

## Leasing Basics

### I. How Can Businesses Lease Equipment?

Business is different today. Financial decision-makers need flexibility, convenience and control - all valuable characteristics of leasing. Equipment leasing is an established and proven financing vehicle. Yet, many businesses are newly discovering leasing. Choosing to lease is a smart way to acquire equipment.

Three ways exist for leasing equipment, so you can choose the one that best suits your company's needs:

- A lessee can select and order the equipment and then seek financing through a lessor.
- A lessee can select the equipment by working with a vendor or a manufacturer that offers leasing through its own subsidiary.
- A lessee can obtain the equipment directly through a lessor.

Once a potential lessee has selected the best way to lease equipment, a lease is signed. By signing the lease, the lessee assigns his or her purchase rights to the lessor, who already owns or who then buys the equipment. (The lessee specifies the equipment they want.)

When the equipment is delivered, the lessee accepts it and makes sure it meets all specifications. The lessor pays for the equipment, and the lease takes effect. A lessee then makes lease payments to the lessor.

### II. What Can Be Leased?

There is equipment that can be leased for virtually every industry sector that conducts business. A few examples include:

#### **Agricultural, Forestry, Fishing Equipment    Medical Equipment**

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| <ul style="list-style-type: none"><li>• Harvesting and Planting</li><li>• Hay and Cotton Bailers</li><li>• Tractors</li><li>• Dairy Machinery</li><li>• Food Processing</li><li>• Livestock Equipment</li></ul> | <ul style="list-style-type: none"><li>• Blood Analyzers</li><li>• CT Scanners</li><li>• Exam Tables</li><li>• Dental Equipment</li><li>• Heart Monitors</li><li>• Lab Testing Equipment</li><li>• Optical Equipment</li><li>• Physical Therapy</li><li>• X-ray Equipment</li></ul> |
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#### **Amusement**

- Arcade games
- Gaming Machines
- Juke-boxes
- Pool tables

#### **Mining, Oil and Gas Extraction**

- Blast hole drills

- Simulators

### **Banking**

- ATMs
- Check Scanners
- Sorters
- Encoders

### **Computers**

- CAD/CAM systems
- File Servers
- Hardware
- Macro computers
- Mainframes
- Microcomputers
- PC Network
- Peripherals
- Plotters
- Printers
- Scanners
- Software
- Workstations

### **Construction**

- Bulldozers
- Cement trucks
- Compactors
- Concrete equipment
- Cranes
- Earth moving equipment
- Excavators
- Jackhammers
- Portable construction lighting
- Shovels
- Surveying equipment
- Tractors

### **Electrical**

- AC Motors
- DC Motors
- Generators
- Lighting equipment
- Single & Three Phase motors
- Transformers
- Welders

### **Industrial and Manufacturing**

- Concrete transit machinery
- Draglines
- Electric and hydraulic shovels
- Extraction machinery
- Loaders
- Pumps

### **Office Equipment**

- Copiers
- Embossers/Folders
- Facsimile Equipment
- File Cabinets
- Furniture
- Labeling Machines
- Postage Machines
- Telephones

### **Printing/Publishing**

- Binders/Cutters
- Colorimeters
- Computerized Press Equipment
- Graphic Cameras
- Photo Processing Equipment
- Printing Presses
- Typesetting Equipment

### **Restaurant Equipment**

- Bar equipment
- Countertop griddles
- Electric Slicers
- Food warmers
- Fryers
- Furniture
- Glo-Lite Signs
- Grills
- Hot Dog equipment
- Ice Machines
- Microwaves
- Paging Systems
- Popcorn Makers

### **Telecommunications**

- Multiplexers
- Switches
- Telephone systems
- Transformers

- Grinders
- Lathes
- Material handling machines
- Packaging equipment
- Production equipment
- Punch/Press Machines
- Welding Equipment
- Silkscreen Equipment
- Injection Molding Machinery
- Sewing/Embroidery/Quilting Machines
- Textile machines

#### Material Handling Equipment

- Forklifts
- Pallet Jacks
- Platform Lifts
- Conveyers

#### Transportation

- Aircraft
- Buses
- Containers
- Fresh/Saltwater
- Garbage Trucks
- Passenger Vans
- Tow Trucks
- Railroad
- Trailers
- Trucks

#### Vending

- Candy/Snack machines
- Change machines
- Soft drink dispensers

### III. What are the Benefits of Leasing?

Leasing offers numerous advantages over other financing methods:

- **Tax treatment.** The IRS does not consider an operating lease to be a purchase, but rather a tax-deductible overhead expense. Therefore, you can deduct the lease payments from your corporate income.
- **Balance sheet management.** Because an operating lease is not considered a long-term debt or liability, it does not appear as debt on your financial statement, thus making you more attractive to traditional lenders when you need them.
- **100 percent financing.** With leasing, there is very little money down - perhaps only the first and last month's payment are due at the time of the lease. Since a lease does not require a down payment, it is equivalent to 100 percent financing. That means that you will have more money to invest in revenue-generating activities.
- **Immediate write-off of the dollars spent.** Leasing payments are treated as expenses on a company's balance sheet, therefore, equipment does not have to be depreciated over five to seven years.
- **Flexibility.** As your business grows and your needs change, you can add or upgrade at any point during the lease term through add-on or master leases. If you anticipate growth, be sure to negotiate that option when you structure your lease program. You also have the option to include installation, maintenance and other services, if needed.
- **Customized solutions.** A variety of leasing products is available, allowing you to tailor a program to fit your month-to-month or year-to-year cash flow needs. You are able to customize a program to address your needs and requirements - cash flow, budget, transaction structure, cyclical fluctuations, etc. Some leases allow you, for example, to miss one or more payment without a penalty, an important feature for seasonal businesses.
- **Asset management.** A lease provides the use of equipment for specific periods of time at fixed payments. The lessor assumes and manages the risk of equipment ownership. At the end of the lease, the lessor is responsible for the disposition of the asset.

- **Upgraded technology.** If the nature of your industry demands that you have the latest technology, a short-term operating lease can help you get the equipment and keep your cash. Lease equipment that you expect to depreciate quickly. Your risk of getting caught with obsolete equipment is lower because you can upgrade or add equipment to meet your ever-changing needs.
- **Speed.** Leasing can allow you to respond quickly to new opportunities with minimal documentation and red tape. Many leasing companies can approve your application within one or two days and you can have your equipment very quickly.
- **Improved cash forecasting.** By leasing equipment you know the amount and number of lease payments over the life of the leasing period, so you can accurately forecast cash requirements for your equipment.
- **Flexible end of term options.** There are several options for disposing of equipment after the lease term ends including returning the equipment, renewing the lease or purchasing the equipment.
- **Tax benefits.** Lessors often pass the tax benefits of ownership on to the lessee in the form of lower monthly payments.
- **Improved earnings.** Operating lease accounting provides a lower cost than a capital lease in the early years of a lease.

#### IV. What are the Differences Between a Lease and a Loan?

Loan	Lease
A loan requires the end user to invest a down payment in the equipment. The loan finances the remaining amount.	A lease requires no down payment and finances only the value of the equipment expected to be depleted during the lease term. The lessee usually has an option to buy the equipment for its remaining value at the end of the lease.
A loan usually requires the borrower to pledge other assets for collateral.	The leased equipment itself is usually all that is needed to secure a lease transaction.
A loan usually requires two expenditures during the first payment period; a down payment at the beginning and a loan payment at the end.	A lease requires only a lease payment at the beginning of the first payment period which is usually much lower than the down payment.
The end user bears all the risk of equipment devaluation because of new technology.	The end user transfers all risk of obsolescence to the lessors as there is no obligation to own equipment at the end of the lease.
End users may claim a tax deduction for a portion of the loan payment as interest and for depreciation, which is tied to IRS depreciation schedules.	When leases are structured as true leases, the end user may claim the entire lease payment as a tax deduction. The equipment write-off is tied to the lease term, which can be shorter than IRS depreciation schedules, resulting in larger tax deductions each year. The deduction is also the same every year, which simplifies budgeting (equipment financed with a conditional sale lease is treated the same as owned equipment.)
Financial Accounting Standards require owned equipment to appear as an asset with a corresponding liability on the balance sheet.	Leased assets are expensed when the lease is an operating lease. Such assets do not appear on the balance sheet, which can improve financial ratios.

A larger portion of the financial obligation is paid in today's more expensive dollars.

More of the cash flow, especially the option to purchase the equipment, occurs later in the lease term when inflation makes dollars cheaper.

## V. What Types of Companies Lease?

Businesses that lease - called lessees - vary widely from small, one-person operations to Fortune 100 corporations, and the kinds of equipment being leased are just as diverse. Transactions range from a few thousand dollars worth of equipment (such as fax machines) to multi-million dollar cogeneration facilities, telecommunications systems, medical equipment (including CAT scanners and MRI imaging), office systems, computers, commercial airliners, and transportation fleets.

In 2006, \$229 billion worth of equipment is forecasted to be leased.

## VI. Evaluate Your Financing Options

A lease is a financing agreement for use of equipment. A lease is structured to meet your organization's special needs. To decide if leasing is the best option in your case, you must first understand those needs and ask yourself these questions:

- How does this equipment make your business more competitive?
- What is the most efficient use of your cash flow to pay for this equipment?
- How long will you use the equipment?
- What will your equipment needs be in the future?

Obviously, you will want to factor the cost of leasing into your evaluation. Generally, the cost of leasing is comparable to those of other financing options when looking at the whole transaction. It is important to point out that leases are not loans. As a result, their costs are figured differently from those of loans. Leases take into account that the equipment is worth something at the end of the lease term. This is called its residual. Residuals are built into lease pricing, usually making the lease payments lower than a loan. To compare lease products, it is better to compare monthly payments than to try to compare loan interest rates with lease rates. On a cost-of-capital basis, leasing may be the least expensive option.

Leasing companies can offer competitive rates for a number of reasons. Lessors - with their volume purchasing power - can secure attractive financing deals and pass along the savings to the lessee. The lessor also is better able to take advantage of the deduction for depreciation expense that comes with ownership.

Once you've completed your evaluation and decided to lease your next equipment acquisition, the first step is to select the type of lease that fits your needs. There are several different types of leases (see Glossary of Key Leasing Terms). You and your lessor should consider these factors in determining which is best for you.

- How long you want to use the equipment;
- What you intend to do with the equipment at the end of your lease;
- Your tax situation;

- Your cash flow; and
- Your company's specific needs as they relate to future growth.

You also will need to determine what happens at the end of the lease. Your options can include returning the equipment to the lessor, purchasing the equipment at fair market value or a nominal fixed price, or renewing your lease.

To design a leasing plan that best meets your needs, you need to understand your options. Discuss any questions or concerns you have with your lessor.