WHITE PAPER

IT Leasing for Government Agencies

To make your organization's IT dollars go further, leases offer a hedge against inflation and a way to deploy the latest technology today.

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Executive Summary

The ongoing financial crisis and resulting credit crunch have had an impact on the ability of federal, state and local government agencies to obtain financing. With tax receipts receding and many federal, state and local deficits at all-time highs, governments are looking for creative ways to finance new IT equipment and services.

What is most challenging for government IT departments is that the tight credit markets and the difficulty in making large capital outlays couldn't come at a worse time. Government IT officials are under increasing pressure to deliver self-service e-government applications to the public and web-based services to staff and vendor partners.

Citizens want to pay their taxes electronically, renew their driver's licenses online or simply obtain fishing licenses without a lengthy drive to a government office. And in the workplace, cash-strapped agencies must find ways to deliver more web-based applications, as well as accomplish daily work more efficiently with fewer people.

Faced with these challenges, more government IT managers are finding leasing equipment to be an attractive option. Leasing offers a way to keep up with the latest technology, but doing so in a way that is affordable and does not require inordinate initial capital outlays.

This white paper examines the reasons why leasing IT equipment may be the most efficient path toward delivering the products and services that will keep government workforces productive while at the same time providing the web-based services expected of 21st century government.

Why and When to Choose Leasing

Although budget is definitely a factor when choosing a lease over a purchase for many organizations, there are other drivers to consider.

Guarding against obsolescence: Many government agencies have found that planning for, buying and deploying IT equipment can be a frustrating process of trying to hit a moving target. Especially for large federal and state agencies, rollouts take several months (even years), and often the technology has evolved a generation or two from the time of initial planning to the time of actual deployment.

Case Study: Broome County

This New York county uses creative financing to secure much-needed IT equipment.

Broome County has been a supporter of leasing for almost a decade. CIO Kim McKinney says the county government, based in Binghamton, N.Y., tends to lease or look for creative financing for big-ticket networking and computer infrastructure items.

The county leased its IBM enterprise storage tape management system and a mainframe computer about eight years ago, a lease it renewed in 2005, she says.

"The great thing about leasing is that we know what the payments will be," McKinney says. "And when we renegotiate the lease, we can keep the payments about the same, yet replace the equipment with the latest gear."

The county's positive experience with leasing gave it the confidence to sign a five-year, zero percent financing agreement on a series of Cisco System switches that will support 20 physical locations countywide.

"Like many other county governments, we didn't have the money during these challenging economic times to make a huge capital outlay for networking infrastructure," she says. "We really needed to replace our networking infrastructure, and there would be no way we could do this without the special financing. Now we can spread out the payments over 60 months."

McKinney says another advantage of the financing package is that — similar to a lease — the county can add equipment to the original agreement. She says the county added Voice over Internet Protocol gear, which will allow it to roll out IP phones and move to a unified communications platform over time.

The Tax Systems Modernization upgrade at the IRS is a classic example, wherein the agency undertook a massive technology restructuring process only to be forced to rethink the lengthy rollout because of the unexpected growth of the Internet in the mid-1990s. Leasing offers agencies a hedge against the inevitable improvements and upgrades the IT industry offers every 12 to 18 months.

Overcoming budgetary and lending constraints: Government agencies don't always have the ability to make significant capital outlays for communications and IT infrastructure because the budget isn't there. Leasing offers the opportunity to make predictable monthly payments that can be spread out over months and years.

The additional feature of tacking subsequent equipment requirements onto an existing lease is of benefit to agencies because such options offer a way to avoid a new credit check. Because of the credit crunch, loan requirements by banks are much stricter today.

This is an inopportune time for many agencies to face re-evaluation of their financial status — especially organizations in recession-battered states. Adding to an existing lease provides a way to acquire much-needed tools without having to undergo today's stricter financial guidelines.

Leasing companies also offer 100 percent financing options and agreements may be structured on or off the balance sheet.

Finding favorable terms and efficient approval processes: Recognizing the opportunity, leasing companies are offering enticing rates and terms. Additionally, many have streamlined their processes to make it easy for government agencies to process their paperwork and get equipment delivered and deployed quickly. Agencies should look for special one-year deals and check out the reduced rates of many three-year leases.

Reducing staff time spent disposing of equipment: In a lease arrangement, the disposal of surplus equipment is the responsibility of the leasing company. Anything government agencies can do to outsource noncore tasks is welcome when budgets are tight.

Understanding the Leasing Models

Before you sit down to any negotiation, it pays to understand the leasing language and particularly the types of vehicles that you will have available.

Operating leases: This is when the agency pays for the use of the equipment, not the ownership. Payments are spread out over time and treated as an expense. These leases allow for financing off the balance sheet. Typically the agency returns the equipment at the end of the lease and renews a lease for new equipment.

Why Leasing Makes Sense

Technology buyers are often under the impression that buying outright is less expensive than leasing. In reality, leasing often works out better on the audit sheet. Regardless of your decision, here are four questions to ask.

1. What will the equipment's value be when you are through using it, and what are the risks and costs you will face when attempting to capture that value?
2. What are the costs associated with using the equipment?
3. What are the net tax benefits?
4. How is total cost of ownership affected by the decision to lease compared to purchasing?

Of all these factors, the crucial financial difference between leasing and purchasing lies in capturing residual value: the amount your equipment will be worth when you're finished with it.

Buyers typically reduce the net cost of IT equipment use by selling the equipment when they are finished with it. The problem is the amount of the return is uncertain until it comes time to sell.

With a lease, the technology provider returns the equipment's expected residual value to the buyer in the form of lower lease payments. In effect, leasing lets the buyer transfer the residual risk to the lessor, letting the buyer lock in a residual value at the earliest possible opportunity.

Source: Relational Technology Solutions

Capital leases: Ownership typically transfers to the agency at the end of the lease. The equipment is capitalized on the IT department's books and depreciated. The payments are spread out over time and treated as a loan.

Hybrid leases: Under this type of arrangement, the agency pays for the IT assets based on usage, and can access additional capacity as required. Instead of predictable payments, agencies can make variable payments.

PC per seat deal: Under this arrangement, the agency acquires a bundle of hardware, software and other services. The services and service levels are customized based on each client's needs. The leasing company provides a combined invoice and contract for hardware, software and services. The lease can be structured as a service contract or a hybrid lease.

What to Look for in a Leasing Company

Finally, any organization considering a lease needs to take a close look at the leasing companies it is considering. Here are some factors to weigh.

Existence of a government marketing arm: It's important for the leasing company to understand the timeframes, processes and legal obligations of the government buyer. Especially in the federal government, you need to find a leasing partner that understands how

End Game

The close of a lease needs to be worked out from the get-go.

It's crucial to set a plan for what will happen when your lease runs out. How will you manage equipment returns? Failure to do so could result in additional costs. You don't want that to happen, so here are some factors to resolve when you set your agreement.

For planning:

- Require advance notice of lease expiration
- Review the contract for lessor-specific notification periods and return requirements
- Obtain end-of-lease pricing for purchase, renewal and extensions
- Identify equipment location, configuration and program dependencies
- Perform equipment assessment
- Notify lessor on behalf of every line item on a lease schedule
- Remove equipment from maintenance

For managing equipment returns:

- Prepare equipment for return
- Remove password protections and sanitize data
- Repair damaged equipment, if any
- Remove any agency-identifying tags
- Prepare list items to be returned
- Compare list with lease schedule to ensure every line item is accounted for
- Prepare machines for shipment following lessor-specific instructions
- Insure the equipment

Source: Gartner

CDW Preferred Financing Partners

- Cisco Capital
- HP Finance
- IBM Global Finance
- Microsoft Finance
- VAR Resources
- GE Capital*
- Apple Finance*
- Macquarie*
- PNC Finance*
- Global Capital
- De Lage Landen (DLL)

**Partners with an asterisk offer financing to state and local agencies, but not federal agencies. All nonasterisk partners cater to federal, state and local agencies.*

to do business in the government sector and is willing to meet any mandatory guidelines.

Long-term financial viability: Leases can be sold off to third parties just like mortgages. That means the agency should find out what happens if the lease changes hands. It's equally important to understand what will transpire if the third party goes out of business and all of a sudden a bank is dictating terms. Find out the parameters for all these possibilities given who you might end up doing business with.

Close ties between financing and sales: Because they are expensive products that tend to anchor data centers, products such as mainframe computers, storage and network switches have a greater likelihood of being leased or financed.

For example, IBM Global Finance and Cisco Capital established a hand-in-glove relationship between its sales organizations several years ago. This approach really goes a long way toward developing leases that satisfy the needs of both IT and finance at government organizations.

Clarity at end of financing: Be sure to work with a company that is clear about when the lease ends and what your options are. Also, have the legal department closely review the end-of-financing terms. You want to avoid any hidden terms, such as automatic-renewal clauses that carry higher interest rates if you don't respond by a certain time. You want to sign on with a company that will share information about your obligations transparently and from the start.

Flexibility: Technology is constantly changing — just as requirements on long projects tend to change — so you want a company that is willing to adjust your lease six months or a year down the line so you can bring in the latest technology. Also, it's wise to find out if the company is willing to finance gear from another company to keep your business.

Management services offered: Find out what extra services are available. Does the technology provider offer data-wiping services for returned equipment? Is there management software or a web portal to help you track equipment and leasing cycles? These are all tools that reduce the lease management burden for the IT department.

Financing maintenance and services: Another item to review is how the leasing company finances maintenance and services. The pricing and lease structures vary widely for these, and you will want to evaluate them based on your organization's specific needs.

Incentives: Look for deals. Providers typically will be aggressive when trying to obtain your business. And in most cases, the longer the lease you commit to, the better the financing will be. So take advantage of offered incentives where you can.

A New Lease on Life

This Pennsylvania township looks to leasing as a way to more effectively budget for IT equipment.

Adam Osterrieder, CIO of Cranberry Township, Pa., says based on his township's positive experience leasing two HP blade servers (contracted about a year ago), he expects that it will also lease storage equipment and replacement PCs.

"For the blades, we make yearly payments of about $22,000 for three years, and then the equipment is ours," he says. "On the fourth year, we can either apply the $22,000 we have budgeted to another lease for blades or buy other equipment."

Osterrieder says the township's financial managers appreciate when the IT budget is based on predictable expenses. "We try not to surprise them with any major purchases," he says. "It's a lot easier to get the projects approved when you are not increasing your budget."

By exercising the option to lease, the township acquired the two blade servers before it started virtualizing its servers with Microsoft Hyper-V and Windows Clustering. Over the last year, the township consolidated 30 servers, slowly moving the Hyper-V virtual machines to the blade servers. Plans are also in the works to consolidate another 15 servers throughout 2010.

"Without the leasing program, we would have to buy physical boxes and piece the applications together," Osterrieder says. "It really helped to bring in the blade servers from the start."