LEASING VS. BUYING

There is no easy way to figure out whether it's cheaper to buy or lease. So you've got to do it the hard way.

by Rudd McGary and Ed Wandtke

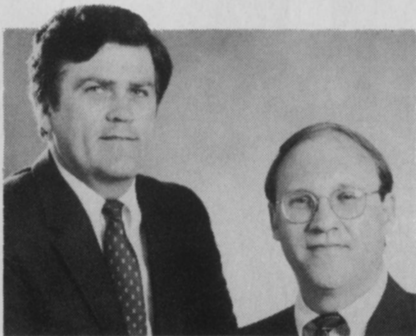
The decision whether to lease or buy equipment for most landscape managers is requiring more complex analysis. The evaluation can be quantitative but in the end, it's a case of choosing the "best fit."

For the proper analysis, you need to take into consideration the goals of your company, the effects of the Statement of Financial Accounting Standards No. 13 on the balance sheet and the income statement (this is available from the American Institute of Certified Public Accountants), the impact of any decision on the cash flow requirements of the firm, and income taxes.

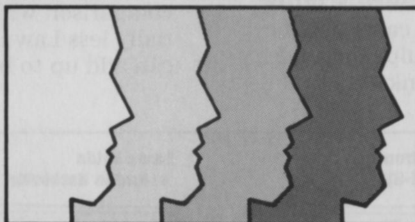
Leasing dates back to 1400 B.C. when the Greeks introduced maritime leases. Leasing today offers flexibilities not even considered then but which can be especially beneficial to a modern business. Leasing as a form of financial leveraging allows otherwise under-financed firms to obtain the needed capital to continue expanding their business.

Four types of leases are offered today: capital leases, leveraged leases, financial leases, and operating leases. One will be appropriate, depending on the equipment or vehicles being financed.

With the capital lease, nearly all the benefits and risks of ownership of the asset are transferred to the lessee.



Wandtke and McGary are senior consultants with All-Green Management Associates in Columbus, Ohio. McGary focuses on marketing and management issues. Wandtke focuses on operations and financial questions.



The Accounting Standards Board requires the asset and liability to be recorded on a firm's balance sheet.

The leveraged lease's principal attraction is the ability to secure financing from various sources to fund the acquisition of complex technologies involving $1 million or more.

A financial lease provides the lessors an opportunity to transfer all their rights to the lessee for a fixed period of time (less than the economic life of the assets leased).

Operating leases allow the lessor to retain title, benefits, rights and the equipment that is being leased without the risk of owning the equipment.

The following will focus on leasing in general. It will not isolate specific risks, pitfalls or opportunities in using one of the types of leases mentioned above.

Leasing

Some of the advantages of leasing are:

1. Low costs can be passed on to the lessee because the lease's tax benefits are being retained by the lessor. In many instances, the lessee can not use the accelerated tax depreciation and tax credits available through purchasing.

2. Loan payments, though equal to lease payments over the life of the lease, are usually higher than early lease payments.

3. A lease can be structured to accommodate a lessee's desire to either have the lease "on" or "off" the accounting books (balance sheet).

4. Leases can provide financing for a company which may be otherwise restricted from incurring debt because of loan covenants.

5. Having fixed-lease monthly payments may be a hedge against inflation.

6. If technology changes, as seen with computers and telephone systems, you frequently are allowed to upgrade your equipment by breaking your current lease and signing a new one.

7. Funds will be available to pursue other business options or requirements.

Some of the disadvantages of leasing are:

1. Initial flexibility of a lease may prove to be only illusionary if noncancelable features are invoked when a piece of equipment becomes obsolete or expensive to maintain.

2. A lease may include a maintenance agreement on the equipment at a premium price when the maintenance could be done cheaper inhouse.

3. You may pay a considerable premium for a lease when you add equipment to a lease that has a different useful life than the prime leased equipment. Example: tanks placed on a manufacturer's chasis.

Quantitative evaluation of the lease options comfronting most of us require that you also look at the implications of TEFRA 1982, ERTA 1981, SFAS No. 13, your firm's financial position.

Beware of the salesman who promotes leasing as a way to defer expenditure of capital. He is really saying you are deferring the expenditure of cash. Another line we just heard was that a tax timing advantage would result from leasing. When we reviewed the numbers he was correct, but the advantage went to purchasing.

Purchasing

There are several advantages to purchasing that must be evaluated before making the lease/buy decision.

The larger your firm, the more leverage you will have to choose purchasing instead of leasing. In addition, firms which have surplus cash, high liquidity, and use low technology assets should investigate buying.

Some of the advantages of pur-

chasing are:

1. Preferred interest rate from the financial institution that is helping you expand your business.

2. Investment tax credits are available to a purchaser but not available to a lessor except with a price increase in the lease.

3. Higher level of control over vendors who will deal with you.

4. Benefit of the ACRS tax advantages are available only to ownership.

After evaluating the above options of leasing versus buying, you will need to prepare a financial analysis of the options under consideration. Make sure that you compare apples to apples; all too often we see people comparing dissimilar features, such as the before-tax cost of purchasing and the after-tax cost of leasing. Use financial advisors to assist you in making this analysis, since the benefits in cost savings, improved flexibility, and profitability will be worth the additional input.

For the more adventuresome, computer programs are available for use on IBM and similar compatible hardware.

Even though leasing of equipment continues to grow, purchasing continues to be the principle means of acquisition.

The analysis

The analysis should look at the net present value of the cash flow between the two options; the net present value of the monies to be expended; tax benefits of the options; depreciation benefits of purchasing; impact of the present low interest rates; and return on investments your firm is making on its equity.

The following list of information is needed to do a net present value analysis:

1. Initial outlay (out-of-pocket costs) to acquire the asset net of any adjustment for investment tax credit.

2. Funds from the old asset's disposal, if any.

3. Tax effect of the gain or loss from selling the old asset.

4. Projected recovery from the disposal of this asset at the end of its useful life.

5. Annual revenue to be generated from acquiring this asset.

6. Annual costs of operating and maintaining this equipment.

7. Tax benefit from deducting total lease payment on tax return.

8. ACRS depreciation benefits of owning the asset.

9. Depreciation tax shield on disposal of the old asset.

While this list of information may look complex at first, once you begin to work with and understand the benefits of the analysis you will find the information necessary to make an intelligent decision.

Even though leasing of equipment continues to grow, purchasing continues to be the principle means of acquisition. Any company with liquidity, the ability to secure its own financing, or can use more tax benefits should consider buying over leasing.

Even though you may have found making a decision between buying or leasing is still confusing, your decision will ultimately be made on the basis of tax benefits and the ability to sustain the cash flow required. **WT&T**

Sweep Clean, Fast

II-SPEED™ sweeper—unsurpassed pick-up

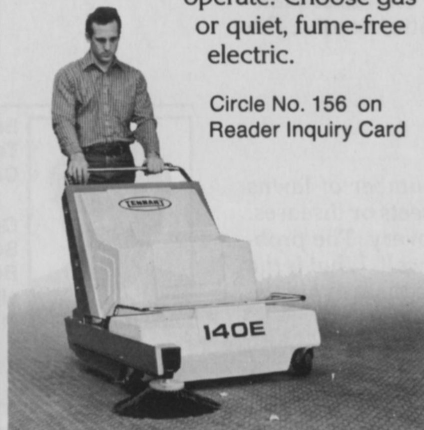
TENNANT® 255 lets you choose the sweeping speed best for the job—standard for up to ⅓ longer brush life than competitive makes, high velocity for tough jobs such as sand, paper, pine needles. Sweeps 53″ path. 18-month/1,500 hour warranty (except normal wear parts). Attachments scrub, remove snow.

Circle No. 155 on Reader Inquiry Card

Economical sweeper cleans inside and out

TENNANT® 140 cleans 37″ path with optional side brush, more than 15,000 sq. ft./hr. In less than 15 minutes, does 1-hour hand sweeping job. Powerful vacuum/filter system controls dust. Self-propelled, easy to operate. Choose gas or quiet, fume-free electric.

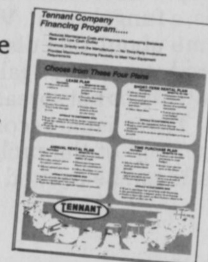
Circle No. 156 on Reader Inquiry Card



4 easy ways to get your TENNANT® machine right now

You don't have to buy…ask us how you can rent, lease, or time-purchase. Send for free brochure.

Circle No. 157 on Reader Inquiry Card



Free demonstration, data and return-on-investment analysis.

CALL TOLL FREE:
800-328-5727 EXT. 768G