**Financing Solicitation**

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**Attachment A**

# Sample Provisions for Lease

Following are elements commonly included in a Tax-Exempt Lease Purchase Agreement. This describes certain terms that apply to municipal lease financing in most states. While this information is intended as a reference source to explain these general terms, it should not be relied upon as a substitute for professional financial and legal advice with respect to construction of a particular lease financing document.

**Tax-Exempt Lease Purchase Agreement Standard Terms and Definitions**

Characteristics of a Tax-Exempt Lease Purchase Agreement (TELP) – A TELP allows a municipal entity to purchase and acquire certain identified equipment, which will be delivered to the municipal entity either on a specified closing /funding date, or over a stated period of time. Most energy savings performance contracting (ESPC) projects will require that financing is available over a specified installation period. Typically an escrow account or an acquisition account is created by or at the direction of the municipal entity in which an escrow agent or trustee acting on behalf of the investor(s) will hold the funds that are advanced by the investor(s) for the equipment acquisition program. Moneys are then withdrawn from the account at the direction of the municipal entity to pay acquisition costs of the equipment as it is acquired and installed. Moneys in an escrow or acquisition account represent the proceeds of the financing, are invested in qualified investments at the municipal entity’s direction, accrue investment earnings for the benefit of the municipality (subject to any arbitrage rebate policy) and typically are pledged as security for the municipal entity’s lease payment obligation.

Each tax-exempt lease financing agreement should be carefully structured in light of federal law and applicable state law. The laws of each state are unique in the treatment of a variety of issues that relate to lease financings. A municipal entity considering lease financing should consult closely with public finance professionals and experienced legal counsel to determine the precise application of controlling legal principles to the contemplated lease financing. The index below illustrates and highlights some of the common terms and conditions that are found in a tax-exempt lease purchase agreement for energy savings performance contracting projects.

**Index of Standard Terms/Conditions in a Tax-Exempt Lease Purchase Agreement**

**Abatement –** A legal concept whereby the municipal entity reduces its rent proportionately or totally to the extent it does not have use of the financed equipment. For tax-exempt leases, in California and some other states, a municipal entity is not required to make rental payments without use of the financed equipment, permitting a termination of the lease payments. Some leases allow a municipal entity to abate partial payments if use of the equipment is limited. Lenders are likely to protect their interests in leases that contain abatement provisions by requiring the municipal entity to maintain casualty and rental interruption insurance.

**Abatement Lease** - A type of multi-year tax-exempt lease purchase agreement whereby the municipal entity can commit to make lease payments for the entire lease term unless the leased equipment is not available for use, in which case abatement occurs.

**Assignment Provisions** – Typically the Lessor may assign its rights to receive lease payments and its security interest in the equipment installed pursuant to the energy services performance contract, but only with the written consent of the municipal entity. Each assignment should specifically mention the municipal entity’s rights regarding prepayment.

**Bank Qualification –** A representation as to whether the municipal entity issuing the obligation reasonably anticipates to issue no more than $10,000,000 of tax-exempt obligations in the calendar year in which the particular lease financing is being funded.

**Equipment Delivery and Installation** – The municipal entity agrees that it will be solely responsible for the selection and use of the equipment measures and any other associated equipment, programs or services included in the financing. In addition, the municipal entity should agree it is solely responsible for the delivery and installation of the equipment and make representations that prior to acceptance it has examined and accepted the equipment in “where-is and as-is” condition.

**Escrow Fund –** An escrow account should be incorporated into the tax-exempt lease purchase agreement to provide financing for the costs of the equipment that will not be fully delivered and accepted on the closing/funding date. At closing, the monies shall be fully funded into an escrow account and then moneys are then withdrawn from the escrow or acquisition account at the direction of the municipal entity to pay for the equipment as it is acquired and installed. Moneys in an escrow or acquisition account shall represent the proceeds of the financing, should be invested in qualified investments at the municipal entity’s direction, and accrued investment earnings should be for the benefit of the municipality (subject to any arbitrage rebate policy). These monies will be pledged as security for the municipal entity’s lease payment obligation.

**Essential Use** – This clause or certificate is designed to provide comfort to investors that the nature of the financed equipment is so “essential” to the provision of government services that the municipal entity will not be likely to NOT appropriate funds to make lease payments because the loss of the financed property would adversely affect the operations of the municipal entity.

**Fiscal Funding (Non-Appropriation Clause) -** State law will dictate whether a municipal entity may enter into multi-year contracts or if a non appropriation provision must be included to avoid treatment of a lease as “debt” for state constitutional and statutory purposes. This clause permits the municipal entity to terminate a tax-exempt lease purchase contract at the end of any appropriation period if funds are not appropriated or otherwise available to make the payments due under the lease contract in the subsequent appropriation period. The provision will typically include a “best efforts” clause in which the municipal entity agrees it will use its “best efforts” to obtain the necessary appropriations to continue the contract.

**Indemnification –** An indemnification clause stipulates that the municipal entity shall hold the lender harmless from a variety of third-party claims or suits. The municipal entity is often asked to agree to hold the lender harmless against claims by all third parties that arise in connection with the selection, purchase, delivery, installation, possession, use and operation of the financed equipment. In addition, the municipal entity may be asked to hold the lender harmless from any and all claims or proceedings in which the lender is a party as a result of its interests in the contract. State law will often provide limitations on indemnification clauses to be utilized in tax-exempt lease purchase agreements.

**Interest Rate Limitations –** Depending upon applicable state law, the interest rate borne by a tax-exempt lease purchase agreement should not exceed any applicable usury limitation or otherwise exceed limitations on the maximum interest rate for public obligations. Generally a tax-exempt lease purchase agreement will be written at a fixed rate of interest for the term of the financing. Any leases that are written with variable interest rates should include a clause that defines how the initial interest rate shall be determined along with the relevant index and terms for determining any future interest rate resets.

**Introductory Provisions** – The *true nature of the agreement* provision states that although the contract may be in the form of a lease, it provides for the purchase of the “leased” property by the municipal entity. The intent of this provision is to make clear that the parties to the contract intend for it to be a conditional sale or lease purchase contract rather than a true lease, thereby helping to qualify the contact as a tax-exempt obligation

**Late Charges -** The lender is typically permitted to charge interest on any payment made by the municipal entity that is delinquent. The provision should state the rate at which such interest will be charged, or it may simply state that interest will be charged at the highest rate allowable by state law.

**Lease Term** – All contracts have a provision that specify the commencement date of the lease term and its duration, renewal, if applicable, and expiration.

**Lease Payments/Unconditional Obligation** – This provision sets forth the municipal entity’s obligation to make periodic lease-purchase payments. A payments provision may include a “no-abatement or set-off payments” clause, also frequently called a “hell-or-high-water” clause. This clearly states the municipal entity’s obligation to make the periodic lease payments unconditional, except in the case of non-appropriation.

**Legal Title and Security Interest** – Title to property subject to a tax-exempt lease purchase agreement may remain with the lender until the municipal entity has completed all the lease payments or may pass to the municipal entity at the inception of the agreement. In some states, state law shall dictate how title is to be passed during the contract. If the municipal entity defaults or exercises the non-appropriation clause, the lender shall have the right to repossess the leased property without recourse to judicial procedure or court action.

If title to the financed equipment is passed at the inception of the contract, the lender typically retains and perfects a security interest in the leased property. The title and security interest provisions usually require the municipal entity to keep the leased property fee of all liens, encumbrances or claims except those of the lender, and if such a lien, encumbrance, or claim arises, to remove it at the expense of the municipal entity as soon as it arises.

If title passes to the municipal entity at the inception of the contract, the provision shall provide that if the municipal entity defaults or exercises the non-appropriations clause, title to the property will automatically revert to the lender free of any right, interest or title of the municipal entity in the property.

**Lessee Covenants** – Under these covenants the municipal entity acknowledges or represents that “the municipal entity is a political subdivision of the state, the agreement is a legal, valid and binding obligation; that the municipal entity has the authority to enter into the contract; and that the contract has been properly authorized and executed according to all applicable laws and regulations.

**Lessee Responsibilities and Warranties**

The municipal entity will provide the lender with all financial statements, budgets, evidence of appropriation, and other information that relates to the ability for the municipal entity to undertake and continue its obligations under the contract. The scope of additional representations and warranties included in a tax-exempt lease agreement vary from lender to lender.

**Lessee Default and Lessor Remedies in Event of Default -** Every contract will differ as to what constitutes an event of default; however, most cover the failure of the municipal entity to make lease payments or other sums or obligations when due under the lease or failure to observe a representation or warranty in the lease or violation of a covenant in the lease. The lender generally has certain remedies that may be exercised when the municipal entity is in default (after the expiration of any applicable periods to cure the default) under the tax-exempt lease purchase agreement. Many of the remedies are authorized under Article 9 of the UCC but may include additional remedies or preclude certain remedies authorized by Article 9. State law will often determine the extent to which remedies may be imposed.

**Lessor’s Rights upon an Event of Non-appropriation -** Upon notice of a municipal entity’s intent to not appropriate funds to make the remaining lease payments, there are a number of rights and remedies available to the lender. Although the right to repossession and disposition of the equipment are standard provisions, there are significant differences between lenders as to what will appear in this section of a tax-exempt lease purchase agreement.

**Option to Purchase/Prepayment** - This clause shall detail the terms under which the municipal entity may prepay the contract and notification requirements.

**Quiet Enjoyment Clause:** A contractual provision which provides that a municipal entity’s use of the financed equipment will not be interrupted by the lender, as long as the municipal entity is not in default under the agreement.

**Rental Interruption Insurance -** A form of insurance that provides a flow of funds to protect the lender in the event that the leased equipment is not usable and the municipal entity elects to use the abatement provisions of the contract. If the equipment is not usable and, as a result of the lease contract, the municipal entity is not required to make lease payments, insurance proceeds would be used to continue the payment stream unless or until the equipment is restored to a usable condition or the lenders are paid the principal and interest due. However many rental interruption insurance contracts are limited to cover payments for a fixed number of years which period is deemed adequate to restore the equipment to useable condition.

**Risk of Loss –** The municipal entity shall bear all risk of loss if the equipment is damaged or destroyed.

**Tax Covenants - A** municipal entity acting as a lessee under a tax-exempt lease purchase agreement must agree to comply with the applicable requirements under the Internal Revenue Code to assure that the lease will not be treated as an “arbitrage bond”, including compliance with arbitrage rebate where necessary. Most contracts will include a clause wherein the municipal entity agrees that it will not take any action that could cause the obligation to become taxable and will do all things within its power to protect the tax-exempt nature of the obligation. The inclusion of a gross-up provision is standard in this section.

 **Triple Net Lease –** The typical tax-exempt lease purchase agreement makes the municipal entity responsible for all risks of ownership, including the cost of all maintenance, taxes and insurance on the financed property during the lease term. Lease purchase agreements will differ in presentation of the municipal entity’s responsibilities pertaining to maintenance, taxes and insurance.

**Warranties and Disclaimer of Warranties –** The lender typically shall disclaim all representations or warranties relating to the suitability or performance of the equipment. The municipal entity should work directly with the manufacturer or vendor to make sure it has covered any ongoing service, maintenance or warranty agreements directly with the vendor or manufacturer of the equipment. This provision may repeat the “no set-off or abatement of payments” provision. Unless specifically required under State law, the municipal entity shall not be allowed to delay or reduce any lease payment to the lender for any reason, including failures of the vendor’s performance under separate contractual agreements.