Leasing guidance for schools

Department for Education

FLA

NASBM

Making the decision to lease

Leasing can be a great way for schools to secure the equipment (and facilities) they need to provide students with a first-class education.

The Finance & Leasing Association (FLA), National Association of School Business Management (NASBM) and the Department for Education (DfE) have prepared this guide to help you ensure that where you do choose to lease equipment, you're making the right choices for your school.

The commissioning process

Always go through your normal commissioning process for the equipment before considering any type of finance. This might involve a pre-purchasing review to confirm what equipment is needed, and preparation of specification and evaluation criteria.

The Government's advice to schools on how to plan and run an efficient procurement process for goods, works or services is an ideal way of assessing whether your existing commissioning process is sufficiently robust.

When you're ready to move ahead with the actual procurement, it's always a good idea to compare the cost of leasing against the cost of purchasing. Do shop around, as the most competitive quotes for purchasing the equipment might come from a supplier that doesn't offer leasing, or vice versa.

In addition, make sure you're comparing like with like. This can include whether different equipment models have a similar level of functionality and whether some leasing options include extras like maintenance and supplies (more on this later).

Do remember that leasing allows schools to:
- acquire equipment by making payments at regular intervals over the period it will be used.
- avoid very steep up-front purchase costs, especially in situations where cash flow considerations are key. But as with any finance product, schools should know the cumulative costs incurred by leasing, that is the annual charges mutiplied by the number of lease years. This total cost should be the comparison for purchase costs.

Things to consider when taking out a lease

Know the finance company: Although some equipment manufacturers may supply both equipment and finance, many businesses offering leasing arrangements to schools are equipment suppliers who offer finance via third party finance companies.

When dealing with an equipment supplier, always check who the finance company will be. If they are members of the Finance & Leasing Association (FLA), this will give you the added assurance that the lender will be subject to FLA's Business Finance Code which sets out high standards for customer service, information and complaints procedures.

The leasing process

Understand the costs:
Lease agreements will generally require a school to make regular fixed payments over an agreed period of time, but there may be additional costs related to your use of the equipment.

Always ensure that you understand all the potential costs and whether these may change during the lease. For example, in the case of photocopiers there may be a charge per copy, based on mono or colour, and there may be charges for ancillaries, such as staples and ink.

As part of its procurement training for schools, the Government has prepared a special module on leasing, which suggests some further considerations you should undertake before leasing equipment that is commonly used by schools (e.g. photocopiers and telephone systems).

Minimum lease period: This is the shortest period for which the school will have to make rental payments for equipment. The period is fixed regardless of other factors, such as changes in technology or changes in the school's needs.

Consider how long the school has tended to keep similar equipment in the past, or speak to other schools leasing similar equipment to ensure that the minimum lease period is appropriate.

What happens at the end of the lease:
Generally, this will involve either continuing to lease the equipment at fair market rates, or returning it to the leasing company.

Ensure that you understand what you might need to do in each instance (e.g. give notice that you will be returning the equipment). If switching suppliers, do not let the new company clear any outstanding lease debt. The agreement is between the school and the original finance company. If the new company fails to pass on the settlement, the school could still be liable.

Always check what options are available at the end of the lease period before signing the agreement.

Maintenance and supplies: It should always be clear when maintenance or supply services are included or excluded in the lease. These simple checks can help you understand the obligations of each party, and who will provide any services under the lease agreement:

- Check whether the maintenance or supply contract is a separate agreement to the lease. If it is, check whether the length of the two agreements is the same, and how much notice might be required to terminate each one;
- Check what level of service you will get – for example will there be regular maintenance visits and supply deliveries or will you need to request these when necessary;
- Check the maintenance or supply costs and whether a similar level of service could be obtained from a different supplier at a lower cost;
- Check what would happen if the company providing the maintenance or supplies went out of business, and how this might impact on your use of the equipment and lease payments.
- If additional services/add-ons are to be provided as part of the lease, it would be beneficial to have these detailed within the lease agreement. This way, the school will know what is needed, who will provide it, and at what cost.

Upgrades

Keeping the equipment you have until the end of the minimum lease period will almost always be cheaper than upgrading before the end of the agreement. However, if your needs do change and upgrade becomes necessary, always speak with your current finance company as they will be able to provide you with details of the available options.

Upgrading your equipment will require settlement of the remaining balance on your existing agreement. You can do this by either paying off any outstanding rental payments up front, or including these payments in a new lease along with the cost of the new equipment. If you opt for the latter, you will be paying capital and interest charges on both the new equipment and the balance of the old agreement carried forward. This is not seen as good practice due to the increased cost the school will incur.

Do bear in mind that the inclusion of a prior lease settlement figure in a new lease may mean the new lease is a finance lease, requiring Secretary of State approval which, in practice, is rarely provided. See the differences between a finance lease and an operating lease below.

When considering whether to upgrade, go through all the same checks you have done for a new lease agreement, and seek appropriate advice.

What type of lease is right for our school?

There are two different types of lease – operating leases and finance leases – but **schools should generally only enter into operating leases, as the use of finance leases require the Secretary of State's approval.**

Understanding the main differences between a finance lease and an operating lease is essential:

Operating lease agreements typically have a shorter duration than the working life of the equipment. Under an operating lease, the leasing company ("lessor") retains the risks and rewards of ownership, and it will also retain an investment in the equipment being leased, known as the Residual Value. You will not own the equipment at the end of the agreement.	**Finance lease** agreements usually run for all, or a substantial proportion, of the equipment's estimated working life. Under a finance lease, the leasing company ("lessor") transfers all of the risks and rewards of ownership of the equipment to the customer ("lessee"). You will not own the equipment at the end of the agreement. Leases that do not meet the operating lease criteria will be finance leases.

The difference between a finance and operating lease depends on the substance of the transaction rather than the form of the contract. The table below may help:

Questions to ask	Answer Yes	Answer No
Is the lease term for the major part of the economic life of the asset, even if title is not transferred?	Finance lease	Operating lease
At the inception of the lease does the Net Present Value of the minimum lease payments amount to at least substantially all of the fair value of the leased asset?	Finance lease	Operating lease

If still unsure as to type of lease, i.e. a mix of yes and no answers to the section above, consider the next set of questions:	Answer Yes	Answer No
If the lessee is entitled to cancel the lease, are the Lessor's losses associated with the cancellation borne by the lessee?	Finance lease	Operating lease
Does the lessee have the ability to continue to lease for a secondary period at a rent that is substantially lower than market rent?	Finance lease	Operating lease

More information on leases

Operating Lease:

- An Operating Lease requires the school to pay only a proportion of the capital value of the equipment over an agreement term that is shorter than the equipment's 'useful economic life.'
- As part of the current accountancy regulations, the funder is required to take 'sufficient risk' in the lease. What this means is that the lease rentals paid under the primary lease must not exceed 90% of the original capital cost. When working out the '90% test', auditors exclude the interest to work out how much capital is being repaid – so it's important not to simply add up your rentals.
- The length of the agreement should not exceed the expected 'useful economic life' of the equipment. This will depend on how often the equipment will be used, maintained and serviced. You should think about how often you have used similar equipment in the past and consider a lease term which represents a proportion of this.
- At the end of the agreed lease term you will not own the equipment and the school will be required to return the equipment. There should be no option for the school to gain ownership of the asset at any time.
- Payments are shown on the profit and loss account and not the balance sheet.
- Further details of an operating lease can be found under the relevant accountancy regulation SSAP 21 - Accounting for leases and hire purchase contracts. Note a new standard was introduced on 1 January 2015, FRS 102. The impact of this in relation to leases will be minimal. FRS 102 takes a risks and rewards approach to the classification of leases, as does SSAP 21, but under FRS 102, the 90% test noted above is no longer relevant.

Finance Lease:

- The finance company or lessor is the legal owner of the asset but will permit the school to have use of that asset during the lease, paid for via a series of rentals or instalments over an agreed term.
- A finance lease may be considered to be economically a form of borrowing, where 100% of the capital plus interest is repaid during the primary term.
- At the end of a finance lease the school may continue to use the equipment by paying the same rentals or may have the option to keep the asset, by either paying the last rental, or in some cases, paying a nominal fee or a significantly reduced purchase price.

The information above is subject to change if IFRS 16 comes into effect in January 2019.

Last but not least: Incentives such as cash-back, 'free' equipment or accessories, subsidised rentals, offers of the school being used for marketing purposes can sound very appealing in the short term, but you should not lose sight of the terms of the lease agreement and the regular payments this will entail.

If it sounds too good to be true it probably is, and if a school takes on financial commitments it is unprepared for, this can be very costly.

The FLA's Checklist for business finance customers offers additional guidance on successful leasing:

We recommend that customers taking out business finance agreements follow these steps:

1. Read your business finance agreement carefully before signing it. Never sign a business finance agreement which is not fully complete. Retain copies of all documentation.

2. Ensure that the final contract:

    a. corresponds with any verbal or written quotation on the rental amount and period of hire;
    b. accurately reflects what you are agreeing to pay for, including any maintenance or services included in the repayments;
    c. accurately describes the equipment you are expecting to receive (e.g. whether it is new or used) and that its working life is appropriate to the length of the finance agreement.

3. Make it clear who has the authority within your own organisation to sign the agreement.

4. Make sure you understand and agree with all terms and conditions of the business finance agreement and, if you are unsure, ask for these to be explained or seek advice.

5. Make sure you understand all the costs involved and whether these will change during the course of the business finance agreement.

6. Check that the supplier of the equipment is reputable.

7. Understand whether there are any notice period or settlement terms required to terminate the agreement.

8. If there is a maintenance or service contract which is serparate to the finance agreement, check that the length, start date, notice period and settlement terms of the two agreements is the same, and if not, that you are happy with this.

9. If the name of the leasing company contracting with you is not shown on the agreement ensure that you are informed at the earliest possible time.

10. Check whether the funder is a member of the FLA, as all asset finance members adhere to the FLA Business Finance Code.

11. If any amendments are made to the business finance agreement or a further agreement is required to replace an existing agreement, do not sign it until you have made the same checks as you did for the original agreement.

12. If a new business finance agreement includes an element of refinancing from a previous agreement with a different provider, check that the settlement figure provided by the former provider matches the refinancing figure used by the new provider.