

Finding the Gotchas in Equipment Leasing Before They Find You

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Abstract. If your company is like most businesses, you lease equipment. A U.S. Department of Commerce report states that 80% of all businesses lease equipment. Leasing is one of many financial tools available to businesses whether they are publicly traded corporations or family owned private companies. Leased assets include the full range of equipment necessary for a company to conduct business.

Our research indicates that there are three areas in which all companies can improve their leasing processes, decrease total financing costs and save time. To accomplish this, companies need to understand the language of leasing, improve their lease negotiation skills and develop more detailed RFPs that include enhanced lease requirement sections. Very large organizations with extensive annual leasing needs should consider a RFP that is entirely dedicated to leasing. This RFP is separate from the equipment request and only deals with the financing.

Many municipalities, corporations, service businesses and not-for-profits seek out a lease line of credit that will cover all equipment acquired during a specific period of time, usually a calendar or fiscal year. The lease line of credit may be renewed annually if both parties are satisfied with the working relationship. Using a lease line of credit means a company negotiates a Master Lease document only once, saving valuable staff and legal time investments. Companies who choose to use this approach should have a well organized budgeting process, accurate product and market forecast models and open channels of communication between procurement, finance and operations.

Leasing and Equipment Financing Industry Statistics. Equipment Financing is a \$600 billion dollar industry. A study conducted in December of 2007 and January 2008 by the Independent Equipment Company (IEC) and the Equipment Leasing and Financing Association (ELFA), reported that leasing companies may be adjusting their credit policies and collateral department risk assessment profiles. The 141 executives surveyed report some of the reasons for belt tightening are changes due to weak US economic conditions, an unstable

world economy, pending changes in US tax laws pertaining to lease accounting treatment, continuing devaluation of the U.S. dollar, the mortgage crisis, high oil prices and an increase in credit defaults.

The joint IEC and ELFA study reported that the hottest types of equipment for leasing companies in 2008 are expected to be medical, oil, gas and energy, marine and intercoastal, aircraft, and hi-tech and computers.

In a survey of over 500 senior financial decision-makers at companies with revenues between \$25 million and \$1 billion, the Economic Intelligence Unit and the CIT Group found that respondents were confident about business growth in the years ahead despite the challenges from current market conditions and the world economy. Thirty-six percent planned to make investments in new technology and over fifty percent planned to make capital expenditures during 2008.

What this means to procurement professionals is that their current leasing company resources as well as other financing resources, upon whom they have counted to provide aggressive rates and competitive pricing, may be less interested in equipment in the “not-so-hot” categories. The IEC-ELFA survey said that the less favored equipment types are expected to be automobiles, over-the-road trucks and trailers, construction, furniture, fixtures and office equipment, telecom, printing and plastics manufacturing equipment. Leasing companies will take a less aggressive residual risk position on these equipment groups. Lower residuals mean higher monthly payments.

The new market conditions may require enhanced RFPs that include more detail regarding the leasing needs and new negotiation techniques and skills to get the best deal available from leasing organizations.

Guides to Great Lease RFP, RFB and IFBs That Save Time and Money. (For purposes of this paper, we will use the term RFP synonymously with RFB and IFB although we know that their purpose and restrictions may be different. We hope that our tips will help when using any of these procurement tools.)

Recruit the team.

- Select the equipment and leasing RFP team from staff involved in the financing, maintenance and operation of the equipment. RFP Teams often include the plant operations managers, procurement managers, the company finance officer, and the maintenance department manager.
- Consider hiring an RFP specialist experienced in drafting and analyzing the leasing portion of the RFP. They can guide you through the confusing double-talk of leasing and help save time and money. They allow you to keep focused on your day-to-day operation and, if the company plans to create the RFP for a lease line of credit, these specialists will be extremely helpful in focusing on the common lease traps and how to steer through them.
- If leasing is an attractive option, discuss the tax benefits and implications of leasing with the company accounting and tax departments.
- If the dollar amount of the investment is large or if the company is privately held and the leasing companies requires personal guarantees from the owners or partners, consider adding the company attorney or a representative from the company in-house legal staff to the RFP negotiation team.

Budgets and timelines.

- Don't get carried away with all the bells and whistles that you read about in equipment trade publications. The needs of the business are not the same as the wants of equipment managers.
- Your budget is your business. Don't let the equipment dealer or the leasing company sales person know exactly how much you plan to spend.
- Include possible financing alternatives you have read about or studied. Be specific. Suppliers and manufacturers may have interesting financing options including special leasing plans or low interest finance plans.
- Always remember: there is no such thing as a Free Lunch or Interest Free money. Free is never really "Free." An international software company presented a \$2 million dollar software license renewal program to a very large Midwestern municipality as a zero interest finance program. The municipality hired an independent lease review specialist to study the contracts. The analyst found that the true finance rate was 8%. The City had an alternate

lease line of credit negotiated by their Treasury Department for just such a project at a lease finance rate of 4.25%. The software vendor's "free money" option was rejected for a better deal.

- Always ask for the total equipment cash purchase price. Never focus exclusively on the monthly payment. Remember to step back and look at the total cost of the lease over the life of the contract. And always read the fine print.
- Find dealers and leasing companies you can trust and stay in contact with them.
- Establish timelines and require bidders and the lease review team to adhere to them.

What goes in ---what stays out?

- **Company History:** Include company background such as number of employees, is the company publicly traded or privately owned, identify all company locations where equipment will be located. Describe the primary company business functions.
- **Equipment:** List the equipment specifications that are essential and options you might consider. Prioritize the equipment features as either mandatory or optional.
- **Seasonal Payments:** If you have seasonal fluctuations in your cash flow, consider requesting structured lease payments. Sometimes higher payments when cash flow is strong and lower payments in the off season create a perfect fit. Some traditional banks and financial institutions are not big on flexible payment plans. Leasing companies understand structured payments.
- **Trade-In:** Will there be trade-in equipment available? Understand the used equipment market and the true value of your trade-in.
- **Maintenance:** Who will maintain the equipment? Will the equipment dealer supply maintenance or will you need an additional maintenance company to service the equipment? Many lease agreements require maintenance contracts on all assets in addition to the standard manufacturer's warranty coverage. Leasing companies may request copies of the maintenance contracts for their records. If copies are not available, fines may be levied.

- **Lease Quotes:** Always get lease quotes from at least three independent leasing sources in addition to the equipment vendor's leasing sources. Independent leasing companies have no affiliation to the equipment supplier. Their only business is financing and leasing.
- **Bank Quote:** Don't forget to contact your banker. Many banks have leasing divisions that provide excellent financing options and your business already has a track record with them.
- Require all bidders to submit their proposals with copies of all documentation required to do the deal. If leasing is involved, that means receiving copies of all standard lease documents, equipment schedules, proof of insurance requirements, personal or corporate guarantees, upfront payment requirement and security deposit requirements. All lease contracts contain "gotchas" that increase the total cost of financing.

The final steps.

- **Analysis:** The lowest selling price or lowest lease payment is seldom the BEST deal. One healthcare institution focused only on the monthly per computer payment when comparing three leasing company proposals on \$2 million dollars in new desktops computers and servers. They chose the company quoting the lowest monthly payment. What they didn't realize until it was too late was that "low payment" leasing company contract forced the healthcare organization to pay 12 additional payments over the life of the lease. The 24-month lease term they agreed extended for 36 payments.
- **Read Terms and Conditions:** Examine all maintenance and service contracts from each equipment distributor. Who will maintain the equipment according to the manufacturer's recommendations? It is extremely important that someone commit to delivering timely preventative maintenance to avoid expensive emergency service calls. Maintenance contracts, like lease contracts, are negotiable.
- **Lease Quotes:** If you consider leasing, get quotes that include a fair market value purchase option lease, fixed purchase option lease and a \$1.00 purchase lease. The lease term should be one that works not only because the monthly payment fits company cash flow but because the length of the lease parallels the time the equipment will be of value in your company plan.

The clock is ticking.

- Don't let the process drag on forever. Limit analysis time.
- Timing of manufacturer, dealer or distributor discounts should work in the customer's favor. Equipment sales teams face production quotas at various times of the year. Coordinate the RFP process with their selling cycle and receive maximum discounts.
- Equipment leasing companies have the best and most aggressive tax pricing in the 4th calendar quarter of the year. This is due to the benefit of depreciation that leasing companies utilize to pass on lower monthly payments to customers. If at all possible, schedule equipment delivery for leased assets to occur in the October, November and December time frame.
- The decision is taking too long if you started with brown hair and are now bald or very gray.

Know when to walk away.

- Always be prepared to walk from the deal. Be ready to tell the sales representative, "We do not have to do this deal now. We can wait until next month, quarter or even next year."
- Negotiate the price of the equipment first. The lease negotiation comes second. The bigger the discounts on the selling price, the lower the monthly payment will be.
- Use the Kenny Rogers Technique: Know when to hold them: know when to fold them. And Know When To Walk Away.

Two Lease RFP Success Stories. A very large county located on the East Coast sought municipal lease financing for a computer-to-plate system for their in-plant print shop. Their first draft of the RFP did not contain a detailed description of their financing preferences. The original RFP did not address specifics about their lease needs. They retained the services of a lease RFP specialist to assist the procurement department and the in-house print shop with writing the lease request portion of the RFP. The result is that they received proposals that met their needs and the county saved money. The financing they selected matched the life cycle of the equipment in their department and the payments met their budget expectations.

Equipment and Leasing RFP's are not just for large multi-national publicly traded corporations. Shook Hardy and Bacon LLP is a Kansas City based law firm and one of the top 50 law firms in the United States. The firm decided to write a lease RFP to locate very competitive leasing

companies to finance millions of dollars of telephones, furniture, computers and video conferencing equipment for their new corporate headquarters. Dale Chaffin, the Chief Operating Office of Shook Hardy and Bacon LLP (now retired) knew leasing made good business sense for many reasons. IT helped the firm conserve cash and spread the cost of the new equipment over the useful life of the assets within the organization. The firm worked with a consultant to prepare the multi-million dollar leasing RFP.

The equipment selection bid process was not part of the lease RFP. Equipment decisions took place before preparing the lease RFP. This allowed the firm enough information to give the leasing bidders the equipment brands, quantities, manufacturer names and detailed specifications and pricing. The leasing companies could respond with the most aggressive lease proposals.

The firm sent the lease RFP to 13 leasing companies and financial institutions. Chaffin calculated that the use of the leasing RFP and the aggressive lease negotiation that preceded contract signing saved the firm over one million dollars.

After a full review of all proposals and lease contracts, four leasing companies were invited to continue the competitive process. The firm conducted negotiations with all four leasing companies simultaneously. During the negotiations, one leasing company resisted making changes that Chaffin required. Because he had three other leasing companies willing to accept his terms, Chaffin could shift lease business at any time before the contract signing. This negotiation technique gave Shook Hardy and Bacon maximum leverage throughout the contract negotiations.

Of the lease review process, Chaffin said, "I would not give the proposed lease documents or constructive outline to the attorney to review until after it has been reviewed by the lease review specialist." Of the value of the review specialist, Chaffin further added that "the questions are more related to favorable financial treatment and market competitive terms which need to be first resolved by a lease review specialist." Using the RFP process levels the playing field. It was easier for the Shook Hardy and Bacon RFP team to spot the differences in various financial solutions.

C. Clint Bolte, a full-time printing industry consultant for the past 25 years and a contributing editor to a number of printing and publishing trade publications also supports the benefit of using outside help when crafting the lease RFQ. In his article "*Third-party Lease Review*" Bolte said "firms from other industries have found that having this lease expert actually prepare

a Lease RFQ based upon the firm's specific needs is the best of all solutions." This proactive RFQ is the basis for the ultimate lease agreement." So whether you do it yourself, or locate a lease review specialist, there are ways to save time and money with leasing RFPs.

Negotiation Language and Techniques. No matter how detailed the RFP, the final step to success is in negotiating the lease contracts. It may surprise many that leasing companies will negotiate their "Standard Lease Agreement" contract. The term "standard lease" should not be construed to mean that one-size lease fits all. In the article "*Third-party Lease Review*", C. Clint Bolte says "The delightful surprise is that the manufacturer's leasing department is often delighted to negotiate the terms of the lease, particularly with another professional who understands what the gobbledegook actually means."

Leasing is a finance tool that has been available for over 50 years. The industry is healthy and growing. Procurement pro's must continue to understand the sometimes ambiguous language of leasing and work to improve their lease RFP processes, continually strive to craft leases that fit their needs and not just the leasing company goals negotiate lease and maintenance contract terms aggressively and, finally, track leases throughout the lease lifecycle to avoid automatic term extensions and other end of lease penalties. In this way, procurement managers can make significant contributions to their personal and professional success.

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