

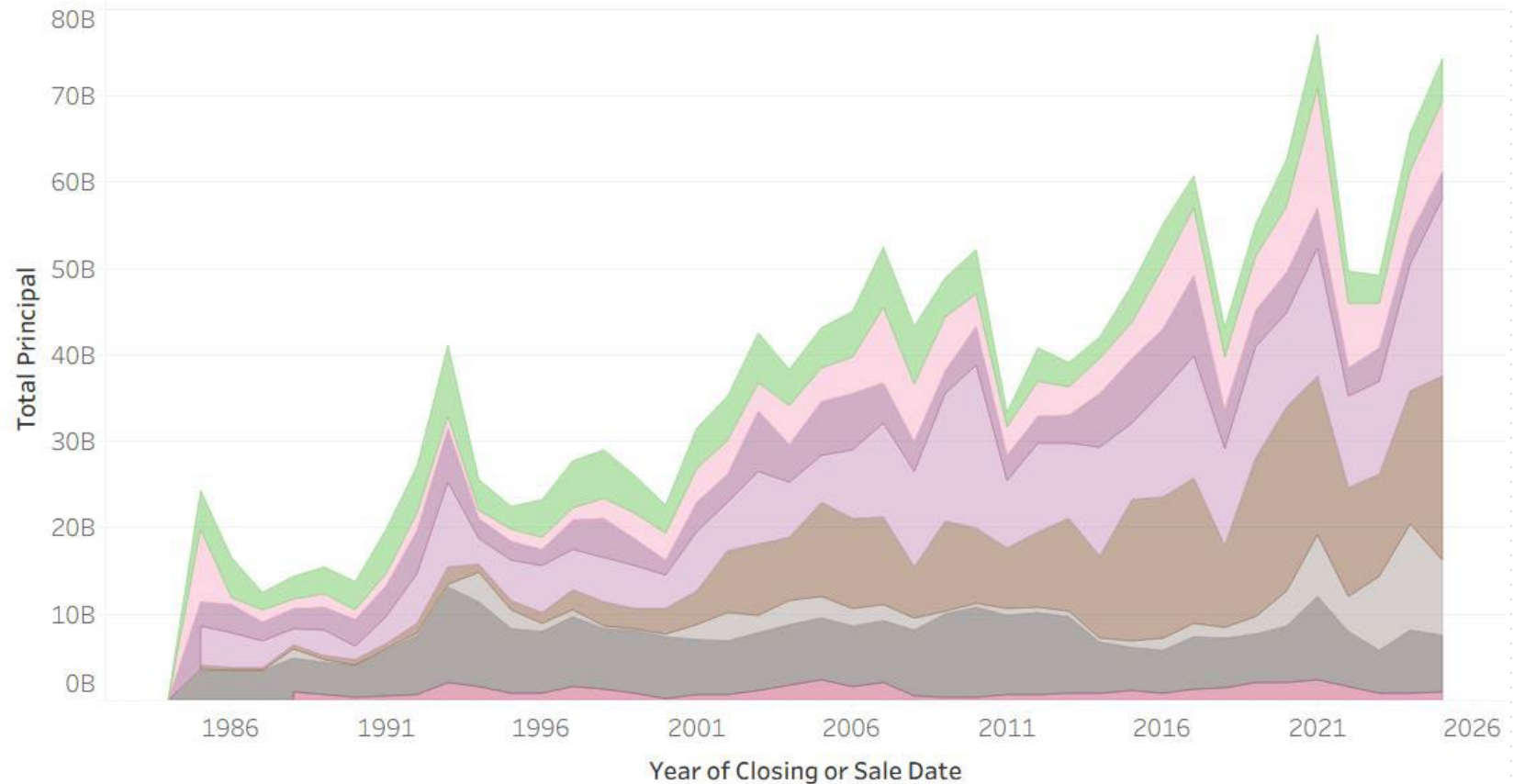


**LEGAL FOUNDATIONS AND STRATEGIC
STRUCTURING OF LEASE FINANCING**

PART 1: MAY 12, 10–11:30AM

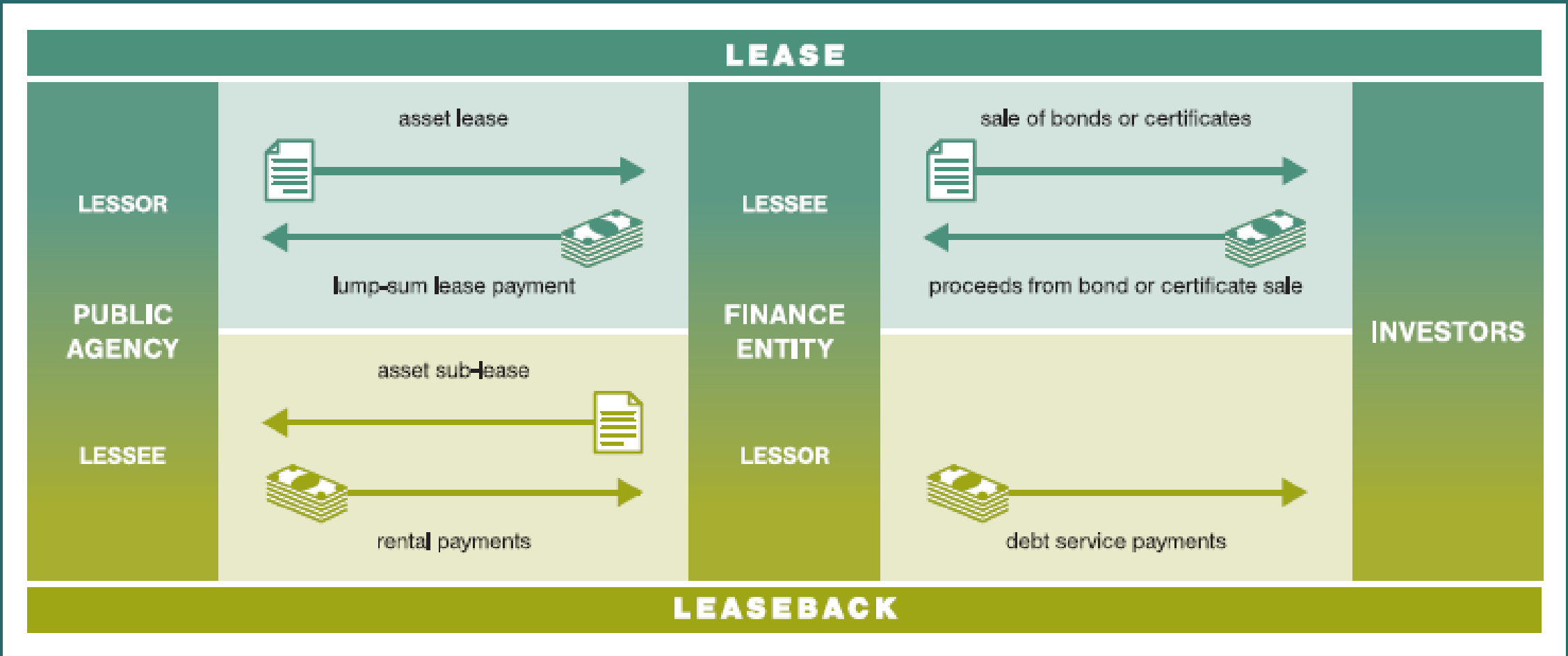
PART 2: MAY 21, 10–11:30AM

LOCAL AGENCY LEASE FINANCING TRENDS



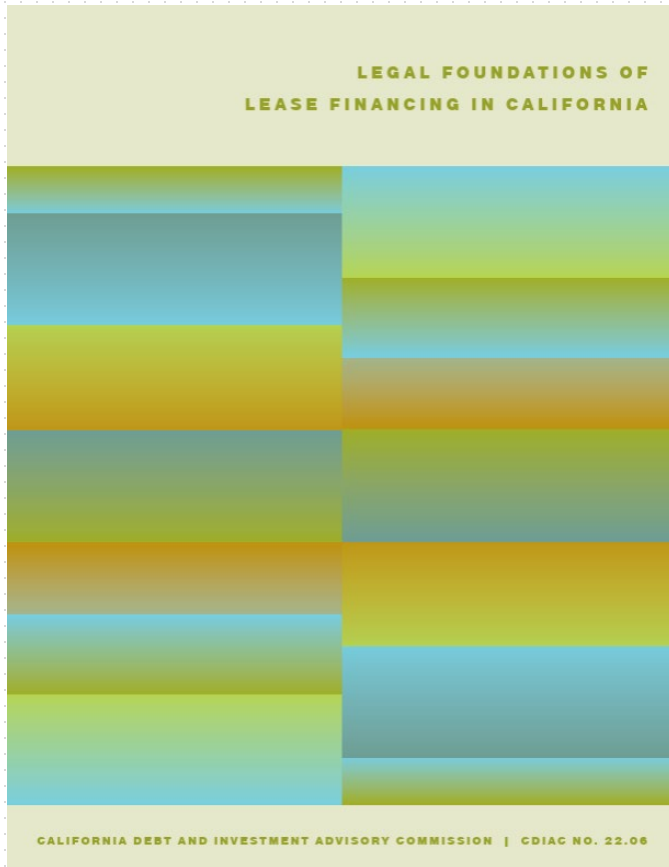
- Lease Debt
- Conduit Revenue Debt
- Limited Tax and Assessment Debt
- Public Enterprise Revenue Bond
- General Obligation Debt
- Other Debt
- CP/Short-Term Note
- Revenue Bond (Pool)

FINANCING LEASE STRUCTURE: “LEASE-LEASE BACK”

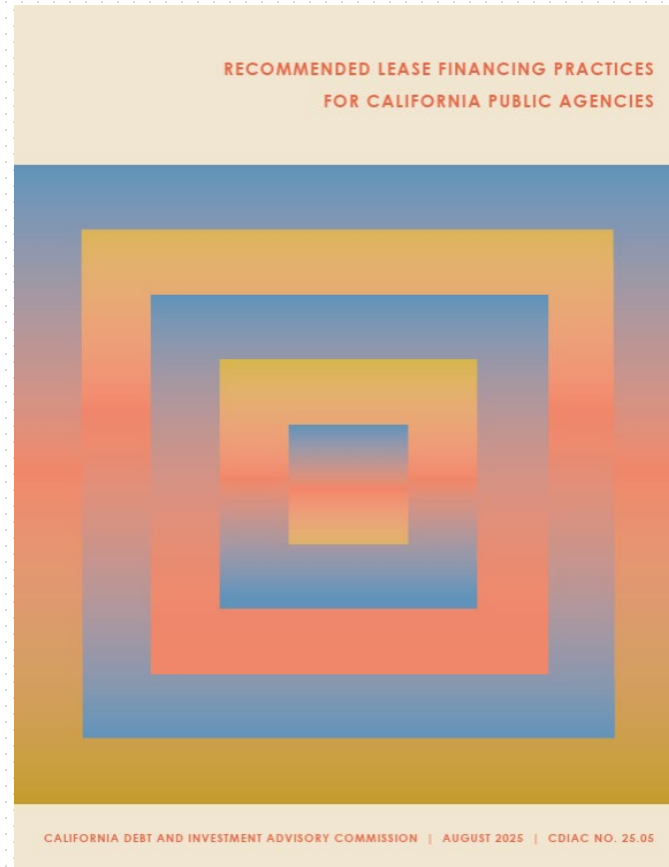


CDIAC's *Lease Financing in California* Series

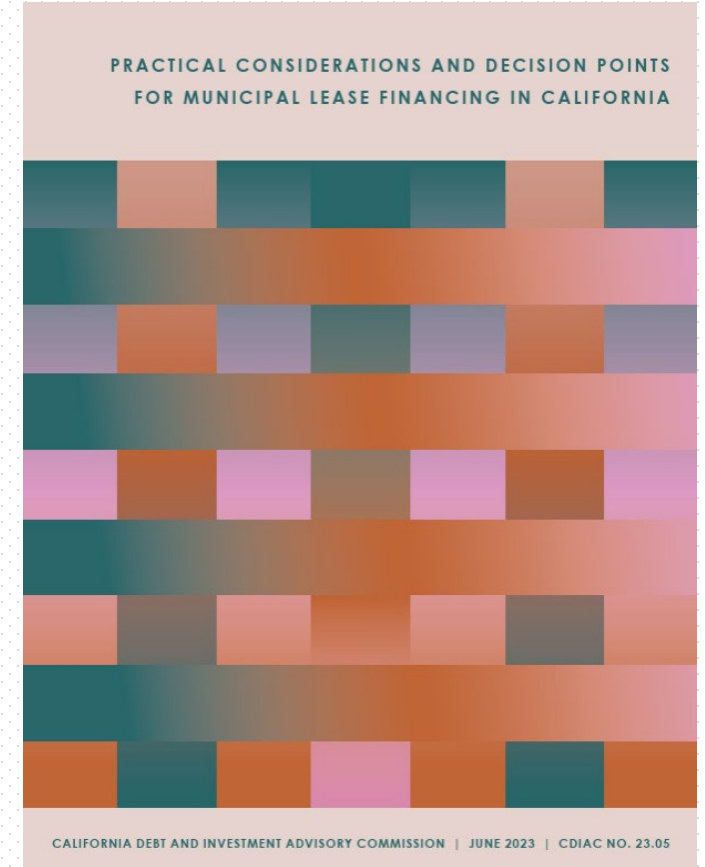
Legal Foundations of Lease Financing in California



Recommended Lease Financing Practices for California Public Agencies



Practical Considerations and Decision Points for Municipal Lease Financing in California



PART ONE: PROGRAM OBJECTIVES

- Examine the legal principals at the foundation of the “Lease Construct”
- Understand the structural elements of a financing lease that are necessary to establish and maintain the “Lease Construct”
- Recognize and consider structural elements that are not legally essential but warrant thoughtful decision-making by issuers.

HOUSEKEEPING

SLIDES

Available on CDIAC's webinar webpage: <https://tinyurl.com/2026Leases>.

QUESTIONS AND POLLING

Submit your questions through the Slido panel on the 'Q&A' tab to be addressed during the designated Q&A period. If you close the Slido panel, re-open it by clicking on  Apps

CAPTIONING

Turn on closed captioning using the  button at the bottom left of your screen.

CERTIFICATE OF ATTENDANCE

Sent to attendees who participate in 70% of the webinar within 2 weeks of initial airing.

WEBINAR REPLAY

A webinar replay will be available within 2 weeks of the initial air date on CDIAC's Education Portal, accessible via the webinar webpage: <https://tinyurl.com/2026Leases>.

TECHNICAL ISSUES

Visit Webex's Help Center at: <https://help.webex.com/en-us/contact>.

SPEAKER INTRODUCTIONS



DANIEL DEATON

Partner

Nixon Peabody LLP



JOHN PALMER

Partner

Orrick, Herrington & Sutcliffe



DAVID BRODSKY

Managing Director

KNN Public Finance

Lease Financing Has a Very Long History

The contractual separation of ownership from use—possession in return for rent—is among the oldest legal instruments known

~2000 BCE

SUMER AND BABYLONIA

Clay tablets discuss land, oxen, and tools leased in Mesopotamia. Code of Hammurabi regulates disputes

500 BCE–500 CE

GREEK & ROMAN LAW

Leases of public lands fund city-states while retaining municipal ownership

1100–1600

MEDIEVAL PROHIBITION OF CHARGING INTEREST

Forced to find structures *economically* equivalent to a loan but *legally* something else, canon lawyers debate, popes opine, and the lease survived as a legal financing instrument

1600–1872

ENGLISH COMMON LAW

Centuries of common law lease doctrine— term, quiet enjoyment, remedies, the landlord's retained reversion, and most relevant to municipal leasing, rent as consideration for current use— were codified in California law

1879–present

CALIFORNIA LEASE FINANCING

Municipal defaults → state constitutional debt limits → lease revenue finance workarounds

The Disease, the Remedy, and the Side Effects

The constitutional debt limit solved one problem and created another: it limited municipal fiscal recklessness but also blocked the capital finance required by a rapidly growing state

1820+

THE 19TH CENTURY STATE AND LOCAL DEBT CRISES

- State financing of canals and railroads (1820–1842), the Panic of 1837, State defaults → State debt limits added to most state constitutions
- Local railroad subsidies (1850–1873), the Panic of 1873, and local government default → Local government debt limits added to most state constitutions

1879

CALIFORNIA'S CONSTITUTION — ART. XI, §18

- 2nd State Constitution adds local government debt limit
- **Two-thirds voter supermajority required for any municipal indebtedness exceeding annual revenues**
- A higher threshold than most other states, significantly restricting local finance

1896

MCBEAN V. CITY OF FRESNO — THE CONDITIONAL OBLIGATION

- Fresno executed long-term contract for sewage disposal services
- Installment contracts are not “debt” if each payment is for consideration furnished that year
- Future obligations are contingent, not absolute

The Legal Framework of Lease Financing Established

Two key cases define the rules

1942

CITY OF LOS ANGELES V. OFFNER—CAPITAL LEASE NOT DEBT

- City contracts for private party to build and operate a rubbish incinerator
- City leases it and has an option to purchase in future at appraised value
- Relying on McBean, long-term lease with purchase option upheld
 - Payments must reflect fair rental value
 - Payment conditioned on use and occupancy
- Annual appropriation obligation ≠ constitutional debt

1950

DEAN V. KUCHEL — LEASE-PURCHASE IS OK

- State entered into long-term lease for a to-be-constructed office building
- Court relies on Offner analysis (different debt limit, same theory)
- Automatic vesting of title at end of lease does not change the analysis
- Contingency of the payment obligation — not resemblance to an installment purchase — is the determinative test

THE OFFNER-DEAN TEST

A lease avoids the debt limit if:

- Payments reflect fair rental value
- The obligation to pay is contingent on continued use
- No acceleration of rent as default remedy
- While the word “abatement” is not used in decisions, contracts provide that there is no payment of rental if there is no use or occupancy

1962

FIRST LEASE REVENUE BOND

Dorothy Chandler Pavilion: \$13.73MM

- Non-profit corp. as lessor
- Private placement to small group of institutions
- Private IRS letter ruling on tax-exemption

1963

REV. RUL. 63-20 CLARIFIES TAX-EXEMPTION

Not tied to any specific deal

- IRS consolidates prior ad hoc rulings
- Nonprofit corp. bonds are tax-exempt if title vests in government at bond retirement

1964

NATIONAL BANKS QUALIFY AS INVESTORS

Anaheim Baseball Stadium: \$21.5MM

- Issued by non-profit corp.
- Comptroller of Currency ruling allowed any national bank to invest up to 10% of capital and surplus
- Transformed a bespoke private placement market into a broad national institutional market

1965

FIRST JPA LEASE REVENUE BOND

Anaheim Convention Center Authority: \$14.5MM

- California JPA served as issuer
- Switch from non-profit → avoids possessory interest tax on leased property
- Private placement

1966

FIRST PUBLIC MARKET SALE — JPA

San Diego Stadium Authority: \$27.75MM

- First JPA bond sold at competitive public bidding
- No SEC no-action letter needed — JPA bonds are municipal securities
- Qualifying as public investment → secondary market liquidity → lower interest rates

FIRST NONPROFIT BOND — PUBLIC MARKET SALE

Orange Co. Manchester Office Building: \$2.2MM

- First nonprofit corp. bond sold at competitive public bidding
- SEC no-action letter obtained — emerging practice for nonprofit public sales

The 1960's: the Building of a Tool

The Municipal Lease Enters the Capital Markets

The Explosion of LRBs and COPs

Proposition 13 creates the need; LRBs and COPs fill the gap; Marks-Roos expands JPA authority; Rider v. San Diego validates the market

1978

Proposition 13 — Catalyzing Lease Debt

- Rolled back assessments of value
- Capped tax rate at 1% of AV
- GO approval legally unavailable
- Major resource reduction slashed municipal budgets
- Lease revenue debt emerged as dominant vehicle for municipal capital financing

Late 1970s–1980s

Certificate of Participation

- Gov. Code capped bond interest at 8%; COPs were not "bonds" and carried no cap
- Gov. Code required competitive bidding, in a world where negotiated sale was ascending in volatile markets
- In response, Offner-Dean doctrine mapped onto a trustee structure — no bonds issued and no enabling legislation required

1985

Marks-Roos Local Bond Pooling Act

- Multiple amendments to JPA act expands use as a financing instrument
- Easier to form JPA and flexible terms, reducing the need for the COP structure for cities and counties
- A "complete and supplemental method" — need not comply with any other state law on bonds

1998

Rider v. City of San Diego

- Taxpayers challenged a San Diego JPA as an impermissible end-run around the two-thirds vote requirement
- California Supreme Court reaffirmed the Offner-Dean principle and affirmed many features that had developed in the market

THE EVOLUTION IN A NUTSHELL

1879

California's Second Constitution — Art. XI, §18 Established Debt Limit

1896

McBean v. City of Fresno — The Foundational Rule of Contingent Obligations

1942

City of Los Angeles v. Offner — Lease is Not Debt

1950

Dean v. Kuchel — Lease Purchase is Not Debt

1960s

Lease Revenue Bonds Created to Fund Capital Projects

1978

Proposition 13 — Local Government Fiscal Crisis and the Explosion of Lease Debt

1998

Rider v. City of San Diego — Affirmation of Current Practices



I have never been more struck by the good sense and the practical judgment of the Americans than in the manner in which they elude the numberless difficulties resulting from their Federal Constitution—Alexis de Tocqueville



The Foundation: *Offner* and *Dean*

Doctrinal principles and market impact before Rider.

OFFNER

- *Offner* (1942) and *Dean* (1950) created the “lease exception” to California’s Constitutional Debt Limit: a bona fide lease with rent not to exceed each period’s fair rental value and subject to abatement does not create prohibited debt.
- Rent can not be accelerated (but prepayment may be permissible).

DEAN

- Automatic vesting of title at term end doesn’t make a lease invalid so long as rent remains for use and occupancy.

WHY IT MATTERED

Because the opinions were of limited scope and didn’t directly address how a lease would interact with bonds whose debt service was paid by lease payments, the practice was conservative: level debt service, static collateral pools, and limited structural flexibility.

- The supreme Court validated the use of a JPA as a separate public entity to issue lease revenue bonds, holding such bonds are not subject to the 23-vote requirement.
- Rider expressly applied Offner-Dean to modern lease-revenue financing structures in which rent equals debt service, extending the lease exception beyond true operating leases to lease-based capital financing.
- The Court reaffirmed that the lessee's obligation is limited to rent for use and occupancy, that rent may not be accelerated, and that abatement for loss of beneficial use protects against prohibited debt.
- The Court acknowledged it was validating a legal fiction but (or because) the fiction is structured within the constitutional authority of municipalities.

RIDER V. CITY OF SAN DIEGO

Rider v. City of San Diego (1999) enabled workable municipal lease prepayment, termination, remedies.

MARKET IMPACT

How lease documentation evolved to be more financeable while managing constitutional debt constraints.

- Issuers widely adopted lease-leaseback structures through JPAs or nonprofit lessors to access capital without a GO vote, provided documents included no acceleration, abatement, and fair rental value.
- Courts have treated Rider as controlling for city/JPA lease-lease back financings that mirror the Offner-Dean elements, reinforcing separation of the JPA's debt from the city's constitutional constraints.
- Legal uncertainties remain, including how to calculate fair rental value.
- We also know that we need abatement provisions, but because abatement is so rare, and, even in the case where the obligation is abated, the lessor often chooses to pay rent anyway, the mechanics of abatement remain obscure.

- Fully funded cash reserves → Surety Reserves
→ Partial Surety Reserves → No reserve.
- Focus on “essentiality”: the idea that the essentiality of an asset determines how likely a lessor is to walk away from the lease has proven unnecessary – entities have continued to pay on non-essential leases even during periods of abatement.

DISAPPEARING CONVENTIONS

ADDITIONAL BONDS AND REMEDIES

Persistent conventions (uncertain value) | Practices that have functionally disappeared

ADDITIONAL BONDS

- The market has also evolved away from a rigid “value = par” approach, and toward permitting additional bonds if rent remains within FRV using appreciated asset value / updated appraisals.

REENTER AND RELET

- The market has moved away from mandatory reenter and relet remedies – many deals are now getting done without these remedies, reflecting a growing understanding that the real property isn’t collateral for bondholders.

ASSET TRANSFERS

- Asset transfers have become the norm, with substitution upon project completion. This avoids having to finance Cap-I and makes the deal more efficient.
- Level rent was favored pre-Rider; post-Rider counsel have focused on ensuring rent in each period is “fair,” even if it isn’t identical.
- This has permitted more flexibility in amortization schedules for the bonds and has permitted variable rate debt.
- Pre-Rider deals often eschewed substitution and/or release; today both are common practice.
- Master Leases have emerged as more efficient ways to manage lease revenue bond programs, and the growing flexibility in substitution and release provisions have made master leases more user-friendly.

TITLE INSURANCE

- Title insurance remains common, but its marginal risk reduction for fee-owned civic facilities with stable agency ownership is modest compared to premium cost and review time.

PERSISTENCE OF VALUE=PAR CONCEPT

- This concept persists despite Rider's emphasis on fair rental value and the ability to deal with overcollateralization / abatement issues through the FRV analysis.

REENTER AND RELET

- The reenter and relet remedy persists for many issuers despite limited enforceability and minimal rating value.

ABATEMENT METHODOLOGY

- No clear market standard for determining how to abate; a one-size-fits-all approach may not be viable.
- Leases should not extend beyond remaining useful life of improvements supporting rent, but "useful life" is often an amorphous concept, particularly in the case of government buildings.

PERSISTENT CONVENTIONS OF UNCERTAIN VALUE

STOCKTON'S PARKING GARAGE

- Stockton had lease revenue bonds backed by a lease of a revenue-producing parking garage and stopped paying on the lease due to fiscal distress.
- The State courts awarded possession to the trustee after non-payment and before the Ch. 9 filing.
- The Stockton Parking Garage dispute was ultimately resolved through the issuance of parking revenue bonds, replacing the pre-petition lease structure and showing how restructuring may be preferable to exercising the reenter and relet remedy.
- Stockton suggests some practice tips, including:
 - Segregate enterprise assets -- they may be treated differently.
 - Make choices about remedies in conjunction with leased-asset selection.

Summary and Discussion

Key takeaways from Rider and Stockton, plus prompts to guide drafting, disclosure, and investor/rating engagement.

KEY TAKEAWAYS

- Rider broadened flexibility in California lease revenue bonds (prepayment; non-acceleration/abatement).
- Market provisions evolved, but conservative conventions persist for comfort/acceptance.
- Essentiality and bankruptcy treatment remain uncertain; they drive drafting and risk dialogue.
- Post-Stockton, test security/enforceability assumptions under distress scenarios.

QUESTIONS FOR CONSIDERATION

- **Balancing flexibility with market acceptance:** How much flexibility is worth investor friction?
- **Appropriate essentiality analysis:** What essentiality case fits operations and disclosure?
- **Ratings and investor view:** Which provisions will agencies/investors scrutinize most?
- **Bankruptcy-remote features:** What features add resilience, acknowledging bankruptcy risk?

QUESTIONS?



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THANK YOU

Please complete
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UPCOMING EVENTS

Legal Foundations and Strategic Structuring of Lease Financing Part II:
**Risks, Realities, and Market Preferences
of Lease Financing Decisions**

May 21, 2026 | Free Webinar

Municipal Debt Essentials

September 15–17, 2026 | San Jose

**25th Annual CDIAC Pre-conference to
The Bond Buyer's 36th Annual
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