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# GLOSSARY OF LEASING TERMS

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California State Treasurer and Chairman  
California Debt and Investment Advisory Commission  
Revised November 1997

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# CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

The California Debt and Investment Advisory Commission was created in 1981 to assist state and local governments to most effectively and efficiently issue, monitor and manage public debt. To carry out its responsibilities, the Commission maintains a database of all public debt issued in California, conducts a continuing education program, publishes a monthly newsletter with debt issuance data and informative articles, and conducts research to develop reports, guidelines and briefs on topical issues. In 1996, the Commission's responsibilities were expanded to include a municipal education program to help local governments to safely and effectively invest public funds.

**Matt Fong**

California State Treasurer and Chairman

**Pete Wilson**

Governor

or

**Craig L. Brown**

Director

Department of Finance

**Kathleen Connell**

State Controller

**Vacant**

State Senator

**Vacant**

State Senator

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State Assemblyman

**Scott Wildman**

State Assemblyman

**Donald W. Merz**

Treasurer/Tax Collector

Sonoma County

**Robert Leland**

Finance Director

City of Fairfield

**Peter W. Schaafsma**

Executive Director

## **FORWARD**

The purpose of this glossary is to provide a helpful reference tool to public officials responsible for leasing decisions. This glossary is one in a series of publications by the California Debt and Investment Advisory Commission designed to assist public officials with tax-exempt financing.

## ACKNOWLEDGEMENTS

This glossary is a revision of the *Glossary of Leasing Terms*, originally published in 1992 by the California Debt and Investment Advisory Commission. The original glossary was adapted from *Leases in California: Their Form and Function*, a study prepared for the California Debt and Investment Advisory Commission by Russell Lombard and James Dudick of Transocean Funding, Inc., Lisa Cole of Cole & Associates, Joshua Cooperman of Gaston & Snow, and Robert Butler of Public Resources, Inc.

## GLOSSARY OF TERMS

This glossary is designed from the perspective of the tax-exempt leasing industry. The glossary defines many terms that also apply to municipal bonds in general and others that have specific meaning for tax-exempt leases. Tax-exempt leasing terminology may vary by transaction structure, the types of parties involved, and even by the individuals involved. For instance, one lessor may request that a lessee execute an acceptance certificate; another may require an acceptance letter. In either case, the document serves the same purpose.

The terms that appear within the definitions in bold-face are defined elsewhere in the glossary; certain commonly used phrases such as asset, lessee and lessor, are not highlighted at each of their references. Refer to the California Debt Issuance Primer, published by CDIAC, for additional definitions that apply to the tax-exempt market in general.

**Abatement** — a legal concept whereby the lessee reduces its rent proportionately or totally to the extent it does not have use of the leased asset. For tax-exempt leases in California and some other states, a lessee is not required to make rental payments without use of the leased asset, permitting a termination of rent. Some leases allow a lessee to abate partial payments if use of the asset is limited. Lessor(s)/investor(s) are likely to protect their interests in leases that contain abatement provisions by requiring the lessee to maintain **casualty and rental interruption insurance**.

**Abatement Lease** — a type of multi-year tax-exempt lease whereby the lessee can commit to make lease payments for the entire lease term unless the leased asset is not available for use, in which case abatement occurs. (This contrasts with a tax-exempt lease with a **non-appropriations clause**.)

**Acceleration of Rents** — also called rental acceleration; an option, found in some tax-exempt leases and exercisable upon a lessee **default**, that allows the lessor (or its **Assignees**) to declare all future rentals then due and payable.

**Acceptance Certificate** — a certificate to be signed by the lessee confirming that a leased asset has been fully delivered, inspected, tested and accepted. By signing the acceptance certificate, the lessee acknowledges receipt of the asset as ordered and that it is in satisfactory operating condition. The acceptance certificate frequently serves as the document that authorizes the lessor or the **trustee** to make a payment to the vendor for the leased asset.

**Acceptance Date** — the date on which the lessee verifies that it has received, inspected, tested and accepted as satisfactory the asset under lease. Some lease transactions use the acceptance date as the date on which the lessee begins its lease obligations.

**Advance Funding** — a method of funding a lease before lessee acceptance of the leased asset. Lease proceeds are placed in an **escrow account** until they are authorized be disbursed to the vendor(s) or **contractors**.

**Advance Payment** — also called payment in advance; a payment structure in which the lease payment is due at the beginning of each period to which the payment relates, as opposed to payment in **arrears**. In some leases, an advance payment may also refer to the payment of one or more periodic lease payments upon lease commencement in the form of or in lieu of a security deposit or downpayment.

**Amortization** — the gradual reduction, redemption or liquidation of the balance (outstanding principal) of an **obligation**.

**Arbitrage** — the interest earned as a result of the difference between the interest rate at which funds are borrowed and the rate at which they are invested. The **Internal Revenue Code** requires that issuers of tax-exempt bonds are generally to rebate to the U.S. Treasury any arbitrage earnings on the investment of proceeds unless the obligation satisfies a rebate exception. Arbitrage restrictions must be addressed in the structuring of certificates of participation as well as in other tax-exempt lease transactions in which lease proceeds are funded and escrowed in advance for the benefit of the lessee.

**Arbitrage Certificate** — a certificate of lessee prepared by the lessor's counsel, bond counsel, or tax counsel confirming that the tax-exempt lease and investment of any proceeds will not violate **arbitrage rules** under the **Internal Revenue Code**. Also known as a No-arbitrage Certificate or a Certificate as to Arbitrage.

**Arrears** — also called payment in arrears; a lease payment structure where payment is due at the end of each period to which the payment relates, as opposed to **advance pay-**

**ment.** Payments in arrears are more typical for tax-exempt leases.

**Asset** — the items of personal or real property being acquired by the lessee through payments over a period of time pursuant to the tax-exempt lease.

**Asset-Based Transfer** — see **Sale-leaseback**.

**Assignee** — the party to which an assignment is made.

**Assignment** — a transfer of legal rights to another; typically, in a tax-exempt lease involving the transfer of the lease and rental payments from the **lessor** to a **paying agent** or **trustee** acting on behalf of the investors or to the investors directly. An assignment may also be used where one investor transfers its interest in the lease to another, especially common in COP transactions. Generally, the lessee will be asked to nominally approve and acknowledge any and all assignments made by the lessor. However, most lessees are themselves prohibited from assigning their rights in or responsibility for a leased asset to another party. If assignment by the lessee is permitted, the lessee is required to obtain the consent of the lessor and to continue to comply with IRC restrictions relative to the financing.

**Bank-Affiliated Leasing Company** — a subsidiary of a bank or bank holding company that is active as a lessor, frequently acting both as lessor, lease broker and/or underwriter.

**Bank Qualified** — under current provisions of the **Internal Revenue Code**, commercial banks can deduct 80% of their interest costs on funds used to acquire or "carry" tax-exempt obligations (bonds and leases) of governments that borrow no more than \$10 million in a calendar year; otherwise, the interest cost is not deductible by the bank. The availability of the interest deduction on bank qualified leases makes them more attractive to commercial banks than obligations of larger issuers. Commercial banks may invest in non-bank qualified leases but the loss of the deduction for

interest costs on funds borrowed by the bank for the initial investment in the lease requires additional compensation through a higher interest rate in the lease than in a smaller, bank qualified transaction.

**Basis Point** — an amount equal to one one-hundredth of one percent (.0001); a shorthand expression to describe differences in interest rates, e.g., the difference between 7.00% and 7.10% is ten basis points.

**Blue Sky Laws** — statutes enacted by state governments that relate to securities registration and prohibitions against fraud, dealer and broker regulations.

**Bond Opinion** — the opinion of counsel specializing in municipal bonds and other tax-exempt transactions that the lease transaction is legal, valid and binding on the lessee. The bond opinion may also incorporate the **tax opinion**. Lease transactions for small dollar amounts frequently do not have a bond opinion. In larger transactions, **bond counsel** may also provide a **10b-5** opinion respecting compliance with securities laws and **disclosure** requirements. Most well-known bond counsel are listed in a section of *The Bond Buyer's Directory of Municipal Dealers of the United States*, informally known as the "Red Book."

**Book Entry Registration** — refers to the system of registration of tax-exempt securities, generally publicly traded, including lease financings, whereby individual securities (bonds or certificates) are not issued to investors. Instead, a record is maintained by an independent company that records the ownership of securities by members of the company, usually **underwriters** or financial institutions. These members (or "participants") are then responsible for the identification of the actual investors through the brokerage or trust accounts maintained by those members. The largest independent company performing "book entry" services is Depository Trust Company of New York; securities qualified as registered for book entry sometimes are called DTC eligible.

**Call** — an option provided to the lessee to prepay the principal balance, accrued interest, and any **prepayment premium** at specific dates during the lease term which are earlier than the normal maturity date.

**Call Protection** — refers to the period of time during which a tax-exempt lease cannot be prepaid; during this period, the investor is assured his yield and his investment is protected from early termination. This is similar to protections provided investors against early redemption of bonds. The investment community also uses this term informally to mean the **payment premium**.

**Capital Lease** — an accounting term for a lease that provides to the lessee all of the rights and obligations to an asset on a basis similar to circumstances had the lessee purchased the asset on a conditional sale or installment purchase basis. Under **FASB Statement 13**, a lease is a capital lease if it meets one or more of the following criteria: ownership of the asset is transferred to the lessee by the end of the lease term; it has an option to purchase the asset at a bargain price (frequently \$1.00); the lease term equals 75 percent or more of the useful life of the leased asset; or the **present value** of the lease payments, including any purchase price, equals at least 90 percent of the fair market value of the asset at the start of the lease term.

**Capitalized Interest** — bond or lease proceeds that are reserved to pay interest for a period of time early in the term of the issue. In construction projects, interest frequently is capitalized through the construction period until the project is accepted by the lessee.

**Captive Credit Corporation** — a wholly owned subsidiary of a corporate organization (usually a vendor) that lease finances the products of the parent corporation.

**Certificate of Participation (COPs)** — a method of structuring and distributing tax-exempt leases to investors by dividing the rental payments and lease into fractionalized in-

terests or shares for individual sale to investors. The share is represented by a formal certificate, much like a bond. COPs can be placed privately or sold publicly. COPs generally are sold for large asset financing and tend to be used more for real property rather than personal property acquisitions.

**Certificate of Title** — an instrument, normally issued by state motor vehicle departments, evidencing title to a motor vehicle. The certificate of title may either show the lessor as owner or it may note the lessor as a secured party and the lessee as owner. Physical possession of certificate of title may remain with the trustee.

**Choice of Law Clause** — a clause generally found in the miscellaneous provisions of the lease specifying that the laws of a specified jurisdiction will govern in construing the lease.

**Closing Costs** — see **Issuance Costs**.

**Closing Date** — also known as **issuance date**; the date on which the lessor or investor provides funds equal to the principal amount of the lease either to the trustee for subsequent transmittal to the vendor(s) or to the vendor directly. This term is most commonly associated with large COPs transactions where the execution of documents occurs in a formal manner similar to bond closings.

**Commitment Fee** — a fee sometimes required by the lessor from the date it commits to act as lessor and finance the assets under the lease, until the final funding date. This fee is most commonly applied in a transaction where there is a lengthy period between the commitment by the lessor and the actual funding date. The fee ensures availability of the funds, and in certain instances, availability of a specified interest rate. The commitment fee frequently is refunded by applying an equal amount as a reduction of the lessee's first lease payment. Payment of a commitment fee may not be allowed under local or state law where payments can

only be made if the asset is available for use by the lessee.

**Competitive Bid** — the response made by a vendor, contractor or financial service provider to a request for bid proposal, usually issued by a governmental unit. In tax-exempt leasing, the term usually describes how a vendor of an asset is selected but may also describe how the lease financing is selected, particularly among small-dollar volume privately placed lease agreements or vendor lease agreements.

**Competitive Sale** — a term describing a method of selling financial obligations (including tax-exempt bonds, leases or COPs) to the bidder presenting the best sealed bid (in terms of price and compliance with the transaction specifications) at the time and place specified by the issuer/lessee (as opposed to a negotiated sale.)

**Concluding Payment** — in a conditional sales agreement (where title to the asset is transferred to the lessee at inception of the lease), this sum is payable by lessee to conclude or terminate the lease. It will include the outstanding principal, accrued interest, and any prepayment premium.

**Conditional Sales Agreement** — a standard form of financing agreement whereby a buyer acquires the immediate use of an asset (and title thereto) and the seller retains a security interest in the asset and the buyer agrees to pay the seller a series of payments equal to the cost of the asset plus interest. Therefore, the transfer of title is conditionally subject to future payments. This is distinguished from an installment sale where the seller retains title until all installment payments are made. In both forms of sale, for federal tax purposes, the Internal Revenue Code treats the asset as owned by the purchaser with payments to the seller constituting principal and interest; for a governmental purchaser, interest usually is tax-exempt. This term is sometimes used interchangeably with the term tax-exempt lease; however, in California, there is an important distinction

between the two (e.g., a lease is constitutionally legal and a conditional sale is not unless it is secured by a special fund.)

**Continuing Disclosure Agreement** — a separate document that is incorporated by reference into the trust indenture, bond resolution or ordinance for purpose as required by the 1994 amendments to Rule 15c2-12, requiring that the contractual undertakings for continuing disclosure to be in a written agreement or contract for the benefit of the holders of the municipal securities being offered on or after July 3, 1995. The **Agreement** lists the items from the official statement that will be updated and identifies the issuer or obligated person as responsible for the item in an annual report. The continuing disclosure agreement must also specify the date by which the annual financial information for the preceding fiscal year will be provided and identifies the repositories to which it will be provided. In addition to the annual financial and operating information, the 1994 amendments to **Rule 15c2-12** require an undertaking to disclose, "in a timely manner", the occurrence of eleven specific events. These events are required to be disclosed when they occur to prevent trading in the secondary market based on a lack of information about events most likely to affect trading.

**Contractor** — see also **vendor**; a term usually describing the party responsible for the construction of the real property improvements to be financed under the lease.

**Credit Enhancement** — a way to protect investors from investment risks by having a third party provide insurance, a guaranty, or additional collateral (e.g., a **letter of credit** or **guaranteed investment (GIC)**) to ensure performance by the lessee of its obligations under the lease. The investors and any rating agencies will evaluate the credit based upon the party providing the enhancement; assuming this party has a higher **credit rating** than the lessee, the rating of the overall transaction will be improved, resulting in a lower interest cost to the lessee. A credit enhancement usually provides assurances to the investor against the risks of **non-appropri-**

**tion or abatement** as well as against the credit risk of the lessee.

**Credit Enhancement Provider** — the party supplying the credit enhancement.

**Credit Rating** — an independent appraisal of the credit quality of a bond issue or lease, usually supplied by a credit rating agency.

**Credit Rating Agency** — an organization that analyzes new and outstanding obligations of the public and private sectors and assigns a rating as to their comparative credit quality to help investors make their decisions as to the rate at which they will loan funds. The three largest organizations are Moody's Investors Service, Standard & Poor's Corporation and Fitch Investors Service.

**Cross-Default Provision** — a clause, if included in a lease, which states that if an event of **default** arises in other obligations of the lessee, it becomes an event of default under the lease.

**Debt** — an obligation arising from the borrowing of money to be repaid over a period of time, and if over a multi-year period, subject to state and local constitutional provisions, statutes, and judicial and administrative determinations. In California, tax-exempt leases with **non-appropriation** or **abatement** clauses are not considered debt under the *Offner-Dean* series of court cases.

**Default** — the failure of the lessee to pay payments or other sums or obligations when due under the lease or failure to observe a representation or warranty in the lease or violation of a covenant in the lease, and the expiration of applicable periods to cure the default. An event of **non-appropriation** or **abatement** is not normally considered an event of default, even when the remedies are substantially similar for each event.

**Defeasance** — the termination of the obligations of a issuer/lessee by providing for the full **prepayment** of its obligations. Frequently, a properly documented, usually larger, tax-exempt lease can be defeased (like a bond) by the deposit of sufficient funds with a trustee to pay the future lease obligations until maturity or until the first date permitted for prepayment of the lease. Depending upon the structure, the amount of funds to be deposited may be determined by giving effect to investment earnings to be derived from the funds deposited, particularly when investments are made for stated maturities and at pre-determined rates. Defeasance is different than prepayment because although the lessee's obligations are fully satisfied, the lease and the related certificates remain outstanding to be paid later from the funds deposited, avoiding any prepayment premium or similar obligation. Defeasance usually occurs if a lessee wishes to discharge its obligations before the **call protection** period has expired and assuming the lease specifically permits such actions.

**Delphis-Hanover Scale** — an index which is published regularly and reports the current level of interest rates applicable to municipal securities of various rated quality and term.

**Disclaimer of Warranties** — a reference to typical provisions of tax-exempt leases under which a lessor, who is not a vendor, will disclaim (reject) any and all responsibility for the suitability or performance of the assets selected by the lessee to be financed under the lease agreement.

**Disclosure** — information provided on the issuer/lessee, to permit an investor to evaluate the creditworthiness of the issuer/lessee, the risks associated with the financing, and the appropriate yield required by the investor for the investment. The information must include financial data. Under a 1989 rule of the federal Securities and Exchange Commission (**Rule 15c2-12**) and subsequent amendments to the Rule adopted in 1994, the timing and filing of disclosure statements relating to tax-exempt financings have been regulated. Disclosure is usually provided through an **official** or

**offering statement or for private offerings, a private placement memorandum.**

**Disclosure Counsel** — special counsel hired by issuers to assist them in understanding and pursuing their disclosure responsibilities in connection with primary offerings and in determining when and how to provide secondary market disclosure. Depending on the needs of the issuer and characteristics of the financing, there are a number of services disclosure counsel may provide including: preparing any disclosure documents, providing opinions on the accuracy and adequacy of disclosure documents and coordinating the expertise necessary to complete disclosure documentation.

**Effective Interest Rate** — see also **implicit rate**; the rate of interest payable by the lessee taking into account accrued and **capitalized interest, issuance costs, discounts and premiums.** (As opposed to **Nominal Interest Rate.**)

**Enterprise Lease** — see **Lease Revenue Bond.**

**Environmental Law Opinion** — an opinion of counsel (specializing in environmental and hazardous substances law), which may be required in some real property financings, respecting the environmental or toxic substances liabilities associated with the property being financed. Owners of real property (and potentially their lenders) may incur liabilities to remediate hazardous substances present or associated with the property.

**Equipment Schedule** — the schedule or exhibit to a lease which identifies the property being leased.

**Escrow Agent** — also known as **trustee**; usually a financial institution that provides administrative services, through an **escrow agreement**, for the benefit of the parties to a financing including the execution and delivery of COPs, the safekeeping of proceeds, and holding physical possession of title documents for the leased asset. Depending on the

lease structure, the escrow agent may have other responsibilities such as disbursement of funds to vendors, investment of reserve and acquisition funds (until delivery or construction is completed) and arbitrage calculations. In COPs, the escrow agent's role may also include the collection of lease payments from the lessee(s) and the regular disbursement of payments of principal and interest to investors.

**Escrow Agreement** — also known as a **Trust Agreement**; a legal document that outlines the duties and responsibilities of the **escrow agent**. This agreement specifies the terms of the securities issued including maturity dates, interest rates, security for payment, redemption procedures, rights of prepayment, etc. When transaction proceeds are to be held by the escrow agent, the agreement specifies the purpose, the documents and authorization needed for disbursement, and dictates the use of earnings on funds held prior to disbursement. The agreement also covers other procedural matters such as dealings with a **credit enhancement provider**, compensation or replacement of escrow agent, etc.

**Essential Use Certificate** — a certificate executed by the lessee indicating that the asset being leased is essential to the lessee's governmental purposes and daily activities. Lessors in almost all tax-exempt lease transactions with a **non-appropriations** provision require confirmation of essential use from the lessee, either through a representation in the lease or a separate certificate, or both. In addition, for some transactions, lessees may also be required to provide a **project feasibility study** and certify the feasibility of the leased asset as well as its essentiality.

**FASB Statement 13** — the formal pronouncement of **FASB** relating to leases and their accounting applications; the **GASB** has specified that **FASB Statement 13** is the standard by which governments using generally accepted accounting principles are to report and account for their lease transactions.

**Feasibility Study** — a report analyzing the practicality of a proposed facility including review of operating, financial, engineering, and revenue estimates.

**Financial Accounting Standards Board (FASB)** — the independent non-profit organization supported by the public accounting profession and charged with the responsibility of promulgating generally accepted accounting principles.

**Financial Advisor (FA)** — a consultant to a lessee who provides assistance in the structure, timing, terms and other topics concerning new or existing leases. A financial advisor also assists a lessee in analyzing competitive bids received in response to a request for proposal or in the preparation of a preliminary **official statement** needed for competitive sale.

**Financing Statement** — see **UCC-1 Financing Statement**.

**Form 8038, 8038-G, 8038-GC, 8038-T** — forms of the Internal Revenue Service that governmental borrowers (including lessees) must complete to report on the issuance of tax-exempt securities, their general purpose, their general financial terms, the exemption used for tax-exempt private activity bonds, and to transmit arbitrage rebate amounts to the IRS.

**Full Service Lease** — an **operating lease** in which asset maintenance or other service is the responsibility of the lessor.

**Funding Date** — the date on which funds are transferred from the investor(s) to the vendor(s), or trustee if the lessee has not accepted the asset. Frequently, the **closing date**, **funding date**, and **acceptance date** occur simultaneously.

**Funding Resolution** — the action taken by a governing body that authorizes the government to enter into a lease financing.

**Government Accounting Standards Board (GASB)** — the standard-setting body for governmental accounting.

**Government Finance Officers Association (GFOA)** — a non-profit organization that represents state and local finance professionals in the United States and Canada. Beginning in 1976, the GFOA, formerly the Municipal Finance Officers Association, has been in the forefront of promulgating voluntary disclosure guidelines for the issuance of tax-exempt securities.

**Governmental Bonds** — a term used in connection with federal arbitrage regulations meaning obligations (bonds or leases) that are not private activity bonds.

**Hell-or-High Water Clause** — a clause contained in most tax-exempt leases that holds the lessee responsible for its lease payments and all other obligations under the lease regardless of the status of the leased asset or any dispute between the lessee and any other party. This clause does not prevent the lessee from exercising its right to non-appropriate. In some states, such as California, the lease is altered to permit the lessee to terminate rental payments pursuant to an abatement clause.

**Implicit Rate** — also called the effective interest rate; the interest rate at which the present value of all payments made by the lessee, including issuance costs and all rent payments, will equal the asset cost.

**Incumbency Certificate** — a document executed by the lessee (usually the lessee's board secretary or clerk) that indicates the title and authority (as well as providing facsimile signatures) of persons authorized to execute and deliver the lease and other documents or instruments.

**Indemnity Clause** — a clause contained in most tax-exempt leases that holds the lessor, trustee and credit enhancement provider harmless from any loss or damage suffered by the lessee or third parties due to the use of or

because of the leased asset or the tax-exempt lease; such clauses may also extend to facts and circumstances concerning the tax-exempt nature of interest under the lease.

**Independent Lessor** — a lessor that is not affiliated with a bank, credit corporation or any other organization or corporation. The independent lessor might be an investor using its own funds or it might be a **lease broker** using funds received or to be received from other investors.

**Installment Sales Agreement** — see **Conditional Sales Agreement and Lease Revenue Bond**.

**Insured Value** — the value at which assets are insured for casualty purposes under the lease; usually defined to include, at a minimum, the outstanding principal, accrued interest and any **prepayment premium**.

**Integration Clause** — a clause generally found in the miscellaneous provisions of the lease specifying that the language in the lease documents (as to specific terms provided in such documents) controls over any and all oral or written understandings or arrangements respecting such items prior to execution of the lease.

**Interest** — compensation paid for the use of money or the return on investment from money invested or lent; the interest rate is the interest charge expressed as a percentage of **principal**.

**Internal Revenue Code (IRC)** — the codification of federal tax laws enforced by the U.S. government's Internal Revenue Service.

**Investor** — in a tax-exempt lease, the party that provides the funds to pay for the leased asset and benefits from the tax-exempt interest whether directly as a single investor or in concert with many investors as a purchaser of certificates of participation.

**Issuance Costs** — costs associated with closing and funding the principal amount of the lease including, but not limited to, fees for the **bond, tax and securities counsel**, printing costs, **credit enhancement costs** (if any), **credit rating costs** (if any), **underwriter's discount** (as applicable), **financial advisor** or other professional fees, governmental filing costs (if any) and, where appropriate, costs of feasibility studies.

**Issuance Date** — see **Closing Date**.

**Issuer** — see **Lessee**.

**Joint Powers Authority (JPA)** — a public authority created by a joint exercise of powers agreement between any two or more governmental agencies. An authority may perform any function which all parties to the agreement can perform independently and which will be of benefit to all parties. A JPA may also issue debt to consolidate the financing of several projects with a single bond issue or purchase bonds issued by local agencies with the proceeds of their bond issues.

**Lease Broker** — usually an independent leasing company that negotiates leases between lessees and investors. A lease broker may serve as **nominal lessor** or may **underwrite** or guarantee the financing. In either case, the broker **assigns** its rights and interests in the lease to an investor.

**Lease Line of Credit** — an arrangement that allows a lessee to make periodic withdrawals from a line of credit established to finance lease acquisitions. The arrangement is documented as a single tax-exempt lease with multiple **equipment schedules**. A schedule is executed for and at the time of each acquisition by the lessee. Administratively, a line of credit eliminates the documentation hurdle of separate leases on smaller-valued assets and ensures a continued funding source at rates competitive with larger transactions. A lease line of credit is typically utilized in larger dol-

lar financings with extended or variable delivery schedules or in lease pools.

**Lease Pool** — an arrangement whereby a number of unrelated tax-exempt leases are grouped together for purposes of a single public offering. The governments are usually similar in nature (e.g., school districts) and are brought together through some common interest association. The lease pool is different than a **master lease** which groups the leasing needs of several departments or agencies in a single issuer/lessee, such as a state or county.

**Lease-Purchase Agreement** — see tax-exempt lease.

**Lease Revenue Bond** — also referred to as lease-backed revenue bond; a bond having as its repayment source a lease to which project revenues have been pledged for making regular payments, although the source of lease payments may also include General Fund revenues. In California, such leases are frequently referred to as **enterprise leases**, **installment sales agreements**, or **special fund leases**.

**Lease Term** — the length of time during which the lessee has an obligation to make rental payments. The term should coincide with or be shorter than the useful life of the asset being leased.

**Lessee** — also called the **issuer**; in a tax-exempt lease, the lessee is a unit of government otherwise qualified to issue tax-exempt obligations which finances the acquisition of assets through the tax-exempt lease by paying specified sums of interest and principal for a pre-determined period. In an operating lease, the lessee only uses the asset for a period of time and returns it to the lessor. To be tax-exempt, the lessee must be a qualifying governmental entity under the IRC.

**Lessee's Counsel** — the attorney who provides the opinion to the lessor (and, as applicable, the assignee, paying

**agent, or trustee)** that the lessee is a governmental entity, is authorized to enter into the transaction, that it has done so legally, that the officials executing the lease have the authority to do so, that the lease is in compliance with all procurement and other regulations, and that the transaction is legal, valid and binding on the lessee.

**Lessor** — in a tax-exempt lease, the **secured party** (see **security interest**) that may provide the funds and act as investor or that may assign its interest in the leased property to another party for these purposes. If the lessor is also the investor, the lessor benefits from tax-exempt income. In an **operating lease**, the lessor owns the asset and derives the tax benefits of ownership which include, as applicable, depreciation.

**Lessor's Counsel** — the attorney who provides the opinion that the lessor's involvement in the lease has been properly authorized and has been or will be entered into in compliance with lessor's corporate documents and procedures. Opinion of lessor's counsel is not provided in all leases, especially in smaller dollar-volume transactions.

**Letter of Credit** — see also **credit enhancement**; a credit facility from a financial institution in which the institution agrees to provide specified funds to meet payments due under a tax-exempt lease, if the lessee does not make those payments. A letter of credit is used to allow the financial institution's credit rating to supplement that of the issuer and to provide additional security that money will be available to pay lease payments. The financial institution is typically reimbursed for any funds drawn by the issuer or by a **security interest** in the asset.

**Marketability** — a term used to indicate how readily an obligation can be sold to lessors or investors. Also called **financeability**.

**Master Lease** — an arrangement that involves one lease document for the acquisition of different types of assets at

different times by one lessee or agencies and departments of one lessee.

**Municipal Securities Rulemaking Board (MSRB)** — an independent, self-regulatory organization established by federal law with general rulemaking authority municipal securities market participants (generally, brokers and dealers). The MSRB proposes and adopts rules concerning professional qualifications standards, rules of fair practice, record keeping, the scope and frequency of compliance examinations, the form and content of municipal bond quotations, and sales to related portfolios during the underwriting period.

**Negotiated Sale** — the method of selling obligations (including tax-exempt bonds, leases or COPs) where the terms of the obligation, in particular the interest rate, are negotiated between the lessee and the financing source (as opposed to **competitive sale**).

**Net Interest Cost** — a technical measure of the interest cost of a lease or bond derived by adding together all interest payments for the term of the issue or lease and dividing that sum by the sum for all bonds of the amount of each bond multiplied by the number of years it is outstanding. Net interest cost differs from **true interest cost** in that NIC does not take into account the **time value of money**.

**Net Lease** — see **Triple Net Lease**.

**No-Arbitrage Certificate** — see **Arbitrage Certificate**.

**Nominal Buyout** — a provision in some tax-exempt leases that allows the lessee to purchase the lessor's interest in the lease at the end of the lease term for a "nominal" price, usually \$1.00.

**Nominal Interest Rate** — see **effective interest rate**; the rate of interest often stated in a tax-exempt lease or quoted by a lessor which does not include the effect of **issuance**

costs, discounts, premiums, or accrued and capitalized interest.

**Nominal Lessor** — an entity brought into a tax-exempt lease transaction for the sole purpose of acting as lessor and as a conduit of acquiring the asset for lease to the lessee through the tax-exempt lease. The nominal lessor may be a private organization that is paid for its services or may be a not-for-profit organization, such as an existing development agency, or a corporation organized for the sole purpose of acting as lessor. The nominal lessor has no responsibilities for nor rights to the leased asset.

**Non-appropriations Clause** — a provision contained in some California and most non-California tax-exempt leases that allows a lessee to discontinue its lease payments if, in future years, funds are not appropriated to make lease payments (usually following a best efforts undertaking by the lessee to obtain the funds.) A lessee is not in default under the lease if it non-appropriates. Due to this annual condition placed on the obligation to pay rent, the courts in many states view rental payments as operating expenses under state law and, therefore, not as debt. In the event of non-appropriation, the lessee loses use and possession of the asset.

**Non-appropriations Lease** — a type of tax-exempt lease in which the lease can be terminated if sufficient appropriations are unavailable to continue its payments. (This contrasts with an abatement lease.)

**Non-substitution Clause** — a provision contained in many tax-exempt leases that restricts a lessee from substituting other equipment or property, or as applicable, from obtaining the same equipment or services from third-party vendors, to provide the services of the assets for which payments have been non-appropriated or abated. The period during which a lessee cannot substitute can vary from one month to a year or to the term of the original lease.

**Obligation** — any written promise or commitment to pay money or take certain actions.

**Official Statement** — also called an OS or Offering Statement; the document by which the issuer provides financial and other information to potential investors respecting the transaction and the issuer to permit more educated investment decisions. For **privately placed** transactions, this document may also be called a **private placement memorandum**. In a competitive sale of COPs, the lessee and its advisors usually prepare a **preliminary official statement (POS)** which is distributed to prospective bidders (**underwriters**) prior to the time designated for submitting sealed bids. After the transaction is awarded, the final OS is prepared. In a negotiated sale of COPs, the **underwriter** usually assists in preparing the OS and its distribution to prospective investors prior to the pricing of the transaction. The review and distribution of official statements is discussed in the SEC's Rule 15(c)2-12.

**Offner-Dean cases** — *Offner* involved a proposed long-term lease of an incinerator to be erected on City-owned land and leased by the lessor to the City. The lease provided for purchase options at specified periods at the greater of a minimum price specified in the bid or an appraised value. The lease was challenged on the basis that it constituted an installment sale over a multi-year period and violated the debt limitations. The court held that the proposed agreement constituted a lease, not an installment sale, because the rentals and purchase options represented "fair value". As stated by the court, where the lease obligation, even if multi-year, was entered into in good faith and confined liability for rent was for consideration of the asset furnished during the year, "no violence is done to the constitutional provision." The rationale in *Offner* was amplified in *Dean v. Kuchel*, a subsequent case involving the lease of a building by the State on a triple net lease basis over a multi-year period. The lease was structured to conform to *Offner*, in that the rental was "for and in consideration" of the facility. However, unlike *Offner*, the State was to receive title upon

further expiration of the lease without any further payment, and in any event (even if the State defaulted), 10 years following the stated term of the lease. Notwithstanding these factors, the court held the principles of *Offner* applied.

**On-behalf Of Agency** — see **63-20 Organization**; a non-profit agency or corporation organized to issue bonds or enter into lease transactions on behalf of a government or a group of governments. The property so acquired must be owned by the establishing government(s).

**Operating Lease** — a type of lease that has none of the characteristics of a capital lease for accounting purposes. In an operating lease, the lessee has use of the leased property but the lessor retains ownership, including ownership for tax purposes. The **implicit interest rate** in an operating lease is at taxable rates and payments are considered rent (and not payments of principal and interest). The lessee usually must agree to maintain and insure the property and pay all property and sales taxes in the same manner as in a **tax-exempt lease**. This type of lease is frequently used for assets that the lessee wishes to use for short periods that are less than the full useful of the asset.

**Paying Agent** — in a COP or master lease arrangement, a party appointed by the lessor or the lessee(s) as agent to collect the proceeds at the sale of the COPs and other sums provided by the investors and disburse such monies as directed by the lessee(s). In addition, the paying agent collects rental payments from the lessee(s) and disburses them to the investor(s) as directed by the lessor or under an agreement with the lessor and lessee(s). This function is frequently performed by the **escrow agent**, also called **trustee**.

**Payment Schedule** — a schedule or exhibit to the lease with the date and amount of each payment due and the principal and interest components of each payment. For purposes of the **Internal Revenue Code** to be tax-exempt, the interest component of rental payments must be identified and set forth at the inception of the lease. Most pay-

ment schedules will also identify the date and price at which the lessee can exercise its **purchase option**.

**Payment Terms** — the frequency with which lease payments are made. Depending on the transaction, payments can be monthly, quarterly, semi-annually, or annually. Payments can be in **arrears** or in **advance**. Most COPs call for quarterly or semi-annual payments in arrears.

**Premium** — the amount by which the price of an obligation exceeds its principal amount; for tax-exempt leases, this usually is expressed in the offering memorandum for the COPs (and may constitute funds available to the **underwriter** for **issuance costs** and **underwriter's discount**).

**Prepayment Premium** — also called a prepayment penalty; if a lessee exercises its **purchase option**, it frequently will also have to pay a prepayment premium. The amount of the prepayment premium is generally shown on the **payment schedule** as part of the total **purchase option price**. The premium includes amounts necessary to cover **issuance costs** that were included in the original **principal or interest rate** for the transaction but have not yet been amortized. The prepayment premium may also include amounts to compensate for the early termination of the lessor/investor's investment. In some cases, the premium is expressed as a specific percentage of the remaining lease principal obligation. However, in other transactions, the amount of premium is not clearly distinguished but is blended into a schedule of prepayment prices.

**Present Value** — the equivalent value today of money available in the future, either at one time or in a series of payments. The present value is influenced by the interest rate factor applied to the future payment(s).

**Principal** — the amount loaned and repaid, usually the cost of the asset and may include certain issuance costs. Interest is charged based on the outstanding principal.

**Private Activity Bond** — under federal tax law, bonds of which more than (i) 10% or more of the proceeds are used in the trade or business of nongovernmental persons and 10% or more of the debt service is secured by or derived from property used in the trade or business of nongovernmental persons, or (ii) 5% or more of the proceeds are loaned to nongovernmental persons. Interest on private activity bonds is tax-exempt only if certain requirements of Section 141 of the IRC are satisfied.

**Private Placement** — a method of selling financial obligations (including tax-exempt bonds, leases and COPs) where the investors are a limited number of informed individual or institutional investors who purchase the obligations for their portfolios and not for resale (as opposed to a public sale).

**Private Placement Memorandum** — see also **official statement**; the disclosure document respecting the tax-exempt lease and lessee pursuant to which private placements are offered and sold.

**Progress Payments** — periodic payments made to a vendor or contractor for the completion of specified phases or deliveries of a project or asset. In a construction project, for example, a contractor will receive payments in reimbursement for work completed to date or in progress. To guarantee that the project will be totally completed, the contractor may be required to post a performance bond.

**Property and Casualty Insurance** — insurance that lessees are required to maintain on the leased asset to protect the investor in the event the asset is damaged or destroyed. The lessee can be required to maintain the insurance for the original or replacement value of the asset or for the outstanding principal balance. The lessee will have to sign a Certificate of Insurance or provide other proof that it has the insurance at the proper value.

**Public Sale** — a method of selling financial obligations (including tax-exempt bonds, leases, and COPs) where an

underwriter offers the securities to a large number of investors in denominations as low as \$5,000. Normally, a public sale is made pursuant to an **official statement**.

**Purchase Option** — a provision that gives a lessee the opportunity to purchase the leased asset at specific times during the lease term by paying the then-outstanding principal, accrued interest, and, as applicable, the **prepayment premium**.

**Purchase Option Price** — the amount due to be paid by a lessee upon exercise of its **purchase option**. This amount includes the outstanding principal, accrued interest, and, as applicable, the **prepayment premium**. This amount may also serve as a casualty value or stipulated loss value for insurance purposes. **Purchase option prices** generally are shown in the **payment schedule**.

**Quiet Enjoyment Clause** — a provision in the lease which specifically states that so long as a lessee is not in default, the lessee shall be entitled to the quiet use and enjoyment of the leased asset and that the lessor or its assignees shall not interfere or otherwise obstruct such use.

**Quit Claim Bill of Sale** — legal evidence of a sale of an asset without warranty.

**Rebate** — the payment of certain **arbitrage** earnings required to be paid to the United States Treasury under the **Internal Revenue Code**.

**Redemption** — the repayment of principal of a lease or bond.

**Refunding** — a financing structure applicable to government obligations, including tax-exempt leases, through which the obligation is redeemed by a new financing of the same or a related **issuer** on generally more favorable financial or legal terms. Refundings are subject to certain criteria under the **IRC**.

**Registration** — see also **book entry registration**; the act of maintaining a listing of the names and addresses of the owners of municipal bonds and COPs. Registration usually is the responsibility of the **trustee** or a registrar. However, every issuer of tax-exempt securities with a term in excess of one year, including lease transactions, is responsible under the IRC for maintaining or causing to be maintained the registry of the holders of its securities.

**Renewable Lease** — a lease written initially for a short term (commonly one or two years depending on the lessee's budget cycle) which is renewable for subsequent similar terms until a full term equal to the **useful life** of the asset is reached. In many such leases, renewal occurs automatically unless the lease is specifically terminated by the lessee.

**Rental Interruption Insurance** — a form of insurance that provides a flow of funds to protect investors in the event that leased property is not usable and the lessee elects to use the **abatement** provisions of the lease. If the asset is not usable and, as a result of the lease contract, the lessee is not required to make lease payments, insurance proceeds would be used to continue the payment stream unless or until the property is restored to a usable condition or the investors are paid the principal and interest due. However, many rental interruption insurance contracts are limited to the payment of rentals for a fixed number of years (commonly two) which period is deemed adequate to restore the asset to useable condition.

**Reserve Fund** — a special fund established from lease proceeds from which moneys can be drawn to make lease payments if the lessee is otherwise unable. The fund can be set up entirely from lease proceeds or can be partially funded by the lessee over the term of the lease. A typical reserve fund would be an amount equal to maximum annual payments for the lease, but not to exceed 10% of the original principal amount of the lease.

**Rule 10b-5** — a rule of the Securities and Exchange Commission under the Securities Exchange Act of 1934, which requires that persons purchasing or selling securities (whether or not registered) not engage in any device or scheme to defraud or make any untrue statement of a material fact or omit to state a material fact to cause the disclosure statement to be misleading. The liabilities of failing to disclose may extend to **bond counsel, underwriter's counsel, underwriters** and other participants in the lease financing.

**Rule 15c2-12** — a rule, effective January 1, 1990, of the Securities and Exchange Commission (SEC) that governs the review and delivery by **underwriters of official statements** released in conjunction with the sale of municipal securities. Rule 15c2-12 Amendments adopted by the SEC in 1994 and effective on or after July 3, 1995 prohibit a broker-dealer from acting as an underwriter in a primary offering of municipal securities, in principal amount of \$1 million or more, unless it has reasonably determined that the issuer or an obligated person has undertaken to provide annual financial information and notices of material events to various information repositories.

**Safe Harbor** — an exemption from a rule or restriction provided that the conditions of the exemption are satisfied.

**Sale-leaseback** — an arrangement where one party sells an asset it owns or is acquiring to another and leases it back so that the lessee receives an infusion of cash from the sale of the asset but still retains its use. The lease can be structured as an **operating lease** where the new owner can depreciate the asset or as a tax-exempt lease for which the new owner receives tax-exempt interest and the original owner reacquires the asset. In the latter case, the sale-leaseback may be referred to as a sale-saleback. This structure is frequently used to permit lessees to employ the equity in assets they own to finance capital expenditures or other programs. For some governmental units, a sale-leaseback is not possible since some may only be permitted to

sell property if it is "surplus" to its needs. It would then be a contradiction to first declare an asset surplus for the sale and immediately declare it essential for the lease. Surplus property rules vary from one governmental unit to another even within the same state.

**Secondary Market** — a term describing the purchase and sale of securities (including tax-exempt bonds, leases, and COPs) between investors at a time after the original sale of the securities. Frequently, the underwriter will maintain a secondary market for large issues to facilitate the orderly buying and selling of the securities at any time during their term. There is very little secondary market activity for individual privately placed tax-exempt leases. Some larger institutions have sold parts of their tax-exempt lease portfolios to other institutions or public unit trusts.

**Section 103** — the section of the Internal Revenue Code that defines the types of governmental units that qualify as tax exempt.

**Security Interest** — a legal claim to property that provides security to an investor (the secured party) in the event the borrower/lessee fails to make all payments otherwise due. Security interests are usually granted under the terms of the lease agreement. In most cases, security interests are recorded through the filing of a UCC-1 for equipment or, for vehicles with license plates, by a notation on the vehicle's certificate of title of the secured party's interest. For transactions involving real property, the security interest is usually recorded in the same manner as a mortgage lien. Secured parties have superior rights to creditors of the lessee respecting the assets in which they have a security interest, both prior to and in bankruptcy proceedings.

**Simple Interest** — interest charged only on the principal amount and not on interest earned but not paid.

**63-20 Organization** — a shorthand expression for a non-profit corporation created by a municipality to act as nomi-

**nal lessor** to build and acquire assets for which the municipality is lessee. Its name is derived from Revenue Ruling 63-20 (of the Internal Revenue Service) which establishes the parameters for this type of organization.

**Sublease** — also sublet; a document or act by which a lessee allows another party to use the leased asset. Subleasing by the initial lessee is often restricted by the terms of the tax-exempt lease. The restrictions usually are meant to ensure the continuation of the tax-exempt status and the security of the original lease.

**Tax-Exempt Lease** — also called a municipal lease, installment purchase lease, conditional sales agreement, or a lease purchase agreement; a financing arrangement whereby a state or local government or agency or subdivision thereof, as lessee, obtains the use and ownership of an asset by making periodic lease payments of principal and interest. Because the lessee is a tax-exempt entity and will own the asset, and assuming compliance with the IRC and, in California, the Revenue and Taxation Code, interest it pays is exempt for federal and state income or franchise tax purposes.

**Tax Opinion** — the opinion of counsel specializing in tax-exempt obligations that the interest portion of rental payments received by the lessor or investor(s) from the lessee is exempt from federal income taxes and, as applicable, state income or franchise taxes. The tax opinion may be incorporated into the bond opinion or be separately provided.

**Time Value of Money** — see also present value; an economic concept which takes into account the fact that funds due in later periods may have a diminished present value due to the intervening period and loss of investment earnings by the lender until the payment is received.

**Triple Net Lease** — also called a net lease; a term describing a lease agreement where the lessee is responsible for all maintenance, insurance, utility charges, taxes, etc.,

associated with the leased asset and that all lease payments to be made are net of all such expenses. Tax-exempt leases are usually triple net leases.

**True Interest Cost** — see also **effective interest rate, net interest cost**; a measure of the interest cost of a lease or bond issue that accounts for the time value of money.

**True Lease** — a lease, which does not involve tax-exempt interest, in which (i) the lessor owns and receives tax benefits of depreciation on the asset being financed, enjoys the benefit and risk of any residual value at the end of the lease term, and is considered the true owner of the asset and (ii) the lessee receives only a right to use (has no equity build-up), can deduct its rental payments (if the lessee is a taxable entity) and has the option to purchase the asset at approximately its fair market value at the end of the lease.

**Trust Agreement** — see **Escrow Agreement**.

**Trustee** — see **Escrow Agent**.

**UCC-1 Financing Statement** — see also **Certificate of Title**; a form, that once executed by a lessee and lessor and filed with the appropriate state agency (viz., the Secretary of State and, as applicable, the county recorder) records and perfects the lessor/investor's **security interest** in the leased property. The UCC-1 is used in the vast majority of tax-exempt leases in which title to the leased property is in the name of the government lessee.

**Underwriter** — purchases bonds or COPs from the lessee/issuer or **escrow agent** with the intent to resell the securities to investors. In a firm underwriting, the **underwriter** guarantees the purchase of securities at a predetermined interest rate. In a best efforts underwriting, the underwriter agrees to utilize all reasonable resources to sell the securities (but without liability to do so or to purchase unsold securities.) Where the purchase is guaranteed, the under-

writer will usually pre-sell the certificates to investors prior to closing or if unable to, the underwriter, for at least a temporary period, may be the owner of the certificates.

**Underwriter's Concession** — also known as underwriter's spread; the amount deducted from the proceeds of the sale of securities by the underwriter as compensation for the undetermined selling efforts and related risks.

**Underwriter's Counsel** — an attorney that represents the interests of the underwriter in a negotiated sale of COPs. Underwriter's counsel usually will review all transaction documents and will negotiate issues affecting the underwriter. Areas of particular concern include **disclosure** and securities laws compliance and **registration** requirements.

**Underwriter's Discount** — also called underwriter's spread; the difference between the principal amount of a security and the purchase price paid to the issuer or the trustee by the underwriter.

**Useful Life** — a period of time during which an asset will provide the desired service to the party using it. The useful life of a piece of technical equipment could be substantially less than its expected technical life (e.g., computers due to technical obsolescence.)

**Vendor** — the seller or supplier of personal property.

**Yield** — the rate of interest paid to an investor.

