

# The Case For Equipment Leasing: An Appealing Strategy For Cost-Conscious Companies

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Leasing offers a number of advantages over traditional sources of financing for capital equipment expenditures.

As the credit markets remain dislocated and companies keenly focus on conserving their all-important working lines of credit, equipment leasing is now frequently being considered as a viable alternative financing solution. Structured properly and undertaken in the right circumstances, equipment leasing can offer flexibility to your company that otherwise is simply not present in the typical secured lending arena.

However, for all the potential upside that leasing offers, this form of financing also has its own set of risks and complications that can lead to far-reaching and unintended negative consequences for the unwary.

## The Case for Leasing

So, why do eight out of ten U.S. companies finance at least 30% of their equipment needs through a leasing related product?

Some of the advantages of leasing include:

- Leasing requires no equity contribution so 100% financing often is available. In fact, so-called “soft costs” for items such as freight, installation and taxes

are often rolled into the lease payment and therefore do not come directly out of the lessee's pocket upfront. This aspect of leasing helps conserve capital of the company for more productive operational uses and business opportunities.

- The leased equipment itself is usually all that is needed to secure the transaction, whereas a loan typically requires the borrower to pledge other assets for collateral.
- Leases are customarily free of restrictive covenants that limit the lessee's ability to borrow funds. Conversely, a loan agreement usually includes covenants that require the borrower to maintain tight financial ratios that may impede their access to the capital markets.
- Under a lease, the risk of equipment obsolescence is transferred to the lessor. This feature is particularly important when it comes to high technology equipment—such as medical diagnostic equipment or computers that quickly become dinosaurs to new innovations.
- When leases are structured as “true leases,” the lessee may claim the entire lease payment as a tax deduction (as opposed to a loan where only the interest portion of the payment and depreciation deduction may be claimed). The equipment write-off is tied to the lease term, which can (and often is) shorter than the applicable IRS depreciation schedule associated with such asset class resulting in greater tax deductions for the lessee during the lease term. The deduction is the same every year, which simplifies budgeting and brings clarity to long-term objectives.

- Leased assets are expensed when the lease is structured as an operating lease and therefore are not required to appear on lessee's balance sheet. This advantage can help improve all-important financial ratios contained in lessee's other credit facilities with banks. With a loan, Financial Accounting Standards require the borrower (as the owner of the equipment), to list the equipment as an asset with a corresponding liability on the balance sheet.
- Leases help free up a company's cash flow—especially when the purchase option occurs later in the term when inflation makes dollars cheaper. Under a loan, a larger portion of the financial obligation is paid in today's more expensive dollars.
- Leasing helps free up bank lines for emergencies and diversifies your credit portfolio.
- The terms of a lease generally are easier to negotiate and more flexible than a loan.

In addition to some of the direct benefits noted above, the popularity that leasing now enjoys is also the result of the current market conditions and the efforts by state and federal governments to help mitigate financial hardship on businesses. For example, many programs earmarked for favorable tax incentives require the use of equipment that is very lease friendly (think high-tech, energy efficient equipment). Banks and other financing companies are certainly privy to this and have marketed leasing products they offer aggressively to take advantage of certain tax credits available to "owners" (lessors) of such equipment. Moreover, with the tightening of lending to small businesses—in part due the collapse of CIT, many leasing companies are rushing to help fill the void created in this important market segment and are competing against one another for greater market share by driving down implicit rates—all to the benefit of potential customers.

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## Devil in the Details

But, while lease agreements offer many advantages over traditional loans, they still contain numerous pitfalls that require special care and attention to avoid.

When executing a lease agreement, in-house counsel must be aware of a whole host of legal issues spanning the gamut—from commercial law (UCC Articles 2A and 9) to tax law, from accounting concerns to state and federal regulatory ramifications. As in-house counsel, it will be imperative that you make sure the lease—whether a \$5,000 piece of office equipment or \$100 million facility of oil rigs—complies with all the appropriate laws and regulations. Moreover, care must be taken to ensure that the lease itself does not run amok of existing credit facilities creating inadvertent defaults thereunder. And, it goes without saying, but a sale leaseback situation can lead to a variety of frustrations—especially when your assets are already subject to a blanket lien in favor of the bank.

Time and attention must also be given to selecting the best lease product for your particular business as an alphabet soup of equipment leases exist, from true leases to TRAC leases to conditional sales to synthetic or "off balance" leases, each with their own special concerns. You will need to pick the type of lease that best meets your company's business needs and financial concerns

The general rules of thumb—as with anything else in-house attorneys must deal with—are be careful and do your homework. But as long as you make informed choices, leasing can be a cost-effective solution to helping your company meet its goals. It's an option you should at least consider the next time your company's leaders debate a large equipment purchase.



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