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OFFICE OF THE PUBLIC DEFENDER
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ADMINISTRATIVE AND RESEARCH OFFICE
BUDGET, PROGRAM PLANNING AND MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION

October 17, 2001

DIRECTOR OF FINANCE MEMORANDUM — Memo No. 01-21

TO: All Department Heads

FROM: Neal Miyahira
Director of Finance

SUBJECT: Financing Agreement Program as Authorized by Act 200, SLH 01

Act 200/01 amends Chapter 37D, Hawaii Revised Statutes, relating to the management of financing agreements, and authorizes the State to implement a centralized financing agreement program for the lease/purchase of essential equipment (hereinafter referred to as the "Master Lease Program" or MLP). The intent of the MLP is to centralize and aggregate the purchase of essential equipment to obtain financing at a more favorable interest rate than would be possible if your agency were to negotiate a lease/purchase agreement directly with a vendor.

The implementation of MLP is necessary because under the provisions of Act 200/01, State agencies (with the exception of the Hawaii Health Systems Corporation and under certain circumstances for the University of Hawaii) may no longer enter into a financing agreement except through the Department of Budget and Finance.

In order to design an effective program, we need your assistance and input. The purpose of this memorandum is to assess your agency's needs for depreciable equipment and the potential cost of the program. Please complete the attached survey by October 31, 2001. It is my intent to continue a discussion on this as we progress in the program design; therefore, meetings with interested departments will be conducted on an as-needed basis in the next few months.

Attached is some general background information. Should you have any questions or would like to comment further, please contact me or your staff may contact Ms. Kay Ewaliko at 586-1641 or email at Kay_T_Ewaliko@exec.state.hi.us.

Attachments

Financing Agreement Program (Multiple Lease Program) Frequently Asked Questions:

What is the "financing agreement program"?

Prior to recent amendments, Chapter 37D, HRS, allowed the State to use financing agreements to procure equipment and fund capital improvement projects. Upon the approval of the Department of Budget and Finance (B&F) and the Attorney General (AG), any State agency could enter into a financing agreement using operating funds regardless of the means of financing.

Act 200, SLH 2001, amended Chapter 37D to establish the financing agreement program and no longer allows an agency to negotiate financing agreements (with the exception of the Hawaii Health Systems Corporation and the University of Hawaii under certain circumstances). B&F is now the State coordinator for all financing agreements. The purpose of creating a centralized lease program is to be in a better position to obtain favorable financing terms and rates.

What is a "financing agreement"?

A financing agreement is an agreement to finance the improvement, use, or acquisition of real or personal property that is or will be owned or operated by the State or any State agency and is structured to amortize the purchase price of an asset. Under an "operating" or "true" lease, the State rents property for a period of time and at the end of the period of time, the property is returned to the lessor. Payments are considered "rent" and not as payments of principal and interest, and no component of the rental payment is tax exempt. Under a financing agreement, principal and interest are part of the payments and, assuming compliance with applicable State and federal laws, the interest portion of the lease payment is exempt from federal and State taxes.

What can be funded by a financing agreement?

Equipment, motor vehicles, medical equipment, emergency vehicles, etc. that are essential to the agency's operations with a useful life of at least two years are good candidates for a financing agreement because the payments can be amortized over the useful life of the acquired item. Lease/purchase is not used as a source of funding for items of a consumable nature such as office supplies. The leasing of office space is considered a "true" lease (we pay for the use of the leased property but do not intend to purchase it) and would not be funded by a financing agreement unless the State decides to purchase the office space (as in the case of the Hemmeter Building).

What is the advantage of lease/purchase versus outright purchase?

The outright purchase of equipment typically requires a large, one-time expenditure for which that current year's revenue projections may not be able to accommodate because of other more critical budget requirements. Under the lease/purchase arrangement, an agency can acquire more of the equipment it needs and spread the costs over time to match the useful life of the equipment.

What are the disadvantages of acquiring equipment using the lease/purchase option?

The funds used for financing agreements are not considered "debt" which is backed by the full faith and credit of the State as in the case of general obligation bonds. Under the provisions of Chapter 37D, HRS, payments for financing agreements must be appropriated by the legislature for the fiscal periods in which the payments are due; however, the legislature is not obligated to appropriate or otherwise make the moneys available.

As such, should the legislature not appropriate funds for the payments, an agency would lose the use of the equipment acquired by a financing agreement because the equipment would revert to the lessor. Agencies must make a good faith effort to include the amounts in their budgets (Table BK of the budget details must be used to show the requested/appropriated financing agreement amounts; "true" leases not involving purchase will continue to be displayed in Table BJ-2, Other Current Expenses). Although no one can predict with any certainty whether the legislature will or will not fund such payments, it is expected that due to the "essential to State government operations" nature of the funded equipment, continued funding would be made available.

What's next?

In order to design a financing agreement program that provides the State with the optimum flexibility and usefulness, we need to first assess the potential scope of the program. Completing the enclosed survey in a timely matter is the first step in this process.

DEPARTMENT:

CONTACT PERSON/TITLE:

PHONE NUMBER:

Present Lease/Purchase Agreements (AS BUDGETED IN TABLE BK OF BUDGET DETAILS; OR REQUESTED IN FY 03 SUPPLEMENTAL BUDGET):				
Prog.ID/org.code:	**Item/Purpose:**	**FY 02**	**FY 03**	**MOF**
	(indicate if item is budgeted in Act 259 or requested in			
	FY 03 Supplemental Budget submitted to B&F)			

Operating Budget Leases (STRAIGHT LEASES OF EQUIPMENT/OTHER ITEMS; NO PURCHASE INVOLVED, DO NOT INCLUDE OFFICE LEASING):				
Prog.ID/org.code:	**Item/Purpose:**	**FY 02**	**FY 03**	**MOF**

Equipment (including portable buildings and motor vehicles) to be acquired with an expected useful life exceeding 2 years					
Prog.ID/org.code:	**Item/Purpose:**	**FY 03**	**FY 04**	**FY 05**	**MOF**
	(FY 03: as budgeted in Act 259 or requested in FY 03 Supplemental budget submitted to B&F)				
	(FY 04-05: as a projected budget request for the next biennium)				