

MINUTES OF THE SENATE COMMITTEE ON LOCAL GOVERNMENT

The meeting was called to order by Sen. Don Montgomery at
Chairperson

9:00 a.m./~~xxx~~ on January 24, 1990 in room 531-N of the Capitol.

All members were present except:

Senators Ehrlich, Daniels and Steineger - Excused

Committee staff present:

Mike Heim, Legislative Research
Shirley Higgins, Committee Secretary

Conferees appearing before the committee:

Bev Bradley, Kansas Association of Counties
Norm Wilks, Kansas Association of School Boards

The Chairman began the meeting with a discussion of lease-purchase agreements which was continued from yesterday. He called attention to a hand out from Barbara Butts dealing with interest rates at 12 or above which had been requested by Sen. Daniels yesterday (See Attachment I).

Bev Bradley, Kansas Association of Counties, followed with her testimony. She stated that John Torbert of her organization had given testimony to a Special Committee on Local Government in 1988, and their opinion has not changed since that time. (See Attachment II). Basically, the Association of Counties feels that the arrangement is working currently and, therefore, there is no need to change the statutes. Since the law is working now for counties as it is, she requested that if changes are made, that it be left so it is workable. The Chairman agreed with this and added that it is felt that all that is needed is some safeguards.

The Chairman called attention to other pass outs--a copy of the Interim Committee Report on lease-purchase agreements (See Attachment III), an Attorney General's opinion (See Attachment IV), testimony of Ernest G. Wilson presented at the annual conference of the National Institution of Law Officers (See Attachment V) and a copy of 10-1116b and 72-8225 which had been discussed a yesterday's meeting (See Attachments VI and VII).

The Chairman asked Norm Wilks, Kansas Association of School Boards, to address the problem expressed by Pat Baker yesterday. He said that problems occur with contracts due to the inexperience of school boards in dealing with this type of contract. Many school districts do not have counsel and rely on and trust the persons who are proposing the deal. The Chairman noted that if counsel is available for a school board, many times counsel does not come to a school board meeting unless called. The Chairman asked Mr. Wilks to explain 72-8225 mentioned briefly by Pat Baker in her testimony yesterday. Mr. Wilks said 72-8225 does not speak in terms of lease-purchase agreements but is in terms of leases, and one has to go back to the cash basis law to conclude that it refers to exemptions of lease-purchases. Staff added that the cash basis law applies to school districts who have a specific grant of authority for ten years. Chapter 72 applies only to leases but one does not negate the other. It is unclear because no opinion has been written on it.

The Chairman recalled the concern of lease-purchase agreements being used for construction. Mr. Wilks agreed that this is a legitimate concern but stated that the school boards are seeking changes in regard to long term building construction and reminded that the maximum time is ten years under 72-8225.

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON LOCAL GOVERNMENT

room 531-N, Statehouse, at 9:00 a.m. ~~p.m.~~ on January 24, 1990

Mike Heim reviewed the Attorney General's opinion with attached letter (Attachment IV) and testimony presented at the Annual Meeting of the National Institution of Law Officers (Attachment V). With regard to page 3 of Attachment V, the Chairman began a discussion of bid requirements for equipment. Sen. Gaines had comments on the list presented by Mrs. Butts, Attachment I, and the committee report on lease purchase agreements, Attachment III. There being no further time, the Chairman asked that committee members be prepared to express their ideas at the next meeting so that a bill can be drafted from recommendations of a subcommittee appointed by the Chairman.

The minutes of January 23 were approved.

The meeting was adjourned at 10:00 a.m.

SUMMARY OF LEASE PURCHASE FORMS
REPORT OF LEASE PURCHASES WITH INTEREST RATE OF 12% OR MORE
JANUARY 23, 1990

MUNICIPALITY NAME	ITEM PURCHASED	CONTRACT AMOUNT	TERM	INTEREST RATE
CHAUTAQUA COUNTY	COMPUTER	2920	5YRS	12
CHAUTAQUA COUNTY	COMPUTER	6720	5YRS	12
CHEYENNE COUNTY	MOTOR GRADER	50028	3YRS	15.0
CHEYENNE COUNTY	MOTOR GRADER	52920	3YRS	15.0
LABETTE COUNTY	PHONE SYSTEM	1717	48MO	12.3
MIAMI COUNTY	COPIER	3748	3YRS	20.4
MIAMI COUNTY	COPIER	11855	3YRS	20.4
MIAMI COUNTY	LANDFILL EQUIP	90000	5YR	18
NEOSHO COUNTY	COPIER	3104	3YRS	12
SEDGWICK COUNTY	COPIER	11466	5YRS	14.72
SEDGWICK COUNTY	COPIER	8565	5YRS	14.62
SEDGWICK COUNTY	COPIER	9311	5YRS	14.76
SEDGWICK COUNTY	COPIER	6463	5YRS	14.61
SEDGWICK COUNTY	COPIER	6807	54MO	15.71
SEDGWICK COUNTY	COPIER	1480	3YRS	15.9
SEDGWICK COUNTY	COPIER	7427	5YRS	14.72
SEDGWICK COUNTY	COPIER	9125	5YRS	15.41
SEDGWICK COUNTY	COPIER	6250	5YRS	15.71
SEDGWICK COUNTY	TELEPHONE SYSTEM	7375	3YRS	14.62
SEDGWICK COUNTY	COPIER	11666	5YRS	15.13
SEDGWICK COUNTY	COPIER	7253	5YRS	14.99
SEDGWICK COUNTY	COPIER	8565	5YRS	14.01
SEDGWICK COUNTY	PHONE SYSTEM	4396	3YRS	15.86
SEDGWICK COUNTY	COPIER	6807	5YRS	15.62
SEDGWICK COUNTY	COPIER	9125	3YRS	15.71
SEDGWICK COUNTY	COPIER	11400	5YRS	15.22
SEDGWICK COUNTY	COPIER	13781	5YRS	15.41
SEDGWICK COUNTY	COPIER	9125	54MO	15.14
SEDGWICK COUNTY	COPIER	9541	5YRS	15.2
SEDGWICK COUNTY	COPIER	13487	5YRS	15.9
SEDGWICK COUNTY	COPIER	3950	5YRS	15.62
SEDGWICK COUNTY	COPIER	6807	55MO	15.62
SEDGWICK COUNTY	COPIER	8565	5YRS	14.97
SEDGWICK COUNTY	COPIER	10068	5YRS	15.44
SHAWNEE COUNTY	COMPUTER MODEM	1170	5YRS	15.3
SHAWNEE COUNTY	COMPUTER MODEM	1170	5YRS	15.3
SHAWNEE COUNTY	COMPUTER MODEM	1170	5YRS	15.3
SHAWNEE COUNTY	COPIER	2745	3YRS	18.1
ANTHONY	COMPUTER EQUIP	36870	4YRS	9.25-12.4
ARKANSAS CITY	COPIER	7830	4YRS	13
COLBY	COPIER	12983	3YRS	18.0
EMPORIA	COMPUTER	6300	3YRS	13
FLORENCE	POLICE CAR	6064		12
HALSTEAD	COPIER	8395	4YRS	12.5
HERINGTON	PHONE SYSTEM	8732	4YRS	15.5

Sen. Local Gov't
1-24-90
Attachment I

SUMMARY OF LEASE PURCHASE FORMS
REPORT OF LEASE PURCHASES WITH INTEREST RATE OF 12% OR MORE
JANUARY 23, 1990

MUNICIPALITY NAME	ITEM PURCHASED	CONTRACT AMOUNT	TERM	INTEREST RATE
HESSTON	FIRE TRUCK	75000	7YRS	12.0
KINSLEY	POLICE CAR	15659	3YRS	14
KINSLEY	PHONE SYSTEM	3186	5YRS	12.3
LAWRENCE	COPIER	66424	5YRS	12.45
MILFORD	TRACTOR	21734	4YRS	12
OTTAWA	TELEPHONE SYS	22844	3YRS	13.0
POTWIN	COPIER	3245	3YRS	18.26
SABETHA	COPIER	14048	5YRS	14.45
SOUTH HAVEN	FIRE EQUIPMENT	2255	1YR	12
TYRO	TRACTOR	3000	2YRS	13
VALLEY CENTER	TRACTOR	15728	2YRS	12
WESTWOOD	STREET SWEEPER	89500	3YRS	12
WICHITA	COMPUTER SYS	120024	3YRS	12
USD 212	PHONE EQUIP	4124	3YRS	14.5
USD 222	STATION WAGON	17241	4YRS	13.76
USD 222	SCHOOL BUS/VAN	27770	5YRS	12.42
USD 222	MOWER	7299	3YRS	16.9
USD 229	TELEPHONE SYS	4009	4YRS	12.3
USD 229	TELEPHONE SYS	4043	5YRS	12.3
USD 229	TELEPHONE SYS	4399	4YRS	12.5
USD 229	TELEPHONE SYS	8000	4YRS	14.5
USD 229	TELEPHONE SYS	5234	4YRS	14.5
USD 229	TELEPHONE SYS	3530	4YRS	12.3
USD 242	COPIER	6598	3YRS	15.5
USD 253	PHONE SYSTEM	9561	54MO	14.03
USD 257	COPIER	4775	3YR	20.0
USD 257	COPIER	24024	3YR	20
USD 257	COPIER	4775	3YR	20
USD 274	COMPUTER	36961	5YRS	12
USD 280	COPIER	18431	4YRS	16
USD 303	POSTAGE METER	2112	4YRS	13.29
USD 329	SCHOOL BUSES	114725	5YRS	21.65
USD 329	SCHOOL BUSES	81712	5YRS	24.6
USD 329	SCHOOL BUSES	112200	5YRS	27.5
USD 333	CAR	12000	3YRS	12.25
USD 372	COMPUTER SYSTEM	30352	5YRS	13
USD 372	COMPUTER SYSTEM	7261	5YRS	13
USD 411	DICTOPHONE	955	3YRS	20
USD 422	TELEPHONES	9933	5YRS	12.3
USD 455	SCHOOL BUS	28276	3YRS	14.2
USD 464	SCRUB MACHINE	4847	2YRS	18.75
USD 470	RISOGRAFH	12191	3YRS	20.0%
USD 482	MACS	12280	5YR	13
USD 489	COMPUPTER	73429	5YRS	13.05
USD 491	COMPUTER SYSTEM	37555	5YRS	13.25

SUMMARY OF LEASE PURCHASE FORMS
REPORT OF LEASE PURCHASES WITH INTEREST RATE OF 12% OR MORE
JANUARY 23, 1990

MUNICIPALITY NAME	ITEM PURCHASED	CONTRACT AMOUNT	TERM	INTEREST RATE
USD 497	ENERGY MAINT EQ	658700	7YRS	12
USD 508	COMPUTER	20199	5YRS	16.5
ATTICA HOSPITAL	PHONE SYSTEM	20650	6YRS	18
COLBY COMM COLLEGE	ICE MACHINE	4200	2YRS	18.6
HOSPITAL DIST #1 SUMNER C	CLINICAL ANAL	44910	5YRS	13.5
NESS COUNTY HOSPITAL	EQUIPMENT	69840	6YRS	15.52
NESS COUNTY HOSPITAL	PHONE SYSTEM	38263	10YR	13.29
NW KS LIBRARY SYSTEM	PHONE SYSTEM	4536	5YRS	15
NW KS LIBRARY SYSTEM	MAILING MACH	7620	5YRS	18
SPEARVILLE HOSPITAL	LAB EQUIPMENT	4050	3YRS	14.62
SPEARVILLE HOSPITAL	LAB EQUIPMENT	13495	5YRS	14.62
ST JOHN HOSPITAL DIST	AMBULANCE	41843	5YRS	13
STAFFORD HOSPITAL DIST	CELL COUNTER	15004	5YRS	14.3
WASHBURN UNIV	COPIER	8871	4YRS	14.5
WASHBURN UNIV	COPIER	4062	4YRS	16
WASHBURN UNIV	COPIER	2087	4YRS	15.5
WASHBURN UNIV	COPIER	2268	4YRS	17.5
WASHBURN UNIV	COPIER	3971	4YRS	14.5
WASHBURN UNIV	COPIER	2376	4YRS	14.5
WASHBURN UNIV	COPIER	2087	4YRS	15.5
WASHBURN UNIV	COPIER	2252	4YRS	15.5
WASHBURN UNIV	COPIER	2087	4YRS	15.5
WASHBURN UNIV	COPIER	4302	4YRS	14.5
*** Total ***				
		2686168		

John T. Torbert

September 7, 1988

Testimony -

To - Special Committee on Local Government

From - John T. Torbert, Executive Director
Kansas Association of Counties

Subject - Proposal #33 - Lease Purchase Arrangements

The legislation that precipitated this hearing, as you know, was SB 612 which was offered by Senator Warren. That legislation would have prohibited townships and counties from entering into any sort of installment - purchase agreement.

Let me say right at the outset that KAC is opposed to SB 612. That legislation limits already existing authority and we generally oppose legislative limitations. However, I don't feel that anybody is really contemplating an outright prohibition at this time so let's move on to the issue at hand.

I have always held it as a principle that legislation should only be written to answer a specific need or meet a specific problem or set of facts. In other words, the legislature responds to specifically voiced concerns and wants - as it should. If the situation is such that things are functioning well and properly under existing law, leave it be - you've done your job.

That is one concern we have with this entire discussion - what need is being addressed? All units of government have functioned effectively under the current law. Not one person has been able to point out specific abuse or misuse of the system. The private sector has testified as to the scrutiny they give the lease/purchase system. It's their money at stake too and abuse or misuse would not serve them. We have a system that polices itself with checks and balances - in both the public and private sector. No one has come in as a proponent or suggested specific changes that need to be made - so again - why are we here? It seems that the committee is concerned about something bad that might happen at some unspecified time in the future. Is that a basis on which to make new laws?

*Senate Local Gov't
1-24-90
Attachment II*

The concern is expressed that lease/purchase allows circumvention of the cash basis law. I would point out that lease/purchase is not a circumvention of the law - it is specifically allowed by it. The legislature has specifically said that lease/purchase is exempt from the cash basis law as long as a city or county can provide for the cost in the budget - so please don't accuse us of doing something illegal or shady. We're only using authority that we've specifically been given by you.

The lease/purchase system as it now exists is flexible and most importantly, it works. It allows us to meet needed capital costs in a prompt fashion without going to the time and added expense of bonding. No fund warrants are time consuming and don't have the flexibility of a lease/purchase. There is also some chance that a no fund warrant might adversely affect a jurisdiction's bond rating.

Lease/purchase also allows us the ability to keep pace with technology. If, for example, a local government "buys" a computer, it is married to that technology until it can afford to "buy" another one. That may take several years - years in which technology and the state of the art moves quickly. The purchased system quickly becomes outmoded and obsolete. A lease/purchase gives the necessary flexibility to, at the end of a lease term, buy out the equipment or turn it back and get new equipment. Taxpayers are better served when their government has the access to new technology.

I understand that there will be proposals made today as to some procedural limitations that might be put in place. If the committee is predisposed to look at this statute and change it - please keep the statute flexible and easy to use. Don't get it so cumbersome and paper intensive that it ends up destroying a valid, time tested financing method that works - and works well. Rather than looking at substantial change that may restrict governmental ability to respond to its citizens, congratulate yourselves for some well written statutes that have allowed flexibility and the use of common sense when making equipment or physical plant decisions.

We are willing to accept the responsibility these decisions impose. We hope that in granting the responsibility, you also gave us the authority and trusted our judgement to make these decisions correctly.

RE: PROPOSAL No. 33 -- LEASE-PURCHASE AGREEMENTS

Proposal No. 33 called for the Committee to review the law regarding lease-purchase agreements by local units of government to see if there is a need for limitations or safeguards such as requiring public notice, a public hearing, or some type of debt limit.

Background

The interim study request originated from discussions regarding 1988 S.B. 612 introduced by Senator Joe Warren. The bill would have amended a section of the cash basis law to prohibit townships and counties from entering into installment-purchase agreements. A hearing was held on the bill in the Senate Local Government Committee, but no action was taken when a consensus of the Committee was reached to recommend an interim study of lease-purchase agreements. Senator Warren's primary concerns were that there were not enough safeguards in the current law; that smaller units of local government may not be getting adequate financial advice before entering into these agreements; that governing bodies entering into these arrangements are effectively binding the hands of future governing bodies; and that taxpayers do not have adequate notice of local government plans to enter into these arrangements.

Local Expenditure Controls

The Kansas Legislature in 1933 enacted three laws which had as their principal object the establishment of control over and the regulation of the fiscal policies of the various local units and taxing subdivisions of the state. These laws were the budget law (K.S.A. 79-2925 et seq.), the cash basis law (K.S.A. 10-1101 et seq.), and the tax-limitation law (originally Chapter 79, Article 19).

Prior to the Depression, many taxing subdivisions had accumulated sizable outstanding debts. At that time, many governing bodies did not know and probably could not readily ascertain their true financial condition. The 1933 cash basis and budget laws were enacted to remedy that situation.

*Senate Local Gov't
1-24-90
Attachment III*

Cash Basis Law

The original cash basis law provided for a period in which claims or debts could be ascertained and provision was made to pay the resulting claims by issuing bonds. Thereafter, all taxing subdivisions were required to operate on a planned "cash basis," or, as it is known in municipal accounting terminology, a "modified pay-as-you-go plan." The net effect of this law was to prohibit any municipality, defined to mean a county, township, city, municipal university, school district, community junior college, drainage district, and other similar political or taxing subdivision, from spending money or creating an indebtedness in excess of the money it actually has on hand in its treasury.

The law contains several exceptions to the strict cash basis requirement. These include: cancellable purchase orders for school supplies and equipment, school buses, books purchased in conjunction with text book rental programs, and data processing equipment (K.S.A. 10-1113); payments which have been authorized by a vote of the electors, bonds or no-fund warrants, municipal airport revolving funds, special recreation facilities reserve funds, enterprise funds, intragovernmental service funds, and teacher contracts (see K.S.A. 10-1116); extraordinary emergencies involving municipal utilities (K.S.A. 10-1116a); and for electric interconnection or transmission facilities or services, a lease agreement with or without an option to buy, or an installment-purchase agreement if any of these latter agreements state that the municipality is obligated to pay only for the current budget year (K.S.A. 10-1116b).

The Kansas Supreme Court in State, ex rel v. Board of Education, 137 Kan. 451 (1933), explained the purpose of the cash basis law as follows:

The act pertains to the indebtedness of subdivisions of the state authorized by law to raise money by taxation and to expend the money so raised in performing their respective governmental functions. Broadly speaking, it is designed to have such governmental units operate their respective functions on a cash basis -- not to spend money they do not have or incur obligations they cannot meet promptly. Some of them, for one reason or another, had not been doing that, but had conducted their business somewhat on a credit basis. In some, proper books had not been kept, or sufficient publicity given, so that its citizens could know its financial status. It was thought waste, extravagance and an

undue burden on taxpayers resulted from such method of doing business, and the legislature deemed it prudent to change such practices and put all such governmental units on a cash basis

Budget Law

The budget law requires that the governing body of the taxing unit must adopt an itemized budget each year by August 25. The approved budget constitutes an appropriation for each fund and there can be no transfer of money between funds, with certain exceptions. The law makes it unlawful to create any indebtedness in excess of that which was adopted for that budget year unless payment for this indebtedness is approved by the voters or provision is made for the issuance of bonds or warrants. These budget standards do not apply to any township with an annual expenditure of less than \$200 if located in a county unit road county, to any money received as a gift or bequest, any revolving fund set up for the operation of a municipal airport, any special recreation facilities reserve or any special recreation facilities fund, or for the expenditure of federal aid money.

The Kansas Supreme Court summarized the purpose of both the cash basis and budget laws in Shouse v. Cherokee County Commissioners, 151 Kan. 464 (1940), by stating:

The purpose of the cash basis law and the budget law is to prevent a deficit in the funds of the municipality at the end of the fiscal year. To effectuate that purpose the budget is to be carefully made, and the estimate of expenditures therein specified is to be faithfully observed.

Bonds, No-Fund Warrants, and Debt Limits

The primary way that cities, counties, school districts, townships, and most special districts may borrow money is by the issuance of bonds or no-fund warrants. Most bond issues are governed by the General Bond Law (K.S.A. 10-101 et seq.), the Utility Revenue Bond Law (K.S.A. 10-1201 et seq.), and related statutes which establish uniform procedures for the issuance of bonds, prescribe maximum interest rates that may be paid and set the maximum length of maturity, establish penalties for violations, and establish debt limitations for general

III - 2

obligation bonds normally expressed as an amount not to exceed a certain percent of the assessed valuation of the taxing or political subdivision.

No-fund warrants are normally required to be paid within several years and require approval by the State Board of Tax Appeals.

City and County Capital Improvements and Equipment Reserve Funds

Laws were enacted in 1985 for cities and 1987 for counties permitting them to establish capital improvements funds and equipment reserve funds. Specifically, the law permits cities and counties which have adopted a multi-year capital improvement plan to establish capital improvements funds. Either entity may provide for the budgeted transfer of moneys from other funds lawfully available for this purpose, including federal revenue sharing and general fund moneys. Any property taxes levied shall be adopted under home rule powers.

Moneys can be used for any public improvement need, including the repair, restoration, and rehabilitation of existing facilities. Moneys spent for engineering and other advance plans and studies may be reimbursed to the fund from bond proceeds, special assessments, or state or federal aid available for the project.

Moneys credited to the fund are not subject to provisions of the budget law, but the budget shall show the amount on hand and the amounts expended from these funds. Procedures also are established for transferring unneeded moneys out of these funds.

Cities and counties also may establish equipment reserve funds to finance the acquisition of equipment. Equipment may include machinery, vehicles, computer hardware and software, and other personal property. Moneys may be budgeted and transferred to this fund from any source, including equipment use charges, which can lawfully be used for this purpose. Moneys credited to these funds shall not be subject to provisions of the budget law, but the budget shall reflect the amounts credited to them and moneys on hand. Also, procedures are established for transferring unneeded moneys out of these funds. (See K.S.A. 12-1,117; 12-1,118; 19-119; and 19-120.)

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Lease and Lease-Purchase Arrangements

The Lease Document. Lease and lease-purchase financing have become increasingly popular financial tools of local governments for the purchase of equipment and to a lesser extent, facilities.

The centerpiece of the transaction is the lease agreement itself. This document embodies a legal arrangement for the use of property between the owner of the item and the local government desiring to use it. If the lease agreement includes an option to purchase the leased property at the end of the lease term for a nominal purchase price, then the document is usually characterized as a lease-purchase agreement. The lessor provides the use of the property to the local government in return for the payment of rentals which can approximate the reasonable rental value of the property, but more typically reflect the amortization over the term of the lease of the purchase price of the property plus an interest factor. The lessor is usually the vendor of the property, the consumer finance arm of the vendor, or a commercial leasing company.

These agreements usually require the municipal lessee to pay all maintenance expenses, taxes, and insurance on the leased property. Because of their governmental nature, local governments are able to exempt the property itself from property taxes for the period of time it is subject to government use pursuant to the lease. Most lease agreements contain provisions for recovery of possession and use of the equipment by the lessor in the event of default or nonappropriation by the city. The lessor usually retains a security interest under Article 9 of the Uniform Commercial Code. Many agreements contain provisions which state the city's intent to make the appropriation annually for the lease rentals, and a covenant by the city that for the remainder of the lease term it will not terminate the lease by nonappropriation and then replace the leased property with purchased property. These covenants are not considered legally binding because of the language contained in K.S.A. 10-1116b.

Federal Tax Implications. The interest portion of the rental payments made by a local government under a lease is excludable from gross income for federal income tax purposes in the same manner as interest on a local government's bonded debt, if the local unit is exercising its borrowing power and the lease agreement provides for the payment of interest on the unpaid balance. A local unit incurs an obligation pursuant to its borrowing power if the unit receives something of value, e.g. equipment or property, for which it will make payment with

interest in the future. Consequently, if the transaction is structured as a conditional sale or installment purchase rather than as a true lease, the interest portion of the rentals will not be includable in the gross income of the lessor (or owner of a certified participation in the lease) for federal income tax purposes. For this to be the case, the agreement must provide that the local unit acquires an equity interest in the leased property, and is obligated for the purchase price, except for non-appropriation. As this tax-exempt feature has become better known, local governments have sought vendors or lessors to lease them the property they want with rentals having an interest factor generally comparable to interest rates on the local units' bonded debt.

Certificates of Participation. The municipal finance industry has devised a method for syndicating local government leases so that small interests in the leases themselves can be purchased by individual investors, in the same manner as they would purchase the local entity's bonds. The investment-sized undivided interests in a municipal lease which are sold to investors are called certificates of participation. This investment security is not a bond or note per se, but is a certificate evidencing a proportionate interest in the municipal lease and corresponding right to receive rental payments thereunder. Certificates of participation (COP) may be issued in any denomination, but are typically issued in denominations corresponding to a similar issue of a local government's bonds. The structure of a COP issue varies slightly from a bond issue. The local entity enters into a trust indenture with a bank or trust company acting in its fiduciary capacity, which agrees to issue and sell the COPs and use the sale proceeds to purchase the property to be leased to the local unit. The trustee under the indenture then acquires the property, leases it to the local entity in the customary municipal lease form, usually with option to purchase, collects the rentals for the use of the property from the local entity, and distributes them proportionately to the owners of the COPs. This financing structure resembles an industrial revenue bond issue in reverse, in that the local government uses the property acquired with the proceeds of the certificates and pays for retirement of the certificates out of its tax revenues. The indenture and COP format permits features to be added to the financing which are typical of other types of municipal bond issues, including reserve accounts, early redemption features, and provisions for issuance of additional certificates to provide for additions, enlargements, modifications, or improvements to the leased property. Certificate of participation financing documents significantly resemble those of an ordinary municipal bond issue, substituting for bonds the lease-purchase agreement, which includes non-appropriation provisions

and provisions for restoration of possession of the property in the event of nonappropriation.

Municipal Leasing of Real Property Improvements. Almost any property which can be used or occupied by a local unit has been the subject of a municipal lease or lease-purchase agreement. These properties include real property and improvements, such as city halls, jails, police and fire stations, and convention centers. More innovative uses include the financing of university classroom buildings, dormitories and parking garages, state prison facilities, and racetrack facilities. In many of these arrangements, the site for the facility to be leased is already owned by the prospective lessee, being a part of a campus or complex, and title to it is transferred to the trustee under the indenture, or leased to the trustee under the indenture as a site for the facility for a term at least as long as it takes to retire the COPs. This is done to give the COP owners some ability to recover their investment if the local entity terminates the lease by non-appropriation. When the certificates are all paid and the local government exercises its purchase option, title to all the property goes to the local government unencumbered.

Testimony of Conferees

The Committee heard from representatives of the League of Kansas Municipalities; the Kansas Association of Counties; the cities of Wichita, McPherson, and Stockton; Douglas, Johnson, and Sedgwick counties; the Kansas Development Finance Authority; the Municipal Accounting Section of the Division of Accounts and Reports; the Division of Purchases; Martin Tractor Company; Berry Tractor and Equipment Company; Columbia Securities Corporation; and the Wichita law firm of Gilmore and Bell.

The representative of the State Division of Purchases explained the four guidelines the state uses regarding equipment acquisition by state agencies through lease-purchase arrangements. These include that the installment purchase be restricted to capital equipment and services directly related to the procurement; that the term of the agreement not exceed the useful life of the equipment; that a dollar threshold of \$15,000 or more be established; and, that each agency must certify with their budget equipment procurements for the coming year noting outright purchases and installment purchases. It was noted that state agencies

had incurred about \$72 million in installment obligations for 1988 and 1989.

The representative of the Kansas Development Finance Authority noted that its first financing project in 1987 was issuing \$16,280,000 in certifications of participation to finance or refinance equipment purchases of several state agencies and universities.

The representative of the Municipal Accounting Section stated that the state does not currently require any reporting or identification of lease-purchase arrangements of local units of government in the budget documents filed with that state agency. It was noted that a requirement could be instituted to provide that local governments list outstanding lease-purchase agreements, amounts of these agreements, and interest rates as a part of a statement of annual bonded indebtedness that is filed with their budgets.

The representatives of the two tractor and equipment firms noted lease-purchase arrangements with municipalities constitute a major share of their business with these entities. Berry Tractor noted 41 percent of its new and used motor grader sales to municipalities in 1987 were sold on a lease-purchase agreement basis. Martin Tractor Company said lease-purchase agreements constitute 50 percent of their total business. Both equipment firms opposed any efforts at the state level to restrict the ability of local units of government to enter into lease-purchase arrangements. They noted the current law permits needed flexibility for equipment purchases particularly in emergency situations when there has been an equipment breakdown.

A representative of Columbian Securities Corporation explained that two types of lease-purchase arrangements exist, i.e., those in which the lessor finances the arrangement and those in which certificates of participation are issued. He noted the lease-purchase financing tool is growing in use.

Local government representatives explained the various uses of lease-purchase agreements and the extent of their use. The city of Wichita reported lease-purchase agreements in that city totaled \$2.7 million in principal amount and \$614,812 in interest costs with annual payments of \$677,200 during a five-year payoff period. The city has used lease-purchase agreements for purchases of computers, telecommunications equipment, fire apparatus, and copying machines. Interest rates run from 6.5 to 7 percent at the present time.

III-8

The city of Stockton reported in a letter to the Committee that it has entered into a lease-purchase arrangement for wastewater treatment equipment installed at its treatment plant.

Johnson County reported using lease-purchase agreements for heavy equipment, copiers, weather radar, computer equipment, vehicles, and real property. Outstanding leases totaled \$5.58 million as of December 31, 1987. Sedgwick County reported a lease-purchase arrangement was utilized to purchase a \$450,000 radio system for its Emergency Medical Services operation. Douglas County reported three active lease-purchase agreements each for copying machines with interest rates of 8.88 percent on two contracts and 14.14 percent on the third contract.

The consensus of the representatives of local units of government listed above the Kansas Association of Counties and the League of Kansas Municipalities was that the current law was working well and that there was no need for any restrictions on this authority. Several conferees noted that lease-purchase arrangements are not a circumvention of the cash basis law since this is one of a number of specific exceptions from that law. They said the lease-purchase system is flexible, allows a response to a need in prompt manner with a minimum of procedural requirements, permits local units to keep pace with new technologies, and permits cancellation of agreements on an annual review basis.

The League of Kansas Municipalities offered an amendment to the cash basis law for Committee consideration only if the consensus of the Committee was that changes in the law were necessary. The League did not advocate the amendment nor believe that it was needed or warranted. The amendment would require a majority vote of members of the governing body on all lease-purchase arrangements (rather than a majority of a quorum) and would require notice and a public hearing on all proposed lease-purchase agreements for agreements longer than three years and involving amounts greater than 5 percent of the local unit's annual budget.

Committee Conclusions and Recommendations

The Committee believes that lease-purchase agreements provide local units of government with a needed tool in financing equipment purchases and in some circumstances the acquisition of facilities.

The Committee is mindful of the concerns of some persons that there are not adequate controls or safeguards in the law to prevent local governments from binding future governing bodies with unwanted or ill-advised agreements. The Committee believes, however, that the current requirement that these agreements be made subject to annual appropriation does provide a safeguard. Further, the political process itself which requires local officials to stand for election as well as the existing open meetings and open records laws provide general safeguards against ill-advised decisions. Finally, the Committee notes that no one appeared at the Committee hearings to present information about examples of specific abuse.

The Committee therefore concludes that no change is needed in the current law on lease-purchase arrangements at this time. The Committee is aware of the growing popularity in the use of this financing tool, however, and believes, that the information should be gathered about the extent of the use of these agreements and their financing terms. For this reason the Committee recommends that the Municipal Accounting Section of the Division of Accounts and Reports begin requiring local governments to include a statement reflecting the amount of lease-purchase obligations, and the basic terms of these agreements in addition to their annual statement of bonded indebtedness. The Committee is mindful that the Municipal Accounting Section felt they currently had authority to require this information and that they would begin to do so if requested by the Committee. The Committee believes this requirement will provide a data base for future decision makers to more clearly evaluate the extent of the use of these agreements and the key terms of these agreements. Further, the information will provide a basis for comparison of this financing tool with others available and help future decision makers determine if abuses are present or if further legislative controls are needed.

Respectfully submitted,

October 5, 1988

Sen. Don Montgomery, Chairman
Special Committee on Local
Government

Rep. Ivan Sand, Vice-
Chairman
Rep. Elizabeth Baker
Rep. Nancy Brown
Rep. Kent Campbell**
Rep. Denise Everhart**
Rep. Elaine Hassler
Rep. Mary Jane Johnson*
Rep. Connie Ames Kennard
Rep. Robert D. Miller
Rep. Alfred Ramirez
Rep. Debara K. Schauf
Rep. John Sutter

Sen. Eugene Anderson
Sen. Norma Daniels
Sen. Audrey Langworthy
Sen. Jack Steineger
Sen. Ben Vidricksen

* Ranking Minority Member
** Representative Campbell was replaced on the Committee by Representative Everhart on September 2, 1988.



STATE OF KANSAS

OFFICE OF THE ATTORNEY GENERAL

2ND FLOOR, KANSAS JUDICIAL CENTER, TOPEKA 66612

ROBERT T. STEPHAN
ATTORNEY GENERAL

February 13, 1989

MAIN PHONE (913) 296-2215
CONSUMER PROTECTION 296-3751

ATTORNEY GENERAL OPINION NO. 89-16

Mr. Frank E. White, Jr.
Chautauqua County Attorney
121 N. Chautauqua
P.O. Box 6
Sedan, Kansas 67361

Re: Bonds and Warrants -- Cash-Basis Law -- Lease or
Installment-Purchase Agreements; Contracts for
Services

Synopsis: Based upon commonly accepted and statutory
definitions of the terms installment-contract and
purchase, and mindful of the intent of the
legislature to provide additional authority to
acquire equipment, it is our opinion that K.S.A.
10-1116b does not authorize installment-purchase
contracts for services. Cited herein: K.S.A.
10-1101; 10-1116b; 84-1-201(32); 84-2-612(1).

* * *

Dear Mr. White:

As Chautauqua County Attorney you request our opinion
concerning K.S.A. 10-1116b. Specifically, you ask whether the
authority contained therein pertains only to the installment
purchase of tangible property or if it also allows installment
purchase of services, with the contract extending over several
years. K.S.A. 10-1116b provides:

*Senate Local Gov't
1-24-90
Attachment IV*

"Nothing in the provisions of K.S.A. 10-1101 et seq. shall prohibit a municipality from entering into (1) an agreement to pay for electric interconnection or transmission facilities or services, (2) a lease agreement, with or without an option to buy, or (3) an installment-purchase agreement, if any of such agreements specifically state that the municipality is obligated only to pay periodic payments or monthly installments under the agreement as may lawfully be made from (a) funds budgeted and appropriated for that purpose during such municipality's current budget year or (b) funds made available from any lawfully operated revenue producing source."
(Emphasis added).

Thus, provided the agreement specifically states the required language concerning the extent of obligation undertaken by a municipality, K.S.A. 10-1116b allows a municipality to enter into an installment-purchase agreement. The issue therefore becomes what types of agreements can be defined as installment-purchase agreements.

K.S.A. 10-1101 et seq. does not define installment-purchase agreement. Installment is generally defined as "partial payment of a debt or collection of a receivable. Different portions of this same debt payable at different successive periods as agreed. Partial payments on account of a debt due." Blacks Law Dictionary 717 (5th ed. 1979). Purchase is defined as the "transmission of property from one person to another by voluntary act and agreement, founded on valuable consideration . . . the term 'purchase' includes any contract to purchase or otherwise acquire." Id. at 1110. (Emphasis added). A purchase agreement is "an agreement between a buyer and seller of property, setting forth, in general, the price and terms of the sale. A sales agreement or contract." Id. at 1110. (Emphasis added).

Enterprise v. Smith, 62 Kan. 815 (1900), discussed whether the word "purchase" or "purchasing" could include property acquired pursuant to condemnation proceedings. In holding that it did not, the court discussed the meaning of the term purchase:

"The word 'purchase' has two significations - a popular but restricted one, and a legal but enlarged one. The definition of the word in its legal and general sense is given as follows: 'A term including every mode of acquisition of estate known to the law, except that by which an heir on the death of his ancestor becomes substituted in his place as owner by operation of law.' (Bouvier.) Blackstone defines the word in its legal and enlarged sense in the same way, but, after doing so, says: 'Purchase, indeed, in its vulgar and confined acceptation, is applied only to such acquisitions of land as are obtained by way of bargain and sale for money, or some other valuable consideration.' (2 Bla. Com. 241). 'A purchase, in the ordinary and popular acceptation of the term, is the transmission of property from one person to another, by their voluntary act and agreement, founded on a valuable consideration. But, in judgment of law, it is the acquisition of land by any lawful act of the party, in contradistinction to acquisition by operation of law; and it includes title by deed, title by matter or record, and title by devise.' (4 Kent, Com., 14th ed., 441.). 'The word 'purchase,' in common sense, means no more than when a man gives money for anything, but in a legal sense every man is a purchaser of an estate who does not take it by descent.' (Martin v. Strachan et al., 1 Wils. 72.) Id. at 818-819. (Emphasis added).

K.S.A. 84-1-201(32) contains a statutory definition of purchase: "taking by sale, discount, negotiation, mortgage, pledge, lien, issue or reissue, gift, or any voluntary transaction creating an interest in property." (Emphasis added). K.S.A. 84-2-612(1) defines an installment contract as "one which requires or authorizes the delivery of goods in separate lots to be separately accepted." While Enterprise v. Smith contemplates purchase meaning "no more than when a


man gives money for anything," other definitions and statutory law appear to define installment contract and purchase as the transfer of property rights in some legal interest. While statutory definitions contained in the Kansas Commercial Code are not necessarily applicable to K.S.A. 10-1110 et seq., unless a contrary interpretation appears, statutory words are presumed to be used in their ordinary and usual sense and with the meaning commonly attributed to them. Atchison, Topeka and Santa Fe Ry. Co. v. U.S., 628 F. Supp. 1431 (Kan. 1986); Appeal of Armed Forces Co-op Insuring Ass'n, 5 Kan. App. 2d 787 (1981).


K.S.A. 10-1116b contains no clear statutory intent concerning contracts for services, nor does it define installment-purchase contract. When the plain language of a statute does not clearly express legislative intent, other sources may be utilized in determining such intent. Maxl Sales Co. v. Critiques, Inc., 796 F. 2d 1293 (10th Cir. 1986); State v. Phifer, 241 Kan. 233 (1987). February 11, 1980 minutes of the house committee on local government indicate that the sponsor of House Bill No. 2955 explained that the bill "adds an exception to the cash-basis law for any county which enters into an optional lease-purchase agreement for the acquisition of equipment." It appears that this bill was introduced in response to letters and opinions by the office of the Attorney General concerning lease or purchase agreements in violation of the cash-basis law. (See enclosed; Attorney General Opinion No. 77-279, and letters dated November 14, 1979 and August 24, 1971.) Subsequent amendment to the language of the bill added the provision concerning installment-purchase agreements, however, minutes from future committee meetings do not reflect further discussion concerning what type of "property" the legislature intended to permit counties to acquire by these means. Thus, the only discussion of these agreements by the legislative committee indicates an intent to permit the acquisition of tangible property. Thus, legislative history does not indicate a prohibition forbidding the purchase of services by installment. However, there appears to be no clear intent to permit installment-purchase agreements (extending beyond a year) for services.

Commonly accepted and statutory definitions of the terms installment-contract and purchase indicate that the acquisition of tangible property is contemplated. The intent expressed by the legislature in enacting K.S.A. 10-1116b

evidences the desire to provide an exception to the cash-basis law in order to permit acquisition of equipment. It is therefore our opinion that K.S.A. 10-1116b does not authorize installment-purchase contracts for services that would otherwise violate the cash-basis law.

Very truly yours,


ROBERT T. STEPHAN
ATTORNEY GENERAL OF KANSAS


Theresa Marcel Nuckolls
Assistant Attorney General

RTS:JLM:TMN:bas

Bonds and Warrants

Chapter 10

LETTER, January 28, 1971, to Hon. Fred Rosenau, Representative, Topeka
 Re: SAME—*Bonds, Proceeds, School Facilities*

Question: May unused proceeds from a bond issue, authorized for the purpose of constructing and equipping certain designated schools facilities and "for the remodeling and renovating of existing elementary buildings and grounds, be used to remodel, renovate or build additions to existing elementary school facilities in the district"?

Answer: No as to additions. Yes as to remodeling and renovating.

The proposition stated at the bond election, the substance of which is restated in the question above, clearly authorizes the expenditure of funds for *remodeling* and *renovating* existing elementary school facilities. The question of whether building additions falls within this authorization turns on the meaning to be given to the words *remodeling* and *renovating*. Do either of these words contemplate "to build additions"?

Words and Phrases, "remodeling" states:

"Remodel means to model, shape, form, fashion afresh, or to recast, and is also defined as meaning to model anew; to reconstruct. It is a word of broad meaning. Among other definitions it means to reform, reshape, reconstruct, to make over in a somewhat different way. Remodeling of a building in more than 'repairing' it or making minor changes therein. The ordinary significance of the term imports a change in the remodeled building practically equivalent to a new one. In common understanding the 'building' of a house means the 'erection' or 'construction' of a new house and not the 'repair' or 'remodeling' of an old one."

Words and Phrases, "renovate" states:

"Renovate means to renew, make over, or repair, or to restore to freshness, purity, a sound state, or newness of appearance."

It would appear that even under the broadest interpretation of the words used in the proposition that "additions" were not contemplated nor authorized by the voters.

SRM

LETTER, August 24, 1971, to Lawrence E. Christenson, Winfield

Re: SAME—*Cash Basis Law, Installment Payment Agreement between IBM and Kansas Municipalities*

You inquire regarding the legality under the Kansas cash basis law, K. S. A. 10-1101 *et seq.*, of an installment payment agreement

proposed by International Business Machines Corporation with Kansas municipalities.

The contract initially provides for a total cash payment, consisting of state and local taxes, if applicable, plus the balance of the machines involved, or (2) upon the date of purchase thereof, the balance according to either of two methods. I provides for annual or biennial payments with respect to new machines, and monthly payments following the month of installation of machines, on the first business day of the month of effective purchase. Payments are due on the first business day of each month. Each periodic payment includes the amount then current. Under Payment Plan B, the balance is paid in monthly consecutive installments, with the first period included in the payments. The balance of the obligations created under the contract is to be paid in monthly consecutive installments.

"Notwithstanding the foregoing, the Purchaser shall make such Periodic Payments or monthly installments as are due from funds budgeted and appropriated for such purpose. The Purchaser agrees to notify IBM at the earliest practicable date of funds from which to make any Periodic Payment thereof by a letter. . . ."

"In the event the Purchaser may not be able to make any monthly installment thereof within a reasonable time after the end of the month in which the Periodic Payment has been made, or within the time in which an installment is due and unpaid, enter an agreement with the premises and will retain all sums previously received."

"The Purchaser acknowledges and agrees that upon the execution of this Agreement funds are to be made available for the purpose of this contract, and will remain available for the purpose. The Purchaser will pay in full the Total Cash Payment of the contract in monthly installments thereof to be made over a period of one year. Purchaser further agrees to use the funds to encumber and have available for the purpose of making the Periodic Payments including the balance of the contract in each succeeding budget year."

K. S. A. 10-1102 provides thus, in part:

"All municipalities are required to comply with the provisions of this act provided, in the manner and to the extent provided in this contract no indebtedness after May 1, 1971, shall be incurred."

proposed by International Business Machines Corporation for use with Kansas municipalities.

The contract initially provides that the Purchaser agrees to pay a total cash payment, consisting of the cash down payment and state and local taxes, if applicable, (1) upon the date of installation of the machines involved, or (2) with respect to installed machines, upon the date of purchase thereof, and to pay the contract time balance according to either of two payment plans. Payment Plan I provides for annual or biennial periodic payments, the first due, with respect to new machines, on the first business day of the month following the month of installation, and with respect to installed machines, on the first business day of the month following the month of effective purchase. Successive periodic payments are due on the first business day of each succeeding fiscal period. Each periodic payment includes the interest due for the fiscal period then current. Under Payment Plan II, payments are made in equal monthly consecutive installments, with the total interest in the fiscal period included in the payments. The pertinent provisions regarding the obligations created under the contract are thus:

"Notwithstanding the foregoing, the Purchaser is obligated to pay only such Periodic Payments or monthly installments thereof as may lawfully be made from funds budgeted and appropriated for the purpose. The Purchaser agrees to notify IBM at the earliest possible time of the non-availability of funds from which to make any Periodic Payment or monthly installment thereof by a letter. . . .

. . . .

"In the event the Purchaser may not lawfully make further Periodic Payments or any monthly installment thereof under this contract, IBM will, within a reasonable time after the end of the current Fiscal Period for which the Periodic Payment has been made, or within a reasonable time after a monthly installment is due and unpaid, enter and take the machines from the . . . premises and will retain all sums previously paid. . . .

"The Purchaser acknowledges and represents to IBM that at the time of execution of this Agreement funds are available, encumbered for the purpose of this contract, and will remain available from which the Purchaser lawfully will pay in full the Total Cash Payment and all Periodic Payments including monthly installments thereof to be made within the Purchaser's current budget year. Purchaser further agrees to use his best efforts to budget, appropriate, encumber and have available for the purpose sufficient funds from which to make the Periodic Payments including monthly installments thereof, to be made in each succeeding budget year."

K. S. A. 10-1102 provides thus, in pertinent part:

"All municipalities are required to pay. . . their valid indebtedness as in this act provided, in the manner and at the times herein set forth, and to contract no indebtedness after May 1, 1933, except as herein provided. It is

hereby declared that the purpose of this act is to provide for the funding and payment of all legal debts and obligations except present bonded indebtedness of all municipalities and for the future conduct of the financial affairs of such municipality upon a cash basis."

The cash basis law prohibits a municipality from incurring a contractual indebtedness, the amount of which exceeds that actually on hand in the treasury at the time for that purpose. Under the contract in question, the municipality represents to IBM that, at the time of execution, funds are available and encumbered, and will remain available "from which the Purchaser lawfully will pay in full the Total Cash Payment and all Periodic Payments including monthly installments thereof to be made within the Purchaser's current budget year." The obligation of the municipality extends only to "pay such Periodic Payments or monthly installments thereof as may lawfully be made from funds budgeted and appropriated for the purpose." Accordingly, the indebtedness contractually undertaken by the city does not exceed the amount available and encumbered for the purpose, and necessary to complete all payments due including the initial Total Cash Payment, and all periodic and installment payments due, together with stated interest thereon, during the city's current budget year.

In our opinion, this contract respects the prohibitions of the cash basis law, and is not unlawful thereunder.

JRM

LETTER, February 10, 1972, to Hon. Lawrence D. Slocombe, Representative,
Topeka

Re: SAME—Highway Bonds to Finance Construction

You inquire as follows:

"Since our State operates on a cash basis, . . . [is] the proposed Senate bill No. 137, which gives the State authority to issue highway bonds for financing the construction, improvement, and reconstruction of highways . . . unconstitutional."

The cash-basis law at K. S. A. 10-1101 *et seq.*, is not, of course, a part of the constitution, and is, at any rate, inapplicable to the indebtedness or financial affairs of the state. *State ex rel. Beck v. Barton County Comm'rs.*, 142 Kan. 624, 51 P. 2d 33 (1935).

We assume your inquiry is addressed to Article 11, § 6 of the constitution, which provides thus in part:

"For the purpose of defraying extraordinary expenses and making public improvements, the state may contract public debts; but such debts shall never, in the aggregate, exceed one million dollars, except as hereinafter provided."

Presented at
1989
NIMLO
Annual
Conference
(Oct. 1989)
Seattle

SHAPIRO AND OLANDER
A PROFESSIONAL ASSOCIATION
ATTORNEYS AT LAW
TWENTIETH FLOOR
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**RECENT TRENDS
IN MUNICIPAL LEASING**

ERNEST G. WILSON

I. Definitions and Basics.

What is "leasing" and in what situations might a municipality consider a leasing transaction.

a. Faced with the need to raise funds to acquire a facility for which the municipality does not wish to pay presently, the municipality can either borrow or lease. Leasing in simplest terms is a method of financing the acquisition of needed assets as an alternative to the issuance of bonds.

b. A municipality may consider leasing in almost any circumstance that it would also consider borrowing. Since 1975 when tax-exempt leasing was done with a dollar value of \$200 million per year, the value grew to \$7 billion in 1987. As municipal attorneys know, they are likely to encounter a leasing transaction as a financing vehicle for any facility, including realty and improvements, although the earlier and more "traditional" leasing transactions focused on personal property such as phone systems, computer equipment and vehicles because of the residual value of such assets as security under the lease.

Senate Local Gov't
1-24-90
Attachment **V**

RECENT TRENDS IN MUNICIPAL LEASING

Page 2

c. The term "lease" is a misnomer in the sense that municipal leasing includes installment sale agreements, installment purchase contracts, conditional purchase agreements, lease-purchase agreements and even purchase orders. What is common to all is the payment of money over time for use of an asset currently. Generally, like so much in the arcane world of financing, when financial people talk about municipal "leasing" they really aren't talking about a "true lease" at all, one in which the municipality is paying a fair market rent to a true owner of the property, recognized as such for federal income tax purposes. Instead, "municipal leasing" typically involves (1) a rent that is determined by reference to the cost of financing (with a stated principal and interest component to the rental or purchase price to be paid), (2) an option to purchase by the municipality for a minimal price or a price less than fair market value, and (3) a "non-appropriation clause" that makes payment of rent contingent upon appropriation (or budgetary approval) by the municipality. Each of these items are discussed more fully below.

d. Invariably, the obligation to pay rent or purchase price installments is not considered "debt" in any constitutional or statutory sense. This is really the key legal conclusion and provides the basis for every financing lease transaction. In fact, most leasing transactions are entered precisely because of this local/state law factor. Because leasing is not debt (and the

RECENT TRENDS IN MUNICIPAL LEASING

Page 3

objective of raising capital in this manner is to avoid characterization of the lease obligation as the issuance of bonds or debt), the lease transaction is designed to avoid the constitutional and/or statutory procedures and limitations relating to bonds, such as:

- i. debt limits;
- ii. referendums;
- iii. statutory limits on maturity and repayment terms;
- iv. competitive bidding requirements for the sale of bonds;
- v. other procedural delays relating to debt;
- vi. other limits on debt provisions, e.g., floating or variable rate debt.

II. Federal Tax Matters.

Even though the lease typically may not constitute "debt" or "bonds" under state law, it must be a "debt" for purposes of federal income taxes in order to bear tax-exempt interest.

a. To qualify as a "tax-exempt obligation" of a state or local subdivision, under Section 103 of the Internal Revenue Code of 1986, payments by a municipality under a lease or conditional purchase contract must have several key features:

- i. Perhaps the most important feature is that rental or purchase price payments by the municipality lessee/purchaser

RECENT TRENDS IN MUNICIPAL LEASING

Page 4

must include a specified interest component. In other words, to qualify as interest exempt from federal income taxes, there must be "interest" either specifically stated or otherwise readily recognizable as such. Marsh Monument Co. v. United States, 301 F.Supp. 1316 (E.D.Mich. 1969); Newlin Machinery Corp. v. Commissioner of Internal Revenue, 28 T.C. 837 (1957); Kurtz Bros. v. Commissioner of Internal Revenue, 42 B.T.A. 561 (1940). The tension between state and local law considerations on the one hand in which a municipality is endeavoring to avoid classification of its lease as "debt" and the federal tax law requirement on the other hand that there must be an obligation bearing interest is apparent. The seminal ruling from which this entire concept derives is Rev. Rul. 55-540, 1955-2 C.B. 39. The key feature of this ruling is that the lessee/purchaser under a contract will be treated for federal tax purposes as the tax "owner" of the asset sold or leased under the contract, and as a "debtor" for the purchase price plus interest even though the contract designates payments as "rent" or as "purchase price" installments.

ii. the lease or conditional purchase agreement must not be a "true lease", but must be a conditional purchase agreement under Rev. Rul. 55-540. The factors cited in that ruling as indicative of the status as a conditional purchase agreement are as follows:

RECENT TRENDS IN MUNICIPAL LEASING

Page 5

(a) The lessee will acquire title to the property for an inadequate consideration or nominal consideration other than "rental payments";

(b) The total amount that the lessee is required to pay for a relatively short period of use constitutes an inordinately large proportion of the total sum required to be paid to secure the transfer of the legal title to the property to the lessee;

(c) The rental payments materially exceed the current fair market rental value of the property; and

(d) Some portion of the rental payments is specifically denominated as interest or is otherwise readily recognizable as the equivalent of interest.

iii. The lessee/purchaser must be a state or a political subdivision thereof or an entity entitled to act on behalf of the state or its political subdivisions (see Rev. Rul. 57-187, 1957-1 C.B. 65), and the obligation under the lease must represent a "borrowing" for federal income tax purposes. Fox v. United States, 397 F.2d 119 (8th Cir. 1968); Holley v. United States, 124 F.2d 909 (6th Cir. 1942), cert. denied 316 U.S. 685 (1942); Kings County Development Co. v. Commissioner of Internal Revenue, 93 F.2d 33 (9th Cir. 1937), cert. denied 304 U.S. 559 (1938); King v. Commissioner of Internal Revenue, 77 T.C. 1113 (1981); Newman v. Commissioner of Internal Revenue, 68 T.C. 433 (1977).

RECENT TRENDS IN MUNICIPAL LEASING

Page 6

a. Once it is determined that the leasing transaction meets the foregoing criteria it will constitute a "state . . . [or] local bond" within the meaning of Section 103 of the Internal Revenue Code of 1986. In order for the "lease" to bear tax-exempt interest it must meet all of the same tests relating to tax exemption as any other "bond". For example, if the proceeds are used in a manner that causes the financing to constitute a "private activity bond" under Section 141 of the Code, it will bear tax-exempt interest only if it is a qualified bond meeting one of the exceptions available to private activity bonds. Similarly, the arbitrage bond rules apply, and failure to comply with those rules will cause the lease financing to become taxable from the date it is entered. The "proceeds" of a lease-purchase financing are often disbursed immediately on the effective date of the lease if a specific item or items of equipment are involved. In this circumstance, arbitrage restrictions will not apply unless "proceeds" are later realized through a sale of the equipment. However, where a contract is funded in advance of delivery of equipment or construction of a building, the usual arbitrage considerations, including rebate requirements, will apply to the proceeds pending disbursement. In addition, reserve funds are sometimes included in lease financings, and arbitrage restrictions must be observed. Note also that lease financings do count against the \$10 million limit for "qualified

tax-exempt obligations" (eligible as "bank qualified tax-exempt bonds") to the same extent as any other tax-exempt bond.

b. It has been held that, to qualify for tax exemption, bonds (and therefore lease purchase contracts) must be validly issued by the municipality under state and local law. See Power Equipment Company v. U.S., 784 F2d 1130 (1984). Predictably, the Internal Revenue Service has followed this position in Rev. Rul. 87-116, I.R.B. 1987-46, 7.

III. Structural Considerations.

a. The basic document in the leasing transaction is a lease-purchase agreement running from a financial institution, vendor or "stake-holder" lessor to the municipality as lessee or purchaser. The most important feature from an investor's point of view is that it contain a stream of rental or purchase price payments from the municipality.

b. In cases where the original vendor is not serving as lessor, it will assign the contract to a third party who funds the acquisition of the property. The vendor assigns and relinquishes all right and interest in and to the lease and the leased property, in favor of the assignee, subject to its obligations as vendor or service provider.

c. Where the assignee of the lease/purchase contract is a single investor or several investors (usually a financial institu-

tion), the assignee provides the funds to build or acquire the asset and is assigned the stream of income/rental payments under the contract. Where the interests in the lease are to be widely distributed, the lease and the payments are assigned to a trustee who executes and delivers "certificates of participation" to multiple investors. Each certificate represents a proportionate interest of the owner of the certificates in the lease payments to be made by the governmental lessee. Thus, where the payments represent the underlying payments of principal and interest, the trustee is authorized to act on behalf of all of the certificate holders under the lease-purchase agreement. In most respects, the certificates of participation are structured to have exactly the same rights and features as bonds.

d. The legal ramifications of "non-appropriation" and "non-substitution" clauses are mentioned later. However, for purposes of structuring a transaction, it is important to realize the effect of inserting a provision that states, in effect, the municipality can get "off the book" any year it determines not to "renew" or not to appropriate funds to make rental or lease payments. Lenders and underwriters have struggled gamely with this problem and have devised several methods of assuring, to the extent possible, that the municipality won't simply walk away. These include:

i. "Best Efforts" clauses to require the lessee's officers to use their best efforts to obtain funding for the rent

RECENT TRENDS IN MUNICIPAL LEASING

Page 9

payments. Such provisions usually include an obligation on the executive to include the item in the budget submitted to the legislative branch;

ii. Non-substitution clauses, in which the governmental lessee agrees not to use property performing a similar function for a specified period if the contract is terminated for non-appropriation. The validity of such clauses, as mentioned below, is unclear;

iii. Representations (and factual determinations) that the facility to be lease-purchased is "essential" to the municipality make the investor more confident that payments will be made because the municipality "needs" the facility. Such considerations apparently did not deter, for example, the State of Oklahoma from cancelling its lease of IBM computer equipment that is now the subject of litigation in Oklahoma. The Indiana National Bank v. State of Oklahoma Department of Human Services, CJ 86-5982 (D.C. Oklahoma County). Nor did such concerns deter the Minnesota State Zoo Board and the State of Minnesota from disavowing its installment sale obligation with respect to a ride facility at the Dakota County Zoo. U.S. Fire Insurance v. Minn. State Zoological Board, 307 N.W.2d 490 (1981). Perhaps the most succinct listing of the considerations of the investor in a certificate of participation transaction is set out in the Standard & Poor's criteria for rating structured lease transactions attached as Exhibit A.

IV. Legal Authorization.

Legal authority for entry of lease or purchase transactions is generally found under general language of statutes or charters permitting leasing, purchase or the acquisition of real or personal property. For a helpful survey of the general laws relating to governmental leases in each of the 50 states see G. Markikes, P. Cone & J. Horn, Governmental Leasing: A Fifty State Survey of Legislation and Case Law, 18 URB. LAW 1 (1986).

a. Lease v. Installment Sale.

Whether a lease as opposed to installment purchase is entered is sometimes dependent on counsel's view of the answers to the following questions:

i. Does a statute permitting "purchases" also permit purchase in installments? If not, then a lease is indicated.

ii. Is the location of legal title important? For example, title in the lessor in a lease transaction may cause lessor to incur ad valorem taxes. To avoid this, an installment sale agreement with title passing immediately may solve the problem. May title pass to the municipality immediately in an installment sale situation? May it pass immediately in the lease situation and still have the transaction characterized as a lease? In some states, title must remain with the lessor in order to avoid an invalid mortgage or other encumbrance of public property or challenge of the contract as invalid debt.

iii. In the case of the acquisition of a facility to be constructed, is the municipality legally empowered to lease equipment or assets that have not been built or delivered? Will an installment purchase agreement be more consistent with the acquisition of an asset to be built but for which purchase price installments must be made prior to completion of construction?

b. Procurement Laws; Minority Business Enterprise.

Although the provisions of law relating to the sale of bonds at competitive sale can usually be avoided in a leasing transaction, the lease or purchase of property is often the subject of procurement laws. If such laws are not observed, the lease can be invalidated and the municipality/lessee relieved of any obligation to pay rent. See McBirney & Associates v. State (Alas. S.Ct., April 15, 1988) 753 P.2d 1132. Included among the "procurement" rules that may require compliance are minority business enterprise quotas and "set asides". The possibility of lengthy and risky challenges to a leasing transaction after closing based on factual issues are one of the features of such transactions that are often avoided by mechanical procedural compliance in bond issues.

c. Lease v. Debt.

i. As previously noted, the key issue in the validity of a municipal lease or conditional purchase agreement is the characterization of the agreement for state and local law purposes as something other than debt. The most usual method by which this

is achieved is the insertion of a so-called "non-appropriation clause" or "fiscal funding clause". See examples at Exhibit B. This clause provides that the obligation of the governmental unit to continue making payments under the contract is subject to annual or biennial appropriation of the funds necessary to make the rental payments for the subsequent fiscal year or biennium.

ii. In some states, a lease-purchase contract may not be automatically renewed from year to year. The governmental unit must take specific action to renew the contract. The point is that the governmental unit must not be under any compulsion to renew the lease, and different lawyers view differently the level of "compulsion" that the jurisdiction may be under before invalidating the lease. For example, most leases contain a covenant to use best efforts to budget and appropriate funds to make the rental payments required by the lease-purchase contract. Some lawyers worry, however, whether this "obligation" results in a compulsion sufficient to cause the agreement to constitute debt. See further discussion under "Recent Developments".

iii. Typically, the governmental lessee bears full risk of loss after delivery and acceptance of the property. In the event of total damage or destruction to the property, the governmental lessee must pay the then stipulated purchase price for the property, normally covered by the proceeds of insurance required to be obtained by the lessee. Some attorneys question whether such

provisions will push the contract over the line and cause them to constitute debt.

iv. "Non-substitution clauses", pursuant to which the governmental lessee agrees not to use property performing a similar function for a specified period if the contract is terminated because of non-appropriation, is also often included. However, the validity of such clauses has not been tested. Once again the tension between the rating agencies/purchasers on the one hand and the need to avoid the characterization of the transaction as "debt" is intense. If the property financed is truly "essential" to the municipality, there is always a question as to the legal ability of the municipality to contract away its sovereign power to acquire essential facilities. Once again, the argument will probably be that what is "essential" for purposes of satisfying a rating agency may not be "essential" to the operation of the affairs of government.

V. Recent Developments.

a. While the general history of municipal leasing has been one of great expansion, not all of the recent cases have been positive. Challenges in New Mexico, Oklahoma and South Carolina have all generally focused on the distinction between leasing and debt. Unfortunately, sometimes bad cases make for bad law. The cases focusing on the validity of leasing as debt are Caddell v.

Lexington County School District No. 1, 88-CP-32-190 (Court of Common Pleas) (presently on appeal to the South Carolina Supreme Court), Montano v. Gabaldon, VA 88-94-CV (presently on appeal to New Mexico Supreme Court), Board of State Commissioners of San Miguel County v. GELCO Municipal Services Company, 87-0149-SC (District Court of New Mexico), and The Indiana National Bank v. State of Oklahoma Department of Human Services, CJ 86-5982 (D.C. Oklahoma County) which all involve challenges to municipal leasing.

b. In the Caddell case in South Carolina, the School Board in question had proposed and lost three referendums to issue bonds, and therefore chose to do a lease mechanism using non-appropriation language. The lower court held that the non-appropriation language did not insulate the lease in question from constituting debt. In the New Mexico case, the Attorney General of the State of New Mexico reversed long-standing opinions of the Attorney General's office and suggested that leases, particularly for essential projects, could not avoid the characterization of impermissible and invalidly issued debt. The lower court in the Montano case in New Mexico has upheld the validity of the lease and the matter is now on appeal. The challenge in Oklahoma involves the State of Oklahoma's repudiation of a non-substitution clause in the lease. This is another egregious case in which the state leased earlier generation IBM equipment and immediately replaced it with later model equipment in contravention of a non-substitution provision

in a lease. It is possible that the Oklahoma courts may avoid reaching the question of the validity of the non-substitution clause and the validity of a non-appropriation clause in this matter because the non-substitution clause was added to the lease after the competitive bidding process for the equipment was completed and the non-substitution clause was not part of the competitive bid process. Accordingly, the clause may be held to have been improperly included in the contract. Happily, at least one case has recently upheld leasing. In a case recently decided in the North Dakota Supreme Court, Haugland v. City of Bismarck, the Court recently upheld a municipal lease against a challenge that it created constitutional "debt".

c. Another court decision of some interest is Pollard v. City of Bozeman (Montana Supreme Court, August 20, 1987) 741 P.2d 776, in which the Montana Supreme Court held that title of the facility in the lessor resulted in the imposition of ad valorem taxes despite the fact that the facility was leased to a governmental entity. This case may be an aberration, but it shows the potential importance of the location of title to the equipment.

d. Another recent trend, which is probably a direct result of the Tax Reform Act of 1986, is that municipal leasing and the sale of certificates of participation are likely to become much more commonplace in transactions in which interest is not exempt from federal income taxation. For the same reasons that many

issuers are finding it necessary or desirable to issue taxable debt and taxable bonds, it is also desirable to issue taxable certificates of participation. Many of the same state and local issues will arise in connection with taxable transactions, but to some extent the tension between having to characterize the leasehold interest as debt for purposes of federal income taxes, as opposed to "non debt" for purposes of state law, will disappear. This is an emerging phenomenon, but issuers will be anxious to issue taxable certificates of participation for the same reasons that they have sought to engage in municipal leasing transactions, namely, to avoid the various limitations and restrictions incident to the creation of debt.

e. Another recent phenomenon that is becoming an important issue in leasing transactions involving the acquisition of real property is the application of the so-called Superfund (CERCLA & SARA), 42 U.S.C. Sections 9601, et seq. and parallel state legislation, since in the typical transaction the lessor is an "owner" and therefore strictly liable for hazardous materials clean-up and damages costs. Lessors and therefore investors in certificates of participation will become increasingly hesitant to become involved in municipal leases of realty without adequate assurances that appropriate due diligence has been undertaken, including, at the least, testing the property for the presence of hazardous materials or substances. Even if lessors and their

RECENT TRENDS IN MUNICIPAL LEASING

Page 17

assignees do not worry about being charged with a clean-up, this law will certainly affect the approach of municipal leasing companies when they are dealing with real estate leases. Since the existence of hazardous waste on the property may result in a non-appropriation of additional rentals, proper on-going management and supervision of the operator's activities are essential.

f. The final case that must be mentioned in any discussion of municipal leasing is the celebrated case of United States Leasing Corp. v. City of Chicopee (Mass. S.J. Ct., April 19, 1988) 521 N.E.2d 741. In this case, the City of Chicopee entered a leasing transaction for a term of five years with the usual non-appropriation provisions and actually made the payments for the first two years. Unfortunately, the City Charter contained a provision requiring that the Mayor of the City sign any such contract as a pre-condition to its validity, and the Mayor had not signed it. The lease was declared invalid despite the fact that two years' payments had been made and, more importantly, the fact that the City Solicitor signed an opinion to the effect that the lease was binding and enforceable. While the facts in the case do not so state, it is doubtful that the United States Leasing Corporation can find much comfort in the fact that it had an opinion of counsel for the City under the circumstances. The "trend" occasioned by such cases would clearly be the continued and increased involvement of outside bond counsel and special tax

RECENT TRENDS IN MUNICIPAL LEASING

Page 18

counsel in municipal leasing transactions which, depending on your point of view, is not an entirely undesirable result.

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V-18

LEASE OBLIGATIONS

Lease obligation criteria

This policy statement updates and expands S&P's tax-exempt lease obligation criteria. Over the years, S&P has rated numerous lease transactions both of the instalment-sales and leveraged-lease types, for both real and personal property. Although the basic rating approach remains unchanged, some new innovations in the field, such as "master" leases and lease pools, have required some additional criteria implementation.

Lease-secured ratings differ depending on the lease provisions and the strength of the repayment source. Because constitutional and statutory laws regarding leases vary, few generalizations can be made about them. However, lease obligations generally fall into two categories:

- (1) Leases resembling long-term debt.
- (2) Higher risk obligations requiring annual appropriations and having limited legal remedies.

Ratings for the first category emphasize the long-term and binding nature of certain leases regardless of whether they are considered debt for other purposes such as debt limits or voting requirements. In cases where the lease is long-term, where the lessee covenants to budget and appropriate, where failure to appropriate constitutes an event of default, and where the legal recourse of a holder is similar to that of a long-term debt holder, ratings may be as high as the lessee's senior debt rating, depending on the capacity to make lease payments.

The second category involves leases which depend on budgetary appropriations (fiscal funding) by the lessee, and where legal remedies are limited in the event of nonappropriation. Owing to the risk that lease payments may be terminated before the obligation is repaid, ratings on these transactions are lower than the lessee's full faith and credit rating. Typically the lease rating is one full category below.

To rate a lease transaction requiring an annual appropriation, S&P evaluates the following:

- General creditworthiness of the lessee.
- Essentiality of the leased property.
- Security features in the lease agreement.

In addition, an opinion from a recognized bond counsel is necessary stating that the agreement is a net lease without the right of offset. A second opinion from lessee's counsel is also required stating that the lease transaction is valid, legal, binding, and enforceable.

Rating approach

S&P will rate a lease upon receipt of a formal application. If the entity appropriating the lease payments is rated, a meeting with S&P may be optional. However, the nature of the leased property or lessee may make a meeting advisable. All documentation is due at least two weeks before the rating date. If additional information is needed, the process may take longer.

Lease ratings reflect the credit qualities of the lessee and, therefore, the analysis begins with a review of the lessee's long-term creditworthiness. Since the lease payments are generally not a direct and continuing obligation, the lease rating is lower than the lessee's senior debt rating unless additional credit strengths are present.

After assessing the lessee's general credit strengths, the analysis focuses on the potential for an event of nonappropriation. Since leases must generally be renewed annually or biannually, nonappropriation is a major risk for the lessor and, by assignment, the certificate holder. Whether or not funds will be appropriated often depends on the importance of the leased property in providing essential services such as police and fire protection, general government or courthouse facilities or utility services. In addition, personal property leases for telecommunication systems, fleet purchases of rolling stock (such as police and fire vehicles), and centralized computer equipment are usually considered essential. The use of the property is more important

than its potential for technological obsolescence. However, the lease term should be matched to the property's useful life. S&P, therefore, gives greater weight to leased properties fulfilling essential roles. Leases for less than essential, real or personal property are viewed as weaker credits unless the lessee demonstrates—usually via a certificate of essential use—the need for the leased property. In all cases, the risk of nonappropriation may be reduced by the presence of a non-substitution provision which precludes the lessee from using the same or functionally similar property for at least 30 days in the event of nonappropriation. For property such as seasonal equipment, a longer period may be more suitable.

The history of legislative authorizations for lease financings, prior leasing experience, and the "intent" of the lessee (indicated, for example, by an equity interest in the leased property) are all important in determining lease ratings. These factors, however, are not substitutes for adequate legal protections. In some states, owing to constitutional or political limitations, lease debt is the only financing option. This tends to enhance these financings. For those leases where the effective date depends on successful completion or acceptance of the property, the rating is "provisional." For a master lease, when the lessee uses one agreement for multiple leased property, S&P requests that acceptance and the effective date of lease payments be tied to the receipt of the major lease component. The lessee can also substitute other leased property to assure timely payments. Particularly for state level master-leases where numerous operating departments may be involved, a simplified appropriation process helps assure the timely payment of obligations. A debt-service reserve can provide additional strength.

A rating is assigned for each issue accepted for review, whether or not it is of investment grade quality. Applications which do not meet S&P's basic criteria may not be accepted.

The following structural elements are viewed positively. Their absence or significant variation may adversely affect the rating:

- The term of the lease matches the term of the issue. This avoids exposure on renegotiation; if state law prohibits long-term leases, renewal should be automatic.
- The lessee unconditionally agrees to make rental or purchase-option payments as agreed. Such payments are not subject to counterclaim or offset pending the outcome of possible litigation over the leased property, the lease agreement, or any other aspect of the transaction.
- The lessee agrees to request appropriations for lease payments in its annual budget.
- The lease has a nonsubstitution provision of at least 30 days in the event of a nonappropriation.
- In the event of a nonappropriation, the lessee agrees to make the specified purchase-option payment or to return the leased property to the lessor at its own expense.
- The lessee agrees to maintain the leased prop-

erty in good repair and to insure it against loss or damage in an amount at least equal to the purchase-option value or replacement costs, if repair and replacement are mandated by the lease agreement. If applicable, the lessee maintains business interruption insurance and a special hazard policy. Self-insurance for these risks is permitted, so long as adequate reserve levels are maintained.

- For corporate lessors, there must be a sale and absolute assignment of lease rental payments to the trustee. This assures timely payment to the certificate holders if the lessor becomes insolvent. Other methods of "insolvency-proofing" the lessor must be provided for leveraged lease transactions.
- A security interest in the leased property is provided.
- Potential taxability exposure to the certificate holders should be addressed.
- Permitted investments for "trusteed funds" should meet applicable guidelines.

Documentation requirements

The following documentation is required:

- A completed rating application.
- A bond ordinance or trust agreement.
- An official statement or private placement memorandum.
- Authorizing resolution of the governing body.
- The lease agreements.
- An assignment agreement.
- The lease payment schedule with principle and interest components and the end payment in each year.
- A description of the lessee, its functions, services, management, and budgeting process, particularly as it concerns the lease payments.
- A general description of the leased property.
- A certificate of essential use describing the purpose and function of the leased property, focusing on its importance to the performance of the lessee's services for the duration of the lease term.
- If applicable, a delivery and installation schedule and a copy of the acceptance certificate.
- The opinion of a recognized bond counsel that the lease agreement is a net lease without the right of offset, and an opinion from lessee's counsel that it is valid, legal, binding, and enforceable in accordance with its terms.

Additional documentation may be requested if needed.

EXHIBIT B

Section _____. Nonappropriation.

In the event sufficient funds shall not be appropriated for the payment of the Purchase Installments required to be paid under Exhibit _____ to continue the acquisition of the Facility, Purchaser may terminate this Agreement at the end of the last fiscal year or earlier date for which an appropriation is available and Purchaser shall not be obligated to make payment of the Purchase Installments provided for in this Agreement beyond the last date for which an appropriation is available. Notwithstanding any provision of this Agreement to the contrary, if a request for an appropriation to pay a Purchase Installment has been made by the Governor to the General Assembly and the General Assembly fails to make the appropriation requested, the Purchaser shall have the right to terminate this Agreement as set forth in this Section _____. Purchaser shall deliver notice to Seller of such termination no later than 30 days after the Purchaser has knowledge that an appropriation will not be available. The failure to give such notice shall not extend the term beyond such fiscal year. Upon termination of this Agreement for nonappropriation, the obligations of the Purchaser requiring the expenditure of money will cease so long as all payments previously approved or appropriated have been made, and all title and interest of the Purchaser in the Facility will terminate and, subject to the Mortgage, be conveyed to Seller, who may thereupon take possession of the Facility and may take such other actions as are permitted to be taken upon an Event of Default as provided in Section _____ hereof.

Section _____. Current Expense.

The obligations of the State under this Lease, including its obligation to pay the Rental Payments due with respect to the Project in any Fiscal Year for which this Lease is in effect, shall constitute a current expense of the State for such Fiscal Year and shall not constitute an indebtedness of the State within the meaning of the Constitution and laws of the State. Nothing herein shall constitute a pledge by the State of any taxes or other moneys, other than moneys lawfully appropriated from time to time by or for the benefit of the State in the State of _____'s annual budget and the proceeds or Net Proceeds of the Project, to the payment of any Rental Payment or other amount coming due hereunder.

Section _____. Termination of Lease.

The State shall have the right to cancel and terminate this Lease, in whole but not in part, at the end of any Fiscal Year of the State, in the manner and subject to the terms specified in this Section and Sections _____ and _____, if the State of _____'s legislature does not appropriate moneys sufficient to pay the Rental Payments coming due in the next Fiscal Year. Lack of a sufficient appropriation shall be evidenced by a specific provision in a State of _____'s law appropriating moneys to or for expenditure by or on behalf of the State, which prohibits the expenditure of State funds for this purpose. The State may effect such termination by giving _____ a written notice of termination and by paying to _____ any Rental Payments which are due and have not been paid at or before the end of its then current Fiscal Year. The State shall endeavor to give notice of termination not less than sixty (60) days prior to the end of such Fiscal Year, and shall notify _____ of any anticipated termination. In the event of termination of this Lease as provided in this Section, the State shall deliver possession of the Project to _____ in accordance with Section _____, and release its interest in the Improvements and the Equipment granted under this Lease within ten (10) days after the termination of this Lease; it being understood and agreed that in no event shall the State be obligated to deed its fee title in the Land to _____.

10-1116b

BONDS AND WARRANTS

percent (25%) of the revenues from sales of service of such utility for the preceding year. Such warrants shall be redeemed within three (3) years from date of issuance and shall bear interest at a rate of not to exceed the maximum rate of interest prescribed by K.S.A. 10-1009.

History: L. 1941, ch. 98, § 2; L. 1970, ch. 64, § 7; March 21.

Research and Practice Aids:

- Municipal Corporations §904(1).
- C.J.S. Municipal Corporations § 1900.

10-1116b. Lease or installment-purchase agreements; agreements for electric interconnection or transmission facilities; when allowed under cash-basis law. Nothing in the provisions of K.S.A. 10-1101 *et seq.* shall prohibit a municipality from entering into (1) an agreement to pay for electric interconnection or transmission facilities or services, (2) a lease agreement, with or without an option to buy, or (3) an installment-purchase agreement, if any of such agreements specifically state that the municipality is obligated only to pay periodic payments or monthly installments under the agreement as may lawfully be made from (a) funds budgeted and appropriated for that purpose during such municipality's current budget year or (b) funds made available from any lawfully operated revenue producing source.

History: L. 1980, ch. 51, § 1; April 12.

10-1117. Clerk or secretary; record of moneys; contracts and indebtedness of municipality; records of orders, warrant checks; exhibition of records upon request; notice. The clerk or secretary of every municipality shall keep a record of the amount of money in the treasury and each particular fund and shall keep a record of all indebtedness and contracts creating a liability against the municipality. In such records there shall be shown the date of the making of the contract or the creation of the debt, the amount of the contract or debt, the time payable, and the particular fund from which payment is to be made. Such clerk or secretary shall also keep a record of each order, warrant check or check, drawn on the treasury and paid, giving the date of payment. Such clerk or secretary shall, upon the request of any person, exhibit such records to such person and any person contracting with the municipality shall be chargeable

with knowledge of what such records contain.

History: L. 1933, ch. 319, § 17; L. 1973, ch. 54, § 1; L. 1974, ch. 48, § 1; July 1.

Law Review and Bar Journal References:

Budget law provisions discussed, Fred E. Gulick, 14 J.B.A.K. 100, 103 (1945).

CASE ANNOTATIONS

1. Purpose of act discussed; applies to statutory claims. *Shouse v. Cherokee County Comm'rs*, 151 K. 458, 461, 462, 99 P.2d 779. Affirmed: 152 K. 41, 102 P.2d 1043.

10-1118. Treasurer; record of moneys on hand and in each fund; exhibition of record or statement in writing. The treasurer of every municipality shall keep a record of the amount of money on hand in the treasury; which record shall show at all times the amount of money in each particular fund. Such treasurer shall, upon the request of any person, exhibit such record to such person or give such person a statement in writing, showing the balances on hand in each of the funds of the municipality.

History: L. 1933, ch. 319, § 18; L. 1973, ch. 54, § 2; July 1.

CASE ANNOTATIONS

1. Purpose of act discussed; applies to statutory claims. *Shouse v. Cherokee County Comm'rs*, 151 K. 458, 461, 462, 99 P.2d 779. Affirmed: 152 K. 41, 102 P.2d 1043.

10-1119. Void contracts and orders. Any contract entered into between the governing body of any municipality and any person, which violates the provisions of this act, shall be void, and any order, warrant, check or other evidence of indebtedness drawn on the treasurer of any municipality in violation of the provisions of this act shall be void.

History: L. 1933, ch. 319, § 19; March 31.

Law Review and Bar Journal References:

Negotiated agreements would be invalid if they violated the cash basis school financing laws, Larry L. Deemer and Robert J. Fowks, 7 W.L.J. 291, 297 (1968).

CASE ANNOTATIONS

1. Teacher's contract creating indebtedness in excess of funds held void. *Patterson v. Montgomery County Comm'rs*, 145 K. 559, 563, 66 P.2d 400.

2. Purpose of act discussed; applies to statutory claims. *Shouse v. Cherokee County Comm'rs*, 151 K. 458, 461, 462, 99 P.2d 779. Affirmed: 152 K. 41, 102 P.2d 1043.

3. Township's lease purchase contract for road machinery held invalid hereunder. *J. D. Adams Co. v. Dor Township*, 153 K. 623, 624, 625, 626, 627, 628, 631, 632, 113 P.2d 138.

Senate Local Gov't
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Attachment VI

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ior college may employ school security officers to aid and supplement law enforcement agencies of this state and of the community in which such school district or community junior college is located. The protective function of such school security officers shall extend to all school district property and the protection of students, teachers and other employees together with the property of such persons on or in any school property or areas adjacent thereto, or while attending or located at the site of any school or community junior college-sponsored function. While engaged in such protective function, as hereinbefore provided, each school security officer so employed shall possess and exercise all general law enforcement powers and privileges in every county in which there is located any part of the territory of such school district or community junior college.

History: L. 1969, ch. 363, § 1; L. 1976, ch. 321, § 1; July 1.

CASE ANNOTATIONS

1. Individual engaging in unofficial narcotics investigation is not exempted from weapons violation because he is a school security guard. *State v. Hargis*, 5 K.A.2d 608, 610, 620 P.2d 1181.

72-8223. Payment of student tuition by board of social welfare in certain cases. The state board of social welfare shall pay tuition to the board of education of any school district for children in any institution under the jurisdiction of the state board of social welfare who attend any of the schools of such school district. The amount of tuition shall be determined on the basis of the average operating cost per pupil of said school district, less the proportionate amount of state aid received by such school district as determined by the state board of education.

History: L. 1969, ch. 313, § 1; July 1.

72-8224.

History: L. 1970, ch. 297, § 1; L. 1971, ch. 243, § 1; Repealed, L. 1974, ch. 309, § 7; July 1.

72-8225. Lease of real and personal property; exception; terms and conditions; cash basis and budget laws not applicable. The board of education of any school district, as lessee or lessor, may enter into written contracts for the use of real or personal property, except that no board of edu-

cation shall enter into any contract under authority of this section as lessor of any school bus, as defined in K.S.A. 72-8301. The term of any such lease may be for not to exceed 10 years. Such lease may provide for annual or other payment of rent or rental fees and may obligate the school district to payment of maintenance or other expenses. Any contract made under authority of this section shall be subject to change or termination at any time by the legislature. Any assignment of rights in any contract made under this section shall contain a citation of this section and a recitation that the contract and assignment thereof are subject to change or termination by the legislature. The provisions of the cash basis and budget laws shall not apply to any lease made under authority of this section in such a manner as to prevent the intention of this section from being made effective.

History: L. 1970, ch. 298, § 1; L. 1977, ch. 258, § 1; L. 1981, ch. 269, § 2; July 1.

72-8226. Budget and certification of tax levies to pay certain bond issues; option of boards of education. Notwithstanding any of the provisions of K.S.A. 72-67,106, the board of education of any unified school district may elect to budget and certify tax levies for the retirement of bonded indebtedness of any disorganized school district if the building or facility for which such bonded indebtedness was created is located within such unified school district. Any such board of education so electing shall notify the county clerk of any county in which any of the former territory of such disorganized school district is located on or before August 25 of the year preceding the year in which the next installment of such bonds and the interest thereon shall become due and payable. Tax levies under this section shall be made on the territory of the disorganized school district unless otherwise provided by special act of the legislature. Funds collected from such levies by any county treasurer shall be distributed to the school district in the same manner as other school funds are distributed, and the school district shall forward such bond and interest installments to the state treasurer in the manner prescribed by law. No bonded indebtedness levy shall be made by any county clerk pursuant to K.S.A. 72-67,106