Quadrant II – Notes

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Name of the Presenter: Prof. Manoj Kamat

Leasing

Meaning

A lease agreement is an arrangement between two parties – lessor and lessee, by which the lessor allows the lessee the right to use a property owned or managed by the lessor for a specified period, in exchange for periodic payment of rentals.

The agreement does not provide ownership rights to the lessee. However, the lessor may grant permission to the lessee to modify or change the property to suit his needs. The lessee is responsible for the condition of the property during the lease period.

Lease agreements may be used for the lease of properties, vehicles, household appliances, construction equipment, and other items.

Common contents of a lease agreement include:

1. Names of the lessor and lessee or their agents.
2. Description of the asset
3. Amount of rent and due dates, grace period, late charges.
4. Mode of rent payment.
5. Methods to terminate the agreement before the expiration date and charges if any.
6. Amount of security deposit and the account where it is held.
7. Utilities furnished by the lessor and, if the lesser charges for such utilities, how the charge will be determined.

8. Amenities and facilities on the premises which the lessee is entitled to use such as swimming pool, laundry or security systems.
9. Rules and regulations such as pet rules, noise rules and penalties for violation.
10. Identification of parking available, including designated parking spaces, if provided.
11. How tenant repair requests are handled and procedures for emergency requests.

Various Types of Leases

(1) Finance lease:

A lease in which all risks and rewards related to asset ownership are transferred to the Lessee for the leased asset is called a finance lease. It is one of the long-term leases and cannot be cancellable before the expiry of the agreement.

<u>If any one of the following conditions is satisfied then it is a finance lease:</u>

(a) Lease transfers ownership to the lessee at end of lease term whether in main or by a separate agreement
(b) Lessee has the option to purchase leased asset at a price sufficiently lower than the fair value of the asset at the date when the option becomes exercisable.
(C) Lease term covers a major part of the life of the asset leased.
(d) Lease term covers the major part of the life of the asset.
(e) At the inception of the lease Present Value of minimum lease payments (receivable over the non-cancellable lease period amount to at least substantially all the fair value of the leased asset.
(f) Leased asset is special that only the lessee can use.

(2) Operating lease:

Operating leases is one of the short-term and cancellable leases. In an Operating lease the owner, called the Lessor, permits the user, called the Lesse, to use an asset for a particular period which is shorter than the economic life of the asset without any transfer of ownership rights.

(3) Sale and leaseback:

A sale and leaseback is a type of lease where the Lessee sells one of his assets to a prospective Lessor and then immediately leases it back for a guaranteed minimum period for a specified amount of Rental payments. It may be in the form of operating leasing or financial leasing. This type of lease is popular in Real estate matters.

(4) Direct lease:

It is a contract in which a lessor purchases a new asset from the manufacturer and leases it to the lessee. It may involve 3 or 2 parties.

(5) Single investor lease:

It is a lease in which the lessor funds the entire investment by an appropriate mix of debt and equity funds. The debts raised by the lessor to finance the asset are without recourse to the lessee, that is, in the case of default in servicing the debt by the leasing company, the lender is not entitled to payment from the lessee.

(6) Leveraged lease:

Under this lease, there are three parties involved; the Lessor, the lender and the lessee. Under the leveraged lease, the Lessor acts as an equity participant supplying a small portion of the total cost of the assets while the lender supplies the major part. In this, the lessor has no risk on the finance the lender gave. And the lessee's payments go to the lender who takes the leased asset on default and the lender holds the title of the asset.

(7) Domestic Lease:

If all the parties in the lease i.e, Lessor, lessee, and lender belong to the same country then it is called a domestic lease.

(8) International lease:

A lease in which the parties are domiciled from different countries is called an international lease.

Conclusion:

To summarize, lease finance is appropriate for an individual or business which cannot raise money through other means of finance like debt or term loans because of the lack of funds. The business or lessee cannot even arrange the down payment money to raise debt. The lease works best for him. On the other hand, the lessor, who wants to invest his money efficiently, becomes the financier for the lessee and earns the interest.

To learn more on Leasing: Advantages & limitations

https://efinancemanagement.com/sources-of-finance/advantages-and-disadvantages-of-leasing