TECH NEXT™

NASPO TECH NEXT SERIES

Leasing vs Owning: Hardware and Software

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In this edition of the Tech Next series, we will explore:

Leasing Options

Quick Facts

Considerations: To Buy or Lease?

Owning or Leasing Hardware & Software: Questions to Consider

With the constant development of new and better Information Technology (IT) hardware and software, the need for maintenance and support, and the increasing budgetary constraints, state procurement officials are faced with the decision of whether their state should lease or own hardware and software. There are many factors to consider when determining which model is best, depending on each state's unique needs and challenges. In this edition of Tech Next, we will explore the options available when it comes to leasing, discuss the benefits and challenges that come with both methods of IT procurement, and provide addi-tional resources for continued reading on this topic.

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Leasing Options

Capital Leases

The supplier (lessor) transfers ownership of the equipment to the state (lessee) at the end of the lease. Payments are spread over time and modeled after a loan. The state (lessee) assumes some of the risks in order to receive the benefit of usage. The equipment is typically capitalized in the IT department's financials and depreciated over time, and there is usually a "buyout" option at the end of the lease which is at or below fair market price for the equipment. The lease agreement may or may not address required repair, maintenance, and/or upgrades to the equipment over the lease duration, but those items should be considered in the total cost of ownership. Traditional finance companies may not offer finance packages on hardware and/or software, while some large-scale technology companies offer financial packages through specialized financial institutions.

Operation Lease

The state (lessee) is only paying for the use of the equipment from the supplier (lessee) and will not own at the end of the lease. Payments are predictable and steady over time, with an option to review and/or trade in the equipment at the end of the lease. Typically, repair, maintenance, and/or upgrades are included as a part of the rental cost and the risk remains with the supplier (lessor). There may also be a "buyout" option for the state at the end of the lease.

Hybrid Leases

The state (lessee) pays for the equipment based on usage. There is an option to increase capacity as required; however, decreases may not be allowable under the agreement. Payments are usually predictable but can be variable. Storage costs should be considered carefully.

Quick Facts

Information provided by Procurement IQ

"Benchmark Price" for a computer lease is $17.81 per month for 36 months

Average lease term is 36 months for both desktop and laptop computers

Key pricing factors include the model of the computer, functionality, length of lease, and additional services requested

Average price for a desktop computer in n 2023 is $580

Average purchase price for laptops in 2023 is $740

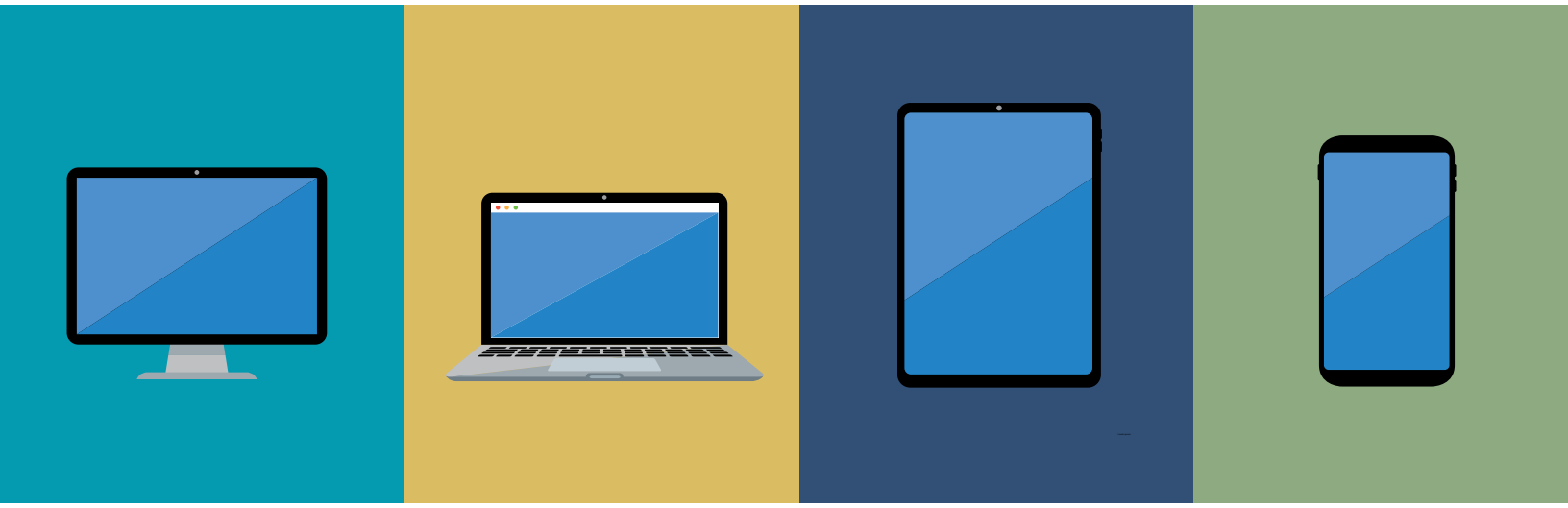
The average price of desktop computers has been rising in the last three years

Laptop computer prices are expected to continue declining marginally through the next three years

Considerations: To Buy or Lease?

The RFI/RFP Process

Buying and/or leasing IT can present unique benefits and challenges.Like many other procurement decisions, determining which method is best will depend on the specific needs and budget of the state or agency at the time of purchase/ lease, and the current market conditions. Full exploration of both options may be needed to make the best decision. State procurement officials will want to consider producing one or multiple solicitations that request information and pricing to decide which method best meets the state's needs. This approach will allow the state to compare options and determine the best method for the given procurement. The goal, as always, is to promote maximum competition and yield the most useful information for the negotiation process.



Cost

Each time hardware and software need to be updated or replaced, budget and cost control are concerns that must be addressed. When buying IT, it is important to be aware that any large purchase being made at one time can take up a large portion of budgeted resources and procurement team allocation. Budgeting for a large purchase at one time can be done. This is possible because most states plan to create a set budget for one fiscal year at at time. Buying also comes with the cost of disposal—computers and other hardware are not "landfill" materials and must be disposed of in an environmentally responsible way. If the hardware can be reused or resold, there is often a cost for wiping the system and reinstalling the basic operating system and minor costs associated with handling surplus property such as warehousing and resale costs.

Leasing has gained some ground in recent years as a viable option for states when budget constraints did not provide for a large purchase of hardware and software. Smaller, predictable payments can sometimes provide a way for the state to obtain what it needs without sacrificing quantity or quality. When leasing, the same budget concerns for upfront costs exist as there are for buying, though not as large. Leases also often come with administrative upgrade fees. Additionally, payment plans, even with zero percent interest, are a possibility for major leases, but may still need to be treated as finance agreements based on states' procurement codes and statutes.

With buying or leasing hardware and software, there should also be consideration for staff time in terms of research, review, and negotiation phases, as well as the cost-potential of early termination fees in both types of contracts. Other operational considerations include encumbrance, accounting, and payment disbursement requirements for lease payments.

Lifespan and Replacement

Most states are moving toward open-ended contracts for their hardware and software, since these are repetitive need items, and re-bidding is not necessary every time a purchase needs to be made. However, new mandates or standardization requirements could mean a re-bid, depending on the specific changes made or substantial changes in the market.

Without an open-ended contract, replacing purchased hardware and software due to breakage or changes in required functionality may mean having to go through the procurement process again. Upgrades are typically not included in purchase deals but can be negotiated or added. For example, the contract could be a five-year agreement with annual renewal and upgrade options.

Leasing could mean that hardware and software is replaced or upgraded automatically and/or annually, or at the end of the contract, based on the terms and conditions. This process can lead to the state's ability to obtain the "best in class" technology. However, it can also mean additional fees, increased monthly pricing, and/or other upfront costs. Additional fees for upgrade allowances can increase overall costs, but also provide an opportunity to set a fixed fee as a cost-control measure. Technology becomes outdated quickly, and leasing with allowance for upgrades may help keep the state in line with the rapid pace of innovation.

Security, Maintenance and Repair

Cybersecurity is always a major concern when purchasing or leasing IT. Security integrity can be maintained through upgrades with hardware and software, no matter the procurement model, depending on terms and conditions of the contract. Further, the security environment and the enterprise architecture of the state must be understood and considered carefully, regardless of the options for how to procure.

Purchasing IT from standardized suppliers or in standardized models/configurations creates the opportunity to train in-house staff on hardware repair; however, warranties may require that the work be performed by certified technicians. States must then consider whether to certify their own technicians or outsource repairs. Warranties are available based on the terms and conditions of the contract. Retraining of in-house technicians might be required as hardware and software is replaced, e.g. moving from Windows-based systems to Apple operating systems.

When leasing, repair needs are generally handled by the manufacturer, who most likely employs certified technicians. This may reduce training and certification costs for the state. The cycle time for repairs should be made clear by contract terms and conditions to prevent unnecessary delays in state services; states can consider a "loaner" provision in their contract to allow for continued use of the computer systems while repairs are being made. Moving to a leasing model with outside technicians may mean having to redistribute in-house IT staff who have been serving as technicians.

SUGGESTIONS FOR FUTURE READING:

- **Computer Leasing Report from ProcurementIQ**
  NOTE: This report is exclusive to NASPO members through their ProcurementIQ member benefit.
- **NASPO Content Library: Market Research**
- **Public Procurement Practice Lease Purchase Decision from NIGP Principles and Practices of Public Procurement.**
- **Paying for IT** from ComputerWeekly.com
- **IT Equipment Procurement – Impact on Your Budget and Efficiency from Manage IT Out.**

OWNING OR LEASING HARDWARE & SOFTWARE

Questions to Consider

- ☐ What is the current hardware/software need?
- ☐ What are the budget constraints/amounts?
- ☐ Which model—leasing or owning—fits best within the state's enterprise architecture framework?
- ☐ Which model provides the best options when it comes to cybersecurity?
- ☐ What should be included in the RFI/RFP to yield the best information for comparing the options to buy or lease?
- ☐ Is a multi-step solicitation appropriate?
- ☐ If leasing is the best option, which leasing model is most appropriate for the procurement at hand?
- ☐ For each option—buying versus leasing: What is the procurement team allocation required?
- ☐ What is the cost of disposal?
- ☐ What are the early termination fees? What is the availability for upgrades on the hardware/software?
- ☐ Is the state getting the most innovative or "best in class" technology?
- ☐ How will repairs be addressed?
- ☐ Who will perform maintenance on the hardware/software?