

# COMMERCIAL FUNDING NETWORK, INC

<http://www.commercialfundingnetwork.com/equipment-vehicle-lease-financing/index.htm>

		Purchase Cost					Leasing Cost				
		<i>Loan Information</i>									
PV Factor	Year	Pymts	Interest	Deprec	Deduction	Tax Savings	Net Cost after tax	PV Cost of Purchase	Net Cost after tax	PV Cost of Lease	
[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]	[10]	[11]	
0.93258347	1	\$24,084	\$3,911	\$13,000	\$16,911	\$5,750	\$18,334	\$17,098	\$ 16,611	\$ 15,491	
0.86971192	2	\$24,084	\$2,453	\$20,800	\$23,253	\$7,906	\$16,178	\$14,070	\$ 16,611	\$ 14,447	
0.81107896	3	\$24,084	\$889	\$12,480	\$13,369	\$4,545	\$19,539	\$15,847	\$ 16,611	\$ 13,473	
0.75639883	4			\$0							
0.70540504	5			\$0							
		\$72,252	\$7,252	\$46,280			\$54,051	<b>\$47,016</b>	\$49,833	<b>\$43,411</b>	
								<b>Net Advantage to Lease</b>		<b>\$3,605</b>	

Assumptions	
Tax Rate	34.00%
<b>Money Rate</b>	<b>7.00%</b>
Equip. Cost	\$ 65,000
Terms (Yrs)	3
Lease Pmt / Mo.	\$ 2,097.37

Lease Pmts (pre-tax)	
1	\$25,168
2	\$25,168
3	\$25,168
4	
5	
	\$75,505

Depreciation Rates [12]	
1	20.00%
2	32.00%
3	19.20%
4	
5	
	71.20%

- This factor discounts future payments to today's dollars, using the assumed **Money Rate**: <http://www.commercialfundingnetwork.com/Links/fedrates.htm>
- The year for which the figures in that row apply
- Total payments for that year on a **FIXED RATE** (see: Money Rate) **loan** for **100%** of the equipment cost. (exception terms for a conservative assumption)
- The amount of deductible interest on that year's loan payments.
- The deductible depreciation for that year (also see note 12)
- Total deduction expenses associated with the purchase loan **Interest** (4) + **Depreciation** (5)
- Based on the assumed Tax Rate, the amount of taxes saved as a result of the deductions in item 6
- Net cost is the total payments less the tax savings.
- The Present Value of the Net (after tax) Cost of the purchase - using the assumed Money Rate
- The after-tax costs of that year's lease payments (1-assumed Tax Rate)\***Lease Payments**
- The Present Value of the Net (after tax) Cost of the lease payments
- MACRS Depreciation Rates - assumes 5 year life

## Notes for Lease vs. Buy: NPV Analysis

### **What is It?**

*Net present value* (NPV) analysis is a method accountants and financial managers use of comparing two future streams of income or expenses by converting them to today's dollars. It can be used effectively to turn an apples-to-oranges type comparison to an apples-to-apples one! It does so by *discounting* future income or expense streams to arrive at their equivalent in today's dollars. Discounting recognizes the *time value of money*; that money today is worth more than money tomorrow.

### An example:

Someone owes you one thousand dollars due one year from today. They ask how much you'll take if they pay you off today. You say nine hundred.. You've just discounted or present valued that future one thousand dollars to today's dollars. In this case, you've used a discount rate of 10% Why would you? Perhaps you have another investment today for the nine hundred dollars which will return you more than a thousand dollars by next year.

Because comparing leasing and buying of fixed assets involve differing tax benefit savings and expenses in the future, net present value is a good way to see what the choice means in cash to you today.

### **Assumptions**

Key factors involved in the analysis are the future tax benefit savings and the discount rate. For our sample analysis, we've had to make some assumptions for these so we make them conservatively.

- 1) We assume, for example, that in purchasing an asset, you'll use the Modified Accelerated Cost Recovery Systems, (MACRS), to speed up your depreciation. That generally should have the effect of lowering your after tax cost to purchase.
- 2) Since leasing tends to be used by more successful businesses, we also use a higher tax rate in establishing the value of any depreciation or lease expense tax benefits.
- 3) The discount rate should be either your cost to borrow funds or your opportunity cost of capital, (what you could earn by using the cash for another purpose). Since we can't know either of those, we assume a borrowing rate for fixed rate loans at or near the prime rate and use that. That errs on the conservative side, being lower than most fixed rate loans. As to opportunity cost, you should be able to earn at least that rate on your cash, (or it wouldn't make any sense to borrow.)

### **What's not covered**

The analysis does not cover the purchase option or the salvage / ownership value of the leased equipment because owning the equipment is not a requirement to benefiting from it. The purpose of this analysis is to look at only the minimum requirements necessary to use and benefit from it.

One of the chief benefits of using leased equipment is the ability to write off the use of it faster than you could if you owned it yourself, (resulting in more of the cost being paid with dollars you would have paid in taxes anyway).

While you could, if you had purchased it, continue to lower the net cost through the remaining years of depreciation, you'd have to commit to using it for those additional years.

If you did need or desire to replace or upgrade the equipment, you'd be forced to recapture the accelerated depreciation you'd taken in the early years. That kind of tax penalty frequently locks businesses into using outdated equipment and technology they'd be better off replacing.

If you do decide to purchase and keep equipment you've been leasing, you can still expense or depreciate that option then; but you don't have to make that decision until after you've benefited from the equipment, not before.

**In summary**, leasing is a cost effective way of using the best equipment and technology in your business. Even if you want and expect to own the equipment someday, because of the way lease payment scan be written off for tax purposes, and because a portion of the cost can be deferred to future, cheaper dollars, the cost of leasing equipment compares very favorably with the cost of buying it