

# Purchase or Lease?



A Guide to Ag Equipment Leasing from John Deere Credit.

# Ag Equipment Financing: Which Option Is Right for You?\*

Agricultural equipment is more than machinery – it’s your livelihood. The difference between getting by and getting ahead. You’ve taken an important step forward in considering John Deere to meet your needs. But now the question is, “how should I acquire my equipment?”

With money on the line and your bottom line a constant concern, it’s important to do your research. To consider your specific needs, explore your options and make an informed decision based on the facts. And since your needs are always changing, the right option today might not be the right option tomorrow. It can get confusing. This is where John Deere Credit can help.

\*Other advantages and disadvantages may apply. Consult your tax and accounting advisors.

	Advantages	Disadvantages
<b>Cash</b>	<ul style="list-style-type: none"> <li>• The transaction is over and done with immediately.</li> <li>• Less paperwork.</li> <li>• You own the equipment outright from day one.</li> </ul>	<ul style="list-style-type: none"> <li>• You run the risk of depleting your cash reserves and coming up short in an emergency.</li> <li>• Keeping the money you invested in your farming operation is generally worth more than the cost of financing.</li> </ul>
<b>Leasing</b>	<ul style="list-style-type: none"> <li>• Depending on term, less money up front.</li> <li>• Generally lower payments than installment loans of the same term.</li> <li>• Pay for the use of the equipment, return it at lease end, or exercise your purchase option.</li> <li>• Enables you to schedule equipment replacement at less cost than a cash purchase.</li> <li>• Reduces downtime, keeps newer equipment in the fleet longer.</li> <li>• Expense payments at level amounts vs. declining depreciation benefit.</li> <li>• Increase your cash flow with lower payments and generally lower upfront cost.</li> </ul>	<ul style="list-style-type: none"> <li>• Depending on the lease type, your equipment does not count as an asset on your financial statement (off-balance sheet financing).</li> <li>• Subject to hour restrictions (annually).</li> <li>• The equipment does not appear as an asset on financial statements.</li> </ul>
<b>Loan</b>	<ul style="list-style-type: none"> <li>• You own the equipment when you’re done paying for it.</li> <li>• You can depreciate the equipment.</li> <li>• The equipment appears as an asset on your balance sheet.</li> </ul>	<ul style="list-style-type: none"> <li>• Higher upfront requirement (i.e., down payments).</li> <li>• Payments are many times higher than a lease.</li> </ul>
<b>Rent</b>	<ul style="list-style-type: none"> <li>• Good for short-term projects, especially when the equipment is not likely to become part of your regular operation.</li> </ul>	<ul style="list-style-type: none"> <li>• No ownership.</li> <li>• Not a good option for long-term needs.</li> <li>• Generally higher payments.</li> </ul>

# A Common Misconception About Leasing.

Some farmers believe that leasing is the most expensive form of financing, because, they say, at the end of the term, you still have to pay the purchase option in order to own the machine. However, this thought overlooks several key facts:

1. This is only true if you purchase the equipment.
2. If the equipment is not purchased, it can be returned, giving you a lower equipment use cost than in installment notes, and keeping you in control.
3. Total lease payments are almost always less than the original cash price of the equipment.
4. The money saved in lower cash up-front, and low lease payments can be reinvested back into your farming operation. This saves dollars for other, higher cost forms of borrowing, and increases the return in your operation.

So the idea that leasing always costs more isn't necessarily true. When weighing the cost it's important to consider all the other factors involved, such as: Internal Rate of Return (IRR), Time Value of Money (TVM), tax implications, and more. The fact is, when a lease is structured properly, your overall cost can be lower than that of a loan — and much, much lower than the cost of paying cash.



# How Do You Know if Leasing Is Right for You?

Leasing only seems complicated. And since it can help cash flow, it's worth checking into. John Deere Credit knows which questions to ask to determine if leasing is your best option:

- How long will you need the equipment?
- Do you want to own the machine at the end of the term?
- Are you interested in keeping up with the latest technology?
- Any chance you'll want to buy out early?
- Are there tax, cash flow, and financial issues you're trying to satisfy?
- Are you more concerned about the lease rate or the overall cost?
- Are you interested in transferring risk?
- Are you just looking for the lowest possible payment?

Your John Deere dealer or John Deere Credit representative can help determine if leasing is the right option for you.

Please note that leasing isn't for everyone. However, it's important to remember that the benefits of leasing are tremendous. Do yourself – and your business – a favor by telling your John Deere dealer you'd like to know more and receive a lease quote.

## Ag Equipment Acquisitions – Why Consider a Lease?

**Q: What makes leasing preferable to an installment loan?**

**A:** You pay only for the use of the equipment. Whether you choose a short-term lease (2 – 3 years) or a long-term lease (4 – 5 years) your payment will be for the term less considerations for the purchase option.

**Q: What sort of down payment can I expect with a lease?**

**A:** A lease generally requires one annual payment up front. The upfront payment is also known as an Advance Payment.

**Q: As a farmer I've always owned my equipment. Why should I start leasing now?**

**A:** Leasing lets you use the equipment only as long as you need it, and then to return it with no further obligation. If you're ready to explore the benefits of leasing, let your John Deere dealer know. Make sure you ask him to give you a quote for an installment note and a lease.

**Q: Will I have lower payments with a loan or a lease?**

**A:** In most cases, a lease gives you lower payments. Since cash flow is always a concern of a profitable farming operation, leasing is often your best option. In addition, a lease not only provides lower payments, but also a shorter contract period. Consider the example below\*:

**Q: Why package the lease with PowerGard™?**

**A:** Because your equipment will be more marketable at the end of the lease term. You can also purchase PowerGard with no increase in payment, and if you elect to keep it at the end of the lease, you'll have 12 months of warranty remaining.

8430 Tractor			
<b>Selling Price</b>		\$165,000	
<b>Amount Financed</b>		\$132,000	
	Installment Note	JD Value Tractor Lease w/o PowerGard	JD Value Tractor Lease with PowerGard
<b>Term</b>	60 months	36 months	36 months
<b>Hours</b>	N/A	600	600
<b>Down Payment</b>	\$33,000	N/A	N/A
<b>PowerGard</b>	N/A	\$0	\$2,000
<b>Amount Financed</b>	\$132,000	\$165,000	\$167,000
<b>Advanced Payment</b>	N/A	\$27,807	\$27,620
<b>Purchase Option</b>	N/A	\$106,950	\$110,050
<b>Rate (fixed)</b>	6.90%	6.90%	6.90%
<b>Payment</b>	\$32,158	\$27,807	\$27,620
<b>Total Operating Cost</b>	\$193,790	\$190,371	\$192,910
<b>Difference in Operating Cost</b>		\$3,419	\$880

\*Equipment ownership through installment note financing may also create depreciation tax deductions. Consult your tax advisor.

# Managing Equipment Acquisition and Cash Flow.

The first rule in any business is to stay in business, and the key to staying in business is cash flow. The four major items affecting cash flow are cash on hand, down payments, payments, and overall costs. Let's take a look at each of these items.

Paying cash is certainly one option when you're acquiring equipment, but it isn't the only option. In profitable farming operations, many farmers operate with good cash flows. When times are good, cash reserves are in abundance and farms have cash on hand to spend on major equipment purchases.

However, when times are not as good and cash flow is not as abundant, but you need to acquire equipment, what should you consider?

## Down payments

Now it becomes a matter of how much cash you can afford to put down for your equipment or the equity you have available in your trade. Installment loans typically require down payments of 10% to 20% (depending on your credit), which amounts to as much as \$20,000 up-front on a \$100,000 machine.

A John Deere Credit Lease requires only one payment in advance or the equity in your trade, which is substantially less cash outlay and considerably more affordable for most farmers than taking cash out of their business.

## Payments

Often the acquisition of new equipment becomes feasible only if the payments are manageable. If the size of the payment is a major consideration, leasing will become a more attractive option.

### 8430 Tractor

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<b>Rate (fixed)</b>	6.90%	6.90%
<b>Payment</b>	\$32,158	\$27,620
<b>Customer Savings</b>		\$14,456

## Overall Cost

Ask yourself two questions while it's still early in the equipment acquisition process:

- 1. How much am I paying to acquire and use this equipment?*
- 2. What's the best use of my cash and the best way to pay for this equipment?*

If you pay cash, you avoid finance charges and have no payments. On the other hand, you've also reduced your cash reserves significantly.

Whether you use a lease or choose an installment loan, be sure to consider the overall cost of financing. This includes the internal rate of return and the time value of money.



# Finding the Right Solution When You're Looking for Ag Equipment.

Before you make your next equipment acquisition decision, we recommend the following:

1. Talk to your local John Deere dealership, a great source for both equipment and financing answers.
2. Talk to John Deere Credit. Our knowledge of the agricultural industry gives you a real advantage when you're acquiring equipment. Our qualified and experienced financing professionals can review your specific needs and match them to the appropriate financing product.
3. Consult your Tax Advisor.

## Internal Rate of Return (IRR).

IRR is a financial measurement commonly used to compute yields. Yields reflect the overall return of the net resources invested in a business. In general, IRR is equal to income divided by equity.

*Q: Why not just use profitability to measure success in a business?*

**A:** Because it's possible to show a profit on paper and not have income. (Reason: no cash flow.) No matter how you pay for the equipment, the money comes out of your farming operation. For instance, if you take money out of the cash flow you're using internally, you lose the value of your internal rate of return. Your objective is to choose the alternative that has the smallest impact on your farming operation's IRR.

## Time Value of Money (TVM).

*Q: What is TVM?*

**A:** TVM is a term used to describe what money will be worth at a specific time in the future. Time Value of Money calculations compensate for Future Value of money. The Future Value method adds investment earnings to cash flow. This allows you to see what the value of today's money would be worth if you received a specific investment return, and helps determine what your money is worth now, compared to what it will be worth as it's paid back. When calculating TVM, you must use the current IRR of your business as the Future Value factor.

When you do a thorough analysis of the cost of paying cash, the cost of an installment loan, and the cost of leasing, you will often find that a lease has the lowest overall cost — sometimes by a wide margin.

Naturally, this isn't true 100% of the time. There will be occasions when the best option is an installment loan. Remember, though: rarely, if ever, will paying cash be your best option.

# Off-Balance-Sheet Financing.

Off-Balance-Sheet financing is a situation where you can acquire equipment without it appearing on your balance sheet. There are a number of advantages to be gained from Off-Balance-Sheet financing, as you'll see below.

*Q: What exactly does it mean to say my equipment doesn't appear on my balance sheet?*

**A:** It means your new equipment is considered neither an asset nor a liability.\* Off-Balance-Sheet financing may be achieved by acquiring your equipment through an operating lease.

*Q: What are the advantages of Off-Balance-Sheet financing?*

**A:** The advantages are significant:

- Off-Balance-Sheet financing generally has no effect on your borrowing capacity. (An installment loan, on the other hand, reduces the amount you can borrow later.)
- You see a higher reported return on your assets.
- Your finance ratios should remain intact. When you get a loan, the equipment goes on the asset side of the balance sheet, and the loan appears on the liability side. This generally changes your finance ratio, but not for the better.

*Q: What does that mean to my bottom line?*

**A:** It means your business will appear less encumbered by debt, more liquid, and more profitable. In addition, your business's balance sheet will appear stronger financially.

*Q: What are the guidelines?*

**A:** The Financial Accounting Standards Board (FASB) has established four guidelines. All four guidelines must be met to qualify for Off-Balance-Sheet financing. See your accountant for details. In general, FASB rules state:

1. It automatically transfers ownership to the lessee by the end of the lease. (Example: A dollar-out lease.)
2. It contains a "Bargain Purchase Option." (Generally, this means a lease with a purchase option of less than 20%.)\*\*
3. It has a term equal to 75% or more of the economic life of the asset. (Example: If an asset has an economic life of 10 years, the lease term cannot be seven years or longer.)
4. The Present Value of the minimum lease payment is 90% of the equipment's Fair Market Value today.\*\*\* (Essentially this is a mathematical formula.)

According to the FASB, if the answer is "yes" to any of the guidelines described, it is a finance lease, not an operating lease. The answer must be "no" to each guideline to qualify as an operating lease.

*Q: How do you determine if you meet the FASB guidelines?*

**A:** The best way is to consult with your accountant.

\*Off-Balance-Sheet financing information is shown in the footnotes of audited financial statements.

\*\*Always discuss your equipment acquisition plans with a qualified accountant.

\*\*\* The Purchase Option is not used when doing the Present Value calculation, as it is an option, not a required payment. According to FASB, if the answer is "yes" to any of the guidelines described, it is a finance lease, not an operating lease. The answer must be "no" to each guideline to qualify as an operating lease.



# John Deere Credit and Ag Equipment Financing.

## Flexible ways to harness the power of John Deere.

Some of our most advantageous financial solutions are built around leasing. We offer several types of leases specifically designed with farmers and government agencies in mind. Each is capable of being structured to meet our customers' unique needs. The following lease options are specifically designed for our agricultural customers:

### John Deere Value Tractor Lease:

This lease provides a wide range of flexibility for leasing your *new* tractor. This is a three-year lease with lower fixed rates, low payments, and attractive purchase options. You can add PowerGard to your purchase with very little difference in payments.

### John Deere Credit Lease (JDC Lease):

This lease provides a wide range of flexibility for the customer. Offered in three- to five-year terms, it's ideal for those who want lower payments than an installment note with the added benefits leasing offers. It provides customers with the opportunity to use the equipment for a short period of time or to own later with attractive purchase options.

### Low-Hour Used Tractor Lease:

This is designed for customers looking to lease a used tractor. This lease is for premium tractors three years old or newer, with less than 1000 hours. Low rates are available, with terms of two to five years.

All three of our leases offer the following options at lease end:

- The customer can purchase the equipment
- The customer can return the equipment
- The customer can refinance the equipment using one of many options

Make sure you talk to your John Deere dealer to see what John Deere Credit lease works best for your farming operation. You can also call John Deere Credit at 1-800-828-8297 and talk to our finance professionals who are ready and willing to help answer any of your leasing questions.



Always discuss your equipment acquisition plans with a qualified financial professional.

The information in this guide is intended for general illustrative purposes only, and is not offered as legal, tax, or accounting advice. This information does not consider taxes, depreciation, the half-year convention, expensing the lease payments, interest deductions, etc. Loan rates, lease charges, and residual values vary based on lease type and creditworthiness.

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