nyrej

Equipment leasing: Innovative financing for building renovations

December 17, 2007 - Owners Developers & Managers

Savvy building owners have found equipment leasing to be a fast, easy, cost-effective way to finance a variety of building renovations where the items being financed are not strictly equipment.

The trend started during the last economic downturn when a few equipment leasing companies were looking for a way to generate a greater dollar volume of business to compensate for a slowdown in equipment sales. Because these companies were already including soft costs such as delivery and installation along with the equipment cost in the lease, it was not a big stretch for them to allow creditworthy customers to also include the cost of related leasehold improvements; and with that, the door was opened!

Today, we are financing building renovations on 5-year (sometimes longer) equipment leases with a $1 purchase option at the end. The cost of labor as well as material such as paint, wallpaper, ceiling tiles, flooring and window treatments are being leased as well as HVAC upgrades and elevator modernizations. Rather than spend cash when picking up the tab for tenant improvements, a building owner conserves cash by leasing the improvements and offsetting equipment lease payments with tenant rents.

Leasing energy-efficiency improvements is very popular given the current greening of buildings as well as the need to combat soaring energy costs. Through NYSERDA, we are providing leases to building owners in New York for energy-saving improvements and renewable energy technologies at interest rates below U.S. Treasuries.

The key benefits of leasing cited by chief financial officers include 100% financing which improves liquidity and working capital, preservation of existing bank lines for other financing needs and emergencies, overcoming budget constraints with fixed monthly payments, and investing freed up cash elsewhere at a higher return.

Building owners are attracted to leasing for certain advantages over mortgage financing. There is no mortgage lien placed by the leasing company on the building and there is no subordination or waiver required from the existing mortgagee. A lease is the financing solution where the building mortgage has been securitized and the securitization trustee will not give a subordination or waiver for a second mortgage. Unlike a mortgage financing, closing costs for a lease are minuscule. A building appraisal, environmental study, and attorney are typically not required. There is no mortgage tax and no need to refinance a mortgage, eliminating any early termination penalty. Finally, a sizable lease can be approved, documented and funded in a matter of weeks, not months.

A lease is not a loan, even thought it is being used as a financing vehicle for building renovations. A lease is a contract whereby an owner of an asset (lessor) conveys the right to use the asset to another party (lessee) for a period of time (term) in return for a periodic payment (usually monthly).

A lease provides that the asset is to be returned at the end of the term. A $1 purchase option at the end of the term, typically provided in a separate document, results in the classification of the lease agreement as a capital lease.

The accounting and tax treatment for a capital lease is the same as for a loan. The lease amount is recorded by the building owner as an asset on its balance sheet with a corresponding liability in the same amount. The asset is depreciated and the portion of the monthly lease payment deemed interest, easily determined with a financial calculator, is expensed.

The approval process for a capital lease involves a review of financial statements and tax returns for the company that owns the building and any required lease guarantors. Credit officers look for a positive cash flow and a debt service coverage ratio that will include the new lease payment. A guaranty of the lease may be required from a related company where there is a history of inter-company borrowing or management fees, and will typically be required from the individual owners of the company. However, guarantees may be waived where there is a stable situation, good liquidity, equity on the balance sheet, and strong cash flow. Credit officers, quoting from the American humorist Will Rogers, are more concerned about the return of their money than the return on their money. Therefore, a "bankable credit" as lessee is required.

The bottom line is equipment leasing is a good cash management technique which can be used as an attractive form of financing. The next time you have a building renovation, an equipment lease may be your best financing alternative.

Stanley Fishbein, J.D., LL.M. (Tax), is the president of CapQuest Group, LLC, Yonkers, N.Y.