

# **About Equipment Leasing**

**...And 2 Things Your  
Banker May Not Tell You!**

# What Exactly Is Leasing?

- An equipment lease is a contract for the use of a specific piece, (or multiple pieces of), equipment or furnishings for a specific period of time and for specific lease (rental) payments agreed upon in advance.
- The lessor is the owner of the leased equipment and makes the initial cash investment for its purchase. The lessee is the user of the equipment and gets all the benefits of its use, just as if they owned it. Leasing lets you finance the use, without having to finance the purchase.
- **No business pays it employees' salary in advance.** Instead, people are paid as they contribute. It should be no different with a contributing asset like business equipment. Leasing is the use of an asset. **Asset leasing enables you to pay monthly as you utilize.**

# What Kinds Of Businesses Lease Equipment?

- Any growing business can benefit from using equipment leasing. It provides a practical way to stay abreast of the latest trends and use the newest, most productive equipment without draining valuable equity cash from the business or tying up important bank lines of credit. Tying up cash in fixed assets can severely restrict the ability to move quickly on other opportunities.

# Why Businesses Lease Equipment

- **Make money using; not owning; new equipment**

Remember, your business makes money by using your equipment, not by owning it; you don't have to own the electric company to benefit from electricity. A plan which lets you defray, delay or diminish costs by using someone else's equipment may be more practical than buying your own.

- **Use cash for other reasons**

Fast growing, successful businesses recognize the need to move quickly on income opportunities. They want their cash and bank credit lines available and not tied up in depreciating assets.

- **Faster write off**

A properly written lease may offer you the fastest possible way to write off the costs of using new equipment. This lets you use money you would have paid in taxes to help keep your business modern and competitive.

# Why Businesses Lease Equipment – cont.

## ■ Cash Flow

Equipment Leasing generally requires the least amount of up front cash to get new equipment in place and working for you. Just as you wouldn't pay a new employee their lifetime wages in advance, it's not necessary to pay up front for all the expected utility and benefit of new equipment or furnishings. Leasing them let's you pay for them as they work for your business.

## ■ Hedge against obsolescence

Also, by writing it off faster, you avoid making long term commitments to rapidly changing technology. Under the current MACRS, (Modified Accelerated Cost Recovery System), depreciation schedules, it may take you 6 or 8 years to fully depreciate the purchase of technology you may only use for 3 years. Computers, telecommunication systems, and medical equipment are all good examples.

# What Can Be Leased?

- An amazing variety of things can be leased. Basically, anything that can be considered personal property, not permanently attached to real estate, can be leased. A good rule of thumb is; if it can have the same use somewhere else and can be moved there, it can be leased.

# Doesn't It Cost More To Lease?

- Leasing is a practical way to use new equipment and compares favorably with other forms of financing, costing you about the same. That, of course, is no coincidence; the marketplace demands it and leasing rates are set accordingly.
- Leasing companies look at what typical bank loan rates are and then factor in your interest deduction and depreciation to arrive at what a loan really costs you; your *net after tax cost*. They then set their rates to be competitive and work backwards, factoring in the greater deductions offered by the lease, to arrive at lease payments that will give you the same approximate net cost.
- Anyone who says that leasing always costs more is just as wrong as anyone who says it always costs less. The truth is it costs you about the same to lease equipment as it might to buy it. Businesses lease for cash flow and other reasons as cited above.

# What's the interest rate?

- Because you're not borrowing any money when you lease equipment, there's no interest rate on the lease like there would be on a bank loan. You can, however compare the cost to lease with the cost of a loan.
- To accurately answer that question you have to look at your net-after-tax-cost. The "list price" may not tell the whole story. Just as a \$625 television in an electronics store appears to cost more than the \$600 model sitting beside it; if there's a \$25 rebate on it, then its net cost to you is the same. Not looking at the total transaction; the net cost; might "cost" you the choice you really want to make. Comparing leasing and purchasing is very similar.



*To Lease or Not  
to Lease...*

### **Leasing**

A non-cancelable contract extending over a fixed term

#### **ADVANTAGES**

- \* Expense entire payments
- \* Easy add-on/Trade up
- \* 100% Financing
- \* Conserves Capital
- \* Can lessen Tax Liability
- \* Flexible Terms
- \* Hedge against Inflation
- \* Obsolescence protection
- \* Fixed Terms & payments
- \* Full use without ownership
- \* Creates new credit source

#### **DISADVANTAGES**

- \* Non-cancelable

### **Bank Loan**

Repaid in regular installments

#### **ADVANTAGES**

- \* Direct Ownership
- \* Depreciation
- \* Appropriate when bank lines remain untapped or there is a loan covenant requirement

#### **DISADVANTAGES**

- \* Capitalizes Equipment
- \* Relatively Short Term
- \* Extensive documentation
- \* Covenant Restrictions
- \* Exhausts credit line
- \* Non-Financeable charges
- \* No obsolescence protection
- \* May require a down payment, compensating balances, origination fee
- \* Non-cancelable

### **Cash Purchase**

Using working capital for acquisitions

#### **ADVANTAGES**

- \* No Finance Charges
- \* Direct Ownership
- \* Depreciation
- \* Appropriate when lacking investment alternatives for excess cash, or annual depreciation expense exceeds annual capital expenditures

#### **DISADVANTAGES**

- \* Attacks Cash Reserves
- \* Negates Time Value of Money
- \* No hedge against inflation
- \* No obsolescence protection



**Smart Finance Options, Inc.**

Commercial Financing and Equipment Leasing

# What Kinds Of Leases Are There?

- Equipment leases can be written for a variety of terms up to 84 months, but typically range from 12 to 60 months. The most popular term is 60 months. Most leases are monthly - but quarterly and annual payment leases are also done.
- Also available are step payments, wherein the lease payments start out low and increase each year; delayed payments, wherein the equipment can be installed and used for several months before the lease payments begin; seasonal payments, wherein the payment schedule can be set to match the seasonal cash flow of the business; and a variety of other customized terms.

# What Kinds Of Leases Are There?

Cont.

- **True Leases** -- Sometimes called "tax" or "FMV" leases, these are designed to meet IRS tax guideline definitions of a lease and may offer you the fastest way to "write-off" the use of new equipment. Leased equipment may be re-leased, purchased, returned or traded in at the end of the lease.
- **Abandonment Leases** -- Frequently called "\$1-Buy-Out" leases, these transfer ownership for a token sum at the end of the lease. They're basically a sales finance type contract. They offer the convenience of leasing for those not needing the full tax deductibility of their lease payments.
- **Operating Leases** -- This type of lease can be designed to meet accounting standards for off-balance sheet financing according to FASB (Financial Accounting Standards Board) rules.
- **Sale/Leasebacks** -- In this type of lease, the lessor purchases the leased equipment from the lessee who leases it back from the lessor and continues to use it. It's an effective way to free up working capital which may be tied up in fixed assets.

# What Happens At The End Of The Lease?

- What happens at the end of your equipment lease is up to you. You may make that decision at the beginning by the type of lease you choose or, more likely, you'll want to choose a lease that allows you the flexibility of waiting until the end of the lease to decide. Generally it will be one of these choices:
- **You may return the equipment at the end of the lease with no further obligation.** Assuming the equipment is in normal working condition, your security deposit will be refunded to you.
- **You may re-lease the equipment.** Many leases offer annual or monthly renewals at re-negotiated lease payments. Because the leasing company has already gotten a good deal of their investment back, you can generally look for drastically reduced lease payments.
- **You may trade in or upgrade the equipment** for a lease on newer equipment. In this way you may effectively get the value of a trade in on equipment you didn't even own.
- **You may purchase the leased equipment.** In the case of the so called "\$1-Buy-Out" lease, you'll take ownership for \$1.00.

**2 Things  
Your Banker  
May Not Tell You!**

# 1-Leasing uses up your credit line

- It comes as an untimely surprise to many business people when the available cash they've been counting on through their bank credit line is **reduced by the amount of equipment leases they've done with the bank's leasing department.** Because commercial credit and leasing are frequently different departments within the bank, it's easy to assume that the commitments made by each are separate and cumulative.
- **That's rarely the case.** That's also why successful money managers plan ahead and establish multiple, unrelated credit sources, turning to independent, non-bank leasing companies for their equipment needs. **Your bank has a credit limit that they'll extend to you and typically whatever you do with them counts towards that credit limit, whether it's short term cash borrowing or long term leasing.** If you want to be sure to have cash available quickly when you need it, you won't want to tie that credit line up in leasing fixed assets from your banker.
- **Turn to independent leasing specialists.** That's all they do. Keep your money in the bank.

## 2-Compensating balances increase interest costs

- Many businesses are lured by seemingly unbeatable rates to bank leasing plans as part of an overall banking plan. But if any part of that plan includes minimum or compensating balances in any other account, it's may not be as good as it seems. The promise of any kind of financing at prime rate is always flattering. But for a \$50,000 package with as little as \$2,000 required to be kept in any related account, the actual rate can be as much as 2% over prime!
- Banks play an important role in financing your growth, but it always pays to ask questions and shop around.  
**For equipment leasing, turn to leasing specialists.**



# **Smart Finance Options, Inc.**

**Commercial Financing and Equipment Leasing**



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