

Hertz LEASING[®]

POWERED BY DONLEN



Lease vs. ownership

4 reasons to lease your fleet vehicles

Why choose leasing?

One of the most important decisions companies have to make is whether to purchase their vehicles or lease them through a fleet management company (FMC). While many people think that ownership is a superior option to leasing when it comes to fleet vehicles, leasing is almost always the better choice. In the following document, we will provide you with four reasons why you should lease your fleet vehicles:

- 1. Pay only for what you use**
- 2. Lower financing costs**
- 3. Improve credit strength and borrowing capacity**
- 4. Gain a complete view of TCO**

In almost every scenario, leasing your fleet vehicles through an open-ended TRAC lease is more cost effective than vehicle ownership.

Cash-flow analysis

Before we get into specific reasons why you should lease your fleet vehicles rather than purchase them, we want to show you what the numbers have to say.

It is first important to know that there are several different types of leases. For the purposes of this document and the following cost analysis, we will talk specifically about the open-end TRAC (Terminal Rental Adjustment Clause) lease, which is what we generally recommend to our customers. This essentially refers to a lease with a minimum term period of 12 months that is thereafter renewable on a month-by-month basis at your discretion.

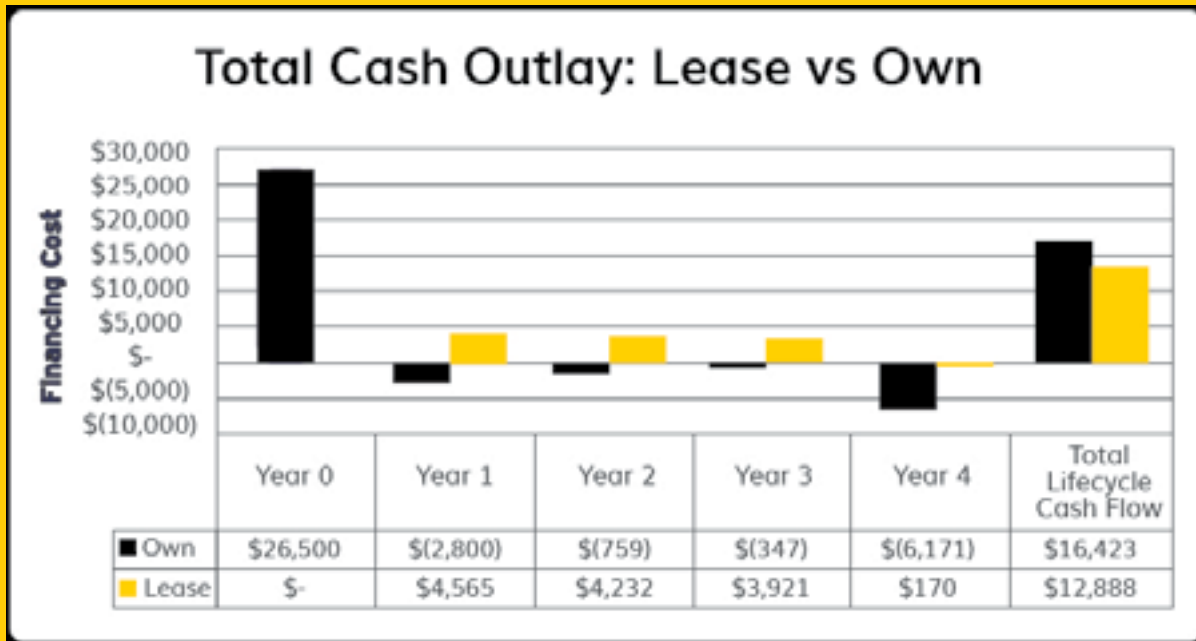
Donlen's Strategic Consulting team compared the costs of leasing versus owning a vehicle over the same period of time. As the following analysis will demonstrate, leasing a vehicle is typically more cost-effective than owning a vehicle. The difference in cost is hardly insignificant—for this analysis, we found that the net lifecycle advantage of leasing this vehicle would be \$3,535.

To demonstrate, we compared the cash flow over a 48-month lifecycle for a passenger vehicle (under 6,000 lbs. GVWR) in an ownership scenario versus an open-ended TRAC lease scenario. The model here is specific to the state of Florida* and assumes a corporate tax rate of 35 percent, a cost of capital of 5 percent (identical in both scenarios) and sales tax/use rate of 6 percent. We assumed that the acquisition cost of this vehicle is \$25,000. The savings demonstrated are associated with the funding of the vehicle, and assume that operational costs (such as fuel and maintenance) are equivalent across the two scenarios.

Under these assumptions, the lifecycle present value of cash flow is \$16,423 in an ownership scenario versus \$12,887 with an open-end TRAC lease. In other words, the lifecycle benefit of leasing one vehicle is \$3,535 for this scenario. A fleet of 350 vehicles would then experience cost-savings of \$1,237,250.

So, the numbers clearly show that the net lifecycle advantage of leasing is \$3,535 according to the difference in the total present value of cash flow for both scenarios. But the question still remains—what

causes this net lifecycle advantage? What long-term benefits can leasing a vehicle bring to your company? Let us show you.



Reason 1: You pay for what you use

When you lease a vehicle, you pay for what you use rather than paying everything up-front and investing in a depreciating asset. Rather than trying to make up for that lost value after you sell the vehicle, you only pay for the time the vehicle is in operation (in this scenario, 48 months) and ultimately face a smaller difference between the vehicle's resale proceeds and the money you spent to lease it.

Time value of money

People often forget about the time value of money when choosing to invest in a depreciable asset (for example, purchasing a car). The \$25,000 you pay at the beginning of that car's lifecycle is for the entire life of the car. When working with fleets, it is unlikely that the car will remain in your operation until it's run into the ground, so it doesn't make much sense to pay \$25,000 for something you plan to sell in four years, because you will not get the full \$25,000 back when you sell the vehicle. Paying solely for those four years through monthly lease payments—i.e., spreading out your payments rather than investing 100 percent of your capital up front—optimizes your cash flow and ultimately increases your returns when it comes time to sell.

The time value of money is an important concept that influences a number of other factors contributing to the net lifecycle advantage of leasing a vehicle, so it is important to keep in mind.

Optimizing tax outlay

In the total cash outlay graph for the lease versus own scenario, you may notice that the year 0 amount for the ownership scenario (or the purchase cost) is \$26,500, even though the acquisition cost of the vehicle is only \$25,000. The capitalized cost in the ownership scenario, then, would be \$1,500 more than the capitalized cost in the lease scenario. The \$1,500 is the sales tax on the vehicle.

As with any purchase, when you purchase a vehicle, you have to pay a certain percentage of the acquisition cost in sales tax. Like the acquisition cost, that sales tax is something you pay up-front when you purchase a vehicle, raising your overall capitalized cost. We've already talked about how the time value of money can make investing in a depreciating asset an unwise choice, especially when you only plan to use that asset for a portion of its actual life. The tax you pay on that asset is included in that when you purchase a vehicle.

When you lease a vehicle, you minimize state sales tax by paying your sales tax on a monthly basis along with your lease payment. You only pay tax on what you use, rather than paying tax on the entire acquisition cost of the vehicle.

Reducing opportunity cost

Notice that, in the cash flow summary for the ownership scenario, there is a category called "opportunity cost." When you spend a lot of money on a depreciating asset, the acquisition cost of that vehicle (and related taxes) are not the only costs you incur. Opportunity cost in this scenario refers to the money that you could use to invest in other business ventures that is instead sitting in a depreciating asset. In other words, every investment involves choosing what to do with your money. When you invest \$25,000 in a depreciating vehicle, you lose the opportunity to use that \$25,000 elsewhere.

Taking into account, yet again, the time value of money, this opportunity cost actually increases as your purchased vehicle depreciates in value. According to our cash flow summary, the opportunity cost over four years of owning the vehicle in the stated scenario would amount to \$2,565. Essentially, by purchasing that vehicle instead of leasing it through an FMC, you lose the opportunity to invest \$2,565 in another non-depreciable business venture that could actually make money for your company.

By leasing a vehicle through an FMC, you give yourself the freedom to take the money you would have spent purchasing the vehicle/that would otherwise be sitting in that depreciating asset and put it toward other business ventures that are able to earn returns on that money.

While optimizing cash flow by paying for what you use is the most easily demonstrable and obviously significant benefit of leasing versus ownership, there are many other benefits that leasing can bring to your company.

Reason 2: Lowering financial costs

When you purchase a vehicle, you need to finance that purchase with a bank loan. Let's say that loan amounts to \$25,000 for the vehicle. If that sounds like a large loan, that's because it is. Over the life of the vehicle and, indeed, even after you cycle the vehicle, you need to recover the money used to pay back that loan. As we have already demonstrated that investing in a depreciating asset does not yield great financial returns, paying off that loan is inevitably going to be costly.

By leasing, on the other hand, you are simply financing what you use through monthly payments based on the residual cost of the vehicle. Rather than taking out a \$25,000 loan for a vehicle purchase and laboring to pay it all back regardless of how much use you get out of the vehicle, you might be responsible for monthly payments of \$400 or \$500 over the time period you are actually using the vehicle.

Leasing, essentially, is another form of financing that typically costs less than traditional debt financing, which is the route you would seek if you were to purchase a car. By leasing a vehicle, you only need to finance the costs of what you use, not the entire vehicle.

Reason 3: Improved credit strength and borrowing capacity

By leasing your fleet vehicles, you can significantly improve your credit and increase your company's overall borrowing capacity for not only your fleet, but any other areas that will require you to take out loans.

To explain why this is the case, we need to first look at the same ratios that your bank looks at. Return on Investment (ROI), Return on Assets (ROA) and your debt to equity ratio are all used by creditors, lenders, investors and stockholders to determine how productive and profitable your company is. When you borrow money for, say, a vehicle, your company is required to report that loan on its balance sheet, which then impacts your financial ratios and how others view your company financially.

We've already discussed how leasing is a less costly financing option than traditional debt financing, or taking out a large loan for a vehicle purchase. This translates to how large the balance sheet component is for your fleet vehicles, and how much of a negative impact your financing will have on those important financial ratios.

With an open-ended lease, the balance sheet component is significantly smaller than it would be with a large loan for a vehicle purchase—therefore, leasing effects your financial ratios less. When you have a smaller balance sheet component, creditors and lenders view you as a less risky borrower, therefore improving your credit and borrowing capacity, or the amount of money you can borrow for other purposes. Because your financing is spread out in smaller, less costly intervals through leasing, you have more room to borrow money for other projects that require financing.

Reason 4: Gain a complete view of your TCO

When you lease your vehicles through an FMC, you generally gain access to on- and off-road services that provide a more accurate view of your vehicle's total cost of ownership (TCO).

In an ownership scenario, the depreciation of your vehicle would not be captured in the same location as your other fleet expenses. Because an FMC would not be managing the payments on your vehicle, it would lack insight into that vehicle's depreciation. The effect that has on the TCO analyses performed by your FMC is significant, as depreciation accounts for the largest cost category in your TCO.

Leasing your vehicle through an FMC enables heightened visibility of a critical cost component: the depreciation of the vehicle. By leasing through an FMC, your lease payments are captured in the same system as your other fleet-related expenses, allowing you to streamline your view of your TCO in one location. This results in not just improved visibility to your total costs related to your fleet, but allows for more in-depth analysis and ultimately opportunities to reduce your total cost of ownership.

Essentially, when you lease a vehicle through an FMC, the FMC is able to capture all aspects of that vehicle's TCO because it is the one handling and setting the vehicle payments. While an FMC can provide insight into most of your TCO components such as fuel, maintenance and accident—regardless of whether you own your vehicles or lease them through the FMC—the FMC cannot give optimally accurate insight into the vehicle's depreciation if it does not have the necessary data.

By gaining a more accurate overall view of your vehicle's TCO, you can improve your benchmarking and analytics, and more effectively strategize how to lower your TCO.

Conclusion

As you can see, there are several reasons to lease rather than own your fleet vehicles. However, there are several misconceptions regarding fleet leasing that can scare some fleet managers away from the better option.

It is important to note that these misconceptions concern open-end TRAC leases. Many of the restrictions that apply to closed-end leases do not apply to open-end leases.

Cycling flexibility

An open-ended TRAC lease is very different from the type of lease one would get at a dealer—essentially, it is much more flexible. The minimum term for the type of open-end lease Donlen offers is 12 months. After 12 months, the lease is renewed on a month-by-month basis. You gain incredible flexibility in your ability to decide how long to keep the vehicle and when to cycle it depending on your fleet needs.

Mileage restrictions

Believe it or not, open-ended TRAC leases have no mileage restrictions. When you have drivers covering larger territories, it can be difficult to predict exactly how many miles they will incur over the lease period. Not only does an open-ended TRAC lease offer extreme flexibility in the length of lease, but it does not penalize companies if their drivers go over a mileage restriction for the lease period—because there are no mileage restrictions.

Wear-and-tear

In an open-ended TRAC lease, there are typically no wear-and-tear penalties. While a dealer might charge you for a ding on the vehicle's windshield, a FMC utilizing an open-end TRAC lease will not penalize you—any condition provisions are typically built in to the lease payment itself.

People tend to think of leases as restrictive and expensive, but that is far from the truth. As we have demonstrated, open-ended TRAC leases are almost always the better and most cost-effective option, regardless of how many vehicles are in your fleet.

At Donlen, we analyze the individual fleet needs of each customer to determine the best and most cost-effective plan for fleet management. To learn more about the savings you can realize through leasing, or any of Donlen's services, contact us at 1-847-714-1400.