# MACHINERY FINANCE: HIRE GOES HIGHER

*By Eddie Henderson and Colin Theedom*

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**At first glance there seems to be very little similarity between machine tools, company cars and professional grass maintenance equipment. However, take a look at the way they are financed by business and it's certain that you will find that operating lease or hire is one common denominator that links them all – not to mention many other types of business assets too. In this review of 'operating lease', the authors explain the concepts and show why 'operating lease' has become the fastest growing form of machinery finance in the turfcare industry, with the number of transactions doubling year on year over the past five years.**

### BUY OR HIRE?

Basically there are only two ways for a business, an individual or an organisation to acquire anything – either it can buy it or hire/rent it. The difference is ownership or 'title' to the goods. Purchasers get title immediately – eg, using cash, cheque and loans or, under some forms of finance agreement, on completion. Under a lease, the finance company (the lessor) usually buys the goods and then hires these to the hirer (the lessee). Therefore under a lease, title never passes to the lessee.

Historically many golf clubs, in common with smaller businesses, have avoided leasing on the basis that "buying is best because you actually own the machine!" In some cases that may have been true, although without good financial advice it would be difficult to judge. For the same reason, those same clubs avoided using finance at all, which limited their options for replacing machinery because their 'capital investment pot' was fixed every year and had to satisfy the competing demands of the house and the course.

### THE BENEFITS OF FINANCE

The use of finance by the turfcare industry has grown significantly over the last 10 years as clubs recognise the benefits that it offers. These include:

Reduced pressure on cash flow: Machinery does not work any harder nor does a club gain any other advantage because it pays cash on day one. Instead, finance enables it to match the cost of new course machinery to its planned working life at the club. That's good for cashflow because the cost is spread and machinery pays for itself as the club uses it – season by season.

More accurate budgeting: Under both lease and purchase finance agreements the size and timing of repayments are agreed and fixed in advance. This makes for simple and more confident budgeting.

Quick and easy to arrange: Machinery finance is usually available at point of sale from the supplying dealer, making it quick and simple to arrange. What's more, leading machinery manufacturers often support their machinery marketing programmes with finance offers that are available at low APR rates of interest.

These benefits are common to hire purchase, finance lease and operating lease – giving clubs a choice of options. So what else does Operating lease offer that leads it to feature in the machinery investment programmes of a rising number of clubs?

### OPERATING LEASE

In its simplest form, hiring a car at the airport when you go on holiday is a type of operating lease. All you want is the use of the car over a fixed period of time, say, for two or three weeks until you return to the airport and hand it back to the hire company. You are responsible for the fuel and any accidental damage – while the car hire company carries all the other risks. For example, depreciation plus breakdown and maintenance, additional services that extend the basic operating lease into contract hire.

For clubs and businesses, operating lease is much the same, except it is arranged over longer periods that are suited to the particular types of machinery being used – typically between 24 and 60 months.

The main difference between a finance lease and an operating lease is the treatment of residual risk. Under a finance lease, although the hirer never owns the machinery, it participates in the proceeds of sale by way of a rebate of rentals on disposal. Under an operating lease the machine is simply returned to the lessor at the end of the agreement meaning the lessee has no share in any rewards (disposal surplus) but, equally important, no share in the risk of any losses!

Residual risks can be substantial and hard to forecast. When the finance company prices an operating lease, it estimates the disposal value of the machine at the end of the agreement. For example after 36 months. This amount reflects the total hours that the machine will work over the period, the type of work it will do and other factors that impact on its resale value. The finance company then offsets the estimated disposal value against the initial price of the machine and the rentals are calculated on the balance. This means that operating lease rentals are normally significantly lower than those for a comparable finance lease or hire purchase agreement.

Another difference is that the level of initial rental (deposit) is also lower for an operating lease which means there is a cash flow benefit too.

Like any lease, the rentals the club pays are recorded in the accounts as a business expense in the year they are paid, just like wages, fuel and other operating costs. This can provide corporate/business hirers with tangible tax benefits and the added advantage that the machinery is not included as an asset in the balance sheet, which can improve the financial ratios – a benefit where performance is measured by the market and shareholders.

**CONTRACT HIRE**

Contract hire is an operating lease with the cost of full maintenance and servicing built into the rentals. Although companies like Toro provide a limited two-year warranty that covers major components, contract hire goes further to include the cost of servicing in accordance with the manufacturer's recommendations and maintenance support subject to conditions about hours and exclusions specified at the outset.

**INCREASED SPENDING POWER**

The level and sophistication of financial planning at many clubs today means that accurate budgeting and financial information are now features of machinery operating and replacement programmes. The pages of the latest edition of Newslines, the magazine published by Toro Commercial Products, contain a number of examples of clubs replacing their machinery fleets with fixed period financing to match, much of this on operating lease.

Instead of viewing their machinery replacement budgets as a mix of capital – say, £15,000 pa, plus maintenance of, say, £10,000 pa, the clubs have rolled these into one amount of £25,000 and viewed this as an annual operating lease rental over a number of years – increasing their immediate spending power substantially.

Toro has just gone further in announcing a brand new extended warranty package called Protection Plus, which protects clubs against unforeseen costs of major breakdowns and repairs. This plan gives extended protection for commercial turf equipment beyond the manufacturer's standard two-year warranty for up to another three years. This makes it an ideal addition to operating lease agreements over periods up to five years.

Regular replacement of key machinery offers clubs a number of advantages. The increased reliability of new machines reduces the incidence of breakdowns and subsequent maintenance costs. New machines also incorporate the latest design features and technology and produce a better job – impacting on the presentation of the course and its potential to increase green fee income.

Under an operating lease the period is agreed to match the machinery replacement programme that is best for the club or for a particular class of machine. At the end of the agreement the equipment is returned to the lessor and another agreement is written for a new machine. However, there are occasions when a machine has not had the expected amount of use and/or is still performing well at the end of the agreement. So much so that the club wishes to retain it. This usually presents no problem since, under these circumstances, the operating lease can be extended.

**CONCLUSIONS**

It's important to have a physical plan and a financial budget to ensure the course machinery matches the course management and development programme set by the club.

All the financing options should be reviewed impartially, with support from professionals and others able to provide the accurate financial information and projections to enable the committee / management to reach realistic decisions.

The best packages are tailor-made to the club and may contain a mix of different financing facilities and support services (eg, planned maintenance agreements/extended warranty products).

## EXAMPLE OF OPERATING LEASE EMPLOYED BY A GOLF CLUB

Undoubtedly, operating lease works well with quality machinery that has strong, proven resale/residual values. Often, the operating lease packages that Colin Theedom has constructed with clubs contain a mix of machinery from different manufacturers. Take, for example, this large 18-hole club in the South East:

### The Problems:

- Some use of machinery finance but no history of financial planning
- A mix of ageing machines with rising maintenance and operating costs – annual budget of £13,500 for repairs and £17,500 for new machinery.
- Problems with performance and effect on greens' staff morale.

### The Solution:

- Dispose of eight old machines applying cash generated to first year operating lease rentals and upgrade to irrigation system.
- Apply £26,000 rentals each year on four-year operating lease for seven new machines comprising greens, fairway and rough mowers and a new utility vehicle.

**ABOUT THE AUTHORS**

Eddie Henderson has held senior management positions at board level in a number of leading finance companies. His company now manages the retail finance operations on behalf of a number of household names in turf-care and agricultural machinery manufacture and distribution. Eddie can be contacted at *eddie@echenderson.co.uk*

Colin Theedom has been involved in asset finance for more than 30 years – with a successful track record in direct sales and sales management. His company currently works with Toro and a number of its key distributors to provide effective financing solutions for clubs of all types and sizes. He can be contacted on 07776 197498.