How to...

Save on Interest in 2008

Making a case for planning equipment purchases for the year now.

by Carl Villella, CLP

A new year is always a good time to reflect and contemplate the future. Reflecting on the past by reviewing previous financial statements and comparing them to the year just completed gives manufacturers a great read on the direction their company is headed and any adjustments that may be beneficial.

Contemplating the upcoming year at this point is also beneficial for reasons such as, how likely will previous trends continue, what will change this year from last year, or what equipment will need to be added or replaced. This article will address the financial benefits of planning ahead for equipment purchases.

One reason I encourage component manufacturers to look at their long-term equipment needs is to secure a better interest rate on their purchase. Believe it or not, this can make a big difference in the total amount paid in interest throughout the loan period.

Asset based lenders such as leasing companies (i.e., lenders where the equipment financed is the only collateral) typically reduce their interest rates as the requested amount of financing increases. For example, a $150,000 loan/lease could be as many as 50 basis points (or one-half of one percent) lower than a $50,000 loan/lease. This savings is usually fixed for the term of the transaction. This option should be carefully considered as you plan your depreciable capital equipment purchases.

Let's compare three $50,000 transactions made separately throughout 2008 as opposed to all three at the same time (or within an allotted time frame). In this case, let's assume the rates are the same throughout the year for the separate purchases. This means that the payments for each of these three separate $50,000 purchases are all the same. Therefore a one-half percent decrease in rate—like 8.31 percent versus 8.83 percent—is equal to about $13 per month lower payment. $13 per month x 3 pieces of equipment = $39 per month total savings. Over the course of a 60-month term, the total savings is $2,340. (Note: If rates of each individual loan increase throughout the year, the savings of a lumped together loan is even greater.) And we could all use some extra pocket change these days!

Many component manufacturers ask: "What if I don't need the equipment at the same time but over the course of a time period?" This response is especially common given the current conditions of the housing market. To address this issue, some asset based lenders offer a Master Lease/Finance Agreement. This agreement allows the finance company to approve the entire $150,000 transaction while permitting you to purchase the equipment over a given period of time by adding schedules to the Master Agreement.

Here's how it typically works. As you purchase equipment, a new schedule is added and payments on the new purchase start 30 days after you take delivery. Sticking with the example above, the interest rate of that payment could be, at the $150,000 level, 8.31%*, instead of the level that would apply at the lower equipment cost—8.83%*. The benefits include not only the dollar savings of a lower interest rate, but also that payments do not start until after the equipment is acquired and installed, in typical cases.

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at a glance

- ❑ Planning ahead for big equipment needs can reduce interest rates.
- ❑ Check out Master Lease/Finance Agreements which allow for multiple equipment purchases over a period of time at a lower interest rate.

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Risky Business?

There are drawbacks to using this long-term equipment finance model, and it's important to understand that this may not be the most prudent option for some component manufacturers. The timeframe to use the total amount of money borrowed is usually 60 to 90 days (although 30-day extensions are routine). Penalties may also apply for early termination, and can vary widely, from "Rule's of 78" (name for the most common method of calculating payoffs and has built in penalties) to the sum of the remaining payments.

A little planning can save your company money by consolidating equipment purchases and taking advantage of economies of scale offered by asset based lenders. SBC

* Note actual interest rates vary with financial strength of the company as well as the dollar amount of the transaction.

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