Economic Lease Term

Deposit Application

Purpose of the Deposit

Most lease agreements require a deposit in the amount of one month's rent due with lease proposal signing. This deposit is often applied to the final payment due under the lease. In any lease agreement, the leasing company incurs significant costs related to the underwriting process, documentation of the lease and legal costs related to the filing of UCC financing statements and perfection of security interest. When a lease proposal is signed, in order to ensure the lessee is acting in "good faith" and is committed to funding the lease with the leasing company, a deposit is due that is later applied to the final payment due under the lease.

"May" is Not "Shall"

As you review lease proposals and lease documentation, be sure that the lease you are considering states that the deposit shall be applied to the final payment due under the lease. If the language states that the deposit may be applied, it is likely that the leasing company has added the deposit as an additional fee. After all, if you see that it *may* be applied, it is possible that it *may not* be applied as well.

Deposit to Cost

Instead of specifically applying the deposit to specific payments due under the lease, the leasing company may state that the "deposit in the amount of one month's rent shall be applied to the costs of the lease" or the "deposit shall be applied to amounts due". This vague language is open to interpretation at best. The lease contract does not specifically state which rental payment will be removed as the result of the deposit payment. Many times, it is an attempt by a leasing company to earn the deposit as a fee in addition to the regular monthly rental payments.

Why This Is Important

Some leasing companies can hide the true cost of their lease by earning the deposit as an additional fee. This results in an artificially low lease rate factor on the proposal. Unfortunately, this additional cost is not realized until the end of the lease when the final payment is not removed. On a 36-month lease with an implied interest rate of 5.00%, failing to apply the deposit to a specific lease payment would increase the cost of the lease to over 7.15%. Because of this, the application of the deposit is an important factor to consider when evaluating lease proposals and documentation.

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