WHITE PAPER

A Leasing Guide for Fleets: Where Closed-End Leases Work

While open-end lease structures are widely accepted in the U.S., this 8-part guide breaks down the advantages of closed-end leases and how this structure can improve your company's image and bottom line.

OWN VS. LEASE

Many savvy fleet managers know that the numerous advantages of leasing and the many headaches of vehicle ownership it solves. Nuances of different lease structures, though, can get confusing when you haven't leased before or have used the same lease structure by default. For example, in the U.S. open-end leases in fleet are more common, but this structure isn't necessarily the best case for every fleet.

To help clarify the differences, this series will take a look at closed-end leasing compared to ownership and open-end lease structures, breaking down the benefits of closed-end leasing that many fleets might not be aware of. closed-end leases can be beneficial to fleets looking for one accounting standard, or for fleets looking for predictability in budgets or that are looking to switch from reimbursement to a company-provided vehicle. These are just a few of the examples where closed-end leasing can make sense.

But first, let's start by taking a brief look at some of the main benefits to leasing and some of the differences in lease structures before taking a deeper dive into how a closed-end lease could be a good choice for your fleet.

Fleets That Lease Vehicles Only Pay for the Value They Use
The cost of a "closed-end" vehicle lease is determined by the difference between its sticker price and its "residual value," i.e. its projected value at lease end. So the cost of a three-year lease for a $30,000 vehicle that is expected to be worth $20,000 in three years would be a $10,000 difference divided into equal monthly payments, plus any interest.

Another option available to fleet managers is an "open-end" lease, also known as a finance lease or terminal rental adjustment clause (TRAC), which allows the lessee to terminate the lease after a minimum term (typically 12 months). The lessee determines the depreciation factor and makes progressively lower monthly payments.

In both scenarios, the cost of the lease is designed to reflect the value of the vehicle the lessee uses. At a glance, selecting a closed-end lease allows the lessee to avoid assuming the risk of the residual value, which we will look at in more detail later in this series.

Leased Vehicles are Cycled Out Regularly
Some companies may put a premium on owning assets, including vehicles. But purchasing requires capital that many companies don't have or could be put to better use. Perhaps more importantly, it typically results in fleets comprised of older vehicles whose appearance can reflect poorly on a company's image and incur increasingly high maintenance costs.

Leased vehicles require the same regular service as owned vehicles, but, in the absence of defects, misuse, accidents or recalls, they typically do not need replacement parts. And by the time they begin to show their age, they are in line for replacement, ensuring that at least one highly visible component of the company's public profile remains clean, modern and sophisticated.

Leasing Vehicles Allows Fleet Managers to Reduce Their Administrative Workload and Build More Accurate Budgets

With greater maintenance concerns come more hassles for fleet managers and more downtime for vehicles and drivers. In the commercial sector, every minute counts - and breakdowns, towing and waiting for replacement parts all cost undue time, money and aggravation for fleet managers, drivers and clients.

On top of that, leasing vehicles with a full maintenance plan allows fleet managers to more accurately plan their annual budgets. Maintenance can become a fixed cost, and incidents of unplanned expenses, downtime and overtime pay can be reduced since maintenance is essentially being managed for you.

Considering all the benefits of leasing, it's no wonder more fleet managers are exploring this option. But careful consideration must be paid to the different types of leases available to commercial vehicle operators. In the next section, we'll give an overview of the closed-end lease structure and how it plays a role in the world of fleet.

AN OVERVIEW OF CLOSED-END LEASING

In the previous section, we took a broad look at leasing compared to ownership. In this section, we'll examine a lease structure that is popular in Europe: the closed-end lease. We'll break down how it differs from the open-end variety, which many fleets in the U.S. are already familiar with.

Unlike an open-end lease, a closed-end lease has a set, specific term of ownership. These leases typically run for 12-48 months, and at the end, the lessee returns the vehicle to the owner.

Another notable difference from open-end leases is that the monthly payment is a fixed mount. There is no "step-down" payment that decreases over time; rather, a fixed rate is determined at the beginning of the lease, calculated by using the average outstanding balance on the vehicle for the life of the lease.

In further detail, a closed-end lease usually includes the following parameters and features:

- At the end of the lease term, the lessee returns the vehicle with no further obligations. There is no chance of a hidden cost if the vehicle is sold for less than the predetermined value, making the total cost of the lease predictable.
- On a closed-end lease, the leased fleet vehicle will have a set number of miles it can be driven in a calendar year — again, as negotiated when the agreement is first created. Some lessors will write fleet lease agreements with no mileage restrictions, and many will renegotiate after a certain period if the reality of operations aren't matching the lease terms.
- The lease doesn't impact the organization's balance sheet. Since it is considered an expense and not an asset, it is treated as a line item in the financial accounting.
- A closed-end lease provides the ability to negotiate additional expenses into the monthly payment, making it even more predictable. Examples of this could be insurance payments or regular maintenance costs. By rolling these items into the lease itself, the fleet manager can make the costs of owning and maintaining the vehicles far more regular, with fewer surprises along the way.

In the next section, we'll take a closer look at what fleet scenarios make the most sense for a closed-end lease.

WHERE A CLOSED-END LEASE MAKES SENSE

In general, a closed-end lease is going to be a better option for most fleets looking to minimize budget surprises. While many U.S. fleets lean toward open-end lease structures, some of these fleets could be benefiting more from a closed-end plan.

Broadly speaking, a closed-end lease works when it results in having a lower guaranteed total cost of ownership than can be achieved on an open-end lease, under realistic wholesale resale values. This is because most open-end leases include what's called a terminal rental adjustment clause (TRAC), which goes into effect when the vehicle is turned back into the lessor and then sold to a third party. If the proceeds from the sale exceed the originally determined amount that he vehicle would be worth at the end of the lease, the lessee actually gets the difference back. If they don't, however, the lessee is required to pay the lessor the difference. In practical terms, this means it is the lessee who is assuming all the depreciation risks, not the lessor. While that amount can be written off as a tax expense, it still could end up costing the fleet more than anticipated. Because of these factors, the total cost of an open-end lease can be difficult - if not impossible - to predict accurately. A closed-end lease, on the other hand, takes that financial risk off the fleet and onto the lessor.

To achieve that lowered guaranteed cost of ownership with a closed-end lease, here are some examples of scenarios in which a closed-end lease structure makes the most sense:

- Fleets in which the closed-end mileage terms are not too restrictive. With today's technology like telematics/GPS tracking, it's much easier to predict a vehicle's duty cycle and actual mileage accurately to confidently avoid any potential fees, so there are likely more fleets today that wouldn't have as much difficulty managing the miles.
- Fleets that can stick to the return condition provisions. This includes vehicles that aren't likely to exceed the agreed upon wear-and-tear or can accurately predict the type of wear and tear your fleet accrues and negotiate that into the terms.
- Companies that prefer or require fixed lease costs for budgeting purposes. This includes companies that have fixed-cost projects that need predictability over the monthly cost for a specific period or term. This could also include companies that want to avoid any potential volatility in the used vehicle market or that are generally risk-averse.
- Companies converting from reimbursement that want fixed, guaranteed costs in switching to company-provided vehicles for their drivers.
- Fleets that operate internationally and want one accounting standard.

A closed-end lease, generally speaking, makes sense for fleets that simply want to remove themselves from managing vehicles as much as possible so they can focus on their core business. Open-end leasing as well as ownership requires more attention from a company's in-house fleet or operations team.

In the next section, we'll take a closer look at the various ways a closed-end lease will help a fleet manager plan ahead with more accuracy and ensure budgets are more predictable.

PLANNING A CLOSED-END LEASE

The first major advantage to a closed-end lease is the ability to bring regular, consistent and predictable planning to the fleet budget. The monthly rate is negotiated up front, so there will be no hidden costs or fees to worry about down the line. And even basic service, maintenance and insurance can be negotiated into the agreement, further lowering the potential amount of extra capital the fleet will need to maintain the vehicles.

- Make sure the specifics as to what constitutes "wear and tear" are clearly negotiated into the contract. This is especially true if your fleet vehicles see any kind of hard usage. You'll want to make sure you know upfront what the lessor considers "normal" and what they consider "excess" and then plan your usage around those definitions.
- Conduct routine inspections. You might not catch everything, but it's not a bad idea to give all the fleet vehicles a once-over at least as often as they come in for their regular oil change. You already know what the lessor considers normal wear and tear to be, so you can make sure your vehicles stay well within that range and take steps to mitigate problems before they have a chance to grow into a larger issue.

Before you sit down with a lessor to lease any fleet vehicles, you should have a good idea of how many miles your average vehicle covers in a year. Pad that number slightly to give yourself enough room to account for emergencies, route changes or other unexpected events that could add miles to the total. It is likely the lessor will increase the monthly payment amount in exchange for the increase in miles, but that then becomes part of the regular expense that can be easily planned around - as opposed to a surprise expense that breaks the budget at the end of the lease term.

A regular, predictable budget is the gold standard for a fleet manager, and a closed-end lease provides just that. Using a closed-end lease to make many of the fleet expenses predictable and regular - especially with a full-maintenance plan included — will make the fleet manager's job that much easier.

In the next section, we'll take a closer look at usage, how routing and estimating mileage works, and why it helps make closed-end leasing all that more attractive.

MANAGING MILES IN A CLOSED-END LEASE

In the last section, we glanced at how closed-end leasing can help fleet managers create and maintain a predictable budget, and in this section, we will take a look closer at how fleets can take advantage of plotting mileage and vehicle usage to keep a lease predictable and profitable.

Many fleets today use telematics systems to promote accountability and safety or as a part of a fuel-savings campaign, if not both. These systems often allow fleet managers to track things like how often a driver brakes, their average miles per hour driven or how long they have been on the job and how many stops they made in a given day.

These same systems can be used to plot usage statistics before the fleet manager ever sets foot in a lessor's office.

Fleet managers can also pull route information from the telematics system — the actual mileage as well as engine hours to account for idle time. Trending this out will give a better idea of how things like traffic and construction affect your mileage throughout the year. Fleet managers can take the number of miles each vehicle averages in a given year and then average that number across the fleet to get the minimum number of miles that each vehicle will need in the lease.

Whatever the minimum mileage described in the lease contract, you know that means each individual vehicle will need to stay under that number to avoid any additional mileage overage charges at the end of the lease. Here are a few strategies to keep in mind:

- The lessor will only look at the total number of miles on the vehicle at the end of the lease, and most closed-end leases have terms of three years. If a vehicle clocks more than the

allowed miles in the first year, you have plenty of time to reduce that vehicle's workload to make up for it.
- The number of miles in the lease agreement can be negotiated. Armed with the knowledge of the average miles the fleet clocks annually, the fleet manager should try to ensure the agreement meets or exceeds that number. This could potentially raise the monthly payment on the lease, but this then becomes a predictable cost rather than an unpleasant surprise at the end of the lease term.

Knowing the usage of the vehicles in the fleet both individually and as a whole will help fleet managers negotiate a better deal for the company and help ensure there is no balance due at lease end.

In the next section, we'll take a closer look at another aspect of closed-end leasing that fleet managers need to consider: value. There are a number of advantages to this lease structure when it comes to value, including depreciation, risk and even the vagaries of the automotive market when it comes to valuing specific makes and models.

CONTROLLING COSTS IN A CLOSED-END LEASE

n this section, we'll take a closer look at how closed-end leasing can help fleet managers control one of the single biggest line-item costs they will face: depreciation.

The difference in value between the original cost of the vehicle when it is brand-new and what it is worth when it is time to resell or trade it in is known as the depreciation of the vehicle. Depending on the make and model of the vehicle, as well as its age and condition, that can be a significant amount. By choosing a closed-end lease instead of buying the fleet vehicles outright or taking on that risk with an open-end lease, the fleet manager almost completely removes that concern from the equation.

It is important to note why in an open-end lease that depreciation is still going to be a factor, as this helps highlight the major difference between the two lease structures. As we have learned, in an open-end lease the lessee will be paid the sale proceeds - that is, the difference between the actual sale price and the original estimated residual value. But the lessee will also have to pay the lessor the difference if that price is lower than anticipated. So in an open-end lease, depreciation can be problematic.

In a closed-end lease, however, it doesn't matter whether the lessor ultimately sells the vehicle for more or less than what they originally thought when first signing the lease agreement. The lessee's only responsibility is to pay the agreed-upon amount for the agreed-upon time, and once that term has expired, the value of the vehicle has no impact on them whatsoever. This is yet another reason why a closed-end lease can be a great option for fleets looking to create a predictable budget.

Interest rates, on the other hand, will also have an impact on the value of the vehicle to the fleet. With a closed-end lease, just as with ownership, interest rates and credit will play a role in the monthly payment amount.

When buying a vehicle outright, the popularity of a model, the trim and standard equipment and other factors can all conspire to drive the rate up. However, with any type of leasing, this is a bit less of a concern. For most fleet managers, the goal isn't to get the latest and greatest technologies, but rather to get a dependable vehicle that will be able to get the job done. Many lessors that cater to fleets offer a basic trim option that is identical across all the vehicles in the leased fleet. By stripping down the options and simplifying the process, the fleet can usually get a better rate than if they were buying outright.

We've looked at some of the many financial reasons as to why a closed-end lease can make sense for a fleet, and in the next section we'll look at a different aspect: the company image. The fleet vehicles are often the first and last impression a company will leave on customers, and leasing can help businesses ensure they are always projecting the best possible image.

MAKING GOOD IMPRESSIONS WITH A CLOSED-END LEASE

When it comes to a company's image, the first - and often last - impression many consumers will get is a good look at its fleet vehicles, be they in motion or parked on the street, in a driveway or in a lot. In this section, we'll look at how closed-end leasing will help fleet managers ensure they are always projecting the best possible image to the general public.

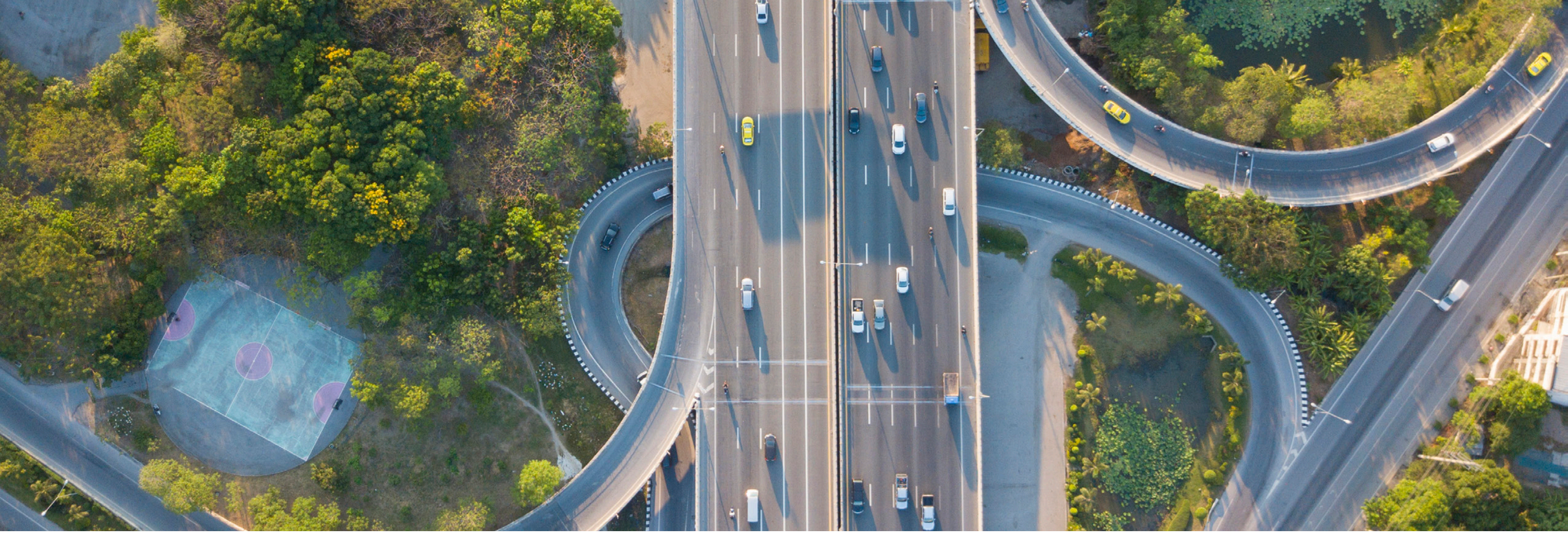
Always New

When leasing, the vehicles in the fleet are never older than the term of the oldest lease. This means the vehicles will always be new models with clean exteriors and interiors - no dents, chips, scratches or other issues that would give the impression at first glance that the company can't afford or doesn't care enough to maintain their fleet.

Always Working

If a leased vehicle ever has mechanical problems or a recall alert, it can be brought to the lessor or a third party to quickly and professionally resolve the issue (assuming maintenance and service were written into the contract). By taking advantage of these programs and keeping the vehicles running at peak capacity, the prospect of having to cancel a customer visit or show up far past the scheduled time of arrival can be avoided. Always being prompt and having your drivers arrive when you say they will, gives customers a very positive impression of your company. Making excuses for the quality of your vehicles will have the opposite effect.

A tip for both keeping the vehicle looking great and giving off the impression of a company that is conscious of the image it projects — as well as helping to ensure the wear and tear stays minimal to avoid potential fees down the road — consider using a vehicle wrap. These materials



are applied by professionals, and can be printed with any look and feel desired, from a basic design that includes the company logo, tagline and contact information, to something more ambitious, such as a "cutaway" interior of a truck or van.

Vinyl wraps will not damage the paint in any way; in fact, they protect it from UV rays, which can fade a vehicle's color over time. So as a fleet manager, you get the peace of mind of knowing you are protecting yourself from potential surprise fees at the end of the lease, while further enhancing the image you project. Many fleet management companies can help in coordinating these efforts.

In the last section, we'll take a closer look at Merchants Fleet and the way our team ties all the benefits of closed-end leases together to offer fleet managers a custom, comprehensive solution.

THE BENEFITS OF CLOSED-END

In the preceding sections, we covered the benefits that leasing offers to fleet managers. Merchants Fleet has been working with fleets of all kinds for more than 50 years, providing customized total leasing solutions to businesses both large and small.

Our leases are designed to provide fleet managers with a variety of benefits over and above what standard closed-end leases provide. A few of the features we offer include:

- The flexibility of including excess mileage and wear-and-tear costs in the lease structure i itself, so there will be no end-of-lease considerations to worry about.
- A fixed interest rate with no payment variations - what you pay in the first month is what you will pay in the final month of the lease term, and there's no worrying about payments fluctuating over time.
- We offer scheduled maintenance and service solutions budgeted right into the lease terms, cutting down even further on surprise costs.
- Terms written right into the lease that are designed specifically with fleets in mind.

Merchants Fleet was founded on the philosophy that fleet managers should be in the driver's seat. We pride ourselves on listening to what your fleet's specific problems are and customizing a fleet leasing solution that will match - we don't come in with a limited set of options and force you to choose the one that only meets some of your many needs. We take the time to learn about your organization - your size, your goals, your history, your risks - and then we work with you to create a lease program that will address those issues.

The way we see it, a fleet is like a fingerprint: No two are alike. Every fleet will have unique challenges, unique opportunities and unique needs, and as a business with an active owner who is involved in running the operations, we understand that better than most.

Fleet managers who lease with us receive fast answers to any questions or problems, unparalleled service, and the financial stability of a private company with no shareholders to answer to. Our most important stakeholders are our customers, and we want to make sure every fleet manager is completely happy with the terms of their lease.

In addition, Merchants Fleet is working with fleet managers to create even more options for closed-end leases that will further enhance the benefits leasing will bring to a company. With the help of our clients, we are designing solutions that will:

- Lock in the resale value and gains at the start of the lease.
- Customize everything from the mileage parameters and the payments to the terms and conditions, based on the individual fleet's needs.
- Offer different types of leases and options based on different vehicle makes and models.

Leasing is an incredibly smart business decision for the cost-conscious, value-conscious and image-conscious fleet manager. It brings a wide range of benefits over ownership, such as financial stability, control of the company image and peace of mind. Merchants Fleet is here to help.