

Equipment Procurement To lease or to own?

2nd TEFMA Grounds Workshop

Massey University - October 2009

TORO. Count on it.

PERFORMANCE GUARANTEED
parkland



Common questions

- How do I work out which financing option is the cheapest?
- What are the tax implications?
- Explain how ownership risk involves risk?
- What impact does utilization have?



Finance options

- An Operating Lease is a fixed term hire agreement. Essentially a rental agreement.
- A Financial Lease is like a nil deposit conditional purchase agreement. Essentially a loan.
- Hire Purchase or chattel mortgage.
- Cash



What are the financing choices?

Operating Lease (Rental)	Finance Lease	Conditional HP
<p>Fund between 70% to 85% of cost depending on term. No deposit payable. Debt NOT on balance sheet. Investment allowances available to financier passed on in the form of lower rentals (Australia) At the end of the lease the <u>supplier</u> owns equipment .</p>	<p>Fund 100% of ownership. Relevant for use > 5 years. No deposit payable. Debt on balance sheet. At the end of the lease <u>you</u> re-sell the equipment and take the profit or loss.</p>	<p>Fund 70% of ownership. Relevant for use > 5 years. Deposit around 30% payable "up front" Account for depreciation and interest. Debt on balance sheet. <u>You</u> carry the ownership risk.</p>

Disclaimer – Please take expert financial advice



Key advantages of leasing over owning

- Capital is preserved for other projects.
- Rental payments are term are fixed. Therefore, capital costs are known and easily budgeted for.
- Operating costs are known and easily budgeted for through parallel maintenance contracts.
- Equipment is turned over on a regular basis.
- Therefore, R&M expenditure is kept under control.



Additional advantages of an Operating Lease (Rental)

- At the end of the lease the financier and / or the supplier takes the ownership risk.
- If the item is re-sold at a lower cost than the residual value used to calculate the original lease payments then it is not your problem!
- Investment Allowances mean lower rentals (Because the taxpaying financier receives a tax benefit) – Not for profits - Australia only
- Transactions are off balance sheet.
- **Easier to get the boss to sign off!**



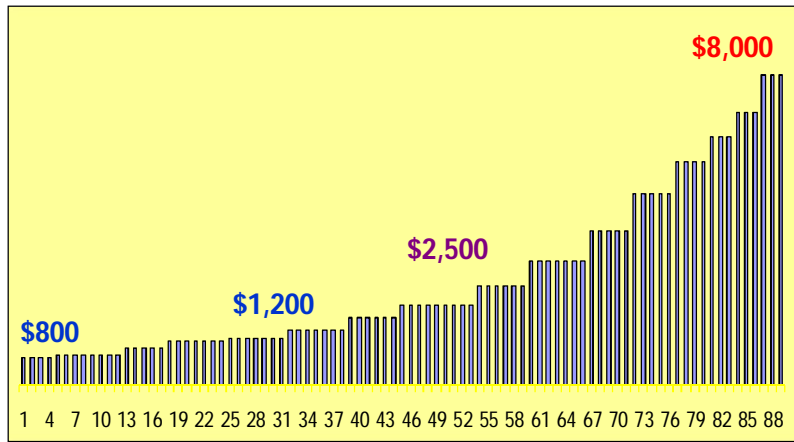
What type of finance is best?

Operating Lease (Rental)	Finance Lease	Conditional HP or Cash
<p>High Utilization items in your fleet; for example Rotary Mowers and Reel Mowers.</p>	<p>Medium Utilization items in your fleet; for example Spray Units, Vehicles etc.</p>	<p>Use for Low Utilization items in your fleet; such as Tractors, Aeration, & Small Plant etc</p>



Ownership risk?

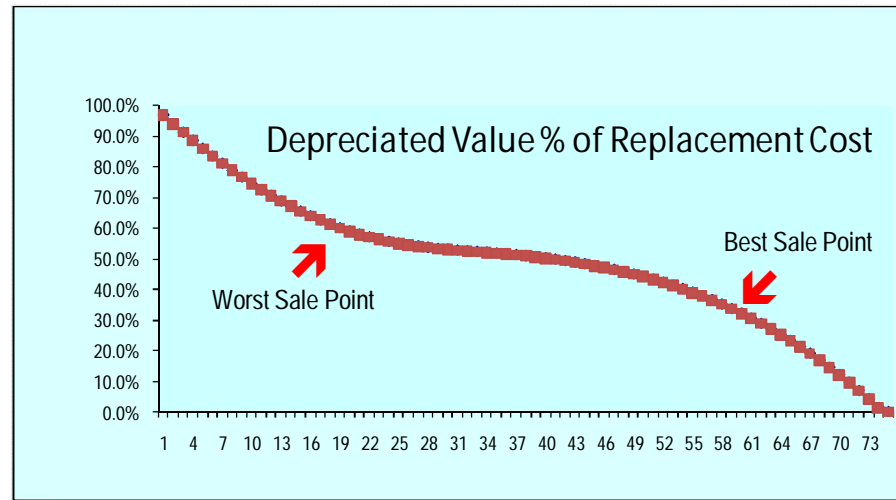
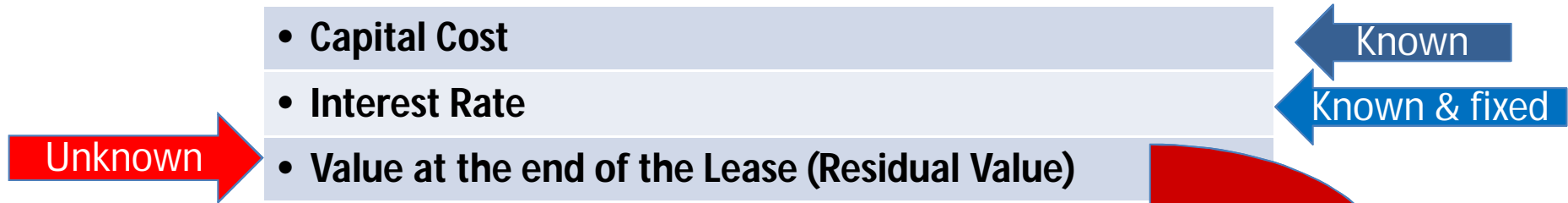
- 5 years ago our products were more expensive for the same quality. So there is a risk to ownership by holding onto older models and missing out on our newer and better models.
- Maintenance costs of old equipment grows alarmingly.



- It can be hard to get management to agree to replace “adequate” but old equipment.
- Insufficient depreciation can create a book loss – which Accountants love to avoid!



Components in Operating Lease calculations



Financial difference between leasing and owning

	Finance Lease	Operating Lease	Finance Lease	Operating Lease
Cost ex GST	\$100,000	\$100,000	\$100,000	\$100,000
Term	36 months	36 months	48 months	48 months
Residual Value %	24.9%		19.8%	
Residual Value \$	\$24,860		\$19,750	
Swap Rate	5.76%		6.00%	
Finance Margin	2.75%		2.75%	
Total Rate	8.51%		8.75%	
Monthly Rental ex GST	\$2,531	\$2,531	\$2,116	\$2,116
Total Payments	\$115,965	\$91,116	\$121,322	\$101,568

If the value of the machine at the end of the 3 year lease is \$24,800, then there is no financial difference between leasing and owning.

Or \$19,750 at the end of a 4 year lease.



Financial difference between leasing and owning

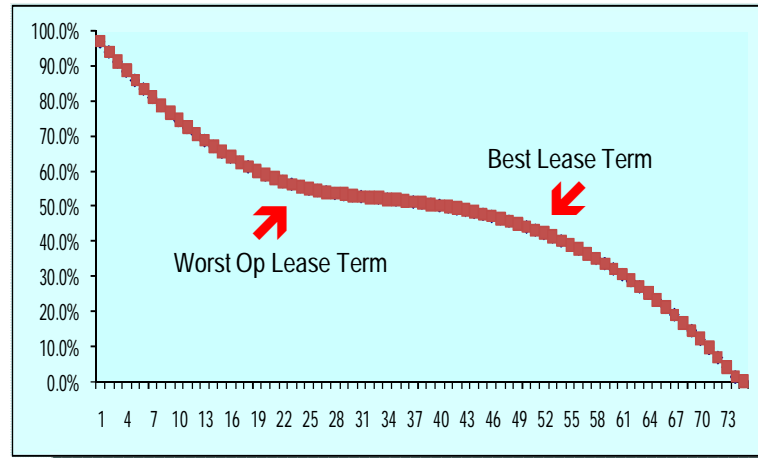
	Finance Lease	Operating Lease	Finance Lease	Operating Lease
Cost ex GST	\$100,000	\$100,000	\$100,000	\$100,000
Term	60 months	60 months	48 months	48 months
Residual Value %	14.4%		19.8%	
Residual Value \$	\$14,400		\$19,750	
Swap Rate	6.08%		6.00%	
Finance Margin	2.75%		2.75%	
Total Rate	8.83%		8.75%	
Monthly Rental ex GST	\$1,862	\$1,862	\$2,116	\$2,116
Total Payments	\$126,127	\$111,738	\$121,322	\$101,568

If the value of the machine at the end of the 4 year lease is \$19,750, then there is no financial difference between leasing and owning.

Or \$14,400 at the end of a 5 year lease.



Optimum Operating Lease term?



[Quote Calculator](#)
[KRW Partners](#)

	36 months	48 months	60 months
Total Cost with Residual Value	\$115,965	\$121,322	\$126,127
Residual Value	\$24,860	\$19,750	\$14,400
Lease Component / Operating Lease	\$91,105	\$101,572	\$111,727
Cost - 1st to 3rd years - 4th - 5th years	\$30,368 pa	\$10,467	\$10,155
Loss / Gain on Sale	-\$4,860	-\$4,750	-\$4,400
Revised Cost - 1st to 3rd years - 4th - 5th years	\$31,988	\$15,217	\$14,555
Resale Value	\$20,000	\$15,000	\$10,000



What can we do to be more productive?

Think about this

You have 40 hectares of turf to mow which on average is cut 40 times per year.
That's 40 hectares x 40 cuts = 1,600 hectares of turf to mow



• A 6 foot out-front takes **1,095.9 hours**

• A zero turn mower takes **439.6 hour**



• An 11 foot wide area mower takes **372.1 hours**

• A 16 foot wide area mower takes **190.5 hours**



Product	Mowing rate ha/hr	Hectares to cut	Cuts per year	Hour required to cut
6 foot out front – GM3280	1.46	40	40	1095.9
Zero turn mower – GM7210	3.64	40	40	439.6
11 foot wide area mower – GM4100	4.30	40	40	372.1
16 foot wide area mower – GM5900	8.40	40	40	190.5



=



=



=



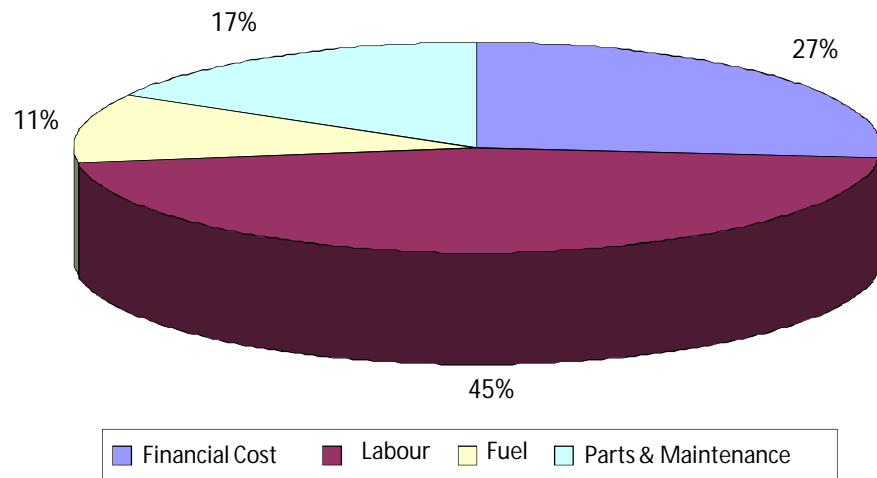
Cost comparison- wide area mower vs smaller rotary

	GM3280 – 1.8 m deck	GM4100 - 3.5 m deck
Depreciation	\$5,000	\$9,500
Investment	\$3,000	\$7,000
<u>Financial Costs</u>	\$8,000	\$16,500
Labour	\$21,000	\$8,500
Fuel	\$3,000	\$2,800
Parts & Maintenance	\$6,000	\$2,600
<u>Operating Costs</u>	\$30,000	\$13,900
<u>Total Cost per year for 40 cuts</u>	\$38,000	\$30,400
Hours used per annum	1,050	400
Expected Life	5 to 6 years	8 years

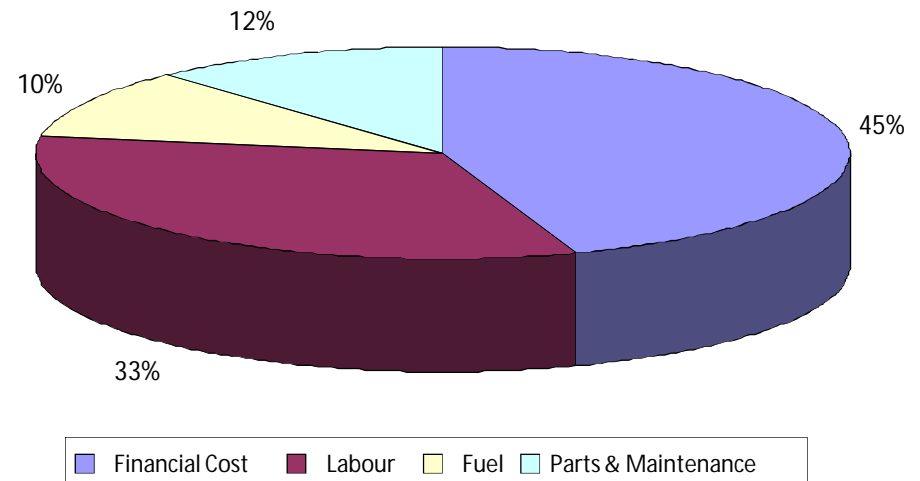


Cost components

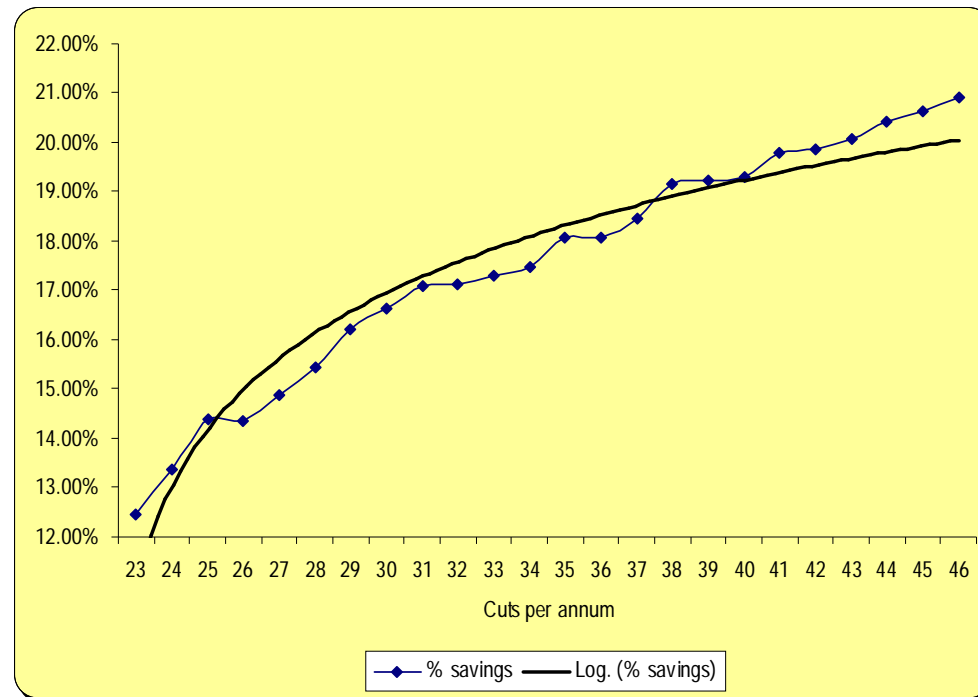
1.8 metre Z mower



3.5 metre mower



Savings grow as the number usage increases



In summary

Operating Lease is best :

- For high use equipment.
- Which is frequently “rolled over”
- When re-sale value at the end of the roll over period is uncertain.
- When capital is scarce.



The key issue influencing operating lease cost

- Select the optimum lease period – not too short – but avoid long leases where high maintenance and depreciation impact costs.

