LEASE WITH OPTION TO PURCHASE

(Reviewed 11/2014) **3750**

Evaluation of the Option to Purchase. It may be best to lease with an option to purchase instead of regular lease or purchase. A lease with an option to purchase is like a regular lease but it gives the right to purchase the equipment at some time before all of the lease payments have been made. This alternative may be best when it is necessary or advantageous to proceed with the acquisition of the equipment that meets system specifications, but it is desirable to temporarily postpone a decision to purchase. This may be the case when an agency wants to try the system out for a short while to first prove the validity of the system design. This is especially the case when there is no previous experience with the system, or when decisions which might substantially alter the system specifications are imminent.

The possibility that future advances in technology will render the selected equipment comparatively obsolete before the cost advantage point (see break-even analysis) is reached should not stop an agency from purchasing the equipment as long as the equipment is able to satisfy their requirements.

Evaluate the above considerations against the costs associated with postponing the decision to purchase. This cost is determined as follows:

[(Purchase price–rental credits towards purchase) x Present Value of $l] – [Price–(Present Value of Annuity of $1 x lease payment)]

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Example:

For this example, assume the same facts as in the sample form and instructions used in SAM Section 3740, and also assume the following:

1. 100 percent of the first three months of rental is credited toward the purchase.
2. After the first three months, 50 percent of the monthly rental payments is credited toward the purchase.
3. Payments are credited up to a maximum of 50 percent of total payments.
4. The decision to purchase will be postponed for one year.

The cost of postponing the decision to purchase is determined as follows:

Purchase Price =	$8,000
Total rental payments for one (1) year =	$4,200

Rental Credits:	
Months 1-3 =	$1,050
Months 4-12 =	$1,575
TOTAL =	$2,625
50 percent of total rental payments =	$2,100

Credit Allowance =	$2,100
Cost =	($8,000-$2,100) x .9134172*
	$8,000-(11.4294263** x 350)
	($5,900 x .9134172) – ($8,000-$4,000)
	$5,389-$4,000
	$1,389 = cost of postponing decision to purchase

* See tables for monthly payments Present Value of $1.
** See tables for monthly payments Present Value of Annuity of $1.

Compare the cost of postponing the decision of whether to purchase *(as determined above)* with the advantages of postponing the decision in order to gather additional information. When the desired equipment has been used or tested by other units, there is generally little need to further test the equipment.