Hedge your bets

Last month's interest rate hike, plus rising truck prices and the accumulation of Euro VI used trucks, are likely to reduce the attractiveness of truck finance. This may be a shock for an industry accustomed to low-cost deals, reports Kevin Swallow

Fraikin financed Middlebrook's new Mercedes tractors

Choosing whether to buy, lease or hire depends on whether you want to take responsibility for the asset, or let someone else worry about it. Either way, the acquisition sector is competitive.

Between July 2007 and March 2009, the Bank of England (BoE) helped reignite investment by reducing the basic rate of interest from 5.75% to 0.5%. This made borrowing affordable for businesses. The rate dropped again in August 2016 to 0.25%, though last month it returned to 0.5%.

In 2013, Andrew Haldane, BoE's chief economist, declared that "the age of asset management is upon us", as banks moved into the investment industry to counter the declining power of the banking sector and the potential risk this posed to financial stability.

The author experienced this trend first-hand, when in 2015 Lloyds Bank Asset Management financed his tipper truck at 1.9% APR. To compete with banks, the cost of finance supplied by truck manufacturers has been cut to the bone.

No surprise then that up to 60% of the assets sold by MAN Truck & Bus UK are funded through MAN Financial Services, and are lease agreements, explains director Peter Collins, with 30% seeking hire-purchase deals (where they gradually take a stake in the asset) and the rest paying cash. He argues: "People use a lease agreement because they don't want surprises."

These days, credit is so cheap that leases are commonplace. Just about everyone borrows, even if they don't need to, according to John Bartlett, who runs bulk operator W Rolls in Somerset. "We bought the last couple [of trucks] for cash, but if you do that too often you lose your credit rating.

"So we usually have a small draw on a vehicle using a manufacturer's finance packages to part-finance some new trucks coming into the fleet, usually over two years at around 1.4%," he adds.

In the current environment, three-year replacement programmes – a package favoured before the recession – are now back in fashion among OEM finance offerings. This time around, the shorter timescale has fed a used truck market craving Euro VI chassis. Now, as more new trucks enter the used market, those strong residual values (RVs) will soften, warns Paul Young, senior asset manager at Paccar Financial.

PRICE HIKE

What's more, OEMs suggest that there will be a significant price hike for Euro VI trucks starting from January 2018 – as much as 10% – to pay for new technology, and cover potentially worsening exchange rates. The latter is driven by uncertainty over Britain's withdrawal from the EU.

"Brexit is pushing up import rates, so prices will need to go up," states Nigel Butler, operations director at Renault Trucks UK. He echoes Young's warnings about Euro VI RVs, too; he sees the rates for contract hire changing over the next 12 months. That finance type offers fixed terms (ranging from two to five years)

> ***"Fraikin's contract hire agreements tend to be five years, with the optimum cost of ownership at just below six years"***
> Colin Melvin

and some supplier servicing. "Two- and three-year contract hire rates have been competitive and driven by customer demand, but that won't continue. A rise in capital cost and reduction in RVs as more Euro VI second-hand vehicles enter the market will move people away from contract hire back towards ownership."

Contract hire has lower monthly fees than finance leases, as the RV is already in place. In contrast, finance leases provide an option to extend the agreement.

Further support is offered by a hire purchase deal including a balloon payment at the end. This brings down the monthly repayments and is often accompanied by a repair and maintenance (R&M) package. So says Renault's Nigel Butler, who adds that this it is suitable for smaller operators looking to own the asset but reduce the cost of ownership.

"The balloon payment can be paid by the operator at the end to complete the deal, or used as a part-exchange for a new truck. With R&M and warranty in place, the operator gets the benefits of ownership but we have the risk," he says.

For customers wanting even more support services bundled with their truck, Asset Alliance Group offers fleet management, maintenance schedules, tyre replacement, truck servicing, R&M, safety inspections and breakdown cover in various finance packages.

Dave Potter, commercial director at Asset Alliance Group, contends: "The owned workshop is becoming a thing of the past. We put all our assets into a main dealer: a recent deal with Steinhoff, which owns Bensons for Beds and Harveys, is an example. It was a DAF customer; now it uses us to provide DAF trucks [pictured below] and the one-stop-shop back-up, and we take back the vehicles. So Steinhoff avoids any issues surrounding vehicle disposal."

In just two years, Asset Alliance Group has increased its portfolio from 1,500 assets to 4,000; contract hire accounts for 70% of those. "Contract hire deals have come down from five years to two and three. Some want a flexi-hire deal with a set pricing structure and a 12-month notice period built into the agreement," he adds. (Such deals are so named because they can be terminated during the hire period; however that option adds cost, either in extra regular fees or a one-off payment.)

Potter concedes that Asset Alliance Group's contract hire rates are likely to go up next year to cover the anticipated OEM price hike, expected interest rate rise and softening RVs. He adds: "We are currently talking to customers about prices going up, because the cost [of borrowing] over the next five years will increase."

Fraikin, a truck contract hire and rental company, argues that its very size will protect it, and its customers, from any price hike or a weakening pound. Sales director Colin Melvin says the business has 3,500 vehicles out on contract hire, and offers an additional 1,000 for rental. The company is based in nine countries across Europe.

"Fraikin purchases vehicles in the thousands; the company has good terms and agreements that are well in advance of a potential price rise," he says. A fixed-term agreement brings security, he adds, so its customers' rates are not affected by a change in the interest rate rise when it happens.

"Fraikin's contract hire agreements tend to be five years, with the optimum cost of ownership at just below six years. So we can run a contract hire for seven years comfortably," he explains. TE

FURTHER INFORMATION

British Vehicle Rental and Leasing Association code of conduct – https://is.gd/tokume

HGV finance calculator – https://is.gd/iquley