A Guide to Asset and Vehicle Finance

Asset Finance

Paying cash for a business asset can be a significant drain on your working capital so leasing the asset instead can give you access to the asset without paying for it all at once. All forms of leasing are rental agreements giving you (*the lessee*) the right to use an asset owned by *the lessor* (typically banks and independent leasing / finance companies) for a specific period of time in return for regular payments (rental payments).

You can lease almost anything, from equipment valued at a few thousand pounds to assets worth millions. Leasing contracts are flexible and can be tailored to a specific business's needs.

When considering the right type of asset finance for a business, careful consideration should be given on the effects on accounting, reporting, tax and the business's cash flow.

The most common types of financing an asset and leasing are:

Direct Lease:

The business identifies the asset, negotiates the price and arranges for the leasing company to buy it from the manufacturer (if new) or the previous owner (if used) then rent it to you.

Sale-and-Leaseback (also called Purchase Leaseback):

The business sells an asset that they already own to the leasing company for fair market value or book written-down value (whichever is less) and then lease it back. In both cases, the lessor owns the asset, not the business, and rents it back. As with any other rental agreement, the business must return the asset at the end of the lease to the lessor. Some leases grant an end-of-lease option to renew the lease at a minimal cost (secondary period) or to sell the asset to a third party as agent of the lessor.

Operating Lease:

Often with a shorter time frame than finance leasing (always significantly shorter than the working life of the asset), operating leasing is more like a regular rental. The lessor expects to be able to either sell the asset in the second-hand market or to lease it again and will therefore not need to recover the total asset value through lease payments. There may be an option to extend the leasing period at the end (this negotiation can only take place at the end of the initial rental period).

Vehicle Finance

More and more companies chose to acquire their vehicles through some form of funding agreement rather than buying them upfront. They have a choice of either purchasing or leasing them and both usually involve paying a regular amount over a contracted period, typically three years or 60,000 miles in the case of company cars.

Purchase-based funding methods include **Hire Purchase** and **Contract Purchase**. Lease-based methods include **Contract Hire** and **Finance Lease**. Before opting for a funding method, a business needs to consider the overall cost of each approach, the flexibility it provides, how it will affect the balance sheet and what the potential tax implications are.

Hire Purchase

With this method of financing, the vehicle becomes the property of the lessee at the end of the period. The monthly payment is determined by the amount of deposit paid, the period of the contract and the sale price of the vehicle. The loan is secured against the vehicle, which can be repossessed if payments are not kept up.

In the event of the vehicle being sold before the end of the agreement a business would still be required to pay the loan back in full. The vehicle appears on the balance sheet and the purchaser can claim a capital allowance for its depreciation as an asset. The interest elements of the hire purchase fee can be offset against taxable profits.

Contract Purchase

Contract Purchase is a finance agreement for companies who want to own their vehicles, but want to avoid the risk of depreciating assets. With a Contract Purchase agreement, the monthly finance payments are not subject to VAT. The business hires a vehicle from a provider for a specified period and makes regular monthly payments to rent it. At the end of the contract, the company or driver can then purchase the car for a predetermined amount (also known as a balloon figure) so long as the terms of the agreement have been completed.

Contract Hire

Contract hire is the most popular way of hiring a business vehicle – more than half of all new company cars registered each year are funded this way. A vehicle is leased to an organisation for a set time and specified mileage, in return for an initial fee (usually three months rental) and a subsequent monthly charge. At the end of the contractual period, it is returned to the leasing company.

This type of hire removes many of the risks of vehicle ownership, including depreciation, servicing costs and eventual sale. The hirer benefits from the leasing company's greater buying power and knowledge of the used car market. However, a business could also miss out on any potential benefits of car ownership, for example, lower than anticipated maintenance costs or an unexpected upturn in the residual value of a particular vehicle.

Because it is owned by the leasing company, a contract hire vehicle does not have to be shown as an asset on your balance sheet. Some or all of the rental charge can be offset against taxable profits.

Finance Lease

With a finance lease a business can choose to pay either the entire cost of the vehicle, including interest charges, over an agreed lease period or opt to pay lower monthly rentals with a final payment based on the anticipated resale value of the vehicle. The business benefits from a fixed cost but does take on the administration and operating risks, for example unexpected maintenance, repairs and losses in residual value.

At the conclusion of the contract the business can continue to operate the vehicle for a nominal fee, but at no time take ownership of the asset. Ownership of the vehicle remains with the leasing company for the duration of the contract, but the car does appear on the company's balance sheet with the capital element of the outstanding rentals representing a liability. Some or all of the rental charge can be offset against taxable profits.

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