

The Leasing Question

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Leasing is not a new concept, but it is becoming more common place. This article will examine what a lease is, and how leasing should be used as a financial alternative.

A lease is a legal contract which provides for use of the subject matter, this will be a forklift in this article, for a finite period of time. A lease requires two parties to create the contract. First is the Lessor. The Lessor is the legal owner of the equipment. The second party is the Lessee; this is the party who is entitled to "quiet enjoyment" of the equipment. To obtain this right the Lessee is obligated to pay monthly rental payments for the right to have that use or "quiet enjoyment". This is one of the most important concepts of a lease. The Lessee has no legal title of ownership in the equipment. The Lessor is often times a financial institution, which has only a financial interest in the contract. The party, who initially holds the equipment for sale, in this case WITCO as a forklift dealer, might not be the Lessor. For this reason it is important to distinguish the party who will sell and provide future service for the forklift, the Dealer, from the party who owns the equipment.

A lease is a financial instrument. By this I mean that there is a mathematical formula for calculating a monthly lease payment. The variables of a lease are: capitalized cost, residual value, interest rate and term. Capitalized cost is the amount the Leasing Company will buy the equipment for from the dealer. Residual value is the estimated future value of the equipment. The Leasing company must be willing to accept this future value, as it owns the asset. Interest rates are normally tied to short term market interest rates such as Prime. Term is how long the contract will last for. The parties to a lease will have different goals with respect to these variables thus, the need for a negotiated contract. The dealer will work with both the Lessee and Lessor to execute a fair contract for all parties.

The next major concept of a lease is that it is a contract for a finite period of time. Leases normally are consummated for a period of between two and six years in duration. The specific length of time will depend on the individual usage characteristics of the Lessee. There are two important considerations here, the amount of hours used per year and the environment that the forklift is being used in. The Lessee must be careful to balance the term of the lease with the specific usage application. To do this the Lessee, with the assistance of the Dealer, must examine the Lessee's operating environment and determine annual usage of the forklift in hours. First, to examine usage in hours, this can be broken into three basic categories. The "light" user will have annual usage requirements of less than One-Thousand operating hours per year. The "medium" user will have usage requirements of between one and Two Thousand hours annually. The "heavy" user will need to operate the forklift in excess of Two-Thousand hours annually. The question of application is very Lessee specific, and thus more difficult to discuss in an article. The key consideration is wear that the Lessee's operating environment will place on the forklift, and how this will impact functionality of the lift truck over the course of the lease. To answer these two questions accurately the Lessee needs to provide the Sales

Consultant from the Dealer accurate information on usage accompanied by a personal inspection of the Lessee's operations.

Now that we have looked at the basic terms of the lease, why are these things important and how should they impact the decision to lease. The decision whether or not to lease is both a financial and operations question. I am sure every one has heard the old phrase "buy low and sell high". Well another way to state this is, own assets which appreciate and lease assets which depreciate. A forklift falls into the depreciating category. From an operating stand point the forklift is a piece of machinery with increasing maintenance needs as the equipment ages. If you can accept the depreciation of the value of the property and are willing to accept responsibility for long term upkeep, then outright ownership is best. There are many instances where this applies. However, many businesses want to manage cash flow by establishing more control over expenses. This is where leasing is a strong financial management tool. This financial tool is also a strong management tool when the lease is accompanied by a maintenance agreement with the selling dealer. This agreement will insure productivity from the asset with regular service monitoring and repairs.