Lift truck financing: Understanding lifespan

More savvy lift truck fleet managers are realizing that buying, renting, or leasing practices set the tone for future savings.

BY **JOSH BOND,** EDITOR AT LARGE

It can be said that the recent economic downturn was the catalyst of modern fleet management, forcing lift truck fleet owners to analyze their operations in ways they never had before.

Not only has the market seen tremendous advancements in fleet tracking and monitoring technology, but it has also witnessed the evolution of lift truck financing options. Savvy customers have developed an understanding of a truck's economic lifespan, and lately more are focusing on the beginning of that life—the moment when a signature finalizes a purchase, rental, or lease.

Because that moment can make or break a company's efforts to optimize its fleet over the coming years, *Logistics Management* spoke with industry analysts and lift truck finance experts to help readers prepare for that pivotal stroke of the pen.

"When a business considers acquiring a new piece of lift equipment, that's akin to a consumer considering whether to buy, lease, or rent a new car," says Jonathan Kipp, relationship manager with GE Capital. "Few consumers would rent a car just to get to work, or lease a backup vehicle, and fleet owners would be wise to avoid these situations as well."

Currently, many more lift truck customers lease rather than rent or buy outright, according to Kipp. "Many of the benefits of leasing apply just as much to small businesses as to Fortune 500 companies," he says. "Leases can be structured to maximize cash benefits in addition to helping address a maze of tax and accounting rules, while mitigating many risks and expenses of asset ownership."

Although the affordability and predictability of leasing offers improved cash management and flexibility, some customers still cling to the historical perception of leasing as a restrictive agreement destined to produce huge end-of-term bills.

However, as customers become more devoted to squeezing each and every penny from their fleets, so have equipment finance partners

the economic

developed products around the same goal. Along with the fairly straightforward processes of buying, renting, and leasing, customers can now pursue pay-by-the-hour leases, unconventional term lengths, negotiable lease provisions, and on-the-fly term extensions or monthly payment adjustments.

None of these options is a guaranteed success, but with a comprehensive understanding of the lift truck's application and a working relationship with a finance partner, fleet owners will be ahead of the curve.

When and how to buy

Not long ago, more customers were buying outright than leasing, says Jeff Bailey, director of Crown Credit Company. "It has been a very trying last few years," says Bailey. "During the recession, there wasn't a lot of anything going on."

There was pent-up demand, he says, and a lot of companies had cash built up—so, many bought outright. Government incentives for capital expenses contributed to the recovery. "Now we're trending differently," says Bailey. "Now it's flip-flopping again, and more customers are leasing."

For Brian Markison, senior manager for national accounts at Nissan Forklift, the decision of whether to buy or lease hinges on how quickly the customer will consume the economic life of the asset. If the answer is "quickly," then lease. If the lift truck will only be used 1,000 hours per year, don't lease. Instead, the customer might buy or rent long-term.

Another consideration, says Markison, is whether the asset in question is a specialty item or has a robust secondary market. If not, it might be best to buy.

Bill Buckhout, marketing manager for Raymond Leasing Corporation, says the customer niche that buys equipment should have an application where equipment will last a long time, maybe as much as 20 years. "For all the right reasons, a customer who would like to pay in cash should not buy outright," says Buckhout. "They might consider a single-payment lease, but then they'll have to plan for that equipment to go away at some point. All kinds of bad things can happen when people try to buy something with a finite economic life."

When and how to rent

Rentals for any length of time, whether one day or one year, require the customer to pay a premium for the convenience of returning a lift truck at their leisure. While rentals can provide great flexibility, they are also more costly.

"Short-term rentals must be just that—no more than two to three months," says Markison. "A customer who keeps renewing these agreements can spend as much in one year as the asset would cost to buy outright."

Some customers slip into this cycle accidentally, he says. Rental expenses might come from a different budget than capital expenses, and might be subject to less scrutiny as a result. "I've seen operations with rental trucks that corporate didn't even know about," says Markison. However, if a company is strongly averse to a commitment of more than 12 months to 24 months, a long-term rental might be appropriate, he says.

Tina Goodwin, director of financial services for NACCO Material Handling Group, has a different rubric. "When I look at renting, I think of a customer with seasonal peaks who needs a truck for just a month or two at a time," she says. "That's the only time I would recommend renting."

Realistically, however, customers often end up in long-term rentals if they can't find the right lease agreement to satisfy internal provisions, or if for any reason a rental is not subject to the same internal scrutiny, as in the case of Markison's customer.

"Otherwise, there are essentially no advantages to the customer over a lease for the same term," says Goodwin.

When and how to lease

Back when businesses were flush and lift trucks languished at the bottom of the list of priorities, lease agreements were executed hastily as a matter of housekeeping. Canned agreements rarely lined up with the disparate realities of the lift

Jean-Francois Podevin

The right finance option should be tailored to the application, which often varies within a facility.

truck's application, and leasing ended up with the reputation it is still working to shed.

"The lessee's viewpoint was that leasing was just a ticket to get taken at the end of the deal," says Bailey. "Now it's a very desirable program. We quote leasing options on every sale."

According to Kipp, the equipment finance industry continues to be a powerful engine for the U.S. economy, driving manufacturing and service sector supply chains across the country. In fact, the Equipment Leasing and Financing Association (ELFA) estimates that last year U.S. businesses, non-profits and government agencies financed $628 billion of capital goods or fixed business investments, up 21 percent from the year before.

"Companies that are in business today have worked hard, made smart choices, and navigated many challenges to get to this point," says Kipp. "In my opinion, companies are carefully managing their working capital and they're aware of the need to keep sufficient liquidity on hand. One of the ways they can manage their cash is by taking advantage of the benefits of leasing equipment rather than buying it."

Leasing today looks very different than the landscape even a decade ago, when Bailey says some customers "had no idea a lease was expiring until a salesman came out to visit." Especially after the credit crunch, customers are looking for consolidated services—equipment, maintenance, and financing—from the OEMs.

"Customers are starting to get smart about tracking their fleet, and that's changing things," says Bailey.

Eric Gabriel, senior manager of sales operations for MCFA, says customers should begin with an application survey and structure the lease around the available data.

"We want to bring precision to that agreement for our customer, and the more precisely they know the application, the better," says Gabriel. "Replacement should be happening at the exact

right moment."

Now, instead of traditional three-, four-, or five-year leases, customers can enter a 39-month term, says Markison, if that's what works for their application. Still, too many customers rely on faulty—and costly—assumptions.

"It's common for customers to sign an agreement for 2,000 hours per year and end up returning a really nice piece of equipment with 5,000 fewer hours than they paid for," says Markison. "Unfortunately, customers assume that because an operator is paid for eight hours a day that magically the forklift will be used for 2,000 hours per year—when in reality it is probably much less."

Goodwin says she sees customers on almost a daily basis who keep lift trucks far too long. For example, one customer averages about 4,000 hours per truck per year. They requested a five-year lease, which means they'll return equipment with 20,000 hours on it.

"That's just unheard of," says Goodwin. "The whole purpose of leasing is to use the truck for its economic life. The maintenance costs in that scenario would be huge, and the monthly payments for the lease are going to be comparable to buying the truck outright."

A strategic replacement cycle ensures operators benefit from state-of-the-art equipment and safety features.

That customer should be on a 36-month term, says Goodwin, but is fixated on the lowest possible monthly payments. The same fixation can lead customers to shop different leasing companies for the lowest payment despite huge differences in the structure of the lease. "That customer comes back to us within a couple of years and says they got a huge bill for all sorts of nickels and dimes at the end of the term," says Goodwin.

Signing the contract

According to Rhonda Endo, product marketing manager at Toyota Financial Services, just 10-15 years ago, the local warehouse or operational managers made the buying decisions for purchasing or financing equipment in their areas. They might have been in the habit of swapping entire fleets every so often, as opposed to establishing staggered replacement cycles that are key to cost management.

"Today, customers are moving toward

more centralized procurement models that bring a higher level of sophistication into the buying process," says Endo.

But that doesn't mean operations should be kept out of the process. Markison recommends operations personnel consult with the CFO during lease negotiations to ensure the customer has a thorough understanding of their obligations, such as return provisions. What is acceptable end-of-term damage? What about overtime, relocation, early termination?

"So many people sign a document without reading it," says Buckhout. "Lease contracts require more than legal overview. Someone who understands the operation must look it over in advance of signing, and should negotiate with the lease company to ensure a good fit. In fact, if you're dealing with a leasing company that does not work with you to tailor the agreement, you're dealing with the wrong company."

Kipp recommends that lift truck customers expand from local or regional banks to financing companies and specialty lenders, where they will gain more than alternative sources of funding.

"They gain a trusted financial adviser and a valuable ally who can suggest additional leasing scenarios that may offer improved capitalization strategies over the long term," he says.

When the end of the lease term arrives, Gabriel says it's generally not ideal to extend the lease, which can often result in unplanned costs. However, lease extensions can also be used strategically, he says, instead of an emergency alternative to careful planning.

"I've seen customers that have gone as long as 24 months defaulting to monthly or quarterly renewals," says Gabriel. "You should be well-prepared to make a decision at least six months before the lease expires."

For instance, if utilization were slow over a two-year period of the lease, a 12-month extension might be just the thing to ensure the customer gets value for their money.

As leasing structures evolve, attentive forklift customers will likely find themselves with as much flexibility, predictability, and liability as they might like.

Future trends…

Endo predicts the economy will continue to improve, as will customers' equipment expenditures. Leasing is flexible and convenient, she says, and could remain the ideal choice for many businesses. But now that the traditional three-, four-, and five-year structures have been broken down, what other innovative approaches lie ahead?

In early June, NAACO Material Handling Group formally launched a new product called "Power Advantage," according to Goodwin. The program features pay-per-hour leases that can be paired with pay-per-hour maintenance. Under the program, the lease company tracks and bills for hours used. Those administrative functions, as well as the risk associated with lease/sub-lease arrangements, are lifted from the dealer's shoulders, says Goodwin.

This sort of new, more flexible structure resembles a "material handling as a service" model, although that's currently a term without a definition, says Buckhout. The concept could allow fleets from 1 to 100 to purchase the use of equipment. As far as the customer is concerned, the truck has no serial number and might be new or used. Buckhout says that this approach began in the 3PL industry, which is constantly pushing for more flexibility.

"It is very difficult for even a large company to make a five-year commitment these days," says Buckhout. "These sorts of tools will allow customer to confidently scale their fleets."

Buckhout also mentioned some potential changes to the Generally Accepted Accounting Principles (GAAP), the standards for the preparation of financial statements. Though currently in the proposal stage, the new initiatives are designed to put assets back on balance sheets in an effort to make a statement a more honest depiction of the organization.

Currently, many lease expenses do not appear as capital assets on these balance sheets, he says. The ramifications of such a move include a potential reduction in a company's return on assets, on which some bank loans and employee incomes are predicated.

"These changes could be three to five years out," says Buckhout. "Those companies that prepare financial statements three years in arrears are likely listening closely, but it remains to be seen how new leasing products will fit into any new standards."

As leasing structures evolve, attentive forklift customers will likely find themselves with as much flexibility, predictability, and liability as they might like. In the mean time, they can prepare themselves by shedding outdated practices, mining for data, and finding the right business partners for equipment, maintenance, and financing.

If they're lucky, they might be able to get all three from the same source. "After all," says Goodwin, "Fleet and finance go hand in hand."

—Josh Bond is Editor at Large for Logistics Management