

### A handy guide to some of the terms used in leasing documents.

- **Arrears** (also called payment in arrears) - a lease payment structure in which payment is due at the end of each period, as opposed to advance payment.
- **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).
- **Effective Interest 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.)
- **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.
- **Forms 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. The form requests information regarding general purpose, general financial terms, the exemption used for tax-exempt private activity bonds, and transmittal of arbitrage rebate amounts.
- **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.
- **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.
- **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).



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### What Makes a Transaction Tax-Exempt?

- Lessee must be a government unit (as defined in Section 103 of the Internal Revenue Code) or a qualified entity of the type eligible to issue tax-exempt bonds [501(c)(3)].
- Lease purchase obligation must be incurred under the lessee's borrowing power and must contain a clearly defined "interest" component.
- Transaction must be an installment sale (acquisition of an asset not a rental) and not a true lease.
- Transaction must comply with the rules of Sections 103 and 141-150 of the Internal Revenue Code related to arbitrage, regulations, governmental usage purposes (as opposed to private activity) and other issues.

### What are Badger Meter's Additional General Requirements of a Tax-Exempt Transaction?

- Lessee must be a state or local governmental unit or a highly rated 501(c)(3) entity. The asset must be used for essential governmental usage purposes and lessee must represent they will not impair the tax-exempt status of the transaction (i.e., private activity issue or violation of management contracting rules, etc.)
- Non-appropriation is the only acceptable reason for termination (i.e., no termination for convenience).
- Lease/purchase agreement must be separate from vendor service or performance agreements. Also, the payment must be unconditional (other than non-appropriation) and not subject to set-off for any reason.
- Lessee must be responsible for taxes, insurance and maintenance (triple net).
- Lessee holds title and lessor has a security interest (exceptions can be structured to comply with prevailing state statutes).
- Vendor makes a disclaimer of warranties and risk of loss is with lessee.



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### What is a Tax-Exempt Lease?

- A contract that allows a public entity to purchase equipment and related services (subject to IRS rules) by making periodic payments over the useful life of the asset (i.e., an installment purchase contract)
- Included as a line item in the lessee's operating budget and not considered debt
- Interest income for lessor is tax-exempt because the customer is a government entity
- Interest rates are lower than commercial rates due to the tax-exempt treatment
- Lease payments are subject to annual budgetary appropriations by the municipality
- Unlike debt financing, voter referendum is generally not required

### Who is Eligible?

Any municipality or political subdivision which can issue tax-exempt securities generally can utilize tax-exempt leasing:

- States
- Counties
- Cities
- School Districts
- Universities
- Hospitals
- Special Purpose Districts
- Section 501(c)(3) Not-for-Profit Organizations

### What Assets are Commonly Financed?

Essential-use assets may be financed under a lease purchase:

- Water metering systems
- Computer hardware & software
- Telecommunications systems
- Energy management systems

### What are the Benefits of Tax-Exempt Leasing?

- Low-cost, tax-exempt capital
- Maximizes use of budgeted funds
- Matches expense with product useful life
- No debt created
- Flexible repayment terms
- Protection against obsolescence
- Easy to upgrade financed assets
- Simple & quick



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# Benefits of Leasing

## Lease vs. Purchase Scenario

### How to increase your purchasing power by using a tax-exempt lease structure versus a cash purchase:

- You have allocated \$5,000,000 per year for the next three years for water metering expenditures (a total of \$15,000,000 during that period). Under a cash purchase scenario, you would only be able to purchase \$5,000,000 of equipment per year in order to comply with your budgetary allocations.
- By using a tax-exempt lease purchase, you can purchase \$13,654,602 worth of equipment while preserving your currently allocated budgeted payments. The greater purchase now allows you to receive immediate benefits from your system upgrade. Because of the tax-exempt status, you receive lower interest rates, which translate into lower monthly payments (and greater purchasing power). Flexible repayment terms also allow for convenience and flexibility.
- A tax-exempt lease purchase is a “win-win” proposition for you and your constituents. (See example below).

### Example Amortization Schedule:

Totals:	Payments	Interest	Principal	Rate		
	\$15,000,000	\$1,345,398	\$13,654,602	4.850% (factor .366177)		
	Outstanding Payment #	Payment Date	Payment Amount	Interest	Principal	Balance
		10/15/03	\$13,654,602			
	1	10/15/04	\$5,000,000	\$662,248	\$4,337,752	\$9,316,850
	2	10/15/05	\$5,000,000	\$451,867	\$4,548,133	\$4,768,717
	3	10/15/06	\$5,000,000	\$231,282	\$4,768,717	\$0.00

### Purchase Scenario

	First Year	Second Year	Third Year
Annual budgetary allocation for equipment	\$5,000,000	\$5,000,000	\$5,000,000
Cost of each unit of equipment purchased	\$125	\$125?	\$125?
Number of units purchased	40,000	40,000?	40,000?

### Lease Scenario

	First Year	Second Year	Third Year
Annual budgetary allocation for equipment	\$5,000,000	\$5,000,000	\$5,000,000
Cost of each unit of equipment purchased	\$125	\$0	\$0
Number of units purchased	109,236	0	0



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