



Purchasing Equipment For Your Company...

Ultimately, It's Your Decision

At some point during a company's equipment acquisition process, the question always seems to come up: "Should I lease or should I finance?" Of course, paying cash is an option too, but not one that many growing and expanding companies have the luxury of doing, especially in today's economy, and particularly in the trucking industry.

Many articles and whitepapers have been written on the advantages and disadvantages of financing and leasing – and then suggest one over the other based upon the writer's

point-of-view: are they trying to get you to lease or finance? The objective of this article is to provide the facts about both, so that YOU can decide which option is right for your business. No two businesses are alike and their financial situations can differ. What may work for one company may not work for another similar company. *It is recommended that you confer with your Tax Consultant in order to make the final determination of tax deductibility.* **What's right for YOUR business?**

Leases

Whenever a seller, lender or finance manager begins to talk about leases, many folks are unclear about what leases really are. What are their benefits and pitfalls? What are all of the factors that need to be considered before making a lease versus retail finance decision? Therefore, many buyers may stay away from an attractive and beneficial method of acquiring equipment for their company.

Let's look at the three primary types of leases and their similarities and differences:

Leasing vs. Financing: What's Right For Your Business?

one TRAC Lease Terminal Rental Adjustment Clause

- A **Finance (Capital) Lease** where the lessee retains ownership of the equipment.
- Lessee is responsible for the TRAC value at termination, with the option to purchase the equipment at a pre-determined price at the end of the lease.
- A TRAC lease is a special type of **True Lease** that is often used for “over-the-road” vehicles like trucks, tractors and trailers. A True Lease is a type of transaction that qualifies as a lease under the Internal Revenue code. It allows the lessor to claim ownership and the lessee to claim rental payments as tax deductions.
- Special provisions of the I.R.S. code allow for pre-determined **Residual Values** (as opposed to “future or fair market values”) to be negotiated at the time of the lease.
 - *This allows you to maintain the “full deductibility” of a **True Lease**.*

two Finance Lease Capital Lease

- Another type of lease is a **Finance (Capital) Lease** where the lessee retains ownership of the asset.
 - May also be referred to as a nominal or (\$1) dollar-buyout lease. These leases share the advantage of fixed monthly payments but with the guaranteed option to purchase the equipment for a nominal price at the termination of the lease.

- With this type of lease there is *no uncertainty about the value of the equipment* at the conclusion of the lease as the buyout terms are generally a part of the initial agreement.
- The lessee is considered the owner of the equipment and maintains full control of the residual value, unlike an FMV lease.
- The lessee can depreciate the equipment.
- Lessee generally records the equipment as an asset and the lease payments as liabilities on their balance sheets.

three FMV Lease Fair Market Value Lease

- The most notable feature of this type of lease is that its structure does not contemplate a full payout of the cost of the equipment as is the case in a **Finance (Capital)** type lease.
- Two common requirements are:
 - The term of the lease is generally not greater than 75% of the equipment’s anticipated useful life.
 - The present value of the lease payments should not exceed 90% of the **Fair Market Value** of the equipment using the lessee’s incremental cost of borrowing.
- A significant benefit is that the monthly payments are generally less on an **FMV Lease** than on a **Finance (Capital)** type lease (described above) or even a bank loan.
- Typically the lessee has either two options:
 - Returns the equipment at the conclusion of the lease yet responsible to meet pre-established return requirements and excess mileage charges.
 - Ask for and be granted the opportunity to purchase the equipment from the lessor for the fair market value.

Leasing vs. Financing: What's Right For Your Business?



- Payments under this kind of lease structure are treated (by the I.R.S.) as rental payments and therefore are generally 100% tax deductible as operating expenses. Also, as rental payments, neither the asset nor its corresponding liability typically appears on the company's balance sheet. The lessor (owner) retains the right to depreciate the equipment on their books.
- An FMV Lease is considered a "Walk-away" lease with return conditions & mileage caps.

Why Choose Leasing?

- There are beneficial accounting & tax implications
 - See your Tax Consultant in order to make the final determination of tax deductibility. A financial tax advisor or qualified accountant can help you determine the advantages or disadvantages of leasing specific to your company.
- You may obtain lower monthly payments and improve your **Cash Flow**
 - Lower Payments can preserve vital cash that may be needed for additional improvements or expansion of your company
 - Frees up working capital lines of credit for other business needs
 - You only "pay for what you use"

- You may be able to purchase necessary equipment with Little or No Money Down with a **TRAC Lease** or **Finance Lease**
 - Generally, these leases require minimal cash outlay
- You can choose from potential Income Tax Advantages
 - The **FMV Lease** or TRAC Lease provides flexibility if your company does not need the depreciation for its books. The **Finance Lease** does not.
- You can choose between the advantages of ownership and non-ownership
 - With a **FMV Lease** (only), the equipment asset does not appear on your balance sheet (Operating Lease).
 - With an TRAC or Finance Lease the asset generally does appear on your balance sheet (Capital Lease).
- An FMV Lease allows you to potentially take advantage of future truck values.
 - Also may guard you against rapid deterioration of future truck values.
- Leasing offers you more flexibility & convenience
 - You avoid **capital expenditures**
 - You only "pay for what you use"

General Leasing Benefits

- A Capital Lease (Finance Lease) allows you to spread state sales tax liability over the term of the contract (check with your local State Regulations)

Leasing vs. Financing: What's Right For Your Business?

- Finance lease may require a standard down payment based on credit quality.
- TRAC and FMV leases typically require lower upfront costs as compared to a Finance Lease – preserves cash
- A retail financed contract often requires a larger down payment
- An FMV lease generally allows you to expense lease payments
- TRAC and FMV leases are written to a residual value at termination, which significantly reduces cash flow through the term
- TRAC and FMV leasing can free up your credit line availability
- A **TRAC Lease** gives you ownership options at termination at a known residual value versus an **FMV Lease**

A Few Facts...

Fair Market Value (FMV)

lease facts

- An FMV lease allows you to “walk away” at termination
- You essentially “pay for what you use”
 - An FMV does carry with it certain Return Conditions and Mileage Limits, generally 120,000 miles per year
- You are responsible to return the unit in a condition meeting standard “Trade Term Conditions”
 - Trade terms are spelled out in detail in the Lease Agreement and should be reviewed prior to maturity
- You can purchase the asset at Fair Market Value price at maturity

Important FMV point to remember!

- You will be responsible for any excess mileage costs
 - Generally \$.05 per mile, up to 102% of the mileage limit agreed to. \$.10 per mile thereafter
 - It is important to review and understand your Return and Excess Mileage commitments

TRAC

lease facts

- Generally, you have the option to purchase the unit for the stated residual value at maturity
- Or you may be able to trade it with the dealer if the dealer agrees to accept for the TRAC value
- Remember, a TRAC Lease is NOT an **FMV Lease**, so there are no mileage, maintenance or return condition requirements
- You may be able to trade the unit at maturity and use the value above the TRAC residual as **advance payments on a subsequent TRAC Lease**
- Or, you may want to retain the unit a while longer IF the lender will agree to continue the lease or refinance the residual for some nominal period
- In all cases, you own the unit for the residual value. Once an option is selected, it's your asset!
- Remember, though, if you offer to allow the Lessor to dispose of your unit, any shortfall below the stated TRAC residual remains your financial responsibility to the Lessor.

Leasing vs. Financing: What's Right For Your Business?

TRAC Lease Example

2006 Volvo VNL 670. 350 – 385K miles. 48 Month Term. Small Fleet.

Capitalized Cost	\$40,950.00	
Capitalized Cost Reduction	\$912.00	(2.2%) 1st Payment
Adjusted Capitalized Cost	\$40,038.00	
X Payment Factor	X .02226	
Monthly Lease Payment	\$891.24	
Residual	\$8,190.00	@ 48 months

Standard Finance Example – Example based on Retail Financing

2006 Volvo VNL 670. 350 – 385K miles. 48 Month Term. Small Fleet.

Sales Price	\$40,950.00	
Down Payment	\$ 4,095.00	(10%)
Amount Financed	\$36,855.00	
Interest Rate	12.00%	
Monthly Payment	\$970.53	
Monthly Payment Difference	\$ 79.29	
Cash Flow Savings =	\$3,806	@ 48 months

TRAC Lease Vs. Standard Finance Comparisons

By reviewing the charts to the left, if a small fleet, for example, is adding 5 trucks to their fleet and decides to utilize a **TRAC Lease**, there is a cash-flow savings over 48-months of \$19,030.

However, the initial cash outlay (**Capitalized Cost Reduction or Advance Rentals, depending upon the Lessor's practice**) on a lease compared to the Down Payment on a financed deal, varies significantly: ***\$20,475 on a financed transaction versus \$4,560 on a lease.***

And at the end of the TRAC lease, you will be responsible for paying the Lessor \$8,190 if you decide to keep the equipment. You also have the option of selling the equipment at the current Market Value. If the value is less than \$8,190, you are responsible to pay any difference to the Lessor. ***If Market Value is more than \$8,190, then you capitalize on the gain. What's Right for Your Business?***

Leasing vs. Financing: What's Right For Your Business?

	Standard Finance - Taxes In	Finance Lease
Sales Price	\$40,000	\$40,000
Fees	\$200	\$200
Sales Tax (may vary by State)	\$3,620	\$0
Delivered Price	\$43,820	\$40,200
Due from Customer at Closing	\$9,820	\$6,813
Less Tax on Down Payment	\$0	\$613
Net Effective Down Payment	\$9,820	\$6,200
Amount Financed	\$34,000	\$34,000
Loan Term - Months	36	36
Monthly Principal & Interest Payment	\$1,179	\$1,179
Plus Sales Tax on Monthly Payment	\$0	\$106
Total Monthly Payment	\$1,179	\$1,285
Total of Payments	\$42,430	\$46,249
Down Payment	\$9,820	\$6,813
Total Time Cost of Purchase	\$52,250	\$53,062

Finance Lease Vs. Standard Finance Comparisons (Tax - In State)

As shown to the left, *you are able to purchase the truck through the Finance Lease for about \$3,015 less* due at Closing, with the additional sales tax cost spread over the three-year term of the lease.

The sales tax liability difference between **Finance Lease** and **Standard Finance** is \$3,620

By reviewing the charts to the left, if a small fleet, for example, is adding 5 trucks to their fleet and decides to utilize a **Finance Lease**, *there is a sales tax savings of \$196.*

The finance lease advantage over FMV lease is there are no early termination (payoff) penalties. *What's Right For Your Business?*

But I Still Have Questions

“I really like this piece of equipment, but how can I afford it?”

- It may make sense to consider a TRAC lease, since it can provide you with lower payments than financing
- Leasing can provide lower initial cash outlays versus traditional retail financing
 - First payment versus substantial down payments
- You can use your trade-in to reduce the Capitalized Cost and reduce payments even further

“I really like this piece of equipment, but this monthly payment is too high!?”

- Take a look at an example of how leasing to a residual can reduce monthly payments substantially – perhaps \$100's per month
- Ask your lender to extend their term another 6 or 12 months
- What is your current truck costing you in maintenance? Could the purchase of a newer truck save dollars in maintenance and mileage to offset the increased monthly payment?
- OK, no one really wants to consider buying a higher mileage unit, but they do cost less!

“I can't afford to pay anything up front.”

- Determine what monthly payment you can handle
- Determine if leasing is the right solution for you
 - Remember: Leasing initial cash outlays are typically much less than for retail financing
- Talk to your finance professional to determine other ways of making the finance transaction work for you.

Retail Financing And Leasing Terminology

Retail Financing

Total Sales Price
Down Payment/Trade Equity
Amount to Finance
Balloon
Payment Factor
Interest Rate
Monthly Payment
Term

Leasing

Capitalized Cost or Cap Cost*
Capitalized Cost Reduction**
Adjusted Capitalized Cost
Residual
Payment Factor***
Implicit Rate
Monthly Payment
Term

* *Capitalized (Cap) Cost: The total cost of a leased truck, similar to the sales price used in retail financing.*

** *Capitalized Cost Reduction: Any payment or trade-in on a lease which is made to reduce the capitalized cost, similar to a down payment.*

*** *Payment Factor (Leasing): The number provided by the lessor to calculate monthly payments. Whereas payment factors in retail financing are solely based on interest rates and terms, payment factors in leases are calculated through a formula that includes the monthly cash and tax flows, as well as the implied rate (i.e., interest rate), term and the residual value.*