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Board Briefing Report

DATE: February 2, 2024

TO: Board of Supervisors

SUBJECT: Amendment to Bank of America Master Equipment Lease/Purchase Agreement Resolution

SUMMARY

The purpose of this briefing report is to provide your Board with background information on why an amendment to the resolution is necessary and to provide information on how the Bank of America Master Equipment Lease/Purchase Agreement (MELPA) fits with the overall county leasing program. This report also provides the history on why the leasing program was established in Fiscal Year 2016-17. Finally, this report walks through two scenarios on acquiring Fire Department 'rolling stock' and the fiscal and operational considerations associated with each method.

HISTORY/STATUS

Resolution Amending Resolution 2024-005

Resolution 2024-005, adopted by your Board on January 16, 2024, was a resolution to increase the aggregate principal component of payments under all Leases entered under the Bank of America MELPA to an amount not to exceed $12,115,862.50, an increase of $4,588,979 from the previous not to exceed amount. The increase is necessary to allow borrowing capacity for the current fiscal year leases for Fire Department 'rolling stock' as well as Sheriff patrol and general fleet replacement vehicles and IT equipment purchases. Prior to establishment of the Bank of America MELPA, individual leases were secured to finance the listed equipment. The resolution also sets a maximum interest rate that is allowed for any lease schedules that is issued from the MELPA. On January 22, 2024, County staff was informed by Bank of America that they had erroneously included 3.5% as the max rate, which was the historical limit when interest rates were low, and that the max rate should have been 6.0% to reflect the current and projected market environment. County staff were also informed that the effective rate of the current borrowing would be 4.88%, which is already above the 3.5% max rate authorized in the resolution and thereby necessitating an amendment if the County were to proceed. County staff pointed out that since this oversight was from the Bank, that they should review things they could do to reduce the rate for the proposed borrowing. Bank of America has offered to reduce the rate for the proposed borrowing to 4.42%.

History of the County Leasing Program

In August 2016, the Board directed the development of a Fire Equipment Replacement & Reserve Policy (Fire Equipment Policy), which was adopted on November 1, 2016. At the time of the adoption of the Fire Equipment Policy, the average age of the 23 Fire Engines the County had in service was over 28 years old.

Sixteen of these Fire Engines were over 28 years old and an additional five between 22 and 28 years old. The industry standard is to replace Fire Engines once it reaches 20 years old to ensure efficient maintenance time and cost. It was determined that a combination of the high up-front cost of 'rolling stock' plus the economic impacts of the 2010 recession were the primary reasons why fire equipment replacements stalled.

The Fire Department developed a points-based system to identify annual equipment replacements. This resulted in a schedule that would replace an average of one to two Fire Engines per year plus an additional one to two Water Tenders to keep up and reduce the age of the fleet to more normal and recommended levels. A leasing program was also determined to be the most financially effective way to achieve this replacement schedule as it spread up-front costs over ten years thereby allowing the Fire Department to follow the replacement schedule and reduce maintenance costs quicker than it would have had to under an outright purchase scenario. Replacing the recommended vehicles based on the replacement schedule also had the benefit of avoiding cost escalation cycles.

In 2017, the County leasing program was expanded to include County fleet vehicles. At that time, Enterprise Leasing was piloted but by Fiscal Year 2018-19, it was determined not to be financially scalable for the County fleet. Since the County fleet recovers depreciation through mileage rates, the most efficient way to implement leasing would be to ensure that leased vehicles hit those mileage replacement targets within a lease term of 3 – 5 years. Since a good portion of fleet vehicles are driven multiple times for short mileage, a lot of the vehicles do not hit replacement mileage targets until they are 8 to 10 years old. This leaves the County Fleet fund a cost to carry as it would take an extra 5 to 10 years to collect the depreciation for each vehicle. In Fiscal Year 2019-20, Sheriff vehicles were included in the County leasing program as part of a bank lease. Enterprise Leasing was not considered as Enterprise was not dealing with patrol cars at that time. Going through a bank lease also allowed the County to utilize state negotiated rates for patrol vehicles versus retail rates that would be applicable through Enterprise Leasing. Sheriff patrol vehicles reach mileage replacement targets within 3 years, which made it financially viable to match with a 3-year lease schedule as sufficient depreciation would be collected through mileage rates during the life of the lease.

POLICY CONSIDERATIONS

Financial Considerations (Outright Purchase vs Leasing)

The main advantage of leasing Fire Engines and other high upfront cost vehicles is that it allows spreading the high cost of acquisition over time. This, in effect, makes capital equipment purchases more of an operational cost consideration instead of a cyclical high-dollar fixed asset investment, which puts purchases at risk of deferral when budgets are tight. Continuously deferring capital purchases and not sticking to a replacement schedule ultimately costs more as it subjects equipment prices to inflation and create operational impacts to departments related to maintenance and down time. While leasing does incur interest cost compared to outright purchases, these are offset by avoiding the loss of purchasing power related to inflation.

Table 1 shows an example where leasing could prove better financially and operationally when compared to purchasing outright. In the lease example, 10 Fire Engines and 5 Water Tenders were acquired over a period of seven years. The total amount financed (principal) of $10,284,595 and interest cost across the life of each of the five ten-year leases of $1,808,685 combines for a total debt service amount of $12,093,280.

In the outright purchase example, the annual debt service of the lease (column L4) was utilized as the annual budget allocation for an outright purchase method. This means that purchasing equipment must be deferred so that sufficient funds can accumulate before a purchase can be made. As can be seen in columns P1 and P2, a much more stretched out schedule of 15 years was needed to accumulate sufficient funds to purchase the same amount of equipment. Further, because of the longer replacement schedule, the purchases were subjected to more cost escalation, resulting in total payments of $12,291,971, which is higher than the total of all annual debt service payments in the lease method. However, it is worth noting that the net present value of Annual Debt Service Payments (column L4) and the net present value of Outright Purchases (column P3) are roughly the same at $8.8 Million using a discount rate of 4%.

TABLE 1: Lease vs Purchase Outright Example

	Lease Purchase (10 Year Schedules)				Purchase Outright		
	L1	L2	L3	L4	P1	P2	P3
Year	**Engines Purchased**	**Water Tenders Purchased**	**Amount Financed**	**Total Annual Debt Service (All Schedules)**	**Engines Purchased**	**Water Tenders Purchased**	**Amount Paid for Engines & Tenders**
1	2	1	$ 1,813,605	$ 220,570			$ -
2	2	1	$ 1,899,838	$ 443,148		1	$ 348,279
3	2	1	$ 1,990,191	$ 667,474	1		$ 811,465
4			$ -	$ 667,474	1		$ 848,793
5	2	1	$ 2,184,057	$ 910,864		1	$ 408,383
6			$ -	$ 910,864	1		$ 928,678
7	2	1	$ 2,396,903	$ 1,209,328	1		$ 971,397
8				$ 1,209,328	1	1	$ 1,495,480
9				$ 1,209,328	1		$ 1,037,057
10				$ 1,209,328	1	1	$ 1,555,897
11				$ 988,758	1		$ 1,078,955
12				$ 766,180	1		$ 1,100,534
13				$ 541,854			$ -
14				$ 541,854		1	$ 539,158
15				$ 298,464	1		$ 1,167,895
16				$ 298,464			
Total	**10**	**5**	**$ 10,284,595**	**$ 12,093,280**	**10**	**5**	**$ 12,291,971**

ACTION TIMEFRAME

The amended resolution is in the Board's agenda for consideration on February 6, 2024.

CONTACT FOR QUESTIONS

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