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Fleet Funding…..where next?

Companies offering company car benefits to employees need to consider a number of different factors when deciding on the appropriate method of funding such a benefit. The main factors to consider are cost, risk and impact on the performance measurement criteria of the business.

For large corporations with sufficient cash reserves the historical preference has been to outright purchase company cars. The rationale for this is that these organisations have a lower cost of funds than if they leased the cars and that the fleet size is sufficient to dedicate specific resource at a low per unit cost and spread risk. This option became more cost efficient after changes in VAT legislation in 1995 which allowed these organisations to access 50% of the VAT leakage they suffered hitherto by setting up internal leasing companies.

However in recent years there has been a trend by these organisations to move away from this method of funding due to the following factors:

- A general trend towards the outsourcing of what is considered a non-core activity.
- An increase in the required return on investment resulting in higher returns from investing in projects than the savings from funding the car fleet.
- An increase in the use of return on assets based performance measurements resulting in the desire to remove assets from the balance sheet.
- To remove or avoid residual value risk. The continuing fall in residual values has resulted in organisations funding fleets through outright purchase making losses on disposal when compared with the expected residual values at the time of purchase of the vehicles.

To achieve the above objectives many of these organisations have moved to either contract hire or to employee PCP / Employee Car Ownership (ECO) scheme arrangements.

For smaller companies the usual method of funding has been contract hire. The advantages of this funding method are that the leasing company is taking the risk on residual values, there is no balance sheet presence in relation to the cars and all fleet management can, if required, be provided by the leasing companies. The fact that there is no balance sheet presence enhances return on asset performance indicators which are becoming increasingly more popular.

There are, however, certain "hidden" costs of contract hire as a method of funding when compared to outright purchase, such as a restriction of corporation tax relief on expensive vehicles, i.e. those costing more than £12,000 and early termination penalties typically 50% of outstanding rentals, although the latter can be mitigated through commercial arrangements.

As stated above one of the main reasons for moving towards contract hire is that of the traditional methods of funding cars, i.e. outright purchase, finance lease and hire purchase, it is currently the only funding method where there is no balance sheet presence. However as indicated in the G4+1 discussion paper on operating leases issued by the International Accounting Standards Board, there is likely to be a requirement for operating leases, which includes contract hire, to be disclosed on a company's balance sheet.

Employee PCP and ECO schemes have become more popular in recent years. The main driver for implementing these arrangements is a reduction in the total cost of operating a fleet. It is also possible within these arrangements to pass some or all of the risks and costs of early termination and excess mileage on to the employee. However these types of arrangements are not suitable for all companies as the economics depend on the sensitivity of certain fleet variables and profiles such as type of benchmark vehicle or level of entitlement and total and business mileage. Due to the complex nature of these arrangements it is recommended that a full due diligence exercise is conducted to establish the total cost, including all secondary taxation costs, before a decision is made to implement such a scheme.

ECOs can be structured to have either a balance sheet presence or be off balance sheet. Should contract hire be required to have a balance sheet presence in the future (see above) then employee PCP or ECO schemes would be the only methods of funding a car fleet which is off balance sheet.

For leasing companies is important to understand the needs of their customers and develop products and solutions to meet those needs. This may require offering multiple products and solutions to one client to meet their objectives. It also means leasing companies being able to react quickly and have flexibility as customers' fleet requirements change due to merger and acquisitions activity or changes in objectives and performance measurement criteria. To ensure success it is therefore important for leasing companies to have the necessary resources able to provide best advice to customers to ensure that their needs and objectives are met.

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About CBS

Car Benefit Solutions Ltd (CBS) is an organisation based in the North West, devoted to the development of cost effective strategies to maximise the perceived value of car benefit for employees whilst minimising the provision cost to the employer. Since their inauguration in July of 2002, CBS have established themselves as a leading authority on structured workplace car schemes and the supplier of choice to several major UK corporates. Their business is dedicated to the design, development, implementation and ongoing management of tax efficient alternatives to the traditional company car.

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