MEMORANDUM

TO: Agency and Department Heads  
FROM: Jeb Spaulding, State Treasurer  
        Charles P. Smith, Secretary of Administration  
DATE: October 13, 2005  
RE: Leasing Office or Other Equipment

This memorandum follows up Deputy Secretary of Administration Steve Gold’s memorandum dated September 12, 2005, concerning Leasing Office or Other Equipment. It clarifies that the authority to enter into an encumbrance of debt on the State resides only with the State Treasurer and explains the differences between an operating lease and a capital lease.

A lease can be categorized as an operating lease or a capital lease. These two lease types must be treated differently because a capital lease creates an encumbrance of debt on the State of Vermont.

Only the Treasurer is authorized to create an encumbrance of debt on the State of Vermont.

32 VSA Sec 902 (a) .....the state treasurer, with notification to the governor, on behalf of the state may borrow on the credit of the state for the purpose of raising funds to pay expenses of government.....

Since capital leases do create an encumbrance of debt and thus increase the State of Vermont debt load, any new capital leases, if deemed the preferable acquisition method and approved through BGS by the Secretary of Administration, must also be approved by the Treasurer. No agency, department, or unit of State government is authorized to enter into a capital lease without the approval of the Secretary of Administration and the Treasurer. Given the tremendous demand on the capital bill for debt encumbrance and the limit of $45M set in the debt affordability recommendation, it is very unlikely that any capital lease will be approved.

REVIEW PROCESS

The approved and only acceptable process for leasing office or other equipment is as follows:

All leases for office or other equipment, with a term of more than 12 months, must be requested through BGS prior to execution. BGS will then determine if the lease is an operating lease that falls under the budgetary
authority of the department head, or a capital lease that should be purchased through the Equipment Revolving Fund (ERF), or if, in fact, the purchase request should be a capital purchase.

Departments may “rent” equipment on a short-term basis of less than 12 months if the cumulative amount of the payments are within their appropriated current year budgetary authority.

In an effort to explain the differences between capital and operating leases, the following definition and examples are provided:

**DEFINITION**

A lease is a contract granting use or occupation of property during a specified time for a specified payment.

**LEASE TYPES**

**OPERATING LEASE:**

*An operating lease is one where the risks, benefits, and ownership stay with the lessor.* The lessee accrues no rights of ownership or favorable purchasing right over the term of the lease; the lessee simply gets to “use” the leased item for a fee. Leasing space is an example of an operating lease. Regardless of how long the lease term is, at the end of the term the lessor still owns the space and the lessee has no ownership, no right to purchase the space at a bargain price, and no right to continue to occupy the space. Leasing equipment from BGS through the ERF or the copy center is also categorized as an operating lease.

**CAPITAL LEASE:**

*A lease that meets one or more of the following four criteria is categorized as a capital lease: 1) the lease term is greater than 75% of the property's estimated economic life; 2) the lease contains an option to purchase the property for less than fair market value; 3) ownership of the property is transferred to the lessee at the end of the lease term; and/or 4) the present value of the lease payments equals or exceeds 90% of the fair market value of the property.*

A capital lease is accounted for in much the same way as a capital purchase is, for accounting purposes. Hence, we say we are “capitalizing the lease” or that it is a “capitalized lease.” This requires the purchase price value to be recorded as a fixed asset and depreciated over the life of the leased item. The lease payments, when paid, or at year-end, are split between principal (purchase price value of the leased item) and interest expense (difference between the purchase value and the cumulative lease payments during the lease term). If the lease term is more than one year, as most capital leases are, the lease (along with its associated debt) is said to be long-term. For a capital lease, the remaining principal value must be shown as long-term debt and impacts the state’s debt load, borrowing capacity, and credit rating.

If you are not sure which type of lease you are thinking about requesting, please contact BGS’s Internal Services Division, or Finance and Management’s Financial Operations, or your Budget Analyst.