Brockett's Ag Advice

By John E. Brockett
Farm Management Agent
Lewistown Extension Office

WHAT ABOUT LEASING EQUIPMENT

Short term leasing quite often is an excellent way to acquire the use of equipment that you only need for a limited period of time. The cost per hour is quite high but the cost per year may be well below the cost of owning the item. Example: You need the use of a "Bob Cat". You really only need it about 3 times per year for about 30 hours each time. If you purchased one new the cost would be $8000. Annual costs would be $1680 (depreciation for 7 years, interest at 12%, repairs and insurance) Thus the ownership cost per hour would be $18 if you used it for 90 hours per year. If you can rent or lease one for less than $18, you would probably be dollars ahead.

Most field machinery can be leased for short periods of time at rates that are better than your ownership costs. Using the example above you can figure the annual cost of owning equipment yourself. Then you can figure the break amount of use to justify owning over leasing. For fast wear, high repair items such as flail choppers use 20 to 22 percent of purchase price to figure the annual ownership cost. For low wear items such as tillage tools use 12 to 14 percent of purchase price to figure the annual ownership cost. Other items would be in between. Example: If the annual ownership cost of an item was $1680 and you could rent the item for 20 dollars an hour, the breakeven use would be 84 hours per year.

Long Term Lease - Purchase

Long term equipment lease with an option to purchase is for all practical purposes a way to buy an item. Is it worth it? Sometimes the answer is yes but quite often it is no. When is it justifiable?

1. You don't need investment credit and the company will give you a lease rate well below the cost of borrowing the money for it. Don't forget to include the amount you will have to pay at the end of the lease to purchase it.

Example: a $10,000 item with a possible investment credit of $800; you can lease purchase it for $182.49 per month over 5 years plus $1000 which you will borrow at the end of that time. Total cost of 11,949 plus interest on the 1000 (12.5% for one year) or $12,038. Since you can not use the $800 investment credit anyway don't count it as a cost. If you borrowed the $10,000 at 12.5% amortized over 6 years (same as lease + 1 year for purchase after lease), the cost would be $198.12 per month of $14,265. Since you can not use the $800 investment credit, don't count it. In this case the lease would save $2182 of dollar outlay so the lease would be the less expensive.

2. The savings for leasing is greater than the tax savings of investment credit.

3. The cash outlay per month is 20 percent less than the cash outlay per month for purchase. Remember you may have an extra amount to pay at the end of the lease period.

When is it probably not a wise move?

1. You do need or will soon need the investment credit yourself and the savings of leasing over owning is less than the value of the credit. Example: a $10,000 item with a possible investment credit of $800; you can lease-purchase it for $182.49 per month over 5 years plus $1000 at end of lease period. Total cost of 11,949 plus interest loss on the $1000 plus loss of $800 for a cost of $12,794 or charges of $2794. The net loss of interest if you used your own money then paid it back into the account over 5 years would be $2700 (9% annualized rate) less the investment credit you gained or $1900. In this case the lease would cost $894 so purchase would be less expensive.

2. The cost of purchase at the end of the lease is not stated (not possible before 1981).

3. The monthly cash outlay for leasing is equal to or greater than the cash outlay for purchasing. Remember that with a lease you will have a purchase amount tied to the end.