Is Leasing FF&E Right For You?

Buying furniture, fixtures, and equipment (FF&E) as part of a remodel of guestrooms may be in your budget for a makeover of dowdy and undated décor, but a complete refurbishing may put more strain on your budget. Therefore, you may want to consider leasing.

Many lodging property owners are not familiar with leasing and do not realize the advantages it provides. There are some additional costs, but a lease also serves as a tax write-off each year. Leasing rates may be higher than an equity line rates, because with an equity line, the property is used as security and the bank has tangible collateral if there is a default. Still, leasing may allow you to save that credit line for a roofing job you may need next year.

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"About 90 percent of my customers purchase FF&E, but at least 10 percent find leasing more attractive," says CLIA member, Ken Mintz, of Hospitality Plus, Inc., a full-service provider of FF&E.

It's financially prudent to budget for remodels and refurbishing of soft goods every three to five years, and case goods every seven to 10 years to keep your lodging property attractive. But oftentimes, a property owner may start replacing carpets, drapes and bedspreads, then realize that everything else looks outdated. They begin to look for ways to finance other room furnishings.

"The hot thing right now is new beds," says Mintz. "Guests are demanding more comfortable beds with duvet covers and quilts."

If one thing leads to another and you want to add new night stands and dressers to complement your new beds, you may need to look outside your budget for funds.

Why Lease?

"Leasing preserves working capital, if you haven't set money aside," says Mintz. Property owners who would rather not tap into their line of credit when they need to finance a refurbishing project may find leasing a good alternative, because it does not tie up their equity funds and does not effect their credit report or credit score.

Leasing requires less money up front, so all you are normally required to pay is the first and last payment. When you purchase, most suppliers require 50 percent of the purchase amount as a deposit and the balance at delivery. There are two types of leasing structures:

Lease Purchase – you will own the case goods at the end of the lease. This structure is appropriate for furniture or equipment you may be keeping that would not be outdated by the end of the lease.

Lease Only – You trade in the furniture or equipment at the end of the lease and renegotiate a new lease for newer and be updated FF&E.

"I recommend this kind of lease for computer systems, as there is no real value for them in three to five years," says Mintz.

"The other hot items to update guestrooms are flat-screen and panel-screen TVs."

Higher-end properties are looking ahead to changes in technology in television, because their guests' demand for good electronic equipment. For example, analog television will be outdated in a few years, so if you want flat screen TVs in your guest rooms today, you may want to consider a lease.

"Everything will be digital technology in the next few years," says Mintz. "The federal government has not established a firm date for this turnover in communication technology, but it's expected about 2008-2009."

Tips for FF&E Leases

By Mitchell Miller, JD, MBA

Q: When is a FF&E lease a *true lease* and not a *purchase lease*?

A *true lease* has a fixed period, after which the FF&E must be returned unless there is an option to purchase based on the fair market value on the date of exercise, i.e., the "residual value."

Tip: In a *true lease*, full payments are entirely deductible as a business expense, if the FF&E is used in the trade or business. In a *purchase lease*, the underlying financing cost is tax deductible, and the balance is depreciable over the useful life of the equipment. Often this is a less advantageous tax treatment, minimizing the deduction because the allocation to capital expenditure is not deductible.

Q: The residual value – what is the importance?

Tip: As the residual value increases, the total monthly payments should decrease an equal amount. If not, the underlying interest rate is increasing.

Residual Value Computation: (1) Subtract the residual value from the price of the equipment; (2) Subtract the difference from the total monthly payments under the lease; (3) The remainder is the financing cost from which we can calculate the underlying interest rate.

Tip: After you negotiate the best price for the FF&E, negotiate the lowest monthly payments without trying to increase the residual value. In effect, you will be negotiating a lower interest rate.

Q: How may a FF&E lease be impacted by my lodging property loans?

Tip: As best you can, have the senior loan contract authorize a junior security interest on personal property not specified in the UCC-1 filing recorded by the senior lender.

Tip: Make sure the UCC-1 Financing Statement encumbers only what is actually leased and not all personal property or other FF&E. This could be a breach of your other security agreements, could impair your ability to get future financing or could become a nightmare in a foreclosure or bankruptcy proceeding.

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