GTF Event
Equipment Finance

FINANCE

Unless you or your business is in the enviable position of being cash rich, you will inevitably need to raise finance to purchase new equipment and expand. It is the same for all businesses and even countries (although generally Countries don't approach Asset Finance Lenders).

Business borrowing is generally for two purposes; cashflow and equipment acquisition. The most common forms of borrowings are:

Bank Loan
Finance Lease
Hire Purchase
Commercial Loans

Below is an explanation of the types of asset finance available their pros and cons, although the article does briefly touch on other forms of borrowing.

FINANCE LEASE

Legal Status
In the letter of the law a Finance Lease is effectively an Equipment Hire Agreement for a fixed term and at a fixed rate, it is not technically an interest bearing facility like a loan or hire purchase. The Customer chooses the equipment supplier, specification & price, then the Lender purchases the equipment on their behalf and subsequently hires the equipment to them on a fixed term/rate agreement.

The Customer does not own the equipment so it qualifies as an operating expense and these can be deducted from taxable profits as a trading expense effectively reducing the tax paid. The VAT is paid along with the monthly rentals for better cashflow.

End of Term
At the end of the Primary Rental, for example 36 months the agreement legally automatically goes into a Secondary Rental period. The secondary rental period is generally 1 month's rental payment per annum, however most agreements do not enter this secondary rental period because the customer elects to take title of the equipment. Generally, Lenders will agree to the transfer of title for the payment of one month's rental. It is worth noting that technically the lender cannot agree the sale in advance of the end of the primary period because this would change the legal status of the agreement from a "hire" agreement to a "purchase" agreement. This would affect the tax treatment of the agreement.

The transfer of title is not done directly with the Lender. The Lender legally needs to invoice a nominated third party (generally the Broker) for the payment for transfer of title. The broker would then duly invoice the Customer, once paid the customer would have full ownership.
TIP: Always try to establish what the brokers policy is – some unscrupulous brokers have been known to increase this amount substantially.

Tax Treatment
The rentals are treated as a business expense, which are fully recoverable against the profits effectively reducing the company's taxes. The advantage that Finance Lease provides when compared with Hire Purchase is that the equipment can be fully depreciated over a short period.

For Example; A machine on a 36 month Finance Lease – all the payments are expensed and reduce the tax paid by the company. By comparison with Hire Purchase, only the interest portion of the payments is expensed plus an allowance for depreciation. The depreciation of the asset would be over a greater period taking much longer to claim the tax reductions. Ultimately with Hire Purchase when the machine is fully depreciated the tax saved would be the same as Finance Lease it just takes longer to achieve

Early Settlement
Early settlement of a finance lease is not generally recommended. If you wish to settle your Finance Lease early i.e. end of month 24 on a 36-month agreement, then the settlement figure would be the 12 monthly remaining payments + an early settlement fee. Early redemption under 4% for the whole finance industry.

ADVANTAGES
Fixed monthly payments – the payments are fixed and never vary
Pay as you earn – Pay for the equipment from the revenue it generates
Tax Treatment – Tax saving in the short term

HIRE PURCHASE

Legal Status
Hire Purchase is effectively a Hire Agreement for a fixed term, but you have also agreed to purchase the equipment from the outset. From the start of the agreement your business is treated as the owner of the equipment and the equipment would appear on the asset register and be depreciated in accordance with the company's accounting policies.

All the VAT is paid with the deposit in the first payment, which can occasionally cause a cashflow issue if the date of purchase is a long time before the next Vat return is due.

You will make regular monthly payments over a fixed term but no VAT will be charged because this has been charged in full with the first payment.

End of Term
At the term end, there is a Transfer of Title Fee which is normally between £175.00 to £250.00 + VAT, depending on the Lender.

Tax Treatment
The monthly payments you make are not subject to VAT. Whilst the monthly payment is a single figure it is made up of two portions: Repayment of the loan and interest. The interest portion of the payment can be expensed reducing the profit and tax. Additionally, you can claim depreciation of the asset against the company's tax liability over the life of the equipment. A finance lease is generally more tax advantageous in the short term, although once the asset is fully depreciated the tax eventually saved will be the same.

Early Settlement
If you settle an HP agreement early, then the Lender calculates the outstanding interest, fees etc and will duly advise a final settlement figure.

ADVANTAGES
Choice between fixed monthly payments & variable interest rates
Early settlement of a Hire Purchase agreement will generally be cheaper than for a Finance Lease.
Equipment appears on the Balance Sheet

THE APPLICATION PROCESS

This process can to some seem long winded but a good broker will able to help you through the process. Not all the elements list below will be required for every application and in the case of new start business will not be available. However, if you think about it logically the information you provide is all the Lender has to judge you or your business with, to then decide whether they think that you are a good or bad risk. You will be confident in your business ability to flourish and prosper but if you don't give information (some of which will be in your head) to the lender you may get a rejection.

So what's needed?

Personal information
Passport, Driving License, Utility Bill. Lender need to know and verify who they are dealing with (money laundering checks)

Company Accounts
The company's most recent accounts and management accounts if the annual accounts are over 6 months old.

Bank Statements
Three months' recent statements – lenders are not specifically looking at the bank balance they are interested in how you operate the bank account. A clean bank account with no overdraft breeches or returned cheque's demonstrates a business under control.

Business Plan
This is the thing that most people get stressed about and can come in all formats from a single page to "War and Peace". The important thing about business plans is to communicate to the lender your vision and why borrowing the money will help your business grow. It should show that you have considered the key elements of the project; competition, costs, overheads and the most important how sales will be delivered.

Financial Plan
A basic financial model showing income and expenditure. The main purpose of the projection is to show that you have thought about the project and to prove affordability. Lenders obviously want to see that you will be making a good profit and so can pay them back the money you want to borrow.

Other Information
These can be varied from CV's for directors to business tenancy agreements and will vary dramatically between different assets and businesses.

Always remember – the more comfortable you can make the lender feel about your business – the more likely you are to borrow successfully at a lower rate

PERSONAL GAURANTEES

In most cases a personal or directors guarantee will be required, it's is just the way the Finance industry is setup. People are averse to signing them for obvious reasons, but think about it from the Lenders perspective. Unlike the bank who will have security over all the business assets and probably some personal ones as well. By contrast the asset finance lender only has security over their asset, which the moment you take delivery is immediately second hand and worth less than they paid for it. The lending then takes it on trust that you will manage your business effectively, they have no control over how you run your business or even ask to review your accounts. By comparison with a bank that generally has surplus security and reviews its position and can withdraw funding if they choose the Asset Finance lender is taking a far greater risk so they rely on a personal guarantee. In this respect the guarantee is to focus your mind upon making sure that they are repaid and it is worth noting that the guarantee reduces with every payment you make. The guarantee is only ever for the outstanding balance of the finance after the equipment is sold.

OTHER SOURCES OF FUNDING

The Bank
Most business will already have some bank funding. It is generally the cheapest form of funding, banks can afford to give good rates because in general they will be full secured. However, this rate comes at a cost, banks rates will normally be variable and their facilities reviewable so they can call in the loan if they feel that the business is not performing and don't forget the arrangement fees these can make a big difference. On the flip side of the coin bank borrowing is generally good for working capital because your overdraft can flex with the demands of the business.

The Family Silver
By far the cheapest form of borrowing with flexible repayment terms and with a bit of luck you might not ever have to pay it back. On the negative side families, don't always make the best business partners.

Commercial Loan
Like a bank loan, but is normally used in addition to a bank facility. Good for funding working capital or none asset spending like ground works. More expensive than a bank loan in most cases because the lender will not have the same level of security as a bank

Crowd Funding
Some businesses have used crowd funding very successfully but it is not the simple solution that people believe. The principal of lots of people personally lending you a small amount each works. However, crowd funders are quite selective, not cheap and in general like a business with at least a two-year track record with a good story to advertise.

CONSIDERIONS

Whatever type of finance you use people get hung up about the interest rate percentage – It's not the interest rate that is important it's the monthly cost.

Ask yourself

- Can the business afford to pay the fee every month, winter and summer alike?
- Can taking out finance help the business grow?
- Can taking out finance ultimately generate more profit?

If the answer isn't yes to these three questions, then don't do it

GTF Event Equipment Finance
In our experience, it pays to discuss what equipment your buying, please call us on 01283 - 246224 for an informal chat