PARADIGM SHIFT IN LEASE-PURCHASE FINANCING FOR SCHOOL DISTRICTS

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Copiers, computers, school buses, bleachers, lawn mowers and now even text books. All school districts have something that is lease-purchased. It is the medium term financing tool of choice when paying for equipment over its useful life. The equipment lease will normally be for a term of five years or less. The term should never be longer than seventy-five percent of the projected useful life of the equipment. For a substantial capital building project with a term of more than ten years, the financing method of choice would be the bond, with Certificate of Participation (COP) leases as a more expensive alternative.

The lease-purchase agreement's Federal tax-exemptability emanates from the Internal Revenue Code of 1986. Basically "obligations of" a state and its political subdivisions, such as a lease-purchase agreement for a school district, are exempt from federal income taxation.

Vendor Driven Accommodation Financing

Lease-purchasing is popular with vendors because it has taken the sting out of closing the sale. Sales calls are expensive. Sales people are trained to create agreement and not give you the opportunity to answer with a simple yes or no! "Do you want to buy my product?" is never heard at the end of a sales presentation. More often than not the phrase "How would you like to pay for this?" is asked. This gives a sales person the continued ability to talk and convince you of the benefits of their product. A vendor needs a tool to make the sale today as opposed to a year from now. **Financing is that tool.**

How to Avoid Frittering Away Taxpayers' Dollars

Remember, a lease is a lease! Attorney's reviews, high interest costs per transaction, and lack of competition can fritter away taxpayer's dollars. The work that goes into each lease is basically the same. The cost of doing the paperwork is too, whether it's for a $25,000 or a $250,000 lease-purchase. From the lender's point of view bigger is better. The larger the lease-purchase, the better the interest rate. This is due to the cost associated with the booking of the transaction. Up front costs are basically a constant. With larger leases the up front costs have less impact on the rate.

There are transaction costs for the school district as well. Each lease that a district enters into should be reviewed by counsel. Each lease must be paid according to its own schedule. Counsel fees and check generation, combined with the higher interest rate of the smaller transactions, spend tax dollars that could be better employed elsewhere in the district.

Taking Control... A Little Planning Yields Big Rewards

The annual ritual of budget preparation alerts you to what your needs are for the following fiscal year. Planning your financing needs should go hand in hand.

During the budget process you should have a general idea of how much you need to allocate for lease-purchase payments. What is unknown are the exact prices you will obtain in bids for different items. Traditional bidding practices let tax dollars slip through school districts. The problem is that so much time is spent in developing equipment specifications that the question of how to pay for that equipment is normally left to an after-thought line in the bid.

Many districts design their specifications based on those supplied by vendors. This allows the districts to obtain what they want, honor the competitive bid requirement, and allow other bidders to prove the "or equal" of their product.

Bids for equipment will normally have a lease-purchase option that takes advantage of the vendor financing available. For all the work put into the design of the bid for the equipment, the portion for the financing winds up as an anemic request rather than a definitive statement of requirements.

Repetitious annual bid specification may be serving you poorly from a financing aspect. Plan ahead, review specifications, and incorporate latitude for financing. You've moved to create a bid package that is both fiscally and mechanically responsive to the district's needs.

BIFURCATION IS NOT A DIRTY WORD

When you need legal advice you talk to your lawyer; an accounting question is normally clarified by your accountant; the structural integrity of the old high school roof will be under the purview of the board's architect. Why do boards leave financial recommendations to their vendors of buses, computers, phone systems, software suppliers, energy contractors and the like? Further, why would a board preclude a source of financing to bid for financing?

Shift the thought process to the essentials. Money comes from banks and lending institutions. Tax-exempt lease-purchases are financed by these institutions. Vendor sponsored financing programs are set-up to help sell equipment by companies that make or distribute the equipment. Contrary to popular belief, the manufacturers, vendors, or distributors do not fund these programs themselves. The funds come from the banks and lending institutions.

By advertising a bid for equipment with a financing option, many districts are precluding financial institutions from even bidding. These bids are structured in such a way that they preclude anyone but the vendor respondent to submit a financing proposal. Bids crafted this way demand a middleman, the vendor sponsored financing accommodation. The solicitation of only vendor financed programs restricts healthy competition and encourages the resultant higher rates.

By simply reviewing your bid specifications and by adding a few extra lines, you bifurcate the bid. This will give your district the opportunity to save hundreds, even thousands, of dollars in interest for the same items. The bifurcation will allow financial institutions to bid on the financing aspect of the bid apart from supplying the equipment. Since those institutions are not supplying the equipment, only the financing, exempt them from the bid and performance bond requirement.

TAKE THE SHIFT OF THINKING A LITTLE FURTHER...

Assemble a list of all the equipment and small projects that your district will need in the next fiscal year. Calculate the amount to fund the aggregate list. Although the next step may take some effort, it could reap some additional savings for your district. Review existing lease agreements to determine buy-out figures, payment dates, and the length of payment. Once this is done you have the basis of a bid.

Consolidation of your existing needs along with the opportunity to refinance the outstanding leases will produce a lease-purchase financing request that will get the attention of potential bidders. What you are bidding for is the utility of money. What you are paying for is the interest on that money.

In structuring your own bid you can outline the terms that are best going to meet the fiscal needs of your district. Take the funds you have budgeted for the aggregate list and use it as a down payment. It makes no sense to borrow for what you have in hand for this fiscal year. Select a comfortable repayment schedule that meets your cash flow requirements. This should be set up to commence in your next fiscal year since you are already making a down payment. Let the aggregate list be one portion of your bid. As an addition to the request for bid of the financing of the aggregate list, request interest rates for the existing terms of your outstanding leases.

As part of the bid, request that the funds be placed into an interest bearing escrow account. This account will be used to release proceeds of the lease to your respective vendors and equipment suppliers as delivery takes place over the year. Keep in mind that you are already paying interest for the funds on deposit in the escrow account. Interest is earned on the escrowed funds. That income should be paid to your district for the proceeds on deposit. It is your district's money so reserve the right to direct the investment of the proceeds.

In terms of refinancing the bid, the simplest analysis is to give the bidders your buy-out figures and have them furnish you with a repayment term and frequency that will mirror your existing schedules. If the new payments are lower than the old, given the same number remaining, award the re-financing. If not, don't. Remember that you are conducting this bid. It is not the accommodation of a vendor program. So the flexibility is yours to craft into the specifications, the repayment terms, and structures which best benefit your district's fiscal needs.

The New Jersey Paradigm Real World Example

School districts in New Jersey share with California the honor of getting the lowest interest rates for lease-purchases in the United States. Why?

California started the ball rolling years ago with Proposition 13. The experience gained over the years, and the necessity that was legislated, developed a sophistication level among the school districts, their financial advisors, and the funding institutions serving them.

New Jersey is a geographically small state, but is densely populated. School business officials have a strong network and share ideas and new concepts freely on a county and state level.

What started as an idea four years ago to out-source the development of a customized competitive bid for lease-purchase financing has taken hold. In excess of 50 bids have been conducted for districts around the state. Bids range from $250,000 to $17,000,000, and have been administered for the smallest as well as the largest districts.

There has been a consistency of bid quality, and a degree of control which has had the effect of attracting only direct lenders. The districts offer lease-purchase documentation to the lowest bidder to attract local banking institutions who would not ordinarily compete. This combination of consistency of specifications, a broad based bidders list that includes national sources, as well as local lenders, has tipped the balance of rates bid to favor the New Jersey school districts on the whole.

In an informal survey of lease-purchase funding sources around the nation, interest rates bid for New Jersey school districts are consistently 40-60 basis points under similar competitive bids for districts in other states other than that of California districts. In comparison to vendor sponsored lease-purchase financing, the New Jersey districts are approximately one full percentage point below what is offered.

These are true tax dollars saved from being spent on interest. They can be employed in either purchasing more equipment or hiring more teachers.

Quantifiable Savings

Ridgewood Board of Education, Bergen County, has an on-going program to spend approximately $650,000 per year in lease-purchase payments to maintain and consistently upgrade computer technology in the district. They lease-purchase between $500-650,000 per year in new technology. In the summers of 1997 and 1996 they entered into leases that were manufacture-sponsored national programs. The interest rates for these were 5.5% and 7.01% respectively.

In the summer of 1998 they conducted a competitive bid for this year's acquisition and also bid the refinancing of the '96 and '97 leases. The savings from the refinancings of the two existing leases amounted to $36,000. The national manufacturer-sponsored leasing program was invited to bid on the refinancing as well a the new acquisition. They did not respond to the bid.

The state operated School District of Newark conducted a bid for the financing aspect of an energy conservation project for their 81 buildings. Energy conservation projects and the associated financing are exempt from bidding requirements as long as savings generated from the implementation of conservation measures only are used to make the payments on the lease purchase.The original proposal from their contractor was 5.5% for ten years with additional fees for financing of an undisclosed nature.

The district conducted a bid for this financing as a good business practice. The bid was for $17,000,000 for a ten year term. Due to the size of the issue, the transaction was not bank qualified, therefore non-bank financial institutions were solicited. The district obtained an interest rate of 4.76%. The additional fees were not included in the analysis. The additional purchasing power obtained by bidding versus vendor financing was $592,000.

A textbook leasing proposal was offered to another state operated school district for $4,000,000. This proposal was contemporaneous with the conducting of a bid for the financing of a security system for the state operated School District of Newark. Both districts were on par as far as credit worthiness. The lease-purchase amounts were similar and the term was the same. Newark's bid garnered a 4.65%. The textbook vendor's proposal for the other state operated district was 5.1%. When the Newark rate was applied to the vendor proposal, the bid rate would effectuate a savings of $46,000.

Hunterdon Central Regional High School District in Flemington is known as a leader in the successful implementation of technology programs in the state. The school has been honored as a National Blue Ribbon School of Excellence. Their "Classroom of The Future" has been showcased at state meetings. It is a model for other districts wanting to incorporate partnerships between business, industry, the community, and universities to create a virtual environment that encourages up-to-date learning with constant outside input. In 1996, their board committed to the acquisition of $1,000,000 in additional technology. Working with their financial advisor, the administration structured a bid for lease purchase financing.

The equipment the district was acquiring was coming from five main vendors with delivery schedules spread out over an eight month period. The district had committed $100,000 for a payment in their 1996-1997 budget. The district offered lease-purchase documentation to the lowest bidder, if that institution did not have documentation, in order to induce local banks to compete in the bid.

The low bidder in the transaction was a local bank who wanted the CRA (Community Reinvestment Act) credit (although the CRA doesn't do anything monetarily for the bank, it is a necessary component for banks to pass muster with the federal auditors). The local bank bid a rate of 4.78%. That rate was 36 basis points below the next higher bidder. They took advantage of the district's offer to document the transaction. The funds were deposited into an interest bearing escrow account. As different vendors finished their portion of the project, the district was able to release funds from escrow on a timely basis.

The national vendor who responded to the lease-purchase bid was 42 basis points higher than the bid winner. The difference was $14,000 to the benefit of the district before the additional income of the escrow earnings was factored in.

Summation

As we move inexorably to the next millennium, your ability to meet the increasing needs in your districts is sure to present greater challenges to each of you. Coincident with the need for heightened standards, capital improvement programs, reduction in class sizes and increasing the number of teachers (not to mention federal and state mandates), you each are annually faced with local budget justification with your local property owners.

A judicious approach toward obtaining financing through lease-purchase planning and competition is a necessary tool for the future. Developing an efficient lease-purchase program that puts a stop to unnecessary costs and higher interest expense can only help you in meeting your goals and objectives. ❖

NJASBO PEOPLE

A wonderful recognition was bestowed upon **Richard R. Dorow**, assistant superintendent for business, Northern Valley Regional Regional High School District. Mr. Dorow was named *New Jersey Administrator of the Year* for 1998 by the New Jersey Association of Educational Office Professionals at the New Jersey Teachers Convention held in Atlantic City on November 13, 1998.

Mr. Dorow has been a long time supporter of the goals of this organization and has been instrumental in bringing together NJASBO and NJAEOP in pursuit of continued betterment and education.