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Deanna D. Smith
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10/21/03
Date

2003 SENATE INDUSTRY, BUSINESS AND LABOR

SB 2261

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12/21/03
Date

2003 SENATE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. SB 2261

Senate Industry, Business, and Labor

☐ Conference Committee

Hearing Date 01/29/03

Tape Number	Side A	Side B	Meter #
Tape 1	x		4500-end
Tape 1		x	0-3660
Committee Clerk Signature <i>Lisa VanBerkom</i>			

Minutes:

Senator Mutch opens SB 2261.

Senator Nething introduces and goes over bill. (Testimony and information attached)

Senator Espgaard: You mentioned something about this going into the bank of ND profits how would that go into the Bank of ND profits ...

Nething: There would be a depository of dollars there and those dollars could be lent out. You earn money by lending money. You strike a deal with the people to pay out a certain percent interest.

Senator Heltkamp testifies in support of SB 2261. All this bill does is empowers us to go and do our homework because there may be a potential opportunity to do this. If you take a look at the last project we did which was Ransom-Sargent Water Union which covers part of two of those counties it was a \$21 million project, the potential is enormous.

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Page 2
Senate Industry, Business and Labor
Bill/Resolution Number SB 2261
Hearing Date 01/29/03

Scott Scofield, resident of South Dakota and member of the ALCO finance firm. (see handout attached)

Senator Klein: What are the arrangements in South Dakota?

Scofield: South Dakota has passed this legislation last session with overwhelming votes. We are now in process of finishing the project.

Senator Espgaard: With the interest rates now, it probably isn't a good time is it?

Scofield: The interest rates have some affect to whether it is close to 3% or 4%. The interest rates due on the lease will be paid by the interest rates on the deposit account.

Senator Heitkamp: Is WEB looking at this now?

Scofield: As we describe how the transactions work to political subdivision and entities we see skepticism

Senator Krebsbach: What would happen with a financial failure?

Scofield: Nothing, imagine you have leased back the assets would continue to have titles to the assets one would assume they would go through some kin of bankruptcy formality.

Jay Lindgren, Attorney Dorsey and Whitney Law Firm. Is working with Scott Scofield. He goes through bill section by section (attached summary) Proposes an amendment (attached)

Senator Krebsbach: Will it include the NW Pipeline?

Lindgren: Maybe in the future, but not as right now it is not included.

senator Espgaard: Where in the internal revenue code is this?

Lindgren: It's not in the code.

Senator Heitkamp: What about Minnesota?

Lindgren: We are looking at Minnesota as well.

Page 3

Senate Industry, Business and Labor

Bill/Resolution Number SB 2261

Hearing Date 01/29/03

Stewart Carlson, Executive Director of ND Rural Water Systems Association. In support of SB 2261. This will give the option for a water district to invest in lease agree to use proceeds for capital improvements, operation maintenance, and to help create reserve accounts. this could provide another tool in financial toll box for these water districts.

Testimony handed to committee in support of bill by Connie Sprynczynatyk. (Attached testimony)

Ed Sather, Bank of North Dakota.

Heltkamp: Can it work?

Sather: I don't see where this would have any negative impact.

Senator Espeland: The water treatment plant in Grand Forks, they have bonds.

Lindgren: Any other existing financing, you would need to take care of that. One way would be loan or grant programs for the government. It can not be done if it effects the debt.

No opposition on Bill.

Close SB 2261

2003 SENATE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. **SB 2261**

Senate Industry, Business, and Labor

☐ Conference Committee

Hearing Date 02/04/03

Tape Number	Side A	Side B	Meter #
Tape 2		x	
Committee Clerk Signature			

Minutes:

Senator Mutch re opens SB 2261.

The committee goes over bill, and amendments offered by Jay Lindgren.

Senator Nething makes motion to move the amendment (30587-0101)

Senator Every 2nd

6 yes 0 no 1 absent

Senator Nething moves for amendment 0105

Senator Espegard 2nd

6 Yes 0 No 1 Absent

Senator Espegard moves to pass amendment 0106

Senator Nething 2nd

6 Yes 0 no 1 absent

Senator Nething moves a Do Pass as amended

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10/21/03
Date

Page 2

Senate Industry, Business, and Labor

Bill/Resolution Number SB 2261

Hearing Date 02/04/03

Senator Espegard 2nd

6 Yes 0 no 1 Absent

Carrier: Senator Nething

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10/21/03
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FISCAL NOTE STATEMENT

Senate Bill or Resolution No. 2261

This bill or resolution appears to affect revenues, expenditures, or fiscal liability of counties, cities, or school districts. However, no state agency has primary responsibility for compiling and maintaining the information necessary for the proper preparation of a fiscal note regarding this bill or resolution. Pursuant to Joint Rule 502, this statement meets the fiscal note requirement.

John Walstad
Code Revisor

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Deanne Walstad
Operator's Signature

10/21/03
Date

30587.0101
Title.

Prepared by the Legislative Council staff for
Senator Nething
January 22, 2003

PROPOSED AMENDMENTS TO SENATE BILL NO. 2261

Page 1, line 21, after "to" insert "subsection 5 of"

Page 2, line 12, after "to" insert "subsection 5 of"

Page 4, line 7, after "in" insert "subsection 5 of"

Page 4, line 30, after "to" insert "subsection 5 of"

Page 5, line 13, after "under" insert "subsection 5 of"

Page 9, line 25, after "to" insert "subsection 5 of", after the first underscored comma insert "subsection 12 of section", and after the first "or" insert "subsection 23 of section"

Page 9, line 27, after the first "or" insert "subsection 23 of section"

Page 10, line 15, replace "constitutes" with "does not constitute"

Page 10, line 26, after the second "to" insert "subsection 5 of"

Page 10, line 27, after the first underscored comma insert "subsection 12 of section" and after the first "or" insert "subsection 23 of section"

Page 11, line 3, after the first "or" insert "subsection 23 of section"

Page 11, line 11, after "under" insert "subsection 5 of"

Page 11, line 14, after the first "to" insert "subsection 5 of"

Page 11, line 26, replace "sections" with "subsection 5 of section" and after "and" insert "section"

Page 11, line 29, after "to" insert "subsection 5 of"

Renumber accordingly

Date: 2-4-03
Roll Call Vote #: 1

2003 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 2261

Senate IBL Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken Move to Amend

Motion Made By Nothing Seconded By Every

Senators	Yes	No	Senators	Yes	No
7- Sen. Duane Mutch, Chairman	X		Sen. Michael Every <u>5</u>	X	
1- Sen. Jerry Klein, Vice Chairman	X		Sen. Joel Heitkamp <u>4</u>	A	
6- Sen. Duaine Espegard	X				
2- Sen. Karen Krebsbach	X				
3- Sen. Dave Nething	X				

Total (Yes) 6 No 0

Absent 1

Floor Assignment _____

If the vote is on an amendment, briefly indicate intent:

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Diana Walsh
Operator's Signature

12/21/03
Date

30587.0105
Title.

Prepared by the Legislative Council staff for
Senator Nething
February 4, 2003

PROPOSED AMENDMENTS TO SENATE BILL NO. 2261

Page 1, line 1, after the comma insert "a new section to chapter 15-10,"

Page 1, after line 16, insert:

"SECTION 2. A new section to chapter 15-10 of the North Dakota Century Code is created and enacted as follows:

Long-term lease and leaseback transaction revenue. The board shall use revenue earned from long-term lease and leaseback transactions under chapter 54-01 for the repair and upkeep of campus buildings commonly referred to as deferred maintenance projects."

Renumber accordingly

Date: 2403
Roll Call Vote #: 2

2003 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 2261

Senate IBL 226 Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number 0105

Action Taken

Motion Made By Nothing Seconded By Espey

[illegible]

Total (Yes) 6 No 0

Absent

Floor Assignment

If the vote is on an amendment, briefly indicate intent:

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Operator's Signature Dean R. Smith Date 10/21/03

30587.0106
Title.

Prepared by the Legislative Council staff for
Senator Nething
February 4, 2003

PROPOSED AMENDMENTS TO SENATE BILL NO. 2261

Page 1, line 1, after "enact" insert "a new section to chapter 6-09,"

Page 1, after line 8, insert:

"**SECTION 1.** A new section to chapter 6-09 of the North Dakota Century Code is created and enacted as follows:

Long-term lease and leaseback transaction revenue. Revenue earned by the Bank through financial services provided for long-term lease and leaseback transactions made under this Act must be used for economic development projects, including seed money, venture capital grants, export promotion, loan forgiveness for specified programs, tourism promotion efforts, and any other suitable uses as determined by the Bank."

Renumber accordingly

Page No. 1

30587.0106

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Operator's Signature

Date

Date: 2-4-03
Roll Call Vote #: 3

2003 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 0001

Senate	IBL	FILE/RESOLUTION NO.	226	Committee
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☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken

Motion Made By

Seconded By

[illegible]

Total (Yes)

No

Absent

Floor Assignment

If the vote is on an amendment, briefly indicate intent:

Operator's Signature

Date _____

30587.0107
Title.0200

Adopted by the Senate Industry, Business
and Labor Committee
February 4, 2003

93
2-5-3

PROPOSED AMENDMENTS TO SENATE BILL NO. 2261

Page 1, line 1, after "enact" insert "a new section to chapter 6-09," and after the comma insert "a new section to chapter 15-10,"

Page 1, after line 8, Insert:

"SECTION 1. A new section to chapter 6-09 of the North Dakota Century Code is created and enacted as follows:

Long-term lease and leaseback transaction revenue. Revenue earned by the Bank through financial services provided for long-term lease and leaseback transactions made under this Act must be used for economic development projects, including seed money, venture capital grants, export promotion, loan forgiveness for specified programs, tourism promotion efforts, and any other suitable uses as determined by the Bank.

Page 1, after line 16, Insert:

"SECTION 3. A new section to chapter 15-10 of the North Dakota Century Code is created and enacted as follows:

Long-term lease and leaseback transaction revenue. The board shall use revenue earned from long-term lease and leaseback transactions under chapter 54-01 for the repair and upkeep of campus buildings commonly referred to as deferred maintenance projects.

Page 1, line 21, after "to" insert "subsection 5 of"

Page 2, line 12, after "to" insert "subsection 5 of"

Page 4, line 7, after "in" insert "subsection 5 of"

Page 4, line 30, after "to" insert "subsection 5 of"

Page 5, line 13, after "under" insert "subsection 5 of"

Page 9, line 25, after "to" insert "subsection 5 of", after the first underscored comma insert "subsection 12 of section", and after the first "or" insert "subsection 23 of section"

Page 9, line 27, after the first "or" insert "subsection 23 of section"

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Page No. 1

30587.0107

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Page 10, line 26, after the second "to" insert "subsection 5 of"

Page 10, line 27, after the first underscored comma insert "subsection 12 of section" and after the first "or" insert "subsection 23 of section"

Page 11, line 3, after the first "or" insert "subsection 23 of section"

Page 11, line 11, after "under" insert "subsection 5 of"

Page 11, line 14, after the first "to" insert "subsection 5 of"

Page 11, line 26, replace "sections" with "subsection 5 of section" and after "and" insert "section"

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Page No. 2

30587.0107

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Date

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BILL/RESOLUTION NO. 2261

☐ Check here for Conference Committee

Action Taken

Seconded By

7-
6-
2-
3-

No

Floor Assignment

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Date _____

REPORT OF STANDING COMMITTEE (410)
February 6, 2003 9:26 a.m.

Module No: SR-23-1806
Carrier: Nothing
Insert LC: 30587.0107 Title: .0200

REPORT OF STANDING COMMITTEE

SB 2261: Industry, Business and Labor Committee (Sen. Mutch, Chairman) recommends **AMENDMENTS AS FOLLOWS** and when so amended, recommends **DO PASS** (6 YEAS, 0 NAYS, 1 ABSENT AND NOT VOTING). SB 2261 was placed on the Sixth order on the calendar.

Page 1, line 1, after "enact" insert "a new section to chapter 6-09," and after the comma insert "a new section to chapter 15-10,"

Page 1, after line 8, insert:

"SECTION 1. A new section to chapter 6-09 of the North Dakota Century Code is created and enacted as follows:

Long-term lease and leaseback transaction revenue. Revenue earned by the Bank through financial services provided for long-term lease and leaseback transactions made under this Act must be used for economic development projects, including seed money, venture capital grants, export promotion, loan forgiveness for specified programs, tourism promotion efforts, and any other suitable uses as determined by the Bank."

Page 1, after line 16, insert:

"SECTION 3. A new section to chapter 15-10 of the North Dakota Century Code is created and enacted as follows:

Long-term lease and leaseback transaction revenue. The board shall use revenue earned from long-term lease and leaseback transactions under chapter 54-(1) for the repair and upkeep of campus buildings commonly referred to as deferred maintenance projects."

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Page 4, line 7, after "in" insert "subsection 5 of"

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(2) DESK, (3) COMM

Page No. 1

SR-23-1806

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REPORT OF STANDING COMMITTEE (410)
February 6, 2003 9:26 a.m.

Module No: SR-23-1806
Carrier: Nothing
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(2) DESK, (3) COMM

Page No. 2

SR-23-1806

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2003 HOUSE INDUSTRY, BUSINESS AND LABOR

SB 2261

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2003 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. SB 2261

House Industry, Business and Labor Committee

☐ Conference Committee

Hearing Date March 19, 2003

Tape Number	Side A	Side B	Meter #
1	x		0.0-end
1		x	0.0-9.2
1		x	20.0-end
2	x		0.0-15.0
Committee Clerk Signature <i>Judith Hamma</i>			

Minutes: **Chairman Keiser** opened the hearing on SB 2261.

Senator Nething, District 12, introduced SB 2261. (See Attached #1). He called this enabling legislation "privatizing depreciation". The Senate attached two amendments. The first amendment will direct that proceeds earned from the University systems through the leasing mechanism must be spent on deferred maintenance projects on their campuses. A second amendment will address BND's earnings, as it will be a depository for some of these funds held in defeasance accounts. BND will pay interest to the equity investor at a negotiated rate. Proceeds will not be deposited in the general fund but will be used for economic development purposes such as seed moneys, loan forgiveness and tourism projects.

John Olson, legal counsel for ALLCO Finance Corporation, introduced **Jim Wavle**, Sr. Vice President of ALLCO, New York, and **Jay Lindgren**, attorney at Dorsey Whitney, Minneapolis, also representing ALLCO. Wavle is a specialist who outlined how these projects can be set up

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10/21/03
Date

Page 2

House Industry, Business and Labor Committee

Bill/Resolution Number SB 2261

Hearing Date March 19, 2003

and illustrated how beneficial such a program can be for our state. Olson has collaborated with a number of local entities who can participate in and contribute to this: the League of Cities, Southwest Pipeline, the State Water Department, Board of Education Office, the Industrial Commission at BND, and the Governor's office. Olson also distributed written testimony in support of SB 2261 from **Connie Sprynczynatyck, Executive Director for North Dakota League of Cities. (See attached #2)**

Jim Wavle, ALLCO, testified in support of SB 2261. (See attached 3 and 4) Leaseback transactions are different in that rather than providing a substitute for borrowing, the intention is to provide a one time cash upfront benefit. Existing assets from a public entity provide funding. **Chairman Keiser:** If investors who form the trust put in 20%, where does the other 80% come from?

Jim Wavle: The other 80% is borrowed from financial institutions.

Rep. Ekstrom: Would BND be a potential lender for this?

Jim Wavle: BND isn't enabled to do that under their charter. The investor enters into a chain of leases. The entity leases these assets to the state, under the auspices of the Industrial Commission for 98-99 years. The state leases them to the trust. In return for the lease, the Trust pays back the 100% of fair market value to the state and the state would pay up to that amount to the entity. The cities have 100% of fair market value, the Trust has a lease. The leaseback is for a period of 20 to 35 years. The entity has full control of managing the asset. At the end of the leaseback they will have the opportunity at a fixed rate to make it collapse and go away. This is not used for borrowing but to generate up front cash. Entities prepay their lease from the state at 96-97% of the fair market value they receive. That leaves them with 3-4%. The state puts the 96-97% in

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House Industry, Business and Labor Committee

Bill/Resolution Number SB 2261

Hearing Date March 19, 2003

defeasance investments and that will service that lease rental obligation for the 25-30 year term and provide funds to exercise the buy out option. Everything is a fixed rate obligation. It is important to aggregate the assets of an entity so that investors can evaluate it as one transaction. That is why the state is involved as a gathering point. Investors can survey it all at once. This will assure due diligence from a legal, tax and regulatory perspective.

Rep. Ekstrom: Do you have an estimate of the value of projects that might be available for these transactions? Are there some deals that are already in the works?

Wavle: Discussions thus far have been limited to gathering information on water and waste water of municipalities. The value of the waste water assets alone in the top 14 cities in South Dakota that are involved in this type of deal are estimated at a billion dollars. They are looking at 30-40 million dollars of up front benefits this year. We anticipate similar numbers for North Dakota.

Rep. Ekstrom: What about forfeiture of leases if properties aren't maintained? What safeguards are in place?

Wavle: Leases require assets be maintained and in compliance with laws. If there is a natural disaster or something, the damage would have to be repaired.

Chairman Keiser: The only projects that qualify are those that have a revenue stream, correct? Land acreage and roads would not. Are there limitations on political subdivisions in these agreements relative to the fees associated with the revenue streams?

Wavle: Correct, or a potential for a revenue stream. And no, the municipalities would continue to set their fees and that's because the defeasance account will be managing all payments, not the revenues themselves.

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10/21/03
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Page 4
House Industry, Business and Labor Committee
Bill/Resolution Number SB 2261
Hearing Date March 19, 2003

Rep. Severson: Is the 80% of the investors borrowed against the equity?

Wavle: It's what's known as nonrecourse debt. Lenders look to the stream of lease rentals for repayment, not the investors.

Chairman Kelser: Do I understand this correctly? I'm an investor, I borrow 80% and there's some kind of default, the lending institution comes after me, not after the political subdivision?

Wavle: The lending institution looks to the lease rental first. The lender has senior position to the investor. If a municipality defaults, the investor, as lessor, has the right to foreclose.

Rep. Zaiser: Is there a minimum asset value, in terms of creating an aggregate amount? Would small municipalities with limited revenue streams be precluded from participation?

Wavle: Typically, for the type of assets we're talking about, investors want to see something in the range of 200-250 million dollars. That's why it's important for the state to be involved as the aggregator. That will assure critical mass. It's been a self selecting process in South Dakota. No assets--no involvement. If there aren't the personnel to assemble data, that would preclude them. There isn't a hard, fast minimum. the smallest city in SD involved has a population of 5700.

Rep. Ekstrom: Moorhead built two wind generators, a non-profit type project, would that be good for this type of deal?

Wavle: Alternative energy wind farms would be great but they tend not to have very large dollar volumes associated with them. But they do have the characteristics we're looking for. And there are special tax credits available for them too.

Rep. Froseth: What happens at the end of 30 years?

Wavle: The municipality has the option to buy out the transaction. It used to be called a purchase option because title had been transferred at the outset to the investor. In this case, the

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House Industry, Business and Labor Committee

Bill/Resolution Number SB 2261

Hearing Date March 19, 2003

investor has the leasehold interest. The municipality or entity can buy the remaining 70 years of the leasehold. The transaction is collapsed and they have the asset back. The price for exercising the option is set at day one.

Chairman Kelser: In theory, the defeasance account, if everything works appropriately, has the funds to pay the interest, the earnings over the thirty years, and purchase it at the guaranteed price.

Wavle: That's correct.

Rep. Froseth: Do they have the ability to renew the lease on the same system?

Wavle: Typically, there is not that option. They either have to exercise their purchase option or hand the asset back to the investor.

Chairman Kelser: And the reason for that is that all the depreciation value has been used by the end of 25-30 years, correct?

Wavle: Correct. Investors are careful about the way these things are structured. A shorter term is better for the entities.

Rep Dosch: What happens if there is an outstanding bond on a municipal water system? When put in place, what would happen if a water or waste system had to be expanded during the term of the lease? Would the assets be tied up?

Wavle: At the outset, existing debts and federal grants are analyzed on a case by case basis.

There are strategies to ensure that a transaction can be done with jeopardizing its status.

Outstanding bonds would indicate that the system itself has a lien it or against or the revenues associated with it has a lien. For this, it would be subordinate to outstanding liens. It's also important not to jeopardize tax exempt status. Not all assets have to be put into the system. As

Page 6
House Industry, Business and Labor Committee
Bill/Resolution Number SB 2261
Hearing Date March 19, 2003

far as future funding, the same analysis is used. Something outside of the footprint of the initial transaction is not an issue. You'd have to jump through hoops to fund replacement for a leased system.

Chairman Kelser: Municipalities bond on good faith and they have two options. They could lose their water or sewage system. Or if they don't manage their bond payments accordingly, they have to pay. Hence, it is not a real risk to investors.

Jay Lindgren, ALLCO legal counsel, Minneapolis, appeared to testify in support of SB 2261.

(See attached #5) I'd like to respond to Rep. Ekstrom's question. It was decided that BND couldn't do an appropriate type of loan and there would have to be a legislative change for them to make this type of loan. They decided from a business standpoint that it wasn't good for them.

At this point, BND will be a depository for the defeasance accounts.

Rep. Ekstrom: Were all considerations given to home rule charter cities when this bill was drafted?

Lindgren: Yes, any city with a significant volume of assets can participate.

Ed Sather, Sr. Vice President, Bank of North Dakota, testified in support of SB 2261. BND might have some problems with Section 1. There could be an accounting nightmare inherent in this. Based upon earning streams, BND will have to track flows and operating expenses specifically. Most of our earnings are appropriated to the general fund. This changes all that.

Frances Ziegler, Project Director for Department of Transportation, appeared neither in support of or opposition to SB 2261, but to provide information to the committee. DOT has 20 leases with an annual income of \$11,028. Any lease they do, 80% must be returned to the Feds. That's a lot of paperwork required for a return of small proportions. DOT respectfully requests

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that they be exempted from consideration for this program. Specifically Section 12 is what our attorneys pointed out that would seriously and negatively impact the Department of Transportation. He presented an amendment for the committee's consideration.

Chairman Kelser: We'll keep DOT posted on our amendments as we craft them so that DOT can participate.

Pat Seaworth, Attorney for the State Board of Higher Education , testified in favor of SB 2261.

Stu Carlson, Executive Director of ND Water Users Association, testified in support of SB 2261, insofar as it is enabling legislation.

Rep. Froseth: Mr. Olson, the Southwest Water Authority is alluded to here. Would the Northwest Water Supply Project qualify also for this?

Olson: At some point, it may qualify, it wouldn't qualify right now because it is not an asset. When it becomes a significant asset, it could be incorporated in some future project.

As there was no one else present to testify in support of or opposition to SB 2261, **Chairman Kelser** closed the hearing.

Chairman Kelser called for committee work on SB 2261.

Jay Lindgren addressed the issues brought up by DOT in amendment .0201 he drafted and explained its intent. It clarifies that the long list of types of agreements will apply only if they are entered into as part of a long term lease and leaseback transaction. The Industrial Commission is favorably disposed to this amendment as well. **Rep. Klein** moved a Do Adopt on .201. **Rep.**

Ekstrom seconded the motion. A voice vote carried the move to adopt.

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Ed Sather, Bank of North Dakota, presented amendment .0202 that addresses the redundant accounting issues that prove cumbersome to BND. The particular section from the bill is removed.

Rep. Severson: Was that section put in by the Senate?

Sather: Yes it was one of two amendments proposed by the Senate.

Rep. Klein: So the way it reads now is that on line 1, and enact a new subsection. And then we remove lines 20-16. And this is supposed to removed redundancy in bookkeeping?

Chairman Keiser: The bank sees a problem in separating commingled funds and earnings etc. Affected parties will benefit from earnings associated with their transactions.

Rep. Severson: If we remove this, is it just the recording of those issues or does it mean that any revenue earned by the bank will go to the general fund or to the bank? It won't be distributed, is that correct?

Sather: Those would just accumulate in overall earnings and be appropriated by the legislature.

Rep. Froseth: That amount of earnings would be definable, so if the next legislature wanted to increase funding for economic development efforts, they would know how much those earnings were and be able to virtually use them in the economic development budget. Is that correct?

Sather: Not specifically, we are trying to eliminate this accounting for these dollars being allocated for this loan, these funds are placed here etc. If BND is a participant in some of this financing and the influx of dollars results in additional earnings to the bank, we could then say it was approximately X amount of dollars.

Rep. Kasper: But don't banks track all transactions, every penny? Why does this become such an onerous task?

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Sather: We have profit center accounting, we collectively analyze costs associated with every profit generated by our treasury, trust, investments, student loans, farm, real estate & home loans, commercial agriculture. What we would have to do here differs from cost accounting or transfer pricing. We do account for every dollar, ultimately.

Rep. Severson: As a legislative body, how do we know how much money is earned, there has to be a tracking mechanism that provides accountability for all these complex programs to the Legislature from BND. Isn't that correct? How will that information be tracked if we take this language out of the bill?

Sather: In general terms, not specifically dollar for dollar. Current legislation mandates that we must maintain income from this transaction and allocate it towards a specific purpose. If we participate in this program as an investment provider, we would be able to report in a general estimating form but it would be generated.

Rep. Kasper: But the aggregate has to come from the specific, where is the problem?

Sather: Basically, we would look at net interest margin to track performance of BND. That interest margin is interest income minus interest costs, that is the blend of all the interest costs. If we receive funds coming into the bank, it's a blend of interest costs versus a blend of interest income. The net would say this is our net interest margin which results in this dollar amount of net income.

Rep. Kasper: That's what I'm trying to say. You have to do this blend accounting, wouldn't it be easy enough to give us the math you go through to get the big numbers? Can't you make those reports available?

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Sather: That's available in our annual report. But it's in the general term, the roll out, not specific allocation. It's the overall management of assets and liabilities of the bank that generate the net interest income.

Rep. Dosch: Is the problem here, part of the money coming in goes for economic development, part goes for seed money, venture capital, and you're saying how can you keep track when there is a dozen things that can be done with it? I can see that would be cumbersome. In reality, the bank has a lot of programs. The Legislature is interested in the bottom line profits of BND, how much money can be transferred out and into the general fund. From the general fund, we have all these programs out there to which the funds are funneled. Rather than BND doing some of this and the Department of Commerce doing some, I can see how it could get to be a mess. I'm just commenting. We want to know the net profit. It's the Legislature's responsibility to determine that profits from BND are being put into various programs, rather than BND itself parceling it into various programs.

Rep. Kasper: I'm not questioning how the money is spent, my questions is directed towards tracking the earnings. I suggest that BND must be doing that already, so they should be able to track earnings on dollars as they come in, not on how you spend the dollars.

Sather: Our net loan growth at the bank is 90-100 million dollars a year. If we increase deposits 100 million dollars tomorrow, we don't have 100 million dollars in new loans. That cash flow is already there. There is the 100 million dollars that just came into the bank. Where does it go? We have to account for it. Does it go into the overhead market? Student loans? Dollar for dollar, that's the issue we are looking at. All this accounting to be so specific, it's not practical. That is the cumbersome issue we object to.

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Rep. Thorpe: If we remove the section, can it be rephrased to say that it could go to the capital funding for the Department of Commerce? They cover most of these things anyway.

Chairman Keiser: But that doesn't correct the accounting problem.

Rep. Dosch moved to Adopt the Second amendment. Rep. Klein seconded the motion.

Rep. Dosch: Read line 16, any other suitable uses as determined by BND. I don't want BND to determine how funds should be distributed for seed capital, economic development, venture capital, etc. That is our job, as legislators, to decide that kind of things. BND provides the profits, we will decide how to break it out.

Rep. Kasper: If this is removed, moneys will come in, they'll give us the best estimate for each year what they've earned on these dollars with their accounting methods. But it still goes into the general fund and the Legislature will appropriate the money.

Chairman Keiser: Actually they don't have to report what came in. It goes into the bottom line at the Bank of North Dakota. We won't have a way to know what profits are generated from the program unless someone requests that they break it out.

Rep. Klein: So they can't give us that number?

Chairman Keiser: The language in the bill requires that they generate that number. If the language is removed, what is BND's incentive to go through the process to generate the figures which they say they can't find?

Rep. Kasper: Can't we tweak this somehow, and say something like, "revenue earned must be reported to the Legislature on a biennial basis"?

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Ed Sather: This language makes it so dollar specific that we would have to create a separate new accounting system to track these specific dollars in terms of where they go. The language, "revenues earned off of transactions with this kind of financing", is dollar specific.

Rep. Severson: If we changed this amendment to ask you to report to us at the next legislative assembly and let us distribute the money, can you do that? Get us the total dollar amount of earnings from this particular project?

Sather: Yes, but we'd have to duplicate the accounting to make it dollar specific.

Results of the roll call vote to adopt the second set of amendments were: 7-6-1.

Rep Ekstrom moved a Do Pass As Amended.

Rep. Severson seconded the motion.

Rep. Kasper: Are we too late to talk about another amendment? I really want there to be a tracking mechanism within this bill so that you can get a feel for what the dollars are worth at the end. How can you tell how well something is performing without more detailed accounting? This is terrible policy.

Rep. Severson: I have a suggestion. On line 12, we'd have to further amend to put back a new chapter of 609 and then leave lines 10-14 in, But line 12 would read, "revenue earned by the bank through financial services provided for long term lease and leaseback transactions made under this act must be reported to the next legislative assembly.

Chairman Kelser: But that gets them back into their dollar for dollar situation.

Rep. Kasper: We're talking about revenue earned. But what I'm talking about is income generated. Those are two different items. If we take up Rep. Severson's suggestion on line 12, if

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we strike "revenue" and say "income received" on the next one rather than "revenue received".

That would track income, not revenue. Then we could estimate what it is doing.

Sather: If BND is involved in this project, we become a depositor only. We would bid on money, if it is attractive, money in the secondary market is more attractive. The question is, once you have the dollars, from a duration analysis, what do I invest it in until it goes out? If I'm going to have this money for six months, I'm not investing in a five year fixed rate loan. It goes in the overnight funds market at 1.10%. This is where hedging comes in. And regulators look at interest rate risk. Those are the issues I am referring to when I say it is cumbersome to track this stuff. We can do fine in telling you what our dollars and our margins are.

Rep. Dosch: Wouldn't you envision a separate account for the leaseback program? Wouldn't you treat it like a savings account, so we could learn what the average earnings are?

Sather: As a funds manager, I could earmark deposits. But where does it go, on the assets side? You're essentially asking for our net interest margin. That is published in every bank financial statement. But it is in overall generic terms, not specific per each investment or liability. It's collectively what earning assets are and interest bearing liability.

Chairman Kelser: We're getting a homogenized statement. It's not serving any value.

Rep. Boe: Is it possible, or could it be simplified if we specified a rate of return and let the bank manage the money, make the best rate of return they can, and we specify what percentage return we want and designate it for our leaseback program and any above and beyond that goes to the general fund?

Chairman Kelser: I don't think so. We had a program, with the State Mill, it did not work.

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Rep. Froseth: In two years, if IBL asks for a breakdown of what has been invested in this program, will you be able to tell us?

Sather: I could tell you how much money we received from this program.

Rep. Froseth: And we should be able to figure out, based on your average earnings, how much the Legislature can appropriate to the Department of Commerce, correct? They can build into their budget based on BND's net earnings.

Chairman Keiser: BND is not set up to manage money like a 401 K program can

Sather: BND does proper accounting, the difference between this is and a 401K is that we are a bank, a financial institution, depositors don't come in and say, put my money in this specific program. Deposits come in, we allocate where they go.

Rep. Zaiser: We're going round and round and not going anywhere. I move to call the question.

Rep. Ruby: With this dollar specific talk, are we doing the same thing in Section 2 on page 2?

Or is that different?

Sather: It's commingled dollars, but it is different. That's upfront money, not thirty years and in a cash flow.

Results of the roll call vote for a Do Pass As Amended were: 12-1-1.

Rep. Severson will carry this on the floor.

Deanna O'Neil
Operator's Signature

10/21/03
Date

30587.0201
Title.

Prepared by the Legislative Council staff for
Representative Severson
March 19, 2003

PROPOSED AMENDMENTS TO ENGROSSED SENATE BILL NO. 2261

Page 9, line 13, after the third "agreement" insert "entered as part of a long-term lease and
leaseback transaction"

Renumber accordingly

Page No. 1

30587.0201

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Date

30587.0202
Title.

Prepared by the Legislative Council staff for
Representative Severson
March 19, 2003

PROPOSED AMENDMENTS TO ENGROSSED SENATE BILL NO. 2261

Page 1, line 1, remove "a new section to chapter 6-09,"

Page 1, remove lines 10 through 16

Renumber accordingly

Page No. 1

30587.0202

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Date: 3/ /03
Roll Call Vote #:

2003 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO.

House INDUSTRY BUSINESS & LABOR Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number .0202 SW Set BND

Action Taken ~~DO PAS~~ DO ADOPT.

Motion Made By _____ Seconded By _____

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser		✓	Boe		✓
Vice-Chair Severson		✓	Ekstrom		✓
Dosch	✓		Thorpe	✓	
Froseth		✓	Zaiser	✓	
Johnson	✓				
Kasper		✓			
Klein	✓				
Nottestad					
Ruby	✓				
Tieman	✓				

Total (Yes) 7 No 6

Absent 1

Floor Assignment _____

If the vote is on an amendment, briefly indicate intent:

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10/21/03
Date

30587.0203
Title.0300

Adopted by the Industry, Business and Labor
Committee

March 20, 2003

**House Amendments to Engrossed SB 2261 - Industry, Business and Labor Committee
03/20/2003**

Page 1, line 1, remove "a new section to chapter 6-09,"

Page 1, remove lines 10 through 16

**House Amendments to Engrossed SB 2261 - Industry, Business and Labor Committee
03/20/2003**

Page 9, line 13, after the third "agreement" insert "entered as part of a long-term lease and
leaseback transaction"

Renumber accordingly

1 of 1

30587.0203

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10/21/03
Date

Date: 3/19/03
Roll Call Vote #: 1

2003 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 2261

House INDUSTRY BUSINESS & LABOR Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

30587.0203 / title. 0300

Action Taken

Do Pass As Amended (both)

Motion Made By

Ekstrom

Seconded By

Severson

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser	✓		Boe		✓
Vice-Chair Severson	✓		Ekstrom	✓	
Dosch	✓		Thorpe	✓	
Froseth	✓		Zaiser	✓	
Johnson	✓				
Kasper	✓				
Klein	✓				
Nottestad	✓				
Ruby	✓				
Tieman	✓				

Total (Yes) 12 No 1

Absent 1

Floor Assignment Severson

If the vote is on an amendment, briefly indicate intent:

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Deanna Waller

Date

10/21/03

REPORT OF STANDING COMMITTEE (410)
March 20, 2003 3:06 p.m.

Module No: HR-50-5369
Carrier: Severson
Insert LC: 30587.0203 Title: .0300

REPORT OF STANDING COMMITTEE

SB 2261, as engrossed: Industry, Business and Labor Committee (Rep. Kelsor, Chairman) recommends **AMENDMENTS AS FOLLOWS** and when so amended, recommends **DO PASS** (12 YEAS, 1 NAY, 1 ABSENT AND NOT VOTING). Engrossed SB 2261 was placed on the Sixth order on the calendar.

Page 1, line 1, remove "a new section to chapter 6-09,"

Page 1, remove lines 10 through 16

Page 9, line 13, after the third "agreement" insert "entered as part of a long-term lease and leaseback transaction"

Renumber accordingly

(2) DESK, (3) COMM

Page No. 1

HR-50-5369

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2003 TESTIMONY

SB 2261

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Scott Scofield

1-29-03

Concept Overview

The purpose of a Long-Term Lease/Leaseback transaction is to allow tax-exempt entities such as the municipalities or rural water districts of North Dakota, or even the state itself, to enter into a transaction whereby they lease to a private entity such as a very large bank or insurance company, an asset, and then immediately leaseback the asset. Through this lease and leaseback transaction, the tax-exempt entity receives a significant cash benefit (typically 3%-4% of fair-market-value of the asset) at execution of the agreement, and retains operating control of the system. The private entity receives the benefit of the depreciation on the asset over the life of the lease and transaction costs as offsets to its income.

For example, a North Dakota political sub-division, (through the assistance of Allco) leases certain qualified assets to a large bank, and then immediately leases the assets back on a lease of approximately 30 years. The same opportunity applies to state assets.

Through the transaction, the political sub-division receives at the execution of an agreement, cash from the bank as the 100% up-front "Long-Term Lease payment" on the assets. Approximately 96%-97% of this cash is immediately placed by the political sub-division into an account. These accounts, known as a defeasance accounts, typically are guaranteed-investment-contracts backed by AAA rated insurance companies. The defeasance accounts automatically makes the "Leaseback payments" to the bank over the 30-year lease. The remaining 3%-4% up-front cash received by the political sub-division on the closing date is the cash benefit realized. *(We are in the process of quantifying this transaction for the top 14 cities in South Dakota. Our preliminary estimates are the cities will realize \$26-\$40 million cash benefit at the time of closing a transaction)*

As stated above, the benefit to the bank in this is example is depreciation on the assets, as well as transaction cost.

During the lease period in this example, the political sub-division continues to operate the assets, deliver services and charge user rates as they typically would as if the transaction had never occurred.

There typically are no out-of-pocket expenses incurred by the political sub-division in entering into the transaction.

At the end of the lease, the final payment from the defeasance accounts buys the asset back at the option of the political sub-division.

Scott D. Scofield

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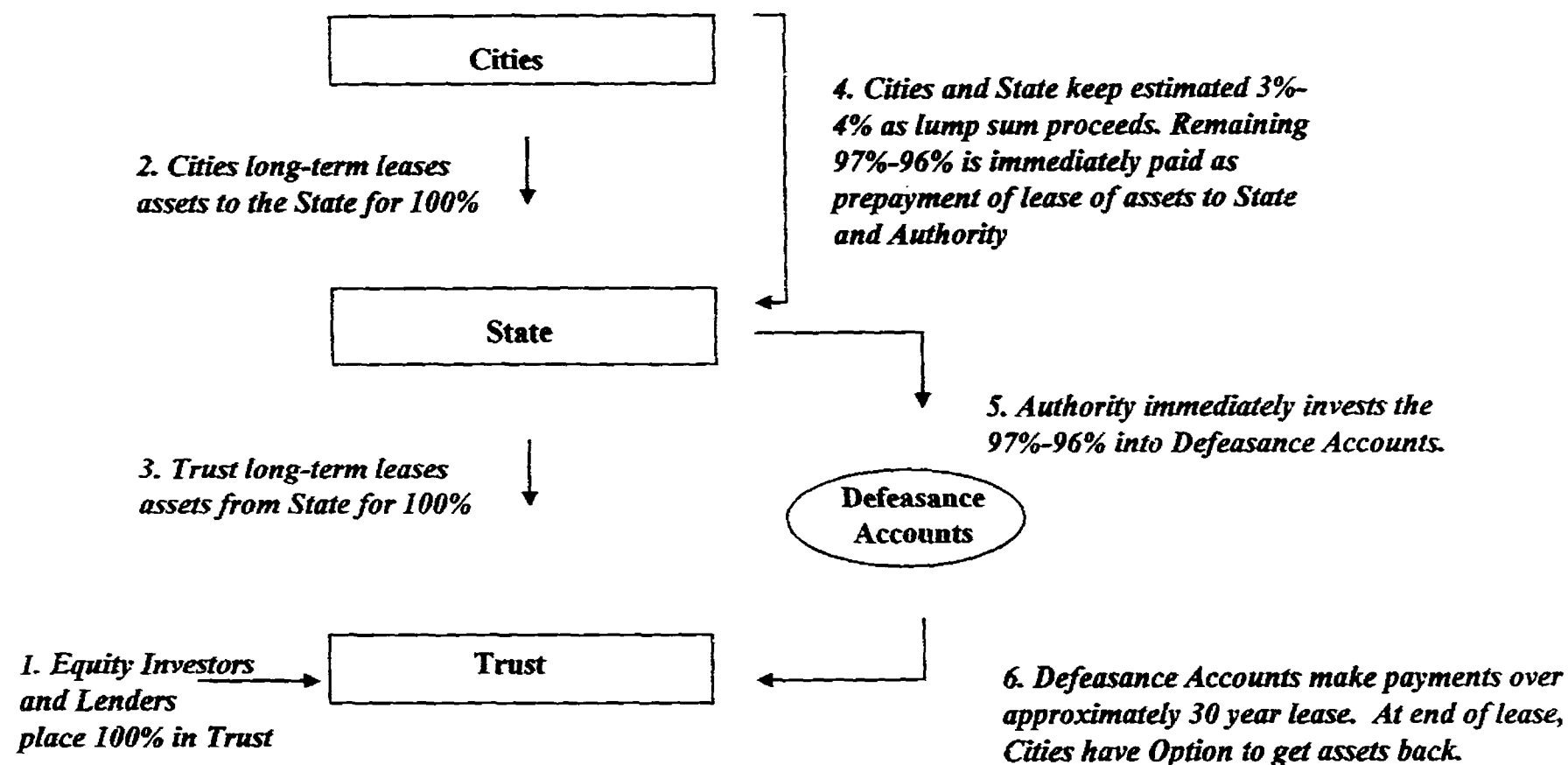
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Scott Scofield 1-29-03 SB2261

Long-Term Lease/Leaseback



Comments:

SB #2261 is "permissive" legislation, is only a vehicle to execute a transaction if terms and conditions are satisfactory to cities and State.

There are no up-front fees or out-of-pocket expenses incurred by the cities or the State if a transaction is not executed.

If a transaction is executed, all fees (appraisal fees, legal fees, etc.) are deducted from the gross proceeds, resulting in an estimated net proceeds of 3%-4%.

At the end of the lease period, the defeasance accounts have funds for cities to elect option to collapse the "head-end lease" (no out of pocket expense to the cit

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1/29/03
Date

**SENATE BILL NO. 2261
SUMMARY**

GENERAL OVERVIEW. This enabling legislation allows the cities, the Southwest Water Authority, and water districts organized under NDCC 61-35 (collectively the "Municipalities" or individually a "Municipality") as well as the State of North Dakota (the "State") to examine, and at their election, to participate in a long-term lease/leaseback transaction (the "Transaction").

The purpose of a Transaction is to allow a tax-exempt entity such as the Municipalities or State, to enter into a transaction whereby they lease to a private entity such as a very large bank or insurance company (the "Equity Investor"), an asset, and then immediately leaseback the asset. Through this lease and leaseback transaction, the Municipalities, or State, in the case where the State is participating in the Transaction with State assets, receive a significant cash benefit, typically 3%-4% of fair-market-value of their asset at the time of closing (which can be used for any defined public purpose allowed by law) and they still retain operating control of the asset. The private entity receives the tax benefit of depreciation on the asset over the life of the lease as well as transaction costs as offsets to its income.

This enabling legislation is designed to allow the Municipalities and State to examine the benefits of participating in a Transaction, and choose whether to participate in a Transaction. This legislation provides authority for a Municipality to convey by lease all, or a portion, of its wastewater treatment and collector system, and or its drinking water treatment and distribution system to a trust established for the benefit of equity investors (the "Trust"). The State could similarly choose to lease State-owned facilities to a Trust. The Municipal and State Assets are referred to as the "Assets."

In the case of the Municipalities, the Municipalities working collectively through the North Dakota Industrial Commission (the "Commission"), will receive at the execution of an agreement, cash from the Equity Investor, as the 100% up-front "long-term lease payment" on the assets. Approximately 96%-97% of this cash is immediately deposited into a defeasance account(s). These accounts, known as a Payment Undertaking Agreements (the "PUA"), typically are guaranteed-investment-contracts offered by highly rated sources such as the Bank of North Dakota. The PUA automatically makes the leaseback payments to the Trust over the leaseback period. The remaining 3%-4% up-front cash received by the Municipalities on the closing date is the cash benefit realized.

Because the Municipalities are leasing the Assets to the Trust (versus selling), title to the Assets remains with the Municipalities. The term of this lease (the "Prime Lease") would exceed the appraised remaining useful life of the Assets (but must not exceed 99 years). Consequently, federal tax ownership is realized by the Trust.

The Trust would, in turn, enter into an approximately 30-year leaseback of the Assets to the Commission (the "Commission Lease"). The Commission Lease will call for annual payments and a fixed-price option at the end of the Commission Lease term to collapse the remaining portion of the original 99-year Prime Lease. If the Commission does not exercise the purchase option under the Commission Lease, the Trust will have the option to require that either (i) the Commission vacate and return the Assets in accordance with the return provisions of the

Commission Lease, or (ii) the Commission arrange a service contract meeting agreed upon terms and conditions.

The Commission would then lease the Assets back to the Municipalities (the "Leaseback") for a term equal to the term of the Commission Lease. The Leaseback will include the same end-of-term options as the Commission Lease.

The Municipalities' obligations under the Prime Lease and the Leaseback would not be general obligations of the Municipalities. Similarly, the obligations of the State and Commission would not be general obligations of the State or the Commission. The State and the Commission would merely be acting as a conduit in the Transaction authorized under this legislation.

In the case of the State, the fundamental elements of the Transaction are identical to the Transaction with the Municipalities, except that the State Transaction will be authorized by a State board, commissioner, or other executive officer of the commission, agency or institution holding the property, and is subject to approval by the Commission.

Key to Senate Bill No. XXXX is that it is enabling legislation, allowing the Municipalities, State and the Commission to examine a Transaction, but does not compel any to execute a Transaction. There are no up-front or out-of-pocket expenses incurred by the Municipalities or the Commission if a Transaction is not executed. If a Transaction is executed by the Municipalities, the Commission or the State, all fees (appraisal fees, legal fees, etc.) are paid by the Equity Investor. And, at the end of the Leaseback, the PUA's have the funds necessary to pay for the collapse of the remaining portion of the original 99-year Prime Lease.

SECTION 1. Grants to the Municipal Bond Bank the powers to assist the Industrial Commission or other State entity in making, entering into, and enforcing all contracts or agreements necessary, convenient, or desirable for the purposes of leasing any Assets.

SECTION 2. Grants the governing body of a municipality the power to lease its Assets.

SECTION 3. Provides an exemption from public sale requirements for municipal leases of Assets.

SECTION 4. Provides specific authorization for a municipality to lease, by resolution, from or to any private entity or the State or State entity, the municipality's Waterworks Systems. Provides that no lease obligation of a municipality shall constitute an indebtedness of the municipality, or a pledge of the full faith and credit or unlimited taxing resources of the municipality. Provides that, notwithstanding any other law, a municipality may solicit and accept one or more proposals for a lease transaction, including the arrangement thereof.

SECTIONS 5-6. Exempts the lease of Assets from requirements relating to filing and electorate approval requirements.

SECTION 7. Provides that a municipality may pay the cost of leasing any municipal Waterworks System from the Industrial Commission, the State, or any agency, board, or institution of the State, solely from revenues to be derived by the municipality from:

- the ownership, sale, lease, disposition and operation of the Waterworks System;
- the funds or any other amounts invested by the municipality pursuant to the NDCC;

Deanna Waller
Operator's Signature

10/21/03
Date

- the funds or any other amounts invested on the municipality's behalf by the State, or any commission, agency, board, or institution of the State, in conformity with policies of the Industrial Commission, including investment in a guaranteed investment contract and any pledged earnings thereon; and
- funds, if any, appropriated annually by the governing body of the municipality for such purposes, or available from another state or federal source.

SECTION 8. Provides specific authorization for a municipality to lease, by resolution, from or to any private entity or the State or State entity, the municipality's Sewer Systems. Provides that no lease obligation of a municipality shall constitute an indebtedness of the municipality, or a pledge of the full faith and credit or unlimited taxing resources of the municipality. Provides that, notwithstanding any other law, a municipality may solicit and accept one or more proposals for a lease transaction, including the arrangement thereof.

SECTION 9. Provides that a municipality may pay the cost of leasing any Sewer System solely from revenues to be derived by the municipality from:

- the ownership, sale, lease, disposition and operation of the Sewer System;
- the funds or any other amounts invested by such municipality pursuant to the NDCC;
- the funds or any other amounts invested on such municipality's behalf by the State, or any commission, agency, board, or institution of the State, in conformity with policies of the Industrial Commission, including investment in a guaranteed investment contract and any earnings thereon, to the extent pledged therefor; and
- funds, if any, appropriated annually by the governing body of the municipality for such purposes, or available from another state or federal source.

SECTION 10. Authorizes the State, or any commission, agency, board, or institution of the State to lease to or from any private entity or the State or State entity, assets of the State. Authorization for any such lease must be authorized by the board, if any, or commissioner or other executive officer of the commission, agency or institution, and approved by the Industrial Commission. Provides that no lease obligation of the State shall constitute an indebtedness of the State, or a pledge of the full faith and credit or unlimited taxing resources of the State. Provides that, notwithstanding any other law, the State may solicit and accept one or more proposals for a lease transaction, including the arrangement thereof.

SECTION 11. Provides that the State, acting through the Industrial Commission, may lease any Assets to or from a municipality or other political subdivision or agency of the State, or any private party. Provides that such a lease shall be payable by the State solely from:

- revenues to be derived by the State from the ownership, sale, lease, disposition and operation of the Assets;
- any funds or investments permitted under State law, and any earnings thereon, to the extent pledged therefor;
- revenues to be derived by the State from any support and operating agreement, service agreement or any other agreement relating to the waterworks or sewer system;
- funds, if any, appropriated annually by the State Legislature for such purposes, or available from a federal source; and
- income or proceeds from any collateral pledged or provided therefor.

Provides that no lease obligation entered into under this section shall constitute an indebtedness of the Industrial Commission, the State or any agency, board, department, or officer or agent thereof, or a pledge of the full faith and credit or unlimited taxing resources of

the Industrial Commission, the State or any agency, board, department, or officer or agent thereof.

SECTION 12. Grants a property tax exemption for all property, including any possessory interest therein, relating to any Assets leased by the State or Municipalities, which property is operated by, or providing services to, a municipality or other political subdivision or agency of the State, or its citizens.

SECTION 13. Authorizes the Southwest Water Authority to exercise the powers of a municipality to lease Waterworks Systems. Provides that the authority may pay the cost of leasing any Waterworks System solely from:

- revenues to be derived by the authority from the ownership, sale, lease, disposition and operation of the Waterworks System;
- the funds or any other amounts invested by the authority pursuant to NDCC;
- the funds or any other amounts invested on the authority's behalf by the State, or any commission, agency, board, or institution of the State, in conformity with policies of the Industrial Commission, including investment in a guaranteed investment contract and any pledged earnings thereon; and
- funds, if any, appropriated annually by the board of the authority for such purposes, or available from another state or federal source.

SECTION 14. Authorizes water districts under NDCC 61-35 to exercise the powers of a municipality to lease Assets. Provides that the authority may pay the cost of leasing any Assets solely from:

- revenues to be derived by the district from the ownership, sale, lease, disposition and operation of the Assets;
- the funds or any other amounts invested by the district pursuant to the NDCC;
- the funds or any other amounts invested on the district's behalf by the State, or any commission, agency, board, or institution of the State, in conformity with policies of the Industrial Commission, including investment in a guaranteed investment contract and any pledged earnings thereon; and
- funds, if any, appropriated annually by the board of the district for such purposes, or available from another state or federal source.

SECTIONS 15-18. Provides for an effective date immediately upon filing with the Secretary of State and declares the Act to be an emergency measure.



NORTH DAKOTA
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*Service, Advocacy, Leadership,
Education & Support*

SB 2261

Senate Industry, Business and Labor Committee
January 29, 2003

Senator Mutch and Committee Members,

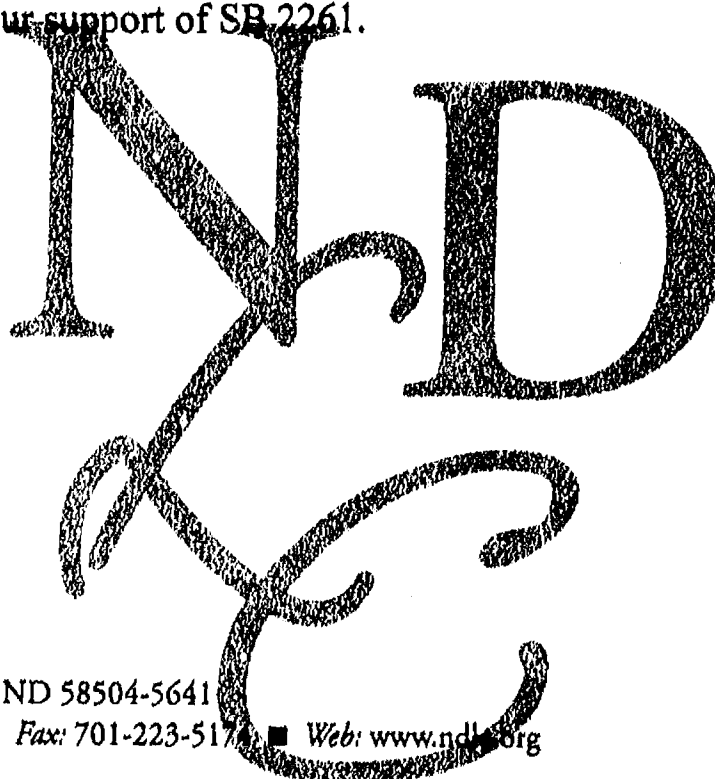
Over the past six months, the League of Cities has been involved in the exploratory stages of the lease/leaseback concept that the advocates of SB 2261 will explain in their testimony today. The League has assisted cities with some of the preliminary research and discussions, and it appears there is sufficient interest among the largest communities to continue exploration of this concept.

Because of the continual need to find ways to fund city services without increasing the reliance on the property tax, this concept may have merit. However, it does not appear possible to move forward without the statutory changes in SB 2261.

It is our understanding passage of this legislation will not obligate any North Dakota city to enter into a lease/leaseback agreement. Rather, SB 2261 gives cities the flexibility to determine whether the risks are small enough and the rewards great enough to move ahead. Each city will retain its full and individual decision-making power.

The League's legislative committee requests your support of SB 2261.

Connie Sprynczynatyk
Executive Director



410 East Front Avenue ■ Bismarck, ND 58504-5641

Phone: 701-223-3518 ■ Toll Free (in state): 1-800-472-2692 ■ Fax: 701-223-5174 ■ Web: www.ndlc.org

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H/

TESTIMONY
SB 2261
by Senator Dave Nething
March 19, 2003
House Industry, Business & Labor Committee
Representative G. Kelser, Chairman

Chairman Kelser and Members of the Committee. My name is Dave

Nething. I am the Senator from District 12. I will give you a brief overview of SB 2261 which will be a potential revenue producer for certain political subdivisions, water districts and the State of North Dakota. I call this "privatizing depreciation".

SB 2261 is enabling legislation that allows the cities of North Dakota and the State to take a look at a transaction that may provide as much as \$40 million or more to the cities and state (potentially yet this year).

SB 2261 allows ND to reap the rewards of a financial tool that is safely and commonly used around the world.

Page 1

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Dennis D. Nething
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Date

**TESTIMONY
SB 2261
by Senator Dave Nething**

The concept of the transaction fundamentally is simple: a city or the State of North Dakota, long term leases (98-99 year lease) an asset to an equity investor such as a very large bank or very large insurance company (see attached) for 100% of Fair-Market-Value. In doing so the equity investor gets certain tax benefits.

The city or state immediately leases the asset back from the equity investor, but only has to pay 96%-97% of Fair-Market-Value. Thus, the city or state makes 3%-4% profit on the transaction (South Dakota's top 14 cities estimate \$25-\$40 million).

The city or state deposit the remaining 96%-97% funds in debt retirement accounts (it is presumed that the Bank of ND will be one or more of the depositories), and in doing so, economically funds the leaseback payments.

Page 2 of 4

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**TESTIMONY
SB 2261
by Senator Dave Nething**

Potential ND beneficiaries of this concept are:

Cities (wastewater and drinking water assets)

Rural Areas (water districts)

SW communities of the state (SW pipeline)

State (SW pipeline, colleges/university dormitories, other?)

The cities or the state do not incur any out-of-pocket expense to look at a deal. There are no upfront expenses, and if the cities or state do not like the terms or conditions of a transaction, they simply walk away.

If they do execute a transaction, all transaction expenses are paid by the equity investor.

And, the defeasance accounts have the exact amount of funds necessary to make the leaseback payments over the leaseback period.

The transaction is not considered debt by the cities or state.

Page 3 of 4

**TESTIMONY
SB 2261
by Senator Dave Nething**

SB 2261 does not compel or force the cities, water districts, or state to do anything. It is simply a tool for them to be able to examine the merits of a transaction.

I will be pleased to answer questions relating to this overview.

However, we have some experts who can better explain the intricate details of this excellent piece of legislation.

Thank you for your attentiveness.

Page 4 of 4

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U.S. Structured Lease Financings

Set forth below is a list of the U.S. domestic tax-exempt entities of which we are aware that have participated in structured U.S. lease financings

Massachusetts Bay Transportation Authority (Boston)
Metropolitan Transportation Authority (New York)
Southeastern Pennsylvania Transportation Authority
Connecticut Department of Transportation
New Jersey Transit
Port Authority of Allegheny County (Pittsburgh)
Washington Metropolitan Area Transit Authority
Miami-Dade Transit
Metropolitan Atlanta Rapid Transit Authority
Greater Cleveland Regional Transit Authority
Metra (Chicago metropolitan area)
Chicago Transit Authority
Bi-State Development Agency (St. Louis transit)
Metropolitan Transit Authority (Houston)
Dallas Area Rapid Transit
Regional Transportation District (Denver)
Utah Transit Authority (Salt Lake City area)
Los Angeles County Metropolitan Transportation Authority

Metropolitan Transit Development Board (San Diego)
North County Transit District (San Diego area)
Southern California Regional Rail Authority
California Department of Transportation
Santa Clara Valley Transportation Authority
Peninsula Corridor Joint Powers Board (Silicon Valley/San Francisco regional)
San Joaquin Regional Rail Commission
Bay Area Rapid Transit District (San Francisco)
San Francisco Muni (bus, streetcar, cablecar transit)
Sacramento Regional Transit District
San Mateo County Transit District
Tri-County Metropolitan Transportation District of Oregon (Portland area)
Sound Transit (Seattle area)
Tennessee Valley Authority
Old Dominion Electric Cooperative
Oglethorpe Power Corporation
City Public Service of San Antonio

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Current Investors

Many well-known insurance companies, financial institutions and other companies invest in structured lease transactions.

AIG
Ameritech
Amsouth
Banc One
Bank of America
Bank of New York
Bank of Tokyo Mitsubishi
Bell Atlantic (Verizon)
Branch Bank and Trust
CIBC
CIT
Citicorp
Con Edison
Daimler Chrysler
Dana Commercial Credit

Edison Capital
GATX
GE Capital
Fifth Third Bank
First Hawaiian Bank
First Union National Bank
Fleet Bank
ICX Corporation
John Hancock
Key Bank
Metlife
Michigan National Bank
Mitsubishi Trust
Pacific Century

Philip Morris Capital
Pitney Bowes
PNC Bank
Potomac Capital
Prudential
PSEG
Southern Energy
State Street Bank
and Trust
Sumitomo Leasing
Suntrust
US Bank Corp
Wachovia Bank
Wells Fargo

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Operator's signature D. J. S. S. Date 10/21/03



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Education & Support*

#2

SB 2261
House Industry, Business and Labor Committee
March 19, 2003

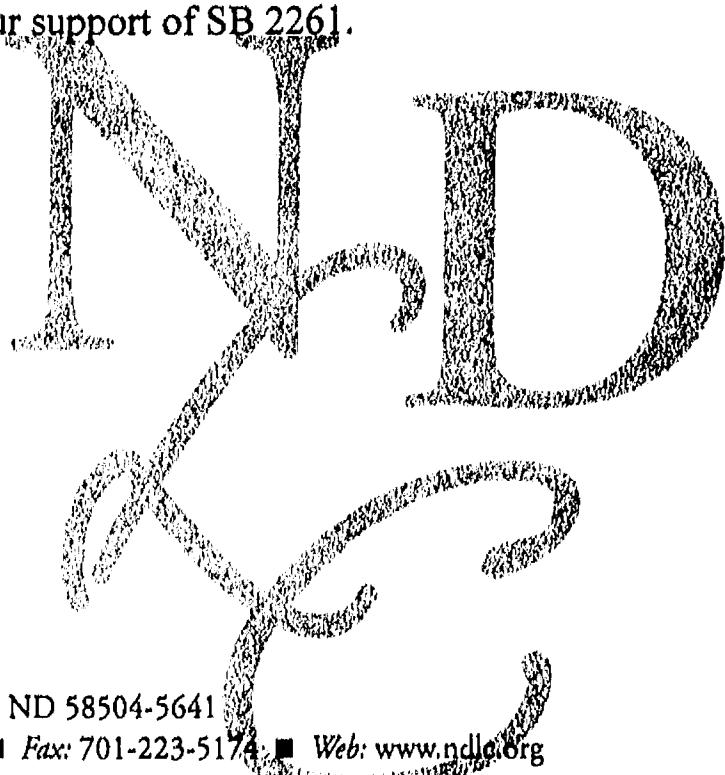
Representative Keiser and Committee Members,
Over the past six months, the League of Cities has been involved in the exploratory stages of the lease/leaseback concept that the advocates of SB 2261 will explain in their testimony today. The League has assisted cities with some of the preliminary research and discussions, and it appears there is sufficient interest among the largest communities to continue exploration of this concept.

Because of the continual need to find ways to fund city services without increasing the reliance on the property tax, this concept may have merit. However, it does not appear possible to move forward without the statutory changes in SB 2261.

It is our understanding passage of this legislation will not obligate any North Dakota city to enter into a lease/leaseback agreement. Rather, SB 2261 gives cities the flexibility to determine whether the risks are small enough and the rewards great enough to move ahead. Each city will retain its full and individual decision-making power.

The League's legislative committee requests your support of SB 2261.

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Concept Overview

The purpose of a Long-Term Lease/Leaseback transaction is to allow a tax-exempt entity such as the municipalities of North Dakota, to enter into a transaction whereby they lease to a private entity such as a very large bank or insurance company, an asset, and then immediately leaseback the asset. Through this lease and leaseback transaction, the tax-exempt entity receives a significant cash benefit (typically 3%-4% of fair-market-value of the asset) at execution of the agreement, and retains operating control of the system. The private entity receives the benefit of the depreciation on the asset over the life of the lease and transaction costs as offsets to its income.

For example, a North Dakota municipality, (through the assistance of Allco) leases certain qualified assets to a large bank, and then immediately leases the assets back on a lease of approximately 30 years.

Through the transaction, the municipality receives at the execution of an agreement, cash from the bank as the 100% up-front "Long-Term Lease payment" on the assets. Approximately 96%-97% of this cash is immediately placed by the municipality into an account. These accounts, known as a defeasance accounts, typically are guaranteed-investment-contracts backed by AAA rated insurance companies. The defeasance accounts automatically makes the "Leaseback payments" to the bank over the 30-year lease. The remaining 3%-4% up-front cash received by the municipality on the closing date is the cash benefit realized. *(We are in the process of quantifying this transaction for the top 14 cities in South Dakota. Our preliminary estimates are the cities will realize \$26-\$40 million cash benefit at the time of closing a transaction)*

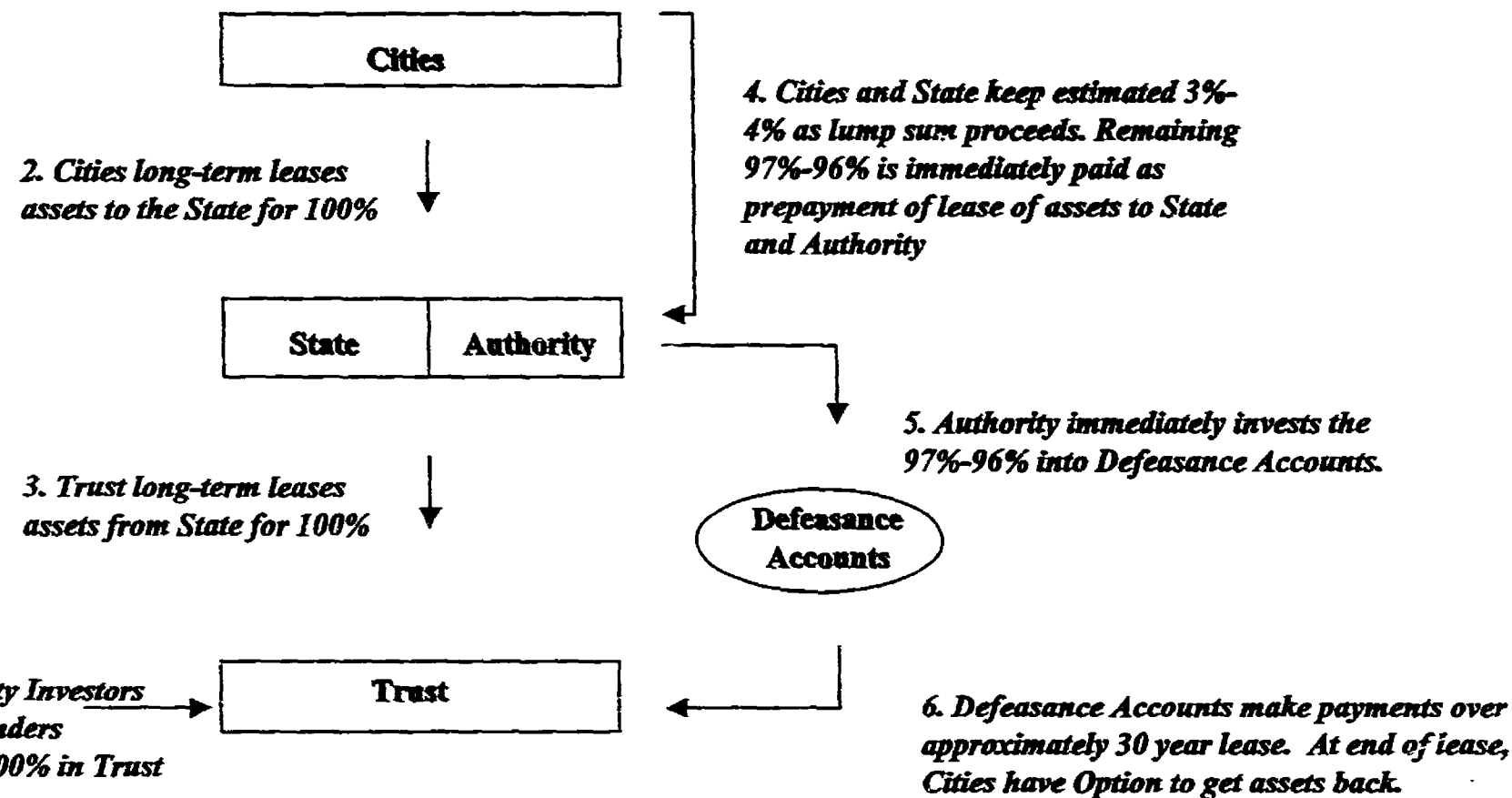
As stated above, the benefit to the bank in this is example is depreciation on the assets, as well as transaction cost.

During the lease period in this example, the municipality continues to operate the assets, deliver services and charge user rates as they typically would as if the transaction had never occurred.

There typically are no out-of-pocket expenses incurred by the municipality in entering into the transaction.

At the end of the lease, the final payment from the defeasance accounts buys the asset back at the option of the municipality.

Senate Bill 2261 is enabling legislation that would authorize the State, Cities and Rural Water Districts to enter into these transactions, but only if the relevant governing body determines it is in the public's best interest.



Comments:

- There are no up-front fees or out-of-pocket expenses incurred by the cities or the State if a transaction is not executed.
- If a transaction is executed, all fees (appraisal fees, legal fees, etc.) are deducted from the gross proceeds, resulting in an estimated net proceeds of 3%-4%.
- At the end of the lease period, the defeasance accounts have funds for cities to elect option to buy assets back (no out of pocket expense to the cities).

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Attached #4

5

**SENATE BILL NO. 2261
SUMMARY**

GENERAL OVERVIEW. This enabling legislation allows the cities, the Southwest Water Authority, and water districts organized under NDCC 61-35 (collectively the "Municipalities" or individually a "Municipality"), as well as the State of North Dakota or agencies or instrumentalities thereof (the "State"), to examine, and at their election, to participate in a long-term lease/leaseback transaction (the "Transaction").

The purpose of a Transaction is to allow a tax-exempt entity such as the Municipalities or State, to enter into a transaction whereby they lease to a private entity such as a very large bank or insurance company (the "Equity Investor"), an asset, and then immediately leaseback the asset. Through this lease and leaseback transaction, the Municipalities, or State, in the case where the State is participating in the Transaction with State assets, receive a significant cash benefit, typically 3%-4% of fair-market-value of their asset at the time of closing (which can be used for any defined public purpose allowed by law) and they still retain operating control of the asset. The private entity receives the tax benefit of depreciation on the asset over the life of the lease as well as transaction costs as offsets to its income.

This enabling legislation is designed to allow the Municipalities and State to examine the benefits of participating in a Transaction, and choose whether to participate in a Transaction. This legislation provides authority for a Municipality to convey by lease all or a portion of its wastewater treatment and collector system or its drinking water treatment and distribution system (the "Assets") to a trust established for the benefit of equity investors (the "Trust"). The State could similarly choose to lease State-owned facilities to a Trust (see below).

In the case of the Municipalities, the Municipalities working collectively through the North Dakota Industrial Commission (the "Commission"), will receive at the execution of an agreement, cash from the Equity Investor, as the 100% up-front "long-term lease payment" on the assets. Approximately 96%-97% of this cash is immediately deposited into a defeasance account(s). These accounts, known as a Payment Undertaking Agreements (the "PUA"), typically are guaranteed investment contracts offered by highly rated sources such as the Bank of North Dakota. The PUA automatically makes the leaseback payments to the Trust over the leaseback period. The remaining 3%-4% up-front cash received by the Municipalities on the closing date is the cash benefit realized.

Because the Municipalities are leasing the Assets to the Trust (versus selling), title to the Assets remains with the Municipalities. The term of this lease (the "Prime Lease") would exceed the appraised remaining useful life of the Assets (but must not exceed 99 years). Consequently, federal tax ownership is realized by the Trust.

The Trust would, in turn, enter into an approximately 30-year leaseback of the Assets to the Commission (the "Commission Lease"). The Commission Lease will call for annual payments and a fixed-price option at the end of the Commission Lease term to collapse the remaining portion of the original 99-year Prime Lease. If the Commission does not exercise the purchase option under the Commission Lease, the Trust will have the option to require that either (i) the Commission vacate and return the Assets in accordance with the return provisions of the Commission Lease, or (ii) the Commission arrange a service contract meeting agreed upon terms and conditions.

The Commission would then lease the Assets back to the Municipalities (the "Leaseback") for a term equal to the term of the Commission Lease. The Leaseback will include the same end-of-term options as the Commission Lease.

The Municipalities' obligations under the Prime Lease and the Leaseback would not be general obligations of the Municipalities. Similarly, the obligations of the State and Commission would not be general obligations of the State or the Commission. The State and the Commission would merely be acting as a conduit in the Transaction authorized under this legislation.

In the case of the State, the fundamental elements of the Transaction are identical to the Transaction with the Municipalities, except that the State Transaction will be authorized by a State board, commissioner, or other executive officer of the commission, agency or institution holding the property, and is subject to approval by the Commission.

Key to Senate Bill No. 2261 is that it is enabling legislation, allowing the Municipalities, State and the Commission to examine a Transaction, but does not compel any to execute a Transaction. There need not be any up-front or out-of-pocket expenses incurred by the Municipalities or the Commission, regardless of whether a Transaction is or is not executed. And, at the end of the Leaseback, the PUA's have the funds necessary to pay for the collapse of the remaining portion of the original 99-year Prime Lease.

SECTION 1. Provides that if the Bank of North Dakota earns revenue from providing its services in connection with a long-term lease/leaseback transaction, such revenue must be used for economic development projects and any other suitable uses as determined by the Bank.

SECTION 2. Grants to the Municipal Bond Bank the powers to assist the Industrial Commission or other State entity in making, entering into, and enforcing all contracts or agreements necessary, convenient, or desirable for the purposes of leasing any Assets.

SECTION 3. Provides that the State Board of Higher Education shall use revenue it earns from long-term lease/leaseback transactions for maintenance projects for campus buildings.

SECTION 4. Grants the governing body of a municipality the power to lease its Assets.

SECTION 5. Provides an exemption from public sale requirements for municipal leases of Assets.

SECTION 6. Provides specific authorization for a municipality to lease, by resolution, from or to any private entity or the State or State entity, the municipality's waterworks systems. Provides that no lease obligation of a municipality shall constitute an indebtedness of the municipality, or a pledge of the full faith and credit or unlimited taxing resources of the municipality. Provides that, notwithstanding any other law, a municipality may solicit and accept one or more proposals for a lease transaction, including the arrangement thereof.

SECTIONS 7-8. Exempts the lease of Assets from requirements relating to filing and electorate approval requirements.

SECTION 9. Provides that a municipality may pay the cost of leasing any municipal waterworks system from the Industrial Commission, the State, or any agency or institution of the State, solely from revenues to be derived by the municipality from:

- the ownership, sale, lease, disposition and operation of the waterworks system;
- the funds or any other amounts invested by the municipality pursuant to the NDCC;
- the funds or any other amounts invested on the municipality's behalf by the State, or any agency or institution of the State, in conformity with policies of the Industrial Commission, including investment in a guaranteed investment contract and any pledged earnings thereon; and
- funds, if any, appropriated annually by the governing body of the municipality for such purposes, or available from another state or federal source.

SECTION 10. Provides specific authorization for a municipality to lease, by resolution, from or to any private entity or the State or State entity, the municipality's sewer systems. Provides that no lease obligation of a municipality shall constitute an indebtedness of the municipality, or a pledge of the full faith and credit or unlimited taxing resources of the municipality. Provides that, notwithstanding any other law, a municipality may solicit and accept one or more proposals for a lease transaction, including the arrangement thereof.

SECTION 11. Provides that a municipality may pay the cost of leasing any sewer system solely from revenues to be derived by the municipality from:

- the ownership, sale, lease, disposition and operation of the sewer system;
- the funds or any other amounts invested by such municipality pursuant to the NDCC;
- the funds or any other amounts invested on such municipality's behalf by the State, or any commission, agency, board, or institution of the State, in conformity with policies of the Industrial Commission, including investment in a guaranteed investment contract and any earnings thereon, to the extent pledged therefor; and
- funds, if any, appropriated annually by the governing body of the municipality for such purposes, or available from another state or federal source.

SECTION 12. Authorizes the State, or any agency or institution of the State, to lease to or from any private entity or the State or State entity, assets of the State. Authorization for any such lease must be authorized by the board, if any, or commissioner or other executive officer of the commission, agency or institution, and approved by the Industrial Commission. Provides that no lease obligation of the State shall constitute an indebtedness of the State, or a pledge of the full faith and credit or unlimited taxing resources of the State. Provides that, notwithstanding any other law, the State may solicit and accept one or more proposals for a lease transaction, including the arrangement thereof.

SECTION 13. Provides that the State, acting through the Industrial Commission, may lease any Assets to or from a municipality or other political subdivision or agency of the State, or any private party. Provides that such a lease shall be payable by the State solely from:

- revenues to be derived by the State from the ownership, sale, lease, disposition and operation of the Assets;
- any funds or investments permitted under State law, and any earnings thereon, to the extent pledged therefor;
- revenues to be derived by the State from any support and operating agreement, service agreement or any other agreement relating to the waterworks or sewer system;

Deanna Wallis
Operator's Signature

10/21/03
Date

- funds, if any, appropriated annually by the State Legislature for such purposes, or available from a federal source; and
- income or proceeds from any collateral pledged or provided therefor.

Provides that no lease obligation entered into under this section shall constitute an indebtedness of the Industrial Commission, the State or any agency, board, department, or officer or agent thereof, or a pledge of the full faith and credit or unlimited taxing resources of the Industrial Commission, the State or any agency, board, department, or officer or agent thereof.

SECTION 14. Grants a property tax exemption for all property, including any possessory interest therein, relating to any waterworks system or sewer system leased by municipalities, the Southwest Water Authority, or a water district, or other assets leased by the State, which property is operated by, or providing services to, a municipality or other political subdivision or agency of the State, or its citizens.

SECTION 15. Authorizes the Southwest Water Authority to exercise the powers of a municipality to lease waterworks systems. Provides that the authority may pay the cost of leasing any waterworks system solely from:

- revenues to be derived by the authority from the ownership, sale, lease, disposition and operation of the waterworks system;
- the funds or any other amounts invested by the authority pursuant to NDCC;
- the funds or any other amounts invested on the authority's behalf by the State, or any commission, agency, board, or institution of the State, in conformity with policies of the Industrial Commission, including investment in a guaranteed investment contract and any pledged earnings thereon; and
- funds, if any, appropriated annually by the board of the authority for such purposes, or available from another state or federal source.

SECTION 16. Authorizes water districts under NDCC 61-35 to exercise the powers of a municipality to lease Assets. Provides that the authority may pay the cost of leasing any Assets solely from:

- revenues to be derived by the district from the ownership, sale, lease, disposition and operation of the Assets;
- the funds or any other amounts invested by the district pursuant to the NDCC;
- the funds or any other amounts invested on the district's behalf by the State, or any commission, agency, board, or institution of the State, in conformity with policies of the Industrial Commission, including investment in a guaranteed investment contract and any pledged earnings thereon; and
- funds, if any, appropriated annually by the board of the district for such purposes, or available from another state or federal source.

SECTION 17. Declares the Act to be an emergency measure.

DOT

PROPOSED AMENDMENTS TO ENGROSSED SENATE BILL NO. ~~2148~~ 2261

Page 9, line 31, after the period insert "The provisions of this section do not apply to the department of transportation."

Renumber accordingly

Francis Zigler's
amendment

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