Concept of Leasing:

DEFINITION of Lease

A lease is a contract outlining the terms under which one party agrees to rent property owned by another party. It guarantees the lessee, also known as the tenant, use of an asset and guarantees the lessor, the property owner or landlord, regular payments from the lessee for a specified number of months or years. Both the lessee and the lessor face consequences if they fail to uphold the terms of the contract.

BREAKING DOWN Lease

Leases are the legal and binding contracts that set forth the terms of rental agreements in real estate. If a person wishes to rent an apartment or other residential property, for example, the lease prepared by the landlord describes the monthly rent amount, when it is due each month, what happens if the lessee fails to pay his rent, how much of a security deposit is required, the duration of the lease, whether the lessee is allowed to keep pets on the premises, how many occupants can live in the unit and any other essential information. The landlord requires the tenant to sign the lease, thereby agreeing to its terms before occupying the property. Leases for commercial properties, on the other hand, are usually negotiated in accordance with the specific lessee and typically run from one to 10 years, with larger tenants often having longer, and more complex, lease agreements.

Breaking a Lease

Consequences for breaking leases range from mild to damaging, depending on the circumstances under which they are broken. A tenant who breaks a lease without prior negotiation with the landlord faces a civil lawsuit, a derogatory mark on his credit report or both. As a result of breaking a lease, a tenant may also encounter problems renting a new residence, as well as other issues associated with having negative entries on a credit report. Tenants who need to break their leases often must negotiate with their landlords or seek legal counsel. In some cases, finding a new tenant for the property or forfeiting the security deposit inspires landlords to allow tenants to break their leases with no further consequences.

Some leases have "early termination" clauses that allow tenants to terminate the contracts under a specific set of conditions or when their landlords do not fulfill their contractual obligations. For example, a tenant may be able to terminate a lease if the landlord does not make timely repairs to the property.

Commercial Real Estate Leases

Tenants who lease commercial properties sign various types of leases structured to put more responsibility on the tenant and provide greater up-front profit for the landlord. For example, some commercial leases require the tenant to pay rent plus the landlord's operational costs, while others require tenants to pay rent plus property taxes and insurance. The four common types of commercial real estate leases include: single-net leases, in which the tenant is responsible for paying property taxes; double-net leases, which make a tenant responsible for property taxes and insurance; triple-net leases, where tenants must pay property taxes, insurance and maintenance; and gross leases, in which the tenant pays rent while the landlord is responsible for other costs

(i) Lessor:

The party who is the owner of the equipment permitting the use of the same by the other party on payment of a periodical amount.

(ii) Lessee:

. The party who acquires the right to use equipment for which he pays periodically.

Lease Rentals:

This refers to the consideration received by the lessor in respect of a transaction and includes:

(i) Interest on the lessor's investment;

(ii) Charges borne by the lessor. Such as repairs, maintenance, insurance, etc;

(iii) Depreciation;

(iv) Servicing charges.

At present there are many leasing companies such as 1st Leasing Company, 20th Century Leasing Company which are doing quite a lot of business through leasing, It has become an important financial service and a lucrative avenue of making sizable profits by leasing companies.

Types of Leases:

The different types of leases are discussed below:

1. Financial Lease: This type of lease which is for a long period provides for the use of asset during the primary lease period which devotes almost the entire life of the asset. The lessor assumes the role of a financier and hence services of repairs, maintenance etc., are not provided by him. The legal title is retained by the lessor who has no option to terminate the lease agreement.

The principal and interest of the lessor is recouped by him during the desired playback period in the form of lease rentals. The finance lease is also called capital lease is a loan in disguise. The lessor thus is typically a financial institution and does not render specialized service in connection with the asset.

2. Operating Lease:

It is where the asset is not wholly amortized during the non-cancellable period, if any, of the lease and where the lessor does not rely for is profit on the rentals in the non-cancellable period. In this type of lease, the lessor who bears the cost of insurance, machinery, maintenance, repair costs, etc. is unable to realize the full cost of equipment and other incidental charges during the initial period of lease.

The lessee uses the asset for a specified time. The lessor bears the risk of obsolescence and incidental risks. Either party to the lease may termite the lease after giving due notice of the same since the asset may be leased out to other willing leases.

3. Sale and Lease Back Leasing:

To raise funds a company may-sell an asset which belongs to the lessor with whom the ownership vests from there on. Subsequently, the lessor leases the same asset to the company (the lessee) who uses it. The asset thus remains with the lessee with the change in title to the lessor thus enabling the company to procure the much needed finance.

4. Sales Aid Lease:

Under this arrangement the lessor agrees with the manufacturer to market his product through his leasing operations, in return for which the manufacturer agrees to pay him a commission.

5. Specialized Service Lease:

In this type of agreement, the lessor provides specialized personal services in addition to providing its use.

6. Small Ticket and Big Ticket Leases:

The lease of assets in smaller value is generally called as small ticket leases and larger value assets are called big ticket leases.

7. Cross Border Lease:

Lease across the national frontiers is called cross broker leasing. The recent development in economic liberalisation, the cross border leasing is gaining greater importance in areas like aviation, shipping and other costly assets which base likely to become absolute due to technological changes.

Merits of Leasing:

(i) The most important merit of leasing is flexibility. The leasing company modifies the arrangements to suit the leases requirements.

(ii) In the leasing deal less documentation is involved, when compared to term loans from financial institutions.

(iii) It is an alternative source to obtain loan and other facilities from financial institutions. That is the reason why banking companies and financial institutions are now entering into leasing business as this method of finance is more acceptable to manufacturing units.

(iv) The full amount (100%) financing for the cost of equipment may be made available by a leasing company. Whereas banks and other financial institutions may not provide for the same.

(v) The ‘Sale and Lease Bank’ arrangement enables the lessees to borrow in case of any financial crisis.

(vi) The lessee can avail tax benefits depending upon his tax status.

Demerits of Leasing:

(i) In leasing the cost of interest is very high.

(ii) The asset reverts back to the owner on the termination of the lease period and the lesser loses his claim on the residual value.

(iii) Leasing is not useful in setting up new projects as the rentals become payable soon after the acquisition of assets.

(iv) The lessor generally leases out assets which are purchased by him with the help of bank credit. In the event of a default made by the lessor in making the payment to the bank, the asset would be seized by the bank much to the disadvantage of the lessee.

Difference Between Hire Purchasing and Leasing:

Basis for Comparison	Hire Purchasing	Leasing
Meaning	The deal in which one party can use the asset of the other party for the payment of equal monthly installments is known as Hire Purchasing.	Leasing is an agreement where one party buys the asset and allows the other party to use it by paying consideration over a specified period is known as Leasing.
Governing Accounting Standard	No Specific Accounting Standard	AS- 19
Down Payment	Required	Not Required
Installments	Principal plus interest	Cost of using the asset
Asset type	Car, trucks, lorries etc.	Land and Building, Property.
Ownership	Ownership of the asset is transferred to the hire purchaser on the payment of the last installment.	Transfer of ownership depends on the type of lease.
Repairs & Maintenance	Responsibility of hire purchaser.	Depends upon the type of lease
Consideration	Initial payment plus installment.	Lease Rentals
Duration	Short Term	Comparatively Long term