100%

EQUIPMENT

FINANCING

AND

LEASING

PROGRAM

AT

THE

LOWEST

PRICE

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WHAT IS A LEASE?

A lease is simply an agreement by the customer to pay a monthly rent for a specific amount of time for the right to use equipment during the term of the lease period. The customer does not own the equipment during the term of the lease but is usually responsible for insurance, maintenance, and all other costs of ownership.

According to small Business Administration, seven out of ten American companies lease some of their equipment-every year a growing number of companies choose to procure new productive equipment through leases rather than loans. A loan requires the end user to invest a down payment in the equipment. A loan usually requires the borrower to pledge other assets for collateral.

WHY LEASE?

Leasing has become the preferred method of acquiring equipment among businesses. Currently, **30%** of all equipment is leased. Leasing offers real advantages including better value, more convenience, and greater control.

MAKE BETTER USE OF YOUR MONEY

- Conventional debt financing may be 15-25% down payment.
- Bank loans usually require more down payment up front than leasing.

FINANCE 100% OF YOUR COSTS

In most cases, the full amount of the equipment, as well as the service, shipping, installation costs, and maintenance can be included in the lease. You can tailor a solution that meets your requirements.

Leasing is flexible so that you can tailor the length and amount of your down payments to meet your business needs.

IMPROVE YOUR CASH FLOW FORECASTING

The fixed nature of a lease obligation eliminates uncertainty about the future cost of the equipment. Leasing allows you to increase the cash flow of your company.

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.

100% financing. Since a lease does not require a down payment, it is equivalent to 100 percent financing.
Balance sheet management. Because an operating lease isn’t considered a long-term debt or liability, it does not appear as debt on your financial statement.

IMMEDIATE WRITE-OFF OF THE DOLLARS SPENT

Leasing payments are treated as expenses on a company's balance sheet.

Flexibility. As your business grows and you need change, you can add or upgrade during lease term.

Speed. Leasing can allow you to respond quickly to new opportunities with minimal documentation.

FLEXIBLE END OF TERM OPTIONS

There are several options for disposing of equipment after lease term ends including returning the equipment, renewing the lease or purchasing the equipment.

ADVANTAGES OF PRE-APPROVED BEFORE YOU BUY ANY EQUIPMENT

1. **Prudent.** There are no costs to you for approvals or credit check.

2. **Renewable.** Your credit line may be renewed upon expiration by simply submitting updated financial data.

3. **Choice.** Be approved for specific equipment, or if you prefer, a lease line approval up to a specific dollar amount.

4. **Ease.** The quick application is a simple one page.

5. **Sensible.** With pre-approved lease financing in place, you can:

- **Plan for growth in an orderly fashion**.
- **Hang on to your working capital and bank lines**
- **Shop like a cash buyer for the best terms and price**.

A **capital** lease has the characteristics of a purchase agreement and also meets any one of the **four criteria**: only that portion of the payment that applies to interest and the depreciation may be expensed.

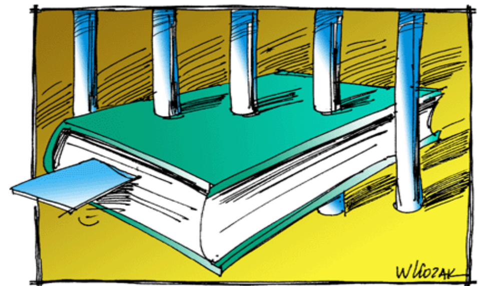
1. The present value of the minimum lease payments at the beginning of the lease term is equal to or greater than **90%** of the fair market value of the property.
2. The lease term is equal to or greater than **75%** of the estimated economic life of the leased property.
3. The lease agreement has a bargain **purchase option**.
4. **Title** to the property automatically transferred to the lease by or at the end of the lease term.

An **operating** lease has the characteristics of usage of the rental agreement and meets none of the four criteria.

In the year 2003, **$700** billion worth of equipment was purchased in the United States of America and **220 billion dollars** were financed through different banks and other financial institutions. By looking at the above figure, we can reach to conclusion that **31%** of business owners need or prefer to obtain financing for the equipment that they purchased for their businesses.

In order to obtain an approval for leasing an equipment, the following items are needed:

1. **Type of equipment**
2. **Value of equipment**
3. **Expiration date of the leasing contract**
4. **How much is the advanced payments?**
5. **Type of lease**
6. **What are the closing costs and expenses?**
7. **Sales tax and insurance requirements**
8. **Residual treatment**
9. **What type of credit score is required?**
10. **Purchase price**
11. **Option to buy**
12. **Duration of payment**
13. **Who is going to sign the contract and will be personally reliable?**
14. **Who are the parties to the lease transaction, lender, vendor or broker?**



Usually, the proposal letters are very well self-explanatory.

To understand the credit process and to be able to analyze **the tax return, balance sheet, cash flow, and financial statements** is very important.

<u>This process is designed to determine if a borrower is able to make the payments on time:</u>

1. **The ability and desire to repay the debt.**
2. **The financial capability to make the payments.**
3. **Borrower has sufficient financial backup for future payments.**

<u>The process of credit application is working like this:</u>

In most cases, the computer will decide on the **credit scoring** system or a professional underwriter who is familiar with rules and policies in making the final decision.

Before coming up with a conclusion, the following routine **credit check** has to be done for sufficient credit references:

1. **Structure of the lease**
2. **Bank rating of the borrower**
3. **Existing trade rating reference**
4. **Landlord payment rating**
5. **New or used equipment**
6. **Location of equipment**
7. **Personal credit score of the lessee**
8. **Years in business**
9. **Lessee's industry type**
10. **Lease structure**

Each bank has its formula to determine the degree of risk based on experience.

The vendor may have a supplier that requires **cash payment** to ship products or equipment.

1. If the vendor requires advance funding to meet the terms of this supplier, will you be able to make this accommodation?
2. How will you work with your funding source to process credit applications?
3. Will you need an increase in your bank credit line to accommodate the anticipated volume increase?
4. Will your vendor assist in managing equipment risk by offering re-marketing?

<u>CREDIT PROCESS AND FINANCIAL STATEMENTS</u>

Credit is the process of lending that determines the acceptability of a proposed transaction, based on the inherent risk of the transaction and the lender's or lessor's credit policies.

The process is designed to determine if a prospective borrower/lessee has the following attributes:

1. **The financial ability to make the payments.**
2. **The desire to repay the debt.**
3. **The reserves to withstand unexpected setbacks.**

The three basic "C's" are:

1. **Character –** the desire to repay the debt
2. **Cash flow -** the ability to make the payments
3. **Capital -** the ability to withstand unexpected negotiations.

LANDLORD'S WAIVER

A Landlord's waiver is an agreement that the lessee's landlord for the real property upon which the equipment will be located will not have an interest in the equipment, will waive any rights to lieu of the equipment for rent, and will not interfere if the lessor should need to repossess it.

1. An acknowledgment that the equipment lease does not breach any terms and conditions of the lessee's real estate lease.
2. An agreement to not impede any repossession efforts by the lessor.
3. A waiver of any rights to lieu of the leased equipment for non-payment of rent to the landlord.
4. A waiver of any interest the landlord may have or try to claim in the equipment.
5. An acknowledgment of the character of the property as personal rather than as a fixture or a component of the real estate.

INSPECTION RIGHTS

Inspection rights give the lessor the ability to physically examine the equipment to verify or determine if it is being properly maintained by maintenance provisions contained within the lease agreement.

RETURN PROVISIONS

If, at lease expiration, the lessee chooses not to purchase the equipment or renew the lease, the terms and conditions of the lease need to address the return of the equipment where it will be returned, and who will pay the costs of the return.

1. CONDITION OF EQUIPMENT

The equipment and its related components should be in proper working order and condition and must have been maintained accordingly. The equipment should be in an acceptable condition.

2. NOTIFICATION PERIOD

To avoid surprise equipment returns at lease expirations and to give the lessor an adequate amount of time to remarket the equipment. This notification period should be at least **75** days before lease expiration.

3. RETURN LOCATION

Determining where equipment will be returned at lease expiration is critical. The equipment should be returned to a location that is suitable for remarketing.

4. EQUIPMENT DEINSTALLATION

When equipment is removed from services and packaged for shipment and packaged for shipment, the reinstallation must be done according to approved manufacturer's specifications to avoid any unnecessary damage.

5. RETURN EXPENSES

Return expenses include equipment **reinstallation, shipping, transportation, insurance** while in transit, and storage at the return location. Some leases stipulate that the borrower/lessee must store the equipment at its site for up to **75 days** after lease expiration at the expense of the lessee.

6. TERMINATION OPTIONS

These options include the purchase of the equipment, renewal of the lease or return of the equipment.

7. RENEWAL OPTIONS

A renewal option grants the lessee the ability to extend the lease on a **month-to-month** basis or for a fixed term.

1. EQUIPMENT REMARKETING PROCEDURES

Remarketing is the process of determining the method of liquidating used equipment inventory that yields the highest possible selling price.

2. EQUIPMENT VALUE

The value of used equipment may be determined in several ways. Some of these methods are discussed in this section.

3. BLUE BOOKS

This type of guide states what equipment should be worth given a certain configuration.

4. SALES DATA PUBLICATIONS

Sales data publications list the selling of actual previous sales of equipment.

5. ADVERTISING PUBLICATIONS/TRADE JOURNALS

This type of publication lists equipment available for sale by butt commercial and private sellers.

6. INFORMATION PROVIDED BY NEW EQUIPMENT VENDORS

Vendors have an intimate knowledge of the products they sell and the markets they are in. Vendors are usually very knowledgeable about the secondary market for their products.

7. USED EQUIPMENT DEALERS

Used equipment dealers are one of the best sources for obtaining values on used equipment because they actively pursue the used market on a daily basis.

8. APPRAISERS

Appraisers are another excellent source of information as they regularly review various types of used equipment.

9. REMARKETING COSTS

Another consideration in determining the best method for remarketing equipment is the cost associated with the remarketing process.

10. SCRAP or SALVAGE SALE

This is as sale in which the equipment is sold to a scrap or salvage operation that dismantles the equipment to reclaim precious metals. This type of sale yields the lowest return to the seller.

CREDIT SCORING SYSTEMS

All lessees must be assessed as to their **creditworthiness**. The assessment process can be costly and time-consuming. Leasing companies, therefore, attempt to alternate this credit scoring by developing spreadsheets.

USED EQUIPMENT PRICES

Used equipment becomes available to vendor-lessor from several sources:

1. **Equipment returned because of upgrades**
2. **Equipment returned on early outs**
3. **Equipment returned at the end of the lease term**
4. **Repossessed equipment**
5. **Trade-ins on new equipment**

FUNDING METHODS

Third parties can provide funding for vendor leasing programs in numerous ways. An important distinction is whether the funding is done on an indirect or direct basis. Indirect funding involves loans to vendor.

DIRECT FUNDING

Direct funding occurs most commonly when the third party provided the funding directly to the customer at the inception of the lease.

NON-RECOURSE SALES OF LEASE RECEIVABLES

In a non-recourse sale of a lease, the buyer has no claim against the seller if the lessee fails to make the lease payments.

RECOURSE SALE OF LEASE RECEIVABLES

In a recourse sale of lease receivables, the buyer can force the seller to buy back the lease receivable.

CREDIT EVALUATION TOOLS

Several tools are available to the **credit analyst** beyond public information. These tools include **credit scoring, financial statements, cash flow analysis, and financial ratios.**

CREDIT SCORING

Traditionally, lenders consider the three Cs of credit whenever making a credit decision. **Character, collateral, and capacity** have been the measures of a

borrower's creditworthiness. Equipment leasing is different from the lending business.
This section goes well beyond the traditional **three Cs** of credit. **25 Cs** of credit are presented to understand the **insight** of equipment needs and business practice.

The Cs of CREDIT has been assigned to six major categories:

1. **Future Potential**

   The lessor must assess the financial ability of the lessee to make payments over the term of the lease transaction.

2. **Capital**

   First- total resources available to a firm.

   Second capital is defined as capital assets, which generally are property, **equipment and plant.**
   Third- capital is defined as cash.

   Fourth capital is divided into debt capital and equity capital.

3. **Capacity**

   Capacity is the ability of the lessee to make payments. Income tax is used to determine the primary sources of repayment.

4. **Cash Flow**

   The lessor must determine the adequacy of the lessee's cash flow.

5. **Course**

   The course is the direction in which the lessee is heading. Forecasts should be examined to ascertain the feasibility of attaining the indicated level of financial performance.
   In forecasting, it is usually assumed that past trends would continue unless sufficient evidence exists to warrant a change in course.

6. **Constraints**

   A lease may have business, governmental, and social constraints to promote its success.

PAST EXPERIENCES

This category refers to historical experience. A proven track record of the lessee meeting its obligations is a very important factor.

1. COMPETENCE

How well has **management** done with the capital, if however, management is not meeting its obligations, the lessor may lose its investment.

2. CONTROL

Feedback systems such as standard cost accounting, budget, and other information systems must be in place.

3. CHRONOLOGICAL AGE

A company with a relatively **short** operating history presents increased risk to the lessor.

4. CHARACTER

Character refers to the **reputation** of a firm and its management and should be considered from both actual and perceived viewpoints.

EQUIPMENT and DIVERSIFICATION

The credit department often is required to ascertain equipment residual value and fair market value.

1. COLLATERAL

The lessor first looks to the equipment in case of default before obtaining any legal remedy directly against the lessee. Collateral with questionable resale value requires the lessor to structure the lease in a manner to minimize this risk.

2. CATEGORY

Certain categories of equipment, such as **elevators** and **air conditioning** systems, create additional risk because they cannot be moved easily.

3. COUNTER CYCLICAL

Counter-cyclical risks refer to the type of behavior a company displays in reaction to general economic conditions.

INDEPENDENT VERIFICATION

The credit analyst must compare the historical actions of the lessee with other credit providers and determine the lessee's consistency.

1. CREDIT

The typical assumption is that the **larger** a company is the **faster** it pays.

2. CONFIRMATION

A prime source of information is the audit report from an auditing firm. Confirmation refers to the ability of the lessor to obtain information on which risk evaluation can be based.

3. CORROBORATION

Corroboration occurs when the lessor validates the credit information supplied by the prospective lessee. Some credit analysts speak with customers of the lessee to determine current relationships between existing and expected contracts for goods or services.

4. CAPU-BETA COEFFICIENT

The model determines the impact of perceived change in **corporate risk**. It establishes a measurement factor by industry and companies within an industry.

MITIGATING CONSIDERATIONS

The credit analyst must determine the ability of the lessee to make its **lease payments**.

1. Co-partner

Risk can be ameliorated by acceptance of some type of relationship with a second investing party or co-partner. If a leasing company is undercapitalized, a genuine partner may be the only avenue available for fast growth.

2. Concealed Value

These assets with concealed value may be required as collateral by consummating a lease transaction or to provide the lessor with additional comfort.

3. Circumstances

Circumstances represent a subjective criterion that might be the incremental justification for extending credit.

ADDITIONAL RISK FACTORS

Several other factors impact the credit decision but do not fit into any of the above categories.

1. **Capability**
   Capability is the lessee's level of management expertise. **New** management is less capable than experienced ones.

2. **Competition**
   Accordingly, the lessor should determine whether the lessee's market is growing or **declining**.

3. **Cross border**
   This measure of credit risk refers to the relationships of one **country** to another.

4. **Currency**
   Currency rates, restrictions, fluctuations, and transactions all increase credit risk to the lessor.

5. **Complexity**
   The technological sophistication of equipment has increased considerably, especially that of high-technology equipment. The analyst must consider the additional risks of entering into a very complex transaction.

6. **Catastrophe**
   The lessor should identify the **worst-case** possibility and the amount of any exposure.

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