FIVE MYTHS ABOUT EQUIPMENT LEASING

Your assumptions about leasing may not be accurate.

by Richard McAuliffe

WHEN IT COMES TO FINANCING capital expenditures, you're probably well versed in the options.

But are you shying away from leasing capital expenditures because it seems just like a term loan? Maybe you've heard that it's just for manufacturing equipment or technology, or it sounds too complicated. You might change your mind about leasing after learning about some of the myths of this popular equipment financing option.

Myth 1 – Leasing is just for technology: Leasing can make sense for all types of capital expenditures, from medical equipment to commercial vehicles and construction equipment to warehouse racking and shelving and everything in between, including IT and communication equipment. If it's equipment – and sometimes even if it's not – it can be leased.

In many cases, companies can even include the cost of installation, service, training and other types of customer support into a lease transaction, making it easy to pay for everything affiliated with a new piece of equipment in a single, predictable monthly payment.

Myth 2 – Leasing is too expensive: With the right financing structure, leasing is competitive with debt instruments and other financial intermediary options, particularly for companies with strong financial statements. Access to the bond market by large companies is a reasonable option, but the rate alone does not reflect the true cost of the borrowed money.

Myth 3 – Leasing is too complicated: In many cases leasing is often less complicated and much faster than a commercial banking transaction. The process for applying and qualifying for lease financing is simple, and in many cases approval can be granted in less than 48 hours. Purchase Money Security Interest (PMSI) secures only the asset(s) within the lease and will not disrupt bank relationships, which further simplifies leasing when compared to commercial banking.

Myth 4 – Leasing isn't right for my company: Nearly every kind of business can use leasing. The two most common lease types are the capital lease, also known as a finance lease, and the operating lease, also known as an off-balance-sheet lease.

The capital lease offers the widest flexibility of term length, which can help keep payments low. With a capital lease:

- Title to equipment is held by the lessor and passes to the lessee when the purchase option is exercised.
- The asset and associated liability are shown as a fixed asset and long-term liability on the balance sheet.
- On the income-statement, the interest portion of the rental and depreciation are expensed.
- For tax purposes, the lessor claims Capital Cost Allowance (CCA) and the lessee is entitled to deduct the full amount of the lease payment.
- There is generally a purchase option available at the end of the original term or stretch term.
- There is no mechanism to return the equipment.
- Traditionally, 100% of the asset purchase cost is financed, and GST and PST are paid by lessor and collected from lessee over the lease term.

With an operating or off-balance-sheet lease, terms are typically shorter than capital leases, and the arrangement resembles a rental. With an operating lease:

- Title to equipment is held by the lessor and passes to the lessee if purchase option is exercised.
- The asset and associated liability are not reflected on the balance sheet. The lease/rental obligations are disclosed in the notes to the financial statements.
- From an income-statement perspective, the full rental is expensed.
- For tax purposes, the Lessor claims CCA and the lessee is entitled to deduct the full amount of the lease.
- There is generally a purchase option available at the end of the original term of Fair Market Value, which, on occasion, can be capped at an agreed-upon amount.

Leasing is often less complicated and much faster than a commercial banking transaction.

- There is mechanism to return the equipment.
- Traditionally 100% of the asset purchase cost is financed, and taxes are collected from the lessee over the lease term.

Another type of lease financing is the ABC or synthetic operating lease. ABC leases typically contain a clause stipulating that the lessee cannot return the equipment.

Myth 5 – All leasing companies are the same: The lessor takes the risk of owning the equipment you're acquiring. It's important to find one with financial stability, industry experience and the ability to make application decisions quickly and flexibly.

Richard W. McAuliffe is Senior Vice President and Chief Operating Officer of the Canadian region of Key Equipment Finance (www.kefonline.com). He can be contacted at (905) 331-3902.