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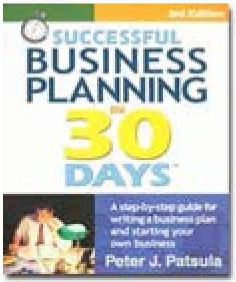

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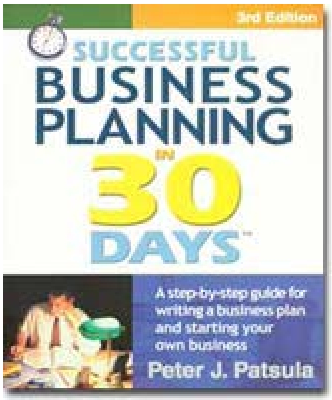

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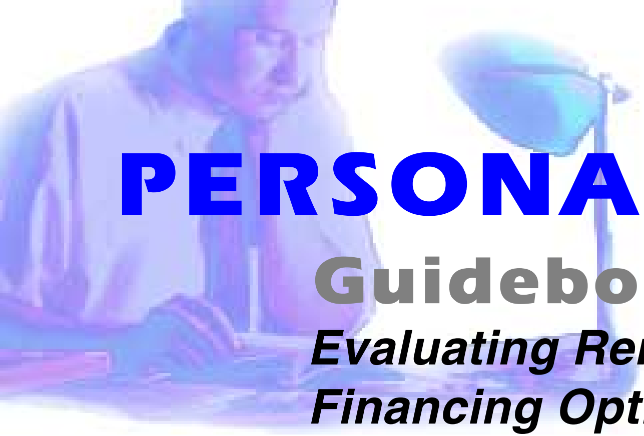
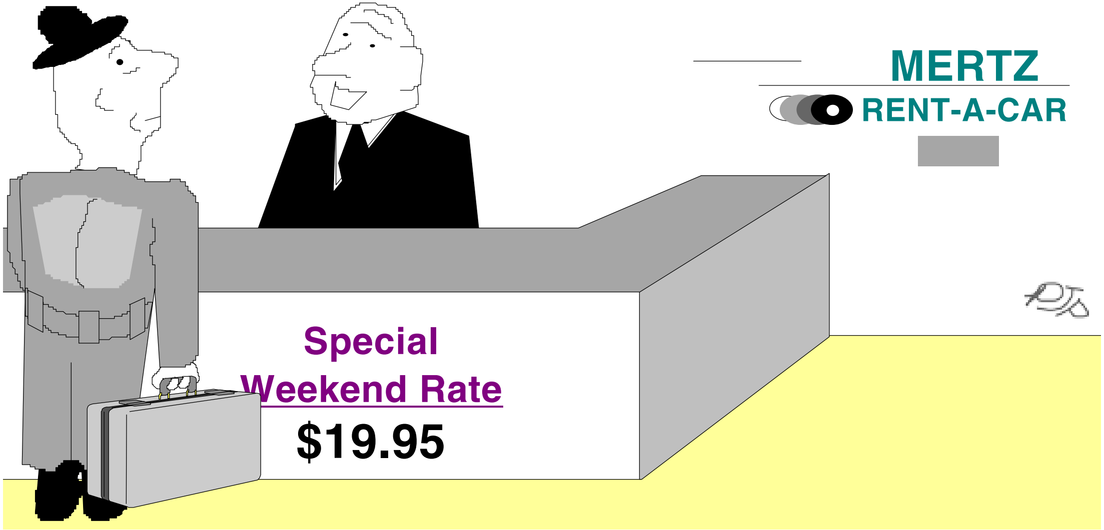


PERSONAL PLANNING

Guidebook #79:

Evaluating Renting, Leasing, Buying, & Financing Options 3



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EVALUATING RENTING, LEASING, BUYING, & FINANCING OPTIONS

EVERY business eventually finds itself in a situation where it has to choose between renting, leasing, buying or financing capital acquisitions. Such acquisitions include the purchasing of automobiles, buildings, computers, equipment, machinery, and real estate.

As can be expected, which route you take will depend upon the particulars of your situation (e.g., cash flow position, capital position & equity position) and the pros and cons of each form of procurement.

RENTING & LEASING

A *RENTAL* is a short-term agreement or contract under which capital property is rented from one person to another on an hourly, daily, weekly or monthly basis with rates tending to decrease the longer the rental period. On the other hand, a *lease* is a long-term agreement or contract, under which capital property is rented from one person to another for a fixed period of time (usually one year or more) at a specified rate.

To lease or not to lease? That is the question. ***FUNQUOTE***

Rentals and leases of any equipment can often be obtained from the company that sells the equipment. If not available through them, you may be able to find a suitable rental or leasing company listed in your Yellow Pages.

Why Rent or lease?

In general, *rent* for convenience, flexibility, to "try before you buy" and to avoid locking yourself into a long-term lease. *Lease* because its cheaper than renting, doesn't require a big down payment, and helps control your cash flow. *Rent* or *lease* because its easier than getting financing, because you lack the funds to buy, to avoid taxing your cash reserves, to avoid maintenance and repair responsibilities, to avoid obsolescence and depreciation, to improve asset liquidity, and to get immediate tax deduction benefits. Each of these reasons are described in more detail below:

Rent for convenience. If you need a computer, lawn mower or typewriter for a short period of time, or only once in a while, or if you need a computer for out of town, to work on the road, or to make a presentation for a show or convention, renting is the best solution, saving you time and money.

Rent for flexibility. Rental companies often have, daily or hourly rental rates, rent-to-lease options, rent-to-own options, operating lease programs, financing arrangements and even discounts to students and seniors.

Rent to "try before you buy." A rental company, having a good selection of the types of equipment you need, can be a valuable resource. Not only can they give you the opportunity to test certain brands and models, but by renting you can also get a better ide which brands and models have the lowest maintenance or highest resale value. This is especially important if you plan to buy multiple units of the same kind of equipment.

In Canada, during the first two years, the allowable business write-off for buying a $24,000 car is $16,920 compared to $15,600 for leasing. ***FUNFACT***

For example, if you need to purchase half a dozen or so computers to run a database program, you may want to test different computer setups to avoid the disappointment of buying a computer system too slow for your demands.

Rent to avoid locking into a long-term lease. A long-term lease can prove to be a real headache, especially if your location suddenly turns sour due to new competition or major clients leaving the area, or if for personal reasons you suddenly have to move to another city.

Lease because its cheaper than renting. Due to the security long-term leases give their owners, more are willing to offer reduced rates over straight month to month rental contracts.

Lease to avoid down payments. On many leases you don't have to make a down payment, which in effect gives you 100 percent financing. This keeps your cash reserves available for more essential expenditures.

On many leases you don't have to make a down payment, which in effect gives you 100 percent financing.

Lease to help control cash flow. Although leases tend to be more expensive than buying outright or financing a capital property acquisition, they have the added benefit of always staying the same. This is particularly important when leasing real estate for a 5 or 10 year period. You will be able to make long-term expense projections more accurately, as well as more precisely control your monthly cash flow. You won't have to worry about rental increases or fluctuating interest rates.

Rent or lease because its easier than getting financing. Rental and leasing companies have fewer restrictions than financing companies. If your credit rating is poor, renting or leasing might be your only option.

Rent or lease if you lack the funds to buy. When high capital requirements for new equipment are necessary and there is little or no cash available – and you can't get financing – renting or leasing may be your only option. This is especially true when you are first starting your business.

NOTE Most businesses starting out have an uncertain future, therefore should strongly consider short-term leasing and renting as much as possible to keep their overhead as low as possible. It is only after a business becomes established that it should start buying outright to improve its profit potential.

One major advantage of renting or leasing is it allows you to conserve up-front capital and save it for when you really need it.

Rent or lease to avoid taxing your cash reserves. One major advantage of renting or leasing is it allows you to conserve up-front capital and save it for when you really need it, or to devote it to other priorities. For example, when starting out, encountering rapid expansion, or after being hit hard by a recession, you may need all available working capital to:

- build, increase or maintain inventories
- renovate, expand or repair plant facilities
- buy new equipment to become competitive, improve your competitive advantage, or to keep the competition from gobbling you up

NOTE Renting or leasing will generally have a positive effect on your financial ratios.

Rent or lease to avoid maintenance & repair responsibilities. Being that maintenance & repair are usually the responsibility of the rental or leasing company, renting or leasing can reduce the risk of having to incur repair expenses at a time when cash flow is tight. Furthermore, if your equipment breaks down you may be able to get it replaced rightaway.

Rent or lease to avoid obsolescence and depreciation. Buying machinery and equipment, especially in high technology fields can be very frustrating. Obsolescence can instantly result due to sudden technological advances and reduce the value of used equipment to a fraction of the same equipment new.

In a matter of a few years, for example a computer purchased for $4,000 may not only become incapable of running the current crop of software or add-on hardware, but may have sunk to a resale value of less than 1/4 its purchase price (meanwhile the tax man has only allowed you to deduct about 1/2 its purchase price).

You can increase your cash reserves by selling an existing asset and replacing it with a leased or rented unit.

Rent or lease to improve asset liquidity. You can increase your cash reserves by selling an existing asset and replacing it with a leased or rented unit.

Rent or lease to get immediate tax deduction benefits. Tax considerations are an important factor in the decision to rent, lease or buy equipment. If you are using equipment for business purposes the price of renting or leasing that equipment is usually tax deductible in the year payments are made. You don't have to depreciate it over a period of years.

Types of Lease Agreements

Below is a list of 5 major types of lease agreements.

20/20 Lease – Requires a 10% security deposit & 20 equal payments. Usually, offers a 10% buy-out.

Deferred Lease – May feature "no payment" for 90 days.

Installment Lease – A type of lease that in reality is a form of financing with a built-in financing percentage (usually high) and a token buy-out figure of $1.

Short Term Lease – A type of lease closer to a rental agreement. Often has an option to renew into a true lease.

A good lease can easily be turned into a bad lease with a few minor changes to its wording and terms.

True Lease – A common type of lease lasting from 24-48 months. Usually has an option to buy outright for an additional 10%.

What to Look for in a Lease

Before you actually sign a lease, make sure you weigh each of the following factors:

Terms of the Lease Contract – A good lease can easily be turned into a bad lease with a few minor changes to its wording and terms. Make sure you understand all provisions of any leases you sign, right down to their last detail. Note the following:

Cancellation Terms if Allowed – It's important to know what happens if you break the lease. Find out if this is possible, and what are the penalties for doing so. Most leasing companies would like you to think that breaking a lease is a serious criminal offense, and never done by respectable business people. In fact however, it's done all the time. Due to financial problems or changing needs, you may have no choice but to break a lease.

NOTE If there is a high possibility you might need to break the lease, find out about their collection procedures. Some leasing companies work in conjunction with personal finance companies whose collection methods are Draconian.

Find out the arrangements for return, renewal or purchase of equipment upon lease expiration.

Lease Expiration – Find out the arrangements for return, renewal or purchase of equipment upon lease expiration. How much will you have to pay if you want to buy the equipment at the end of the lease?

Length of the Lease – A long lease can be both good or bad depending upon your situation. A long lease (at a fixed rate) is great in a booming locaiton, but terrible if the location has gone sour.

Personal Guarantees as well as Company Guarantees Required – If you are an individual or a small business without a track record, you may find that you will be required to provide a personal guarantee when signing a lease such as a credit card imprint or a post-dated check.

Responsibility of Insurance, Maintenance and Taxes – Determine who is responsible for paying any applicable taxes, maintaining the equipment or insuring against lost. Quite often, you will be responsible.

Serial Numbers – Note the serial number, model number, size and date of leased equipment. This information is useful when shopping for the best lease.

Servicing of the Equipment – If you are responsible for maintaining the equipment you also need to know who can do the servicing: yourself, a local repair facility, the equipment manufacturer, a repair facility specified by the dealer, or the dealer themselves. If you are not responsible for maintenance you need to know how long it will take to get equipment repaired.

The longer its life span, the lower the lease rates should be compared to the outright purchase price.

The Value of the Leased Equipment for Insurance and Termination Purposes – What value has the company assigned to the equipment in question? Is this valuable reasonable?

Probable Life Span of the Machine – Determine how long the machine should last. The longer its life span, the lower the lease rates should be compared to the outright purchase price.

Depreciation vs. Lease Expense – Compare the tax deductions allowed for buying equipment and deducting depreciation allowances to leasing the equipment and deducting it as an expense.

Salvage Value – Determine how much the equipment will be worth at the end of its lease.

Original Cost of the Machine vs. Lease Cost – Compare the outright cost of the machine to its lease cost. The lease cost will be substantially higher. However, the smaller the margin, the better the lease.

Delivery of new or leased equipment should be timed with the completion of other major construction activities. You don't want your equipment to be sitting idle.
SUPERTIP

BUYING & FINANCING

OWNING by either *buying* or *financing* is usually always preferable to renting or leasing, unless your company is presently having cash flow problems or you can't get credit.

Why Buy or Finance?

Buy because it's cheaper in the long run. *Finance* because it's cheaper than leasing or renting. *Buy* or *Finance* because of poor selection at rental companies, to avoid being locked into a long-term lease, and to have more control over making improvements. Each of these reasons and others are described in more detail below:

Buy because it's cheaper in the long run. Finance because it's cheaper than leasing or renting.

Buy because it's cheaper in the long run. If you want to save money over the long run as well as lower your monthly overhead, and if you don't have a cash reserve problem – then BUY. Capital property valued at $100,000 at 10% interest, will cost you $160,532 over three years, $220,500 over 10 years, and $430,000 over 25 years. However, if you buy outright it will cost you $100,000, and often less, because cash has bargaining power.

Finance because it's cheaper than leasing or renting. If the cost of a purchase has to be paid in installments, then approaching a bank, finance company, leasing company or other source of loans is a logical option. However, if your first question is going to be, "What's your interest rate?" Than forget the leasing company. Go talk with your bank or finance company first. Financing a purchase will almost always give you a better interest rate than leasing.

Buy or finance because of poor selection at rental companies. If you are looking for the latest fully loaded machine or high technology equipment, selection in rental fleets tend to run from the low to medium range. The newest, most powerful models are in short supply.

Buy or finance because rental and lease companies are not exactly renowned for their stability. Equipment rental and leasing is a highly competitive business; many such companies come and go, both large and small. For the user, this can translate into problems with support, return of the equipment, disruption of usage and worse.

If your business doesn't go well, and you are locked into a long-term lease, you could end up paying a large penalty for breaking that lease.

Buy or finance to avoid being locked into a long-term lease. If your business doesn't go well, and you are locked into a long-term lease, you could end up paying a large penalty for breaking that lease. If you had bought the capital property instead, you could have at least sold it. Being locked into a long-term lease also becomes quite a problem if any leased equipment becomes obsolete over night. If for example you signed a five-year lease on a machine that a year later is revolutionized. You will be stuck with that machine for another four years. Either you have to break your lease or make payments on an obsolete item.

Buy or finance to get tax benefits through depreciation. Although buying your premises or equipment necessitates a large initial investment, you can reap tax benefits through depreciation.

Buy or finance to have more control over making improvements to the property or equipment. When you lease, anything that needs to be changed will have to be first okayed with the leasing company, making management decisions less efficient (and what's worse is the changes needed might not be allowed). If you own the property or equipment, you can do what you want, when you want.

Buy or finance to lower overall costs. No matter how you figure it, in almost all cases the bottom line cost of leasing or renting is always higher than if you had purchased a system outright, except in those circumstances such as short-term usage where you wouldn't' have made a purchase in any case. Higher costs are due to paying higher interest and the lack of salvage value at the end of the lease. Also figured into rental/lease payments is a depreciation factor as well as the net profit the rental company seeks to earn.

Be particularly wary of "rent- or lease-to-own" plans, where often the effective rate of interest is excessively high.

NOTE Be particularly wary of "rent- or lease-to-own" plans, where often the effective rate of interest is excessively high.

MAKING A FINAL DECISION

THE MOST IMPORTANT question to ask yourself when deciding whether to rent, lease, buy or finance is the following:

How will renting, leasing, buying or financing affect my total cash reserves and monthy cash flow?

NOTE Print out the form on **page 22** to help you compare renting, leasing, buying and financing costs.

*Print out the form on **page 22** to help you compare renting, leasing, buying and financing costs.*

Special Considerations for Buildings, Computers, Land & Vehicles

The main disadvantage of renting and leasing a building, computer land or a vehicle is that the effective interest rate is usually higher than the interest rate for financing that acquisition. The major advantage of a lease however, is the low down payment or equity position required to initiate the lease.

Below are more detailed special concerns regarding the acquisition of, buildings, computers, land and vehicles:

Buildings & Business Facilities – Considering the large capital outlay required to purchase a building outright, and the risks involved in financing one, most businesses should rent or lease. When you rent or lease other than the necessity of putting down a deposit as security and paying a month or two of rent in advance, your capital remains relatively untapped. Moreover, with the help of your attorney and a cooperative landlord, you might be able to arrange a favorable lease (see chart on page 21).

Renting and Leasing vs. Owning – The advantage of renting or leasing a building is that you let your landlord worry about paying insurance premiums, meeting property tax liabilities, and repairing, heating, or air conditioning the premise. The disadvantage is that you remain vulnerable to two things:

1. When your lease expires, your landlord may opt for a sharp rise in your rent (unless you anticipated this situation in the wording of the original lease).

2. When your lease expires you may discover that you've lost the location to another bidder, even though you have built up the location over years of dedicated effort.

Most business owners should not speculate in commercial property. Numerous business owners have failed simply because they had their capital tied up in a building when it could have been better used in the business itself. Also keep in mind that if you do decide to sell your business one day, it might be harder to find someone with enough capital to buy both the business and the building.
SUPERTIP

The Importance of Charging Your Own Business Rent – If you put money into a building of your own, that money should bring you an income just as if you invested it somewhere else. In your accounts, your store or office should be charged with either rent or interest, maintenance, insurance, depreciation and other expenses of owning a building. If this point is overlooked, the amount shown as net profit on the business may not, in fact, be a profit at all.

Computers – Renting or leasing a computer is a valid option for a small business which does not have enough cash to make a purchase, or needs a computer temporarily. Both however, are not really a very good option for anyone else. Computer monthly rental rates vary from $99 for a used 486 desktop to the outrageous rate of $500 for a fast Pentium notebook with an active matrix screen. Rates depend on whether the computer is new or used. In general, expect the monthly rate to be between eight and ten percent of the total rental unit's purchase price. Most rental computers are IBM compatible name brands, like Compaq or Toshiba. Macintoshes are available from some, but not all, rental companies.

Make sure you backup your hard disk when you return your rented or leased computer as well as wipe out confidential information.

NOTE Make sure you backup your hard disk when you return your rented or leased computer as well as wipe out confidential information. Many rental store staff for example have read everything from tax returns to love letters.

Renting Software – One of the major downsides of renting or leasing a computer system is that aside from a few public domain or Shareware utilities, no software is provided. In fact, most software manufacturers specifically forbid their software to be rented. This problem is particularly bothersome if you aren't settled on what operating platform you want to use, or if you are in a short-term rental situation and purchasing the software you need is not cost-effective. Nevertheless, software rental outlets do exist. Their operators maintain that the laws are unclear, difficult to enforce and easy to work around.

Land – Tax laws will not allow you to depreciate the cost of land (land does not depreciate according to the government). However, if you lease the land, you can write off the lease payments as an expense.

Tax laws will not allow you to depreciate the cost of land.

Vehicles – Renting a vehicle when on a road trip is an easy decision to make. However, whether to lease or finance a car/truck for an extended period depends on many factors. Consider the following:

Leasing Terms – Before leasing a car or truck consider that:

- car and truck leases often set a specified annual mileage allowance and make additional charges if this present allowance if exceeded
- some leases mandate maintenance in excess of what lessees normally gives a vehicle
- minor cosmetic damages can be chargeable at the conclusion of the lease
- premature lease cancellation is usually accompanied be a substantial penalty
- comprehensive insurance must be carried on behalf of the lessor – this expense is included in the cost of the lease

NOTE At the end of a lease, lessees can usually opt to buy the car at a specified price based on blue book value.

Leasing Costs vs. Financing Costs – Every major study done on the costs of leasing vs. financing a vehicle show that leasing costs you on average 20 to 30 percent more, even when tax breaks are taken into account. When you lease, the lessor makes money not only on the vehicle but also on the financing package. And, if the company it doing its job right, it will also pocket a few extra dollars on your trade-in and on the maintenance contract (if you accept one).

Every major study done on the costs of leasing vs. financing a vehicle show that leasing costs you on average 20 to 30 percent more, even when tax breaks are taken into account.

The best, and only, argument for leasing generally has to do with improving your cash position. Leasing frees up more of your cash to be invested in appreciating assets, not depreciating ones.

Leasing Tax Advantages vs. Owning Tax Advantages – Leasing allows you to write off the business percentage of the lease payment. Owning allows you to depreciate the cost, based on business use. In Canada, for current purchases, most vehicles are depreciated at a maximum rate of allowance of 30% with a limit of $24,000. You can also deduct the business portion of loan interest and depreciation (In the U.S. tax deductions are similar).

✷

What to Look for When Signing a Property Lease

BEFORE signing a lease, be sure to check it thoroughly. Have an attorney or real estate person familiar with lease agreements go over it. He or she might be helpful in tailoring a fair contract and in making useful suggestions on available options. In particular, go over and pay close attention to such details as:

- ☐ Are able to keep your location if it proves successful? Are you free to move after a reasonable length of time if the location does not prove satisfactory (a short-term lease with an option to renew is the best way to take care of both of these possibilities)?
- ☐ Can built-in equipment and fixtures be installed and removed?
- ☐ Who takes care of repairs such as plumbing, electrical or air conditioning?
- ☐ Who is responsible for insurance on the buildings and properties, including liability insurance?
- ☐ Who is responsible for maintenance and supplies?
- ☐ Who is responsible for alterations?
- ☐ Who is responsible for payment of utilities?
- ☐ What is the liability of lease default?
- ☐ What are the *common* charges?
- ☐ Are there any tenant association fees, promotion and/or mandatory advertising fees?
- ☐ Will you be able to expand if business warrants?
- ☐ Can all or any of the property be sublet?

Comparing the Costs of Renting, Leasing, Financing & Purchasing

Description:

	Renting	Leasing	Financing	Purchasing
Length of Lease or Loan:				
Interest Rate Charged:				
Down Payment/Deposit:				
Cost per Month:				
Cost per Year:				
Cost for Three Years:				
Total Cost:				
% of Costs Tax Deductible:				