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Lease Revenue Bonds and COPs

LEASE REVENUE BONDS AND CERTIFICATES OF PARTICIPATION ("COPS")

INTRODUCTION

Lease Revenue Bonds ("LRBs") or Certificates of Participation ("COPs") are essentially long-term municipal debt instruments funded with lease payments that are considered by investors to be a limited source pledge used to secure debt service payments. Specifically, tax-exempt LRBs or COPs are used to finance the acquisition or construction of facilities that are leased by municipalities or 501(c)(3) qualified nonprofit corporations (collectively referred to hereinafter as "Lessees"), with the lease payments being used to pay back the investors who purchased these debt instruments. As LRBs and COPs are secured by lease payments and not by interest payments, they are not legally considered bond debt, so no public election is required under Propositions 13 or 218 to approve them prior to sale. They can be used to finance any leased municipal facilities that can generate sufficient lease revenues to repay the debt, such as an administration building, police or fire station, library, convention center, parking structure, sports arena, or concert venue. As these debt instruments are typically secured solely by a pledge of lease revenues and not by a municipality's General Fund, they usually carry a higher interest rate than General Obligation Bonds. LRBs/COPs may or may not be rated by the bonding rating companies, depending upon the credit quality of each financing. Debt service coverage requirements for LRBs or COPs vary, but lease revenues for a senior debt instrument can range from 150% to 225%, while subordinate and sub-subordinate debt instruments can require coverages ranging from 115% to 150%. The investors who purchase the instruments will receive a specified portion of the lease payments to cover the principal and interest amounts due to them.

FINANCING PUBLIC FACILITIES

In a typical LRB/COP financing, a municipality either establishes a new or utilizes an existing Joint Powers Authority ("JPA") or nonprofit corporation that issues LRBs to finance the construction of a municipal facility. The JPA or nonprofit corporation either owns or leases the land and/or facility, which are then leased (or, in some cases, leased back) to the municipality. A trustee is selected by the issuer for each debt instrument who is responsible for accepting Lessee payments and then disbursing them to investors twice each year. Essentially, the LRBs/COPs are secured by the municipality's pledge to make its lease payments, although there is no requirement that the municipality commit its General Fund to making these payments. In most cases, there is even an abatement clause relieving the public agency from making its lease payments if the property is unavailable due to construction delays, fire, etc. However, in most cases, the actual responsibility for the construction of a leased public facility is delegated to the municipality itself.

PUBLIC-PRIVATE PARTNERSHIPS

In recent years, there has been a relaxation of safe harbor rules by the Internal Revenue Service ("IRS") related to the private management of tax-exempt financed facilities. For example, the maximum length of a management contract with a private entity has been expanded to 30 years (from 15 years) or 80% of the expected useful life of the facility, whichever is shorter. Under the contract, a manager's compensation can be set as a fixed or variable fee that covers all of a private entity's costs, plus a profit percentage, as long as the payment amounts are considered to be reasonable. Private entities are now more motivated towards managing facilities owned by public agencies or nonprofits that can take advantage of lower tax-exempt interest rates and higher loan/value ratios through the use of LRBs/COPs. In many cases, the construction of a municipal or nonprofit leased or owned facility can be undertaken by a private entity that is paid a development fee and then acts as manager of the facility for the following 30 years under a management contract.

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