12 Benefits of Leasing Equipment

Scott Daugherty, for HealthLeaders Media, July 25, 2011

Like businesses of all types and sizes, many healthcare organizations put off the purchase of new equipment during the recent economic downturn due to budget constraints, uncertainty around healthcare reform legislation and staff reductions. As the economy slowly rebounds, many of those organizations are now relying on outdated or unreliable equipment that has been stretched beyond its useful life.

From the Federal mandate that requires the meaningful use of Electronic Health Records (EHR), to diagnostic equipment and technological advances in treatment options, much of the equipment needed to maintain today’s top healthcare facilities comes with a hefty price tag. The large outlay of cash required for many of these purchases can create challenges for the business operations of today’s healthcare providers.

Equipment leasing may be the answer. For many medical practices and healthcare networks, equipment leasing is a viable option for obtaining the equipment required to provide leading patient care while conserving cash and remaining flexible.

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1. **Tax treatment:** The IRS does not consider certain leases to be a purchase, but rather a tax-deductible overhead expense. Therefore, medical practices can deduct the lease payments from income, thus reducing the net cost of the lease.
2. **100% financing:** Since a lease often does not require a down payment, it is equivalent to 100% financing. Healthcare providers can conserve the capital that would have been used for a down payment and reinvest it in the business.
3. **Immediate write-off of the dollars spent:** With leasing, payments are treated as expenses on the income statement, so the technology solution does not have to be depreciated over an extended term.
4. **Flexibility:** As healthcare facilities grow and needs change, the lessee may be able to add or upgrade technology at any point during the lease term.
5. **Asset management:** A lease provides the use of the technology solution for specific periods of time at fixed payments. The leasing company assumes and manages the risk of technology ownership. At the end of the lease, if the healthcare provider elects to return the technology, the leasing company is responsible for the disposition of the asset.
6. **Upgraded technology:** Technology solutions that could depreciate quickly should be leased to limit a healthcare facility’s risk of getting caught with obsolete equipment. Plus, leases make it easier to upgrade or add technology solutions to meet ever-changing needs.
7. **Speed:** Leasing can allow you to respond quickly to new opportunities with minimal documentation and red tape. Many leasing companies approve applications within a few hours.
8. **Improved cash forecasting:** When healthcare facilities lease, they can accurately forecast the cash requirements for equipment since they know the amount and number of lease payments required, and with leases there are no floating fees.
9. **Flexible end of term options:** There are typically three flexible options at the end of a term. The lessee can return the equipment, purchase the equipment from the leasing company or extend the lease for an additional period of time.
10. **Tax benefits:** Leasing companies can pass the tax benefits of ownership on to the healthcare facility in the form of lower monthly payments.
11. **Easier financing than loans:** With a lease, healthcare facilities can avoid requirements like compensating balances, large down payments, client list reviews and cash-flow projections, making the finance process faster and easier.
12. **Finance services:** Training, support and other services are some of the most important components of a new equipment acquisition, particularly when obtaining EHR systems and other healthcare technology. Yet these “soft costs” are some of the most overlooked during the decision-making phase. Often, everything involved in a technology purchase, from servers and scanners to software and services can be bundled into one predictable monthly lease payment, making it easy to budget for all costs associated with a technology acquisition.

Navigating the Leasing Process

Once you’ve made the decision to lease new healthcare equipment, the next step is navigating the options available to your organization. Although both the healthcare and financial services industries have undergone significant changes – and
changes to certain types of lease accounting are still forthcoming – the process of leasing equipment doesn’t have to be complicated or intimidating.

Following are four questions to ask when assessing which equipment leasing option is right for your healthcare facility. Taking the time to think through these questions can yield great benefits in the financing process. The temptation may be to focus solely on the rate or cost of financing, and while this is certainly important, taking such a posture can leave out other important factors.

**What is the useful life of the equipment to your organization?** By understanding how long you plan to use this equipment from the beginning, healthcare facilities can avoid structuring the equipment’s financing beyond its useful life. For example, if you think you may want to dispose of or upgrade the equipment in four years, you’ll most likely want to structure the financing agreement so that after four years it is either fully paid out; gives you the ability to return the equipment and cancel the financing; or allows you to purchase the equipment at a reasonable price.

While you’re considering how long you plan to use the equipment, it’s also a good idea to consider what you’d like to happen with the equipment at the end of its useful life. Many healthcare facilities choose to retain the equipment and put it to use in another, less-demanding role at the end of the lease term. Others choose to dispose of it entirely. With well-structured financing, you may be able to build in the return and disposition options for the equipment upfront.

**Who should take tax ownership of the asset?** Whichever company – you or your equipment finance partner – can best take advantage of the tax benefits associated with the lease should take ownership of the asset.

If your company can use the depreciation currently and in the foreseeable future to shield current income from federal income tax, then your healthcare practice should own the equipment for tax depreciation purposes. However, if your organization cannot utilize these benefits, it may be best to pass them to the finance company by structuring a true lease transaction and allowing the lessor to share those benefits with your organization in the form of a lower cost of borrowing.

Given the current ability to depreciate 100% of a qualifying asset’s acquisition cost, it could be quite likely that an organization ends up with more depreciation than it needs. If this is the case, consider switching to lease financing for equipment once the projected taxable income will be covered by deductions. If your organization is a not-for-profit, you can still pass depreciation benefits to a leasing company. The benefit, however, may be less pronounced, and the structuring options are limited.

**What are the accounting considerations?** Financing can be structured such that it capitalizes both the asset and the liability on the borrower’s balance sheet. Or, it can be structured so payments merely run through the income statement as rent expense with a footnote disclosure regarding the future lease obligation. This decision can have a marked effect on profitability, EBITDA, and balance sheet leverage.

As you consider these options, be aware that the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have jointly proposed significant changes to current lease accounting. Current lease accounting rules dictate that leases fall into one of two categories: operating (off balance sheet) or capital (on balance sheet). The proposed changes would require capitalization of all lease agreements. These changes are extensive, so it’s important to consider them fully. Additionally, the changes are currently under review following the public comment period, so the end result may be different than what is currently proposed. The best approach is to talk through the accounting considerations for your organization with a financial advisor.

**Can the cash flows be shaped to match circumstances?** In many cases, leases can be tailored to fit month-to-month or year-to-year cash flow needs. Customer arrangements can be designed to address requirements such as cash flow, budget, transaction structure, cyclical fluctuations and more. Some leases even allow companies to seasonally skip one or more payments without penalty. Be sure to ask your equipment finance partner what options are available for your healthcare facility.

**Consider guidance**

Another important step in financing is to seek the guidance of an experienced and reliable financing partner. When making this choice, consider whether the finance company:

- understands your health-care organization’s needs
- is quick in its credit application approval process, among other factors
- is stable and able to offer expert guidance through economic ups and downs

Even as healthcare professionals meet new challenges in providing the best possible patient care, so must their supporting healthcare organizations consider all the available tools to pave the way for optimal delivery of that care.

A good financing partner will take the time to ask and, more importantly, to listen to you as you work together through the above questions. The goal is to gain an understanding that will make the financing package as attractive as possible for your organization, because after all, the value of equipment comes from using it, not owning it.

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