The New Lease Accounting Standard's Impact on the Lease vs. Buy Decision

This is the first article in a four-part series of articles in the QuickBrief e-newsletter designed to help ELFA members prepare for the new lease accounting rules. The new rules are scheduled to take effect for financial periods starting after Dec. 15, 2018, for public companies and after Dec. 15, 2019, for private companies. This article is excerpted from information on ELFA's Lease Accounting webpage.

Under the new lease accounting standard, the reasons why businesses lease and the benefits they attain will not change. There are many business reasons why customers lease when the alternative to a lease is to borrow to buy the asset. The key business reasons to lease rather than borrow to purchase an asset are:

- No money down and immediate use of the leased asset vs. a loan typically requiring a down payment
- Avoid using capital to acquire a non-core business asset
- Level fixed-rate payments over a term that closely match the asset useful life
- Outsourcing service in a full service lease for more cost effective, easier management
- Transfer of asset disposal to the lessor
- Convenience: a lease is often point of sale "financing" with a simple, quick process for approval.
- Leasing provides a hedge against obsolescence.

Some of the financial reasons why customers would not borrow to purchase an asset are:

- The customer many not qualify for a loan from a bank
- The loan interest rate will be floating and may be high
- A down payment may be required
- The term and loan payments may not fit the customer's cash management budget
- Full asset cost is on balance sheet, reducing ROA which is often the basis for compensation and investment evaluation
- The loan **IS** debt which may violate debt covenants
- The costs are front ended (imputed interest and straight line depreciation)

Reason for Leasing	Details	Status Under New Rules
Raise Capital	Additional capital source, 100% financing, fixed rate, level payments, longer payment terms, avoid impacting debt limit covenants, lease cost in operating budget, less than 100% of the asset cost on balance sheet	Still a major benefit versus buying financed by a bank loan/debt especially for small and medium-sized entities and non-investment grade lessees with limited sources of capital
Low cost capital	Low payments/rate due to tax benefits, residual and lessor low cost of funds; implied equity vs. the capitalized lease amount is less than actual equity required when borrowing to buy	Still a benefit versus a bank loan and owning the asset
Tax benefits	Lessee can't use tax benefits and the lease vs. buy analysis shows lease option has lowest after tax present valued cost	Still a benefit
Manage assets/residual risk transfer	Lessee has flexibility to return asset	Still a benefit
Service	Outsource servicing of the leased assets.	Still a benefit
Convenience	Quick and easy financing process often available at point-of-sale	Still a benefit
Regulatory	Capital issues	Still a benefit as regulators should still treat ROU assets as "capital free" as they are an accounting contrivance and do not represent an asset in a bankruptcy liquidation
Accounting	Off balance sheet	Still a partial benefit if the present valued capitalized amount is less than the cost of the asset, should be true for high residual assets and the impact of tax benefits

This article is an excerpt from "Navigating the New Lease Accounting Standard" available at www.elfaonline.org/industry-topics/lease-accounting.