A CHASE THOUGHT LEADERSHIP INITIATIVE

EQUIPMENT FINANCING AND THE STRATEGIC ADVANTAGE WINDOW

The capital preservation benefits of Section 179 deductions, a healthier economy, and the growth of the equipment finance market are creating equipment acquisition opportunities.

CHASE

THE PULSE OF THE MARKET

For small and mid-sized businesses (SMBs), acquiring the equipment, machinery and software needed to compete while preserving the capital needed to operate is a delicate balancing act.

Most business owners, it's fair to say, would be reluctant to fund their capital expenditures out-of-pocket and run the risk of depleting cash reserves and interrupting cash flow. As organizations wrestle with the decision to replace, upgrade or band-aid their equipment, the recent convergence of tax-advantaged legislation, a healthier economy and the growth of the equipment finance market has created a reason for cautious optimism.

In 2013, U.S. businesses and public sector agencies will finance over $742 billion in equipment acquisitions.

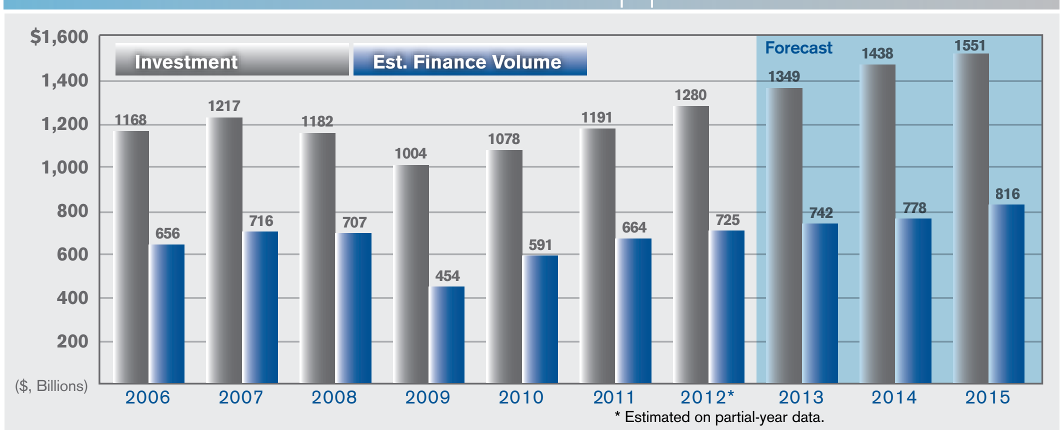
VITAL SIGNS

The projected investment of $1.3 trillion in equipment, machinery and software for 2013 makes the equipment finance market a major contributor to capital formation in the U.S. economy. Of that amount, businesses and public sector agencies will finance over $742 billion according to the Equipment Leasing & Finance Foundation (ELFF) – all of which is expected to be funded through loans, leases and lines of credit.

In December 2012, the ELFF released results of its U.S. Equipment Finance Market Study 2012-2013 that revealed:

- Investment in equipment finance activity was expected to rise approximately 10 percent by 2015 to $816 billion as more companies shake off uncertainty and move off the sidelines.
- 30 percent of companies anticipated increasing their equipment investment through 12/31/13. This correlates with the extension of the Section 179 deductions and the enhanced bonus depreciation benefit embedded in the American Taxpayer Relief Act of 2012.
- Bank financing dominated the market with increased market share when compared to results from the 2007 ELFF borrower survey.
- The primary lenders in all equipment types in 2011 were banks with medical equipment financing showing a significant shift from manufacturers to banks from 2006 to 2011.
- Banks actively shifted their new financing volume to companies with lower risk profiles between 2006 and 2011. "The share of bank financing of highly profitable companies rose from 26 percent to 47 percent between 2006 and 2011, while the share of bank lending to unprofitable companies declined from 65 percent to 53 percent."[1]

Public and Private Investment in Equipment and Software

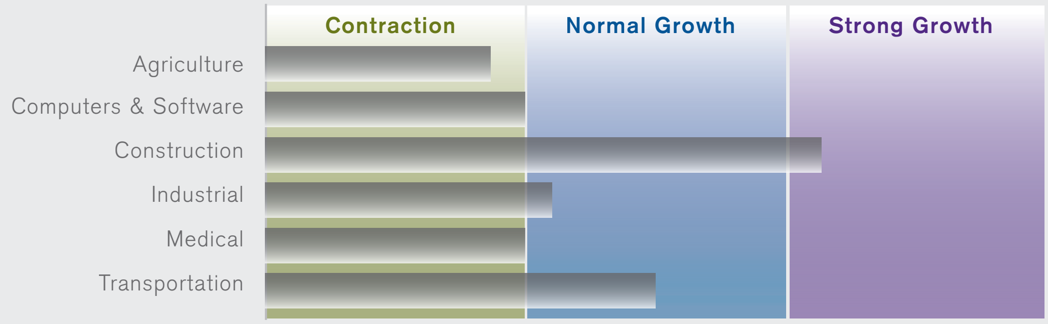


Source: U.S. Department of Commerce Bureau of Economic Analysis and IHS.

1. U.S. Equipment Finance Market Study 2012-2013, Equipment Leasing & Finance Foundation, December 2012.

GROWTH BY INDUSTRY

Key Signposts "Heat Map"



Source: 2013 Equipment Leasing & Finance U.S. Economic Outlook, Equipment Leasing & Finance Foundation, December 2012.

Pent-up demand will ratchet up investment across equipment categories.

Business sector trends indicate the level of investment in construction equipment should see strong growth of approximately 15 percent as the housing market regains momentum, plus:

- Industrial equipment investment will increase at a slower rate vs. the recent past. Manufacturing could be the tailwind for stronger growth in the second half of 2013 if Congress can resolve some of the lingering "fiscal cliff" concerns and pass a national budget.
- Transportation equipment investment is expected to grow moderately, averaging about 10 percent over the next 3 to 6 months.
- Investment in both the information technology and medical equipment sectors is projected for slower growth over the next 3 to 6 months, while the agriculture sector is forecast to contract.

OUTLOOK AND TRENDS FOR 2013

The projected $742 billion investment in equipment financing will be shaped by a series of emerging trends that will affect a large portion of the U.S. economy. Organizations planning to acquire equipment in 2013 should consider the following impacts relative to the benefits[2]:

- Pent-up demand will ratchet up investment across equipment categories, with replacement equipment in the construction, agriculture and transportation categories driving that growth.
- The current climate of low interest rates – at least through the end of 2014 – is ripe for companies to acquire needed equipment while protecting their cash reserves.
- Favorable credit market conditions will hold for long-term equipment acquisition, enabling seven out of 10 businesses to use at least one form of financing.
- The extension of the bonus depreciation benefit through the end of 2013 allows organizations to deduct up to 50 percent of the cost of new equipment purchases and could serve as an incentive to pursue acquisition.
- The impact of cloud computing will create new financing options and change the way companies structure payment for computer hardware and software investments.
- Changes to current lease accounting standards are expected to be announced later this year by the Financial Accounting Standards Board. These new guidelines will change how organizations approach their equipment procurement strategies and allow them to evaluate how their earnings and balance sheets will be impacted by equipment financing agreements.

2. Equipment Leasing and Finance Association Announces Top 10 Equipment Acquisition Trends for 2013, *Healthcare Finance News*, www.healthcarefinancenews.com, January 14, 2013.

SECTION 179 AND CAPITAL PRESERVATION

Over the last few years, Section 179 of the IRS tax code has undergone numerous enhancements as a result of multiple stimulus bills. In 2007, businesses were able to expense up to $125,000 on qualifying equipment with the deduction phasing out for companies that spent over $500,000 in that tax year.

The American Taxpayer Relief Act of 2012 – often referred to as the "Fiscal Cliff" bill – is the most recent economic stimulus to impact the Section 179 deductions by extending them as an incentive for companies to:

- Reduce their current year's tax liability.
- Purchase, finance or lease new equipment and/or software.
- Invest in themselves and spur economic growth.

It also created a window of opportunity to leverage tax-advantaged benefits if capital equipment is acquired and deployed for use before December 31, 2013.

For 2013, organizations can deduct up to $500,000 worth of new or used capital equipment and certain software.

Section 179 Deduction At-a-Glance. For 2013, organizations can deduct up to $500,000 worth of new or used capital equipment – and certain software – purchased for business use as long as the total qualified purchases do not exceed $2 million. The provision works as follows:

- Covers both new and used equipment and can be bundled with bonus depreciation.
- Once the $2 million threshold is exceeded, a dollar-for-dollar phase-out of the Section 179 deduction is initiated.
- Equipment investments in excess of $2.5 million are not eligible for the Section 179 deduction.

Section 179 is neither mysterious nor complicated. It allows businesses to write off the full amount of qualifying equipment and/or software purchased or financed during the year it was acquired and put into service from their gross income. It is, in fact, one of the few provisions included in any of the recent stimulus bills that actually helps SMBs.

While most large companies derive financial benefits from the bonus depreciation on equipment purchases, they are often precluded from capitalizing on Section 179 deductions because the total value of their equipment acquisitions can often exceed the $2 million cap.

Bonus Depreciation At-a-Glance. Reinstated to 50 percent by the American Taxpayer Relief Act, the legislation "Allows larger businesses that exceed the $2,000,000 cap permitted under Section 179 to write-off 50 percent of qualified assets using first year Bonus Depreciation."[3]

- Small businesses that are not profitable in 2013 can use the 50 percent Bonus Depreciation and carry-forward the loss to future profitable years.
- Covers new equipment only that is deployed for use during the 2013 calendar year.
- Equipment must be depreciable under the Modified Accelerated Cost Recovery System with a depreciation recovery period of 20 years or less.

When these provisions are applied, the Section 179 deduction is generally taken first, followed by the bonus depreciation unless an organization has no taxable profit in 2013, since the unprofitable business is allowed to carry the loss forward to future years.

3. www.section179.org/stimulus_acts.html.

To take advantage of the Section 179 tax incentive, equipment must be put in use by December 31, 2013.

Section 179 Tax Deduction and Bonus Depreciation by the Numbers

Equipment	Scenario 1 (New or Used)	Scenario 2 (New Only)
Cost of equipment	$650,000	$2,000,000
Section 179 deduction	$500,000	$500,000
50 Percent bonus depreciation	$75,000	$750,000
Normal 1st year depreciation*	$15,000	$150,000
Total 1st year deduction	$590,000	$1,400,000
Potential tax saving in 2013**	$206,500	$490,000
Equipment cost after tax savings in year one	$443,500	$1,510,000

*Based on an expected 5-year asset life. **Tax savings assume a 35% tax rate.

To take advantage of the 2013 tax incentives, equipment must be put in use by December 31, 2013 since the Section 179 deduction is expected to decrease to $25,000 for the 2014 tax year and the enhanced bonus depreciation benefit is scheduled to sunset. Organizations should consult their tax advisor about the specific impact of equipment financing on their business.

WHO QUALIFIES?

All organizations that purchase, finance, and/or lease less than $2,000,000 in new or used business equipment during the 2013 tax year should qualify. If a business is unprofitable in 2013 and has no taxable income to use the deduction, that business can elect to use the bonus depreciation and carry-forward the loss to a year when the business is profitable. Some businesses may be able to utilize both Section 179 and Bonus Depreciation, depending upon the amount of equipment purchased in 2013.

Case Study: Versatility Tool Works

Versatility Tool Works, based in Alsip, IL, provides complex fabricated components for the architectural, institutional and high-security lighting industries by leveraging its expertise in engineering, stamping, tooling, machining, hardware insertion, robotic welding and assembly.

Challenge: Continued business growth drove expansion to a new, 10,000-square-foot facility. Before this move could be made, however, the company had to ensure that its commitment to innovation for handling high-performance, high-precision jobs would not be compromised.

Solution: A Chase capital equipment loan provided Versatility Tool Works with customized financing to acquire a state-of-the art C1 Punch/Laser Combination Machine to support the workflow while increasing the performance and productivity of their “tooling team.”

Results: The machine’s unique capabilities have enabled the seamless integration of multiple operations and the elimination of labor-intensive processes. As a result, the benefits of lower part costs and shorter lead times are being passed on to customers.

WHAT QUALIFIES?

Most tangible goods, including “off-the-shelf” software and business-use vehicles (with some restrictions), qualify for the Section 179 deduction along with:

- Equipment (machines, etc.) and computers purchased for business use
- Tangible personal property used in business
- Office furniture and equipment
- Property attached to your building that is not a structural component of the building (i.e. printing press or large manufacturing tools)

Equipment, vehicle(s), and/or software acquired must be used for business purposes more than 50 percent of the time to qualify. To determine the eligible amount, multiply the cost of the equipment, vehicle(s), and/or software by the percentage of business-use.

STRATEGIC BENEFITS

For SMBs, regardless of economic and market conditions, financing the acquisition of equipment rather than using cash may offer significant benefits while mitigating risk:

Managing obsolescence is a core benefit of equipment finance.

- Capital preservation. Financing and the type of financing selected – lease vs. loan – can help to reduce the uncertainty of investing in a capital asset that may not yield the desired return or increase efficiency, cost savings or future sales.
- 100 percent financing with no down payment. The sweet spot for preserving cash flow and retaining cash reserves. Funds can be deployed against revenue-generating areas of the business such as worksite improvements, marketing, or research and development. Plus business lines of credit are not affected.
- Improves expense planning. Major capital disbursements to acquire equipment can result in unnecessary budget fluctuations. Financing provides a higher degree of certainty for budgeting purposes by setting up customized, recurring payments to match cash flow.
- Leading-edge technology. Financing puts state-of-the-art equipment and technology needed to grow and compete within reach without having to go out-of-pocket to buy it outright.
- Manage obsolescence. This is a core benefit of equipment finance. While some industries are more prone to equipment obsolescence than others, most businesses use IT equipment and are subject to the required updating to keep their investment on the leading edge. Financing allows upgrading without having to manage disposal and other ownership responsibilities.
- Risk reduction. Investing in capital equipment involves a certain amount of risk, from equipment expertise and large capital outlays to asset management and obsolescence. Financing provides a hedge against inflation by spreading out payments over time and mitigates these risk factors enabling organizations to stay focused on managing their core operations.

ADVANTAGES OF BANK FINANCING

Banks have become the dominant provider of capital for equipment financing in the U.S., adding stability and perspective to an already resilient sector. Accustomed to a relationship-based vs. transactional-based process, banks tend to look beyond the “deal.” By taking a holistic view of the customer’s total financial picture, they are well suited to:

- Help assess the benefits of loan vs. lease.
- Relate the equipment finance investment to overall credit and cash management needs.
- Provide insight and counsel on potential tax and compliance issues.

While needs differ, there are numerous loan and lease options in place that can be customized to meet specific requirements. Some of the more popular financing solutions include:

Equipment Finance Loans. Similar to installment loans for tax and accounting purposes; Customer holds title and capitalizes equipment; Bank holds security interest in the equipment:

- Improves cash flow with up to 100 percent financing.
- Tax benefits of ownership include interest and depreciation deductions.
- Available at fixed or variable rates to match customer needs.
- Payments can be matched to useful life of equipment.

True Lease. Best for capital equipment that can depreciate, including transportation, manufacturing, construction and computers; Bank owns equipment for tax and accounting purposes; Lessee cannot guarantee any part of the residual nor have equity in the lease:

- Improves cash flow with 100 percent financing.
- Avoids equipment obsolescence.
- May reduce tax obligations and strengthen balance sheet.
- Equipment can be purchased at lease end at Fair Market Value.

Terminal Rental Adjustment Clause Lease (TRAC). Used for qualified, over-the-road trucks, tractors and trailers; Bank retains ownership of the vehicle; Lessee has no equity in the lease:

Banks have become the dominant provider of capital for equipment financing.

- Improve cash flow with 100 percent financing.
- Option to buy out vehicle(s) at lease end for the pre-determined residual price.
- Bank gets tax benefits of ownership; Benefits passed to customer as lower monthly payments.

Loan/Lease Comparison

	Loan	Lease
Payment Terms	Borrower repays advance of funds with interest over a specific period of time.	Leases involve the payment of rent.
Terms of Ownership of Equipment	Borrower holds legal title to the equipment.	Lessor bears both the risk and rewards of ownership of the equipment. Lessee merely uses the property in a rental fashion.
Down Payment Requirements	An equipment loan may require a down payment; finances the remaining cost of the equipment.	None. A true lease finances 100 percent of the value of the equipment expected to be used during the lease term.
Payment Scheduling	Loan payments are made in arrears of each loan period.	Lease payments may be made in advance or in arrears of each leasing period.
Collateral Requirements	Depending on the credit worthiness of the customer, a business loan may require the customer to pledge current or fixed assets for collateral.	Leased equipment usually serves as the collateral needed to secure the transaction.
Depreciation Allowance	Borrowers/owners may claim a tax deduction for a portion of the loan payment as interest and for depreciation, which is tied to IRS depreciation schedules.	In a true lease, the end user may claim the entire lease payment as a tax deduction. The equipment write-off is tied to the lease term that can be shorter than IRS depreciation schedules, resulting in a larger tax deduction.
Obsolescence Risk	The borrower/owner bears the risk of equipment obsolescence and devaluation due to new technology.	The lessee transfers risk of equipment obsolescence to the leasing company, since no obligation exists to own the equipment at lease end.
Inflation Impact	A larger portion of the financial obligation is paid in today's more expensive dollars.	More of the cash flow, i.e. the option to purchase the equipment, occurs later in the lease term, when inflation makes dollars cheaper.

Equipment Finance Draw/Term Loan. Best used for identified projects or where progress payments are required. Facility with draw period and permanent financing all in one document; Floating rate with interest-only payments during draw period; Floating rate with payments of principal and interest on termed portion. If index matches term (i.e. 5-year TCM and 5-year term), rate will be set at term-out and will not change:

- Single closing.
- Draw period appropriate for project or need.
- Draws only require copy of invoices.

The Small Business Administration (SBA) also offers a variety of finance options to consider:

- SBA 7(a) Loan Program and SBA Express Term Loans. Best suited for borrowers needing funds for expansion, for purchasing another business, or for managing cash flow.
- SBA 504 Loan Program. Well matched for borrowers planning to expand business through land acquisition, building acquisition, construction, and equipment finance.
- SBA Express and SBA CAPLine business lines of credit offer borrowers funds for expansion, to manage cash flow, or for cyclical working capital needs.

All loans, lines and leases are subject to credit approval. In addition, SBA loans are subject to SBA eligibility.

THE TAKEAWAY

Along with limited-time, tax-advantaged benefits, equipment financing offers flexible equipment acquisition to support growth and manage obsolescence without depleting cash reserves. And this is where we can help. Chase equipment financing professionals have the expertise to:

- Design an equipment loan or lease with the most favorable terms.
- Identify any transactional concerns and recommend strategies to address them.
- Leverage the prevailing legislation for tax and depreciation benefits.

Our solutions include credit and cash management services, merchant services, and business checking products, and other financial tools and resources. All are designed to help your business access working capital, improve cash flow and compete more effectively.

Chase business customers can also access an exclusive series of webinars and live, high-powered business events. All are designed to provide timely and relevant information and ideas for business owners looking to move their companies forward while giving them the opportunity to meet and network with experts and other business owners.

For more information, please contact your local Chase Banker today.

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