Acquiring Equipment? 5 Questions to Consider [To FMV or not to FMV]

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Smart business owners and managers know that preserving capital is an important financial goal. When you are looking to preserve or access capital, equipment financing is an attractive option that offers numerous benefits.

With leasing, knowing the factors that go into deciding whether to enter into a fair market value (FMV) lease or $1 buyout lease will enable you to make the right financing choice for the equipment you need to operate your business.

[FMV = short term use, $1 Buyout = long term ownership]

To begin, it is useful to understand the definitions of an FMV and a $1 buyout lease. **An FMV lease is an operating lease to use equipment, while a $1 buyout lease is a capital lease to own equipment, which essentially acts as a loan.**

With an FMV lease, you use the equipment for a certain period, and typically you use it at a lower cost than if the equipment were purchased outright or with borrowed capital. That is because the equipment has a residual value at the end of the lease, which the financing company can expect to realize through the sale or re-lease of the asset.

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With an FMV lease, you are not paying for the full cost of the equipment. Should you decide at lease end that you would like to continue to use the equipment, you may have the option to buy it at a negotiated fair market rate, you may also continue to rent it, or you may elect to return it to the finance company.

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There are multiple reasons to use an FMV lease. Your business can realize significant benefits from the following:

+ Accurate budget planning
+ Reduced cost of use of the equipment
+ Eliminate equipment obsolescence
+ Outsource the cost and responsibility of equipment management and disposal
+ Receive bundled services, such as financing for software and maintenance, and you may also enjoy free use of a lease tracking system

Many equipment types are suitable for FMV leases. Long-term assets are appropriate since they typically maintain relatively higher residual values. Shorter useful life equipment types, such as technology and office equipment, are also appropriate for FMV leases since they help end users avoid owning obsolete equipment at the end.

$1 buyout leases offer 100 percent financing and no down payment, which enables borrowers to preserve cash. A $1 buyout lease also gives ownership of the equipment to the end user for tax purposes so bonus depreciation and interest expenses can be claimed.

Often the choice between an FMV lease and a $1 buyout lease depends on your preferences. To help make an objective business case, consider the following:

[5 Key Questions to Consider in an FMV or $1 Buyout Lease Decision]

1. How long will your organization need to use the equipment?

Generally speaking, for short-term use (usually 36 months or less), an FMV lease is the preferable option. Equipment expected to be used longer relative to its useful life (or that you know you will want to keep at the end of the term) is appropriate for a $1 buyout lease.

2. How soon will the equipment become obsolete?

Most equipment will become obsolete at some point, some faster than others. The sooner it is

expected to become outdated, the better suited it is for an FMV lease so you do not get saddled with old technology. The best part: you can upgrade to new equipment that can give your business a competitive edge.

3. Do you have the resources to manage assets throughout their lifecycle?

Equipment management is a function that requires specific resources and expertise. Selling or disposing of the asset, performing a Department of Defense-level data wipe, maintenance, repair and other aspects of asset management become the end-user's responsibility at the end of a $1 buyout lease. With an FMV lease, you outsource the asset management function to the equipment leasing company so you can focus on your core business.

4. Do you anticipate the need for additional equipment?

If your business is planning for growth, you will want your equipment to be able to scale. An FMV lease will enable you to get the right type and amount of equipment your business needs in the future, and not be forced to mix and match newer with older assets.

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5. Will the equipment be used for a new venture?

When embarking on an untested business venture, there may be uncertainty of when or if it will be successful. An FMV lease will enable you to mitigate the risks of uncertainty and hedge against ending up owning a piece of equipment you may not need in the future.

Whether you choose an FMV lease or a $1 buyout lease, the most important thing to keep in mind is that both will enable your business to enjoy benefits you cannot attain when purchasing equipment with cash. For informational resources on equipment leasing and financing, including a digital toolkit, videos and a provider directory, visit: www.equipmentfinanceadvantage.org.

William G. Sutton, CAE, is President and CEO of the Equipment Leasing and Finance Association, the trade association that represents companies in the $903 billion equipment finance sector, which includes financial services companies and manufacturers engaged in financing capital goods. ELFA has been equipping business for success for more than 50 years. For more information on equipment financing, please visit www.ELFAonline.org. Follow ELFA on Twitter @elfaonline.