SportsTurf MANAGERS ASSOCIATION

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The Foundation for Safer Athletic Fields

Lease vs. Buy

Deciding if you are going to lease or buy equipment depends on your situation. In general, leasing is more appropriate for businesses with limited capital or need equipment upgrades every few years. Buying equipment is more common for well established businesses or for equipment that has a long usable life. Each situation is unique and the decision to buy or lease depends on each case.

Lease

A lease is a contract calling for the lessee (user) to pay the lessor (owner) for use of an asset. When leasing an asset, a finance company will usually buy the equipment on behalf of your business and you pay for use of the asset in regular installments over a fixed period of time. Leasing means you never own the asset outright, although there are lease arrangements that allow you to buy the asset at the end of the lease term.

Benefits of Leasing

Various types to meet your needs

There are various types of leases available to meet the individual needs of each facility. Some of the more common leases include operating leases and capital leases. An operating lease is generally for a short term and has low monthly payments. At the end of the lease, equipment can be returned to the lessor, renewed, or purchased.

A capital lease is generally for a longer term. Over the term of the lease, the lessee pays the full purchase price of the asset. At the end of the lease term, the lessee owns the equipment.

Preserves capital

Leasing allows you to acquire assets with minimal initial expenditures. Leases rarely require upfront costs and may free up working capital for use in other areas of the business. Large loans are also unnecessary for repayment.

Optimize cash flow

Certain leasing finance options allow you to make the lowest possible payments on equipment. Costs may be spread over a long period of time to match payments to the company budget. Interest rates are fixed so you can estimate cash flow.

No loan

Leasing does not require the lessee to pay the full cost of the asset upfront. The lessee can preserve cash and does not need to borrow money to make payments. Lessees also do not need to worry about withdrawn overdrafts or early loan repayments. Lease terms are often much longer than standard bank loans which can make payment terms better.

Maintain credit

Leases may maintain credit to keep available credit lines open for operations and short-term financing.

Tax incentives

Private for-profit entities can take advantage of the Section 179 deduction of the IRS tax code. Section 179 allows businesses to deduct, for the current tax year, the full purchase price of leased equipment that qualifies for the deduction. That means when you lease a piece of qualifying equipment, you can deduct the full purchase price from your gross income. Section 179 can be used for both new and used equipment.

Lease vs. Buy

Private for-profit entities can also take advantage of "Bonus Depreciation" when leasing new equipment. Bonus depreciation is an acceleration of the depreciation, which is normally taken over several years. The advantage is that this may generate substantial tax savings – quickly. In the end, you still write off 100% of the capitalized cost. As with all tax related matters, it is suggested that you consult with you tax preparer to gauge the tax implications of a planned equipment acquisition. Bonus depreciation is always taken in the first year the asset is placed in service.

As the benefits of Bonus Depreciation accrue to the owner of the equipment, the lease company would receive the benefits if they are the owner of the property during the term of the lease. Typically some of the tax savings generated are shared with the lessee in the form of a lower lease rate.

Cost effective for renewals

Certain types of equipment can quickly become outdated. Leasing equipment allows you to replace equipment at the end of the term without the expense of buying a new model. Leasing prevents you from being stuck with obsolete equipment because you can upgrade or add equipment that best meets your needs. Leasing also allows you to stay on the cutting edge of technology.

For example, some facilities find that leasing high use, mission critical equipment is the most cost effective. Mowing equipment that is used every day is essential to the success of the facility. A short-term lease may be preferred to continually refresh the equipment fleet and minimize maintenance costs.

Reduced obligation

Leasing provides all the benefits of utilizing equipment without assuming the risk of ownership. The lessee is responsible for the maintenance of the asset during the lease term. However, short term leases allow facilities to renew equipment before wear and tear costs could become an issue. Maintenance agreements or service contracts are also available to outsource maintenance on leased equipment.

Flexible

Leases are generally easy to obtain and have more flexible terms than loans to buy equipment. Financing can be customized to fit a variety of leasing and payment plans. Different types of leases and lease terms are flexible to work with varied amounts of cash flow, equipment needs, debt, and tax situations.

For example, a municipal lease allows the lessee to purchase and take title to the equipment. The financing is a full payment contract with no significant residual or balloon payments at the end of the lease term. The lease payments include the return of principal and interest, with the interest being exempt from federal income taxation to the recipient. Typically, a tax-exempt interest transaction will be financed at interest rates lower than equivalent commercial financing. The municipal lease provides for termination for non-appropriation of funds by the government agency.

Disadvantages of Leasing

May be more expensive long term

Depending on your facility's circumstances, leasing could be more expensive in the long term than buying assets outright. Be sure to evaluate your need of the equipment before deciding to buy or lease. A long lease term may mean smaller lease payments and more cash monthly, but because you pay interest on the installments, you will most likely pay more for the asset in the long run. A facility may find that a shorter term lease or leasing equipment with high maintenance costs is less expensive than buying. Leasing also does not allow you to build up any equity in the equipment.

Payment obligation

If you no longer have use for the leased equipment, you are still required to make lease payments for the entire lease term. Some leases may provide an option for cancellation if the business changes direction or equipment is no longer necessary, but usually early termination fees will apply.

Lease terms

You may be locked into inflexible medium or long term agreements that are difficult to terminate.

Lease vs. Buy

Additional Costs

There are various additional costs associated with leases that you should be aware of:

- Non-cancellable agreement – When entering into a lease contract, the lessee agrees to make all lease payments to the end of the term.
- Document fees – Administrative costs due upon signing the lease can range from $50-$350 or more depending on the complexity of the lease contract and size of transaction.
- UCC-1 Fees – Fees required by the Secretary of State where equipment is being leased. The fee is usually a onetime charge that is due upon signing lease documents.
- Taxes – Most states have a 5-6% or more tax on goods purchased. This tax depends on total cost of equipment and state of purchase and is factored into monthly lease payments. Public tax supported entities must either convey a tax exemption certificate to the leasing company, or the tax will need to be included in the lease stream of payments.
- Insurance – The lessee is required to insure the equipment so in the event of theft, fire, etc., the leasing company is fully compensated.
- Value added tax – If it is anticipated that the asset will be owned by the company at the end of lease payments, it is treated as supply of goods. The company will be responsible for paying the value added tax on the whole value at the start of the contract. If the lease does not anticipate assets to be owned at the end of the contract, it is treated as supply of services. The company will be responsible for paying the value added tax periodically.

Buying

Buying entails a transfer of ownership of goods and services from one person to another. Methods of buying an asset include paying the full cost upfront or financing the asset through a loan.

Benefits of Buying

Ownership

If equipment has a long, useful life and is unlikely to become outdated, ownership is a smart option. Ownership allows you to build equity in the equipment. Ownership also prevents the equipment from being repossessed, unless the asset has been used as security for a loan.

For example, it may be cost effective for some facilities to buy equipment that is used less frequently and has a longer life. For example, a tractor that is used infrequently and does not withstand major wear and tear can last 10-12 or more years.

Tax Incentives

Private for-profit entities can take advantage of the Section 179 deduction of the IRS tax code. Section 179 allows businesses to deduct, for the current tax year, the full purchase price of financed equipment that qualifies for the deduction. That means when you buy a piece of qualifying equipment, you can deduct the full purchase price from your gross income. Section 179 can be used for both new and used equipment.

Private for-profit entities can also take advantage of "Bonus Depreciation" when buying new equipment. Bonus depreciation is an acceleration of the depreciation, which is normally taken over several years. The advantage is that this may generate substantial tax savings – quickly. In the end, you still write off 100% of the capitalized cost. As with all tax related matters, it is suggested that you consult with you tax preparer to gauge the tax implications of a planned equipment acquisition. Bonus Depreciation is always taken in the first year the asset is placed in service.

Tax incentives benefit the equipment owner. If a private for profit facility is profitable, it may be a good option to buy and take advantage of Section 179 and Bonus Depreciation. If the facility does not have much profit and decides to buy equipment, the facility may benefit from Bonus Depreciation by having a smaller payment.

No long term agreement

Buying does not involve long term agreements that may be difficult to end.

Lease vs. Buy

Money Savings
Depending on your facility's circumstances, purchasing equipment may save money in the long run. Consider the type of equipment, amount of use, interest rates, and lease terms when deciding whether to lease or buy. Owning equipment also allows you to build up equity.

Disadvantages of Buying

Large capital expenditure
Purchasing equipment is expensive. Some sellers require you to pay the full cost of the asset up front. If you are borrowing money from a bank to make monthly payments, most banks require a 20% down payment. Borrowing could also tie up lines of credit and lenders could place restrictions on future financial operations to ensure you are able to repay your loan.

Payment obligation
If you have poor product knowledge, you may make a poor choice in equipment purchase. Purchased equipment may become outdated and have very little resale value. You also may end up buying equipment you don't need in the future. If you have financed the equipment, you are still required to make the monthly loan payments to pay off the purchase regardless of need.

Maintenance
You are entirely responsible for the maintenance of the asset. You take on all the risk if the equipment breaks down or needs to be replaced.

Depreciation
Depreciation can be broken into tax and accounting depreciation. Tax depreciation is fixed by the tax code.
Accounting depreciation is when the value of the asset declines over time as the equipment is used and wears out. For example, a depreciation expense of $200 per year for 5 years may be recognized for an asset costing $1000. Depreciation expense generally begins when an asset is placed in service. Methods of calculating depreciation are generally based on either the passage of time or the level of use of the asset. Several methods of determining depreciation expense include fixed percentage, straight line, and declining balance methods. Keep in mind that if you do decide to purchase equipment, most income tax systems allow a tax deduction for recovery of the cost of assets used in a business.

Additional Costs
There are various additional costs associated with buying and financing that you should be aware of:

- Non-cancellable agreement – If entering into a loan, the facility agrees to make all of the payments to the end of the term.
- Document fees – Administrative costs can range from $50-$350 or more depending on the complexity of the loan contract and size of transaction.
- UCC-1 Fees – Fees required by the Secretary of State where equipment is being purchased. The fee is usually a onetime charge that is due upon signing.
- Taxes – Most states have a 5-6% or more tax on goods purchased. This tax depends on total cost of equipment and state of purchase and is factored into monthly payments. Public tax supported facilities are tax exempt.
- Insurance – The owner of the equipment will be compensated in the event of theft, fire, etc.
- Consider scaling your Request for Quotation (RFQ) or Request for Proposal (RFP) to the dollar amount of the asset(s) being acquired. On smaller, more routine purchases, you may want to consider leveraging state contracts, cooperative purchasing agreements, and the like. The benefit is that the transaction is easier and more efficient for both the buyer and seller.

Advice when making the decision to lease or buy
Determine the needs and goals of your organization before making the decision to lease or buy. Sports turf managers should consider cash flow, equipment use, tax implications, debt load, and even their location before deciding to lease or buy.

Do a lease versus buy analysis. Be aware of all costs involved with the transaction and balance the costs against the benefits to make the best choice.

Lease vs. Buy

Determine the approximate net cost of the asset. Factor in tax breaks and resale value when making this calculation. After determining the most cost effective option, consider intangible costs. For example, if you purchase equipment, will it become obsolete? If you lease equipment, will your need for the equipment expire before the lease ends?

Compare the tax implications on leased assets versus purchased assets. They may change year to year.

Consider interest rates. Invested money earns interest and borrowed money requires interest payments. However, current interest rates on equipment leases or purchases are minimal. Leasing or purchasing equipment with low interest rates may be more cost effective than the minimal interest accrued on savings.

Consider renting. If the piece of equipment you need is only used several days each year, renting may be a more cost effective option.

Know the rules for your facility. Some public facilities such as municipalities are prohibited from entering lease agreements.

Do your legal homework to avoid bad deals.

Have a lawyer look over a lease before signing it..

Acknowledgements

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