Glossary

Accelerated Depreciation. An accounting method that allows a company to write off an asset's cost at a faster rate than the traditional straight line method, that is, not spreading the cost evenly over the life of the asset. This includes any depreciation method that produces larger deductions for depreciation in the early years of a project's life. It often results in a larger tax deduction on a company's income statement.

Accelerated cost recovery schemes, through accelerated depreciation, may be allowed for policy and tax purposes. These schemes include double-declining-balance depreciation or sum-of-the-years'-digits depreciation. Accelerated depreciation is a method of speeding up the write-off from income of qualifying investments at a faster than normal rate. Annual tax deductions are higher in the first years and diminish in later years of the write-off.

Acceptance Letter. Generally a letter signed by the lessee signifying the equipment has been delivered; however, this will depend on the terms and conditions of delivery. The letter allows the lessor to pay the vendor. Also called Delivery and Acceptance (D&A).

Accounting Rate of Return. The interest rate earned by the lessor in a lease measured by the difference between gross rentals and the value of investment in the lease, calculated on an annual basis.

Accumulated Depreciation. A financial reporting term for a contra-asset account that shows the total depreciation charges for an asset since acquisition.

Advance Payments. One or more lease payments required to be paid to the lessor at the beginning of the lease term as part of the execution of the lease. Lease structures commonly require one payment to be made in advance. This term also refers to leasing arrangements in which the lease payment is due at the beginning of each period.

Advance Rental. Any payment in the form of rent made before the start of the lease term. The term also is used to describe a rental payment arrangement in which the lessee pays each rental, on a per period basis, at the start of each rental payment period. For example, a quarterly, in advance, rental program requires the lessee to pay one-fourth of the annual rental at the start of each consecutive three-month period during the lease term.

Amortization. The process of separating payments into their principal and interest components. An amortized loan is one in which the principal amount of the loan is repaid in installments over the life of the loan, with each payment comprised partially of interest and partially of principal.

Assign. To transfer or exchange future rights. In leasing, the right to receive future lease payments in a lease is often transferred to a funding source, in return for up-front cash. The up-front cash represents the loan proceeds from the funding source, and is equal to the present value of the future lease payments discounted at the leasing company's cost of borrowing. A lease assigned by the lessor to a funding source is called an assigned lease. The assignment of leases is a very common funding technique used by leasing companies.

Assignment. The legal transfer of title to property. The right of the lessor and lessee to transfer their rights and/or obligations under the lease agreement to third parties.

Balloon Payment. A large payment at the end of the loan allowing smaller payments to be made during the term.

Bankruptcy. An action taken by a party to legally protect its remaining assets by declaring that it cannot pay its bills. Typically, liabilities exceed assets. A common definition in the United States for bankruptcy is interest coverage less than one. A firm is generally forced into bankruptcy not when liabilities are greater than assets, but when the firm cannot make its interest payments with current earnings before interest and taxes.

Bargain Purchase Option. A lease provision allowing the lessee, at its option, to purchase the leased property at the end of the lease term for a price sufficiently lower than the expected fair market value of the property, such that exercise of the option appears at the inception of the lease to be reasonably assured.

Broker. An entity which specializes in the arranging of lease transactions between a lessor and a lessee for a fee.

Capital Allowances. Depreciation allowances on assets as allowed by income tax provisions of a country.

Capital Lease. A lease in the United States is classified as a capital lease if it satisfies any of the following: (a) The lease transfers ownership to the lessee at the end of the lease term; (b) The lease contains an option to purchase the property at a bargain price; (c) The lease term is equal to 75% or more of the economic life of the property; (d) The present value of minimum lease rental payments is equal to 90% or more of the fair market value of the leased property less related investment tax credit retained by the lessor. Such a lease is required to be shown as an asset and a related obligation on the balance sheet of the lessee.

Capitalize. To record an expenditure that may benefit future periods as an asset rather than as an expense to be charged off in the period of its occurrence.

Captive Lessor. A leasing company that has been set up by a manufacturer or equipment dealer to finance the sale or lease of its own products to end-users or lessees.

Certificate of Delivery and Acceptance (D&A). A document signed by the lessee to acknowledge that the equipment to be leased has been delivered and is acceptable. Many lease agreements state that the actual lease term commences once this document has been signed.

Civil Law. The civil law system is the most common foundation of legal systems around the world. It is an alternative to common law system and, like common law has its roots in Roman law, though civil law resembles Roman law to a greater extent than common law.

In most jurisdictions, civil law is codified in the form of civil codes, but in some it remains uncodified. Most codes follow the tradition of the Code Napoléon in some fashion, though each country may adapt its civil code to local legal tradition, as is done in Germany.

Civil law is employed by almost every country that was not a colony of the British Empire, including Continental Europe, Quebec, Louisiana, the former Soviet bloc, and much of the rest of the world.

Collateral. This refers to the security that is made available to secure finance. In leasing, collateral can be a pledge of property, bank guarantee etc., and usually refers to the leased equipment.

Common Law. Originally based on Roman law, it developed into a tradition of its own in England, from where it expanded to the United Kingdom (apart from Scotland), to the United States (apart from Louisiana), and to most former British colonies.

Common law is a system of jurisprudence based on judicial precedents rather than statutory laws. The form of reasoning used in common law is known as case-based reasoning. Common law may be unwritten or written in statutes or codes.

Common law, as applied in civil cases (as distinct from criminal cases), was devised as a means of compensating someone for wrongful acts known as torts, including both intentional torts and torts caused by negligence, and as developing the body of law recognizing and regulating contracts. Today, common law is generally thought of as applying only to civil disputes.

Cost of Capital. The weighted-average cost of funds that a firm secures from both debt and equity sources in order to fund its assets. The use of a firm's cost of capital is essential in making accurate capital budgeting and project investment decisions.

Credit References. Banks and suppliers used in the lessee's business and listed on the lease application. Lessor will contact them to check lessee payment habits.

Credit Scoring. An objective method of quantifying creditworthiness by assigning numerical values based on meeting established credit criteria.

Cross-border Leases. A lease deal under which the lessor is located in one country and the lessee is located in a different country.

Default. A condition whereby the lessee does not make the payments required by the lease contract.

Depreciation. A means for a firm to recover the cost of a purchased asset, over time, through periodic deductions or offsets to income. Depreciation is used in both a financial reporting and tax context, and is considered a tax benefit because the depreciation deductions cause a reduction in taxable income, thereby lowering a firm's tax liability.

Discount Rate. An interest rate used to bring a series of future cash flows to their present value in order to state them in current, or today's, currency. Use of a discount rate removes the time value of money from future cash flows.

Early Termination. Premature termination of the contract occurring when a party to a lease fails to meet its obligations under the lease contract, to the extent that entitles the other party (under the law or the agreement) to demand such termination.

Economic Life of Leased Property. The estimated period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease.

Effective Interest Rate. The interest rate on a lease stated on an annual basis. The rate includes the compounding effect of interest during the year.

End-of-term Options. Stated in the lease agreement, options give the lessee flexibility in its treatment of the leased equipment at the end of the lease term. Common end-of-term options include purchasing the equipment, renewing the lease or returning the equipment to the lessor.

Equipment Schedule. A document incorporated by reference into the lease agreement that describes in detail the equipment being leased. The schedule may state the lease term, commencement date, repayment schedule, and location of the equipment.

Equipment Specifications. A specific description of a piece of equipment that is to be acquired, including, but not limited to, equipment make, model, configuration, and capacity requirements.

Estimated Residual Value of Leased Property. The estimated fair value of the property at the end of the lease term.

Fair Market Value (FMV). The value of a piece of equipment if it were to be sold in a transaction determined at arm's length, between a willing buyer and a willing seller, for equivalent property and under similar terms and conditions.

Finance Lease. Finance leases transfer substantially all the risks and rewards incident to ownership to the lessee.

Full-payout Lease. A lease in which the lessor recovers, through the lease payments, all costs incurred in the lease plus an acceptable rate of return, without any reliance upon the leased equipment's future residual value.

Funding. The process of paying the manufacturer of the equipment for the equipment being placed on lease.

Funding Source. An entity that provides any part of the funds used to pay for the cost of the leased equipment. Funds can come from either an equity funding source, such as the ultimate lessor in a lease transaction, or a debt funding source, such as a bank or other lending institution.

Guaranteed Residual Value. A situation in which the lessee or an unrelated third party (for example, equipment manufacturer, insurance company) guarantees to the lessor that the leased equipment will be worth a certain fixed amount at the end of the lease term. The guarantor agrees to reimburse the lessor for any deficiency realized if the leased equipment is salvaged subsequently at an amount below the guaranteed residual value.

IAS-17. The International Accounting Standard (IAS) 17 on lease accounting was published by the IAS committee in London in September 1982 and has been updated regularly. IAS-17 prescribes, for lessees and lessors, the accounting policies and disclosure to apply to leases.

Implicit Rate. The discount rate that, when applied to the minimum lease payments (excluding executory costs) together with any unguaranteed residual, causes the aggregate present value at the inception of the lease to be equal to the fair market value (reduced by any lessor retained investment tax credits) of the leased property.

Inception of a Lease. The date of signing of the lease commitment or agreement where the property to be leased has been constructed or has been acquired by the lessor; otherwise, the date construction is completed or the property is acquired by the lessor.

Incremental Borrowing Rate of Interest. The interest rate the lessee would have to pay on a similar lease. Or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with similar security, the funds necessary to purchase the asset.

Independent Lessor. A type of leasing company that is independent of any one manufacturer, and as such purchases equipment from various unrelated manufacturers. The equipment then is leased to the end-user or lessee. This type of lessor also is referred to as a third-party lessor.

Initial Direct Costs. Costs incurred by the lessor that are directly associated with negotiating and consummating a lease. These costs include but are not limited to commissions, legal fees, costs of credit investigations, and the cost of preparing and processing documents for new leases acquired.

Insured Value. A schedule included in a lease which states the agreed value of equipment at various times during the term of the lease, and establishes the liability of the lessee to the lessor in the event the leased equipment is lost or rendered unusable during the lease term due to a casualty.

Interest. The difference between the total loan payments and original loan amount (principal). Interest is to a loan as earned income is to a lease.

Interest Expense. An amount paid to a lender in return for a loan. Typically the interest is paid out over time, accompanied by a reduction in loan principal.

Interest Rate Implicit in a Lease. The discount rate which, when applied to minimum lease payments and unguaranteed residual value, causes the aggregate present value at the beginning of the lease term to be equal to the fair value of the leased property at the inception of the lease minus any investment tax credit retained by the lessor.

Internal Rate of Return (IRR). Financial analysis technique used to assess the profitability of an investment proposal. The internal rate of return is the rate at which the cash flows associated with an investment sum to zero upon discounting. The rate thus computed is compared with the cost of capital to arrive at a judgment on the financial viability of an investment.

Lease. A contract between the owner of an asset and its user for the hire of that asset. The ownership rests with the lessor, while the right to use the asset is given to the lessee for an agreed period of time in return for a series of rentals paid by the lessee to the lessor.

Lease Agreement. The contractual agreement between the lessor and the lessee that sets forth all the terms and conditions of the lease.

Lease Expiration. The time at which the original term of the lease contract has ended.

Lease Origination. The process of uncovering (through a sales force), developing and consummating lease transactions. Steps in the process include, but are not limited to, prospecting for new lease business, pricing potential transactions, performing credit reviews, and completing the necessary documentation.

Lease Payments. Also called rentals. The amount the lessee pays the lessor in return for using the leased equipment.

Lease Rate. The equivalent simple annual interest rate implicit in the minimum lease rentals. This is not the same as the interest rate implicit in a lease, which reflects the compounding effect.

Lease Term. The fixed, non-cancelable term of the lease. Includes, for accounting purposes, all periods covered by fixed-rate renewal options which for economic reasons appear likely to be exercised at the inception of the lease. Includes, for tax purposes, all periods covered by fixed-rate renewal options.

Lessee. The user of the equipment being leased.

Lessor. The owner of the equipment which is being leased to the lessee.

Lien. A security interest on property to protect the lender in the event of lessee default.

Minimum Lease Payments for the Lessee. All the payments the lessee is obligated to make or can be required to make in connection with leased property, including residual rents or purchase options, but excluding guarantees of lessor's debt and executionary costs such as insurance.

Minimum Lease Payments for the Lessor. The payments considered minimum lease payments for the lessee, plus any guarantee by a third party of the residual value or rental payments beyond the lease term.

Net Present Value. The total discounted value of all cash inflows and outflows from a project or investment.

Nominal Interest Rate. Interest rate stated as an annual percentage without including the effect of interest during the year.

Off-Balance-Sheet Financing. Any form of financing such as an operating lease that, for financial reporting purposes, is not required to be reported on a firm's balance sheet.

Operating Lease. A lease arrangement wherein the lessor seeks to recover his investment in a lease by leasing the equipment to more than one lessee. For financial accounting purposes, an operating lease is a lease that does not meet the criteria for a capital lease or direct financing lease. Also, used generally to describe a short-term lease whereby a user can acquire use of an asset for a fraction of the useful life of the asset. The lessor may provide services in connection with the lease such as maintenance, insurance, and payment of personal property taxes.

Original Equipment Cost (OEC). The amount the lessor pays the vendor for the equipment at the beginning of the lease. Usually includes up-front sales tax.

Payment Stream. The rentals due in a lease.

Payments in Advance. A payment stream in which each lease payment is due at the beginning of each period during the lease.

Payments in Arrears. A payment stream in which each lease payment is due at the end of each period during the lease.

Present Value. The discounted value of a payment or stream of payments to be received in the future, taking into consideration a specific interest or discount rate. Present value represents a series of future cash flows expressed in today's money.

Pricing. Arriving at the periodic rental amount to charge a lessee. A lessor must factor many variables into its pricing, which may include lease term, lessor targeted yield, security deposits, residual value and tax benefits.

Primary Period. The period, in a finance lease, during which the lessor expects to recover the full capital cost of the asset, along with the calculated profit.

Purchase Option. An option in the lease agreement that allows the lessee to purchase the leased equipment at the end of the lease term for either a fixed amount or at the future fair market value of the leased equipment.

Related Parties. In leasing transactions, a parent and its subsidiaries, an investor and its investees, provided the parent, owner, or investor has the ability to exercise significant influence over the financial and operating policies of the related party.

Remarketing. The process of selling or leasing the leased equipment to another party upon termination of the original lease term. The lessor can remarket the equipment or contract with another party, such as the manufacturer, to remarket the equipment in exchange for a remarketing fee.

Renewal Option. An option in the lease agreement that allows the lessee to extend the lease term for an additional period beyond the expiration of the initial lease term, in exchange for lease renewal payments.

Repossession. A situation in which a lessor reclaims and physically removes the leased equipment from the control of the lessee, usually because of payment default.

Residual or Residual Value. The market value of equipment prevailing at the end of the lease term.

Sale-Leaseback. A transaction that involves the sale of equipment to a leasing company and a subsequent lease of the same equipment back to the original owner, who continues to use the equipment.

Salvage Value. The expected market value of an asset on the expiration of its useful economic life.

Secondary Period. Frequently optional, the period in a finance lease which follows the minimum lease period during which lease rentals are usually placed at a nominal value, as the lessor would already have recovered his investment and profit during the primary lease period.

Securitization. The process of selling lease receivables to a separate legal entity that issues stocks and bonds to investors. The investors' proceeds flow through to the company that sold the receivables, and the investors receive their returns from collecting lessee receivables.

Straight-line Depreciation. A method of depreciation (for financial reporting and tax purposes) where a capital asset is depreciated by the same amount each year over the asset's useful life. The cost (or other valuation basis) minus salvage value is divided by the number of years the asset is expected to remain useful and efficient.

Sub-lease. A transaction in which leased property is re-leased by the original lessee to a third party, and the lease agreement between the original parties remains in effect.

Substance versus Form. A concept that implies that the form of a document is subordinate to the intent of the parties involved in the document.

Sum of the Digits Method. A depreciation method for assets providing for the largest proportion of depreciation to be charged at the beginning of the asset's life, with smaller charges in later years.

Tax Written Down Value. The value of an asset after deducting the total capital allowances claimed from the cost of the asset.

Termination Value. The liability of the lessee in the event of termination is set forth in a termination schedule that values the equipment at various times during the lease term. This value is designed to protect the lessor from loss of investment. If the equipment is sold at a price lower than the amount set forth in the schedule, the lessee pays the difference. In the event the resale is at a price higher than in the termination schedule, such excess amounts belong to the lessor. The termination schedule is not the same as the casualty value schedule, insured value schedule or stipulated loss value schedule.

Third-Party Lessor. An independent leasing company, or lessor, that writes leases involving three parties: 1) the unrelated manufacturer, 2) the independent lessor, and 3) the lessee.

Ticket Size. Refers to the cost of equipment being leased. The leasing marketplace is roughly segmented into the small, middle and large ticket markets.

Two-party Lessor. A captive leasing company, or lessor, that writes leases involving two parties: 1) the consolidated parent and/or captive leasing subsidiary and 2) the lessee or end-user of the equipment.

Useful Life. The period of time during which an asset will have economic value and be usable. The useful life of an asset is sometimes called its economic life.

Vendor Leasing. Lease financing offered to an equipment end-user in conjunction with the sale of equipment. Vendor leases can be provided by the equipment vendor (manufacturer or dealer) or a third-party leasing company with a close working relationship with the equipment vendor.

Withholding Tax. Payable on the rentals received from many cross-border leases, depending on the double-taxation arrangements between the countries involved. May be prohibitively high.