

Local Option Capital Asset Lending Program (Washington)

Organization Size: 7 schools (3,400 students in K-12)
Project Scope: Replaced boilers, water conservation, lighting system upgrades
Project Cost: \$1.3 million
Type of Financing: Pooled tax-exempt lease purchase agreement
Other Sources of Funding: \$500,000 state grant, \$200,000 utility incentives
Simple Payback Period: 6.5 years (net project cost / savings per year)
Key Benefits: Energy savings, replacement of aging equipment

In 2009, Washington's Centralia School District pulled together several sources of funding to make \$1.3 million in facilities improvements that reduced the school district's energy and water usage. In addition to a \$500,000 state grant and \$200,000 in incentives from the utility, Centralia financed much of the project through the state's low-cost Local Option Capital Asset Lending (LOCAL) program, which aggregates lease-purchase financing demand from public entities across the state and issues Certificates of Participation (COPs) to fund these projects.

LOCAL Serves All of Centralia School District's Financing Needs

Like all school districts, Centralia has regular needs for capital to fund building repairs, equipment, and infrastructure. The residents of this cash-strapped region are reticent to pass new property taxes, so the school district needed to find other sources of funding. The school district turned to Washington's LOCAL program, which has become their primary source of third party capital for a range of projects, from new school buses to energy efficiency upgrades.

Centralia School District worked with an energy services company (ESCO) in 2009 to define a scope of work that included replacing two boilers and overhauling a third, upgrading lighting, and reducing water usage through measures such as replacing toilets and sinks. The total cost of the project was \$1.3 million and they secured a \$500,000 state grant to pay for part of the costs. They put an additional \$100,000 down from the school district's general fund, leaving them with a balance of \$700,000 to be financed through LOCAL (\$200,000 of utility incentives were received after the project was completed and financed).

Lowering Costs with State-Pooled Tax-Exempt Lease Purchase Financing

Many school districts use tax-exempt lease-purchase financing to fund energy conservation projects, but the LOCAL program makes this financing cheaper and more accessible. Lease-

purchase agreements allow schools to purchase equipment or real estate, using the equipment or real estate itself as the security. The LOCAL program aggregates these projects, enabling participants to get more attractive rates than they would otherwise have access to and avoid the time and effort required to set up their own individual financing options. “LOCAL is our main financing tool – we can’t get better rates anywhere,” says Centralia School District’s Director of Fiscal Services, Mitch Thompson, “The program is easy to use, and the staff is knowledgeable and responsive.” Over the past 6 years, Centralia School District has used the LOCAL program to finance over \$2.3 million for energy projects, as well as school buses, and other buildings upgrades and equipment.

The LOCAL program aggregates the lease-purchase financing needs of entities across the state and issues Certificates of Participation (COPs) twice a year to fund these projects. COPs are marketable securities sold to investors – because they are more liquid (i.e. easy to sell to other investors), they typically attract a broader investor base and more competitive terms than privately-placed leases. In the most recent round of LOCAL funding, the rates were between 0.76% and 1.89% for terms between 2 and 10 years (issuances in the last two years have had rates up to 3.24% for terms up to 15 years). The COPs give investors a fractional interest in the underlying leases; lease payments are passed through to investors based on the fraction of the outstanding COPs they own and the COPs are ultimately secured by the equipment or real estate that secures the underlying leases.

One of the reasons that the LOCAL program delivers such attractive rates is that it includes additional sources of security beyond those typical of a lease-purchase agreement:

LOCAL is our main financing tool, we can’t get better rates anywhere

– **Mitch Thompson**, Director of Fiscal Services at Centralia School District

1. The LOCAL program requires participating entities to make a general obligation pledge. This is atypical for lease-purchase agreements in other states (where security is typically limited to the underlying equipment or real estate), but is standard practice in Washington. In many other states, lease-purchase agreements include “non-appropriations” provisions, which mean that the debt is only paid if the funds are appropriated by the school district’s governing body each year. Because taxpayers are not at risk of having to repay the lease-purchase agreement if funds are not appropriated, this mechanism typically allows school districts to raise capital without voter approval and without the lease counting against their debt limits. However, in Washington all local government leases are subject to debt limitations and represent general obligation

pledges. The state's limit on non-voted debt for schools is a maximum of 0.375% of assessed property value (versus 5% for voted debt).

2. The COPs have an intercept provision, which allows the State Treasurer to step in and make the payment on behalf of the district in the event of nonpayment. To date, they have never used this provision, as no entities have ever missed a payment. As a result, the current program rating is Moody's Aa2.

The structure and ease of use of the LOCAL program has made it an important tool for schools in Washington. To date, the LOCAL program has financed over \$21 million in energy projects for 38 the state's school districts.

Performance of Initial Project Leads to Additional Investment

Centralia's energy upgrade performed as expected, but to ensure that the school district would have the funds to make the lease-purchase payments, Centralia signed an energy savings performance contract (ESPC) with the ESCO that performed the energy upgrades. After completing the project, the school district also received \$200,000 in energy efficiency incentives from the utility that they hadn't originally expected. One drawback of the LOCAL program is that it does not allow pre-payments, so this cash went back to the school's coffers to fund other school activities, instead of paying off part of the lease early.

As a result of this initial experience Centralia School District continues to invest in projects that reduce their energy use – in 2012, they initiated a \$1.5 million project to complete more lighting replacements, water conservation upgrades, and to replace the heating and pumping systems at the district's pool, again using financing from the LOCAL program to fund part of this work.

Resources

Washington's Local Option Capital Asset Lending (LOCAL) program:

<http://www.tre.wa.gov/LOCAL>

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