

Introduction to Equipment Financing





Domestically, equipment finance accounts for \$725 billion of business each year. More than 90% of all U.S. businesses use some type of equipment finance to fund their operations.

Most businesses require equipment in order to operate and make money. To remain competitive, each business has to make the best procurement choices based on many factors such as cash flow, balance sheet impact and available credit lines.

Equipment finance is a key component of asset acquisition for both large and small businesses. Domestically, equipment finance accounts for \$725 billion of business each year. More than 90% of all U.S. businesses use some type of equipment finance to fund their operations. It is one of the most important ways for businesses to invest in capital while managing their balance sheets and cash flow positions.

Types of Equipment Finance

Equipment financing can take many forms, though the traditional methods are via leasing and commercial loans.

Leasing, the most popular form of equipment finance, offers flexible choices that can work with diverse objectives of most businesses. A lease is an arrangement where one party who owns equipment (the lessor) transfers possession and use of that equipment to another party (the lessee). In exchange for the use of the equipment, the lessee pays rent to the lessor over the term of the lease. Typically, 100% of the equipment acquisition cost is financed.

A commercial loan refers to an arrangement where a lender finances the acquisition of equipment by a borrower. Lenders usually finance up to 75% of the equipment cost. The loan is satisfied once the borrower repays the lender the principal plus interest. At the end of the term, the borrower owns the equipment outright.

Types of Equipment Financed

- ❖ *Medical technology and equipment*
- ❖ *Agricultural equipment*
- ❖ *Business, retail and office equipment*
- ❖ *Construction and off-road equipment*
- ❖ *IT equipment and software*
- ❖ *Manufacturing and mining machinery*
- ❖ *Trucks and transportation equipment*

The Advantages of Equipment Finance

With a wide range of benefits, equipment finance can be an optimal alternative for companies ranging from small businesses to Fortune 100 enterprises. Advantages include:

- 1) 100% Financing** – Users can finance the asset with no downpayment.
- 2) Cash Preservation** – Businesses can retain their cash or working capital and use it for other areas of business, such as expansion, improvements, marketing or research and development.
- 3) Risk Management** – Leasing helps mitigate the uncertainty of investing in a capital asset a business needs until it achieves a desired return, increases efficiency, saves costs or meets other business objectives.
- 4) Cash Flow Control** – Financing equipment helps maintain cash flow and greater certainty in budgeting by setting rent payments to match annual or seasonal cash flows.
- 5) Obsolescence Management** – Businesses can acquire more and better equipment through technology upgrades and/or replacement programs.
- 6) Bundled Costs** – Certain finance structures allow customers to finance the entire cost of the equipment (installation, maintenance, training, etc.) into one, easy-to-manage payment.

Comparing Loans & Leases

Which structure is better? Factors to keep in mind include knowing the length of time for which the equipment is needed; the company's tax situation; cash flow; and the company's capital needs related to future growth.

	SIMILAR	DIFFERENT	DESCRIPTION
Payment Terms	X		Borrower repays advance of funds plus interest over a specific period of time. Leases involve the payment of rent with greater flexibility.
Ownership		X	Borrower holds legal title to the equipment. Lender has no expectation of return of the equipment. Lessee may have a right to purchase the equipment at the end of the lease term, but the lessor generally holds legal title to the equipment.
Down Payment		X	A loan usually requires up to 20% or more down payment. A lease usually finances 100% of the cost of the equipment.
Payments	X		Both loan and lease payments can be made monthly or quarterly. Seasonal and skip payments might also be available for both.
Interest Rates	X		Leases are structured with fixed lease payments. Loans can be booked with variable or fixed rates.



*Alternative commercial
Equipment Financing and
Leasing Programs offer the
flexibility for small and
medium size businesses
to grow and prosper.*

Common Leasing Questions

What are the most common lease options?

The two most common types of leases are operating leases and capital leases.

- With an operating lease, the term is shorter than the expected useful life of the equipment. Rental payments do not cover the equipment cost for the lessor (owner/lender) during the initial lease term. This type of lease is popular for companies using cutting-edge technology because shorter-term leases help users stay ahead of equipment obsolescence.
- With a capital lease, the term is longer, more nearly covering the useful life of the equipment. A longer-term provides more flexibility, lower payments and greater cash flow benefits.

What is a lease rate factor?

A monthly lease payment is determined by a lease rate factor, a periodic rental payment to the lessor for the use of the equipment. Lease rates are different from interest rates. With leasing, users are paying to rent the equipment. The lease rate factor is multiplied by the equipment cost to determine the monthly lease payment. The lease rate factor is determined by a number of variables, including length of term, lease structure, the type of equipment and the user's credit history.

What happens at the end of the lease?

For capital leases, the lessee owns the equipment outright at the end of the term once the original lease terms are satisfied. For operating leases, the lessee has three options at the end of the initial lease period: **1)** continue to rent the equipment for an indefinite period; **2)** purchase the equipment from the lessor at fair market value; or **3)** return the equipment to the lessor.

• • •