ROI: Factors to consider

Many factors influence leasing, buying

Trucks need to be replaced as they become uneconomical to operate. Do you purchase a new truck, or do you lease?

The lease or buy decision is not cut and dried. There are financial advantages, but there are also drawbacks. The decision depends on a number of financial and ownership factors.

Leasing provides the opportunity to acquire a truck with little or no down payment. This provides financial flexibility to invest in other revenue-generating projects. Monthly lease payments are typically lower than purchase payments. Monthly purchase payments cover the entire cost of the truck plus finance charges. The monthly cost of leasing is less than the cost of buying.

A purchase option and a lease-to-buy plan allow a fleet to obtain the truck at the end of the lease agreement, but the termination price of the truck may be below or above the market value of the truck.

Purchasing a truck at the end of the lease may or may not make financial sense. It depends on the purchase price of the truck compared to the market value of a similar truck on the used truck market. A lease can reduce financial risk with disposing of the truck if the truck is returned to the lessor.

Future lease payments need not be reported on company balance sheets if the lease is considered to be an operating lease.

A drawback to leasing in the long term is that it is more expensive than purchasing, primarily because there is not a chance to build equity in the vehicle, and the financial benefits of depreciation are captured by the lessor rather than the fleet. In addition, the interest cost of leasing may be higher than the interest cost of financing the truck purchase. Another drawback is the truck reverts back to the lessor at the end of the lease agreement, thereby requiring the fleet to sign another lease or purchase a truck.

If you put $20,000 down to purchase a $100,000 truck and put nothing down to lease the same truck, the lessee can invest the $20,000 in some other investment. If the lease is for five years, then $20,000 at the end of five years earning 6 percent compounded interest will be worth $26,760. The interest earned from what would have been a down payment lowers monthly lease payments. The higher ROI lowers the monthly lease payment.

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The lessee, however, cannot claim depreciation expenses related to ownership, which lowers taxable income. Depreciation expenses are an operating expense, so deprecation expenses reduce net income, and net income is subject to taxes. Depreciation expenses, however, are not a cash outlay, so they increase after-tax cash flow. After-tax cash flow = operating revenues – operating expenses + (depreciation x tax rate).

The tax savings on depreciation is a function of a company's tax rate and the amount depreciated annually.

Tax savings on depreciation = depreciation expenses multiplied by tax rate.

The higher the company's tax rate, the more depreciation expenses shield income from taxes. For example, if a fleet purchases a $100,000 truck and depreciates $80,000 over five years, and the fleet's tax rate is 30 percent, then depreciation expenses will save the fleet $24,000 in taxes over five years ($80,000 x .30).

To operate a truck for a short time period, leasing is more cost effective because you pay rental charges (cost of truck minus resale value). Truck ownership is more cost effective the longer a truck is in the fleet, since the acquisition cost is spread out over a longer period of time.

Before you make your buy-lease decision, put these factors into a spreadsheet. They can help you decide what makes the most sense for your company. **FE**

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