RESTAURANT FINANCE MONITOR®

Volume 26, Number 11 • Restaurant Finance Monitor, 2808 Anthony Lane South, Minneapolis, MN 55418 • ISSN #1061-382X

November 17, 2015

A Fresh View of Equipment Leasing Today

By Dennis Monroe

Equipment leasing was one of the earliest forms of financing for restaurants, used typically to fund furniture, fixtures, equipment and, at times, leaseholds. I got involved in franchise and restaurant finance in 1980, and one of the major players at that time was Bell Atlantic—one of the Baby Bells—who had an equipment leasing program and real estate sale/leaseback program. Other companies, such as Franchise Finance Corporation of America, had not yet combined real estate and equipment leasing into one product.

For many years, particularly during the height of the tax shelter era, equipment leasing firms utilized operating leases where the lessor kept the tax benefits, including depreciation and investment tax credit. When the tax laws governing passive investments, particularly losses, changed, it was not as favorable to use operating leases.

Equipment leasing has been very significant in our industry. Certain vendors (e.g., ice machine makers) have had leasing programs, as well as some of the early technology companies, particularly those focused on POS operations. With the proliferation of securitized lending in the 1990s and early 2000s, separate equipment leasing programs slowed down and went into the background. The advent of banks and finance companies offering a higher level of senior debt further marginalized equipment leasing. In spite of that, equipment leasing is still alive and well and a vital part of our industry, particularly for smaller operators.

So how does an equipment lease work in today's market?

In researching this, I reached out to four individuals who I have worked with on equipment leasing: Spencer Thomas, executive vice president of KLC Financial Inc. in the Minneapolis area; Michael Paszkiewicz, president, and Joe Burns, vice president of sales of Vend Lease Company in Baltimore; and Joe Haynes, regional sales manager for Creekridge Capital, LLC, also in the Minneapolis area.

In so doing, I uncovered some interesting information about equipment leasing. Here's what I gleaned from my discussions:

1. Uses—Equipment leasing is now much more flexible and not just for pure equipment. Leasing can be for leaseholds, remodels and items that can be clearly identified, including the soft costs that can be associated with that collateral. Vend Lease even includes the maintenance contracts in certain technology products.

2. Credit—Almost all of these transactions are credit-driven, and collateral is not the key driving force. Qualified borrowers range across a wide credit spectrum, and leasing companies have a much broader base than senior lenders. All four executives I interviewed said personal guaranties are required except in rare circumstances.

3. Terms of the Lease—The lease terms go from one year to seven years. From what I understand concerning today's equipment loans, there is flexibility as to a smaller payment in early years with an acceleration at the end. Almost all of the leasing programs I have seen require some type of upfront deposit.

4. Prepayment—The borrowers who use leasing products sometimes do not realize that to prepay a lease is different than prepaying a senior loan or SBA loan. When you prepay a lease, the payoff is all of the remaining scheduled payments; it is not an amortizing loan with an interest factor.

5. Rates—Rates vary between a low of around 6% to the mid-teens and look more like mezzanine financing rates. Equipment leasing is not cheap, but in most cases it is readily available and should be taken into consideration.

6. Assets—The franchisor's involvement is not as important for the equipment-leasing company as it is to a senior lender. In most cases, the equipment-leasing company will not take back the ongoing business, whereas a senior lender might. If a leasing company has assets in a business that has defaulted, the senior lender will have to deal with the leasing company. In many cases, a senior lender has to approve the lease because of covenants the senior lender has made on additional indebtedness.

7. Residual Buyout—In general, the leases we have discussed above are based on a $1.00 buy-out. Because it is not certain the depreciation rules under the tax code will remain unchanged or that Congress will continue bonus depreciation, there may be an advantage in getting an upfront deduction for lease payments.

I initially thought equipment leasing had limited use (similar to my initial thoughts about mezzanine financing). However, after speaking with my four experts, its clear equipment leasing is alive and well and may be a great financing alternative for remodels, equipment upgrades, technology changes and ongoing needs after acquisitions.

Dennis Monroe is co-founder and chairman of Monroe Moxness Berg, P.A., a law firm devoted to the restaurant sector in the areas of M&A and corporate and institutional finance. You can reach him at (952) 885-5962, or by email at dmonroe@mmblawfirm.com.