Business/Non-Instructional Operations

Leasing Equipment and Capital Assets

All leases for capital equipment and asset acquisition shall include the following procedures:

- An analysis must be submitted that details the specifics of why a lease is preferable to a direct purchase. Supporting information must be provided on a template created by Business Services.
- All leases that have an asset acquisition value of greater than $100,000 shall be submitted through Business Services for Council approval.
- All lease agreements for any type of lease must be signed by the Executive Director or Assistant Executive Director Finance and Operations.

Policy adopted: No Date

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When acquiring equipment, there are generally three ways to financing a purchase: (1) cash purchase; (2) bank financing or line of credit; and (3) leasing.

The primary reason an organization leases is to manage cash flow, avoid obsolescence, ownership, issues with disposal and maintenance & repairs.

Strictly speaking, an outright cash purchase is often the least expensive means of buying equipment; and bank financing is often cheaper than leasing. But, the flexibility that leasing affords must be taken into consideration when making the best overall purchasing decision.

Leasing is simply an alternative means of financing property. There are a few major areas of consideration before deciding which means of acquisition is best:

- → The useful life of the equipment
- → The length of time CREC needs the equipment
- → The amount of available cash on hand to fund the acquisition
- → The total amount which will be paid for an asset
- → Who will be taking care of maintenance & repairs
- → The need to avoid obsolescence and the responsibility of asset disposal after its (1) needed time frame or (2) useful life

Before following the next series of questions for guidance, it is strongly recommended that prior to acquisition of any new asset in excess of $5,000, a cost comparison of the three major forms of acquisition be performed:

	Cash Purchase	**Financing**	**Leasing**
Equipment cost			
Down Payment			
Contract Length			
Monthly Cost			
Total loan or lease payments			
Residual cost			
Total cash payments			
Residual Value			

If the length of the lease exceeds five years, it may be beneficial to use a discount rate to the financing and leasing Total Cash Payment to arrive at a true cost in today's dollars.

When deciding how to finance the acquisition of property, the following questions need to be asked:

Use & Disposal of Equipment:

1. What is the useful life of this equipment?

   → If it is for a short period of time (under 2 -3 yrs), consideration should be given to short-term operating leasing because the lessee does not need to be concerned with installation, disposal, obsolescence, etc.

   → If asset acquisition and disposal is not of concern, then outright purchase should be compared to the cost of leasing.

   → Often in short term leases, the lessee may be able to negotiate that the lessor to be responsible for maintenance & repairs (a big plus).

   → In short-term leases, the cost of interest may not be significant (assuming interest rates are not very high) due to the short term of the lease, and the ability to “pay” for the asset over 24 – 36 months may be an incentive as opposed to purchasing the asset outright. Depending on the cost of the asset, bank financing may be too cumbersome and should be reserved for higher ticketed items.

   → If CREC foresees needing this asset for a longer period of time, additional factors need to be considered.

2. Will this asset become technologically obsolete to CREC or difficult to dispose by CREC within 2 – 3 years?

   → If so, then consideration should be given to leasing because leasing provides the easiest opportunity to replace/remove outdated equipment with newer equipment without the hassle of disposing of old equipment.

   → *Exception:* If (1) CREC has the ability to recondition the equipment for resale, (2) the equipment had a residual value, and (3) CREC could sell the equipment to the secondary market without difficulty, consideration then should be given to outright purchase of the asset.

   → If this asset will not be technologically obsolete or difficult to dispose of, additional factors need to be considered.

Cash Flow

3. Does CREC have the available cash to purchase the asset outright?

   → If there is available cash flow to purchase the equipment, and there would be no significant impact on cash available to manage operations, then, serious consideration should be given to outright purchase considering it is the least expensive form of financing.

- → Depending on the asset's purchase price, it can be difficult for some organizations to justify tying up cash in a capital purchase when often cash is needed to run day to day operations, expand existing operations, etc. Often, an organization is wary of using a line of credit in the future to fund operating expenses just because current cash was used to purchase assets. So, if cash is available today, an organization needs to make sure it is not needed in the near future either.

- → If no cash exists to outright purchase the asset, additional factors need to be considered.

4. Does CREC intend on using this asset for its estimated useful life and will this asset hold its value?

   - → If so, outright ownership may be the most economically advantageous. Financing, next to cash paid in full, is often the most financially sound and least expensive way to acquire an asset.

   - → *Exception:* If an asset requires a lot of maintenance & repairs (as copy machines do), it may be most advantageous to just lease this type of asset.

Leasing vs Buying Analysis

	PURCHASING OPTIONS		*LEASING OPTIONS*	
	CASH	**BANK FINANCE**	**OPERATING LEASE**	**CAPITAL LEASE**
Ownership	Asset is owned outright.		Asset is borrowed from lessor, who owns property.	
How much will be paid or owed?	Just the purchase price.	The purchase price plus interest over the life of the loan.	Monthly lease payments which reflect the cost of the asset plus and effective interest rate. Lease interest rates can often be higher than bank financing interest rates.	
When is the cash paid?	Use current, available cash to pay for purchase. Must have enough cash on hand and still be able to run day to day business operations.	Borrow money from a banking institution to pay for asset. May need a "down payment". Monthly loan payments are then made to the bank.	Lease payments are made monthly. Lease payments are often the most conservative cash flow means – the least amount is paid out each month.	
Bottom line impact on cash	The <u>least</u> amount of cash is paid over time.	More cash is paid out than outright purchase but usually, less cash is paid out than leasing.	Often, this is the <u>most expensive</u> method of paying for assets. Over time, more cash is paid out using leasing option than financing or outright purchase.	
Term of contract	n/a	Term of loan or line of credit (probably not greater than the asset's useful life).	2 -3 years, often less than the useful life of the asset.	Often 3 years or longer – usually the estimated useful life of the asset.

	PURCHASING OPTIONS		LEASING OPTIONS	
	CASH	**BANK FINANCE**	**OPERATING LEASE**	**CAPITAL LEASE**
Cancellation Policy	n/a	A loan cannot be cancelled – it can only be paid off.	Often cancelable by lessee. May be a slight prepayment penalty.	Often not cancelable. Similar to long term debt.
Disposal of asset	Owners' responsibility. This may be a positive if the asset has a long, useful life or a residual value. This may be difficult if the owner does not have the resources to manage the disposal process.		Lessor responsibility.	Lessor responsibility, unless lessee elects to purchase asset after the lease term.

Pros and Cons

	CASH	BANK FINANCE	OPERATING LEASE	CAPITAL LEASE
Pro's	Always the least expensive method of acquiring assets. Buying is cheaper in the long run.	Financing is often cheaper than leasing in the long run because financing rates are often less than leasing rates.	Helps to control cash flow. Lease payments are predictable and known. Leasing helps to improve & manage your cash position, and conserve available capital .	
	Ownership allows for flexibility with use of and disposal of equipment. An organization can transfer, modify or move equipment as well as sell it when desired. Disposal of equipment can be a "positive for owning" for an organization when there are resources to manage disposal and realize a residual sale value.		Provides ease of disposal of old equipment (lessor is responsible). This can be a "positive of leasing" if disposal of asset is difficult if an organization who doesn't have the resources to handle this, or ability to sell asset for at least residual value.	
			Helps to avoid owning equipment that becomes obsolete. Often when a lease expires, newer equipment replaces it.	
		Allows an organization to acquire significant assets without experiencing a massive outflow of cash.		
			Provides greatest flexibility if business is new and/or equipment needs are expected to change quickly.	
			Often, no down payment is required upon signing. Monthly lease payments are often less than monthly loan payments. Lease payments are fixed, and not tied to any index rate.	

	CASH	BANK FINANCE	OPERATING LEASE	CAPITAL LEASE
			Operating leases can free up credit, and is not shown as debt on the balance sheet.	
			It is often easier for an organization to qualify for a lease than for a bank loan.	
			Can be beneficial if lease includes maintenance & repairs.	
Con's	Uses current cash flow that could otherwise be used to finance daily operations or expand the business.	Possible down payment required.	Leasing is often the most expensive means of acquiring assets.	
	May be difficult and costly to maintain and repair owned equipment		Often effective interest rate is higher than bank financing rates.	
			If an organization plans to "pay off" the asset in the near term, buying may be better than leasing.	
				It is common for maintenance & repairs not to be included.

Regulation approved: No Date