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FARM MACHINERY LEASING PROSPECTS

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Abstract. The article describes the main options for farm machinery purchase. It highlights the main types and advantages of farm machinery leasing.

Keywords: lease, regular payments, dealer, balance sheet, flexibility, payment schedules.

Farm machinery purchase option – buying, leasing, renting, or hiring has advantages and disadvantages. While the vast majority of farm machinery is still acquired for cash or with a conventional loan, leasing is also a popular choice. Both farm machinery manufacturers and independent companies offer lease opportunities.

When acquiring agricultural machinery for a farm, there are many factors that need to be taken into consideration. You need to spend time assessing the worth of the machine you are thinking about buying in order to determine whether it is going to be truly profitable. If you believe it is, you then it’s necessary to compare all of the machines and brands against one another. This can be an extensive process when considering the huge variety of machines and farming brands available today. Nonetheless, before taking all of this into account, the first thing to decide, is whether you should lease the machine or purchase it outright.

There is no overall right or wrong answer when it comes to this choice. Most farm owners tend purchasing farm equipment. It’s because they have ownership of the machine and have something to show for the money spent. Farm managers use equities or will borrow money to finance machine purchases. Not only does the cost of the machine need to be considered, but if a farm owns farm equipment, it is also responsible for all other payments. This includes everything from farm equipment insurance to repair costs that are not included in the warranty, such as general maintenance.

Leasing is ideal for those who do not have the start-up costs to afford to purchase a machine outright. If a farm only requires a machine for a set period of time or is unsure whether purchasing it would be worthwhile, leasing is a great solution.

So, what exactly is a lease? This is a long-term contract between a client and the owner of the machine. The contract permits a client to use the machine for the length of time stated as long as he makes the payments that have been outlined. The contract tends to last between three and five years, and people who go this route usually have the option to pay monthly, quarterly, yearly, or, in some instances, upfront. It is worth noting that cancellation of the lease can result in a penalty.

Two general types of lease plans are available: operating lease and finance lease. The major factor that distinguishes these plans is by how they are treated for tax purposes.

An operating (or true) lease calls for a series of regular payments, usually annual or semi-annual, for a period of years. At the end of the lease period, you have the option of purchasing the machine at a price approximately equal to its fair market value. The option price may be set when the lease is signed or it may depend on the accumulated use and condition of the machine when the lease expires.

Alternatively, the machine can be returned to the dealer or Lease Company, or the lease can be extended. The lease payments are reported as ordinary expenses on a tax return. If the purchase option is exercised, the machine is placed on depreciation schedule with a beginning basis equal to the used purchase price.

A finance lease is treated as a conditional sales contract by the revenue service. A client is considered to be the owner of the machine so it is placed on his depreciation schedule. Payments made to the lease company must be divided into interest and principal, with the interest being tax deductible. Many finance leases are essentially installment loans with balloon payments after three to five years. The difference is that at the end of the lease period, a client has the choice to either return the machine to the dealer and give up ownership, or make the balloon payment and take ownership. Since the finance lease is not taxed as a true lease, the final buy-out price (balloon payment) can be quite variable, depending on the length of the lease and the size of the payments.

Sometimes leasing is touted as “off balance sheet financing”. However, while an operating lease is not a loan, it does represent an obligation to pay and a cash flow commitment is incurred. The Farm Financial Standards Council does not recommend that leases of capital assets be shown as a liability on your balance sheet. Likewise, the leased equipment should not be shown as an asset. However, adding a footnote to the balance sheet that explains the terms of the lease is a good idea.

According to Jeff McGavin, an equipment dealer from Canada, leasing is certainly growing in overall popularity because of the payment flexibility and technological adaptability it affords. He says equipment dealers themselves are also more focused on leasing and low-rate financing, while less focused on more historically common cash discounts.

Farmers hoping to stay up-to-date with new, practical technologies are increasingly turning away from purchasing farm machinery outright. Instead, they are opting for the cash-flow and technological flexibility afforded through leasing.

Although leasing may not be for everyone, there are several advantages:

- Lower payments, compared to most conventional loans. Of course, one reason the payments are lower is that farmers are building little or no equity in the machine. At the end of the lease period they have nothing except the right to exercise the purchase option.
- Machinery leasing utilizes operating capital instead of investment capital. Payment schedules can be matched to periods of high cash flow. Cash requirements for machinery are constant and known in advance. This is particularly beneficial for high volume, low equity operators who can't afford large capital outlays at a point in time.
- Leasing generally offers lower payments than the payments on a loan used to purchase the machine.
- If farmers are near retirement, they may prefer to lease equipment so that it can be easily liquidated in a few years with no income tax recapture.
- Leasing also offers farmers the chance to try out a particular machine for a few years without buying it.

Long-term leasing of farm machinery is becoming more popular, although it has not grown as rapidly in agriculture as in some nonfarm industries. Leases of 3 to 5 years in length are most common. Like ownership, leasing gives farmers complete control of the machine for the period of the lease. They are responsible for labor to operate it, for repair costs, and other operating expenses. At the end of the lease period, they have the options of turning the machine in for a new leased machine, purchasing it, or returning it to the lessor.

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