EQUIPMENT LEASE AGREEMENT & GUIDE

Included:
Overview
Dos and Don’ts Checklist
Equipment Lease Agreement Instructions
Sample Equipment Lease Agreement
1. Overview

To compete effectively in today’s business world, your operation needs the latest technology. Buying equipment can use up available funds and may saddle your company with outdated property. Equipment leasing may be an excellent way to update your business without significant upfront costs. Almost any kind of property can be leased, from computers and heavy machinery to phone lines and cars. When equipment is leased, the renter can have it and use it for a certain amount time in exchange for payment of a rental fee. Another company will continue to own that property.

Leasing equipment may be better than buying for many reasons. A lease can provide lower monthly payments, a fixed financing rate, certain tax advantages, conservation of working capital, and immediate access to up-to-date business tools. On the other hand, long-term leasing may be more expensive than buying the equipment outright. There are many factors that contribute to a decision about whether leasing or buying is right for a given company, including the nature of its industry and the types of equipment it’s interested in.

This package contains everything you need to customize and complete your equipment lease agreement. If you follow the enclosed sample and guidelines, you will have essential documentation of ownership and liability obligations for the equipment. The owner will know that its rights are protected, and the lessee will be well on its way to getting the equipment it needs for its business.

2. Dos & Don’ts Checklist

☐ An equipment lease is an agreement in which one party (the “lessor”) gives the other party (the “lessee”) the right to have and use (but not own) the lessor’s equipment for a certain period of time. In exchange, the lessee will make payments to the lessor and be responsible for maintaining and paying taxes on the equipment during the lease period. At the end of that period, depending on the lease, the lessee may be given the option to buy the equipment that it has been leasing. In other cases, the lessee may be given the option to renew the lease for another term.

☐ There are many types of equipment that can be leased, from furniture to phones, and forklifts to copiers. Generally, items that are valued under a certain amount (usually around $5,000) are purchased, not leased.

☐ There are usually three ways a company can get the business equipment it needs: buy with cash; borrow money to buy; or lease. For new companies, using available capital to make cash payments may not be possible (or wise). Borrowing money may stretch a company’s credit line and be more costly in the long run after calculating interest payments. Leasing equipment will let an organization keep cash on hand, save its credit line, and obtain certain tax benefits. In addition, if the equipment is of a kind that needs to be upgraded or changed consistently (e.g., computers), a lease won’t leave the company owning old property – it can sign a lease for newer property when the need arises.

☐ Before sitting down to sign the lease, decide what your goals are. A good agreement is one that captures the intentions of the parties accurately. Clarify the terms and conditions of your agreement before putting them down in writing.
Allow each party to spend time reviewing the lease. This will reduce the likelihood, or at least the efficacy, of a claim that a party did not understand any terms or how those might affect the lease as a whole.

Both parties should review the completed document carefully to ensure that all relevant deal points have been included. It is better to be over-inclusive than under-inclusive. Do not assume that certain expectations or terms are agreed to if they are not stated expressly in the document.

If both parties expect to have an ongoing relationship, use the enclosed form to create a “master lease.” This will allow you to keep the same document for a long time, adding in or taking out equipment, or changing certain terms (e.g., the lease rate, the expiration date, etc.) by writing new exhibits. You won’t have to change or renegotiate the underlying agreement: most of the text will remain the same.

As a lessor, you may have concerns about providing a “warranty of merchantability” for the leased equipment. A warranty of merchantability is a promise that the property will meet an ordinary buyer’s expectations (in other words, the equipment is what the lessor says it is). If you make the lease a “finance lease,” you may be able to avoid this promise. If this is the case, once the lessee accepts the equipment, it cannot later bring a lawsuit against the lessor claiming that the goods are defective.

If the lessee uses the equipment illegally, the government could confiscate it. Consider including a provision requiring that any use of the equipment be in compliance with all laws.

In some states, the lessor can file a “fixture filing” to protect its interest in equipment that is (or will become) a fixture (in other words, permanently attached to the land or other real property). In other states, however, the lessor should get documentation from the landlord showing that the lessor’s interest in the equipment has top priority if the lessee defaults or at the end of the lease term.

Unless its equipment is or will become a fixture, the lessor is usually not required to file any lease documents with the state to protect its interests. However, it may be a good idea to make such filings to prevent the deal from being seen as a secured transaction.

The lease should disclaim all equipment warranties. Implied warranties can be avoided by using expressions like “as is” or “with all faults,” or any similar language. All disclaimers must be clear and prominent (capitalized, in bold type, or highlighted). To disclaim or change a warranty of merchantability, use language that refers specifically to merchantability.

In Illinois, courts do not like disclaimers of implied warranties. These clauses are read in a way that does not favor sellers. In other words, if there is any way to read the provision in a way that benefits the buyer, that’s how it will be read. If you are looking to disclaim an implied warranty in Illinois, you should make this clear and prominent in your agreement.

The enclosed form prevents the lessee from changing or adding to the equipment without the lessor’s consent. Additions to equipment are considered income for the lessor, which can have immediate and significant tax implications. Talk to a tax professional if you have questions about how this regulation may affect you.
Sign two copies of the lease agreement, one each for you and the other party.

It’s a good idea to get the agreement witnessed or notarized. This will limit later challenges to the validity of a party’s signature.

If your agreement is complicated, do not use the enclosed form. Contact an attorney to help you draft a document that will meet your specific needs.

3. Equipment Lease Agreement Instructions

The following provision-by-provision instructions will help you understand the terms of your lease agreement.

The numbers and letters below (e.g., Section 1, Section 2(a), etc.) correspond to the provisions in the lease. Please review the entire document before starting your step-by-step process.

• **Introduction of Parties.** Identifies the document as an Equipment Lease Agreement. Write in the date on which the document is effective (usually the date that it is signed). Identify the Parties and, if applicable, what type of entities they are. Note that each Party is given a name (e.g., “Lessor”) that will be used throughout the agreement. The Lessor is the Party that is leasing the equipment to the Lessee.

• **Recitals.** The “whereas” clauses, referred to as recitals, define the world of the agreement and offer key background information about the Parties. In this agreement, this section includes a simple statement of the intent to lease the Equipment.

Note that the Equipment being leased is not described in the Lease itself. The document references Exhibit A, and explains that the full description of the Equipment is located on that exhibit. Be as complete and clear as possible in your description of the Equipment being leased. Include any serial numbers that may be available and any additional specifications or requirements that the property must meet.

• **Section 1: Lease of Equipment.** The lease (and acceptance of the lease) of the Equipment. Note that the Lessee may lease additional items from the Lessor by attaching an Exhibit B to the Lease and describing that other equipment. From that point on, the items listed in Exhibit B will be considered “Equipment” (just like the original items) and will be covered by the terms of the Lease.

• **Section 2: Term.** The time period during which the Equipment is leased is called the “Term.” Enter your agreed-on rental period. This period will start on the later of the following dates: the Effective Date, or the date on which the Lessee receives the Equipment. If the Equipment is received after the Effective Date, you should attach, as Exhibit C, the Lessee’s notice of the date it received the Equipment. At the end of the Term, the Lessee can either renew the Lease or give the Equipment back to the Lessor. There is an optional Section 22 to this Lease, which gives the Lessee the opportunity to buy the Equipment at the end of the Term. If you include optional Section 22, you may want to include the bracketed clause at the end of this sentence. If you do not include Section 22, delete this clause. That option is discussed in greater detail later on.
• **Section 3: Rental Payments.** In most agreements, each party is expected to do something. This obligation may be to perform a service, transfer ownership of property, or pay money. In this case, the Lessee is giving money to the Lessor each month to pay for the right to use the Equipment. Enter the amount that the Lessee will pay each month. On the Effective Date, the Lessee will make an advance payment of one month’s rent.

• **(Optional) Section 4: Security Deposit.** This is an optional provision, in which the Lessee agrees to pay a deposit to the Lessor at the beginning of the Lease to guarantee the condition of the Equipment. Enter the amount to be paid. This money will be returned to the Lessee at the end of the Term if the Equipment is still in good condition. If you do not wish to require a security deposit, delete this section. If you do remove the provision, correct the section numbers and references in the Lease.

• **Section 5: Ownership.** States that the Equipment is still the Lessor’s property, even though the Lessee has the right to use it in its business. There is no transfer of title to the Equipment, even if it’s attached to or installed on the Lessee’s property.

• **Section 6: Responsibility for Care, Use, and Maintenance of Equipment.**

  The Lessee must:

  (a) keep the Equipment in good condition, and make any repairs and replacements at its own expense;

  (b) make sure the Equipment is used only by competent employees;

  (c) use the Equipment carefully and properly;

  (d) keep the Equipment at the agreed-on location, and not remove it without the Lessor’s consent. This location will usually be the Lessee’s place of business, but the Parties can agree on another place;

  (e) not change or add to the Equipment. Note that this subsection may need to be rewritten if certain types of Equipment are leased. For example, if you are leasing computers, the Lessee will often need to make upgrades or changes;

  (f) tell the Lessor about any loss, theft, or destruction of or to the Equipment; and

  (g) not assign or transfer the Equipment.

• **Section 7: Lessor’s Representations and Warranties.** The Lessor’s promises about the property that is being leased. More specifically, the Lessor is swearing that:

  (a) it has the ability to lease the Equipment, but doesn’t claim that the Equipment is guaranteed to be a certain way, or useful to the Lessee’s business;

  (b) it will leave the Lessee alone during the Term if the Lessee follows the terms and conditions of the Lease; and

  (c) it will transfer any warranty that can be transferred (e.g., manufacturer’s warranty) to the Lessee.
• **Section 8: Lessee’s Representations and Warranties.** The Lessee’s promises about the property that is being leased. More specifically, the Lessee is swearing that:

(a) the Equipment is in good condition, is what it wanted to rent, and will be used in its business;

(b) if the Equipment isn’t working after the Effective Date, it can bring it up with the manufacturer, seller, or installer only (i.e., not the Lessor);

(c) any expenses paid by the Lessee to bring a warranty claim are not reimbursable. However, if the Lessee receives any money under the warranty, it must turn it over to the Lessor. The Lessor will use the money to repair or replace the Equipment;

(d) even if the Equipment supplier or manufacturer breaches a warranty or representation, the Lessee still has to pay Rent;

(e) it was authorized to give all of the documents it gave under the Lease; and

(f) it didn’t (and won’t) violate any law by signing or performing its activities under the Lease.

• **(Optional) Section 9: Lessor’s Performance of Lessee’s Obligations.** This is an optional section, providing that the Lessor can pay or do anything it thinks is required if the Lessee doesn’t keep insurance coverage, pay taxes or fees, or repair the Equipment. If the Lessor does this, the Lessee must reimburse the Lessor for its expenses, and pay interest on and legal fees for any amounts paid. If you remove this provision, correct the section numbers and references in the Lease.

• **Section 10: Insurance.** During the Term, the Lessee must get insurance on the Equipment and give a copy of any proof of that insurance to the Lessor. The insurance should cover any loss or damage to the Equipment, and also any risk of harm to the general public by the Equipment.

Even if the Parties already have similar insurance, the policy required in this section will be the primary one. The Lessee is allowed to change its coverage only after giving the Lessor at least thirty days’ notice.

• **Section 11: Taxes and Fees.** Requires the Lessee to pay all applicable taxes and fees during the Term, and to provide any relevant paperwork about these payments to the Lessor.

• **Section 12: Liability for Loss and Damage.** There are two options offered in this section, and you should choose the one that best suits your arrangement and delete the other.

  **Option 1**

  Under Option 1, the Lessee is responsible for any damage or loss of the Equipment while it’s in the Lessee’s hands. The Lessee will pay the fair market value of the lost or damaged Equipment to the Lessor.

  **Option 2**

  In Option 2, if the Equipment is damaged, the Lessee must repair it. If the Lessor finds out that some or all of the Equipment has been lost, stolen, or destroyed, it can require the Lessee to (a) replace it or (b) pay any outstanding fees, part of the cost of the item, and the total amount the Lessor would have received as Rent on that Equipment during the Term. If you select this option, you can enter the percentage of the cost of the Equipment you want the Lessee to pay.
• **Section 13: Default.** Lists the events that are considered “Events of Default” by the Lessee. In other words, if the Lessee does any of these things, the Lessor can walk away from the Lease and demand payment or action as required under the Lease. Section 14 explains what the Lessor can do if the Lessee defaults.

• **Section 14: Rights of Lessor on Default.** If the Lessee defaults (as described in Section 13) the Lessor can end the Lease and take back the Equipment. If this happens, the Lessee will pay any related costs. If the Lessee doesn’t deliver the Equipment to the Lessor, the Lessor can go onto the Lessee’s property and retake it, without having to get a court order or police assistance.

An optional, and recommended, provision states that the Lessor has to try to lease the Equipment again and limit any other costs related to the default. In other words, the Lessor can’t just keep incurring expenses without trying to keep them reasonable or eliminate them.

• **Section 15: Interest.** If the Lessee is late on any of its payments, it will have to pay interest on the unpaid amounts until the payment is made. Enter the interest rate you want to apply. The interest will start adding up on the date the payment was due.

Before you choose this rate, make sure you know what the legal limits are for interest rates in your state. If you select a rate that is too high, you may not get any interest at all.

• **(Optional) Section 16: Indemnity.** This is an optional section, explaining that the Lessee will pay the Lessor back for any costs the Lessor incurs relating to the Lessee’s use of the Equipment. If you do not wish to include an indemnification provision, delete this section. If you do remove the provision, correct the section numbers and references in the Lease.

• **Section 17: Return of Equipment.** At the end of the Term, the Lessee must return the Equipment at its own expense, unless it renews the Lease or buys the Equipment.

• **(Optional) Section 18: Lessor’s Right of Inspection.** This is an optional provision giving the Lessor the right to examine the Equipment during normal business hours. If you do not wish to give the Lessor this right, delete this section. If you do remove the provision, correct the section numbers and references in the Lease.

• **Section 19: Successors and Assigns.** States that the Parties’ rights and obligations will be passed on to successor organizations (if any), or other organizations to which rights and obligations may be permissibly assigned.

• **Section 20: No Implied Waiver.** Explains that even if one Party allows the other to ignore break an obligation under the Lease, it does not mean that Party waives any future rights to require the other to fulfill those (or any other) obligations.

• **(Optional) Section 21: Option to Renew.** This is an optional provision giving the Lessee the option to renew the Lease at the end of the Term. The specifics of any new term will be agreed on by the Parties later on. If you do not want to include any provisions about renewal, delete this section.
• **(Optional) Section 22: Option to Purchase.** This is an optional provision giving the Lessee the option to buy the Equipment.

  (a) The Lessee can buy the Equipment at the end of the Term at its fair market value if it performed all of its responsibilities under the Lease. If the Lessee wants to do this, it needs to give written notice to the Lessor a certain amount of time before the end of the Term. Enter the number of days the Lessee has to give this notice.

  (b) The “fair market value” of the Equipment will be decided by both Parties. It will be evaluated on the last day of the Term.

  (c) The Lessee will pay the purchase price within a certain amount of time. Enter the number of days that the Lessee has to make this payment.

If you do not want to give the Lessee the right to buy the Equipment, delete this section and correct all section numbers and references in the Lease.

• **(Optional) Section 23: Additional Documents.** An optional provision indicating that the Lessee will fill out any additional documents that the Lessor thinks are necessary to show that the Lessor is still the owner of the Equipment. If you do not want to include any provisions about additional documents, delete this section. If you do remove it, correct the section numbers and references in the Lease.

• **Section 23: Notice.** Lists the addresses to which all official or legal correspondence should be delivered. Provide a mailing address for both the Lessor and the Lessee.

• **Section 24: Governing Law.** Allows the Parties to choose the state laws that will be used to interpret the document. Note that this is not a venue provision. The included language will not impact where a potential claim can be brought. Enter the applicable state name in the blank provided.

• **Section 25: Counterparts / Electronic Signatures.** The title of this provision sounds complicated, but it is simple to explain: it says that even if the Parties sign the agreement in different locations or use electronic devices to transmit signatures (e.g., fax machines or computers), all of the separate pieces will be considered part of the same agreement. In a modern world where signing parties are often not in the same city - much less the same room - this provision ensures that business can be transacted efficiently, without sacrificing the validity of the agreement as a whole.

• **Section 26: Severability.** Protects the terms of the Lease as a whole, even if one part is later invalidated. For example, if a state law is passed prohibiting interest on unpaid rent, it will not undo the entire Lease. Instead, only the section dealing with interest on unpaid rent would be invalidated, leaving the remainder of the Lease enforceable.

• **Section 27: Entire Agreement.** The Parties’ agreement that the Lease they’re signing, together with any exhibits, is “the agreement” about the issues involved. Unfortunately, the inclusion of this provision will not prevent a Party from arguing that other enforceable promises exist, but it will provide you some protection from these claims.

• **Section 28: Headings.** Notes that the headings at the beginning of each section are meant to organize the document, and should not be considered essential parts of the agreement. In other words, anyone looking at the Lease should pay attention to the content of the clauses, not to the titles.
• **Exhibit A: Inventory of Equipment.** For an equipment lease to be effective, the equipment must be clearly described. Be thorough in your description, and include any available serial numbers, model numbers, etc. If there are any additional specifications you want to make about the Equipment, feel free to do so here.

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EQUIPMENT LEASE AGREEMENT

This Equipment Lease Agreement (the “Lease”) is made and effective as of ___________ 20___ (the “Effective Date”) by and between ______________, [an individual] [corporation] [etc.] (the “Lessor”) and ______________, [an individual] [corporation] [etc.] (the “Lessee”). The Lessor and the Lessee may be referred to individually as a “Party” or collectively as the “Parties.”

RECITALS

WHEREAS, the Lessor is the [sole] owner of that certain equipment described more particularly in Exhibit A hereto and made a part hereof by reference (the “Equipment”); and

WHEREAS, the Lessee wishes to lease the Equipment from the Lessor in accordance with the terms and conditions of the Lease; and

WHEREAS, the Lessor wants to lease the Equipment to the Lessee in accordance with the terms and conditions of the Lease; and

WHEREAS, each Party is duly authorized and capable of entering into the Lease;

NOW, THEREFORE, in consideration of the mutual covenants and agreements contained herein, the Lessor and the Lessee do hereby agree as follows:

...