Buy, Lease, Rent: Options in Equipment Acquisition

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Snow management is an equipment-intensive business, there's no question about that. Where questions can sometimes arise is how best to obtain that equipment. Does it make the most sense to buy or lease or rent it? There are many factors to consider when making this decision, say representatives from several major equipment manufacturers.

A full accounting

When looking to procure a new piece of equipment, the place to start is often not with your dealer but with your accountant, advises Tharen Peterson, territory business manager with **New Holland Construction**. "A lot of times the decision to buy or lease comes down to each contractor or company's individual cash or tax situation," he says. "Your accountant may recommend that you buy or lease something based on what your books look like in a certain year." (Or, he may advise that you don't acquire any new equipment in a particular year.) Cash on hand, depreciation, current tax law, finance rates, etc. – all of these factors and more can be used to calculate which option makes the most sense.

In addition to traditional leases with a fair market buyout at the end, there are also dollar-buyout leases, in which, at the end of the lease, the lessor pays $1 and takes ownership of the equipment. In essence, this is the same as buying equipment with a loan. There can be tax advantages to this type of lease, thanks to the Section 179 tax law, which says, basically, that depending on how you structure the lease deal, if the end-user basically has ownership of that equipment, they (if they are a small- or medium-size company) can take the full cost of that equipment against their income the year they put that equipment in place. For profitable companies, this creates tax savings.

An outright purchase of equipment obviously meets the requirements for Section 179 tax benefits to apply, and so do some leases, such as dollar buyout leases, if they are considered capital leases rather than operating leases (where the financing company still has ownership of the equipment), he states. For comparison sake, a typical car lease, where the vehicle is turned back in after three years, would be considered an operating lease. Again, it’s important to talk to an accountant or a reputable lender to get more details on the tax implications and details about how specific loans and leases work in order to decide what makes the most sense for your business.

The benefits of new equipment

One factor in deciding how and when to acquire new equipment is the demanding nature of this industry. “When it snows, your contracts depend on that removal to happen at a very urgent pace after that snow falls,” says Brad Stemper, product manager with **Case Construction Equipment**. “People need to be assured that their contractor is there, prepared, ready to remove that snow – any downtime that the snow occurrence creates for your customers is potentially lost revenue and people being dissatisfied. So there’s a real urgency.”

What that means from an equipment standpoint is that the approach of getting by with older equipment or fewer machines than needed doesn’t work as well in snow removal as it might in, say, landscape contracting.

“One of the worst things that can happen is you get out to that parking lot at 4 a.m. to try to get it cleared before a store opens and the machine won’t start,” Stemper says. “In snow removal, contractors need to be able to depend on their equipment.”

For that reason, he sees a lot of snow management customers either buy new equipment and roll it over regularly (even trading it in annually) or lease to ensure they are routinely getting a new machine. “That way they can guarantee the newness of a machine, and the expected dependability that comes with a new or a relatively new machine,” he says.

Weighing the options

“Tax advantages, cash flow, total cost of ownership, residual values, repair costs, projected yearly usage and new machine features are just a few items considered when making the decision to purchase, lease or rent,” says Jeff Jacobsmeyer, **Kubota** product manager for excavators, wheel loaders and TLBs. “Each owner has to evaluate and answer these questions and many more to manage to the profitability of their business.”

That said, there are some general guidelines to help in the decision-making process. One key consideration is that “Less cash is usually needed to enter into a lease situation rather than a typical purchase,” Jacobsmeyer says.

“That’s due to the fact that you’re really just paying for the depreciation on that piece of machinery," adds New Holland's Tharen Peterson.

The lower monthly payment gives a company flexibility in how to spend that extra cash, whether it's another piece of equipment or meeting payroll, etc. Leasing can provide flexibility in another way, as well. In the event that companies decide they want to hang on to that equipment "there usually, if not always, is a buyout option at the end of a lease term, and that price is usually laid out upfront so you know what you would be looking at at the end of your term," Peterson says. Of course, he also adds that while leases can offer lower payments, that needs to be weighed against the fact that the user doesn't build up any equity in the machine. And, he adds, "On a leased piece of equipment, the contractor is generally responsible for all maintenance, just like if they owned it."

In addition, leases do include limits on usage – say, for instance, 1,000 operating hours per year. While normal wear and tear that's to be expected based on the hours isn't penalized, any additional damage can incur extra charges, says Case's Brad Stemper. Fortunately, he says, snow removal work doesn't take the same toll on machinery that heavy-duty, off-road construction work, for example, might.

Peterson recommends that contractors factor growth into the projections for how many hours they'll be running a piece of leased equipment. "Nobody goes into business to flatline and just do OK," he says. So projecting for growth is important when it comes to negotiating how many hours will be included in the lease and at what cost.

Some companies would rather purchase than lease equipment, either because they are committed to caring for and maintaining it, or because it makes the most sense given the number of hours they'll need to use it. "Pride of ownership and having other year round uses for the equipment, other than just snow removal, may make an outright purchase more feasible for profitability," says Kubota's Jeff Jacobsmeyer. Sometimes it's possible to split the difference, he adds: "Many times the larger blades and pushing attachments are owned and used year after year and just the power units are under a lease agreement."

Finally, Peterson recommends finding a dependable dealer – someone who is there when service is needed and who asks questions during the purchase process to be sure that a particular piece of equipment will work for the needed application, and that the approach to obtaining it (buying vs. renting vs. leasing) makes sense for the customer's unique circumstances.

Rental rundown

"In snow removal applications, renting equipment tends to be something done to meet a momentary need," says Brad Stemper with Case. That could occur in the event that a piece of equipment goes down, a larger-than-normal storm strikes, a new account is taken on at the last minute, etc. In these emergency situations, rental makes sense as a short-term solution.

New Holland’s Tharen Peterson adds, though, that there are also longer-term rental arrangement that are popular with snow removal contractors. “We see a lot of ‘snow rental’ business from companies that might not have enough work upfront to justify the purchase of a machine, but they’ll rent it for a set period of time, and then they have the right to just return the machine when that period is over,” he says. This might also provide flexibility for a snow management company that has a contract in which they need to have a piece of equipment staged on a client’s site throughout the winter. It also means that there are no maintenance expenses involved.

The risk of going this route is that, in the event of a heavy snow year, the hours limit in the rental agreement may have to be dramatically exceeded, Peterson says. “If you go over your hour limit, you’ll have to pay the dealership extra,” he says, noting that this may be OK for a contractor if they are getting paid extra for all of the added snow work done, but in the case of a fixed snow management contract this can become a financial challenge.

An additional consideration is that the monthly payments for a long-term rental will usually be higher than they would be even for an equipment purchase. “But if you don’t have enough work to keep the equipment running in the off-season, it may make sense,” Peterson says. And he adds that some contractors also find long-term rentals to be a good way to test out (for longer periods than a dealer demo will allow) how well a particular piece or type of equipment works and how the dealership performs before deciding to commit to a purchase.

Finally, Peterson says that some companies will opt for what is called a rental purchase. “They’ll make an agreement to buy the piece at the end of the rental, or to have the option to buy it,” he says. Some dealers will apply, say, the first three payments and a portion of subsequent payments toward the purchase if that eventually takes place. In the event that a piece of equipment is used far more than expected (the scenario outlined above of the monster snow winter), it sometimes becomes less expensive for a contractor to purchase the rental equipment rather than to pay the added cost for going over the hour limit, Peterson says.

Working the system

Whether it’s a lease or a purchase, when a contractor is looking to buy a new fleet or replace an existing fleet of equipment, “they’re looking for an attractive price, sure, but they’re also looking at how that price relates to their potential business,” Stemper says. “They’re looking at the purchasing and financing options that are available to them. They’ll negotiate with the dealership, and they’ll negotiate with the financier to make sure that they have attractive payments.”

Case, for example, works with its dealers to educate and train them on how to serve the needs of customers, not only in terms of the equipment but also the purchase process itself. “Just like with automotive companies, the dealership can be really integral” in presenting financing options, Stemper says. Sometimes the dealer offers financing themselves, sometimes equipment manufacturers have a financing arm that dealers can leverage, and sometimes they can search out options for those that have special circumstances, he says.

In some cases, a manufacturer or dealer may be offering a special lease deal or interest rate on particular models in order to boost sales during a certain times of the year. Kubota, for example, says that it will run seasonal programs in snowy regions to make it attractive for customers to acquire the company's equipment for the season ahead.

It also doesn't hurt to check with your local bank to see what rate they may be able to offer; even if you decide to finance through the manufacturer or dealer, the bank's rate may provide a point of reference or leverage to negotiate a lower rate.

And Stemper notes that it is sometimes possible to structure an equipment purchase or lease where payments can be deferred. "You might be able to pay in advance when it does snow, so that you can skip payments if it doesn't, or defer payments to certain times of the year when you have more consistent income," he says. Stemper adds that this approach is most common with equipment that will only be used for part of the year; for example, a landscape contractor that is looking to get into snow removal might look to arrange for flexible payments on a machine that will only be used for plowing, while signing a more conventional contract on equipment that they know will be in use year-round.