 1987

Mr. Robert J. Link
Director, Division of General Services & Supply
State of Alaska
Department of Administration
Pouch C (MS-0210)
Juneau, Alaska 99811

Dear Bob:

Shearson Lehman Brothers Inc. and Seattle-Northwest Securities Corporation are pleased to present our analysis and program proposal for the refinancing of State equipment leases. As detailed herein, the results of our preliminary investigation reveal that approximately \$424,000 of savings on a present value basis can be achieved under current market conditions. The present value savings, expressed as a percentage of the principal amount of Certificates of Participation ("COPs") to be issued, are 6.3%. To put in the proper context, issuers of refunding bonds or COPs (including the State Bond Committee) typically set a minimum threshold present value savings level of 3%.

Shearson and Seattle-Northwest expect to explore both the public and private placement markets in order to achieve the lowest refinancing rate with the most advantageous terms. For instance, we have had discussions with Ford Motor Credit Company, the purchaser of the recent refunding COPs for the Spring Creek Correctional Facility, about this potential refinancing and their rate for the period ending May 31, 1987 is contained herein.

In addition to the lease payment savings discussed above, the Department of Administration also can secure the following additional benefits through a consolidation of its future equipment lease purchase activities into a Master Lease Purchase financing:

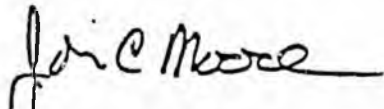
Mr. Robert J. Link
June 16, 1987
Page Two

Cost Reduction - Master Lease Purchase financing consolidates the redundancy of lease purchase for each separate item of equipment. This reduction may save as much as 10% when compared to interest rates charged by vendors and leasing companies. State administrative costs are dramatically lessened by reducing the number of lease payments made. Approximately 1,020 lease payments need to be made under the Department's existing system between July, 1987 and July, 1991. With the Master Lease program, there would be eight payments to be made during the same timeframe. This will obviously cut the personnel time required for processing, freeing staff time for other activities.

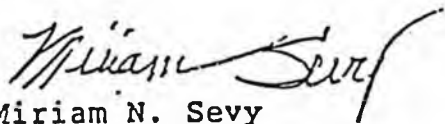
Standardization and Centralization of Operations - By standardizing and centralizing lease purchase documentation, more accurate accounting and financial controls on the equipment acquired by the State can be implemented. Typically, the rating agencies view this as a very positive development in financial management practices.

Shearson Lehman and Seattle-Northwest are prepared to continue to commit the necessary resources to structure, design and implement a successful Master Lease Purchase financing. As evidence of our commitment to this endeavor, we as a team (and Seattle-Northwest in particular) have devoted a substantial amount of time and effort in analyzing over 71 State equipment leases. We look forward to discussing this proposal with you and other officials in greater detail.

Very truly yours,



John C. Moore
Senior Vice President
Shearson Lehman Brothers



Miriam N. Sevy
Assistant Vice President
Seattle-Northwest Securities Corp.

JCM:jm48m

I. Summary Analysis of Savings to be Derived from Refinancing Existing Equipment Leases

Existing Lease Obligations Outstanding as of July 1, 1987

Total Principal Outstanding	\$6,617,494
Total Interest Outstanding	<u>1,392,390</u>
Total	<u>\$8,009,884</u>
Interest Rate on Outstanding Leases	13.86%(1)
Present Value of Total Principal and Interest Payments	\$6,875,275(2)

Proposed Refinancing Under Master Lease Purchase Structure as of July 1, 1987

Public Offering Option

Principal	\$7,785,000
Interest (average rate of 7.127%)	<u>1,205,025</u>
Total	<u>\$8,990,025(3)</u>
Present Value Savings	\$ 424,045
- As a Percent of Existing Leases	5.3%

Private Placement Option

Principal	\$6,960,000
Interest (average rate of 7.515%)(4)	<u>1,356,458</u>
Total	<u>\$8,316,458</u>
Present Value Savings	\$ 274,400
- As a Percent of Existing Leases	3.43%

- (1) Calculated as rate necessary to discount total principal and interest requirements (\$8,009,884) to principal amount outstanding as of July 1, 1987 (\$6,617,494).
- (2) Based on the individual interest rate on each lease, a present value calculation was made. The total of these calculations is \$6,875,275. This is the amount necessary to retire the outstanding leases with the new Master Lease.
- (3) Includes a Reserve Fund equal to 10% of the principal amount of COPs; the Reserve Fund, together with a portion of the earnings thereon, will be used to fund the final year's requirement. The total net debt service requirements are \$7,962,405.
- (4) Provided by Ford Motor Credit Company on July 16, 1987.

II. Next Steps

Shearson Lehman Brothers and Seattle-Northwest Securities Corporation are able to provide the Department of Administration with the most complete package of services available towards completing the proposed financing.

Provided below are the key activities needed to develop the Master Lease and administer it over time. We have assumed that the State Bond Committee's bond counsel and financial advisor will play an important role with the transaction.

<u>Event</u>	<u>Process</u>	<u>Responsibility</u>
Review Existing Leases Develop Demand Survey	<ul style="list-style-type: none"> - Determine the extent of existing lease agreements or installment sales contracts which can be refinanced to produce lower annual payments. Also, determine the demand for lease acquisition over the next two-three years of the categories of equipment encompassed by the program. - Agreement to proceed. 	Dept. of Admin., SLB & SNWSC (completed June 15, 1987)
Evaluate Demand Survey	<ul style="list-style-type: none"> - Refine refinancing analysis. - Review new equipment requests to be included in the program for "essential use" test and useful life (optional). - Aggregate equipment demand by category and prepare debt amortization schedules matching useful lives to maturity schedules. 	SLB, SNWSC Dept. of Admin, SLB & SNWSC SLB & SNWSC
Prepare for Issuance of Certificates of Participation ("COPs")	<ul style="list-style-type: none"> - Determine issuer of COPs and select a Lessor. - Prepare drafts of legal documents including Master Lease Purchase Agreement, standard sublease agreement, Preliminary Official Statement ("POS") or Private Placement Memorandum ("PPM"), Trust Indenture, etc. - Size the COP issue based upon demand survey results and amount of leases to be refinanced. - Decide upon cost effectiveness of credit enhancement and type of offering (public vs. private placement). - If applicable, submit application to credit enhancers and rating agencies. 	Working Group Special Tax Counsel & Underwriter's Counsel SLB & SNWSC Dept. of Admin., SLB & SNWSC SLB & SNWSC
Issue COPs and Execute Master Lease	<ul style="list-style-type: none"> - Mail POS to investors or negotiate directly with institutional purchasers (i.e., financing subsidiaries of major industrial manufacturers, lease financing companies, commercial banks, casualty insurance companies). 	SLB & SNWSC

<u>Event</u>	<u>Process</u>	<u>Responsibility</u>
	- Execute COP Purchase Contract, Master Lease Purchase Contract, Trust Indenture, etc.	Dept. of Admin., SLB, SNWSC, Lessor & Trustee
Refinance Existing Leases	- Trustee issues checks, approved by Lessor, to be delivered to existing vendor/lessor to buy-out lease.	Lessor & Trustee
	- Lessor delivers to Dept. of Admin. new schedule of lease payments.	Lessor
	- On first lease payment date (about 6 months from closing), Dept. of Admin. sends lease payment to Trustee.	Dept. of Admin.
	- Trustee aggregates lease payments together with earnings on unexpended COP proceeds to pay COP investors.	Trustee

The State can realize savings in lease payments by incorporating new equipment purchases into a Master Lease for fiscal years 1988-1991. Shown below are the additional steps necessary to implement a Master Lease program.

Execute New Equipment Purchases	- Dept. of Admin. determines equipment needs and selects model and vendor.	Dept. of Admin.
	- Procurement form sent to Lessor.	Dept. of Admin.
	- Lessor reviews request for "essential purpose" and useful life.	Lessor
	- Lessor sends payment to equipment vendor.	Lessor
	- Vendor delivers equipment to Dept. of Admin. Dept. of Admin. verifies equipment as that requested and notifies Lessor.	Dept. of Admin. & Lessor
	- Lessor delivers to Dept. of Admin. a schedule of lease payments and records lease schedule as part of Master Lease.	Lessor
	- On first lease payment date (about 6 months from closing), Dept. of Admin. sends lease payment to Trustee.	Dept. of Admin.
	- Trustee aggregates lease payments with earnings on unexpended COP proceeds to pay COP proceeds.	Trustee
	- As equipment categories are fully utilized (based upon original demand survey) requests for new equipment purchases may be refused due to depletion of Master Lease funds.	Lessor
	- Lessor notifies Dept. of Admin. as certain equipment categories are fully utilized and Dept. of Admin. conducts new demand survey as a first step in replenishing the Master Lease loan fund.	Dept. of Admin.

III. Public Offering vs. Private Placement/Costs of Issuance

As your investment bankers on the proposed COP financing, Shearson and Seattle-Northwest will explore all markets for the COPs and make recommendations of the type of offering that result in the lowest interest costs and best terms. We are prepared to support either a negotiated public sale or private placement after a more complete evaluation is completed with your input. We have outlined the major differences between a public offering and private placement below.

<u>Provision</u>	<u>Negotiated Public Offering</u>	<u>Private Placement</u>
Interest Rates	Lowest	Highest
Nature of Covenants	Least Restrictive	Most Restrictive
Lead Time to Complete	Longest	Shortest
Initial Issuance Costs	Highest	Lowest
Overall Cost of Capital	Lowest	Highest

Based on current market conditions, the negotiated public sale method is more attractive. We would continue, however, to advise the Department of Administration and the State Bond Committee of this changing environment if private placement opportunities should arise. For instance, we are aware that the State was successful in arranging for the recent private placement of the Spring Creek Correctional Facility Refunding COPs with Ford Motor Credit Corporation at a very favorable interest rate. We recently held discussions with Ford and several other major credit and/or leasing subsidiaries about their interest in purchasing tax-exempt equipment leases from various states. As a result of these discussions, we understand their policies, guidelines and interest rate parameters on equipment leases and we are prepared to share the results of our investigation with you. We will prepare a pricing analysis to support our recommendation. This analysis will include all costs of the transaction and a schedule of lease payments.

Costs of Issuance. The following is our estimate of the categories and amounts of the issuance costs when issuing the proposed COPs. We have assumed a COP issue of \$7,785,000 which only represents a refinancing of existing leases. These estimates represent our best efforts to provide realistic expense projections rather than unreasonably low figures that later might be a source of disappointment or embarrassment.

	<u>"A" Rated Public Offering</u>	<u>Non-Rated Private Placement</u>
Special Tax Counsel	\$10,000	\$10,000
Rating Agencies	6,000	N/A
Trustee	2,500	2,500
Lessor	12,000	N/A
Financial Advisor	7,500	7,500
COP Printing & Registration	2,000	N/A
Printing & Distributing Offering Documents	<u>5,000</u>	<u>500</u>
Total	<u>\$45,000</u>	<u>\$20,500</u>

These costs will vary depending upon final structure and negotiations with each party. For example, if municipal bond insurance is judged to be beneficial, insurance premiums would be added to the above estimate for the public offering option.

Underwriters' Discount. For a public offering, our compensation would be paid out of the discount or "spread" between the price we pay for the COPs and the price at which we sell them. Of course, the discount is entirely contingent upon a successful sale. Our estimated spread would vary depending upon market conditions and structure. Again, we have been conservative to depict the most realistic amounts, as follows:

	<u>"A" Rated Public Offering</u>
Management Fee35%
Underwriting20
Takedown (sales commissions)50
Expenses(1)	<u>.20</u>
Total	<u>1.25%</u>

Private Placement Fee. For a private placement, our compensation would take the form of a fee, payable from the proceeds of the COPs. Our fee will not exceed .875%.

(1) Includes underwriters' counsel, clearance, travel and out-of-pocket expenses, and miscellaneous courier services and conference call charges.

IV. Credit Considerations for a Public Offering

The establishment of an acceptable security can be one of the major obstacles to completing a tax-exempt lease financing. Understanding these points is critical to an appreciation of how a municipal lease-backed Certificate of Participation will be rated for a public offering. It is important to note that investors in a publicly offered COP issue will be looking for much of the same covenants and clauses that the Department of Administration is already providing on its existing equipment leases. For instance, the Department of Administration's existing leases contain nonappropriation language, security interest and remedy provisions, indemnification of lessor provisions and nonsubstitution clauses.

Non-Appropriation Clause. The lease and the subsequent financing provided by the lessor in most cases is not considered a debt obligation of the governmental body because the lease would be subject to annual appropriation (in some states such as Michigan and New Jersey, it is not considered to be debt even if there is a contractual obligation to make payments for the entire lease period). For this reason, lease-purchase financing is often used in situations where governments are constrained by debt limitations or referendum requirements regarding the issuance of debt. The rating ascribed to the issue on a COP financing, however, reflects the ability of the lessee to release his obligation, through non-appropriation, and the increased possibility that the transaction structure will be collapsed in such a circumstance. Typical non-appropriation language included in the lease, would be similar to the following:

Lessee reasonably believes funds can be obtained sufficient to make all lease payments due during the term of the lease. Lessee hereby covenants that it will do all things lawfully within its power to obtain and maintain funds from which lease payments may be made, including making provisions for such payments to the extent necessary in each annual budget submitted for the purpose of obtaining funds, using its bona fide best efforts to have such portion of the budget approved, and exhausting all available review and appeals in the event such portion of the budget is not approved.

In the event that the lessee is unable to obtain funding for any renewal term, lessee shall have the right to terminate this lease at the conclusion of the then current term of the lease and shall neither be obligated to make any lease payments due beyond the current term, nor to make any concluding payment whatsoever, and this lease shall terminate as to that leased facility or equipment. Provided, however, that in the event lessee does not appropriate such funds, lessee will use its good faith best efforts to acquire the necessary funding from other agencies or sources. Upon termination as provided for above, lessor or its agents should have the right to take possession of the leased equipment/facility and lessee shall be liable to return the leased equipment/facility to lessor in full operational and good working order.

Security Interest and Remedy Provisions. Due to the provision for non-appropriation, the security provided to the certificate holders in the event that the government unit ceases to make lease payments, and therefore provide for Certificate debt service, is a critical element to the COP issue's rating. The most fundamental issue will be the ability to grant a security interest, or, in other words, give the certificate holders the right to the ownership of the equipment or facility being financed in the event that payments are no longer made. The ability to grant such an interest is not universal, and in certain states this security feature cannot be included. In those states where a security interest is not a legal remedy, the need to develop strong alternative remedies for the certificate holders is a major concern. One such alternative is to provide to the certificate holders the proceeds of a subsequent sale of the equipment or facility. Increased use of tax-exempt leases has provided a number of examples of how to structure an adequate remedy in those states where a security interest is not available.

Indemnification of Lessor. In a lease financing, the lessor is a party to the primary agreement in the structure - the Lease-Purchase Contract. Although the lessor will typically transfer all rights and obligations to an agent, a claim against the lessor could conceivably collapse the transaction. In order to minimize the likelihood of such an occurrence, the state will typically indemnify the lessor against all claims relating to the use or ownership of the equipment. The need for such a clause relates to the possibility of a liability suit filed relating to an improper use of leased equipment or facility, which names the lessor, or a tax that may be established at some point in time that would apply to the lease payments made to the lessor. In certain states, the lessee has not been able to grant such an indemnification. In those cases, a private corporation is effectively precluded from acting as lessor, and a state agency is alternatively used as the nominal lessor.

Credit Enhancement. Municipal bond insurance provides a third party guarantee of timely payment of principal and interest on a tax-exempt bond issue. The insurance policy is given in exchange for a one-time premium paid upon issuance and calculated as a percentage of total principal and interest payments over the life of the bonds. The insurance provides a AAA rating from one or both of the major credit rating agencies, which can result in substantial savings after the cost of the insurance is taken into account.

Until a few years ago, tax-exempt leases which depended upon annual appropriations were not considered insurable. More recently, because of new entrants into the municipal bond insurance industry and more experience with annual appropriation risk, lease purchase transactions with strong security features have been eligible for such insurance. Typical insurance premium costs range from .65% to 1% of total principal and interest.

Similarly, a letter of credit from a commercial bank provides a guarantee that substitutes the bank's credit for that of the issuer. The letter of credit, however, is provided in exchange for an annual fee expressed as a percentage of the outstanding principal amount of the bonds. The letter of credit usually is available only for less than the life of a long-term bond issue and would have to be renewed (usually every five to seven years) to remain in effect. This can be a particularly attractive option for equipment financings where typical final maturities are in the same range. Typical fees for a letter of credit are presently in the range of three-eighths to one-half of a percentage point per annum, depending on the risk undertaken and the demand for letters of credit.

An issuer and its investment banker would first evaluate the potential costs and economic benefits of using either an insurance policy or a letter of credit for a given COP issue. Conclusions would be drawn based on the interest cost savings of enhancement. The savings would be calculated on a present value basis. In most market conditions, a lease purchase issue which would otherwise be rated A or lower will benefit from the use of insurance, while ratings lower than BBB- are generally not insurable. Next, the availability of such credit enhancement would have to be determined. This will often depend on the legal constraints on the issuer and the degree to which the issuer is willing to comply with the restrictive covenants which the insurer or bank may require as prerequisites to an agreement. The investment banker then would negotiate with one or more firms providing credit enhancement to find the most advantageous terms.

Essential Use Facility/Bondholder's Security. In assessing the cash flow support of instruments backed by a lease-purchase agreement, investors and rating agencies evaluate the possibility of an event of non-appropriation by the lessee. In this regard, the nature of the facility being financed and its importance to the lessee's responsibility of providing essential services are pivotal. Lease purchase financing of non-essential public facilities, such as convention centers, is not as well received by investors as bonds backed by lease-purchase agreements associated with the financing of more vital facilities. Correctional facilities, for example, represent an extreme in essential use because governments obviously must avoid closing down a correctional facility and releasing prisoners. Investors, for this reason, regard lease-purchase financing involving such facilities as representing a strong and attractive credit. To formalize this situation, investors sometimes request the state or local government lessee to provide a letter setting forth the essential nature of the leased property.

Non-Substitution Clause. Investors traditionally have been comforted by inclusion of a non-substitution clause in the lease-purchase agreement which would preclude the governmental body from acquiring the same or a similar facility for a period of time in the event of non-appropriation. This can reduce the risk of early termination of the lease for other than the legitimate absence of sufficient funds. Typical non-substitution language would read as follows:

The lessee agrees that in the event the lessee exercises its right to terminate this lease in accordance with the non-appropriation provisions contained herein, the lessee will not purchase, lease, or rent other property for the purchase of performing the functions and projects which were to be performed by the leased facility for a period of one year from the date of termination of this lease.

Credit Ratings. The rating agencies generally rate lease-purchase issues at least one full grade below the general obligation rating of the lessee. For example, if a state or local government is rated AA, the lease-purchase issue generally would be rated A. This rating policy stems from the risk of non-appropriation. Factors which could improve such a rating are: (i) extremely strong security features on the lease, including a lengthy lease term, automatic lease renewals, a contractual requirement to make lease payments or a non-substitution clause; (ii) additional security backing (such as insurance or a bank letter of credit) or specific additional revenues pledged toward payment on the bonds; (iii) powerful evidence of the essentiality of the facility; and (iv) clear statutory authority for leasing and historical experience by the lessee in making appropriations for tax-exempt municipal leasing. The lower rating will result in a higher interest rate as compared to the lessee's general obligation bonds. If the state or local government has the choice for a given project of using either general obligation or lease-purchase financing with equal annual payments, the impact of either on the governmental body's overall credit rating would be the same. When the lease-purchase financing can be structured to cost less than general obligation financing, the lease purchase issue would have less of an impact on the governmental body's debt capacity and thus help to preserve the credit rating.

Government Finance Associates, Inc.

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Portland, Oregon 97201

503/222-1405

SEPTEMBER 28, 1987

**TO: COMMISSIONER HUGH MALONE
MILT BARKER
TOM BOUTIN**

FROM: GOVERNMENT FINANCE ASSOCIATES, INC.

RE: STATE OF ALASKA MASTER LEASE PROGRAM

I. INTRODUCTION

Lease purchase financing can be an attractive alternative to individual vendor leases or to general obligation financing. A governmental body wishing to purchase facilities through the lease program enters into a lease agreement with either a bank or a leasing corporation acting as escrow agent/lessor. Certificates or bonds are then issued based on the expected lease revenues. In order to qualify as a tax exempt financing the final ownership of the equipment must be with a public entity and the equipment or facilities must have limited private use. These lease rental payments are set at a level equal to the debt service requirements and are paid through the annual appropriation process. The lessor, upon receipt of the lease payments, distributes the payments to the bond or certificate holders. The arrangement is actually a type of installment sales agreement for the purchase of equipment.

Some governments have used lease purchase financing to manage a yearly "master lease" program. This type of program brings together, into a single transaction, all of the individual lease purchases the government plans during the upcoming year. A master lease can reduce the overall administrative efforts in multiple lease agreements as well as reduce the interest cost of the leases. A master lease program is appropriate only for equipment purchases; a different mechanism should be established for the planning and coordination of leasing and/or lease purchase financing of facilities.

There will be a number of policy, as well as financial, matters the State will want to consider as it determines its need for a master lease program. This memorandum will review those considerations as well as outline the process for implementing such a program.

II. DETERMINATION OF NEED

The State may have several reasons to pursue a master lease financing. These needs fall into several areas.

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A. Policy issues

1. Coordination and planning

From a management standpoint, it is advantageous to coordinate purchasing through a central location, reducing the redundant costs of multiple agreements. A focal point for administering the leases also may coordinate future purchasing requirements. The Shearson Lehman proposal included 71 different existing lease contracts. A master lease program would bring all of those contracts (and their resultant payments) under a single master contract with coordinated payments. The State could choose to make only two payments a year, as is typical in Certificates of Participation, or monthly payments, as is typical in traditional leases.

In considering the centralization of lease financing through a master lease program, the State should consider limits on the amount of leasing each year as well as the type or cost of equipment leased. While the programmatic need is the first stage of the decision process, the State should set a standard limit on the yearly total amount of lease financing of equipment. This limit may be set as a percent of total budget, a percent of True Cash Value, or a dollars per capita figure. In this way, the State does not risk inordinate increases in lease financing which might become detrimental to its credit rating. A further limit on the type or cost of equipment financed should be articulated in that some equipment might more reasonably be purchased through current appropriations:

2. Lower cost financing

Individual vendor leases usually charge a higher rate than the borrowing rate for the overall governmental issuer. In some instances, vendor rates range up to 18%. In the State's case, Shearson Lehman calculated the average interest rate on outstanding leases to be 13.86%. By pooling the individual smaller leases, the cost of borrowing can be lowered to near the general obligation debt rate.

3. Financing within the annual budget process

Lease purchases are financed within the operating budget and therefore are not subject to the normal debt issuance approval process. The concept is based in the rationale that, through a lease purchase financing, facilities or equipment can be purchased at a lower cost than they can be leased or rented through individual vendors. The lease obligation is not debt in the traditional sense; it is rather a purchasing arrangement with ownership of the equipment/facilities dependent on fulfilling the terms of the agreement.

4. Administration of the master lease program

A central administrative unit will serve to coordinate the process. This is most commonly accomplished through the department of general services. This does not mean, however, that all the costs of the leases should be removed from the program budgets. One of the concerns of master lease programs is that leases are suddenly seen as free budget increments to the departments initiating the lease. The result is often an explosion in the number of lease financings, which is clearly contrary to the purpose of the master lease program. General Services should establish an accounting system which tracks, and bills to the departments, the costs associated with the lease purchases initiated by those

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departments. These costs should include the yearly principal and interest due, the pro rata share of the issuance costs, and any administrative costs incurred by General Services and other state agencies in managing the transaction.

B. Review of upcoming needs

The size of the financing should reflect upcoming needs over the next reasonably predictable purchasing period. Estimated purchase prices and time lines should be established. As an alternative to the estimation process, purchases may be accumulated through a bank line of credit and re-financed later based on known costs.

C. Review of outstanding leases

In the case of a first master lease, the existing leases should be reviewed as it may be possible to buy out the remaining portions of their leases and re-finance the remainder as part of the master lease. The outstanding balance on leases should be determined as well as any prepayment penalties. The remaining economic life of the equipment should also be determined, as it limits the potential term of the financing.

As the refinancing of existing leases will result in lower costs on existing leases, the State will need to develop a policy for the budget treatment of savings.

III. TERMS OF THE FINANCING

The following should be determined when structuring the issue:

A. Useful life of the financed equipment

The equipment should not be financed for a period longer than its useful life. With equipment purchases, this is usually 3 to 5 years.

B. Repayment schedule

The repayment schedule should meet the cash flow abilities of the governing body. The principal payment typically occurs within the first few months of the fiscal year.

C. Establishment of Trustee

A trustee or escrow agreement will be established with either a bank or leasing company to provide nominal ownership of the equipment or facilities during the purchase period. This agreement establishes an agreement between the governing body and the trustee (or escrow agent) regarding payment for the equipment. This document is usually drafted by bond counsel.

D. Security interest

The lease documents may provide security interest in the purchased (leased) equipment during the purchase period. This means the certificate holders actually own the equipment (through the trustee) until the last payment has been made. This allows the certificate (bond) holders the added security, in case of non-payment, of actually seizing property which may be resold or re-leased in an attempt to offset the remaining payments owed them.

Since the lease purchase agreement is aimed at the purchase of specific property, usually it will contain language itemizing the exact property or equipment to be purchased. An additional clause which prohibits substitution of other non-secured equipment for that equipment which has been identified in the security agreement is also usually required. In effect, this language does not generally prohibit substitution but rather requires notification and approval by the trustee of any substitutions for the original equipment.

E. Security enhancements

Security enhancements such as a debt service reserve fund or an bond insurance policy can be included to overcome certificate purchasers' concerns about the ultimate repayment of the securities. These types of enhancements should be evaluated by a cost-benefit analysis. It seems unlikely that insurance or a debt reserve fund would be necessary for a master lease with the State, however. With longer term lease financings, some concern regarding repayment may be reasonable, but the short term nature of master lease purchase financings reduces these concerns.

F. Non-Appropriation Clause

Most lease purchase arrangements are subject to an annual appropriation process. This distinguishes the agreements from other forms of indebtedness in that the long term commitment can be revoked. No future governing body nor populace is committed to make payments based on past decisions. (There are certain practical obligations which should not be ignored.) However, some governing bodies have the ability to enter into lease purchase agreements which are not subject to the annual appropriation process. This authority is usually found in the charter or statutory authority of the governing body. A "non-appropriation" clause, which subjects lease payments to the annual budget process, reduces the security of the issue, thus generally increasing the interest cost to the governmental body.

G. Non-Substitution Clause

A non-substitution clause precludes a government body from acquiring the same or similar equipment for a period of time in the event of non-appropriation. This type of clause has been traditionally included to give investors comfort that non-appropriation will not be used to get a better deal should one arise at a later date.

IV. RFP FOR SERVICES

After the general needs and terms of the proposed issue have been determined, a Request for Proposals for Leasing/Underwriting services should be forwarded to major firms dealing in this type of transaction. This list might include leasing corporations, banks and/or underwriters. In some cases, this list may be expanded to private placements.

A. General RFP for services

Given the diversity of types of financing instruments, the RFP can take a variety of forms. RFPs should be fairly specific in describing the proposed terms of the financing but should also allow proposers to recommend methods specific to their strengths.

1. *Negotiated or competitive sale*

Given the nature of these transactions, most lease purchases are negotiated. In certain market conditions and with certain types of issuers, a competitive sale may be more advantageous. This determination needs to be made on an issue-by-issue basis. It seems likely, however, that the stature of the State's name would allow a competitive sale to proceed with no disadvantage to the State.

A special kind of negotiated sale is the sale of bonds directly to the final purchaser of the bonds. This is called a private placement. A number of issuance costs can be eliminated in this type of sale in return for somewhat higher interest rates in general. This combination may reduce the total cost associated with the issuance of the bonds.

2. *Interest rates*

In a negotiated sale, the RFP should specifically ask the proposer to indicate the expected interest rates for the proposed transaction. These rates should be modified only if the market experiences significant movement.

3. *Other fees*

Each type of transaction has its own set of costs. Some interest rate proposals will be "all inclusive" in terms of issuance costs. The RFP should ask the proposer to estimate any and all additional costs of the transaction that the issuer might expect to pay.

4. *Structure of financing*

The proposed structure of the financing should be specified to the extent possible. This allows realistic prices for the financing in the proposals. The structure includes the various "terms" described in section III.

B. Evaluation of Proposals

The evaluation of proposals usually presents some problems given their diversity. The three most significant areas of evaluation are:

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1. Present value of cash requirements

Ultimately all financings result in a series of payments made by the borrower to the lender. This is the important measure of the economics of the proposal. The evaluation should create the expected cash requirements as a result of the proposal and discount future cash requirements at the appropriate discount rate for the issuer. The discount rate should be the same in comparing each of the proposals and is generally the then-current borrowing rate for the issuer. The "present value" of the various proposals can then be compared by discounting the future cash flows to the present.

2. Required terms

Each of the various proposals will have some distinct financing terms such as the payment frequency, costs exclusive of interest rates and legal documents required. Some of these terms will be quantifiable and therefore can be included in the present value analysis; others may be policy issues that will have to be weighed on an individual basis.

3. Capacity to execute financing

Basic to the evaluation is the capacity of the proposer to actually do what they propose. The RFP should request an explanation of similar types of financings in which the underwriter has been involved and their level of involvement.

V. PROCEDURE FOR FINANCING:

The procedure for the financing involves getting the necessary individuals together to produce the requisite set of documents.

A. Required Documents

The required documents include:

1. *The Lease purchase agreement*, which is an agreement between the lessee and the escrow agent/vendor. It is prepared by bond counsel.
2. *The Trust indenture or Escrow agreement*, which establishes the various accounts and administrative procedures used by the trustee or escrow agent. It is considered an agreement between the issuer and the trustee for the investors. It is prepared by bond counsel.
3. *Authorizing documents*, which include the resolutions or ordinances passed allowing the governing body to enter into a lease purchase agreement. At the state level these documents are usually statutes or rules. These documents are usually prepared by either local or bond counsel.

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4. *Documents relating to underwriting and sale of securities*, which include the official statement or offering memorandum, the bond sales agreement with the underwriter, the notice of sale and any other local or state notification requirements. These documents are usually prepared by the financial advisor and governmental staff.
5. *A legal opinion*, which is always required in the sale of tax-exempt securities. The opinion, which is prepared by bond counsel, states the issuer has authority to issue this type of obligation and that the issue meets federal and state requirements for tax-exemption.

B. Select Team

The necessary individuals include:

1. *The Trustee or Escrow agent*, as lessor, will be responsible for holding title to the equipment or facilities until the terms of the agreement have been met.
2. *The Financial Advisor*, who will provide advice in setting the terms of the financing and coordinate the development of the necessary documents. Sometimes underwriters provide this type of service as part of the purchase price of the securities, but the potential conflict between advising the issuer on what is best for the issuer and buying the securities at the best price for the underwriting company often lead governments to the use of an independent financial advisory firm.
3. *The Bond Counsel*, who will prepare most of the legal documents and render an opinion on the tax-exempt status of the issue.
4. *The underwriter, leasing company, bank or private investor*, who will purchase the securities. Banks are not generally barred from purchasing certificates of participation but are not currently allowed to underwrite revenue bonds. On occasion a private investor, usually an insurance company or credit company, will directly purchase securities from an issuer.
5. *Central/State administrative agency*, which will act as lessee. In master lease programs this is usually the general or administrative services department.

C. Key Tasks

The following are the key tasks included in the financing:

1. Programs determine the need for equipment
2. General Services coordinate the needs, determining the total amount of the financing.
3. Determine terms and the schedule for the financing
4. Prepare documents
5. Submit draft documents to rating agencies (if rated)
6. Finalize official statement/disclosure documents
7. Sell or price the certificates (bonds)
8. Prepare closing documents
9. Close (exchange the money for the certificates)

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10. Purchase equipment/facilities
11. Pay lease payments
12. Bill departments for their pro rata share of lease payments
13. Transfer ownership at end of payments

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GLOSSARY

Bank line of credit - an established agreement between a bank and an individual or entity. The bank allowing a stated amount of funds, with terms, available for use by the individual or entity when needed.

Bond insurance policy - a covenant between a bond insuring entity and a bond issuer that the insurer will pay investors in the case of default.

Certificate of Participation - representative of a share in the purchase of capital property for a municipality. The investor purchases the certificate with the agreement that the government will make payments at a given rate over a agreed upon period.

Competitive sale - method of sale in which underwriters submit sealed bids. Bids are opened at a specified time and the sale is awarded on the basis of the lowest interest cost bid.

Cost benefit analysis - a financial study to determine the costs relative to benefits in a given situation.

Debt issuance approval process - the steps necessary to obtain permission to issue bonds. In addition to the constitution, statute or charter enabling language, an election is sometimes also required.

Debt service reserve fund - a fund established as a reserve for the payment of principal and interest on debt should insufficient funds be available during any given year.

Escrow agent - the third party placed in trust to hold the ownership document until certain conditions are fulfilled.

General obligation rate - the existing average market rate on general obligation bonds.

Interest - the amount of money paid for the privilege to use another party's money.

Lease purchase contract/agreement - an agreement with terms to pay a stated amount over an agreed upon period for property which may include eventual ownership.

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Lease revenue bonds - revenue bonds paid from lease payments made by projects financed by the bonds.

Lessee - the individual or entity receiving the benefits or property that is at issue in an agreement.

Lessor - the individual or entity giving the benefits or property that is at issue in an agreement.

Master lease - a transaction combining individual lease agreements into one.

Municipal corporation - a political and corporate body established with state authorization for the purpose of providing governmental services and regulations for its inhabitants. It has defined boundaries and a population and is usually organized with the consent of its residents. Cities and towns are usually municipal corporations.

Negotiated sale - refers to a direct sale between an issuer and underwriter. The price, interest, issue structure, and terms are agreed upon and set jointly.

Nominal owner - an owner in name only and not in fact.

Present value - the valuation of what an amount of money expected in the future is worth today given alternative usage and economic considerations and expectations.

Private placement - a sale of securities to the end owner. This type of sale usually bypasses the typical relation of financing and underwriter in that the issuer deals directly with the purchaser. No secondary sale or underwriting exists. This type of sale often is accomplished with fewer documents than typical financings in that the buyer is considered a "sophisticated and knowledgeable" investor and intends to hold the securities to maturity.

Re-financed - to obtain funds preferably at a lower rate and to fully pay an existing debt held at a higher rate.

Remaining economic life - the period of time remaining from optimum usage value to diminished value of property.

Securities - this term is broadly used to refer to notes, bonds, certificates and other various investments.

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Security - used to refer to the enhancement of comfort for bond holders relative to investment safety.

Trust indenture or Escrow agreement - the third party in agreement to hold documents in trust until certain conditions are met.

Underwriter - purchaser of the entire bond issue who intends to resell the bonds. Usually it is a commercial bank or investment firm.

Vendor leases - an agreement between parties allowing the use and/or sale of property with agreed upon terms for the exchange of money. The giving party or vendor is in the business of lending and/or selling.

Original sponsor: Rules/Governor

IN THE SENATE

BY THE LABOR & COMMERCE COMMITTEE

CS FOR SENATE BILL NO. 154 (L&C)

IN THE LEGISLATURE OF THE STATE OF ALASKA

SIXTEENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to state equipment, including equipment lease-financing, and authorizing a master equipment lease-refinancing project; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1 AS 18.55.010 is amended to read:

Sec. 18.55.010. PURPOSE OF AS 18.55.010 - 18.55.290. The purpose of AS 18.55.010 - 18.55.290 is to remedy the acute housing shortage that exists in certain localities of the state by undertaking slum clearance, low-cost housing projects, housing for persons and their families engaged in national defense activities in the state, and housing projects and housing for veterans of World War II and other citizens of the state, and to remedy the short supply of necessary public buildings and equipment by providing for the financing, construction, and acquisition of public buildings and equipment for lease to the state.

* Sec. 2. AS 18.55.080 is amended to read:

Sec. 18.55.080. MEMBERS OR EMPLOYEES PROHIBITED FROM ACQUIRING INTEREST IN PROJECTS. A member or employee of the authority may not acquire an interest, direct or indirect, in a housing, [OR] public building, or equipment project, or in property or a contract for materials or services included or planned to be included in a project. If a member or employee owns or controls an interest, the member or employee shall immediately disclose the interest in writing to the

1 authority. Failure to make disclosure constitutes misconduct in
2 office.

3 * Sec. 3. AS 18.55.100(a)(15) is amended to read:

4 (15) arrange or contract for the financing, design, con-
5 struction, and acquisition of public buildings and equipment for lease
6 to the state in accordance with AS 18.55.010 - 18.55.290.

7 * Sec. 4. AS 18.55.100(d) is amended to read:

8 (d) Notwithstanding (a)(7) and (15) of this section, a proposed
9 public building or equipment project shall be submitted by the author-
10 ity to the legislature for review. The authority may proceed with the
11 public building or equipment project only if it is approved by law.
12 An appropriation does not constitute approval by law for purposes of
13 this subsection.

14 * Sec. 5. AS 18.55.150 is amended to read:

15 Sec. 18.55.150. SECURITY FOR BONDS. The authority may issue
16 bonds including but not limited to bonds on which the principal and
17 interest are payable (1) exclusively from the income and revenue of
18 the housing project financed with the proceeds of the bonds, (2)
19 exclusively from the income and revenue of designated housing projects
20 whether or not they are financed in whole or in part with the proceeds
21 of the bonds, (3) from its revenue generally, or (4) exclusively from
22 rents collected on public buildings or equipment. Bonds may be addi-
23 tionally secured by a pledge of a grant or contribution from the
24 federal government or from another source, or by a pledge of income or
25 revenue of the authority, or by a mortgage of a housing project or
26 other property of the authority.

27 * Sec. 6. AS 18.55.180 is amended to read:

28 Sec. 18.55.180. ISSUANCE AND SALE OF BONDS AND NOTES. Bonds and
29 notes of the authority are authorized by adoption of a resolution

1 prescribing the date of issuance and maturity, interest rate, de-
2 nomination, form, conversion privilege, rank or priority, execution,
3 terms of redemption, medium, and place of payment. Bonds and notes
4 may be sold in the manner, on the terms, and at the price the author-
5 ity determines. Each bond and note is negotiable. The signature of a
6 member or an officer upon a bond or note or coupon is not invalidated
7 by that person's ceasing to hold office before the delivery of the
8 bond or note. The recitation of a bond or note that it has been
9 issued in the financing of a housing, [OR] public building, or equip-
10 ment project under AS 18.55.010 - 18.55.290 is conclusive as to the
11 issuance of the bond or note and the character of the project in a
12 challenge of the validity of the bond or note or the security for it.

13 * Sec. 7. AS 18.55.200(4) is amended to read:

14 (4) covenant with respect to limitations on its right to
15 sell, lease, or otherwise dispose of a housing, [OR] public building,
16 or equipment project or a part of a housing, [OR] public building, or
17 equipment project;

18 * Sec. 8. AS 18.55.200(10) is amended to read:

19 (10) covenant, subject to the limitations contained in
20 AS 18.55.010 - 18.55.290, as to the rents and fees to be charged in
21 the operation of a housing, [OR] public building, or equipment proj-
22 ect, the amount to be raised each year or other period of time by
23 rents, fees, and other revenues, and as to the use and disposition of
24 these revenues;

25 * Sec. 9. AS 18.55.200(15) is amended to read:

26 (15) vest in one or more trustees the right, in the event of
27 a default by the authority, to take possession of a housing, [OR]
28 public building, or equipment project or a part of the project, and so
29 long as the authority continues in default to retain possession and to

1 use, operate, and manage the project, and to collect the rents and
2 revenues from the project, and to dispose of the money according to
3 the agreement between the authority and the trustees;

4 * Sec. 10. AS 18.55.220 is amended to read:

5 Sec. 18.55.220. POWER OF AUTHORITY TO CONFER UPON OBLIGEE RIGHT
6 TO BRING ACTION OR PROCEEDING. The authority may by resolution, trust
7 indenture, mortgage, lease, or other contract confer upon an obligee
8 holding or representing a specified amount in bonds, or holding a
9 lease, the right upon a default as defined in the resolution or in-
10 strument by civil [SUIT,] action or other proceeding

11 (1) to have possession of a housing, [OR] public building,
12 or equipment project or part of one surrendered to the obligee, with
13 possession retained by the obligee as long as the authority continues
14 in default;

15 (2) to obtain the appointment of a receiver of a housing,
16 [OR] public building, or equipment project or part of one and its
17 rents and profits, who may enter, take possession, and for the dura-
18 tion of the default operate and maintain it, collect and receive all
19 fees, rents, revenues, or other charges [THEREAFTER] arising after
20 that, and keep the money in a separate account or accounts to be
21 applied in accordance with the obligations of the authority as the
22 court directs;

23 (3) to require the authority and its members to account as
24 if they were [TO] trustees of an express trust.

25 * Sec. 11. AS 18.55.240 is amended to read:

26 Sec. 18.55.240. POWER OF AUTHORITY TO OBTAIN FEDERAL AID AND
27 COOPERATION. The authority may borrow, accept contributions, grants,
28 or other financial assistance from the federal government in aid of
29 any housing, [OR] public building, or equipment project and for this

1 purpose may comply with conditions and enter into the mortgages, trust
2 indentures, leases, or agreements that are necessary, convenient, or
3 desirable in order to obtain financial aid or cooperation from the
4 federal government in the undertaking, construction, maintenance, or
5 operation of a housing, [OR] public building, or equipment project.

6 * Sec. 12. AS 36.30.080 is amended by adding a new subsection to read:

7 (d) If the department enters into a lease-financing agreement
8 with the Alaska State Housing Authority for the financing or refinanc-
9 ing of equipment purchases by the state under a master lease program,
10 the department shall report to the legislature by January 30 of each
11 year the amount of interest to be saved by each agency during the next
12 fiscal year as a result of participation in the master lease program.
13 The savings shall be calculated as the difference between the total
14 payments to be made to the department by the agency under the program
15 during the fiscal year and the total lease payments that would be
16 required if the equipment were purchased under the same terms except
17 at a true interest cost equal to

18 (1) the rate charged by the vendor for financing purchase
19 of the equipment; or

20 (2) if no vendor financing is available, the prime rate
21 charged by banks on short-term business loans at the time of purchase.

22 * Sec. 13. The Alaska State Housing Authority may acquire new equipment
23 or equipment on lease to the state at the time of its acquisition by the
24 authority, for lease to the state under a master lease program, and may
25 provide refinancing, up to a total of \$40,000,000, for such acquisitions.

26 * Sec. 14. Section 13 of this Act gives the approval referred to in
27 AS 18.55.100(d), as amended by sec. 4 of this Act.

28 * Sec. 15. The Department of Administration may enter into one or more
29 lease-financing agreements with the Alaska State Housing Authority for the

1 refinancing, up to a total of \$40,000,000, of equipment purchases by the
2 state under a master lease program.

3 * Sec. 16. Section 15 of this Act gives the approval referred to in
4 AS 36.30.080(c).

5 * Sec. 17. This Act takes effect immediately under AS 01.10.070(c).
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