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Find the 'Gotchas' in Equipment Leasing Before They Find You

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Abstract. If your company is like most businesses, you lease equipment. According to a U.S. Department of Commerce report, 80% of all businesses lease equipment. Leasing is a one of many financial tools available to all sizes of businesses whether they are publicly traded corporations or family-owned private companies. Leased assets include the full range of equipment necessary for a company to conduct business. Our research indicates there are three areas in which all companies can improve their leasing processes, decrease total financing costs and save time.

In order to accomplish this, companies need to understand the language of leasing, improve lease negotiation skills and develop more detailed Request for Proposals (RFP) that include an enhanced lease requirement section. Large organizations with extensive annual leasing needs should consider a RFP that is entirely dedicated to leasing. This RFP is separate from the equipment request and only deals with the financing. For purposes of this white paper, we will focus on the RFP portion of the solution.

Many municipalities, corporations, service businesses and not-for-profits seek out a lease line of credit that will cover all equipment acquired during a specific period of time, usually a calendar or fiscal year. The lease line of credit may be renewed annually if both parties are satisfied with the working relationship. A lease line of credit means that Master Lease documents are negotiated only once saving valuable staff and legal time investments. Companies that use this approach benefit from having a well organized budgeting process, accurate product and market forecast models and open channels of communication between procurement, finance and operations.

Leasing Industry Statistics

Equipment financing and leasing is a $600 billion dollar industry. A study conducted in December 2007 and January 2008 by the Independent Equipment Company (IEC) and the Equipment Leasing and Financing Association (ELFA) reported that leasing companies may be adjusting their credit policies and collateral department risk assessment profiles. The 141 executives surveyed reported some of the reasons for belt tightening are due to weaker U.S. economic conditions, an unstable world economy, pending changes in U.S. tax laws pertaining to lease accounting treatment, continuing devaluation of the U.S. dollar, the mortgage crisis, high oil prices and an increase in credit defaults.

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A study published in *Equipment Leasing Times,* February 2008 issue, reported the hottest types of equipment for leasing companies in 2008 are expected to be medical, oil, gas and energy, marine and intercoastal, aircraft, hi-tech and computers.

What this means to procurement professionals is that their current leasing company resources on whom they have counted to provide aggressive rates and competitive pricing may be less interested in equipment in the "not-so-hot" categories. The less favored equipment types are expected to be automobiles, over-the-road trucks and trailers, construction, furniture, fixtures and office equipment, telecom, printing and plastics manufacturing. Leasing companies will take a less aggressive residual risk position on these equipment groups. Lower residuals mean higher monthly payments.

The new market conditions may require enhanced RFPs that include more detail regarding the leasing needs and new negotiations techniques and skills to get the best deal available from leasing organizations.

Guides to Great Lease RFPs, RFBs and IFBs that Save Time and Money
(For purposes of this paper, we will use the term RFP synonymously with RFB and IFB, although we know their purpose and restrictions are different. We hope our tips will help when using any of these procurement tools**.)**

1. Recruit the Team

- Select the equipment and leasing RFP team from staff involved in the financing, maintenance and operation of the equipment. RFP teams often include the plant operations managers, procurement managers, company finance officer and maintenance department manager.

- Consider hiring an RFP specialist experienced in drafting and analyzing the leasing portion of the RFP. The specialist can guide you through the confusing double-talk of leasing and help save time and money. This will allow you to keep focused on your day-to-day operation. If the company plans to create the RFP for a lease line of credit, the specialist will be extremely helpful in focusing on the common lease traps and how to steer through them.

- If leasing is an attractive option, discuss the tax benefits and implications of leasing with the company accounting and tax departments.

- If the dollar amount of the investment is large or if the company is privately held and the leasing companies decide they will request a personal guarantee to do the financing,

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consider adding the company attorney or a representative from the company in-house legal staff in writing the RFP as well as during the contract negotiation phase.

2. Budgets and timelines

- Don't get carried away with all the bells and whistles you read about in equipment trade publications. The needs of the business are not the same as the wants of equipment operators.

- Your budget is your business. Don't let the equipment dealer or the leasing company salesperson know exactly how much you plan to spend.

- Include your desired financing alternatives in the RFP. Be specific. Suppliers and manufacturers may have interesting financing options including special leasing plans or low interest finance plans.

- Always remember there is no such thing as a "free lunch" or "interest free" money. Free is never really "free," An international software company presented a $2 million dollar software license renewal program to a large Midwestern municipality as a zero interest finance program. The municipality hired an independent lease review specialist who found the true finance rate was 8%. The Treasury Department had put a lease line of credit in place for just such a project at a lease finance rate of 4.25%. The "free money" option was rejected for a better option.

- Always ask for the total equipment cash purchase price. Never focus exclusively on the monthly payment. Remember to step back and look at the total cost of the lease over the life of the contract.

- Find dealers and leasing companies you can trust and stay in contact with them.

- Establish timelines and require bidders and the lease review team to adhere to the timelines.

3. What goes in, what stays out?

- Company history: Include company background such as number of employees, whether the company is publicly traded or privately owned, the number of company locations in which equipment will be located, and a description of the company's primary business functions.

- Equipment: List the equipment specifications that are essential and options you might consider. Prioritize the equipment features as either mandatory or optional.

- Seasonal payments: If you have seasonal fluctuations in your cash flow, consider requesting structured lease payments. These are higher payments when cash flow is strong

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and lower payments in the off season. Some traditional banks and financial institutions do not favor flexible payment plans. Leasing companies understand structured payments.

- Trade-in: Will there be trade-in equipment available?

- Maintenance: Who will maintain the equipment? Will the equipment dealer supply maintenance or will you need an additional maintenance company? Many lease agreements require maintenance contracts on all assets in addition to standard warranties, and proof must be given to the leasing company or penalties apply.

- Lease quotes: Always get lease quotes from at least three independent leasing sources in addition to the equipment vendor's usual leasing sources. Independent leasing companies have no affiliation to the equipment supplier. Their only business is financing and leasing.

- Bank quote: Don't forget to contact your banker. Many banks have leasing divisions that provide excellent financing options. Your banker already has a history with your company.

- Require all bidders to submit their proposals with copies of all documentation required to do the deal. If leasing is involved, this means copies of all standard lease documents, proof of insurance requirements, guarantees, upfront payment requirement timing specifics and security deposit payment requirements. The lease contracts can have added "gotchas" in them that increase the total cost of financing.

4. The Final Steps

- Analysis: The lowest selling price or lowest lease payment is not always the best deal. In fact, it seldom is. One healthcare institution focused only on the monthly per computer payment when comparing three leasing company options on $2 million dollars in new desktops computers and servers. They chose the company quoting the lowest monthly payment. What they didn't realize until it was too late was that "low payment" leasing company contract forced the healthcare organization to pay 12 additional payments over the life of the lease. The 24-month lease actually ran for 36 months.

- Read terms and conditions: Examine all maintenance and service contracts from each equipment distributor. Who will maintain the equipment according to the manufacturer's recommendations? It is extremely important that someone commit to delivering timely preventative maintenance to avoid expensive emergency service calls. Maintenance contracts, like lease contracts, are negotiable.

- Lease quotes: If you consider leasing, get quotes that include a fair market value purchase option lease, fixed purchase option lease and a $1.00 purchase lease. The lease term should be one that works not only because the monthly payment fits company cash flow but

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because the length of the lease parallels the time the equipment will be of value in your company plan.

5. The Clock is Ticking

- Don't let the process drag on forever. Limit analysis time.
- Timing of manufacturer, dealer or distributor discounts should work in the customer's favor. Equipment sales teams face production quotas at various times of the year. Coordinate the RFP process with their selling cycle to receive maximum discounts.
- Equipment leasing companies have the best and most aggressive tax pricing in the fourth calendar quarter of the year. This is due to the benefit of depreciation that leasing companies utilize to pass on lower monthly payments to customers. If at all possible, schedule equipment delivery for leased assets to occur in the October, November and December timeframe.
- The decision is taking too long if you started with brown hair and are now gray or bald!

6. Know When to Walk Away

- Always be prepared to walk from the deal. Be ready to tell the sales rep "We do not have to do this deal now. We can wait until next month, quarter or even next year."
- Negotiate the price of the equipment first. The lease negotiation comes second. The bigger the discounts on the selling price, the lower the monthly payments.
- Use the Kenny Rogers technique: Know when to hold them, know when to fold them. And know when to walk away.

Two Lease RFP Success Stories

A large county located on the East Coast sought municipal lease financing for a computer-to-plate system for their in-plant print shop. Their first draft of the RFP did not contain specific details regarding their financing preferences. It did not address details about the type of lease required, the length of the finance term and whether they wanted to keep the equipment or return it to the leasing company at the end of the lease term. They retained the services of an independent lease RFP specialist to assist the procurement department and the in-house print shop with writing the lease request portion of the RFP. The benefits they received included detailed lease proposals that saved the county money and the equipment title passed to the county at the end of the lease. The department manager knew the lifecycle of this particular equipment was at least 20 years and the financing was for 48 months.

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Equipment and leasing RFPs are not just for large multi-national publicly traded corporations. Shook Hardy and Bacon LLP, one of the top 50 law firms in the United States and headquartered in Kansas City, used the RFP process while preparing to move into new corporate headquarters. They chose to lease telephones, furniture, computers and video conferencing equipment. Chief operating officer Dale Chaffin (now retired) knew leasing made good business sense for many reasons. The firm worked with a consultant to prepare the multi-million dollar RFP that was strictly for leasing. The equipment selection process and asset RFP was not part of the lease RFP. It had occurred prior to the preparation of the lease RFP. This allowed the firm to provide the leasing bidders with the equipment brands, quantities, manufacturer names, detailed specifications and pricing.

The firm sent the lease RFP to 13 leasing companies and financial institutions. Chaffin calculated the use of the leasing RFP and the aggressive lease negotiation that preceded contract signing saved the firm more than one million dollars. After a full review of all proposals and lease contracts, four leasing companies were invited to continue the process. The firm conducted negotiations with all four leasing companies simultaneously. During the negotiations, one leasing company resisted making changes that Chaffin required. Because he had three other leasing companies to meet his terms, Chaffin could shift lease business at any time before the contract signing.

Using the RFP process levels the playing field. It was easier for the Shook Hardy and Bacon RFP team to spot the differences in various financial solutions and the equipment benefits. Dealer presentations changed from glitzy sales sizzle into firm offers and contracts. A negotiation begins after the selling price and lease terms in a proposal are on paper in a proposal. C. Clint Bolte is a full-time printing industry consultant with 25 years of experience and is a contributing editor to a number of printing and publishing trade publications. In his article “Third-Party Lease Review,” published in the January 2008 issue of *In-Plant Graphics*, Bolte explains “firms from other industries have found that having this lease expert actually prepare a lease RFQ based upon the firm’s specific needs is the best of all solutions. This proactive RFQ is the basis for the ultimate lease agreement.” So whether you do it yourself, or locate a lease review specialist, there are ways to save time and money with leasing RFPs.

Negotiation Language and Techniques
No matter how detailed the RFP is, the final step to success is in negotiating the final contracts. It may surprise many that leasing companies will negotiate their “Standard Lease Agreement” contract to the contract title. One size lease does not fit all. C. Clint Bolte in his article, “Third-Party Lease Review,” states “The delightful surprise is that the manufacturer’s leasing department is often delighted to negotiate the terms of the lease, particularly with another professional who understands what the gobbledygook actually means.”

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Mary A. Redmond, The FearLess Negotiator, works with business professionals who want to become stronger negotiators. After attending one of her workshops or coaching sessions, clients feel more confident in stressful business situation whether they need to close bigger and more complex sales, secure the perfect new job, ask for that well-deserved raise or improve communication with their colleagues, bosses or families.

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