Leasing office equipment offers advantages over purchasing

By Raymond W. Dusch, JD

May 25, 2011

Beware of the fine print

The equipment used by primary care physicians grows more advanced by the day, but its rapid evolution also means you must think carefully about the risks involved in purchasing equipment outright. Whether the task at hand involves a diagnosis, the clinical lab, or data processing, using and maintaining the right equipment—at the right cost relative to the needs of your practice—is a critical part of staying competitive. Little wonder, then, that equipment leasing is such a popular option today.

Buying ineffective or soon-to-be obsolete equipment is a waste of precious time and money that leaves you with little more than buyer's remorse. In financing the purchase through a bank, medical practices typically are forced to pay fees on their lines of credit or to make down payments of 20% to 30% of the loan.

Banks' general lack of flexibility in the terms they offer tends to give you a less-than-optimal degree of latitude. In borrowing too much from banks, you may find that your future borrowing options have been curtailed. Meanwhile, the bank has forced you to accept multiple liens on nearly all of your assets.

LEASING ADVANTAGES: AVAILABILITY AND FLEXIBILITY

Leasing, by contrast, offers many advantages, provided you understand fully both its potential benefits and risks—and leverage that understanding during an informed and productive negotiation.

Organizations that might have trouble obtaining a bank loan typically are able to lease equipment with relative ease. That's because leasing companies have considerable security in the equipment itself. They also evaluate prospective deals based on the cash flow of lessees' businesses. Knowing that physicians tend to have steady cash flows, leasing companies offer robust menus of financing options for medical equipment.

This flexibility can help doctors in several ways. For example, a true lease does not, typically, appear as a long-term obligation on the practice's balance sheet. From an accounting standpoint, lease payments show up only as current operating expenses, allowing the lessee to show less debt on the books. In addition, because they keep title to the equipment, lessors benefit from the depreciation and tax benefits associated with owning that equipment. In order to be competitive, they pass those savings on to their customers by charging a lower rate.

ROLLING OVER THE "SOFT COSTS"

Likewise, leasing companies are often willing to allow physicians to roll over the "soft costs," such as training, service contracts, and consumables, associated with the leases they sign. This allows practices to keep these often-substantial expenses off their balance sheets as well.

It is worth noting that the cost of consumables and training can add up very quickly. The former includes the likes of
vials, syringes, needles, test strips, gloves, lubricant, conducting gel, and tubing. The latter, at least for the most advanced pieces of equipment, can require days or weeks for trainers and trainees.

In the case of service contracts, the lessee may decide to augment the standard manufacturer's warranty with maintenance agreements or extended warranties that cover the entire term of the lease. We once helped a family physician negotiate a deal in which he bought a service contract and rolled the cost of that into the capitalized equipment costs. The formula here is simple: Take the actual out-of-pocket cost of the equipment, add the cost of any other services, and calculate lease payments based on the total.

Leasing also puts 100% financing within easy reach. Leasing companies might require a security deposit—often the cost of one month's rental of the equipment—but this is a far cry from the hefty down payments banks typically require on financed purchases.

In financing fixed costs and agreeing to pay a monthly rental, you need not worry about negotiating interest rates or dealing with variable rates. A young physician working to establish a practice essentially faces one basic financial question regarding the lease on the equipment: Will the proposed monthly payment schedule be affordable as outlined? Gone is the uncertainty of an interest rate that goes up or down based on the vicissitudes of the U.S. economy or the oil markets. For the next 3 years, the doctor will pay an agreed-upon amount each month. So long as that payment is made, the physician has use of the equipment. Simple.

AVOIDING THE OBSOLESCENCE FACTOR

If you purchase equipment outright, you always run the risk that a new industry standard will make your bought-and-paid-for equipment suddenly obsolete. The flexibility provided by lease arrangements, however, protects you against the obsolescence factor.

While 3 years is a typical term, much shorter terms are available. Thus, in the case of the fastest-changing medical technologies, leasing does make it possible for you to get a new model every year.

Leasing companies also understand that different practices have different needs. An emergency medical clinic located near a ski run in Aspen, Colorado, for example, might have seasonal equipment needs: The place is full of banged-up skiers in the winter, but is quiet during the summer. Thus, leasing companies often will give medical practices the option of making flexible lease payments. Sometimes, rent is low in the early years of the lease but increases as the practice grows. Payments also can go down with time, or be altered in recognition of seasonal dynamics.

Larger leasing companies, in particular, frequently negotiate such stepped payment agreements. They will, moreover, often provide you with additional flexibility through a lease line of credit. Large medical offices can work with lessors on a line of credit of up to, say, $1 million worth of equipment.

This pre-approved status, which involves signing a master lease, essentially gives the practice a streamlined approval process for new equipment. It is similar to a committed line of credit from a bank that can be drawn down as needed. The documentation for these lease lines of credit is quite straightforward.

BOTH SIDES BENEFIT FROM LEASING FLEXIBILITY

For leasing companies as well as medical practices, flexibility makes good sense. Giving a startup imaging clinic a lower initial rental rate might enable that business to, say, lease an MRI machine that otherwise would have been out of reach for the practice. By helping their customers thrive in this way, leasing companies are able, in a sense, to expand their own customer bases.

Guarding against obsolescence can be accomplished in other ways as well. Even though a piece of equipment might last 10 years, many physicians want to offer their patients state-of-the-art medical technology. This is why vendors sometimes offer lease clauses that enable physicians to upgrade equipment. If a new system comes out, the practice can turn in the existing equipment and get the new model without any early-termination fees or penalties. Indeed, leasing programs from the bigger manufacturers may even offer guaranteed upgrades. They will say, in effect, "You always have the right to an upgrade if you lease through us."

UNDERSTANDING FINANCE COMPANIES
Modern Medicine: Leasing office equipment offers advantages over purchasing

Doing a good lease deal is all about conducting a smart negotiation, and in negotiations the saying "know thy opponent" is as apropos as ever. Thus, it helps to understand how finance companies are structured.

Typically, larger vendors, such as the manufacturer Hitachi, will have their own financing programs. But even smaller vendors will partner with a leasing company on a joint-venture basis. The company's name might be something like Apex Medical Equipment, but in reality a finance giant like General Electric runs the show. Arrangements with such entities are called private-label leases.

In negotiations, it is good to know that "one-stop shopping" is available from these entities. Your salesperson can take your credit application, arrange for approval and, generally, is empowered to give you attractive rates. A transaction with these captive finance sources reduces uncertainty.

You can find independent leasing companies relatively easily via a Google search, and many community banks are now offering leasing as a service to depositors. While many options are available for lease financing, finding a manufacturer that provides financing may be the best way to go. The larger vendors understand that favorable financing is the key to selling equipment. Because they want your business so badly, they tend to be competitive.

**POTENTIAL PITFALLS: READ THE FINE PRINT**

None of this is to say, however, that leasing is risk-free. More than one medical practice has been saddled with a bad lease for a critical piece of equipment. And as in any deal, failure to read the fine print can trigger regret later. Onerous late fees can and do appear in medical-equipment leases. It is important to understand these fully.

Similarly, automatic payment provisions are commonplace and should be fully understood and disclosed. When not prohibited by state regulations, automatic renewals (sometimes called "evergreen provisions") might dictate that unless the lessee notifies the lessor of intent to terminate the lease in a specified period of time before the lease is due to end, the lease will automatically renew.

These provisions are not particularly sinister. Nonetheless, we have helped physicians secure guarantees that the lessors will send out reminders by certain set deadlines within the lease term. Getting a separate notification gives the lessee a second chance to make sure he or she wants to renew.

In signing what is known as a net lease, the lessee agrees to be responsible for everything related to the equipment, from personal property taxes associated with the items, to the cost of replacement if they are lost or damaged.

**THE RISKS OF THIRD-PARTY FINANCING**

But even if the equipment performs poorly or not at all, the finance company still must be paid. These "hell or high water" provisions are the same as those used in car loans. If you borrow money for a lemon, your only recourse is with the manufacturer. Financing any piece of equipment with a third party carries this risk, which should be taken seriously. It is expensive to get out of these leases before their expiration dates. You need to know your vendor and truly understand how to select the best equipment.

Insurance is an added wrinkle. Some physicians assume their blanket policies cover the new equipment, when in fact it does not. In such cases, you must seek a special rider from the insurance company. It is also a good idea to make sure the leasing company is named as the loss payee, allowing them to be paid if the equipment is destroyed.

In light of all the factors cited above, lease deals for major pieces of equipment tend to be complex, highly negotiated transactions. However, medical practices stand to benefit tremendously from these arrangements, with a degree of risk that is quite manageable.

In an age when financing availability is a major stumbling block, the ready availability of leases can enable your practice to add state-of-the-art equipment with less exposure than what you might experience under financed purchases. Of course, the key is to come to the negotiating table armed with clear objectives and a solid grasp of all relevant facts to assure that the lease is properly structured for your practice.
The author is a partner in the New York City office of the national law firm LeClairRyan and a member of the firm's bank finance and lending team. Send your feedback to medec@advanstar.com [medec@advanstar.com]

Raymond W. Dusch, JD