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**Fair Market Value or $1 Buyout Lease? What You Need to Know to Decide**

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Smart business owners and managers know preserving capital is an important financial goal. Particularly if you’re a small or start-up business, it’s often the case that you don’t have the access to capital that larger or better established businesses do. When you’re looking to preserve or access capital, equipment financing is an attractive option that offers these and numerous other benefits when acquiring equipment. With leasing, knowing the factors that go into deciding whether to enter into a fair market value (FMV) lease or $1 buyout lease will enable you to make the right financing choice for the equipment you need to operate your business.

To begin, it’s useful to have an understanding of the definitions of an FMV and a $1 buyout lease. An FMV lease is an operating lease to *use* equipment while a $1 buyout lease is a capital lease to *own* equipment*,* which essentially acts as a loan (or a finance lease under the new lease accounting rules that take effect in 2019 for public companies and in 2021 for private companies). With an FMV lease you use the equipment for a certain period, and typically you use it at a lower cost than if the equipment were purchased outright or with borrowed capital. That’s because the equipment has a residual value at the end of the lease which the financing company can expect to realize through the sale or re-lease of the asset. With an FMV lease, you’re not paying for the full cost of the equipment. Should you decide at lease end that you’d like to continue to use the equipment, you may have the option to buy the equipment at a negotiated fair market rate or use it at a reduced rental, depending on the lease terms.

There are multiple reasons to use an FMV lease. Your business can realize significant benefits from the following:

* Accurate budget planning
* Reduced cost of use of the equipment
* Elimination of equipment obsolescence
* Outsourced cost and responsibility of equipment management and disposal
* Bundled services, such as a lease tracking system to alert the user to the end of the lease in order to plan for replacement or return of the equipment, and maintenance.

Long life equipment types—aircraft, construction, manufacturing, etc.—are suitable for FMV leases since they typically maintain relatively higher residual values. It is also more economically beneficial to enter into an FMV lease for equipment used in projects, common in construction, and for seasonal needs, such as in agriculture. Some shorter useful life equipment types, such as technology and office equipment, may also be appropriate for FMV leases since they help end users avoid owning obsolete equipment at the end.

$1 buyout leases are often entered into when obtaining financing through equipment manufacturers, and they are frequently offered as a sales incentive. Since end users typically prefer to hold onto their capital, if their objective is to own the equipment in the future, a $1 buyout lease offers 100 percent financing and no down payment which enables them to preserve cash. A $1 buyout lease also gives ownership of the equipment to the end user for tax purposes so bonus depreciation and interest expenses can be claimed.

Often the choice between an FMV lease and a $1 buyout lease depends on the predisposition of the end-user company. To help make an objective business case, consider the following:

**5 Key Questions to Consider in an FMV or $1 Buyout Lease Decision:**

1. **How long will your business need to use the equipment?**

Generally speaking, if the length of time the equipment is expected to be used is short term (which usually means 36 months or less), an FMV lease may be the preferable option. Equipment expected to be used longer relative to its useful life or that you know you will want to keep at the end of the term is appropriate for a $1 buyout lease.

1. **How soon will the equipment become obsolete in the future?**

Most equipment will become obsolete at some point, some faster than others. The sooner it is expected to become outdated, the better suited it is for an FMV lease so you don’t get saddled with old technology, and can upgrade with new equipment that can give your business a competitive edge.

1. **Does your business have the resources to manage assets throughout their lifecycle?**

Equipment management is a function that requires resources and expertise that are beyond the scope of most businesses. Selling or disposing of the asset, maintenance, repair and other aspects of asset management become the end-user’s responsibility at the end of a $1 buyout lease. With an FMV lease, you outsource the asset management function to the equipment finance company so you can focus on your core business.

1. **Do you anticipate the need for additional equipment?**

If your business is planning for growth, you’ll want your equipment to be able to scale. An FMV lease will enable you to get the right type and amount of equipment your business needs in the future, and not be forced to mix and match newer with older assets.

1. **Will the equipment be used for a new venture?**

When embarking on an untested business venture, there may be uncertainty of when or if it will be successful. An FMV lease will enable you to mitigate the risks of uncertainty and hedge against ending up owning a piece of equipment you may not need in the future.

Whether you choose an FMV lease or a $1 buyout lease, the most important thing to keep in mind is that both will enable your business to enjoy benefits you can’t attain when purchasing equipment with cash. For informational resources on equipment leasing and financing, including a digital toolkit, videos and a provider directory, visit [www.equipmentfinanceadvantage.org](http://www.equipmentfinanceadvantage.org).

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Ralph Petta is President and CEO of the Equipment Leasing and Finance Association, the trade association that represents companies in the $1 trillion equipment finance sector, which includes financial services companies and manufacturers engaged in financing capital goods. ELFA members are the driving force behind the growth in the commercial equipment finance market and contribute to capital formation in the U.S. and abroad. For more information, please visit [www.ELFAOnline.org](http://www.elfaonline.org/).

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