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LEASING TO THE FEDERAL GOVERNMENT

OVERVIEW

The Federal Government may acquire equipment by purchasing it outright, renting it or through lease financing. Their decision to lease is based on budgetary restrictions and the planned use of the equipment. When they decide to lease, the responsible contracting officer will receive vendor proposals which, upon request by the government, will include finance Terms & Conditions (T'&C). Upon award the vendor is called a Contractor. The Contractor provides the equipment per the terms of the award and will be the party to whom the government issues it's Purchase Order (P.O.) with all the T&C inside. The Contractor, working with a 3rd Party funding source such as Leasource Financial Services (Assignee), assigns it's interest in the stream of payments to the assignee and is able to book a cash sale.

Reciprocal Immunity Agreement. Seventy years ago, the FED and the States agreed to exempt each other's debt instruments from any applicable income tax liability. Municipal debt instruments, including leases, are exempt from both federal and state income tax. Although federal leases are exempt from state income tax per the Agreement, they are federally taxable the same as Treasury Notes and bonds and other federal debt instruments. Federal lease finance rates are higher than municipal rates because they are federally taxable and they bear a greater default risk.

Assignment of Claims Act. The participation of financial institutions in federal leases is allowed under the Assignment of Claims Act of 1940. Under the Act, payments due from the Government to a vendor (Contractor) for an equipment lease may be assigned out of the original government purchase order while leaving warranties and other issues with the Contractor.

Federal Acquisition Regulations (FAR). Federal procurement is highly regulated. The FAR determines individual agency policy & procedures.

TYPES OF LEASES

A. Lease To Ownership Plan (LTOP)

Under the LTOP, the Government intends to own the equipment. The Government's equity in the equipment increases with each payment and fully amortizes over the term of the lease with no balloon payments due at the end.

B. Lease with Option to Own (LWOO)

Under the LWOO, the Government has the option to purchase the equipment at specified times throughout the lease and at the end of the lease term for a predetermined price. As each payment is made, credits accrue to the Government, and the purchase option price is the cost of the equipment less any accrued credits. At the end of the lease term, the Government may purchase the equipment for a previously agreed upon price, return it to the Lessor or negotiate a new lease.

C. <u>Straight Lease</u> (Rental)

When using a Straight Lease or Rental, the Government does not have the intent to own the equipment, and does not accrue any equity in the equipment. Payments are made over the term of the lease. At the end of the original term, the equipment is returned to the Lessor or a new lease is negotiated.

RIGHTS OF TERMINATION

Pursuant to the FAR, the Government enjoys the right to terminate contracts for a variety of reasons. These rights typically pass through to the Government's contractor.

Termination for Default

Under the FAR, the Government may, at its sole discretion, terminate a contract for any default of the contractor (FAR 52.249-8). This clause is mandatory in all federal contracts. **Default includes, but not limited to, <u>non-performance of either the equipment</u> or the Contractor**. By exercising this right, the Government is not obligated to make any additional payments to the contractor or its Assignee/Lessor. The defaulted contractor may also be liable to the Government for any costs incurred by the Government in acquiring the defaulted products from a more expensive source.

Financing between the Contractor and Assignee/Lessor is done on a non-recourse basis. Assignment documents between the Contractor and Assignee/Lessor contains language which clearly indemnifies the assignee against any loss due to performance deficiencies. In this event, the Contractor is obligated to make the Assignee/Lessor whole, including payment for loss profits. The Contractor is then free to pursue further negotiations with the Government.

Termination for Convenience

Under FAR 52-249-2, Termination for Convenience (T for Q is mandatory in all fixed-price contracts over $100,000.00. Unlike Termination for Default, it is customary for the leasing company to assume the risk of Termination for Convenience. Under this termination right, the Government has the right to terminate the lease at any time it is determined to be in the best interest of the Government. They may not, however, exercise this right in order to avoid contractual obligations. In the event of a T for C, the Contractor is required to assist the Assignee/Lessor in re-marketing the returned equipment.

The best protection for all parties is to insure that the equipment is essential and that its useful life exceeds the lease term.

Termination for Non-appropriation

As with municipal leases, most leases to the Government are subject to annual appropriations. The Government may terminate the lease without liability at the end of each year if funds are non-appropriated. Non-appropriation is a risk that is assumed by the Assignee/Lessor.