

Leasing Options

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Leasing Option

- Contract for **use** of asset between
 - Owner(Lessor)
 - User(lessee)
- For periodical lease rentals by the lessee to the lessor
- Transfer of ownership **not** involved.

Hire Purchase

- Contract of **purchase** of an asset between
 - Seller
 - Purchase
- On understanding to pay total amount(along with interest) by purchase to seller, in predetermined periodical installments spread over a length of time mutually agreed upon.
- **Before final transfer of ownership** to purchase.
- Fixed charge on asset purchased by Lessor.

Project Finance option

- Based on only viability of the project
- Full payment by purchaser to seller and transfer of ownership to the purchaser along with purchase.
- Term loan for said purchase for a definite period.
- Repayment of principal and interest in fixed installments to lender
- Fixed charge security on assets financed.
- Option to sell the financed assets in case of default to recover the balance loan along with interest.

Leasing Options-

Operating Lease Option

- Lease period much less than economic life of the asset.
- Lease terminable as per terms and condition or with moderate penalty.
- Operating knowledge imparted by Lessor.
- Wet lease i.e. repairs and maintenance and insurance by the Lessor
- Dry lease i.e. repair/maintenance and insurance etc. by the lessee.

Operating Lease Option-- contd

- No transfer of ownership
- No transfer of risks & rewards of ownership to lessee
- Direct to the lessee (between Lessor and lessee)

Finance/Capital lease Option

- Indirect mode of borrowing
- Non-cancelable by the lessee
- Lease period divided into primary and secondary periods
- Primary lease period coinciding with economic life of the asset.
- Entire investment (along with interest and reasonable profit) of the asset (at least 95%) amortized fully through lease rentals during primary lease period.

Finance/Capital lease Option --contd

- Lessee always fully responsible for repair/maintenance and insurance of the asset (Dry lease)and payment of taxes etc.
- Lessee has option to renew the lease after expiry of primary lease period at substantially reduced lease rental(to cover administrative/others expenses of lessor)
- Direct/indirect
- Single investor lease without recourse to lessee i.e. lender can not demand payment from lessee in case of default by Lessor .

Finance/Capital lease Option--contd

- Leveraged lease
- ❖ Following parties jointly finance the investment
 - Leasing Company(Equity participant)
 - Lenders(Debt/loan participants)
 - ✓ Fixed rate loan by lender(s) without recourse to Lessor (leasing company) but to lessee.
 - ✓ Each lessee rental bifurcated in
 - Debt service charge on loan to be directly paid by lessee to lender
 - Balance amount payable to Lessor(Leasing company)

Finance/Capital lease Option--- contd

- Loan secured by first charge on the future lease rentals payable by the lessee and fixed charge on leased asset with right to sell it in case of default

Sales and Lease back Option

- Firm sales its asset to leasing company
- Takes it back on lease for uninterrupted use.
- Operating or finance lease model.
- Leads to unlocking of investments.
- Issues of fair-market price and residual depreciation involved.

Rationale of leasing option

- Asset required only for a period much less than its economic life.
- Additional benefits due to likelihood of much **cheaper purchase price** and much **higher scrap value** of the asset for a **large size leasing company** engaged in leasing of **standard assets** and bargaining and investigative power compared to a **small company**.
- Additional benefits of **tax shield** passed in by the leasing company having **higher tax rates** on depreciation and interest.

Rationale of leasing option- Contd.

- User company with **lower credit rating** can avoid **higher interest charges** and **stringent** terms and conditions of lenders by going for leasing option.
- Lesser risk of technological obsolescence in case of operating lease due to diversification and multiple usage options.

Rationale of leasing option- Contd.

- Quick implementation of project due to quick finalization of lease.
- Payment schedule of lease rental can be matched with expected pattern of cash inflows of the user as the leasing company can adjust the overall repayment from other resources.