

## Closed End-Leasing

### CLOSED END LEASING – A TIME'S WHO HAS COME (AGAIN?)

**Today, some twenty five years or so after pretty much falling out of favour, Closed End or "Operating" leases are getting more attention from Fleets. In this piece, Steve Somers, Regional Sales Director Jim Pattison Lease, explains why.**

As fleets close off the current year reviewing gains and losses on vehicle sales, it could be instructive to consider an alternative to the standard Open End or Guaranteed Residual lease.

Closed End or "Walk Away" leases were the standard some 25-30 years ago. Under this convention the owner ("Lessor") assumed all residual or end value risks. The customer ("Lessee") would simply make a set number of payments over the specified term. At the end of that lease the Lessee simply handed the keys to the Lessor who then disposed of the vehicle, absorbing all gains or losses. As more sophisticated financing was introduced, this style of lease, particularly at the fleet/commercial level, became "open ended" where end value consequences moved from the Lessor to the Lessee.

Closed End leasing is getting attention on a number of fronts. Sub performing used vehicle sales have led customers to question why they have to "take the hit" when a vehicle is sold below book value. Even a few losses can create issues with Managers who probably didn't budget for such losses against the Department's P&L responsibility.

A more recent motivation is that increasingly fleets no longer want such risks. Corporate Treasury departments are increasingly reviewing all areas of the organization to mitigate risk at all levels.

Importantly the Closed-End lease convention is fully compliant with accounting requirements of an "Operating Lease". This is important as Canadian corporations publicly listed on Canadian exchanges move to International Financial Requirement Standards (IFRS) within the coming year. As well, this has led many Canadian subsidiaries of European parent companies (where IFRS is already the standard) to prefer a true "Operating Lease".

Closed End also offers a set payment for a fixed period of time, for example \$500.00 per. for 48 months. This allows customers to forecast lease costs to the operating departments. These level payments are also more accurate forecasts of the lease stand-by portion when assessing taxable benefit to the driver. This is also helpful when calculating the source deduction through payroll and total lease payments paid at the end of an assessment period.

One additional feature available to the Closed End Lease is inclusion of all maintenance related costs. Subsequently the monthly payment can be modified to include the fixed (lease) and variable (maintenance, not fuel) components, thereby further simplifying the budget process.

Closed End doesn't remove all customer responsibilities. There remains a requirement for forecasting mileage because excess distance can result in charges and a turn-in prior to the end of the lease can mean short term adjustments because the lessors residual estimate was based on an end of term date with projected mileage and a reasonable condition.

The turn-in is also an opportunity to hold drivers more accountable for vehicle appearance that might exceed normal wear and tear. This issue can have a significant impact on a vehicles resale performance. If a vehicle exceeds normal wear conditions, some expense may be incurred to bring it to acceptable standards. Many closed end fleets charge drivers a portion or all of this cost charged by the lessor.

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Most closed end lessors offer drivers the option to purchase the vehicle at Wholesale levels. This minimizes fleet department involvement and moves the often tricky "price of the vehicle" conversation to the lessor.

At the end of the day both Closed and Open End should translate into roughly the same costs. This makes the Closed End lease an option to consider for a range of issues that have become important today to fleets in Canada.

### Why Use A Closed-End/True Operating Lease

Lessee/  
Customer

Residual/End Value  
Risk Transfer

Lessor/  
Owner

#### Risk Management

- Protection from unanticipated declines in vehicle market values
- Meets with financial conservatism increasingly mandated by CFO's

#### Budgeting

- Set payments for fixed term improves forecasting and ease of allocations
- Ability to include maintenance related costs further simplifying budgeting

#### Control

- As a true operating lease, closed-end leases are fully compliant with IFRS
- Helpful in calculating source payroll deduction and other calculations