Money talks

The decision on whether to hire or buy new vans, trucks or equipment can be a major headache for operators. Keith Read investigates today's finance and leasing deals

Maintaining investment in capital equipment – be it buying vehicles or new equipment to look after them – is difficult enough when the economy is buoyant, but with the country creeping out of recession, it is doubly hard. Bank managers are seldom the pushover that popular myth perpetuates, so, when times are tough, thoughts of replacing ageing fleets just have to be put on the back-burner.

However, finance and leasing deals can open the doors and give operators a fighting chance of emerging stronger after the downturn. And recent figures from the Finance & Leasing Association (FLA) show that more companies are taking advantage. In June, the UK saw growth in leasing and hire purchase for the first time since September 2008 – up 26%, at £2 billion, compared to the same month last year. Finance for commercial vehicles showed a 13% rise.

Commenting on the increase, Julian Rose, head of asset finance at the FLA, says: "Any sign of growth is good news, but the severity of the drop in business investment during the recession means that a return to pre-crunch levels is still a long way off. In the meantime, many businesses are living in a rusting Britain, with equipment that doesn't meet their needs for the recovery."

With many transport operators prepared to say 'Amen' to that, Rick Francis, operations director at Lex Autolease – which owns and manages one in every 75 vehicles on our roads – questions why more haven't made the move from vehicle ownership to contract hire.

One reason could simply be other priorities, with many firms totally focused on sales, customer service or tackling the pension deficit. Another is that off-balance-sheet funding is perceived by some to be less attractive, following changes to the accounting rules. But Francis maintains it is time to re-examine contract hire as an opportunity not only to drive down costs, but also to increase the availability of funding.

"Although liquidity issues may not be as acute as late 2008, there is no doubt that there has been a more or less permanent retrenchment from lending to some sectors," he says.

Outsourcing options

Looking at reasons to consider switching from in-house vehicle provision to outsourced contract hire, Francis cites a recent fleet cost review for nine of Lex Autolease's corporate clients that identified £50 million in savings. "This was calculated over six weeks and is largely accounted for by inefficiencies in the way those customers currently fund and manage their vehicles," he points out. "Those savings equate to almost £2,000 per vehicle on the bottom line – which is food for thought."

So what is on offer? The main packages are lease purchase (also known as hire purchase), finance lease, contract purchase and contract hire, with the latter being the most popular, mainly because of the add-ons that can tailor the package

Trailers for hire

It's not just vans and trucks that are available through finance – trailers are included, too. TIP Trailers Services, a division of GE's Equipment Services business, offers an equipment funding package that can help hauliers secure asset finance, despite tough times. According to TIP, many providers are reviewing their operations or closing their doors.

"The asset finance market is becoming more difficult, with many of the well known providers no longer in the sector," comments Karl Davies, services and marketing director at TIP. "With our equipment funding package, TEF, we can provide a quick solution, as it's a one-stop-shop, covering the full life of the assets."

TIP is based in Amsterdam with operations throughout Europe, including the UK. To date, this year it has funded 1,250 trailers, making it one of the largest buyers in Europe. John Crisp, TIP's equipment funding sales director, says this offers another big advantage for operators. "The biggest factor is the capital cost you are financing. We can assist by leveraging our position as one of the largest buyers of trailers across Europe by driving down that capital cost – and making sure the specification is right. Savings can be made on day one and across the full life of a trailer. A standalone finance broker just cannot offer this facility."

to suit an operator's specific needs.

Contract hire is also the only off-balance sheet lease package, as well as being the ideal solution for those looking to finance a vehicle with a minimal initial outlay, while making use of fixed monthly budgeting. It is also tax efficient, as the overall costs of hiring a vehicle used solely for the day-to-day running of a business can be offset against taxable profits. Additionally, VAT-registered businesses can expect to reclaim VAT associated with the monthly lease rental costs.

That said, the main advantages are: fixed monthly payments; a small initial outlay (typically three months' payment); no risk of depreciation; no responsibility for disposal of the vehicle; and residual value risks carried by the finance company (which retains ownership of the vehicle). Also, contract hire can provide for replacement vehicles on a regular basis. Disadvantages include the fact that, at the end of the contract, operators have no equity in the vehicle; early termination carries financial penalties (possibly large) and there can be fines for mileage above the agreed limit.

Similar to contract hire is business contract purchase (BCP). The main difference is that, with BCP, the operator reserves the right to purchase the vehicle at the end of the contract by paying a lump sum. This 'balloon payment' is sometimes referred to as the guaranteed future minimum value. A typical scenario where a BCP makes sense is when the vehicle is likely to be worth more, if resold following the end of the contract period, than the future minimum.

Contract purchase differs in that, from day one the vehicle is on the company's balance sheet and, once the final payment is made, ownership of the vehicle transfers to the operator. There are some tax allowances on the finance element, but not as significant as for contract hire. For this reason, contract purchase may suit companies that cannot claim VAT. But, in both contract hire and contract purchase, vehicle maintenance falls to the funding company, assuming it's based on an R&M contract.

Finance lease puts more responsibility for the vehicle on the operator and demands a higher up-front payment (typically 15%). At the end of the package, ownership of the truck again transfers to the operator. However, the residual value risk and maintenance costs are carried by the operator, rather than the funding company – although, again, monthly rentals may be offset against tax.

A non-ownership variation of finance lease requires the vehicle to be sold at the end of the contract to clear unbalanced finances. There is risk here, should the sale fail to realise sufficient funds to cover the outstanding sum. However, a big advantage of this finance deal is that it works well for VAT registered businesses, as practically all VAT payable on finance rentals can be reclaimed in full.

Lease purchase – virtually hire purchase – still has a small foothold in the vehicle financing business. Fixed repayments make budgeting easier, cash can be released for other purchases and there are no mileage penalties. But so many alternative packages have been introduced since vehicles were first bought on HP that what we used to call the 'never-never' has fallen somewhat in popularity.

On a hire level

Of all those alternative packages, contract hire comes out as the one that relieves operators of most stress and responsibilities. "Contract hire is leasing – plus, plus," says Olivier Touze, managing director of Dunstable-based BRS, which has a fleet of 2,500 trucks, of which 700 are its own, used for short-term or spot rental. "All the customer has to do is provide the vehicle insurance and the drivers, although we can supply those, too," he adds.

With BRS looking after a vehicle's maintenance and tyres, and taking all the financial risk, operators can manage otherwise unfeasibly large fleets, says Touze. "If they bought that large fleet through outright purchase, they would need a large internal organisation to manage it. Contract hire is like owning a fleet, but without the hassle. And the big advantage is that vehicles are off-balance sheet: they're on his profit-and-loss, of course, but they are not assets."

Touze reckons the UK is ahead of the rest of Europe when it comes to contract hire. "In Germany, large companies want to control everything – even though it's not very efficient. But, in the UK, companies are looking for flexibility, and they want to put their money where the core business is. As a result, 50% of new trucks come through contract hire or spot-rental."

He also says that, with a background in vehicles and operating them, companies like BRS can cut the cost of an operator's fleet by effectively reducing it, while making provision for peak times, through short-term rental. "We bring flexibility," he says. "We can also add in break-clauses. In a fleet of, say, 20 trucks on a five-year contract, we would put five on a break clause after three years and five more after four years."

But there is another difference between BRS and finance-only organisations – in the form of contract managers. "Our people will meet with the customer on a monthly basis to create a bespoke service. We will tell them about excess mileage, help them to manage fuel consumption and generally support them," explains Touze.

Meanwhile, Lee Coulson, marketing and sales manager for Lincoln-based TransLinc, which works extensively with local authorities' transport, believes the biggest advantage of contract hire is fixed payments. "You pay a fixed rate across a set period. You know each month exactly how much is going out – and exactly what you're getting. Beyond that, there's an inordinate amount of back-office support that we provide. It's very rare that we just supply the vehicles. There's a whole bunch of things the operator saves on.

"On top of that, our customers benefit from our expertise when it comes to purchasing what can be complex pieces of equipment. That expertise is not something you can put a monetary value on, but you can see the councils out there who don't have it. It's all very well having procurement teams, but buying an RCV [refuse collection vehicle] is not like buying an office chair."

TransLinc sells mainly to local authorities – not an easy task when, historically, they have had access to cheap funding.

"We're starting to see more councils, who would always have gone for outright purchases, now paying attention to contract hire," comments Coulson. If you've got to replace a fleet of 25 RCVs, that's £5 million worth of capital. That's a lot of money in the current economic climate."