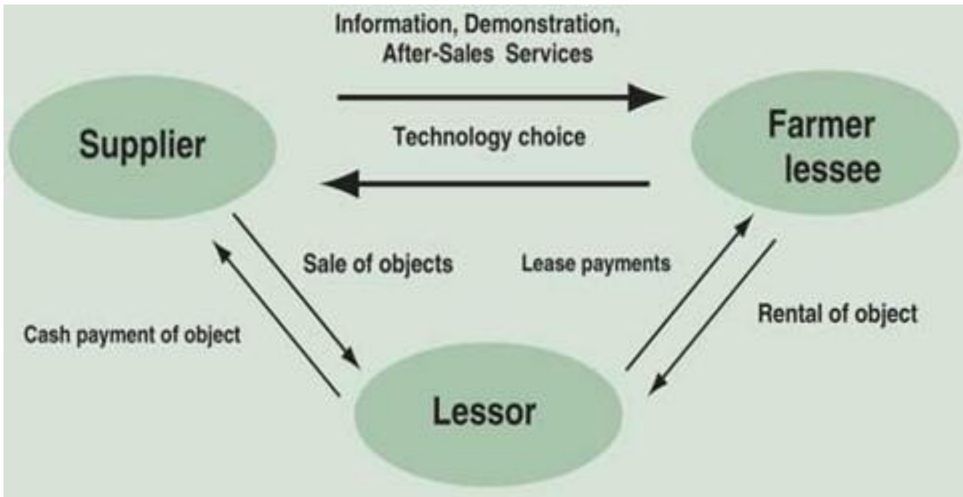
Concept of Lease Financing

Lease financing is one of the important sources of medium- and long-term financing where the owner of an asset gives another person, the right to use that asset against periodical payments. The owner of the asset is known as lessor and the user is called lessee.



The periodical payment made by the lessee to the lessor is known as lease rental. Under lease financing, lessee is given the right to use the asset but the ownership lies with the lessor and at the end of the lease contract, the asset is returned to the lessor or an option is given to the lessee either to purchase the asset or to renew the lease agreement.

Types of Lease Financing

Finance Lease:

It is the lease where the lessor transfers substantially all the risks and rewards of ownership of assets to the lessee for lease rentals. In other words, it puts the lessee in the same con-dition as he/she would have been if he/she had purchased the asset. Finance lease has two phases: The first one is called primary period. This is non-cancellable period and in this period, the lessor recovers his total investment through lease rental. The primary period may last for indefinite period of time. The lease rental for the secondary period is much smaller than that of primary period.

Operating Lease:

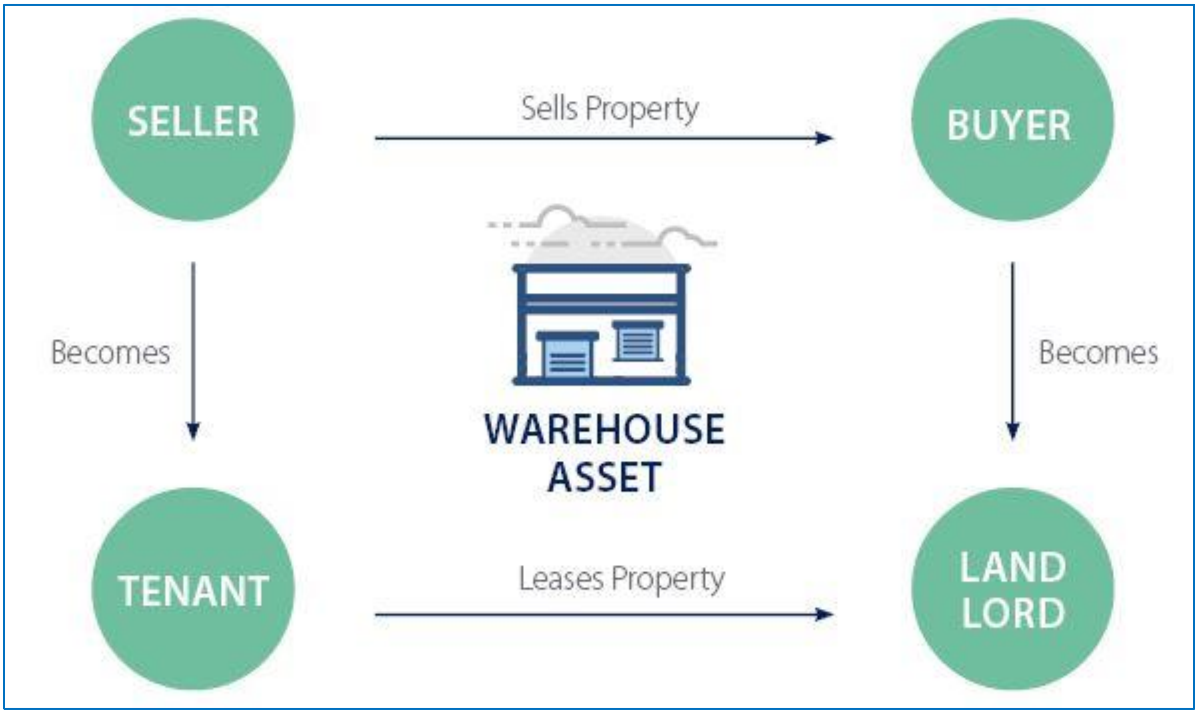
Lease other than finance lease is called operating lease. Here risks and rewards incidental to the ownership of asset are not transferred by the lessor to the lessee. The term of such lease is much less than the economic life of the asset and thus the total investment of the lessor is not recovered through lease rental during the primary period of lease. In case of operating lease, the lessor usually provides advice to the lessee for repair, maintenance and technical knowhow of the leased asset and that is why this type of lease is also known as service lease.

Difference between Financial Lease and Operating Lease

	Operating Lease	Financial Lease
Ownership	With the lessor	Transfer option at the end of the lease period is there with the lessee.
Risks and rewards related to asset	With the lessor	With the lessee
Purchase Option	Does not have any option	The lessee have a purchase option
Expenses Borne	By lessor	By lessee
Running Cost to lessee	No running or administration costs	Running cost and administration expenses are higher
Tax Benefit to lessee	No depreciation can be claimed	Interest and depreciation both claimed

What is sale & Leaseback?

Leaseback is a financial transaction in which the company sells its asset and then takes the same asset on lease from the purchaser, which implies that the seller becomes the lessee, and the purchaser becomes the lessor. This type of sale and leaseback transaction is done on mutual understanding of both the party and all the terms and conditions are predefined in the agreement.


SELLER
Sells Property
BUYER
Becomes
WAREHOUSE
ASSET
Becomes
TENANT
Leases Property
LAND
LORD