

INDUSTRY SYNOPSIS

NAICS 532412, CONSTRUCTION EQUIPMENT RENTAL AND LEASING

I. SCOPE OF SYNOPSIS

A. INDUSTRY DEFINITION

The Construction Equipment Rental and Leasing Industry, NAICS 532412, is being collected and published as a component of the Producer Price Index (PPI) for the first time. According to the North American Industry Classification System (NAICS) 1997, definition, this industry "...comprises establishments primarily engaged in renting or leasing heavy equipment without operators that may be used for construction, mining or forestry, such as bulldozers, earthmoving equipment, or cranes." Excluded from this industry are foreign affiliates or establishments, who do not have profit maximizing centers (PMCs) in the United States.

Loans and leases are both used as forms of financing for acquisition of assets or equipment. Loans are borrowed funds with interest from financial institutions or other financial sources to purchase, rent or lease equipment. The borrower (end-user) has immediate and direct ownership of the asset and is entitled to capital depreciation. Loans and loan making for the acquisition, rental and leasing of equipment are primary to NAICS 522220, Sales Financing. A lease, on the other hand, is essentially a rental agreement, which allows the end-user (lessee) only the use of the equipment for a specified period of time. The owner (lessor) usually holds title to the asset, which may or may not be transferred to the borrower (lessee), at the end of the lease period. Equipment leases (operating and finance) without loan making are primary to this industry.

The terms "rental" and "leasing" are often used interchangeably when, in fact, they are actually distinct service transactions. Rental and leasing agreements often share similar terminology. For instance, the terms rent, rental, rental payment and rental monthly payment, i.e., periodic payments made by the end-user, are used in both types of contractual agreements. An equipment rental transaction is distinguished from a leasing transaction primarily by the length of the contract, i.e., equipment rental is short-term (usually from month-to month); whereas, a lease is most often long-term. The contractual agreement will stipulate whether the transaction is a standard equipment rental (rent-to-rent), rental purchase (rent-to-own) or a lease. In some instances, however, the contract agreement will refer to the transaction involved as a "rental agreement" when, in fact, it is a lease. Please reference the Service Identification Section for a detailed discussion of the various types of lessors and equipment rental and leasing transactions that are classified in NAICS 532412.

1. PRIMARY SERVICE OUTPUT

The primary service (output) of the construction equipment rental (rent-to-rent)_market segment is the provision of a broad range of heavy construction, mining, forestry, oil field and well-drilling machinery and equipment, without operators, for use for a short period of time (usually month-to-month.) under specific terms and conditions.

The primary service (output) of the construction equipment rental-purchase (rent-to-own) market segment is the provision of a wide range of heavy construction, mining, forestry, oil field and well-drilling machinery and equipment, without operators, for use for a short period of time with an option to eventually purchase the equipment.

The primary service (output) of the equipment leasing market segment is the provision of broad range of heavy construction, mining, forestry, oil field and well drilling machinery and equipment, without operators, for use for a long period of time, usually one or more years under specific terms and conditions.

2. UNIT OF MEASURE

The unit of measure for equipment rental or equipment rental-purchase is usually based on the time period that the equipment is in use, expressed as per hour, one-half day, day, week-end, week, month and per year. The unit of measure for equipment leasing is based on the time period that the equipment is in use expressed as per month(s) and per year (s).

3. NAICS STATEMENT

The *North American Industrial Classification System (NAICS) United States, 1997* includes equipment rental and leasing as a component of the sector Real Estate and Rental and Leasing, NAICS Code 53. Under NAICS, the equipment rental and leasing industry is broken down at the seven-digit level by type of equipment, which aggregates to the broader definition, Rental and Leasing Service, NAICS Code 532. The original NAICS title for NAICS 532412, “Construction, Mining, and Forestry Machinery and Equipment Rental and Leasing” has been truncated to “Construction Equipment Rental and Leasing” in order to meet the publication requirements pertaining to the length of the title.

This industry comprises establishments primarily engaged in renting and leasing heavy equipment without operators that may be used for construction, mining, or forestry, such as bulldozers, earth moving equipment, well-drilling machinery and equipment, or cranes. It includes two types of establishments: (1) those engaged in renting (including rental-purchase) of heavy construction, oil field and well drilling equipment and machinery, primarily for commercial use for a short period of time; and (2) those engaged in leasing heavy construction, oil field and well-drilling and machinery for business operations for longer term leases.

The first type typically operates from a retail-like or storefront facility and maintains inventories of goods that are rented. The latter type typically does not operate from retail-like locations or maintain inventories. The leasing establishments work directly with clients to enable them to acquire the use of equipment, or they work with equipment vendors or dealers to support the marketing of equipment to their customers under lease arrangements. Establishments that provide operating and capital (i.e. finance) leases without loan making are included in this industry. Displayed below is the bridge between NAICS 532412 and SICs 7353 and 7359.

NAICS CODE	DEFINITION	SIC CODE	DEFINITION	% of SIC RECEIPTS
NAICS 532412	Construction/mining/forestry machinery & equipment rental & leasing	SIC 7353	Rental & leasing of heavy construction equipment without operators	66%
NAICS 532412	Construction/mining/forestry machinery & equipment rental & leasing	SIC 7359	Oilfield & well drilling equipment rental & leasing	8%

Source: *The 1997 U.S. Economic Census*

Following is a list of industries, which provide primary services similar to NAICS 532412, Construction Equipment Rental and Leasing, but are classified elsewhere in *The North American Industrial Classification System (NAICS) United States, 1997* manual.

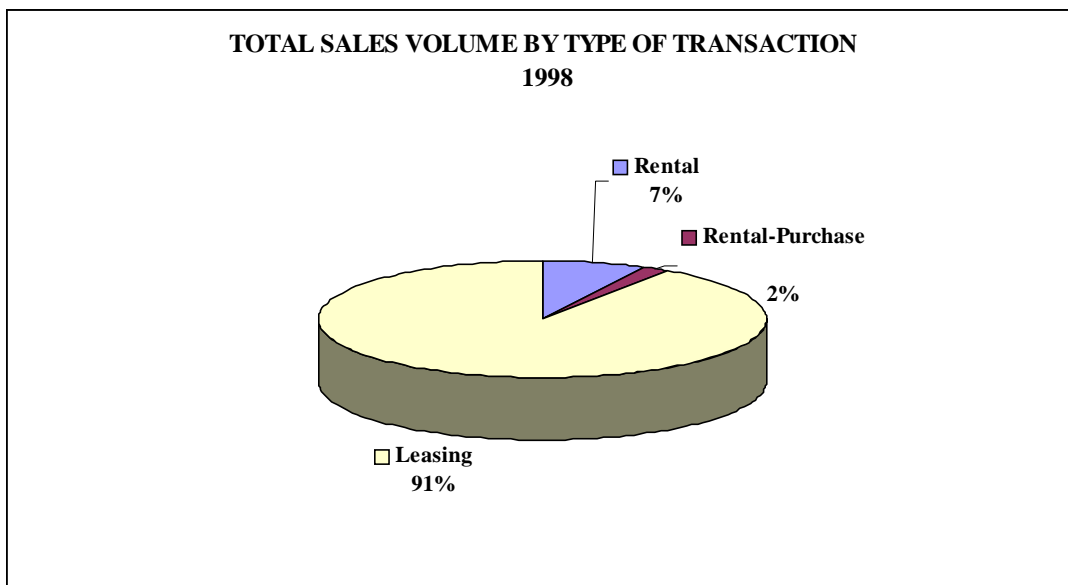
NAICS CODE/SECTOR	INDUSTRY TITLE	DEFINITION
NAICS 23499	All other heavy construction	Comprises establishments primarily engaged in renting or leasing heavy construction equipment with operators.
NAICS 21311	Support activities for mining	Comprises establishments primarily engaged in renting or leasing heavy equipment for mining with operators.
NAICS 532120	Truck, utility trailer, and RV rental and leasing	Comprises establishments primarily engaged in renting or leasing, without drivers, trucks, truck tractors or buses, semi-trailers, utility trailers, or recreational vehicles (RVs).
NAICS 532411	Commercial air, rail, and water transportation equipment rental and leasing	Comprises establishments primarily engaged in renting or leasing off-highway transportation equipment without operators, such as aircraft, railroad cars, steamships, or tugboats.
NAIC 532420	Office machinery and equipment rental and leasing	Comprises establishments primarily engaged in renting or leasing office machinery and equipment such as computers, office furniture, duplicating machines, (i.e., copiers) or facsimile machines.
NAICS 532490	Other commercial and industrial machinery and equipment rental and leasing	Comprises establishments primarily engaged in renting or leasing non-consumer type machinery and equipment (except heavy construction, transportation, mining, and forestry machinery and equipment without operators; and office machinery/ equipment).
INDUSTRY GROUP 1153	Support activities for forestry	Establishments primarily engaged renting and leasing heavy equipment for forestry with operators.
SECTOR 52	Finance and insurance	Establishments primarily engaged in leasing heavy equipment in combination with providing loans to buyers of such equipment.

B. CONTEXTUAL OVERVIEW

The equipment rental and leasing industry is segmented by three distinct market segments: equipment rental (rent-to-rent), equipment rental-purchase (rent-to-own) and equipment leasing. These market segments are legally defined by the United States Internal Revenue Code for tax and accounting purposes and to clearly delineate the boundaries between the owner and the user of rented or leased property. The tax code also establishes guidelines to differentiate between a true lease, a finance lease and a conditional sale. Please note that the following information on pages 4-6 is a statistical snapshot of the entire equipment rental and leasing sector and is not specific to this industry.

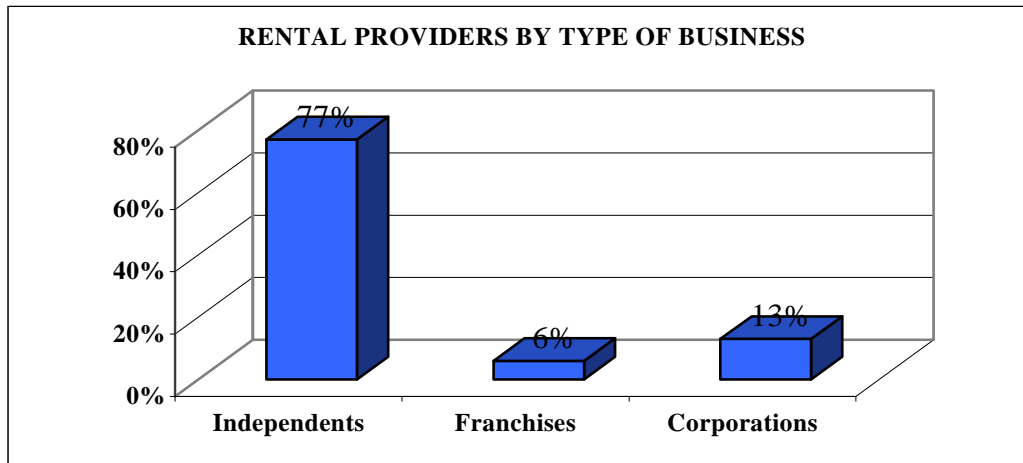
Note: Construction equipment of all kinds was the second most leased asset based on new business volume in fiscal year 2000.

Statistical profiles and reports from various industry sources indicate that the equipment rental and leasing industry overall generated approximately \$228.7 billion in sales volume in 1998. Of this amount, the total sales volume for equipment leasing of all types represented 90.5 percent of the total volume at \$207 billion; equipment rental was 7.4 percent at \$17 billion; and equipment rent-to-own represented 2.1 percent at \$4.7 billion. These figures cover the entire domestic rental and leasing market including all types of equipment and all types of lessors. The following chart depicts the percentage distribution of the total sales volume for equipment rental and leasing by type of transaction in 1998.



Source (s): The American Rental Association, the Equipment Leasing Association and the Association of Progressive Rental Organizations

According to the American Rental Association (ARA), there are approximately 12,000 equipment rental companies currently operating in the United States and Canada. For years this particular market segment was dominated by the family-owned business; however, today it mostly comprises independent rental dealers, franchise operations, regional and national corporations with multiple locations. In an equipment rental (rent-to-rent) transaction, the customer rents selected equipment for a short period of time with the intention of returning the equipment at the end of the contract or re-renting it with unlimited renewal options. Total sales volume for the equipment rentals approximated \$17 billion in 1998. The following chart depicts the distribution of the equipment rental providers by type of business as of 1998.



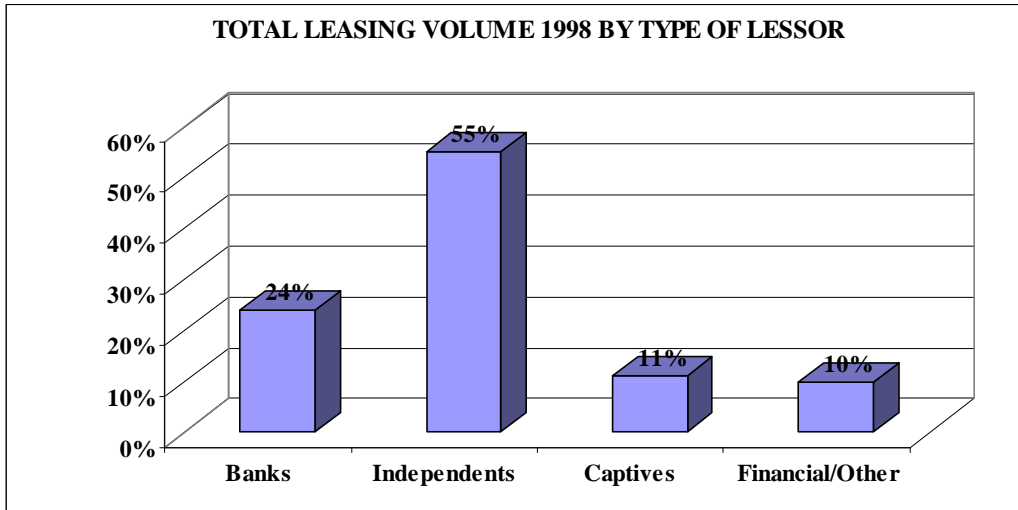
Source: American Rental Association, 1998

The Association of Progressive Rental Organizations (APRO) estimates that there are 8,000 stores (dealers) nationwide in the forty-year old rental-purchase (rent-to-own) business today. The rental-purchase market segment is made up of individual stores, franchises, and multi-store outlets of national corporations with a collective rotating customer base of approximately 3.3 million households per year. Typically, the end-users of rent-to-own (rental purchase) transactions are individuals or households. However, the rental-purchase of equipment that is primary to this industry has become a viable option for many businesses; therefore, it is included in the Construction Equipment Rental and Leasing industry.

In this type of transaction, the customer rents equipment with the intention of ultimately purchasing it at some point. Renewal options to rent the equipment are normally limited to no more than eighteen months at a time. Rental-purchase transactions do not require credit checks and the secondary services, such as maintenance, repair, substitution, delivery and pick-up of the equipment are free of charge to the customer. Consequently, the rental payment in rental-purchase transactions are typically higher than an equipment rental.

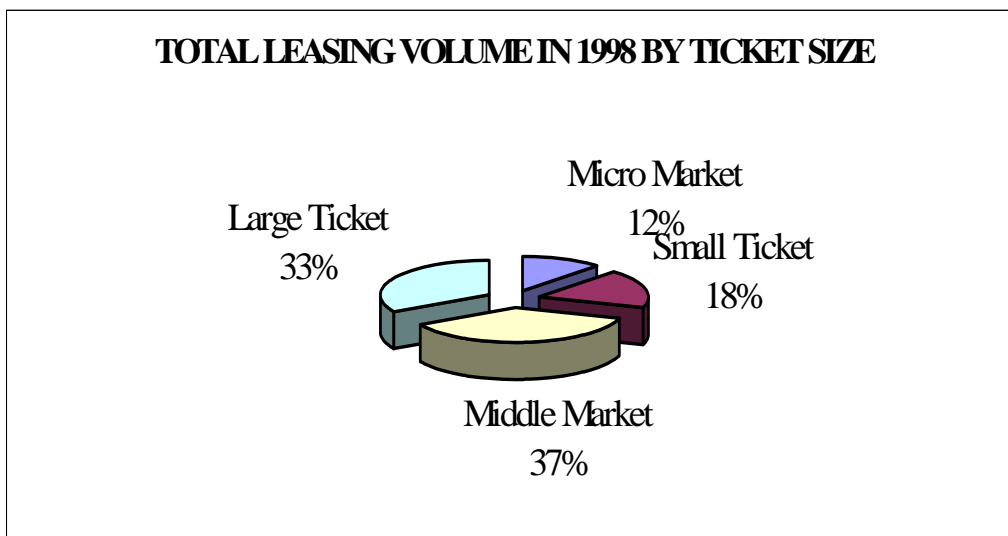
By most statistical measures, equipment leasing is the largest of the three markets based on annual revenue. In the equipment leasing transaction, the customer leases equipment for an extended period of time, usually for one or more years, with the option to purchase the equipment for fair market value at the end of the lease or re-leasing it for unlimited periods.

Market segmentation in the equipment leasing market is commonly characterized by the type of lessor and the ticket (transaction) size. The major types of lessors are banks, captive leasing companies, independents and other financial advisor types. Please note that banks, brokers, and other third party lessors are not classified in the Construction Equipment Rental and Leasing industry; however, bank affiliated leasing companies are primary to this industry. The following chart illustrates the market penetration by type of lessor.



Source: *Survey of Industry Activity, 1999, Equipment Leasing Association*

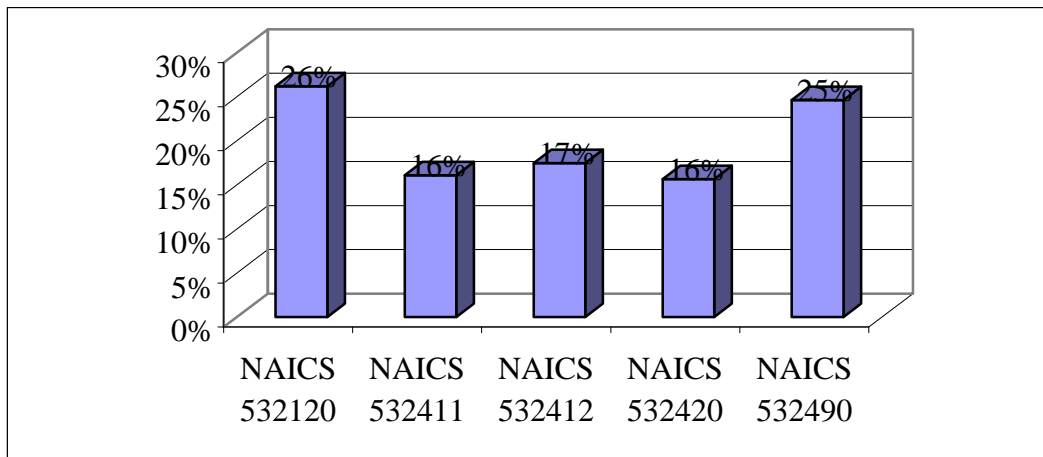
Ticket (transaction) size refers to the total cost of the equipment lease including the finance cost, if applicable. Market segmentation by ticket size is based on the following categories: the micro market comprises equipment leasing transactions up to \$25,000; the small ticket market covers transactions between \$25,000 to \$250,000; the middle market covers \$250,000 to \$5 million; and the large ticket represents transactions over \$5 million. As the following chart illustrates, the percentage of new equipment leasing business volume in 1998 was dominated by the middle market, followed closely by the large ticket market segment.



Source: *Survey of Industry Activity, 1999, Equipment Leasing Association*

Of the \$76,378,784 billion in revenue generated by NAICS 532, Rental and Leasing Services, in 1997, approximately, 9.03 percent was represented by NAICS 532412, Construction Equipment Rental and Leasing, as measured by the US Census Bureau, Sources of Revenue 1997 Report. The following chart depicts the relative size of NAICS 532412 to similar rental and leasing services at the six-digit level based on 1997 receipts.

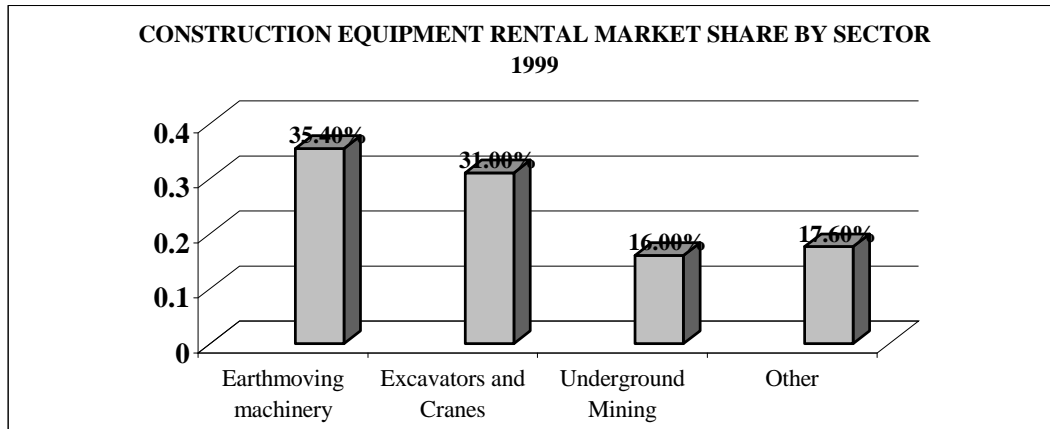
Where: NAICS 532120 = Truck, utility trailer and RV rental & leasing
 NAICS 532411 = Commercial air/rail/water transportation equipment rental & leasing
 NAICS 532420 = Office machinery and equipment rental & leasing
 NAICS 532490 = Other commercial/industrial machinery & equipment rental & leasing



The following comparative analysis demonstrates how NAICS 532412 relates to its higher level aggregates NAICS 532, Rental and Leasing Services and NAICS 53, Real Estate Rental and Leasing based on revenue data from the 1997 *Economic Census, Sources of Revenue*. It indicates that NAICS 532412 was responsible for 9.03 percent of the revenue generated at the three-digit level; however, it accounts for only 2.86 percent of the revenue at the two-digit level.

NAICS	TITLE	1997 REVENUE (000)	PERCENT OF 3-DIGIT	PERCENT OF 2-DIGIT
53	Real estate rental and leasing	\$240,917,556	N/A	100.00
532	Rental and leasing Services	\$76,378,784	100.00	31.70
532412	Construction/mining/forestry machinery & equipment rental and leasing	\$6,894,252	9.03	2.86

The construction equipment rental industry has three major market sectors including earth moving equipment, excavators and cranes, and underground mining equipment. The graph below shows the distribution of the market share for each of these sectors based on market value in 1999. These three sectors account for approximately 82.4 percent of the total market share.



Source: Business Resource Center, 1999

Heavy construction equipment is generally listed by equipment category, and more specifically, by type of equipment including the make, model and specifications within each category. The *AED Green Book, 1999*, lists the following categories of heavy construction equipment, which are included in NAICS 532412. Please note that this list may not be inclusive.

- Aerial Lifts
- Aggregate Equipment
- Air Compressors
- Asphalt Equipment
- Backhoes
- Compactors
- Concrete Equipment
- Cranes
- Crawler Tractors
- Dozers
- Drilling Equipment
- Electric Counterbalanced Lift Trucks
- Excavators
- Forestry Equipment
- Forklifts
- Generator Sets
- Graders
- Hoists and Derricks
- Internal Combustion Counterbalanced Lift Trucks
- Loaders
- Motorized Hand Trucks (Walkies)
- On and Off-highway Trucks
- Pile Drivers
- Portable Water Towers
- Pumps
- Road Maintenance Equipment
- Rough Terrain Lift
- Scrapers
- Skid Steer Loaders
- Sweepers
- Trenchers
- Trucks
- Wheel Loaders
- Wheel Tractors
- Wrecking Balls

The Construction Equipment Rental and Leasing industry includes all types of oil field and well-drilling equipment, without the use of operators, according to the NAICS 532412 definition. In addition to the heavy construction equipment already mentioned, following is an additional list of some of the equipment categories used by the oil, gas and water drilling and exploration industries:

- Gas and well-drilling equipment
- Oil well drilling equipment
- Seismic equipment
- Sub sea system equipment
- Uranium exploration equipment
- Water-well drilling equipment
- Well-head equipment

There are literally hundreds of types of equipment that are rented or leased in this industry. The industry's brochures, catalogues, advertisements and various other publications, which may be available as handouts or posted on the Internet, will provide the types of equipment within each category including the manufacturers, date of manufacture, the models, serial numbers and the related specifications.

Please note that heavy construction equipment, without operators, is primary to this industry. All other types of construction equipment such as light, small, medium sized and heavy construction equipment used with operators, regardless of size, should be given a chance of selection in **Other receipts**. On the other hand, oil field and well drilling equipment of any size, but without operators, is classified in this industry.

II. INDUSTRY OVERVIEW

A. NUMBER OF ESTABLISHMENTS AND COMPANIES

The 1997 US Economic Census, *Sources of Revenue*, indicates that there were 3,957 establishments with a total of 41,545 employed in NAICS 532412 during 1997. Based on a report by the *Monitor*, "100 respondents in their survey collectively employed 88,234 people in the equipment leasing sector for all types of equipment, including construction and oilfield and well drilling, during CY1999.

B. SIZE AND TYPE OF PRODUCTION BY SIZE

When measuring production size in NAICS 532412, rental and leasing of heavy construction equipment had the largest proportion of employees at 32,848, which represents approximately 79.1 percent of the total employed in the industry. Oilfield and well drilling equipment rental and leasing followed by a wide margin with 8,697 employees at 20.9 percent. The table below shows the distribution of establishments and total employed by type of equipment rental and leasing service.

ESTABLISHMENTS AND TOTAL EMPLOYED BY TYPE OF SERVICE

TYPE OF SERVICE	NUMBER OF COMPANIES	PERCENT	EMPLOYMENT	PERCENT
Rental and leasing of heavy construction equipment without operators	3,286	83.0	32,848	79.1
Oilfield & well drilling equipment rental & leasing	671	17.0	8,697	20.9
Totals:	3,957	100.0	41,545	100.0

Source: 1997 US Economic Census, Sources of Revenue

Production shifts in the equipment rental and leasing industry have been precipitated by several economic and non-economic factors including rapid consolidation of the industry, regulatory changes, competition and technological advances, particularly e-leasing. These factors can influence the type of transactions involved, the "ticket-size" of the transaction, and market segmentation by type of lessor, all of which have a significant impact on production.

Consolidation has allowed rental and leasing companies to increase their inventory (asset ownership) and expand their customer base. On the down side, however, consolidations have caused limited growth within existing customer segments according to the Equipment Leasing Association. Because of credit risk exposure policies, equipment lessors are beginning to decline "large-ticket" transactions from current customers and shift production

to the "small-ticket" or "middle market." In the equipment leasing industry, transaction size can dictate the type of equipment available for lease.

C. STABILITY OF INDUSTRY

Overall, the construction equipment rental and leasing industry has experienced consistent growth over the last decade from 1989-1999. The industry appears to be relatively stable by most economic and business measures, including revenue, employment, and profitability. According to the Department of Commerce, employment is reported to increase by 30,000 commensurate with each \$1 billion invested in the dominant equipment leasing market. Additionally, revenue increased in both the heavy construction equipment rental and leasing markets during this time.

The heavy construction equipment rental market's compound growth rate (in value) between 1995 and 1999 was 2.1 percent with the strongest growth occurring in 1999 at 2.8 percent. According to the *Business Resource Company Resource Center Industry Data, 2000*, the heavy construction equipment rental market is projected to reach \$2,908.4 million in 2005, which is an anticipated increase of 11.6 percent from 2000.

Similarly, the heavy construction equipment leasing market business investment in capital equipment grew from \$38.3 billion in 1990 to \$808.4 billion in 2000 according to the U.S. Department of Commerce. During this same period, equipment leasing volume for all types of equipment grew from \$124.3 billion to \$260 billion, an average market penetration rate of 30 percent. Additionally, net asset size grew from \$126.1 billion in 1990 to \$479.4 billion in 2000 (Monitor, June 2000). The total new business volume generated by the construction equipment industry totaled \$21.4 billion in 2000.

The driving forces behind these positive trends in the equipment leasing industry over the last ten years were: (1) the continuing robust economy; (2) technological advances, which have significantly influenced the business model and opened up additional delivery systems; and (3) increasing emphasis in the commercial sector on reducing the cost of doing business.

The rate of growth for this industry has slowed in 2000 generally because of the sluggish economy and more specifically, due to the recession in the manufacturing sector. Major challenges facing the equipment rental and leasing industry include:

1. increased competition from bank affiliated leasing companies and non-traditional companies such as credit card companies;
2. the low cost of capital, which is a disincentive for corporations to rent or lease equipment;
3. regulatory changes at both the Federal, state and local levels, which may affect industry risk levels;
4. aggressive intra and inter-industry competition;
5. continuing slowdown in the economy; and
6. persistent pressures on profitability.

Additionally, rapid consolidation, especially in the rental market segment may reduce the total number of establishments in the short-run; however, it is expected that the Internet will provide an additional vehicle for new market entrants, especially those who provide small-sized and middle market transactions.

D. GEOGRAPHIC DISPERSION

The geographic dispersion of the establishments and employees in the heavy construction rental and leasing industry appears, ostensibly, to coincide with the population density patterns across the United States; however, rental and leasing firms also tend to concentrate in areas of dense production activity. The small and mid-sized independent companies tend to concentrate in specific geographic ranges primarily serving local and regional business. The "giant" corporations serve a broader market nationwide through multiple outlets. Even though proximity to both the equipment supplier and the end-user is preferable, the Internet may make geographic specialization less important.

III. PRODUCTION INFORMATION

A. SERVICE DELIVERY PROCESS

Equipment Rental (Rent-to-Rent) Transactions

The service delivery process for equipment rental transactions may be manual or electronic, however, the standard operating procedures are similar.

- The prospective user of the equipment (renter) notifies the rental company via telephone, Fax, the Internet, in writing, or on-site of the intent to rent selected merchandise.
- The rental company (owner of the property) provides the renter a catalog, brochure or other descriptive literature detailing the equipment specifications and the standard or list price per unit based on a rental day.
- A formal credit application is provided to the renter requesting specific information to verify the renter's identity, physical and building location, type of organization (if applicable), and other critical financial information to determine the applicant's credit worthiness.
- If the application is approved, the rental company negotiates the terms and conditions of the rental agreement with the renter. If the application for equipment rental is disapproved, the applicant is formally notified. At this point, the rental company reserves the right to refund all moneys paid in advance.

- When negotiation of the terms and conditions of the rental agreement have been completed, the renter arranges for delivery and pick-up of the equipment.
- At the expiration of the contract period, the renter has the option to either renew the rental, arrange for pick-up of the equipment, or to exercise the purchase option depending on the terms and conditions of the contractual agreement.

Equipment Rental-Purchase (Rent-to-Own) Transactions

The service delivery process for equipment rental-purchase transactions are similar to the procedures mentioned above for equipment rental, except that rent-to-own transactions normally do not require credit checks. Also, the secondary services, such as maintenance, repair, substitution, delivery and pick-up of the equipment are free of charge to the customer.

Equipment Leasing Transactions

The service delivery process for equipment leasing includes the following;

- In a competitive bid situation, the prospective lessee submits a "Request for Quotes (RFQ) to prospective lessors. The RFQ, which is a formal request for lease rates, includes the equipment description, the proposal guidelines, delivery terms, a payment schedule and the other terms, conditions and options that would apply.
- In a non-competitive bid situation, the prospective lessee may submit an RFQ to only one lessor or simply notify the lessor via telephone, FAX, the Internet, or on-site of the intent to lease selected equipment.
- Once all the prospective lessors' bids have been received and evaluated, an award is made to the successful bidder by signing the approved proposal and forwarding it to the successful equipment lessor.
- At this point, a draft equipment leasing contractual agreement is drawn up and negotiated either between the lessor and the lessee or their legal representatives. Depending on the complexity of the lease, legal interpretation may be required, especially in large-ticket and middle-market transactions.
- After the terms and conditions of the lease agreement have been put in final form, all parties to the lease must sign the document at the "closing."
- If the equipment has not already been built or is not a part of the lessor's current inventory, the lessor proceeds to purchase the equipment from a third party supplier or vendor.

- The vendor or dealer is required to provide a "Bill of Sale" to the lessor upon receipt of payment. This constitutes a warranty in which the seller transfers the equipment title and also warrants that the lessor has full legal ownership of the property.
- If the leased equipment will be situated on real property that is based by a third party or subject to a mortgagee, the lessor can request a waiver from the landlord or mortgagee of any claim to the equipment during the "closing."
- At this point in the delivery process, the lessor may have to file appropriate Uniform Commercial Code (UCC) financing statements to offset any future claims or interests in the leased equipment by other parties, such as the lessee's creditors.
- Also, if a Trust is established, the trustee executes all relevant documents including the lease, participation agreements, the indenture, and any purchase agreement assignments.
- In accordance with the terms and conditions of the contractual agreement, the lessor delivers the equipment to the lessee's location.
- Once the lessee accepts the equipment, the lessee signs and delivers the "Delivery Acceptance Certificate" to the lessor, which is the formal notification of acceptance of the leased equipment. This triggers the rental payments and initiates the lessee's obligation under the lease.
- If stipulated in the contractual agreement, the leased equipment is installed, calibrated, and tested by the lessor. The lessee's staff or operators may be trained as well.
- During the lease term, the lessee may have the option to renew the lease, purchase the equipment or return the equipment to the lessor.
- The "Termination of Lease Agreement" is executed prior to the expiration of the term of the lease.

B. MAJOR SERVICE LINES AND VALUE OF RECEIPTS

According to the *1997 Census, Bridge between NAICS and SIC*, NAICS 532412 generated receipts totaling \$6,894,252. The revenue data are further broken down by type of business, the number of establishments and the estimated value of output as follows:

TITLE	NUMBER OF ESTABLISHMENTS	VALUE OF SHIPMENTS (B)
Construction equipment rental and leasing	3,957	\$6,894,252
Construction equipment rental & leasing, without operators	3,286	5,339,163
Oilfield & well drilling equipment rental & leasing, without operators	671	1,555,089

C. PRICE DETERMINING CHARACTERISTICS

Equipment rental and leasing is a capital-intensive business with up-front capital equipment costs representing a significant portion of operating expenses. Rental payments are usually based on the actual cost of the equipment plus other charges and fees. In today's market climate, however, competitive market forces appear to have more of an impact on price changes than operating costs. Many aggressive marketing and pricing strategies seem to emphasize increasing market share and revenue growth rather than profitability, at least in the short-term. Prices, i.e., equipment rental and leasing rates (rental payments) are affected by both cost push and demand pull economic factors such as capital equipment cost, non-capital operating costs including various fees and charges and competitive market forces.

It is common for equipment rental and leasing companies to develop rate charts (or sheets) that comprise the terms and conditions in the standard contractual agreement plus the current rates. Similar information is provided to the vendor/dealer to expedite processing various equipment acquisitions. The rate chart is usually in a matrix format by rental or lease terms and the equipment cost rate. The rate factor is the coordinate where the lease term and the equipment cost meet. Following is an example of the standard rate chart or rate sheet from the internet that is used by the industry.

SAMPLE RATE CHART FOR EQUIPMENT RENTAL AND LEASING

EQUIPMENT COST	12 MO.	24 MO.	36 MO.	48 MO.	60 MO.
\$2000-4,999	.0952	.0499	.0359	.0275	.0239
\$5,000-14,999	.0942	.0495	.0349	.0272	.0233
\$15,000-34,999	.0903	.0480	.0339	.0269	.0229
\$35,000-49,999	.0889	.0470	.0329	.0261	.0225

Equipment Rental and Rental-Purchase Transactions

The equipment rental and rental-purchase market segments usually publish their rental rates in company brochures, catalogs, the Yellow Pages, the Internet and various other advertising mechanisms. The contractual agreement is short-term and usually in a pre-printed form; however, the terms and conditions may be negotiated depending on the needs of the customer.

The price quoted to the customer may be the book (list) rate or the negotiated price. The industry has advised that book rates have become less common in recent years since equipment rental companies are now differentiated more by their many value-added services rather than the price. Consequently, depending on the terms and conditions of the contractual agreement, there may be a wide divergence between the book (list) rate and the actual transaction price negotiated in the contract. Please note that, in rental-purchase transactions, there is no credit check and most ancillary services are free to the customer. Consequently, rental-purchase payments are typically higher than the rental payments for equipment rental transactions.

The *Rental Equipment Register Rate Guide, 2000*, list 50 factors that make up equipment rental rates; however, for our purposes, the price determining characteristics for equipment rental and rental-purchase transactions include the following:

1. Type of equipment rented.
2. Age of the equipment rented (specify new or used equipment rented in years).
3. Rental term (length of time the equipment is rented).
4. Other equipment rental services.

The following additional service-related charges are not listed in the Checklist for this industry but they may be built into the monthly rental payment or charged separately. If any or all of them are charged separately they should be given a chance of selection in the **Other receipts**.

- Attorney fees
- Administrative charges (other than associated with the normal cost of doing business, such as advertising and marketing on behalf of the customer and picking up the rental payments)
- Bounced check fees
- Duties (for overseas transactions)
- Late fees
- Repossession fees
- Security deposit
- Transaction fees

Equipment Leasing Transactions

There are standardized pricing policies and structures for construction equipment leasing that are universally applied, allowing for variations based on the terms and conditions of the contractual agreement. It is typical for the equipment leasing industry to bundle all of the charges including the monthly rate (i.e., the total equipment cost multiplied by the rate or lease factor), the value-added charges, taxes, the lease interest rate (if applicable), insurance charges, warranties and any other service-related charges and fees.

Equipment leasing rates can be stated in absolute dollars e.g., \$1,000 per month or as a percentage of the total equipment cost leased per period of time, which is commonly referred to as the rate or lease "factor." Leasing rate factors, which are essentially multipliers, are based on several variables including equipment cost, the lease type, the lease structure, the current interest rate, the purchase option alternatives and the lease term. To determine the base monthly lease payment, multiply the total equipment cost by the lease factor.

$$\text{Calculation: } \$50,000 \times 0.024 = \$1,200 \text{ per month}$$

The monthly lease payment (sometimes referred to as the monthly rental payment, lease payment or just rental) is normally calculated based on the depreciated value of the equipment minus its residual (salvage) value at the end of the lease. According to the existing United States Internal Revenue Tax codes, it is required that equipment operating leases must have a residual value of at least 25 percent of the equipment cost. For finance leases, the residual value can be 10 percent or less. The equipment cost takes into account the total cost to the lessor, not just the purchase price of the equipment. Depreciation is normally taken after taxes.

The monthly lease payment comprises fixed incremental payments over the lease term. The lease payments on long-term leasing contracts may be structured based on the unique requirements of the end-user customer. (See also the various lease structures on the following page which coincide with these lease payments.) The most frequently used customized payment structures are:

- Balloon Payments - If the rental payments made during the primary rental period are insufficient for the lessor to recover the full cost of the equipment (finance lease), the lessee makes a lump sum (balloon) rental payment at the end of the primary lease period to cover the capital cost of the equipment.
- Deferred Rentals - Allows the lessee a "rental free" period (moratorium) on payments during those periods when the leased asset is generating little or no revenue. Deferred rental payments tend to be higher.
- Seasonal Rentals - Rental payments are structured to coincide with the seasonal cash flow cycle of the lessee. Rental payments would be higher during peak season usage for the equipment and lower during off-peak season.

- Stepped Rentals - The amount of the rental payments are either increased (step-up rental payment) or decreased (step-down rental payment) during the primary lease period. This is based on the anticipated income of the lessee from use of the equipment.

Interim rent (a.k.a. pre-commencement rent) is the rent charged to the lessee between the time that the construction equipment is delivered (in-service date) and accepted, and the actual start date of the primary (base) period when the equipment is actually in use. According to the industry, interim rents are sometimes included in equipment leasing contracts when there are multiple deliveries, but the lessee prefers that the primary term be the same for all of the units. The amount of the interim rent is arbitrary, i.e., it can be quoted to the lesser as equal to the lease interest rate only on the total cost of the equipment, the equivalent of the agreed upon rental payments or some other amount.

In an equipment leasing transaction, the resultant leasing contractual agreement is for the long-term, i.e., the primary (base) period may range from one to five years. The industry sometimes refers to contracts that are for only one year as "short-term" leases. For small and middle ticket transactions, the primary lease period can be between three and seven years, whereas, large ticket transactions can run for 15 years or more and even indefinitely.

If there is a renewal option in the contractual agreement, the lessee may continue to lease the equipment for a secondary or even tertiary period, after the primary (base) lease has expired. The renewal periods may be from year-to-year; for a fixed number of years or an indefinite period. The important aspect to note is that the amount of the rental payments during the subsequent rental periods can be fixed by the original lease terms or substantially reduced, if the lessor has recovered most of the cost of the equipment during the primary lease term. (Usually this occurs in finance leases.)

Most equipment leases provide an option for the lessee to purchase the equipment when the lease expires. Purchase option provisions vary according to the following:

- Fair Market Value Purchase Option (FMV) allows the lessee to purchase the equipment at the end of the original lease term for its fair market value.
- Fixed Purchase Option permits purchase of the equipment at the end of the original lease term for a fixed percentage of its original cost.
- Prepaid Purchase Option allows payment of the purchase option at or before the beginning of the equipment lease term.
- \$1.00 Purchase Option permits purchase of the equipment at the end of the original lease term for \$1.00.

A recent survey conducted by the Equipment Leasing Association, *2000 Survey of Industry Activity*, found that, on average, of the equipment leases that expired during the most current fiscal year:

- 23 percent were renewed by the original lessees;
- 52 percent involved equipment purchased by the original lessees;
- 14 percent involved equipment re-marketed to a wholesaler; and
- 11 percent involved equipment that was leased or sold to a different user.

Most leasing transactions require advance payments, i.e., two or more monthly payments are required before the start of the lease term to offset up front expenses. If payments are made on a monthly basis, one advance payment will apply to the first month's payment and any additional payments will be applied to lease payments due at the end of the lease. Under certain leases' structures, advance payments are payable only at the end of the lease period commonly referred to as "payment in arrears."

Securitization is a commonly used financial transaction in which the owner (originator) of equipment leases sells the assets (leases) to a third party to generate additional revenue for future equipment acquisitions. In turn, the third party, which is usually a bank or a financial institution, groups the assets in a pool, converts them to commercial paper for sale to investors.

Supposedly, the business relationship between the leasing company (lessor) and the customer (lessee) doesn't change as a result of the securitization agreement. The lessor continues to lease the equipment to the lessee and to collect the monthly rental payments. However, the leasing company remits the rental payments directly to the Trust, after the profits are taken.

It is important for the Field Economist (FE) to understand the concept of securitization because it affects both sample unit identification and the disaggregation procedures. Revenue from the sale of assets will be truncated when determining whether or not a sample unit belongs in the Construction Equipment Rental and Leasing Industry. If the sample unit retains any revenue for the service of collection of the monthly rental payments for assets that have been sold, this revenue should be given a chance of selection during disaggregation. It is expected that this will be very minimal.

Also important to note here is that Construction Equipment rental and leasing companies typically sell both financial assets (such as the leases previously mentioned) and physical assets. Revenue from the sale of physical assets (such as equipment that has been previously rented or leased) should NOT be included in total revenue for these companies. This revenue is not included when determining the correct industry classification of the sample unit and the sale of these assets should not be given a chance of selection during disaggregation. (More details can be found under Sample Unit Identification.)

The price determining characteristics for equipment leasing include the following:

1. Type of lessor.
2. Type of lease.
3. Type of lease structure.
4. Type of equipment leased.
5. Age of equipment leased (specify new or used in years).
6. Lease term (specify in months or years).
7. Other equipment leasing services.
8. Type of purchase option.

The following service-related charges (if applicable) are often built into the monthly rental payment for equipment leases. If charged separately, they should be given a chance of selection in **Other receipts**. Please note that these service-related charges are not itemized in the Checklist.

- Attorney fees
- Administrative charges (e.g. advertising)
- Casualty occurrence fees
- Collection telephone charges
- Commitment fees
- Deal rewrite fees
- Debt costs and placement fees
- Documentation fees
- Equity placement fees
- Excess use charge
- Filing fees
- Late payment charges
- Liability waiver fee
- Nonutilization fees
- Pre-payment penalties
- Re-marketing fees
- Repossession fee
- Transaction fees
- Upgrade financing

D. CUSTOM SERVICES

Normally, custom services are not indicated in small to medium-sized transactions in the equipment rental and leasing industry. Many rental and leasing companies maintain a full inventory of the variety of products available or have direct access to vendors, manufacturers or dealers who can provide the exact make and model that is ordered by the customer. On the other hand, there is a growing trend in component specifying and customization of industrial, construction, farming and oil well drilling equipment, especially in large-sized transactions. Additionally, electronic equipment, engine parts and other types of merchandise with a high obsolescence factor may require custom upgrades on long-term contracts.

E. SEASONALITY

Seasonality is not usually associated with the equipment rental and leasing industry. The rental and leasing companies operate throughout the year and their services are available any time upon request. Even though some equipment may not be available during certain times of the year due to manufacturing cycles, seasonal adjustments do not have to be made in the PPI for

NAICS 532412, since the primary services are generally available for the entire year and can be priced every month.

F. SERVICE SUBSTITUTION

The Producer Price Index (PPI) pricing methodology holds the specifications fixed; therefore, reducing the need for substitutions. Substitutions will only occur if the fixed specification is no longer offered i.e., when the equipment being rented is updated to newer models.

G. QUALITY ADJUSTMENT

Since all of the price determinants in the specification will be held constant, including the type of buyer, there should be minimum service substitutions during repricing. If a respondent upgrades its fleet, i.e., the equipment is updated to include the current model, the respondent will be asked to provide an estimate of the change in the equipment cost, and an explicit quality adjustment will be performed. If the respondent does not have an estimate of the change in the equipment cost, an appropriate Producer Price Index (PPI) will be used to adjust the cost of the equipment.

On the other hand, if the respondent changes the type of equipment priced and shifts asset classes or the types of transactions, then the service provided is no longer directly comparable. Therefore, the appropriate quality adjustment methodology would be the “link to show no change.” If the type of equipment is modified or an aspect of the service changes, such as no longer providing pick-up and delivery services, then an explicit quality adjustment using the difference in the cost of providing the extra service will be performed.

The prices for this industry usually remain the same during the life of the contract. In an attempt to address both the constant quality and reporter burden issues, the type of price that will be calculated for multi-year (two years or more) leases will be the sum of the monthly lease payments (captured only annually) using the number of lease payments equal to the lease term. For example, a single monthly lease payment for each of the most recent three years would be used for a lease with a lease term of three years. The respondent is asked to provide an estimate of their equipment costs each year for the fixed set of equipment specified in the original lease collected. They are then asked to calculate the monthly lease payment using the equipment cost estimate. Using this methodology, the constant quality of the underlying asset is obtained. No other specific adjustment technique is required for these transactions. Other underlying factors that cause a change in the monthly lease payment will be accepted as price change.

IV. MARKET AND TRANSACTION INFORMATION

A. INTERPLANT AND INTRAINDUSTRY SALES

Usually, there are no measurable interplant or intra-industry activities associated with renting or leasing equipment.

B. PRICE BEHAVIOR

Government information pertaining to the pricing behavior in this industry is not available. Also, the Consumer Price Index (CPI) only prices rental of selected popular merchandise to individual consumers. Even though empirical pricing data are not readily available from industry sources, anecdotal evidence suggests that short-term rental rates fluctuate often but not widely because of competition from too many lessors in the market chasing too few customers. Leasing prices, which are negotiated, will probably be flat or change on the margin over the long-term.

C. TYPES OF PRICES

The typical price in the equipment rental and rent-to-own industries is a published or list rate per unit of rental. In equipment leasing, the base price plus the additional charges and fees are negotiated between the lessor and the lessee along with the other terms and conditions to be included in the contractual agreements. Listed below are the types of prices to be collected for rent-to own, equipment rental, except rent-to-own, and equipment leasing.

- Rental payment
- Lease payment
- Sum of lease payments for lease term
- Negotiated price
- List (some adjustments indicated)
- List

For long-term leases (two years or more), the type of price collected will be the sum of the monthly lease payments. This sum will be calculated using an annual monthly lease payment for each year of the lease term. During annual repricing, the respondent will only be required to calculate a monthly lease payment for the current time period. Please see the Industry Specific Procedures for details.

D. TYPES OF BUYERS

The buyers in the construction equipment rental and leasing industry are primarily business entities who rent or lease heavy construction equipment for commercial use. Manufacturers, construction companies, mining and exploration companies, and energy-related companies constitute the end-user customers who utilize these services on a large-scale basis. Tax-exempt

institutions such as Federal, state and local governments and non-profit institutions are also end-users. Other types of buyers include farmers and Tribal Entities within the United States.

E. DISCOUNTS

Most discounts offered by lessors (owners of equipment) to lessees, (prospective users of equipment) are trade discounts offered to regular customers as an incentive for their continued business. This type of discount may be expressed as a percentage reduction of the rental or lease price per unit. Capturing such discounts may be difficult since these particular types of discounts are usually negotiated. Also, lessors may offer lower rates for extended rental or leases.

F. ADDITIONAL CHARGES

Other equipment rental and leasing services have been itemized on the Checklist and should only be relevant if they are built into the monthly rental or lease payment. See the Price Determining Characteristics Section for a list of these charges.

G. SIZE OF PURCHASE

There is no average or typical size of purchase in equipment rental and leasing transactions.

H. CONTRACTS

Equipment rental and leasing transactions require a contract or some written document between the lessor and the lessee, which specifies the relevant terms, conditions and options. Equipment rental and rental-purchase contracts are usually shorter, i.e., no more than one or two pages. This type of contractual agreement is simply structured and covers the type of equipment, the rental payment, additional charges, rental term, pick-up and delivery terms, maintenance responsibility, replacement costs, warranty requirements, damage insurance option, personal liability coverage and a purchase option (if applicable). The equipment leasing contractual agreement, which can be two or more pages (sometimes eighty or more pages), is more comprehensive and detailed because of the complex legal and financial aspects associated with long-term equipment leasing. There are essentially two types of lease formats: namely, the single-transaction lease and the Master lease:

The single transaction lease is a pre-printed form with standard terms and conditions for small transactions and vendor programs. The Master lease is a two-part document, which is typically used for long-term leases with multiple transactions where the equipment is added to the lease over the life of the contract. The first or main section of the lease agreement, which can be over forty pages, contains the standard terms and conditions of the contract that will stay in effect from transaction to transaction such as the delivery and maintenance terms, warranties, representations, tax obligations, etc. The second part of the lease (a.k.a. the schedule) is only a one or two page document. It comprises the terms and conditions such as equipment type, rental terms, and payment schedule that will vary during the lease term. Usually, the Master lease is used for large ticket size transactions over \$5 million dollars.

I. OTHER VARIABLES AFFECTING PRICE

Other variables, which may affect equipment rental and leasing rates directly or indirectly, are:

- a growing economy, which increases production and business activity, which, in turn, increases demand for leased equipment;
- stable interest rates, which encourage capital equipment investment; and,
- federal, state and local regulatory changes which affect market segments, depreciation schedules, and marginal tax rates. Additional taxes are routinely passed on to the lessee by incorporating them into the incremental rental payments. There is a lag time before regulatory and tax code changes affect a company's bottom line; therefore the impact on price movements in the PPI may not be immediately discernible.

V. INDUSTRY INFORMATION AND RELATIONS

A. INDUSTRY RELATIONS

Trade Associations

American Rental Association (ARA)

1900 19th Street

Moline, IL 61625

Telephone number: 800-334-2177

Fax number: 309-764-1533

Website: www.ararental.org

Contact: Mr. Sandy Howell, Director of Public Relations

ARA is a trade association of approximately 7,200 rental business owners, manufacturers and suppliers of general equipment in the United States, Canada and various other countries. Provides advertising, marketing, and training to its members and also monitors legislation affecting the industry via the ARA's State Association Program. Publishes the *Rental Management* magazine and provides various products and services to its members at no cost.

Association of Progressive Rental Organizations (APRO)

9015 Mountain Ridge Drive, Suite 220

Austin, TX 78759

Telephone number: 512-794-0095

Fax number: 512-794-0097

Website: www.apro-rto.com

Contact: Mr. Richard May, Director of Public Affairs

APRO is essentially a non-profit trade association, which represents the rental purchase (or rent-to-own) industry throughout the United States. Since its inception in 1980, APRO has served as an advocate for the RTO industry, especially in regards to legislative matters. Its membership comprises storeowners, franchises and multi-state companies who primarily rent merchandise with an option to buy. The association also publishes a bi-monthly magazine, newsletter and an annual statistical report of the industry's performance.

Equipment Leasing Association of America (ELA)

4301 North Fairfax Drive, Suite 550

Arlington, VA 22203-1627

Telephone number: 703-516-8380

Fax number: 703-522-7099

Website: www.elaonline.com

Contact: Ms. Cecilia Beverina, Director of Public Affairs

The Equipment Leasing Association is a trade association, which promotes and represents the general interests of the equipment leasing and finance industry. Provides marketing, management resources and training/educational activities for its members. It also established a Code of Fair Business Practices for this industry. ELA publishes an annual statistical report.

Equipment Leasing and Finance Foundation

4301 North Fairfax Drive, Suite 550

Arlington, VA 22203-1627

Telephone number: 703-527-8655

FAX number:

Website: www.elaonline.com/Foundation

Contact: Ralph Petta, Managing Director

The Equipment Leasing and Finance Foundation is a non-profit organization established by the Equipment Leasing Association of America (ELA) to provide education training and research in equipment leasing. Publishes a twice yearly *Journal* which summarizes commissioned research and articles provided by various industry experts.

United Association of Equipment Leasing (UAEL)

520 Third Street, Suite 201

Oakland, CA 94607-3520

Telephone number: 510-444-9235

FAX number: 510-444-1346

Website: www.uael.org

Contact:

UAEL, formerly known as the Western Association of Equipment Lessors (WAEL), is a trade association, which represents over 400 firms in the equipment leasing industry. Its primary objectives are to foster networking opportunities among its members and throughout the equipment leasing industry. The association also collects and disseminates industry-related information including a Membership Directory, the UAEL Newslines and a Funding Source Profile. Various conferences, expositions and forums are held during the year to create business opportunities for its membership.

Government Agencies

Information such as special reports, legislation and statistics pertaining to the industry can be obtained from the following federal agencies.

U. S. Department of Commerce
Economics and Statistics Administration
Bureau of the Census
4700 Silver Hill Road
Suitland, MD 20746
Telephone number: (301) 457-1722

U. S. Department of Commerce
Bureau of Economic Analysis (BEA)
1441 L Street, NW
Washington, DC 20230
Telephone number: (202) 606-9900

U. S. Department of Energy
Energy Information Administration
1000 Independence Avenue, SW
Washington, DC 20585
Telephone number: 1-800-Dial-DOE

U. S. Environmental Protection Agency
Office of Public Affairs
401 M Street, SW
Washington, DC 20406
Telephone number: (202) 260-2090

U. S. Department of Labor
Occupational Safety and Health Administration (OSHA)
Frances Perkins Building
200 Constitution Avenue, NW
Washington, DC 20210
Telephone number: (202) 219-8148

U. S. Department of the Treasury
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224
Telephone number: (202) 622-4115

Industry-Related Publications

Publisher: Equipment Watch, a division of
Primedia Business
1735 Technology Drive, Suite 410
San Jose, Ca 95110-1333
Telephone number: 1-866-292-6717
E-mail address: www.equipmentwatch.com

- The *AED Green Book* is a complete reference source of the nationally averaged rental rates of various types of construction equipment including heavy construction equipment.

- The *AED Green Guide* provides the original list price, resale values, and specifications of all types of construction equipment.
- The *Serial Number Guide to Industrial Lift Trucks* provides the make, model and serial numbers of all lift trucks manufactured in the United States.
- The *Serial Number Guide for Used Construction Equipment* provides a glossary of common industry items plus the name, location, telephone numbers, and serial number plate location of all construction equipment sold in the United States.
- The *Specification Data Series* (15 volumes) includes the entire lists of technical and specification data related to construction and material handling equipment.
- The *Specification Reference Book* is a reference source, which includes the dimensions, weights and performance of all types of heavy construction equipment.
- The *Cost Reference Guide* includes the estimated hourly cost data for over 1500 pieces of heavy construction equipment and the various tools and attachments.
- The *Green Guide Auction Guide Reports* provides the most recent auction reports for heavy construction equipment.

Publisher: Cahners Business Information, division of
 Reed Elsevier, Inc.
 275 Washington Street
 Newton, MA 02158
 Telephone number: (617) 964-3030
 FAX number: 1-800-497-5448
 E-mail address: www.coneq.com

- *Construction Equipment* is an industry publication, which provides comprehensive information pertaining to construction equipment including a buyers guide, new products list, specification guide, distributor's guide and various other industry-related economic and statistical data.

Publisher: The Equipment Rental Industry Resource
 23815 Stuart Ranch Road
 Post Office Box 8987
 Malibu, CA
 Telephone Number: 1-800-543-4116
 FAX Number: (310) 317-9644
 E-mail address: www.equipmentrental.com

- The *Rental Equipment Register* is a trade magazine, which provides a variety of industry information for use by the equipment rental industry. It includes a database of the rental

industry's distributors, suppliers, financing sources, manufacturers and an annual rate guide. It is also a free of charge web-based source for statistical data, legislative and regulatory information, which may impact the equipment rental industry.

B. CURRENTLY AVAILABLE PRICE DATA

There are several private industry sources that can provide pricing data on NAICS 532412, Construction Equipment Rental and Leasing. Some equipment rental and leasing companies may publish their basic (book or list) rates through various advertising mechanisms; however, most prices are negotiated based on the terms and conditions of the individual rental or leasing agreement.

When publicly available, equipment rental and leasing rates can be obtained from the Yellow Pages, local regional and national directories, trade associations, and the Internet. The Producer Price Index (PPI) for NAICS 532412 Construction Equipment Rental and Leasing, will be the primary source for pricing data pertaining to this industry.

C. LITIGATION AND OTHER COOPERATIVE ISSUES

There are numerous rules and regulations at the federal, state and local levels, which govern the business activities of the equipment rental, rent-to-own, and equipment leasing industries. Historically, federal legislation was enacted to: (1) determine the asset ownership boundaries in a lease for tax and accounting purposes; (2) distinguish between a lease and a conditional sale; and, (3) define a true lease versus a finance lease for tax benefits. Today, there is existing legislation addressing all of the above-mentioned issues and more, including:

- The Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982 repealed Safe-Harbor leasing, which was a statutory lease code that allowed a lease to qualify as a true lease for tax purposes, even though it did not ordinarily qualify. TEFRA defined finance leasing and its tax implications.
- The Taxpayer's Relief Act of 1997 defined the rental-purchase agreement as a lease, with some exceptions. It also codified the rules and regulations governing rental-purchase transactions that would qualify as a lease.
- FAS Statement No. 13 Accounting for Leases establishes standards for lessors' and lessees' accounting and reporting for equipment leases.
- The Uniform Commercial Code (UCC) establishes the responsibilities and liabilities of the lessee and lessor in leasing transactions. Standardized UCC forms are often used by Lessors to secure their ownership of leased equipment.
- 1971 Amendment to the Banking laws, which allowed United States banks to establish holding companies. Also, it allowed the banks to own other types of financial businesses such as bank affiliated leasing companies.

Also, the Department of Labor's Occupational Safety and Health Administration (OSHA) imposes regulations pertaining to equipment safety and usage. OSHA issues mandatory requirements to ensure compliance with environmental rules, regulations and standards in regard to usage of certain types of equipment and its impact on the environment.

Data collection might be problematic, especially in the rental-purchase and equipment leasing industries because of complex legal contractual agreements, confidentiality concerns and cooperative issues. The Field Economists may have to rely exclusively on the word of the prospective reporter that the contractual agreement meets the legal definition of a true lease or a finance lease and that the parties to the lease are not acting as brokers. Also, there are at least three pricing documents pertaining to equipment rental, rental-purchase and leasing transactions, including the rate chart, the invoice and the contractual agreement, which may or may not be publicly available.

D. SERVICE IDENTIFICATION PROBLEMS

Identification of Various Types of Sample Units

Normally, the status (i.e., "in-scope" or "out-of-scope") of a prospective sample unit can be initially determined during the frame refinement process; however, further clarification of a lessor's role at the regional office level may be necessary. The lessor's intent and interests may be obscured or may shift from one transaction to another depending on the terms and conditions of the actual contractual agreement. For example, a true equipment lessor who is "in-scope" may decide to act as a broker in the leasing transaction being collected. This may not be evident until the terms and conditions of the contractual agreement have been fully disclosed. The various types of lessors who provide equipment rental and leasing include the business types noted below.

The equipment rental and rental-purchase markets are made up of independent rental dealers, franchise operations, and regional/national corporations with multi-store operations. All of these lessor types (rental/rental-purchase companies) fit the definition of the sample units classified in NAICS 532412; therefore, they are considered "in-scope."

The equipment leasing market comprises individuals, independent-leasing companies, lease brokers, captive leasing companies, and bank leasing companies. Each of the following type of lessors involved in equipment leasing is defined by its business model, selected market segment and type of leasing transaction as stipulated in various governing federal and state rules and regulations.

Banks participate in the equipment leasing market in various ways. Bank leasing companies have been established by national and state banks to provide equipment leasing, exclusively. These bank-affiliated (owned) leasing companies operate independently of the parent bank as a subsidiary. Banks also may act as a third party in a leveraged lease transaction, i.e., the bank provides the lessor a percentage of the funds needed for acquisition of the equipment to be

leased. Current banking regulations allow bank lessors (i.e., bank affiliated leasing companies) to provide both "tax-motivated" (true) leases and non-tax motivated (non-true) leases.

Historically, bank management treated equipment leasing as a secondary service to its primary service, i.e. conventional lending (loans). What distinguishes bank equipment leasing from its conventional form of financing is that the bank initially holds the title, interest and the rights of the property (asset) in a leasing transaction.

If a national or state bank leases equipment via an "in-house" operation and treats equipment leasing as a secondary source, it is "out-of-scope." On the other hand, bank leasing affiliates or companies established by banks or bank holding companies, as subsidiaries with separate profit maximizing centers from the parent bank are "in-scope" provided that the bank leasing affiliate does not accept deposits or make loans.

Captive leasing companies (a.k.a. as captive finance companies) are equipment leasing companies that have been set up primarily to increase the sales of the manufacturers or dealers that they serve. They specialize in equipment leasing, traditional financing, and providing administrative type financial services. Captive leasing companies are "in-scope" as long as they operate as a separate business entity and the revenue (or any portion thereof) generated from equipment leasing transactions is not passed through to the manufacturer of the equipment.

Independent leasing companies (a.k.a. as non-bank leasing companies) are lessors whose main business interest is investing in leases. This particular type of lessor can be a small privately held company or a large national corporation. There are two types of independent lessors, including:

- Finance leasing companies act as lessors who provide long-term financing to lessees for equipment leasing. After agreeing on the financing terms, the lessor purchases the equipment from the lessee's choice of vendors. Typically, the lessor does not maintain any inventory of the property. In this type of leasing situation, the lessor transfers the maintenance costs, repairs, insurance fees, taxes, and all of the obsolescence risks to the lessee. The lessee eventually acquires equity and title to the property at the end of the contract. Establishments whose primary service is finance leasing are "in-scope."
- Service leasing companies provide non-financial services in addition to the traditional equipment financing. They also may provide equipment maintenance, repair and continuous operating services. The charge for these services is usually included in the leasing payments. Since this type of lessor provides what is referred to as a true or operating lease, they are considered "in-scope." However, if the service leasing companies also provide loans to buyers of such equipment, then they are classified in Sector 52, Finance and Insurance.

Individual equipment lessors (as opposed to corporate lessors) are one or more persons who directly lease equipment to a lessee for a specified period of time. The individual lessor is "in-scope" for this industry as long as it has legal or tax title to the equipment and is entitled to receive the rental payments.

Lease brokers (lease underwriters or syndicators) can be a company or individual who arranges a lease transaction between prospective lessors and lessees. The fee for this type of lease financing service is usually calculated as a percentage of the cost of the leased equipment. This type of lessor would be "out-of-scope" since the revenue from the lease transaction accrues to the actual lessor or a third party.

Lease originator is defined by the industry as any individual or company that either/or: (1) sells equipment leasing as a service; (2) packages the credit approval; (3) coordinates the purchase of the equipment from the vendor; (4) provides the funding, if needed; and (5) closes the leases transaction deals. A lease originator can be a salesperson, a broker, a financial consultant, an intermediary, an interested third party, a vendor/dealer or the full-service lessor.

If the sample unit primarily receives fees for originating or brokering a lease transaction, (not the rental/lease payments), they are "out-of-scope." Additionally, if the plurality of the sample unit's revenue falls within the category of a "third party," the establishment should be coded "out-of-scope" also.

The Vendor Program is promotional program in which a lessor provides lease financing services to the customers of a manufacturer via a vendor or dealer. Vendors and equipment lessors may form partnerships where the vendor moves product for the manufacturer via its leasing services and the lessor generates more leasing business by gaining direct access to the manufacturer's customer base and product line.

Equipment lessors that operate as a totally separate unit from the manufacturer and who provide leasing services via Vendor Program are "in-scope." This separate unit of the manufacturer must have an inter-company transfer purchase price for the leased equipment.

Following is a table, which displays the various types of equipment renters and lessors previously discussed and their appropriate establishment status for this industry.

SUMMARY: TYPE OF EQUIPMENT RENTER/LESSOR

TYPE OF LESSOR	SAMPLE UNIT STATUS
EQUIPMENT RENTAL/RENT-TO-OWN	
Independent rental dealers	In-scope
Franchise operations	In-scope
Regional/national corporations	In-scope
EQUIPMENT LEASING:	
Banks and bank holding companies	Out-of-scope
Bank affiliates or bank leasing companies	In-scope
Captive leasing companies	In-scope
Independent leasing companies:	
▪ Finance leasing companies	In-scope
▪ Service leasing companies	In-scope
Individual equipment lessor	In-scope
Lease broker	Out-of-scope
Other third parties	Out-of-scope

Service Identification

For clarification purposes, equipment rentals, rental purchases and equipment leases are distinct transactions. Even though the legal definition is similar, there are some fundamental differences in the terms and conditions of the contractual agreements, which clearly identify the type of transaction involved.

An equipment rental is a contractual agreement in which the owner (rentor/lessor) of a property transfers the rights to use the property to another person or business (rentee/lessee) under specific terms and conditions for a short period of time (hourly, daily, weekly or monthly). The rentor/lessor retains the title, rights, and interest in the property and is wholly responsible for its maintenance. Equipment rental transactions are primary to this industry if the type of equipment rented is classified as heavy construction equipment, oilfield and well drilling equipment.

The equipment rental-purchase contractual agreement is similar to the standard rental agreement in structure; however, the rentee/lessee agrees to rent the equipment on a short-term basis with the full intention of ultimately purchasing the property. The typical rental-purchase requires no credit review and the customer can take possession of the equipment at any time without further cost or obligation. Other related services made available to the customer at no additional cost include maintenance, repair and delivery of the equipment. Please note that buyers of equipment rental-purchase services are typically households; however, construction companies are now frequent end-user customers; therefore the rental purchase transaction is included in this industry.

An equipment lease is a contractual agreement between a lessor and a lessee, which allows the lessee use of the equipment, but for a much longer period of time than the standard equipment rental; usually for one or more years. It is generally accepted throughout the industry that there are two main types of leases, namely: the true lease and the finance lease.

1. The true lease (tax lease, tax motivated) is the typical leasing arrangement in which the lessor allows use of the equipment by the lessee for a specified period of time (the lease term) at a pre-determined rate (the rental rate or rental payment). Under this type of leasing arrangement, the lessor is regarded as the owner of the equipment for tax purposes but the lessee can claim the rental payments as a tax deduction. A true lease intends to provide only equipment usage and does not include a pre-determined purchase option or financing charges. The true lease qualifies as a lease (not a loan) according to the guidelines set forth in the United States Internal Revenue Code; therefore it is primary to this industry.
2. The finance lease (a.k.a. financial lease, financing lease, non-true lease; non tax-influenced) is essentially a "net" lease in which the lessor (usually a financial source) only finances the initial acquisition of the equipment. In this case, the lessor procures the equipment from the manufacturer (or dealer) and, in turn, leases the equipment to the lessee. All the insurance costs, taxes, maintenance and obsolescence risks are the responsibility of the lessee.

The finance lease is a long-term financial arrangement in which the rental payments remitted by the lessee (usually over the economic life of the equipment) are used by the lessor to recover the cost of the equipment plus any return on the investment. The lessee usually agrees, up front, to purchase the equipment for a nominal price at the termination of the contract. The United States Internal Revenue Code treats the finance lease as a "conditional sale," not a lease. The finance lease is also primary to NAICS 532412. Following is a comparison between the true and finance lease from various sources including industry periodicals and other publications.

TERMS	TRUE LEASE	FINANCE LEASE
Other Names	Operating Lease Tax Lease	Financial Lease, Nontrue Lease, Financing Lease
Tax Status	Tax motivated, i.e. the lessee can claim the rental payments as a tax deduction and the lessor can claim tax benefits accrued to owners of the property.	Non-tax motivated.
Asset Selection	The lessee selects the equipment from a vendor, dealer or the lessor's inventory.	The lessee selects the equipment from the vendor or dealer.
Asset Ownership	Ownership is retained by the lessor during and after completion of the lease.	Ownership is retained by the lessor during the base lease period, but title passes automatically at the end of the lease term or the lease contains a purchase option.
Maintenance, Insurance and Obsolescence Risks	Responsibility of the lessor.	Responsibility of the lessee.
Lease Term	Must be less than 75% of the estimated economic life of the equipment.	Usually covers 75% or more of the economic life of the equipment.
Rental Lease Payments	The accumulated rental payments must be less than 90% of the equipment's fair market value (FMV). Referred to as non-payout lease.	The accumulated rental payments are sufficient (equal to 90% or more) for the lessor to recover the full cost of the equipment plus any return on the investment. Often defined as full payout.
Residual Value	The rental payments are structured based on the expected residual value of the equipment at the end of the lease period. The lessor takes the residual value risk.	The rental payments cover the full cost of the equipment. The residual value is negligible. The lessee takes the residual value risk.
Disposal of Asset at the End of the Lease	The lessee returns the equipment to the lessor for sale or re-leasing. If sold, the lessee does not share the proceeds from the sale.	The lessee purchases the asset for a pre-determined nominal price.

Within the two broad categories of leases already mentioned are several hybrid leases such as the capital lease, the operating lease, the leveraged and non-leveraged lease, the master lease, the service lease, the single investor lease, and the tax-exempt lease. The following is a brief description of the various types of hybrid leases in this industry.

True Lease Hybrids

The master lease is a continuing lease arrangement whereby additional equipment can be added from time to time under the basic terms and conditions without negotiating a new contract. The equipment lease document is set up in two parts. The main body of the leasing agreement contains the general or boilerplate provisions such as maintenance and indemnification provisions. An annex or schedule contains the types of items that usually vary with each transaction such as the rental rates and the options.

The non-leveraged lease (unleveraged or straight lease) is an equipment leasing arrangement in which the lessor pays for the equipment with his own funds. In this type of transaction there are only two parties involved; the lessor and the lessee. Even though the lessee may prefer this type of leasing structure because of the fewer parties involved, the rent is typically higher than it would be in a leveraged lease.

The operating lease is a short-term leasing arrangement, which is treated as a true lease for accounting purposes. The lessee can deduct the lease payments as operating expenses on its "Balance Sheets." The lessor also agrees to provide additional equipment related services (other than financing) such as maintenance, repairs and technical advice. According to guidelines established by Financial Accounting Standards Board (FASB) 13, an operating lease must have all of the following characteristics: (1) the lease term must be less than 75 percent of the estimated economic life of the equipment, (2) the present value of the lease payment is less than 90 percent of the equipment's fair market value; (3) the lease cannot contain a bargain purchase option (i.e., less than fair market value); (4) ownership is retained by the lessor during and after the completion of the lease term.

A service lease is a short-term lease in which the lessor actually assumes asset ownership responsibilities such as maintenance, repair, property taxes and liability insurance. The lessor also provides the asset financing for the lessee.

The single investor lease (a.k.a. a single source lease) is the typical leasing arrangement in which the lessor retains legal title and the interest in the equipment. The lessee is allowed only the use of the equipment during the leasing term. The word "single" indicates that the owner of the equipment, which can be an individual, a partnership, or multiple owners and has not leveraged his position and is entitled to a percentage of the allowable tax write-off.

A sub-lease is a leasing transaction in which leased property is re-leased by the original lessee to a third party and the lease agreement between the two original parties remains in effect.

Finance Lease Hybrids

The capital lease is an equipment leasing arrangement which is considered a purchase by the lessee and is treated as a sale or financing transaction by the lessor, in accordance with the guidelines established by the Financial Accounting Standards Board (FASB) in FASB 13. This type of lease must meet one of the following criteria: (a) title passes automatically by the end of

the lease term; (b) the lease contains an option to purchase the equipment at a bargain purchase option; (c) the lease term is greater than 75 percent of the estimated economic life of the equipment; or (d) the present value of the lease payments is greater than 90 percent of the equipment's market value.

The leveraged lease is a form of the direct financing lease or a capital lease in which a large percentage of the funds (usually 70 percent to 80 percent) to purchase the equipment is loaned by a bank or some other financial lender. Since the lessor of the equipment provides only a small portion of the equipment's cost, its investment is considered to be leveraged. This type of lease must meet the definition criteria for a finance lease plus all of the following characteristics: (a) there must be at least three parties involved in the equipment leasing transaction - a lessor, a lessee, and a long-term creditor; (b) the financing provided by the lessor is sufficient to cover the transaction without recourse to the lessor; and (c) the lessor's net investment declines during the later years.

The net lease is a leasing arrangement in which a financial source, which purchases the equipment, passes on to the lessee all the cost, such as maintenance, certain taxes, and insurance related to using the leased equipment. These costs are not included as part of the rental payment.

The sale-type lease is a leasing contract by a lessor who is a manufacturer or a dealer. These types of leases usually have the same characteristics and structure of either a capital or a finance lease.

Tax-exempt leasing is a special lease arrangement between a lessor and a lessee who is, either a tax-exempt entity, such as the federal, state, and local government, or a non-profit organization. The lessor retains title to the property and the lessee exercises the purchase option for a nominal amount when the lease term is completed. The tax-exempt entity retains the rights to the equipment, but the interest (allowable tax deductions) is nullified because the lessee derives its income from contributory taxes. Tax-exempt leases are equivalent to finance leases, which legally are conditional sales rather than leases.

The following table summarizes all of the various types of equipment leases that are primary to this industry.

TYPE OF EQUIPMENT LEASES
TRUE LEASE:
▪ Lease agreement with ownership option
▪ Master lease
▪ Non-leveraged (unleveraged or straight) lease
▪ Operating lease
▪ Service lease
▪ Single investor lease
▪ Sub-lease
FINANCE LEASE:
▪ Capital lease
▪ Leveraged lease
▪ Net lease
▪ Sale-type lease
▪ Tax-exempt lease

E. CHECKLIST CLARIFICATIONS

The two Checklists that have been developed for collecting prices in this industry are relatively straightforward. Checklist Code A7354A should be used to collect pricing data in the equipment rental and rental-purchase sector. Checklist A7354B should be used to collect data in the equipment leasing sector.

Service identification should be an internal accounting number or code that the respondent can refer to during repricing. This code should be helpful especially in the case when a full description of the equipment rented or leased cannot be described on the checklist.

Type of equipment should be described as completely as possible (bulldozer, crane, etc.). In the case where the rental contract or the lease includes many types of equipment, use Other Features to continue to list the rented/leased equipment. A master lease will likely include many types of equipment. It is important to remember that the equipment is fixed at initiation and will continue to be repriced over time (creating a hypothetical transaction after the initiation period for many lease transactions), so an adequate description of the equipment included is imperative.

Other equipment rental/leasing services included in rental/lease payment are services that are included in the payment and cannot be priced separately. If these services are priced separately, they should be given a separate chance of selection as other receipts.

Age of Equipment Rented/ Leased should reflect the number of years old the equipment is at the beginning of the rental/ lease term.

Transaction Checklist

Type of price:

Lease payment should be used when the reporter will be providing lease payments monthly for leases where the equipment is leased for less than two years. The rental procedures will be followed in this case.

Sum of lease payments for lease term should be used for leases where the equipment is leased for two years or more and the multiyear lease procedures are used. This type of price reflects the sum of a single month's lease payment for each of the years in the lease term. For example, a three year lease would have three lease payments included in the item price. The price is not divided by the number of years the equipment is leased (three in this case).

Negotiated monthly rental/lease payments are preferable to average or book (list) prices.

F. INDUSTRY SPECIFIC QUESTIONS AND PROCEDURES

A preliminary sample refinement was conducted at the national office level; however, further refinement may be necessary at the regional level (See the Service Identification Problems Section). To the extent possible, the Field Economists should determine if the sample unit is in-scope by considering the following additional verifications during Step #1 of the sample unit refinement process:

- Verify that the primary output, i.e., the type of construction equipment rented and/or leased is primary to this industry and that the equipment is provided without the use of operators.
- Verify that the establishment has asset ownership, i.e., holds the title to the property rented or leased during the primary phase of the contract.
- Verify the type of lessor. (See Service Identification Problems section for a description of those renters and lessors that are classified in NAICS 532412.
- Verify that the establishment is not a broker, originator (only), or a third party to the equipment rental or leasing transactions.
- If the establishment is a vendor or dealership, verify that the revenue or a major portion of the revenue, from rental/leasing transactions is not transferred to the manufacturer.
- If the establishment is a bank affiliate leasing company, verify that it operates as a subsidiary of the parent bank, has a separate profit maximizing center and does not accept deposits or make loans to other establishments or individuals.

- Verify that the establishment receives the rental payments for the equipment rental and leasing transactions.

When determining industry classification, the revenue from existing equipment rental and leasing contracts (awarded prior to the reference period) should be included in addition to revenue from contracts awarded during the reference period (new business volume).

SAMPLE UNIT IDENTIFICATION

The following three examples are provided to illustrate some of the unusual sample unit identification issues in this industry. They outline the collection system entries and any unusual ISDWS (Industry Specific Disaggregation Worksheet) entries that would need to be made in these particular situations.

Each example contains information that would be provided by the reporter. Section A (see detail below) contains the revenue breakdown that is primary to Construction Equipment Rental and Leasing grouped by ISDWS category. Section B (see detail below) contains all other revenue for the sample unit (which has been grouped by NAICS code).

If the Section A total is greater than every individual NAICS code (except in the case of retail trade mentioned below) found in Section B, the sample unit has a plurality of revenue in NAICS 532412 and will be collected in Construction equipment rental and leasing.

A. Primary Industry:

NAICS 532412 has 4 categories of services:

- Construction equipment rental, without operators
- Construction equipment leasing, without operators
- Oilfield & well drilling equipment rental, without operators
- Oilfield & well drilling equipment leasing, without operators

The reporter will be able to give a revenue break down (by percent or an actual revenue figure) as to what part of their business is comprised of these services.

B. Other Industries:

The reporter will also detail the portion of the establishment's revenue that is not primary to NAICS 532412. These percentages/figures need to be grouped by NAICS industry.

Example #1:

A. Primary Industry:

- Construction equipment rental, without operators: **10%**
- Construction equipment leasing, without operators: **10%**
- Oilfield & well drilling equipment rental, without operators: **10%**
- Oilfield & well drilling equipment leasing, without operators: **10%**
- Total: 40%**

B. Other Industries:

- NAICS 441310 (Retail sale of Automotive parts and accessories): **25%**
- NAICS 532420 (Office furniture rental and leasing): **35%**

Collection System Entries:

Product/Service	NAIC	S&R	Rank	%
Construction Equipment Rental and Leasing	532412			40
Retail of Auto parts and accessories	441310			25
Office furniture rental and leasing	532420			35

Collected SIC: 7354

Collected NAIC: 532412

Because the Section A **total** is greater than either individual industry total in section B (40% compared to 25% and 35%, respectively) then this sample unit **has a plurality of revenue** in the primary industry (NAICS 532412) and will be collected in this industry.

Example # 2:

A. Primary Industry:

- Construction equipment rental, without operators: **25%**
- Construction equipment leasing, without operators: **0%**
- Oilfield & well drilling equipment rental, without operators: **0%**
- Oilfield & well drilling equipment leasing, without operators: **0%**
- Total: 25%**

B. Other Industries:

- NAICS 441310 (Retail sale of automotive parts and accessories): **15%**
- NAICS 441320 (Retail sale of tires): **15%**
- NAICS 532420 (Office furniture rental and leasing): **20%**
- NAICS 532120 (Truck, utility trailer and RV rental and leasing): **15%**
- NAICS 532210 (Consumer electronics and appliances rental): **10%**

On the surface, this example looks like the first example. The important difference is that **all retail trade industries** (Sector 44-45) must be combined when determining in which the sample unit is classified.

[**Note:** this is because automotive parts and accessory stores may sell tires and tire stores may sell automotive parts and accessories, so it is not possible to determine which retail trade industry they belong in based solely on the products that are retailed.]

Collection System Entries:

Product/Service	NAIC	S&R	Rank	%
Retail Trade	441310			30
Construction Equipment rental	532412			25
Office furniture rental and leasing	532420			20
Truck, utility Trailer and RV rental and leasing	532120			15
Consumer electronics and appliances rental	532210			10

Collected SIC: 5531

Collected NAIC: 441310

Since this SU has a plurality in retail trade, the usual trade designation (i.e. the sample unit determined retail industry) must be obtained from the reporter (This example assumes that the reporter designated this sample unit as NAICS 441310, Automotive parts and accessories stores). Normal DCM procedures must then be followed to determine whether this misclassified sample unit should be collected.

In sum, this sample unit **does not have plurality** in NAICS 532412 and **should not be collected** in Construction Equipment Renting and Leasing.

Example # 3: (Asset Securitization)

A. Primary Industry:

- Construction equipment rental, without operators: 20%
- Construction equipment leasing, without operators: 5%
- Oilfield & well drilling equipment rental, without operators: 0%
- Oilfield & well drilling equipment leasing, without operators: 0%
- Fees received for collection of lease payments for leases sold: 1%

Total: 26%

B. Other Industries:

NAICS 532292 (Recreational goods rental): 20%

NAICS 532420 (Office machinery and equipment rental and leasing): 20%

Sale of leases to banking institution for eventual asset securitization: 34%

As mentioned earlier, the sale of assets (both physical assets, such as previously rented or leased equipment, and financial assets, such as leases) should not be included in total revenue when determining the industry classification of the sample unit. Therefore, only 66% of this sample unit’s revenue is recorded in the S&R section on the facesheet. The collection system entries shown below (which must add to 100%) take this into account.

Collection System Entries (rounded):

Product/Service	NAIC	S&R	Rank	%
Construction equipment rental and leasing	532412			40
Recreational goods rental	532292			30
Office machinery and equipment rental and leasing	532420			30

Collected SIC: 7354

Collected NAIC: 532412

That means that this SU does have plurality in NAICS 532412 and should be collected in the Construction Equipment Renting and Leasing industry.

Important note for completion of the ISDWS: While the revenue received from the sale of assets is not included in total revenue when determining industry classification, the sample unit may still be collecting monthly lease payments for assets that have been sold for securitization. Even though another entity owns the asset (the lease), the sample unit retains some revenue for collecting the monthly rental payments and providing other typical leasing services for the leases that were sold. The total fees that the sample unit receives from the collection of monthly lease payments should be included in the total S&R entries (see above) and should be given a chance of selection during disaggregation for this sample unit. The total amount of revenue retained by the sample unit for this activity is expected to be very small.

Continuing with this example, the reporter explains that he is collecting the monthly leasing payments for all of the leases that he sold during the last calendar year. The fees amount to one percent of his total revenue and all of the leases sold were for heavy construction equipment. The FE must determine which ISDWS category is appropriate for this retained revenue. In this example, the one percent would be included in the revenue reported in the Construction Equipment Leasing, without operators, category on the ISDWS.

PROCEDURES FOR THE COLLECTION OF ITEMS

- The revenue from existing equipment rental and leasing contracts (awarded prior to the reference period) should be given a chance of selection in addition to contracts awarded during the reference period (new business volume).
- The ISDWS must be completed for all sample units. In addition to serving as the first step of disaggregation, this data will be used by our Statistical Methods Division to post stratify the sample.
- If the establishment operates from multiple locations, next select a rental/lease location by state and city.
- Identify and/or select the type of primary service (rental or rental purchase or lease)

Rental Procedures

If a rental transaction is selected, the procedures are fairly straightforward. Have the respondent choose a representative rental transaction (further disaggregation steps would include rental term and type of equipment rented) and complete the applicable fields on Checklist A. Collect the rental payment that corresponds to the rental term and equipment specified and enter it into the Item Price.

Leasing Procedures

After disaggregation using the ISDWS categories (construction equipment rental, construction equipment leasing, oil field and well drilling equipment rental, and oil field and well drilling equipment leasing) is complete, the next step of disaggregation for leases is the length of the lease. (What percent of leases are 1 year, 2 year, 3 year, 4 year, etc.?) All leases that the sample unit is currently collecting rental or lease payments for should be given a chance of selection. For leases whose rental term is less than two years, follow the rental procedures. For leases whose lease term is two years or more, see the background information and follow the procedures below.

A new methodology that takes reporter burden and quality adjustment concerns into consideration has been developed for collecting long term (or multiyear) leases. Some background information discussing the reasons for this alternate pricing strategy is provided.

Background

One aspect of leasing that requires special procedures is the industry's use of multiyear leases. The revenue that the companies in the industry receive every month may represent current month rental receipts, current year lease receipts, and payments from leases that were contracted in past years. This revenue from multiyear leases is NOT just deferred payment from the point at which the lease was contracted. There is a continued flow of services every month under the multiyear leases. The current month payment on a multiyear lease is payment for the current service provided for the long-term lease for that month. Therefore, the pricing strategy gives the service represented by the current month lease payment on a multiyear lease a chance of selection.

One strategy would have been to price the lease payment for a specified month during a long-term lease (for example, the 15th month of a 36-month lease). However, in order to be representative of the price movement in this leasing industry, this strategy would require a large number of sample units and a large number of items from each sample unit. This strategy would also require monthly repricing. The pricing methodology that is employed for this industry (outlined in the procedures that follow) has been developed to reduce this potential reporter burden. The type of price collected represents a multiyear average.

Another problem with multiyear leases is quality adjustment. Changes in the equipment from year-to-year should not be reflected as price change but rather quality changes in the service provided. However, changes in the **cost** of the equipment leased without changes in the actual equipment should be reflected as price change. The pricing methodology for multiyear leases addresses this quality adjustment problem.

As an illustration of the solution to the quality adjustment problem, suppose a three-year lease is selected. During the initiation visit, the reporter supplies the initial monthly lease payment, the original equipment cost and the date of the lease start. For the most recent two years, the respondent provides an estimate of what it would have cost to acquire the equipment in that month and year. As a fallback the equipment cost can be estimated using the annual average of the PPI for Construction Equipment (or some other index that the reporter deems more appropriate). The reporter will then provide the calculated monthly lease payment using the adjusted equipment cost. At repricing (only once a year in the same month as the lease start, known as the anniversary date), the reporter will provide the current lease rate/monthly rental payment (for a 3-year lease) using their current year estimate of the equipment cost for the selected type of equipment. Every year, the oldest year's data will be deleted prior to repricing such that the actual price used in the PPI will be the sum of the most recent three years monthly rental payments. By adjusting the value of the equipment using an appropriate PPI index (which, by definition, only includes the price change and specifically excludes any changes in the quality of the equipment), further quality adjustment is not necessary.

Procedures for Collecting Multiyear Leases

For leases that have a lease term of two years or more, collect leases that have anniversary dates spread throughout the year. Use the following methodology to collect each multiyear lease.

Collect a single representative lease and describe additional price-determining characteristics such as:

- Type of lease
- Lease term (number of years)
- Origination date of the lease (month and year)
- Purchase option (if applicable)
- Exact type and quantity of equipment
- Actual cost or cost range for the equipment
- Age of the equipment (new or used; if used, number of years old)
- Characteristics of the equipment
- Any additional services included in the rental payment

Record the equipment cost and the monthly lease payment in the appropriate column of the “Summary of Rental Payments” columnar data chart. This data should be recorded for the year and month that the lease started. This data, therefore, may not be for the current year. Complete the Equipment Cost column for the current year and every year prior to that until you have data for the same number of years as the length of the lease. (If initiation of a five-year lease occurred in 2002, then you would have data for 1998-2002).

Note: If the respondent is unable to estimate either the equipment cost or all past monthly rental payments, get as many years as they can provide.

For leases with a lease term of more than five years, only the latest five years of data is necessary. The respondent should estimate the equipment costs for previous years when computing the monthly lease payment for those years. This estimate should include equipment cost changes that do not include price changes due to model year upgrades or other changes in the actual physical equipment.

Fallback Methodology

As a fallback, the Field Economist may use the appropriate adjustment factors (calculated using the percent change in the annual averages of the Producer Price Commodity Index for Construction Machinery and Equipment - Commodity Code 112 – Not seasonally adjusted) provided in the table below to adjust the equipment cost. This index covers a very broad range of equipment and is provided to ease data collection. Any index that is more specific to the actual equipment leased may be used. Also, the actual index for the month and year of the lease can be used (and is preferable) instead of the annual average.

Use the Adj. factor n+1 column to adjust equipment costs from the lease start date forward and use the Adj. factor n-1 column to adjust for any year prior to the lease start date.

Note: Because the annual average for the current year (i.e. the year that the sample unit is initiated) has not been calculated yet, (for repricing, there will also never be an annual average for the current year) the % change in the annual average and the adjustment factors for year n reflects the % change from n-2 to n-1. For example, the 2.8% change listed for 1993 reflects the actual percent change in the annual average from 1991 to 1992. This illustrates the drawback resulting from using annual averages.

YEAR	ANNUAL AVERAGE	PERCENT CHANGE	ADJUSTMENT FACTOR N+1	ADJUSTMENT FACTOR N-1
1991	125.2			
1992	128.7			
1993	132.0	2.8	1.028	.973
1994	133.7	2.6	1.026	.975
1995	136.7	1.3	1.013	.987
1996	139.8	2.2	1.022	.978
1997	142.2	2.3	1.023	.978
1998	145.2	1.7	1.017	.983
1999	147.2	2.1	1.021	.979
2000	148.6	1.4	1.014	.986
2001	149.1	1.0	1.010	.990
2002		0.3	1.003	.997

Example of the Fallback Leasing Methodology

For a five-year lease that began in January 2000, enter the original equipment cost from the reporter (\$20,000) and the monthly rental payment (\$500) for that month and year. Then fill in the equipment costs (FE required entries are denoted in bold below) for 1997-1999, and 2001 adjusting the original equipment cost by the equipment cost estimate provided by the respondent (or as a fallback by the appropriate adjustment factors provided above).

The formula for this adjustment is:

- Equip. cost for year n+1 = Equipment cost for year n * Adj. factor n+1
- Equip. cost for year n-1 = Equipment cost for year n * Adj. factor n-1

MONTH/YEAR	EQUIPMENT COST	MONTHLY LEASE PAYMENT
01/01	\$20,200*	?
01/00	\$20,000	\$500
01/99	\$19,580**	?
01/98	\$19,247	?
01/97	\$18,824	?
Total		?

*\$20,000 x 1.01

** \$20,000 x .979

The reporter must fill in the monthly lease payments for previous years (denoted by a “?”) using the adjusted equipment cost in their formula (the lease payment is calculated by multiplying the company-specific rate factor by the equipment cost). The FE must then total the five monthly lease payments creating what will be used as the item price in the PPI. (Same index effect as averaging).

This methodology yields the equivalent of an average lease payment received by the lessor. The same concept is used in SIC 6512 where average rent per occupied square foot is the price. The average rent is calculated from leases that were started in various years. Pricing five years of rental payments for a five-year lease gives an average price for five-year leases.

Additional Procedures for Specific Lease Types

Some leases have more than one lease payment associated with the lease contract. In this case, disaggregate or judgmentally select only one lease payment and its associated equipment.

Interim rent (lease) payments could be charged to a customer. If the interim rent (lease) payment is a different amount than the monthly lease payment, do not collect interim rent (lease) payments.

Master leases are described in the Service Identification Problems section. In this type of continuing lease arrangement, additional equipment can be added to the lease at any time. It is important to fix the equipment included in the lease at a point in time and describe this equipment on the checklist (use “Other Features,” if necessary). For repricing, instruct the respondent to estimate their monthly lease payment based only on the fixed set of equipment.

Repricing for Multiyear Leases

Repricing will be done annually for each lease item on the anniversary date of the start of the lease. “M” should be entered for the repricing cycle for the month of the lease start and “O” (off-cycle) should be entered for the remaining months. Be aware that this will cause a warning

in the collection system. Please submit the data with this warning. The Washington Office will change the mail flag to “N “(not mailed) for the months that the schedules should not be mailed. Note: The off-cycle flags will remain on each schedule for two months after the anniversary date such that the schedules will be mailed for those two months if the reporter does not return the form before the end of the anniversary month.

Collecting leases with anniversary dates spread throughout the year and pricing only on the anniversary date of the lease will reduce reporter burden and should spread the maintenance load of the IA throughout the year. Depending on the length of the lease, several years of data will be used to calculate the price. Every year the Washington Office will create a line in the Item Specification (at the beginning of the columnar data used to calculate the average price) where the respondent will be asked to:

- enter their estimate of the current year equipment cost and
- calculate a current monthly rental payment.

The oldest year’s data will have already been deleted. The equipment cost estimate that the respondent provides will vary every year with inflation/deflation but otherwise will be held constant since the description of the equipment is kept as a frozen or fixed specification.

The following is an example of what the reporter would see in January 2002 repricing for a five-year lease. The reporter will only be required to fill in the missing data (current lease payment and total).

MONTH/YEAR	EQUIPMENT COST	MONTHLY LEASE PAYMENT
01/02		
01/01	\$20,200	\$505
01/00	\$20,000	\$500
01/99	\$19,580	\$490
01/98	\$19,247	\$470
Total		

After reporter completion:

MONTH/YEAR	EQUIPMENT COST	MONTHLY LEASE PAYMENT
01/02	\$20,261	\$510
01/01	\$20,200	\$505
01/00	\$20,000	\$500
01/99	\$19,580	\$490
01/98	\$19,247	\$470
Total		\$2475

The Item price used by the PPI would be \$2475.

H.

PUBLICATION GOALS

Producer Price Index Revision

NAICS 532412, CONSTRUCTION EQUIPMENT RENTAL AND LEASING

(SIC 7354A1 has been loaded into the Collection System to represent this NAICS Code.)

<u>PPIR Code</u>	<u>PIR Title</u>	<u>Continuation Code</u>
7354	Construction equipment rental and leasing, without operators	
7354P	Primary services	
73541	Construction equipment rental	
73542	Construction equipment leasing	
73543	Oilfield & well drilling equipment rental	
73544	Oilfield & well drilling equipment leasing	
7354SM	Other receipts	
7354M	Miscellaneous receipts	
7354MM	Miscellaneous receipts	
7354S	Secondary services	
7354SS	Secondary services	

GLOSSARY OF EQUIPMENT RENTAL AND LEASING TERMS

Accelerated Cost Recovery System (ACRS) - The depreciation schedule established by the Economic Recovery Act of 1982, which allows accelerated write-offs of equipment capital. It replaced the asset depreciation system, which was based on the concept of useful life.

Add-On - A leasing transaction in which related equipment is added to an existing lease.

Advance Payment (Rental) - Payments made by the lessee prior to the start of the lease or before actual use of the equipment.

Amortization - A method of incrementally reducing the book value of an asset by spreading its depreciation over a period of time.

Annual Percentage Rate (APR) - The nominal or effective rate of interest applied to a rental or lease for a specified period of time.

Assignment - a provision in the lease agreement allowing the lessor to transfer the contract to another party by "assignment."

Bargain Purchase Option - A provision of a lease, which allows the lessee to purchase the leased equipment below market value at the end of the lease.

Bargain Renewal Option - A provision that provides the lessee the option to renew a lease for equipment with rental payments much lower than the fair market value.

Base Lease Term - The period of time that the lessee is entitled to use the equipment. It does not include interim or renewable lease terms.

Base Rental - The rental payment to be made by the lessee during the base (primary) term of the lease.

Book Residual Value - An estimation of an asset's market value at the end of a lease term, which is determined by the Internal Revenue Service codes based on the type of lease. The remaining salvage value at the end of the lease is the equipment's residual value.

Broker (syndicator/underwriter) - An individual or a company who arranges a lease transaction between a prospective lessor (owner of property) and a lessee (user of property) for a fee, which is usually expressed as a percentage of the property (asset) value.

Call - A provision in the equipment leasing agreement, which gives the lessee the right to purchase the equipment during a specific time at a predetermined price. The purchase option may lapse if the lessee doesn't meet the notification time requirements to purchase as stated in the lease.

Casualty Value (Insured Value) - A pre-determined amount of money that the lessee guarantees to pay the lessor in the event the leased equipment is damaged or lost. The value, which is usually expressed as a percentage of the original equipment cost, varies according to the point in time during the lease term when the loss actually occurs.

Collateral - The asset(s) that are used as security for the repayment of a debt obligation. In a typical leveraged lease, the collateral is the leased equipment.

Conditional Sale (a.k.a. security agreement) - A transaction for purchase of the leased property (purchase option) at the expiration of the lease term for a bargain price. The purchase price is pre-determined and the user (lessee) is treated as the owner of the equipment at the outset of the transaction for income tax purposes.

Cost of Money - The cost that a lessor incurs to borrow money. In pricing a lease transaction, a lessor factors this cost into the computation.

Cost-To-Customer - The simple interest rate on a lease transaction.

Coterminous - Two or more equipment leases that are linked so that both will terminate at the same time.

Debt Payment - A long-term lender in a leveraged lease transaction. Usually there is more than one debt participant in these types of equipment leasing arrangements.

Debt Service - The aggregate periodic repayment amount, including interest and principal due on a loan.

Default - Occurs in an equipment lease transaction when a party involved breaches certain material lease obligations, most commonly a delinquent payment.

Delivery and Acceptance - The document in an equipment lease transaction, which indicates the lessees' acceptance of the equipment and begins the term of the lease.

Depreciation - A tax deduction representing a reasonable allowance for exhaustion wear, tear, and obsolescence that is taken by the owner of the equipment in which the cost of the equipment is allocated over time.

Depreciation Indemnity - A tax indemnity given by a lessee against the lessor's loss of anticipated depreciation tax benefits on leased equipment.

Economic Life of Leased Property - The estimated remaining period during which an asset is expected to be economically usable by one or more users. It is used: (a) for purposes of calculating the maximum allowable term of a tax lease; (b) for determining whether or not a lease is a capital lease; and (c) to determine the method of depreciation for a capitalized leased asset. It may or may not be the same as the life used for income tax purposes.

Effective Lease Rate - The effective lease rate (for the lessee) of the cash flows resulting from a lease transaction. When comparing this rate with a loan interest rate, a company must include in the cash flows any effect the transactions have on federal tax liabilities.

Equipment supplier (vendor) - The seller, manufacturer or dealer of the equipment to be rented or leased.

Equity Participant (Owner Participant, Trustor Owner or Grantor Owner) - The lessor or one of the group lessors in a leveraged lease who jointly own and lease the equipment. Equity participants hold trust certificates evidencing their beneficial interest as owners under the owner trust.

Event of Default - An event, such as non-payment of rent under a leasing agreement, which provides the basis of declaration of default. The lessor has the right to declare the lease in default, terminate the base, and reclaim the equipment.

Extended Term Agreement - In a lease transaction, a provision, which allows the lease to be renewed.

Fair Market Purchase Option - A provision in a leasing agreement, which allows the lessee to purchase the leased property at the end of the lease terms at its fair market value. The lessor does not have the ability to retain title to the equipment if the lessee chooses to exercise the purchase option.

Fair Market Value (Fair Market Purchase Option) - an asset's value in the open market, i.e., the price a buyer is willing to pay to a willing seller for the equipment "as-is" at the maturity of the lease.

Fair Market Rental Value (Fair Rental Value) - The rental rate that an asset would command in the open market where there is a willing lessor and lessee.

Fair Rental - The expected rental for equivalent property under similar terms and conditions.

FASB - The Financial Accounting Standards Board.

FAS Statement No. 13, Accounting For Leases - The statement issued by the Financial Accounting Standards Board, which establishes financial accounting standards for lessors and lessees. Also, establishes the guidelines for determining whether a lease is an operating or capital lease for the lessee's purposes.

Financing Agreement (Participation Agreement) - An agreement entered into by the principal parties to a leveraged lease before equipment delivery. It is an agreement between the owner trustee, the lenders, the equity participants, the manufacturer, and the lessee, which spells out the obligations of all the parties involved in the leveraged lease.

Floating Rental Rate - A form of periodic rental payments that change or float upward and downward over a lease's term. Floating rates may be adjusted in proportion to the prime interest rate or the commercial paper rate changes during the term of the lease.

Grantor Trust - A trust used as the owner trust in a leveraged lease transaction usually with only one equity participant. If there is more than one equity participant, the grantor trust is treated as a partnership.

Guaranty (Personal/Corporation/Other) - Business owners (especially in the case of proprietorships, partnerships, closely held corporations and small businesses) may be required to personally guarantee a leasing transaction. If the business is a subsidiary or owned wholly, or in part, by another company, then the "parent" company may be required to guarantee the leasing transaction.

HTG Yield - Refers to the so-called "Honest to God" yield.

Hell-or-High-Water Clause - the clause in a lease, which stipulates the unconditional obligation of the lessee to pay rent for the entire of the lease, regardless of any event affecting the equipment or any change in the circumstances of the lease.

High-Low Rental A rental structure in which the rental payments are reduced from a higher to a lower rate at a prescribed point in the lease term.

Implicit Cost - The nominal annual interest rate implicit in the basic lease payments. It is the interest that discounts the lessee's payments to 100 percent of the equipment's cost at the lease commencement date.

Incremental Borrowing Rate - The interest rate, which a person would expect to pay for a certain loan at a certain time for purchase of the leased asset.

Indemnity Agreement - An agreement in which the owner participants in a leasing transaction and the lessee indemnify the trustees from any liability as a result of ownership of the leased equipment.

Indemnity Clause - In a leasing agreement the indemnity clause usually refers to the tax indemnity clause in which the lessee indemnifies the lessor from loss of tax benefits.

Indenture Trust - An agreement in a leveraged lease transaction between the owner trustee (the lessor's representative) and the indenture trustee (the lender's representative) in which the owner

trustee grants a lien on the leased equipment, the lease rents, and other lessor contract rights as security for repayment of the outstanding equipment loan.

Indenture Trustee - In a leveraged lease, the indenture trustee holds the security interest in the leased equipment for the benefit of the lenders.

Initial Direct Costs - Direct costs incurred by a lessor in negotiating and consummating a lease such as commissions and legal fees.

Institutional Investors - Entities such as banks, insurance companies, trusts, pension funds, foundations, educational, charitable and religious organizations which invest in lease transactions.

Insured Value - See casualty value.

Interest Rate Implicit In a Lease - The discount rate which, when applied to the minimum lease payments, causes the aggregate present value at the beginning of the lease term to be equal to the fair value of the lease minus any investment tax credit retained by the lessor and expected to be realized.

Interim Rent - It is sometimes preferable that the base term begins on the same date for all or a certain group of units in order to facilitate rental payments or so that all of the units come off the lease at the same time. When this feature is used, a charge is made for the use of the unit from its "in-service" date (delivery date) until the date when the base term begins. The interim rate may be the daily equivalent of the base rental rate or some other charge.

Interim Lease Term - The lease term period between the lessee's acceptance of the equipment for lease and the beginning of the primary or base lease term.

ITC - Investment Tax Credit.

ITC Indemnity - A type of indemnification in which the lessee commits to reimburse the lessor for any financial loss incurred through the loss of all or any of the anticipated investment tax credit (ITC). If the lessor has passed through the ITC to the lessee, the lessor may have to give the indemnity.

ITC "Pass-Through" - An election made by the lessor to treat the lessee as the co-owner of the leased equipment for tax purposes. After the election, a lessee can claim the investment tax credit on the equipment covered only by the election.

Layoff - The sale by a lessor of its interest in the lease agreement including the ownership of the leased equipment and the right to receive the rent payments.

Lease (Lease Agreement) - A contract in which an equipment owner transfers the equipment use to another person, business or entity subject to specific terms and conditions for a prescribed period of time and rental rate.

Lease Factor - A multiplier that is used against the total cost of the equipment to yield the lessee's rental payment.

Lease Line (Lease Line of Credit) - A present commitment by a lessor to lease specified equipment to be delivered in the future.

Lease Rate (Rental Payment) - The periodic rental payment made by the lessee to the lessor (owner) for use of the property according to the terms and conditions of the leasing agreement. Another definition of the lease rate is the implicit interest rate in minimum lease payments.

Lease Schedule - An addendum to the master lease agreement describing the leased equipment, rentals, and other terms applicable to the equipment use.

Lease Term - The fixed, non-cancelable term of the lease. It includes all periods covered the fixed-rate renewable options for tax purposes.

Lessee - The user (lessee) of the equipment being leased who is obligated to pay the rentals to the asset owner (lessor) and who is entitled to use and possess the leased equipment during the lease term.

Lessor - The owner (lessor) of the equipment who has the legal or tax title to the equipment and who grants the lessee the right to use the equipment for the lease term. The lessor is entitled to receive the rental payments.

Level Payments Equal payments over the term of the equipment lease.

Leverage - An amount borrowed. The equipment lease is sometimes referred to as "100 percent leveraged" for the lessee; however, in a leveraged lease, the debt portion of the funds used to purchase the asset represents leverage of the equity holder.

Limited Use Property - Leased equipment that will be economically usable only by the lessee or a member of the lessee group at the end of the lease term because of its immobility or unique aspects. The US Internal Revenue Service will not rule that a lease is a true lease where the leased equipment is limited use property.

Low - High Rental - A rental structure in which the payments are increased from a lower to a higher rate at a prescribed point in the lease term.

Low-Ball Bid - A bid to perform a lease transaction purposely priced below market price or with terms not acceptable from a tax or accounting standpoint. The purpose is to renegotiate for a higher price and/or more expensive terms at a later date once the bid is awarded and the low-ball bidder and the other interested lessors are no longer available. Typically, the low-ball bidder raises the price when it is too late for the lessee to seek other equipment leasing sources.

Management Agreement - A contract in which one party agrees to manage a lease transaction during its term, including, for example, rental payment processing and equipment disposal.

Management Fee - A fee that a lease transaction manager receives for service performed under a management agreement.

Minimum Investment - For a leveraged lease to be considered a "true" lease, the lessor must have a minimum "at risk" investment of at least 20 percent in a lease when the lease begins; when it ends; and at all times during the lease term.

Packager - A name used to describe the leasing company, investment banker or broker whom arranges a leveraged lease for a third party.

Present Value - The discounted value of a payment or stream of payments to be received in the future, taking into consideration a specific interest or discount rate. Present value represents a series of future cash flows expressed in today's dollars.

Product Liability - The issue of liability that the lessor has when: (1) the product (equipment) doesn't live up to the performance standards promised by the vendor; (2) or the possibility of a claim from the misuse of the equipment by a third party; (3) or the question of liability from an accident or destruction of property by the leased equipment.

Purchase Option - A provision in a leasing agreement, which gives the lessee the option to purchase, leased equipment at the end of the lease term. In order to protect the tax characteristics of a true lease, an option to purchase the property from the lessor cannot be at a price less than its fair market value at the time the option is exercised.

Primary Lease Term - See base lease term.

Primary Letter Ruling - A written opinion that the US Internal Revenue Service (IRS) issues in response to a taxpayer's request. The letter sets out the IRS's position on the tax treatment of a proposed transaction. In order for the IRS to issue a favorable private letter ruling in a leveraged lease transaction, the request must comply with the IRS's guidelines regarding a true lease.

Put - An option that a lessor may have to sell specified leased equipment to the lessee at a fixed price at the end of the initial lease term. The "put" is usually imposed to protect the lessor's residual value assumption. Care must be taken when a lessor negotiates a "put" with a lessee because the "true" lease characteristics of the transaction may be destroyed. Also, a lessor may negotiate a "put" to a third party as a hedge against future losses on the sale of the residual.

Related Parties - In accordance with Financial Accounting Standards No.13, related parties in a lease transaction could be a parent company and its subsidiaries, an owner and its joint ventures, and an investor and its investees provided they have the ability to exercise significant influence

over the financial and operating policies of the related party. Under the US Internal revenue Code, 50 percent ownership is a general test for a related.

Renewal Option - An option frequently given to a lessee to renew the lease term for a specified rental rate and time period. If this is done improperly, it may be subsequently ruled that the lease is not a "true" lease; with the tax advantages lost and the possibility that the tax indemnity clauses might be activated.

Residual (Residual Value) - The value of equipment at the conclusion of the lease term. To qualify the lease as a "true" lease for tax purposes, the estimated residual value at the end of the lease term must equal at least 20 percent of the original cost of the equipment.

Return on Investments (The yield) - The interest rate earned by the lessor in a lease, which is measured, by the rate at which the excess cash flows permit recovery of the investment. The rate at which the cash flows (not needed for debt service or payment of taxes) amortize the investment of the equipment investor.

Right of First Refusal - If a lease contains a right of refusal, the lessor retains the right to continue ownership of the equipment, at the end of the lease term. The lessor is under no obligation to sell the equipment, but if the lessor offers the equipment for sale at a stated price, the lessee then has the right of first refusal to purchase the equipment or refuse the offer.

Sale-Leaseback - A transaction, which involves the sale of property by the owner to the lessee, who, in turn, leases the property, back to the seller.

Security Agreement - An agreement between the owner trustee and the indenture trustee in which the owner trustee assigns title to the equipment, the lease, and the rental payments under the lease as security for the amount due to the lenders.

Sinking Fund - A fund frequently established by the lessor in leveraged lease transactions to accumulate funds to pay for future taxes.

Sinking Fund Rate - The interest rate that a sinking fund is set to earn on accumulated funds. It is calculated as a percentage of the income used to establish the reserve.

Special Purpose Property - Property which is uniquely valuable to the lessee and not valuable to anyone else, except as scrap.

Spread - The difference between two values. In lease transactions, the term generally is used to describe the difference between the lease interest rate and the interest rate on the debt.

Stipulated Loss Value - See casualty value.

Termination Option - An option which allows the lessee to terminate a lease during the lease term for a predetermined value if the equipment becomes obsolete or surplus to the lessor's

needs. The lessor usually requires the lessee to sell the equipment to an unaffiliated third party and the lessee must pay the lessor any amount from the proceeds of the sale less than the termination value. Typically, any excess sales proceeds go to the lessor.

Termination Schedule - When the lease contains a provision which allows it to be terminated because the equipment becomes obsolete or is no longer needed, the equipment must be sold or transferred to another party unconnected to the lease. The liability of the lessee is set forth in the termination schedule.

Trustee - A bank or trust company, which holds title to or a security interest in a leased property in trust for the benefit of the lessee, lessor, and/or creditors of the lessor. A leveraged lease often has two trustees: the owner trustee and the indenture trustee.

Unguaranteed Residual Value - The portion of a residual value "at risk" for a lessor in the yield computation, i.e., for which no party is obligated to pay.