Lease Financing Summary

What is the Lease Financing?

- Manufacturers lease their equipment at a monthly cost that is a fraction of the purchasing cost.
- At the end of the lease period, building owners have the option to purchase.

To avoid up-front costs, building owners can lease building equipment, such as HVAC roof top units, rather than purchasing it.

- **Operating lease** - the lessor transfers the right to use the equipment, so the lease is treated as an operating expense for tax purposes. Operating lease payments are 100% tax deductible. At the end of the operating lease, the building owner can renegotiate the lease, purchase the equipment for fair market value, or stop using the equipment.

- **Capital lease** - the building owner takes on some of the ownership role for the equipment, so the owner has to declare the equipment as an asset and the lease payments as a liability. The leased asset can be depreciated as an asset, and depreciation can be treated as a tax deduction. At the end of the lease term, the title can be passed on to the building owner. Lease terms usually cover approximately 75 percent of the life of the equipment.

Benefits

- Initial capital outlay by the owner is relatively small, as 100% of the costs can be financed
- Manufacturers frequently offer this type of financing
- Leases require a low level of effort to administer and execute
- At the end of the lease term, the building owner has several options to buy the equipment, renew the lease, or terminate the lease

Challenges

- Tax treatment of capital vs. operating leases can complicate the analysis of which arrangement is ideal for the owner
- Many buildings are owned in single asset LLCs without much creditworthiness, which means that lessors will likely require a significant security deposit
- These leases may require mortgage holder approval, which complicates transactions
- Owner/lessee takes performance risk

Resources

- ENERGY STAR Building Upgrade Manual: Financing Chapter 4

For more information, contact:
Kristen Taddonio
Office of Energy Efficiency and Renewable Energy
kristen.taddonio@ee.doe.gov