Dynamic Chiropractic

YOUR PRACTICE / BUSINESS

Financing Commercial Equipment

As your practice expands and matures, you may experience the need to update or replace old equipment. You may spend hours deciding and evaluating not only which type of equipment is best for your practice, but also how you acquire it. Do you pay cash, use your line of credit, a term loan, a lease, or does it really make a difference? Yes, it does. It will affect your cash flow, taxes, net profit and financial statements.

The first choice a doctor has is to pay cash for the new equipment. If the cash reserves aren't there, the second option is to use a line of credit. This is typically a bank loan secured by accounts receivable, inventory, furniture and fixtures, and sometimes real estate. It usually has a term of one year in which the principal balance goes up or down with the practice's day-to-day cash requirements. The borrower is usually billed monthly for interest only. Its purpose is to help supply working capital to reduce a practice's peaks and valleys in cash flow.

A third option is a term loan. This is usually secured by a specific piece of collateral with a term of six months to 120 months depending on the collateral and the lender. Most lenders require a 10-50% down payment, monthly principal and interest payments.

A lease option is similar to a term loan, as the equipment desired is the collateral and monthly payments are made for a specific term (6-120 months). However, leasing allows use of the equipment without ownership or down payment. If owning the equipment is desirable, usually that option exists at the end of the lease.

Now let's analyze how each process may affect your practice. If you choose to pay cash for a piece of equipment, you have no monthly payments or interest expense, but you have depleted your cash flow or reserves by that amount. Your asset, cash, has been changed to a fixed asset. The equipment may be depreciated according to IRS policy and requirements.

If you borrow the money from your line of credit and borrow 100% of the equipment cost, you are usually billed monthly interest only. However, you are using funds designed for working capital. When a doctor does this, one or two scenarios follow: The practice may require those funds in the future for working capital (payroll, inventory, insurance, rent) but it won't be available; or the equipment is exhausted (worn out) and the principal balance has not been paid off. The accounting is handled the same way as paying cash, except you expense your interest cost. Obviously, this can be a poor choice.

Suppose you decide to use a term loan for equipment. Depending on the lender, you may pay a required down payment of 10-50%, thus depleting cash flow or cash reserves from your practice. The balance would be paid in equal monthly principal and interest payments. The accounting is handled the same way as using a line of credit.

If you would decide to lease equipment with an option of ownership, you would typically pay the first (and sometimes the last) month's payment in advance. This would deplete your cash by one or two payments, which could equal less than five percent. The payments would be a little higher than the term loan due to 100% financing, however, this method requires the least amount of cash.

Many leases can be off-balance sheet financing, which means it is not necessary to show it on the balance sheet. The monthly payment is shown as an expense on the income statement and footnoted in the financial statements. When equipment is leased, your practice has several options concerning how it is accounted for with the Internal Revenue Service. The purchase option can affect the proper and legal procedure, so advice from a competent CPA is recommended.

Cash flow and liquidity are of the utmost importance to all lenders and borrowers. Due to the current dilemma in the various lending industries, creditors (lenders) are looking closer at borrowers, which makes it necessary for all entrepreneurs to evaluate and analyze their alternatives.

These definitions are general and basic. However, there are many creative variations to all of the above financing products. Obviously, one process is not the best for every practice or even every acquisition. It is recommended that the same care and consideration be taken for choosing the type of financing as for choosing the equipment and vendors.

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