

Types Benefits and Financial Applications of Leasing

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Healthcare facilities use expensive equipment to provide quality medical care to their patients. However, there are some instances where purchasing the equipment is not the optimal option. In those circumstances, a better option would be to lease equipment. It allows organizations to manage expenses, including cash, book, and tax expenses. This is also a good option when the equipment is needed for the short term rather than for permanent use. This paper will explore leases, their types, and their advantages in detail.

When an individual or an organization decides to rent a property or an asset that belongs to another individual or organization, they must sign a legal document that outlines the terms and conditions. This document is a contract called a lease, and the act of renting out a property or an asset is called leasing. The person who leases the property is called a lessee, and the person who leases out the property is called a lessor. Several regular payments are agreed upon and paid on agreed-upon time. If both parties do not uphold the terms and conditions of the lease, then they will face consequences for breaking the agreement. Leases fall under incorporeal rights, meaning that even if the property cannot be touched or seen, it is legally binding. Apart from leases, other incorporeal rights include licenses, copyrights, easements, and rights-of-way. Commercial leases, which are used for organizations, tend to differ from organization to organization, but the leases provided to tenants are mostly the same (Chen, 2022).

Types of Leases

When talking about leasing, many types can confuse the lessee; however, there are only three main types of leases: contract hire, operating, and finance. Other types are just sub-categories of these leases. The sub-categories are adapted from the three main lease types explained below.

Operating Lease: This type of lease is used for equipment and can be extremely useful if the equipment is needed for only a short period of time or if the organization cannot afford to buy the equipment in its entirety. After the lease ends, the company that leased out the equipment can legally retrieve the equipment. If the lessee wants the equipment for more time, then they have to request a lease extension before the previous lease expires. The insurance and maintenance of the equipment are the responsibility of the company that leases out the equipment unless agreed otherwise. Leased assets do not need to be shown on the organization's balance sheet.

Finance Lease: This lease is useful when the equipment is needed for the long term. The length of the lease is determined based on the expected life of the equipment. The equipment's expected life

means the time that it will work properly without damage; this is usually three years or higher. When the organization has paid the expected life amount as a down payment, then they keep paying the monthly amount until the whole amount of the equipment has been paid. After that, the company that has leased out the equipment does not want it back as the equipment has been used extensively and will not be in optimal condition to lease out again. For this reason, the lessor recovers the amount of the equipment and charges extra for the extended amount of the lease. The lessee is responsible for insurance and equipment maintenance. After the lease agreement is over, the organization can either keep the equipment or sell it off. The equipment acquired through a finance lease is shown as a capital item on the balance sheet or as a purchase by the company. If the lease term is more than five or seven years, then it is called a “long funding lease”, and the benefit of this type of lease is that the organizations can claim capital allowance, which is usually applicable on assets or equipment bought outright.

Contract Hire Lease: This type of lease is usually utilized by car companies, and it is the responsibility of maintenance and management, which includes servicing and repairs, which fall on the lessor. The assets of this lease do not need to be shown on the balance sheet.

Which Lease is better?

The choice of which lease is better for the healthcare organizations depends on their needs. The contract hire lease will be dropped from consideration as it does not fit the needs of the healthcare insurance; however, the finance and operating leases will be analyzed to understand which one fits the requirements of the healthcare organizations well. Here, the organization will have to consider if they require the equipment for long-term use or short-term use and if, at the end of the lease, they want the equipment to belong to them. If the equipment is needed for a short time, then the operational lease is the best choice; however, if the equipment is needed for a longer duration and at the end of that duration, the organization wants to own the equipment, then the finance lease is the optimal choice. So, in this case, only the needs of the healthcare organizations can determine the best lease type.

Lease Evaluation by Both Parties

In any lease agreement, two sides are involved: the lessee who is interested in renting the property or asset and the lessor who owns the said property or asset. The lease is a legally binding contract, and breaking it can have legal repercussions, so both sides must know their rights and demands before signing the lease. For this reason, both of them need to analyze the agreement thoroughly before jotting down their signature and making the agreement binding. In this section, the lease will be analyzed from the perspective of the lessee and lessor.

Lessee: This group would be renting the property or asset, so they need to know that they need to

make agreed-upon payments to the lessor at the agreed-upon times in the initial agreement. This means that if the lessor tries to get more payments after the agreement, then they can be held legally responsible for the extortion of money. The duration of the lease also needs to be determined within the lease to avoid conflict later. If the lease is operational, then the lessee does not need to worry about insurance and maintenance of the property, but if it is a finance lease, then they will be responsible for the insurance and maintenance of the property. If the lessee is not well-versed in the legality of the lease, then it is advised that they have a competent lawyer on their side to avoid getting scammed. The lessee should know that the lessor cannot re-claim the property until the lease is over, so if they try to do so, then the lessee can press charges.

Lessor: As the legal owner of the property, the lessor should carefully analyze the lease agreement before signing it. The company should understand that even after leasing the property, they retain the ownership of the property and are entitled to periodic payments according to the initial lease terms. If any damage is done to the property that does not fall under insurance, then the lessor is entitled to compensation. If the operational lease is being used, then the insurance and maintenance falls on to the lessor, but if the finance lease is being utilized, then the insurance and management do not concern the lessor. The lessee cannot sell the property of the lessor as it will be illegal, but if this is done, then the lessor is within his rights to sue and recover the property or gain financial compensation equal to the value of the property for further compensation for breaking the agreement. If the lessee learns that his property or asset is being used for illegal purposes, then he is within his rights to reclaim the property or asset, even if the lease is not over yet, and sue for property damage.

The lessor should carefully analyze the lease to see if there is any clause that could act as a loophole in transferring the property to the lessee because this is illegal. If the lessor signs it, this would become legal, and he would be cheated out of his property. The lessor should remember that by leasing the property, he would not be able to freely access it, so if he wants to use it, then he must get permission from the lessee.

Lease Analysis

The lease analysis utilizes different methods and tools to interpret and calculate financial data so that the benefits of leasing can be determined for both the lessee and the lessor. This is done by determining the value of the property and the profit it might bring in. The data collected from this analysis is used to determine the payments that the lessee would pay to the lessor. Lease analysis, in simple words, allows both parties to determine the worth of the property so that the lease payments can be set accordingly (PANKNIN, 2020).

Motivation for leasing

Many businesses prefer to lease property or equipment, and there are numerous motivations for doing so. The first is that leasing anything allows businesses to preserve their working capital, which means that they can utilize the funds elsewhere instead of sending them all to acquire a single property. It also allows them to preserve their credit by not overspending the total exposure limit that the bank allocates to the businesses. This way, they maintain a good credit score. It is easy to set budgets as the lease amount can be tailored to each business's needs, so they do not have to worry about not being able to afford the lease. The profit generated by machines and equipment can be used to pay leases, so it is very cost-friendly. Leasing can provide certain tax benefits.

Case 16:

This case is centred on the Seattle Cancer Center, which is trying to lease equipment called Gemma Knife, but they just require it for a short duration. They started to look into lease options that would allow them to lease this machine for a short duration. It is advised that they opt for an operational lease, which will allow them to lease the equipment for a short time without worrying about insurance and maintenance. They should include a cancellation clause in the lease so that if they do not need the equipment any longer, they can save on the extra cost that they would have to pay if the lease cancellation clause is not included. This way, they will be able to receive tax exemption benefits as well (Reiter et al., 2021).

References

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