# *Finance Factsheet:* Asset Financing

Asset financing refers to the leasing or hire purchase of capital equipment such as plant and machinery, vehicles and computer equipment.

There are three major types of leasing:

- finance leasing;
- operating leasing;
- and contract hire.

Hire purchase is not a form of leasing but a hire agreement that gives you the option of purchase at the end of the term. These forms of finance allow you to use a capital asset over an agreed period in exchange for regular, usually fixed, payments. This makes for easy budgeting and the asset secures the agreement.

## Hire purchase

- Select a hire purchase agreement if you wish to own the equipment at the end of the agreement
- Hire purchase enables you to claim capital allowances, offset the interest elements of the payment against your taxable profits and, if you are VAT registered, reclaim the VAT on the capital cost of the asset.
- Do not forget that the equipment remains the property of the finance company until the final repayment has been made, although you will be responsible for its insurance and maintenance.

There are several different payment arrangements possible which you will have to negotiate:

- Even payments over the agreement term
- Low regular payments with a final balloon payment. This should only be chosen if you are sure you will be able to resell the equipment
- Seasonal payments can be made by companies operating in seasonal industries such as tourism

## Leasing

- With leasing, ownership remains with the leasing company, which claims the writing down allowances and allows you to benefit through reduced regular payments.
- As a rule, you can treat the rentals as a cost for tax purposes and reclaim the VAT on rentals.

There are two different types of lease:

- **Finance lease:** the asset is sold to a third party at the end of the agreement. You receive most of the proceeds in an agreed rebate. It is also possible to extend the agreement for another term (secondary period) at a lower cost.

- **Operating lease:** the total payments are lower because the finance company puts a residual value on the asset hence you do not receive any of the proceeds when the asset is sold.

When would I use this?

- If you want to own the asset at some point in the future and want to take advantage of instalment payments, it probably makes more sense to consider hire purchase.

- If you require the asset for a period of time significantly shorter than the useful life of it; an operating lease may be of more benefit to you.

## Pros

- **Better and simplified cash flow management.** Asset finance makes it easier to control your outgoings and to budget effectively, as the repayments are the same each month for a fixed period.

- **Improved financial leverage.** It enables you to save your capital for other expenditure.

- **No extra security is required.** The equipment itself is the only security required by the financing company.

- **Safeguards your business against obsolescence.** The equipment can be replaced at the end of the agreement if required. This is particularly useful if the equipment is likely to be obsolete by the end of the agreement.

- **Tax advantage.** Operating lease payments are generally tax deductible. Hire purchase agreements allow the lessee to claim capital allowances.

**Servicing agreements.** It is possible to arrange a service contract with the financing company. Many suppliers provide service agreements for equipment such as photocopiers and printers.

## Cons

- **Interest charges.** A finance lease is usually more expensive that buying the equipment outright as it includes finance charges. However it may be cheaper than other forms of finance.

- **Additional guarantees.** The finance company may require additional guarantees if it is not satisfied with your credit rating. These guarantees are provided by your bank, your partners or you.

- **Fixed term only.** It may be extremely costly to terminate a leasing contract early.

- **Fixed interest rates.** The interest rates can be fixed at the beginning of the contract and could not change even if general interest rates are falling. However, variable rate options are available.