Machinery Rental – Precise Financing for the Latest Machinery

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Purchase and ownership are very 'British' concepts. On an individual basis, most Britons aspire to own the house in which they live, whereas in other European countries the majority of properties are rented.

It's much the same in business, particularly among smaller organisations in the UK, where outright purchase is the preferred route, even if this means locking up valuable short-term sources of funds in assets with a longer term payback.

Our European neighbours take a different attitude towards funding assets like machinery and equipment. They prefer to match the source of funds and the payback to the productive life of the asset in the business, simply because it takes pressure off cash flow and makes more sense to them to match payment to productivity.

Ask yourself the question: Does a machine work any harder because you pay cash for it on day one? The obvious answer is 'No'.

So why put valuable resources like cash or the overdraft under pressure by diverting them from the short-term roles to which they are best suited. For example, paying wages, securing additional discounts for prompt payment of fuel or fertiliser bills, etc.

Think cost not price

Maybe one reason is cost, or rather the 'perceived' cost, of borrowing – backed by a faulty assumption that cash is a free resource while a finance agreement attracts interest.

Unfortunately, confusion often exists between the concepts of price and cost.

Take any machine, you know the price on the day you buy it, but you only know what it actually cost on the day you sell it, after you take into account factors like reliability and maintenance, fuel, the sale value and, most important, how well it did the job you bought it for.

That's why it pays to consider all the financing options, when considering new investment, to ensure you choose the one with the best balance of cost and performance.

In every organisation there are competing calls for capital. Even a golf club has to face up to decisions like should we refurbish the locker rooms this year or replace a particular machine.

Inevitably, if the members provide the main source of funds, either the house or the course is likely to be disappointed and important investment deferred.

It's no different in big business. Capital is still rationed although techniques exist to determine the cost and to allocate capital to the projects that offer the best return and also satisfy the priorities of the company.

To cut across this problem of capital rationing, many leading companies that rely on the latest technology and equipment to retain their competitive edge now choose to rent rather than buy.

Rental - designed for use without ownership

Rental, as the name implies, is about use of the latest machinery, not ownership.

'At the end of the rental period the machine is usually returned to the supplier and the hirer enters into another agreement for a new machine to the latest specification'

That's why the structure and terms of an operating lease differ significantly from conventional forms of finance even though it offers a number of similar benefits plus some that are unique (see table opposite).

Because rentals are based on use, they are calculated on an amount that excludes an estimated disposal value for the machine.

For example, if it is reasonable to expect that after 36 months a machine will realise 30 per cent of its original price, this is taken into account in calculating the rentals.

The result is usually a monthly rental that is lower than for a comparable purchase agreement, which is good for cash flow.

Risk-free budgeting

Under a rental agreement, the hirer has no interest in the proceeds of sale, and bears none of the risks if the machine fails to make the estimated sale price.

Instead, the business has full use of the machine, exactly as if it owned it, at a guaranteed monthly rental fixed over the chosen period. This assists accurate budgeting.

Flexible contract options

At the end of the rental period the machine is usually returned to the supplier, normally the agent of the finance company, and the hirer enters into another agreement for a new machine to the latest specification – although the agreement can provide for an extension of the rental period (at a continuing rental) should the hirer wish to retain the original machine.

This means the business or organisation ensures that its machinery fleet is kept constantly up to date and has the capacity to do the job required.

The hirer does have specific obligations under a rental agreement. These include insurance against accidental damage or damage caused as a result of negligence or abuse.

In addition, most agreements contain a set of return conditions. These define the minimum conditions to which the machine must conform when it is returned.

Items that are broken or damaged – for example, cracked lenses on lights – must be replaced and all major systems must function as originally supplied. Although allowance is made for fair wear and tear. Maximum hours worked under the agreement may also be included.

Inclusive service and maintenance

All agreements will require the machine to be serviced in accordance with the manufacturer's recommendations at the correct intervals.

However, the full cost of service and maintenance can be built into the rentals.

This offers a number of

Colin Theedom examines the role of rental as an alternative form of machinery financing worth considering for clubs and businesses.

benefits not normally found in the purchase package.

For example, a single monthly rental that covers hire, service and maintenance is not only convenient, but assures extremely accurate budgeting without the risk of additional maintenance costs resulting from unexpected breakdowns.

Low initial cash outlay

Rental is designed for operators that want to keep their machinery up to date, so agreements are normally over a shorter period, say two or three years.

Unlike conventional hire purchase agreements, there is not always a requirement for a deposit to be paid at the start of a rental agreement.

Instead, the first rental is paid when the agreement is signed and the new machine delivered. This minimises the initial cash outlay, which is good for cash flow.

VAT and tax allowances

A further feature of rental is the way in which VAT is treated. Under any form of purchase – cash or hire purchase – VAT is normally paid at the outset.

Because rental is a hire agreement, the VAT is spread and paid on each rental as it falls due.

Where an organisation is able to reclaim in full the VAT it pays, the cash flow benefit may only be marginal. But for a golf club that cannot reclaim all its VAT, the benefit could be significant.

All the rentals paid by the hirer are normally fully allowable against income as a business expense, just like repairs, fuel and wages.

This means the tax liability can be reduced. Currently, assets hired under a rental agreement are not required to appear in the balance sheets of UK companies and, for some, this offers potential to improve financial ratios.

Nevertheless, every business or organisation considering rental or any other form of financing should always check and confirm all issues regarding taxation, VAT and accounting treatment with its professional advisers.

For more information about rental as an alternative form of machinery financing for your club, contact Colin Theedom at TECH5 on 08702 404559.

THE BENEFITS OF RENTAL

FEATURES	BENEFITS
1. Choice of contract period and hours.	1. Can be easily matched to machinery replacement programmes, contract operations and changes in capacity.
2. Contract rentals, including service and maintenance, are fixed in advance.	2. Provides the opportunity to budget extremely accurately for front-line machinery operations and to plan cash flow accurately and confidently without concerns about unexpected maintenance bills.
3. Low initial cash outlay.	3. No need for large deposits, and VAT paid only on rentals as they fall due, protects cash flow.
4. Off balance sheet finance.	4. Frees capital and offers potential for companies to improve financial ratios.
5. Rentals allowable against tax as a business expense.	5. Reduces tax liability, although all issues regarding taxation, VAT and accounting treatment should be confirmed with a professional adviser.
6. Alternative line of finance designed specifically for use of the latest machinery and equipment.	6. Frees capital that can be invested in other projects. Also leaves existing lines of credit, particularly the bank overdraft, unchanged.