Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: H.B. 489 of the 130th G.A.

Date: April 8, 2014

Status: As Introduced

Sponsor: Rep. Blair

Local Impact Statement Procedure Required: No

Contents: Modifies the terms under which a lease-purchase agreement for public construction may be entered and authorizes the use of lease-leaseback agreements

State Fiscal Highlights

- The bill authorizes lease-leaseback agreements as an alternative for financing construction and renovation projects. The fiscal effects of this change will depend upon the particular project and terms of individual lease-leaseback agreements.
- The bill authorizes the Department of Administrative Services (DAS) to use a request for proposal process rather than competitive bidding when selecting a builder under a lease-purchase or lease-leaseback agreement. This may lower the administrative costs of selecting a builder when these project financing techniques are used. However, because there is no requirement to select the low cost bidder, overall costs for the project may be greater than under current law.

Local Fiscal Highlights

- No direct fiscal effect on political subdivisions.

Detailed Fiscal Analysis

The bill deals with lease financing techniques to provide for construction or renovation of new or existing facilities used for public purposes. To begin, the bill establishes new law that grants the Department of Administrative Services (DAS) authority to enter into a lease-leaseback agreement to provide for construction of buildings, structures, and other improvements under the same terms required for lease-purchase agreements. The bill also modifies existing law governing lease-purchase agreements that DAS may enter into by expressly allowing DAS to make such agreements under a request for proposal process rather than the competitive bidding process required by current law. The potential fiscal effects of these changes are discussed under the headings below.

Lease-leaseback financing for construction projects

The bill authorizes DAS to enter into lease-leaseback agreements providing for the construction or renovation of state-owned buildings and other publicly owned structures. Lease-leaseback agreements provide an alternative financing method for large construction projects under which state property subject to a construction or renovation project would be leased to a builder who in turn would sublet the property back to the state. The upfront costs of construction would be paid by the builder who would then be repaid by the state through payments under the sublease agreement. Under the bill, any lease-leaseback agreements would be subject to a maximum 40-year term consisting of a series of 20 two-year renewable agreements.

There are aspects of lease-leaseback financing that offer the potential for lower costs or greater flexibility to the state. To begin, under these agreements, large scale construction projects can be financed without the need to issue bonds. As a result, the state would avoid the costs of issuing debt, including interest and fees paid to financial institutions. Second, lease-leaseback financing arrangements could allow the state greater flexibility in the use of debt financing. Because lease obligations under lease-leaseback financing arrangements are not considered public debt, lease obligations are not subjected to any debt limitations imposed by the state constitution. This means that the state would be able to use bond financing for other purposes. Finally, lease-leaseback agreements may lower the cost of occupying certain facilities that are currently underutilized. This is because, under continuing law, bond-funded public improvements are generally limited to occupancy by public agencies. This constrains the state's flexibility where buildings are occupied by state agencies that do not require all of the available space. Under a lease-leaseback agreement, the state could lease back only that portion of a building which it needs, allowing the builder to sublet the remaining space to private entities. In this case, the state then only pays for the space it needs, and a portion of any renovation or construction costs could be shifted to nonpublic tenants in the facility.

Alternatively, lease-leaseback arrangements could potentially be a more costly overall form of financing large scale construction projects. This would be the case if the terms of the agreement are structured such that the payments by the state under the sublease portion of the agreement exceed the principal and interest that would be paid in a traditional bond financing arrangement. It is likely that the builder would demand a greater return under the lease-leaseback arrangement because the builder typically assumes all risk associated with construction costs and contingencies under such agreements. In any case, the overall fiscal implications as a result of lease-leaseback financing will depend on the particular construction project being undertaken and the terms of individual lease-leaseback agreements.

Builder selection process under a lease-purchase or lease-leaseback agreement

The bill specifically authorizes the use of a request for proposal process in selecting a builder with whom to enter into a lease-purchase or lease-leaseback agreement, rather than the competitive bidding process as required in current law. Because the request for proposal process would afford DAS greater flexibility and demands fewer formal procedures than a competitive bidding process, there could be a reduction in costs associated with choosing the builder with whom a lease financing agreement would be made. However, because DAS would not be required to select the lowest cost option, the overall cost of an agreement could be greater than under current law.

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