CONSTRUCTION MOVES INTO HIGH GEAR:
OPTIMIZING EQUIPMENT ACQUISITION IN TODAY'S ENVIRONMENT
AN EQUIPMENT FINANCING & LEASING PERSPECTIVE

Citizens Commercial Banking®

Construction companies are loading up on new equipment. As of June 2015, new business volume in equipment leasing and financing was up 4% from last year and up 34% from the previous month.[1] Ever since the economic recovery began, construction firms have been expanding equipment capacity, replacing aging fleets, and upgrading to new technology. At first, firms relied on rentals to meet rising demand quickly. But as the recovery matures, it's time to explore new options for equipment financing.

By the Numbers:
Economic upturn spurs equipment finance activity across all sectors[2]

$1.484 TR	Projected investment in equipment
$922 BN	62% of projected equipment investment will be financed through loans, leases and lines of credit
6.7%	Increase in equipment finance in 2014 over 2013
55%	Portion of bank-funded investment: 31% captive, 14% independent
11%	Portion of construction equipment investment

A BOOMING BUSINESS IN RENTALS

Rentals have flourished in recent years. During the early days of the recovery, a surplus of idle equipment and a lack of consistent work steered contractors away from making major purchases. Looming changes in emissions standards offered another reason for delay, since companies were reluctant to invest in equipment that would soon become obsolete.

Today, the recovery has strengthened, but rentals are still going strong, growing at triple the rate of the overall economy. The American Rental Association's Rental Penetration Index – which measures the total share of construction equipment owned by rental companies – rose to 53.9% last year from 52.9% in 2013.[3]

This continued growth suggests the recession may have caused a long-term paradigm shift in the way companies acquire equipment. Yet, while renting can be a convenient short term solution, it is not without future pitfalls.

ACQUISITION IS ON THE ASCENT

As the recovery continues, equipment acquisition is regaining lost ground. Among dealers, 77% report rising sales this year, and more than half say purchases have gone up by more than 10%.[4] At the same time, there are also signs of a shift from renting to leasing, with leases increasingly becoming a precursor to purchase. In the lease-to-buy scenario, firms gain both the cash flow benefits during the lease term as well as the eventual control of ownership.

Acquisition trends indicate construction companies are feeling more confident about future demand – and more willing to make longer term commitments. That optimism is reflected in changing motivations for renting equipment. In prior years, contractors blamed a lack of consistent work as their top reason for renting. Now, they are most likely to cite an interest in "multifunction equipment adaptable to a variety of tasks."[5]

Why firms are buying now

The resurgence in equipment purchases is a result of several factors:

- **More reliable demand.** The recovery is spreading into new sectors, including oil and gas, infrastructure, surface mining and office development. Firms are beginning to worry less about leaving equipment idle than about having equipment on hand as jobs come in.
- **Low interest rates.** With the Fed committed to a slow rise in rates at best, construction companies can still finance a purchase for a lower recurring cost than a rental or lease payment.
- **Opportunity to upgrade the fleet.** New equipment offers superior fuel efficiency and compliance with Tier IV emissions standards. Advanced telematics can improve maintenance and extend the life of equipment, enabling more efficient amortization. Traditionally, renting offered another way to access new technology, but rental customers can no longer be assured of receiving the latest features. Manufacturers have begun offering stripped-down models built specifically for the rental market.
- **Potential tax advantages.** Construction businesses may be able to deduct depreciation, insurance, repairs, taxes and interest for purchased equipment. In addition, Congressional leadership has expressed an intention to extend Section 179 of the Internal Revenue Code, allowing companies to fully deduct the cost of some newly purchased assets in the first year.
- **Financial benefits.** Purchased equipment adds assets to the balance sheet. Once paid for, they can be leveraged to provide liquidity as needed without tying up capital. By contrast, rentals and leases cost more over the long run and can erode earnings.

Time to diversify your portfolio of lenders?

You invest a great deal of time and effort in your lender relationship. You want to work with people who know your business and can deliver a full suite of financing solutions. But what happens if your primary lender exits the business? You could be left stranded – and in need of implementing a new relationship at a critical time. How can you avoid this? Consider diversifying your lenders. By proactively establishing additional lending relationships, you can not only be more confident that your access to capital will be available when you need it, but also that you are getting advantageous rates, compared across a roster of providers.

Leasing provides a middle path

Finally, leasing – the third option in the financing equation – provides many of the perks of ownership, while maintaining flexibility. The option for 100% financing on leased equipment facilitates a low cost of funds and enhances the overall capital stack. Companies that take the option to buy, particularly newer assets built for greater duration and durability, are positioned to gain even greater value from the equipment, through a strong internal rate of return on the investment and the cash flow made available during the leasing period.

EVALUATING RENTING VS. ACQUISITION

Given a longer term view, renting may not be all that rosy. Consider how the short term advantages of renting are tempered by the forward-looking benefits of acquisition.

Benefits of Renting	*Benefits of Acquisition*
Lower initial expense, enabling a company to acquire equipment with minimal impact on cash flow	**Tax incentives,** including deductions for depreciation and ongoing expenses as well as potential Section 179 deductions
Flexible terms, catering to companies requiring longer payment periods	**Equity,** making assets available for resale or leverage
Easy upgrades, providing firms with the flexibility to access and leverage the latest technology	**Equipment predictability and control,** empowering companies to make stable bids on fixed costs, confirm specialized asset availability and have greater certainty of project variables

In today's environment, construction firms need to pay close attention to the efficient allocation of capital. They have to balance efficient fleet management with reliable liquidity access and improving debt ratios. Fortunately, there are now a vast array of financing options to choose from, including off-balance-sheet arrangements. It's simply a matter of selecting the right tool for the right job.

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1 The Equipment Leasing and Finance Association's Monthly Leasing and Finance Index

2 "2015 Survey of Equipment Finance Activity", The Equipment Leasing and Finance Association

3 "Equipment Makers De-Feature for Rising Rental Market," Engineering News-Record, March 9, 2015

4 2014 *CED* Midyear Business Outlook

5 "Tech Innovations Drive Increases in Heavy Equipment Leases and Rentals", Purchasing.com, Fall 2014