

Intro to CFO Chats

I have written 8 “CFO Chats” which are slices of life in the asset finance business sales business where a leasing sales person or financial advisor calls on a CFO. The first six CFO Chats are available in my online training program (see the Training Tab on this website) and they are sales calls. This chat #7 and #8 are where a lease advisor is talking to a CFO about things to watch for in negotiating a lease with a leasing company.

CFO Chats: Number 8

CFO: Last week you talked about terms to watch out for in a lease and you mentioned interim rents. What are the issues there?

Me, the lease advisor: Well, there are two types of interim rents: the legitimate kind and the kind that is a hidden “extra” profit point for some lessors.

CFO: What is the good kind of interim rents?

Me, the lease advisor: The legitimate kind of interim rents occurs in leases where there is a construction period and the lessor funds the cost of material and construction during a period that precedes the completion date when the asset is placed in service and the lease term begins. The lessor bills the lessee interim rent calculated by applying the yield rate (like interest) in the lease to the amount funded. The amount charged is called interest only as there is no amortization of the lessor’s investment. An example is a truck lease where the truck body is delivered and equipment is subsequently installed on the bed like a cherry picker. The lessor funds each component of the truck and the lease begins when the truck is ready for use as a completed asset. The same goes for a build-to-suit building that is leased.

CFO: That sound good to me, so explain the bad kind interim rents.

Me, the lease advisor: Some lessors quote a lease, say a pc lease, as 36 payments in advance at 2.72% of cost. That looks like an operating lease as the PV of the payments at 6% is 89.41%. But the lessor says lease payments commence on the first of the month after delivery and acceptance of the asset. The lease terms say for every day that the delivery proceeds the first of the month a prorated interim rent will be charged, payable with the first month’s “normal” rent. Say the delivery is 15 days before the first of the month. That means an “extra” 1.36% will be charged while you get no credit for the portion of that rent that includes amortization of the lessor’s investment. There is no need for a lease to “have to” commence on the first of the month – the lessor has designed it so to be able to pick up a few basis points in profit with the hope that you don’t know better.

CFO: I see, but what does that mean to me?

Me, the lease advisor: Well, first it means the lease is a finance lease as the PV of rents, including the interim rent is 99.3% of cost. Secondly, the lease yields an extra 89bps to the lessor, meaning it costs you more than you thought.

CFO: What’s your advice?

Me, the lease advisor: Shop around but only to relationship minded lessors. Carefully analyze the terms and conditions of leases for all payment you can be made to pay. Negotiate for "interest only "interim rents.

CFO: Thanks.

About the Author:

Bill Bosco is the President of Leasing 101, a lease consulting company. Bill has over 45 years' experience in the leasing industry. His areas of expertise are accounting, tax, and financial analysis, structuring, pricing and training. He was on the EFLA accounting committee from 1988 to 2017 and was chairman for 10 years. He is a frequent author and speaker on leasing topics. He was selected to the FASB/IASB Lease Project working group. He can be reached at wbleasing101@aol.com. <http://leasing-101.net>