

THE INSIDE SCOOP ON LEASING: LEASE TERMS BY JOSEPH MARION

As we discussed in our last column, one of the best ways to maximize the value of your IT budget is by leasing your equipment rather than purchasing it outright. But “playing the leasing game” without educating yourself could prove costly. We have dedicated this issue to explaining some common leasing terms, to help you maximize a leasing opportunity.

Master Lease Agreement

Most Lessors have their customer execute a master lease agreement (“MLA”) which establishes the overarching terms and conditions of future business between the Lessor and Lessee. Each time new (or used) equipment is leased, an Equipment Lease Schedule (“ELS”) is added to the MLA which delineates the equipment, lease term, and lease rate for the new transaction. Once an MLA is in place between the parties, adding new Equipment Lease Schedules is quick and easy.

Term

One of the best ways to reduce the cost of your equipment acquisition is to accurately predict how long the equipment will be of use to you. Needs to replace the equipment early or retain it longer than originally anticipated can be costly. A Lessor may not let you return the equipment early without prepaying the entire lease balance, and may even charge you storage for an early equipment return. It is to your economic advantage to minimize any rental payments outside of the original term of the ELS.

Interim Rental

Interim rental is any rental that the Lessor charges before actually starting the clock on the lease term. Some Lessors require that interim rental be paid for installed items until *all* items under an ELS have been installed. Installations for multiple items of equipment in a large transaction can drag on for months, and large amounts of interim rental can be paid before the last item under an ELS is installed and the lease term is even commenced!

Automatic Renewal/Lease Expiration

Most leases do not automatically expire. There are a number of Lessor “tricks” that are employed to get the lease to continue beyond the original term at the same lease rate. For example, I have seen leases that require “six (6) months written notice prior to the end of the Original Term or the Lease will automatically extend, under the same terms and conditions, for successive six (6) month minimum renewal terms until terminated by the Lessee by six (6) months prior written notice.” Upon reading this clause carefully, you will see that if you miss a notice period by one day, you will be locked into six more months of lease payments at the same rate. And if you wait until the lease expires to have any dialog with your Lessor, you could easily be locked into twelve months! Also avoid “all-or-none” termination or renewal clauses. You want to retain flexibility to purchase or renew the lease for individual items of equipment, especially if there are many items on one ELS.

End-of-Lease Options

There are two types of leases: operating leases and finance leases. An operating lease functions very much like a rental in that the user of the equipment does not own the hardware at the end of the lease. At the end of an operating lease the user usually has the option of returning the equipment to the Lessor, renewing the lease at fair market value rental, or purchasing the equipment at fair market value. You will want to clearly define how the fair market value price is to be established. A finance lease (where title may or may not pass to the

Lessee at the end of the lease term) and an operating lease have very different accounting implications. See future columns for more detail on what the accounting aspects of leasing mean to you.

Equipment Return

When it comes time to return your equipment at the end of your lease you will want to make sure that you have the right to substitute your equipment with like equipment especially if you are dealing with small items such as laptop computers.

Taxes

Sales and use taxes are rightfully the responsibility of the Lessee. But the Lessor (owner) of the equipment is responsible for personal property taxes unless the lease passes this obligation on to the Lessee. Be careful not to unwittingly assume this financial burden.

Sublease

The Lessor should not unreasonably withhold their approval of your right to sublease. If you find that you no longer need the leased equipment, having the right to sublease the equipment may offset some of your expenses under the lease.

Upgrade

If you are acquiring equipment that can possibly be upgraded in the future to gain greater speed or capacity, make sure that you have the right to order the upgrade from anyone you wish. In all likelihood, your Lessor will have the best upgrade prices in town, but if not, you don't want to have the possibility of a more economical upgrade withheld.

Assignment

Some Lessors enter into leases with the full intention of selling the lease to someone else at a future date. It is important for you to know that your Lessor today will be your Lessor tomorrow.

You will not likely be able to get all of the terms and conditions discussed here into one MLA. But this is a business negotiation and there are trade-offs—for both Lessee and Lessor. If you negotiate well, and understand and manage the terms and conditions of your lease agreement, you can navigate to maximize the value of your IT Budget.