

## **The Use of Revenue-Backed Lease-Purchase Agreements in the State of Arkansas**

Traditionally, cities, counties, and other governmental entities in the State of Arkansas have relied upon traditional bond financing in connection with the development of their capital improvement projects. In recent years, however, similar issuers across the nation have been utilizing "lease-purchase agreements" in order to accomplish these development projects. The laws of the State of Arkansas similarly allow cities, counties, and other governmental entities to utilize lease-purchase financing in connection with their project developments; and many such issuers have found this to be a less document-intensive manner of accomplishing their goals. This report sets forth a summary of the various Arkansas laws that provide for and allow governmental entity lease-purchase agreement financings.

1. The Lease-Purchase Agreement. The lease-purchase agreement constitutes and comprises a financial obligation of the lessee (the city, county, or other governmental entity). Among other things, the lease-purchase agreement provides that (a) title to the improvements will pass to the lessee upon execution of the lease-purchase agreement but is capable of being reverted back in favor of the lessor should the lessee default in its obligations, (b) each monthly rental payment due under the lease-purchase agreement expressly references a separate principal and interest component which collectively equal the monthly installment sum, (c) all taxes, insurance, operating and maintenance costs and other costs of whatever nature are exclusively borne by the lessee, (d) upon the lessee's payment and completion of all of its financial obligations under the lease-purchase agreement, title to the equipment to the project and its equipment will irrevocably vest in the lessee. The scenario referenced above is recognized by the Internal Revenue Service as constituting a "financing lease" as opposed to a "true lease." The Internal Revenue Service has recognized that municipalities executing financing leases are afforded tax-exempt treatment with regard to those interest components expressly identified therein. The lease-purchase agreement format has been carefully structured so as to take advantage of other provisions of the Internal Revenue Service that serve as a condition to a tax-exempt financing determination. (A "true lease" is one wherein the governmental entity accrues no equity towards its purchase and, at the lease agreement's termination, the lessee either loses its rights to the property, can re-lease the property for a subsequent term, or can acquire the property for its fair-market value.)

2. Revenue Bond. Amendment 65 to the Arkansas Constitution provides that any governmental unit may issue revenue bonds for the purpose of financing all or a portion of the costs of capital improvements of a public nature. Section 3 of Amendment 65 provides that the term "revenue bonds" shall mean "all bonds, notes, certificates, or other instruments or evidences of indebtedness, the repayment of which is secured by rents, user fees, charges, or other revenues . . . . derived from the project, or from the operations of any other special fund or source other than assessments for local improvements and taxes." In other words, Amendment 65 does not mandate that a "revenue bond" look precisely like a traditional bond issue. Rather, a "revenue bond" can mean any "evidence of indebtedness." A lease-purchase agreement such as the type described above is such an "evidence of indebtedness" for Amendment 65 purposes.

3. Special Fund or Source Other Than Assessments for Local Improvements. As noted above, revenue bonds may only be funded by fees derived from the operation of the project or from special funds or other sources other than assessments for local improvements and taxes. In other words, to the extent that the contemplated improvement does not generate revenues, such as a city hall, other available revenues and sources of funds generated by the governmental entity may be pledged to the repayment of the revenue bond as evidenced by the lease-purchase agreement. Such funds would include, without limitation, excess water and sewer revenues, fines and forfeitures, utility company franchise fees, and other "enterprise revenues."

4. Revenue Bonds Require No Vote. In a long line of cases, the Arkansas Supreme Court has concluded on numerous occasions that the issuance of revenue bonds does not require a vote of the electorate so long as the full faith and credit of the governmental entity is not additionally being pledged in support of the repayment obligation. (Special Note: Amendment 78 to the Arkansas constitution allows a city or a county in certain circumstances to become fully financially obligated to a debt so long as the debt does not have a term in excess of five years.) Accordingly, revenue bonds need merely be approved by the governing body of the governmental entity.

5. Miscellaneous Provisions. To the extent that the issuer of a revenue-backed lease-purchase agreement is a city or county, then Arkansas law will mandate that the resolution authorizing the issuance of the agreement be published in a newspaper and that the electorate shall have a thirty-day period of time during which it can, upon petitions presented, refer the resolution to the electorate for a full vote. Arkansas Code Annotated § 9-19-601, *et seq.*, additionally mandates that notice of the issuance of revenue bonds be published of record and that a hearing be held at least ten days after the date of publication.

6. Conclusion. In conclusion, revenue-backed lease-purchase agreements appear to be consistent with the laws of the State of Arkansas and represent a cost-efficient means pursuant to which governmental entities may fund project improvements in an efficient and less paper-intensive manner.

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