

## **LEASING (IJRAH)**

Leasing is a relatively new method of long term financing which is gaining popularity in the industrialized countries. A leasing has been described as a contractual agreement. This is the form for financing the capital assets.

Leasing is termed permissible under the Islamic mode of financing, as the return on investment is not interest but leasing rent. In this form the bank (the lesser) purchases a specific property or assets for a specified time. Then the asset is leased to customer (lessee) for a specified rent for the duration of its economic life. The bank (lesser) retains the ownership of the assets and the customer (lessee) has the right to use it as long as it pays the rentals as per agreement.

At the end of the specified period the assets reverts back to the bank (lesser), however, quit often the customer (lessee) is given an option to purchase the asset form the bank (lesser) at a mutually agreed amount. At present five different types of leases, as per requirement of the customer (lessee), are popularly acceptable. They are operating lease, financing or finance lease, sale-and lease – bank.

## **MAIN TYPES OF LEASING**

The use of this method can enable banks and other financial institutions to provide medium and long – term finance either directly or through their leasing subsidiaries without having to look in to the accounts of the firms.

These are primarily two main type of lease.

Operating Lease.

Finance Lease.

### **1. Operating Lease**

The lease is usually for a short period and does not cover the entire useful life of an asset. It is normally cancelable by either party on a relative short notice.

### **2. Finance Lease**

It is essentially a long-term lease having one of under noted characteristics. The term of the lease covers virtually the entire useful life of the asset. In case the period is shorter compared to useful life of the asset then lease has the option to renew the lease on some per determined term or acquire the property usually at a bargain price or per-agreed price.

The lease is non-cancelable.

The usual risks and rewards of ownership of the leased asset are passed on to the lessee without on actual transfer of title, Thus, the lesser remains formal ownership of the property although the lessee actually uses the assets, pays the ownership expenses such as insurance, taxes, maintenance etc. and also provide for amortization of the leased assets in addition to lease rentals. The periodic lease payments over the life of

the lease are calculated to include full recovery of the investment by the lesser during the lease period end.

A fair return on the investment made by him.

#### **TYPE OF EQUIPMENT:**

Where operating lease is typically restricted to equipments, which have either as established primary market or second hand market. On the hand, finance lease cover whole range of capital equipment used by the industrial projects and commercial firms. Some example of the equipment rent able for operating lease are Cargo Containers, office Equipment, Vending, Machine, Tools, Drilling Rigs and Mining Equipment etc. Likewise equipment which could be leased under finance lease are Cars and Carriers, Computer, Hotel Equipment, Ware House / Factories / Plants, Earth Moving Equipment and Vehicles, hospitals Equipment, Refining plant and Ships.

#### **LEASING AS AN INVESTMENT**

##### **Advantages:**

The financing is largely unrelated to the size of assets and capital base of the lessee and depends principally on the ability of his cash flow to service payments of lease rentals. Leasing has the following characteristics.

##### **100% Finance**

The need to approach more than one institute for is eliminated.

##### **Projected Oriented**

It is project rather than security oriented. The basic security is the ownership of the assets by lesser and related to the cash flow situation of the lessee. Normally no additional collateral is required.

##### **Cash Flow**

It provides cash flow advantages as it's obviated the need for immediate cash disbursements for investment in plant and equipment.

##### **Tax Advantages.**

The lease rentals provide higher tax advantages compared to depreciation allowance for equipment purchase through term loan arrangements.

##### **Off Balance Sheet Financing**

Helps preserves working capital and short-term bank credit lines. Leasing contracts are sometimes not balance sheet items, giving a company an opportunity to obtain the use of necessary facilities without increasing formal debts position.

##### **Credit Risk.**

The category of risk is associated mainly with the viability of the lessee's business. He needs. Therefore, to be assured that user of the equipment is in a position to meet the rentals payable under the lease.

**Evaluating credit worthiness in a financial lease is similar to that of evaluating loan by equipment**

**It required high standards of cash flow based credit analysis. The lesser can improve the credit position by taking additional advantage such as guarantee, and cash etc. However, as against the existing practice the cost of insuring the assets will have to be borne by the lesser in order to make this method conform to the principle of sharia.**