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BUSINESS.COM GUIDE TO EQUIPMENT LEASING

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THE BASICS OF EQUIPMENT LEASING

An equipment lease is a contractual agreement between the owner of the equipment (the “lessor”) and the user of the equipment (the “lessee”) for the right to use the equipment in exchange for payments made over time. Although you may have the option to eventually buy the equipment, you don’t legally own the equipment while it is being leased. The equipment manufacturer or dealer, or a financial institution such as a commercial bank or leasing company, funds the lease.

The big question: **Is it better for your** business to lease or to buy?

The short answer: It depends.

It depends on whether your need for the equipment is short- or long-term, your cash flow, your available credit line, and your tax situation. If you have limited capital or need equipment that must be upgraded every few years, a lease could be a better option than purchase, which is more suited for established businesses and equipment with a long life expectancy.
Simply put, leasing equipment for your business requires less of an upfront financial commitment than purchasing, and little or no collateral. It also enables you to acquire new technology quickly and relatively easily, as well as to easily dispose of and/or exchange equipment that has become obsolete or is insufficient to meet current or expanding needs.

There are tax advantages and disadvantages to equipment leasing. It is always best to consult an accountant to determine if leasing is beneficial in your specific business situation.

Equipment leases can range in length from one to 10 years, depending on the equipment and usage. Payments may be made monthly, quarterly, semi-annually, or annually.

You might also be able to obtain payment arrangements based on your cash flow or other financial requirements. Two common types of equipment leases are “skip” and “step” leases.

Skip leases allow you to miss payments during certain months without penalty. This is particularly attractive to seasonal businesses when cash flow varies significantly over the course of a year.

Step lease payments increase or decrease according to a predetermined schedule. A step lease in which payments increase is for situations pertaining to income-producing equipment, when a piece of equipment is not expected to earn much revenue at first, but will eventually generate more later in the lease. A decreasing step lease is when more is paid at the beginning of the lease. This type of step lease is generally attractive to businesses that anticipate a future reduction in revenues or are planning to incur future debt.

Lease payments are calculated according to a rate factor, or a fixed percentage calculated as a monthly charge per thousand dollars.

Example: The rate factor for a five-year (60-month) lease that charges $24.00 per $1,000 per month is .024. The payment for equipment costing $50,000 is $50,000 X .024, or $1,200 per month.

TYPES OF LEASES

There are two types of leases:

Finance Lease: Also called a “capital lease” or “conditional sale,” requires a full payout of the equipment cost plus all remaining finance charges at the end of the lease terms.

There are several types of purchase options:

- **$1 Option:** Lease payments at the end of the term completely cover the cost of the equipment plus finance charges. Ownership is then transferred for a nominal $1 fee.
- **Fixed Price:** The equipment is purchased at the end of the lease for a fixed percentage of its original cost, typically 5%, 10%, or 15%.
- **Fair Market Price:** Purchase price is the fair market value of the equipment at the end of the original lease term as determined by an independent appraiser.
- **Prepaid:** The expected fair market value at the end of the lease or a fixed percentage of the current equipment cost is paid upfront before the lease inception.
- **True Lease:** Does not require full payout of the equipment cost plus finance charges at the end of the lease, and typically there is no purchase option (although some variations do allow for a fair market option). This is also called an “operating lease” because you can’t classify a true lease as an operating expense for tax purposes since it is technically not an owned asset.

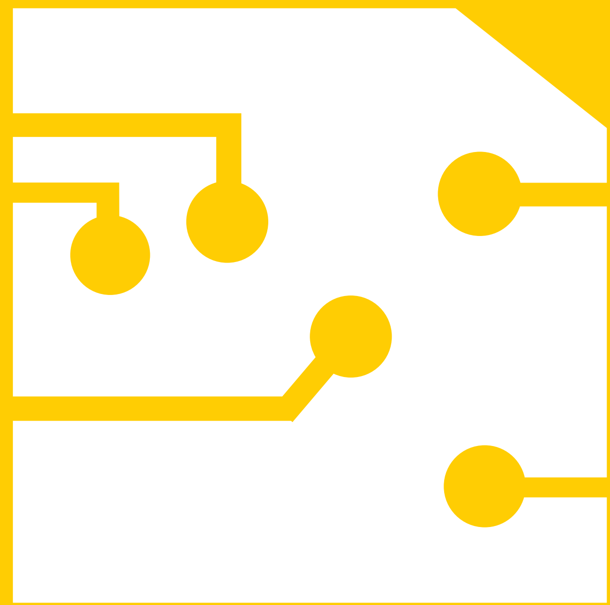
There are tax advantages to both types of leases. As you might expect in any tax situation, it can get complicated. It is always best to consult your accountant. In general, however, a finance lease is ideal if you want to eventually own the equipment.

A true lease, on the other hand, typically has a lower monthly payment than a finance lease and may be suited for equipment you may not want to own. Computer equipment and other high-tech equipment, for example, have relatively short “shelf lives” in terms of technological advances with new options, features and capabilities evolving every three to five years that you would most likely upgrade to anyway.

“A TRUE LEASE, ON THE OTHER HAND, TYPICALLY HAS A LOWER MONTHLY PAYMENT THAN A FINANCE LEASE AND MAY BE SUITED FOR EQUIPMENT YOU MAY NOT WANT TO OWN.”

ADVANTAGES OF LEASING

- **Reduced cash outlay**. Even if financing a purchase, typical loans require a minimum 10% upfront payment.
- **Save the time and hassle** of getting credit approval.
- **Preserve short-term credit** needs for other business uses.
- **Lease terms are generally more flexibl**e than loans to buy equipment outright, particularly if you have a poor credit record or can’t qualify for a longer loan period with smaller payments.
- **“Test drive” the latest technology** without long-term capital investment and commitment to use for entire product life.
- **Fixed-rate financing**. The terms stay the same regardless of interest rate fluctuations.
- **Maintain/reduce overhead**. Maintenance is frequently part of a lease agreement, or at least an option, so there’s no need to hire and train additional personnel to conduct maintenance, or increase the existing workload of your current maintenance staff.
- **Lease payments are tax deductible**, thereby effectively reducing the actual cost of the lease. In many cases, according the nonprofit small business association SCORE, “[...] monthly payments are often tax deductible and may offer a larger tax break than you would get if the equipment were depreciated.”
- **Obsolescent-proof**. For equipment such as computers or other high-tech equipment that become outdated every few years, you can easily dispose of old technology and acquire new technology without much capital investment.



“FOR EQUIPMENT SUCH AS COMPUTERS YOU CAN EASILY DISPOSE OF OLD TECHNOLOGY AND ACQUIRE NEW TECHNOLOGY WITHOUT MUCH CAPITAL INVESTMENT.”

DISADVANTAGES OF LEASING

- **You pay more**. Leasing is always more expensive over the long run than an outright purchase because you are paying finance charges.
- **You don't own it**. You don't have equity in the equipment, unless the lease has a purchase option, and even then you don't outright own the equipment until the lease period ends and you've exercised the purchase option.
- **You're committed to make payments for the length of the lease term**, even if you stop using the equipment or are dissatisfied with it. Some leases have a cancellation option, but these usually include high termination fees to discourage using it.
- **You are not eligible for certain tax incentives** and the depreciation deduction if you bought the equipment outright.

"YOU DON'T HAVE EQUITY IN THE EQUIPMENT, UNLESS THE LEASE HAS A PURCHASE OPTION, AND EVEN THEN YOU DON'T OUTRIGHT OWN THE EQUIPMENT UNTIL THE LEASE PERIOD ENDS."

TYPES OF LEASING COMPANIES

There are three types of equipment lease providers:

1. **Brokers:** An intermediary that "shops" lease requests to banks and other financial services to obtain lease funding. The broker charges a fee of 6% to 8% to obtain the necessary financing.
2. **Captive:** A subsidiary of the equipment manufacturer or dealer.
3. **Independent:** Companies that have their own funding sources to finance a lease. These include banks, dedicated equipment lease specialists, and diversified financial companies.

LEASING STEP-BY-STEP

Do the math. Finance charges for leasing are typically higher than commercial bank loans. If you can qualify for a bank loan to purchase equipment, it might make more financial sense over the long run than a lease. You might want to consult with your accountant.

Negotiate. Most leasing companies want to work with you. They want your business.

Get more than one quote. Get at least four. It will not only give you a good idea of what terms you may qualify for, it will help you negotiate.

"It is a good idea to get a quote from the leasing firm referred by the company that wants to sell you the equipment. The quote should be competitive. After all, the company selling products wants to sell as many as possible, and it surely doesn't win any points by referring a leasing company that gouges its customers." (Entrepreneur)

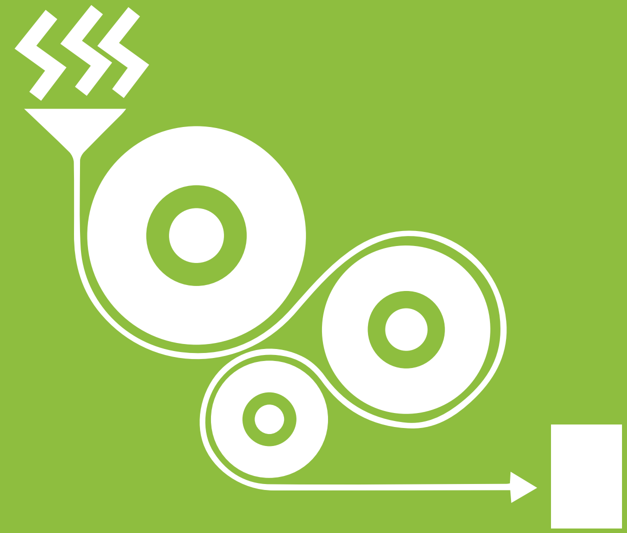
Don't fill out multiple applications. You can usually get many quotes without filling out applications. Lease applications are treated as credit applications and show up on your credit report as an inquiry. Too many credit inquiries can reduce your credit score, which, in turn, could impact your ability to qualify for a lease.

Section 179 Deduction: You may be able to deduct up to $100,000 for qualified leased equipment if your total equipment expenditures are less than $400,000 for the tax year. Check with your accountant.

You might get a good deal from a broker, but... brokers sell your lease to a national funding source, and typically tack on a broker's fee to do it. Some leasing corporations have sufficient capital to lend directly to you, and consequently may be able to offer more competitive terms. On the other hand, brokers can provide you with multiple options to get the best financing terms you would be able to obtain on your own.

Look for the ability to upgrade or downgrade. Don't get stuck with a lease on a piece of equipment your company will soon outgrow. Closely examine the trade-up or trade-in options. Ideally, you would like a lease that allows you to swap out equipment mid-lease to meet your business' changing needs.

Get the maintenance service package. Not all service packages are created equal.



Service packages usually cost a fraction of what a non-covered service call would cost. Also, you usually get access to phone or online support when you purchase a service plan. Be sure to see if labor and parts are both covered, and whether there's a limit to the number of service calls allowed in the package or a surcharge for excess calls.

"GET THE MAINTENANCE SERVICE PACKAGE. NOT ALL SERVICE PACKAGES ARE CREATED EQUAL. SERVICE PACKAGES USUALLY COST A FRACTION OF WHAT A NON-COVERED SERVICE CALL WOULD COST."

DOCUMENTS NEEDED FOR LEASES

Here's a list of the common types of documentation you should have with you when closing on a business equipment lease:

Business Information

- Financial statements (number of years)
- Tax returns (number of years)
- Credit history

Owner Information

- Personal financial/net worth statements
- Credit history
- Tax returns (number of years)
- ID (driver's license, passport)

Vendor Information

- Contact info

Equipment List

- Purchase price
- Installation cost (if applicable)
- Shipping/Training costs
- Annual maintenance costs

TOP TIPS FOR LEASING

- **Interest rates are low and are expected to remain relatively low for years to come.** Consequently, the cost of leasing is relatively "cheap." By leasing equipment, you can hold onto your cash reserves and have more on hand for other expenses.
- **Credit markets are generally favorable**. It shouldn't be difficult to obtain lease financing for equipment acquisition. Many companies will lend up to 100% of the price for new equipment.
- **Lease accounting standards are expected to change soon**. To what, nobody exactly knows nor is anyone sure how long it will take for any proposed changes to ultimately take effect.

- **Find out if there is a penalty (and how much) if you pay off the lease early**. If there is, consider whether you expect to use the equipment for the entire duration of the lease, in which case the penalty is moot. If not, you may want to negotiate this or look for a lease without a prepayment penalty.

"IT SHOULDN'T BE DIFFICULT TO OBTAIN LEASE FINANCING FOR EQUIPMENT ACQUISITION. MANY COMPANIES WILL LEND UP TO 100% OF THE PRICE FOR NEW EQUIPMENT."

CHECKLIST FOR LEASING

	My Needs	Lessor 1	Lessor 2
Type/conditions			
Finance Lease • $1 purchase option • Fixed price purchase option • Fair market value purchase option			
True Lease (Operating Lease)			
Skip Lease			
Step Lease • Payments increase over time • Payments decrease over time			
Prepayment Penalty?			
Maintenance/Service Charges			
Rate Factor			
Lease Term (months)			
Monthly Payment			
Total of All Monthly Payments			
Total of Payments vs. Purchase Price			
Ability to Trade-up/Trade-in During Lease			
Approval Time			
Leasing Company Type • Broker • Captive • Independent			

GLOSSARY OF EQUIPMENT LEASING TERMS

ACRS. Accelerated Cost Recovery System. Prescribes depreciation methods for 3-, 5-, 7-, 10-, 15- or 20-year classes.

Advance Lease Payments: The lease may call for one or more advance payments in addition to the first scheduled periodic payment. If there is more than one advance payment, the first advance is applied to the first month's payment, while any additional advances are applied to payments due at the end of the lease term.

Broker: Company or individual that arranges lease between lessee and lessor.

Captive Leasing Company: A subsidiary of a manufacturer or dealer formed to provide leases for its equipment.

Economic Life: The usable life of equipment; as long as an asset is usable, it has economic (resale) value.

Employee Engagement: The concept that engaging employees to assess and improve job satisfaction results in positive business outcomes. Example: An effective onboarding process correlates with higher employee retention.

Fair Market Purchase: The option to purchase equipment at the end of the lease term for its appraised market value.

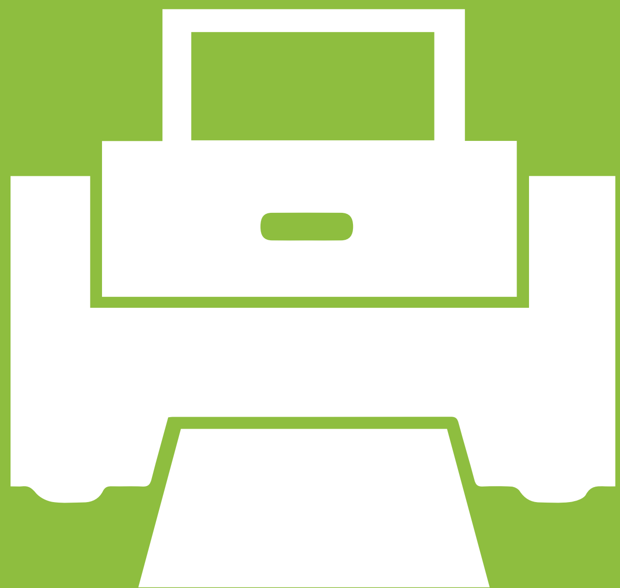
Finance Lease: Also called a "capital lease" or "conditional sale." It requires a full payout of the equipment cost plus all remaining finance charges at the end of the lease term.

Independent Leasing Company: Banks, dedicated equipment lease specialists, diversified financial companies and other services that have their own funding sources to finance a lease.

Lessee: The individual or company that is leasing an asset.

Lessor: Individual or company that is leasing an asset to the lessee.

Rate Factor: A fixed percentage calculated as a monthly charge per month per $1,000.



Residual Value: Resale value of an asset at the end of a lease term.

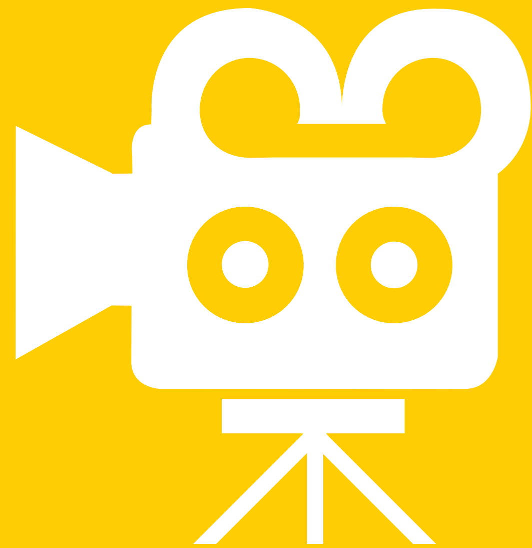
Sale Leaseback: Equipment purchased from the original owner that is then leased back to that original owner. This is a common way to transfer ownership to a holding company to take advantage of various accounting and taxation purposes.

Section 179: Allows you to deduct the full amount of the cost of acquiring new and used capital equipment, as well as some software, even if you don't pay the full amount during the tax year.

Security Deposit: Paid prior at, or prior to the start of, a lease, a security deposit is sometimes required to ensure against the non-return or abuse of equipment.

Step Lease: Payments increase or decrease according to a predetermined schedule. A step lease where payments increase is for situations when income-producing equipment is not expected to earn much revenue at first, but will eventually generate income later in the lease. Decreasing step leases suit businesses that anticipate a future reduction in revenues or are planning to incur future debt.

Skip Lease: No payments during certain months without penalty. For seasonal businesses when cash flow varies significantly over the course of a year.



Terminal Rental Adjustments Clause (TRAC) Leases: Used in the leasing of commercial vehicles, a TRAC lease specifically states what the value is for the asset at the end of the lease.

True Lease: Also called an "operating lease." Does not require full payout of the equipment cost plus finance charges at the end of the lease, and typically there is no purchase option (although some variations do allow for a fair market option).

Uniform Commercial Code Financing Statements (UCC1): Standardized form filed with the state and/or county where equipment is used to secure ownership of leased equipment.