

The Future of the Closed-End Lease

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The following attempts to outline the intrinsic value of closed end leasing, a product that is growing, and continues to be used by Corporate Fleets who want the ultimate in outsourcing for predictable budgeted payments, without the surprises that come when their off lease vehicles are resold.

HISTORY

Closed End leasing, sometimes known as the "Walk away lease" or "Wet Lease", was a significant lease product throughout Canada and the USA 25-30 years ago. Over the years, the product was offered less frequently, as Financial institutions became uncomfortable with their large credit exposure to just the Lessor; whereas, under an Open End Lease, packages of Leases can be funded through securitization, an advantage to the Lessor, with the credit risk in effect transferred to the Lessee.

Today, banks are prepared to fund Closed End leases for Lessors with strong credit covenants.

Similarly, Maintenance Management programs evolved from Full Maintenance Leases, whereby both the maintenance and residual risk is the Lessor's responsibility.

BUDGETING

Closed End Leases can be adapted to meet clients' changing fleet needs. Lessees can use a combination of both Open End leases for Executives, and Closed End leases for high kilometre sales and service vehicles. But with Closed End, all cost components are known at inception.

For most Corporations, it is essential to accurately forecast their transportation costs in the same way they budget for IT or Advertising. Unfortunately, many CFO's decide to utilize low depreciation rates under their Open End leases in order to make the rental payments fit a desired budget number, resulting in major remarketing deficiencies 2-4 years later. Consequently, Closed End leases may reflect higher cash flows if vehicles have been previously under depreciated.

Total life cycle costs will be less in a Closed End lease arrangement through proper cycling and accountability for vehicle damages.

ACCOUNTING AND FINANCE

For the moment, most Closed End leases are compliant with GAAP and IFRS as true Operating Leases.

Comparing Open End lease rates requires an "apples to apples" comparison of the Closed End program to previous Open End results, including all gains and losses on resale.

A review of all operating aspects of the Closed End Lease may shed light on ways to make your fleet more efficient and cost effective even if you remain with the Open End scenario.

MONTHLY PAYMENT

First thing to remember, don't focus on monthly payment.

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Closed End payments represents the lowest possible rentals on vehicles with the highest resale values that meet a Company's needs. Lessor sets realistic residuals based on market data, use of the vehicles and driving habits. Lessor then matches kilometers and months in service to those needs.

Most Closed End Lessees let their Lessor/Partner, the remarketing and maintenance experts, create the appropriate Closed End payments covering interest, depreciation, administration and maintenance, as an option.

VEHICLE RETURN COSTS

Lessor and Lessee should use an independent appraiser to prepare a vehicle condition report to assess any vehicle damages other than normal wear and tear.

Appraiser would assess only those non insurable damages that reduce the wholesale value of the vehicle.

DRIVER ACCOUNTABILITY

Only a few Companies take recourse against drivers for damages in excess of normal wear and tear. The same off lease process is consistently followed in the return and check in of every returned vehicle, requiring no Lessee involvement on Closed End Leases.

REMARKETING

Closed End Lessees are relieved of all residual risk exposure and the unpleasant surprises that arise on the sale of used vehicles under an Open End Lease.

Off lease Closed End vehicles are scheduled for return at the optimum time to maximize selling prices, whereas Open End leases are often extended past the economic life cycle.

Closed End Leases force a better discipline in managing a Company's vehicles.

TRANSPARENCY

Capital cost, interest rate, monthly depreciation, administration fees and residual, can all be disclosed to the Lessee under a Closed End Lease:

For example, let's compare a 36 month Open End lease rate to how a Closed End lease is structured so that all component costs are disclosed:

Vehicle: 2010 Ford Fusion SE, equipped with a 3.0L V6 engine, based on 120,000 Km's in a 36 month lease. Excess KM charge would be .12 cents per KM.

	Open End	Closed End
Capital cost	\$22,000.00	\$22,000.00
Term	36 months	36 months
Monthly Interest @ 4.50%	\$ 52.18	\$ 52.18
Monthly depreciation 2.15%	\$473.00	\$491.33
Administration fee @ .08	\$17.60	\$17.60
Total Monthly Rental	\$542.78	\$561.10

Residual on Open End Leases is (\$ 22,000.00 less \$473.00 x 36) = \$4,972.00

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Upon Resale, Lessee incurs the following selling expenses:

Auction Fee	\$160.00
Clean Up	\$100.00
Average transportation cost to auction	\$75.00
Car Proof	\$25.00 All disclosures must be made
Total:	\$360.00
Residual on Closed End lease: Same as Open End	\$4,972.00
Less:	
Selling expenses	(\$360.00)
Disclosure contingency	(\$300.00)
Revised Residual	\$4,312.00 = Revised depreciation to \$491.33

Total Cost of leasing under a Closed End lease: 36 x \$561.10 = \$20,199.60

Estimated cost of leasing under an Open End Lease:

36 x \$542.78 = \$19,540.00 plus \$360.00 = \$ 19,900.00 assuming resale value of \$4,972.00. However, lessee is still responsible for any reduction in resale value based on market conditions and the obligation to disclose all major repairs and vehicle condition.

FULL MAINTENANCE LEASE OPTION

Both driver behavior and productivity can be greatly enhanced by implementing a Full Maintenance Closed End Lease Program. Rental payments would be structured based on each driver's estimated KM's for the specific term to include all scheduled preventative maintenance expenses, plus any other unscheduled repairs required for the safe operation of the vehicle.

A specified number of replacement tires may also be included in the monthly maintenance charge. Drivers also have the convenience of knowing all maintenance costs are covered. At lease termination date an independent condition report would be prepared and sent to Lessee outlining any mechanical or body damages for which the Lessor or driver would be responsible. Lessee would use Lessor's Fleet Card to ensure that all required maintenance is performed on every vehicle in Lessee's fleet according to schedules dictated by the manufacturers. Adherence to these schedules can reduce unexpected fleet vehicle repairs and driver downtime, and helps to ensure qualification for all warranty coverage. All repair work must be approved by Lessor's vehicle maintenance technicians before any work is performed.

Overall goals by the Lessor are:

- Keep your vehicles on the road safely.
- Minimize any necessary downtime associated with vehicle repairs and maintenance.
- Ensure you get the needed maintenance and repair work done right the first time, at national vendors, franchise dealers or independent repair facilities.
- Budget all expenses into one fixed monthly maintenance charge, with no unexpected charges.
- Achieve post warranty recovery coverage to allow for further reductions in monthly maintenance costs.
- Scrutinize repairs to effectively control maintenance costs by way of our technical fleet team