

MINUTES OF THE SENATE COMMITTEE ON WAYS AND MEANS

The meeting was called to order by Senator August "Gus" Bogina at
Chairperson

11:00 a.m./p.m. on January 28, 1985 in room 123-S of the Capitol.

All members were present except:
Senators Doyen and Talkington

Committee staff present:

Research Department: Richard Ryan, Ed Ahrens, Mary Galligan, Robin Hunn.
Ray Hauke

Revisor's Office: Norman Furse

Committee Office: Judy Bromich, Administrative Aide; Doris Eger, Committee
Secretary

Conferees appearing before the committee:

Art Griggs, Chief Attorney, Department of Administration

CERTIFICATE OF PARTICIPATION FINANCING

Mr. Griggs distributed his memorandum dated January 28, 1985 (See Attachment A). He then reviewed the memorandum for members of the committee.

Following Mr. Griggs' presentation, there were questions from committee members. In answer to a question from the Chairman, he stated that types of equipment included in lease-purchase arrangements are copying equipment, word-processing equipment, hospital equipment, and research equipment at universities.

Senator Feleciano asked if each agency negotiates on its own for the type of financing being discussed. Mr. Griggs indicated that the Department of Administration is going to request legislation for centralized authority, similar to that now authorized for leasing office space. In answer to a question from Senator Gannon regarding the motor pool, Mr. Griggs explained that most vehicles are purchased outright; consequently, his Department has not looked into that area.

Senator Winter asked about bidder interest in the certificates of participation. Mr. Griggs said that, on the DISC refinancing, forty invitations were sent and eight proposals were received. He suggested that investment bankers were not interested in that particular bid because the amount was too small.

There was extended discussion concerning certificates of participation, including the budgetary process. Mr. Griggs indicated that, before an agency could participate in this type of financing, they would need to prove that they had budgeted for a certain type of equipment, for instance.

There being no further questions, the Chairman thanked Mr. Griggs for the information and concluded this part of the meeting.

SB 10 - Abolishing the Federal Revenue Sharing Fund

Mr. Ahrens explained the fund in question, and stated that the last grant was received in 1981; and that the fund has been sunsetted by Congress. He added that the state has been appropriating interest from past balances, as well as using up the balances in the fund; and the amount of money is expected to be negligible at the end of FY 1985. According to Mr. Ahrens, the Governor's FY 1986 budget provides for abolition of the Federal Revenue Sharing Fund; and anticipates that the balance of approximately \$200,000 would be transferred to the State General Fund.

Motion was made by Senator Werts to report SB 10 favorably and to request that it be placed on the Consent Calendar. The motion was seconded by Senator Harder and passed by roll call vote.

The meeting was adjourned by the Chairman.

Unless specifically noted, individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

STATE OF KANSAS
DEPARTMENT OF ADMINISTRATION
JOHN CARLIN, Governor
PATRICK J. HURLEY, Secretary of Administration
Room 263-E, Capitol Building
(913) 296-3011

MEMORANDUM

TO: Senate Ways and Means Committee

FROM: Arthur H. Griggs, Chief Attorney

DATE: January 28, 1985

SUBJECT: Information on Certificate of Participation Financing

In October 1984, the Department of Administration refinanced various installment purchase agreements for computing equipment under the control of the Division of Information Systems and Communications. The contract was entered into pursuant to 1984 S.B. 725 (L. 1984, Ch. 308) which permits the use of a financial services negotiating committee to arrange for financial services. This was the first time that a Kansas state agency had utilized a certificate of participation financing arrangement. The refinancing resulted in a reduced interest expense savings to DISC of approximately \$190,000.

General Description of Certificate Financing

An investor that buys a certificate of participation is, in effect, buying a part of a state agency's equipment lease/purchase contract (installment purchase contract) and receives a portion of the State's payments. The attraction of certificates to investors is that the interest portion of the State's payments are exempt from federal income taxation. Under federal tax laws, an equipment lease/purchase obligation is given basically the same type of tax treatment as a bond issued by a state or municipality. The principal difference between a bond and a certificate of participation is that the former, unlike a certificate of participation, does not have a provision that permits the agreement to be terminated without penalty if the Legislature fails to appropriate funds in a future fiscal year in an amount sufficient to make the scheduled payments. When certificates are sold to investors, the proceeds are held by a trustee bank. The trustee pays the equipment vendors, receives the State's periodic payments and pays the certificate holders.

Details of DISC Refinancing

In order to solicit refinancing proposals from bidders for the DISC refinancing, the Department of Administration first obtained from the vendors of the existing equipment (IBM, Telex and Sperry) the October 1, 1984 purchase option prices on equipment DISC was buying under installment purchase agreements. Many state installment purchase contracts contain this purchase option feature whereby the state agency, rather than continuing to make periodic payments for the duration of the installment purchase contract (generally 36 to 84 months), can elect to outright purchase the equipment at specified prices during the duration of the agreement. Utilizing this purchase option price and the current monthly payment level and number of months remaining on the existing obligations, the Department identified items of equipment that appeared to have a good potential for savings if refinanced. The winning bidder's interest rate was 8.5%. The total of the purchase option prices for the equipment that was refinanced was \$1,660,314; this amount was paid to IBM, Telex and Sperry from the funds raised by the sale of certificates of participation. If the Department had continued to pay the installments to the three vendors rather than refinancing, the total amount paid from October 1984 through the duration of the installment purchase contracts would have been \$2,155,542 versus \$1,964,400 which will be paid out under the refinancing.

Reasons for the Savings

Three primary factors contributed to the reduced interest expense obtained by the DISC refinancing. First, interest earnings on the funds held by the trustee bank helped lower the State's interest cost to 8.5%. Certificates of participation were sold in an amount approximately 15% more than necessary to pay the purchase option price of the equipment to the original vendors. This additional amount was placed in a reserve fund held by a trustee bank. The reserve fund is a comfort to purchasers of the certificates because the reserve fund can be used to make lease payments if the lessee is late in making payment. The reserve fund is an advantage to the State because the interest earnings go to reduce the State's interest expense. In the DISC refinancing, the reserve fund was invested in a U.S. Treasury obligation yielding 11 3/4% which matures at approximately the time

the new lease is paid out. Thus, the difference between the State's 8.5% interest expense rate and the reserve funds interest earnings lowers the overall interest expense. Similarly, the State realized interest earnings by the fact that the purchasers of the certificates are paid annually while the lease payments are made monthly. The monthly payments, from the time the trustee receives them from the State and until they are paid to the certificate holders, are earning 9.75% which inures to the State's benefit.

The other two factors that contributed to the lower interest expense of the DISC refinancing were:

- (1) a shorter payment schedule -- over three-fourths of the dollar volume of the equipment was changed from a remaining payment period of 60 months or more, to a 48-month payment schedule; and
- (2) larger monthly payments -- DISC's monthly payment was increased from \$33,985 to \$40,925.

Summary

This pilot project for certificates of participation financing has demonstrated that such financing can significantly reduce the State's interest expense. While the DISC transaction involved only refinancing of existing equipment, the lower interest expense derived from certificate of participation financing also can be used for new equipment procurements. The Department of Administration is currently gathering data for a new certificate of participation financing this spring which will be available for both refinancing of existing equipment and new equipment procurements. Although the size of the next certificate financing will not be established until further data is obtained from state agencies, the amount could be in the range of \$15 to \$25 million or more.

Because of the relative newness of this type of financing in Kansas and the importance the Ways and Means Committees will play in this type of financing, the Department of Administration has not proceeded with a second certificate of participation financing until having an opportunity to discuss this project with the House and Senate Ways and Means Committees.

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Office of the SecretaryJOHN CARLIN,
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M E M O R A N D U M

TO: All State Agencies

FROM: Marvin A. Harder
Secretary of Administration *M.A.H.*

DATE: January 17, 1985

RE: Installment Purchases of Equipment

The Department of Administration is continuing its efforts to provide state agencies a lower interest rate for installment purchase (lease/purchase) contracts for equipment. This lower interest rate is attainable by the use of Certificate of Participation financing.

Using this method of financing, in October of 1984 the Department obtained an 8.5% interest rate for the refinancing of various data processing equipment. This contrasts with IBM's current rate of approximately 10%, and higher interest rates charged by some equipment vendors and third-party leasing companies. This financing method can be used either to refinance existing equipment contracts at a lower rate, or for obtaining new equipment at a more favorable interest rate than equipment vendors or third-party leasing companies may offer.

By combining the financing needs of state agencies into one certificate financing, the potential for obtaining the best possible interest rate is maximized. In order to accomplish this, the assistance of all agencies involved with installment purchase contracts is needed. It is hoped that by July 1985, the next certificate financing can be in place. However, in order to structure this financing, we will first need to obtain from interested agencies the following information.

For new equipment:

- 1) the estimated purchase price;
- 2) estimated number of months of payments; and
- 3) approximate monthly payment you feel your budget will permit.

A form is attached which may be used to provide the above information for any new equipment your agency may acquire between now and June 30, 1986, which you plan to pay for over a period of 24 months or more.

For existing equipment that is currently on an installment purchase or lease/purchase agreement, the following information is needed if the equipment has a monthly payment of at least \$100 and the existing contract will carry-over into fiscal year 1987:

- 1) number of payments remaining (specify if monthly, annual, etc.);
- 2) size of each payment; and
- 3) the purchase option price as of July 1, 1985.

If the existing contract does not have an attached schedule of the purchase option price for different time periods, you may need to obtain the purchase option price by contacting the current vendor or leasing company.

Many agencies that supplied information on existing equipment in response to the September 19 memo from the Director of Purchases did not provide the purchase option price (prepayment schedule). If your agency has not supplied this piece of data, we ask that you obtain the purchase option price for a July 1, 1985 payment date.

To provide the requested information, a form to be used for new equipment and a form to be used for existing equipment are attached. Please feel free to provide them in several submissions as you obtain the data for various equipment. While it is hoped that the information can be provided by February 28, you may submit the information after that date. The completed forms and any questions relating to this project, should be sent to:

Division of Purchases
State Office Building, Room 165-N
Topeka, Kansas 66612

Attention: Gerald Merryman
296-2376
KANSAN 561-2376

NEW EQUIPMENT
(To be acquired by end of FY 1986)

State Agency

Name & Phone No. of
Contact Person

Equipment Description	Estimated Purchase Price	Estimated # of Months of Payments	Approximate Amount Budgeted Per Monthly Payment

EXISTING EQUIPMENT

State Agency

Name & Phone Number
of Contact Person

General Description of Equipment	Number of Payments Remaining	Current Monthly Payment (specify if payment is other than monthly)	Purchase Option Price as of July 1, 1985