
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: # 59

Master Lease Agreement to Fund Vehicles and Equipment

OVERVIEW

The City Council is being asked to approve an ordinance authorizing the form and execution of a Master Lease Agreement with Chase Equipment Finance, Inc. (Chase) to finance a portion of the City's annual vehicle replacement and equipment needs. The Master Lease Agreement authorizes lease purchase financing for General Fund vehicles and equipment identified for replacement in an amount not to exceed \$9.6 million for Fiscal Year 2011 and not to exceed \$12.6 million for Fiscal Year 2012. After receiving a presentation on this item on December 1, 2010, the Budget and Finance Committee unanimously forwarded this item to the City Council for consideration. This report discusses the City's use of lease purchase financing for fleet replacement needs, comments on budgetary considerations associated with fleet replacement/expected useful life policy and notes certain terms associated with the requested financing.

FISCAL/POLICY DISCUSSION

The City's use of Lease Purchase Financing to Address Fleet Replacement Needs

As noted in the staff report, the City fleet is comprised of approximately 4,045 General Fund and non-General Fund motive equipment items. The Fleet Division of the General Services Department annually assesses all fleet equipment by looking at mileage, technological needs and expected life cycle. Based on an evaluation of these factors, the Fleet Division identifies certain vehicles for replacement every year. The underlying rationale for this practice is that at some point it is cheaper to replace motive equipment than it is to maintain and repair it.

Annual assignment fees are paid by benefitting departments to cover the cost of motive equipment replacement. Annual assignment fees can be accumulated over multiple years to provide funding for motive equipment replacement thereby spreading the cost and ensuring funds are available at the time replacements are needed. Assignments funds can either be used to cash fund or finance annual motive equipment needs. Staff indicates that non-General Fund departments have historically budgeted sufficient assignment fees to cash fund almost all of their annual motive equipment replacement needs. The City has chosen to utilize lease purchase financing for General Fund equipment needs as a cost savings measure to provide annual budgetary relief.

The collection of assignment fees is an effective way to internally finance the replacement of motive equipment. The use of lease purchase financing further leverages the City's ability to annually replace needed equipment at competitive interest rates. The General fund has utilized lease purchase financing for many years. A decision not to use lease purchase financing might result in one or more of the following: 1) further deferring equipment replacement and incurring greater maintenance/repair costs; 2) holding insufficiently maintained vehicles out of service; or 3) increasing General Fund department assignment fees at the expense of other public services.

As long as the term of the financing does not exceed the expected useful life of the motive equipment being financed and interest rates are relatively low, lease purchase financing a portion of the City's annual equipment needs is a reasonable budgetary approach. Based on information received from staff it appears that all of the equipment identified for lease purchase financing in FY 11 and FY 12 has an expected useful life of seven years or more which equals or exceeds the term of the requested financing.

Considerations Associated with Deferred Replacement and/or Expected Useful Life

Owing to disagreement related to the proposed financing of new types of equipment in June 2009, the City Council opted not to approve a Master Lease Agreement for Fiscal Year 2010. Fleet Division was therefore only able to cash fund motive equipment scheduled for replacement in Fiscal Year 2010. Assignment fees contemplated lease financing a portion of the replacement motive equipment at a lower annual cost. Some of the equipment scheduled for replacement in Fiscal Year 2010 was not replaced. It should also be noted that one of the budget adjustments for Fiscal Year 2010 and Fiscal Year 2011 was to unilaterally increase the useful life cycle on all motive equipment by two years. This change is expected to save the City approximately \$10 million over the two years. Staff indicated at the time that the impact to service levels would include "an overall aged fleet and potentially increased repair and maintenance costs".

In order to realize much needed budget savings, there may be future proposals to defer the replacement or extend the expected useful life of motive equipment. If so, improved equipment technology (i.e., Global Positioning Systems) and/or better maintenance practices may be able to partially offset some of the additional maintenance/repair expense. Increased use of lease purchase financing could also be used to reduce annual General Fund expense. The IBA recommends that any new proposals to further defer

replacement or stretch the expected useful life of motive equipment be carefully evaluated against potentially greater maintenance and repair costs in the long run.

Equipment to be Financed

Attachment 2 in the staff report lists five classes of motive equipment to be financed using the Master Lease Agreement. Equipment to be financed includes: light, medium and heavy duty vehicles; police motorcycles and scooters; and construction/off road vehicles. The financing request anticipates 186 or approximately 36% of 511 Citywide vehicles scheduled for replacement in Fiscal Year 2011 would be financed for an amount not to exceed \$9.6 million. Approximately 245 or 72% of 341 Citywide vehicles scheduled for replacement in Fiscal Year 2012 would be financed for approximately \$11.3 million.

The remainder of the not-to-exceed \$12.6 million financing authorization (\$1.3 million) sought for Fiscal Year 2012 is to procure new standard Global Positioning System (GPS) for all City vehicles. It is estimated that 68% of approximately 3700 new GPS units will be installed on General Fund vehicles. The \$1.3 million is a conservative estimate based on preliminary information from vendors. Competitive bids will be solicited once financing is approved. Although many City vehicles currently have varied GPS systems, staff informs the IBA that the reason for a new citywide GPS standard/purchase is: 1) consistency of GPS equipment to maintain/use; 2) accountability for City vehicle use; 3) to gather information that helps to efficiently maintain vehicles; and 4) to realize better unit pricing attributable to a larger quantity of units being purchased in the aggregate.

The requested GPS units are not what the public might think of when they think of GPS units used in many automobiles (Tomtom, Garmin, etc). The proposed GPS system is an effective management tool rather than a navigation tool. It is a modem that is invisible to the vehicle operator. The modem is tied into the vehicles ECM (Electronic Control Unit) as well as the vocational end of the vehicle (trash truck automated arm, street sweeper brooms, vactor trucks PTO). The Fleet Division anticipates that regular monitoring of the vehicle fleet will ultimately result in significantly reduced repair and maintenance costs. Some of the benefits to the Fleet Division and their customer departments include:

- GPS will enable the Fleet Division to receive an alert message regarding mileage for proper preventative maintenance intervals
- Onboard Diagnostics alerts
- Monitor idle time
- Vehicle speed
- Vehicle location/activity
- Assist with accident investigations
- Custom reporting

If the requested financing is approved, Fleet Division plans to issue an RFP in the next few months. The Division expects that all units would be purchased together and

installed over the course of Fiscal Year 2012 as vehicles are purchased or routinely maintained.

Notable Financing Terms

- Fixed interest rates are established when equipment is delivered and accepted by the City. Interest rates are determined by adding a pre-determined amount of interest (approximately 1.50% based on term and amount) to approximately 64% of the three or four-year LIBOR interest index. The LIBOR Index fluctuates with market conditions.
- Based on interest rates as of December 31, 2010, staff indicates that the fixed interest rate for a 7-year financing term would be 2.66%.
- In the event the LIBOR Index was to significantly increase resulting in an effective rate exceeding 6%, Article 2.1. of the Master Lease Agreement prohibits lease purchase financing.
- There are minimal costs associated with this form of lease purchase financing particularly when compared to the normal costs of issuance associated with other forms of debt (i.e., bonds).

CONCLUSION

The City Council is being asked to approve an ordinance authorizing the form and execution of a Master Lease Agreement with Chase Equipment Finance, Inc. The ordinance specifies that the total acquisition cost of the vehicles and equipment financed under the Master Lease Agreement shall not exceed \$22.2 million. Although this item has been docketed on the consent agenda and previously recommended for approval by the Budget and Finance Committee last December, the IBA has issued this report to provide additional information related to the requested action.

Given competitive financing rates and the desire to stretch limited General Fund resources to cost effectively maintain the City's fleet of motive equipment, the IBA believes it is a reasonable budgetary practice to lease purchase finance a portion of annual equipment needs. In their Debt Issuance Guide, the Government Finance Officers Association acknowledges the appropriateness of financing assets with longer useful lives in conjunction with cash financing. It is important to note that term of the financing does not exceed the expected useful life of the motive equipment identified for financing.

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