

# OPTIMIZE YOUR EQUIPMENT COST PER HOUR

## THE DOLLARS AND SENSE OF FAIR MARKET VALUE LEASES

BY NELSON ABELHA

Leasing provides an affordable way to update and upgrade business equipment, preserving cash for other needs. The choice between Fair Market Value (FMV) and capital leases can significantly impact operational efficiency and financial health. To make the best choice, it’s crucial to understand leasing option advantages, particularly in terms of cost per hour.

### THE DIFFERENCE BETWEEN FMV LEASES AND CAPITAL LEASES

FMV leases are operating leases and the prevalent choice in the market today. With FMV leases, the lessee can use the equipment for a specific period, paying relatively lower monthly installments. At the end of the lease term, the lessee has the flexibility to return the equipment, purchase it at its fair market value, or extend the lease. This empowers businesses to align equipment usage with evolving needs, making FMV leases a practical and versatile option.

Capital leases, also known as finance leases, are more akin to a loan. The lessee essentially finances the equipment purchase, typically with higher monthly payments, and owns the equipment at the end of the lease term. With this type of lease, there are higher monthly payments when compared to an FMV lease, but at the end of the lease term, the lessee purchases the equipment for $1. This is like an equipment loan and is ideal if you plan to keep the equipment for a long time, or when equipment obsolescence isn’t a concern.

### COST PER HOUR ANALYSIS

Cost per hour is a crucial metric that measures the total cost of owning and operating equipment; it’s calculated by dividing the total payments for the initial lease term by the number of hours the equipment is used.

FMV leases can provide several cost per hour advantages:

**Lower monthly payments**
Since FMV leases do not require the lessee to pay the full equipment cost over the lease term, the monthly financial burden is significantly reduced compared to capital leases. Lower payments mean better cash flow, allowing businesses to allocate funds to other critical areas, such as labour, materials, and project development.

**Maintenance and repair costs**
FMV leases often include maintenance and repair services as part of the lease agreement. This can equate to substantial savings in equipment operation cost per hour. With maintenance covered, businesses can dodge unexpected repair costs, reduce downtime, and ensure equipment is always in optimal working condition. In contrast, with a capital lease, the lessee is typically responsible for maintenance and repairs, which can be unpredictable and costly.

**Technological advancements**
Heavy construction equipment technology is constantly evolving. With an FMV lease, companies can upgrade to newer, more efficient models at the end of the lease term without the financial burden of owning outdated equipment. This ensures ongoing access to the latest technology, for greater productivity and reduced operational costs. Capital leases could lock companies into long-term ownership of equipment that may become obsolete, leading to higher costs due to less efficiency.

**Flexibility and scalability**
FMV leases offer greater flexibility compared to capital leases. Projects vary in scope and duration, and it’s critical to adjust equipment needs accordingly. With FMV leases, companies can scale equipment fleets up or down based on project requirements without long-term ownership commitment. This ensures equipment costs align with actual usage, optimizing cost per hour.

**Tax advantages**
FMV leases can offer tax benefits not available with capital leases. Lease payments under an FMV lease are often fully deductible as business expenses, reducing taxable income which can provide significant tax savings, lowering overall equipment operation cost per hour. Capital leases typically allow for depreciation deductions, which may not be as advantageous depending on a company’s tax scenario.

FMV leases offer several advantages over capital leases for heavy construction equipment, especially in cost per hour, making FMV leases an appealing option for construction companies seeking to improve their operations and financial well-being.

## TWO SCENARIOS: FMV AND CAPITAL LEASE OPTIONS

| | FMV LEASE | CAPITAL LEASE |
|---|---|---|
| XYZ Construction Company is evaluating leasing options for a $705,000 articulated dump truck (ADT). | XYZ opts for an FMV lease with a monthly payment of $18,437.19 over two years. Maintenance and repairs are included in the lease. At the end of the term, XYZ can return the equipment and lease a new model. | Alternatively, XYZ could choose a capital lease with a monthly payment of $31,177.70 over two years, and be responsible for all maintenance and repair costs, estimated at $15,000 annually. |
| Top-Line Cost Analysis | • Total lease payments: $18,437.19 x 24 months = $442,492.56<br>• Maintenance and repair costs: $0 (included)<br>• Total cost: $442,492.56 | • Total lease payments: $31,177.70 x 24 months = $748,264.80<br>• Maintenance and repair costs: $15,000 x 2 years = $30,000<br>• Total cost: $778,264.80 |
| Cost Per Hour Breakdown (if XYZ uses the excavator for 1,500 hours per year): | $442,492.56 / (1,500 hours x 2 years) = $147.50 cost per hour | $778,264.80 / (1,500 hours x 2 years) = $259.42 cost per hour |

**In this scenario, the FMV lease provides a significantly lower cost per hour – a savings of $111.92 per hour – which would cover the costs of more than two unionized machine operators.**

***“The choice between Fair Market Value (FMV) and capital leases can significantly impact operational efficiency and financial health.”***

— NELSON ABELHA, Regional Vice President, First Financial Canadian Leasing

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