

HIRE PURCHASE

Hire Purchase (HP) is a well established method of financing the purchase of assets by businesses. Under a HP agreement the customer will pay an initial deposit, with the remainder of the balance and interest paid over a period of time.

The finance company who provides finance is known as the creditor. It will purchase the asset of behalf of the customer, known as the hirer. The finance company owns the asset until the final installment is paid for the asset.

Benefits of HP

The assets can be used immediately whilst allowing repayments to be staggered, giving companies a better cash flow.

HP Agreements are easily negotiated and available

The most up to date technology can be hired and used to increase company productivity and efficiency.

The hirer can recover the writing down costs and VAT on the assets

There is a clearly defined financial commitment from the outset

Security is on the transaction that has been financed thus requiring no additional commitment from the customer.

HP is not repayable on demand unless the customer defaults on the agreement

FINANCE LEASES

Under a finance lease the rental covers virtually all of the costs of the asset, therefore the value of the rental is equal to or greater than 90% of the cost of the asset.

The leasing company claims written down allowances, whilst the customer can claim both tax relief and VAT on rentals paid.

OPERATING LEASES

The lease will not run for the full life of the asset and the lessee will not be liable for its full value. The lessor or the original manufacturer or supplier will assume the residual risk. This type of lease will normally only be used when the asset has a probable resale value; for instance aircraft or vehicles.

The most common form of operating lease is known as contract hire. Essentially this gains the customer the use of the asset together with added services. A very common example of an asset on contract hire would be a fleet of vehicles.

RESIDUAL VALUES

A residual value is the value of the asset at the end of the lease term. Residual values play an important role in an operating lease that is used in conjunction with equipment that retains value at the end of the contract period. The residual value will be left out of the rental calculation. Either the leasing company or a third party will take the risk that the asset will not be worth the amount of the residual value at the end of the lease.

BALLOON RENTALS

Under a balloon rental payments are made over the period of the lease, sometimes a larger payment or lump sum called a balloon payment is made at the beginning or end of the lease period. Often the customer would pay a balloon payment on the last day of their lease.

LEASE PURCHASE

A lease purchase is essentially the same as HP; the main difference is in the terms and structure of repayments. Some finance companies differentiate Lease Purchase from Hire Purchase by using it where the customer wishes to defer payment of a substantial part of the asset cost until the end of the agreement.