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In a tough economy, cash is king, and one way a company can create cash is by selling a fleet and leasing it back. The timing of such an arrangement must be carefully considered.

WHEN'S THE RIGHT TIME FOR A SALE/ LEASEBACK?

Cash is king" goes the old saw in business, and it never has been more applicable than today. In an environment in which credit is difficult to find, companies are squeezing every possible nickel of cash from operations — turning inventory, tightening up accounts receivable, floating accounts payable.

One tempting source of cash can be the company fleet. Depending on its size, fleet can represent tens of millions of dollars of ready cash, and with the economy in the doldrums, selling the fleet and leasing it back from a fleet lessor is garnering more attention every day. Though it sounds like a simple decision, the question of when to use this financial tool must be carefully considered.

AT A GLANCE

Factors to consider in determining the appropriate corporate scenario for a sale/ leaseback arrangement include:

- Generates cash from sale of company assets.
- Facilitates the process of changing lessors.
- Incurs administrative costs.
- Presents sales tax liability.

Concept Similar to Home Equity

The sale/leaseback is a relatively simple concept. The company has an asset of some value, sells it, then leases it back from the buyer — not unlike tapping the equity in a home. The buyer owns the asset (the fleet), and the seller pays the buyer for its use.

How much cash can be generated? Let's assume the fleet consists of 1,000 cars and trucks at various points in their respective service lives. Some are new, some near replacement, and the remaining at various points in their lifecycles. If we also assume the average net value of each vehicle (using the unamortized capitalized cost) is $12,000, the sale would gross $12 million in cash for the company. Of course, the leaseback would entail provisions for the cost of funds and some administrative fees, but the primary issue is looking at the generation of cash, not comparative cost.

Sale/leasebacks can be done with either a company-owned or leased fleet (where the fleet is purchased from one lessor by another). The transactions are often used to quickly transition fleet vehicles from one lessor to another (rather than through attrition). However, turning a company fleet asset into cash is the most common purpose of this process.

How It's Done

The easiest way to track the sale/leaseback process is to use one vehicle as an example. Assume the following:

Vehicle book value	$12,000
Mileage	36,000
Replacement policy	36 mos./75,000
Average monthly mileage	2,500

Essentially, the lessor buying the vehicle and leasing it back to the company begins the lease process. The cap cost must be amortized at a rate resulting in a book value at replacement that reflects the market value when sold. Rather than leasing a new vehicle from day one, a vehicle with some months in service is leased. Here is how this can be done.

- At a rate of 2,500 miles per month, the vehicle reaches replacement mileage at 30 months in service (75,000 / 2,500 = 30).
- The vehicle has been in service slightly longer than 14 months already (36,000 / 2,500 = 14.4), and thus would remain in service for another 16 months or so.
- Now assume that at 30 months in service with 75,000 miles on the odometer, the anticipated market value is $7,000. The plan is to amortize the original value of $12,000 down to $7,000 over 16 months.
- Subtracting the target value from the original value, we get $5,000 ($12,000 - $7,000 = $5,000).
- Divide $5,000 by 16 months, and the result is $312.50. This is the monthly amortization in dollars.
- To calculate the amortization percentage, divide $312.50 by the original $12,000, and we get 2.60 percent. This is the amortization portion of the resulting lease rate factor applied to the cap cost.
- The process is the same as for any new vehicle, except the starting point is an already-amortized value. This process is repeated throughout the entire fleet.

Arrangement Benefits Cash Flow

When a fleet is company-owned, a sale/leaseback can remove the assets (and corresponding debt) from the corporate balance sheet.

As previously stated, the primary purpose of a sale/leaseback process is to generate cash. When a fleet is company-owned and the lease agreement is carefully structured, a sale/leaseback can also remove the assets (and corresponding debt) from the corporate balance sheet.

Another use for the sale/leaseback process is to convert a fleet from one lessor to another. With attrition as the alternative (as vehicles come up for replacement, orders are placed with the new lessor), a sale/leaseback can help reduce the difficulties inherent in dealing with two lessors and facilitate a clean break from the existing lessor arrangement. Drivers are spared the confusion of how to get maintenance and repair, report an accident, or renew vehicle registration.

However, turning the fleet asset into cash remains the most common reason for a sale/leaseback. Removing as many as thousands of vehicles and tens of millions of dollars from the balance sheet (in company-owned fleets) or simply securing cash from a leased fleet can give the company a quick cash infusion and spruce up the balance sheet.

Robert Singer from Merchants Leasing points out, "Many companies turn to Merchants for a cash infusion through a buyback program, but they also find our fleet management services benefit their bottom lines. Providing a single point for managing any number of fleet services, including insurance, maintenance, fleet acquisition and disposition, roadside assistance, and more helps provide for a more efficient fleet."

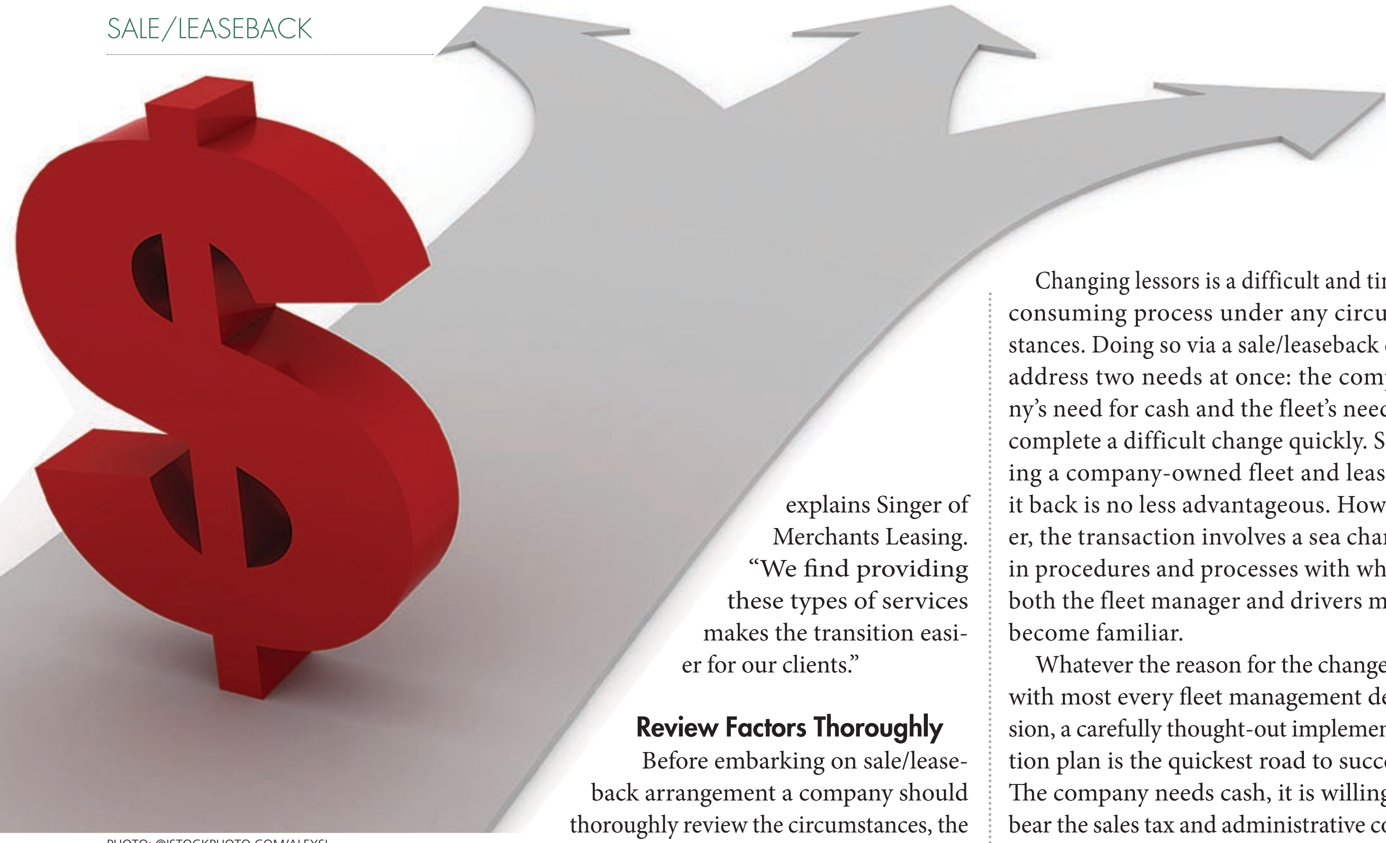
There are advantages, too, when a move from one lessor to another is accomplished via a sale/leaseback. More often than not, fleet leases are only one element of an overall bundled fleet program. Maintenance management, accident management, fuel card programs, and other fleet administrative programs (registration renewal, parking ticket payment, etc.) all entail drivers using the lessor's materials, calling a particular number, dealing with specific processes and procedures. Transitioning from one lessor to another thus often entails changing all of these programs and processes. When such a change is implemented via attrition (the most common method), drivers can become confused, having developed habits based upon a supplier that no longer is their contact.

Other Factors Must Be Considered

Other factors must be considered in determining when a sale/leaseback arrangement is in the company's best interest.

Administrative. The larger the fleet, the bigger the issue. Vehicles are being sold. They must be retitled and re-registered to the new owner (lessor). These tasks entail not only a great deal of administrative paperwork, but also some level of expense, not to mention the possibility the former lessor may not be entirely anxious to cooperate in a timely fashion. The expense can be significant, too. If the average cost for retitling and re-registering each vehicle is a mere $50, the total expense is $50,000 for a 1,000 vehicle fleet.

Sales Tax. No matter what the reason, this mass sale of vehicles from one owner to another will incur sales taxes. Using



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the previous example, if the average fleet vehicle "book value" is $12,000 and the fleet numbers 1,000 vehicles, the total value would be $12 million. With an average sales tax of 5 percent, $600,000 is added to the cost of the transaction (or from another perspective, the cash infusion is reduced by $600,000).

The sales tax problem can be dealt with one of two ways: either the tax is paid separately or it can be capped into the cost of the vehicle. The former impacts the cash flow immediately; the latter entails payment of fees (interest, leasing administration, etc.) on the tax. Those fees can add up to tens of thousands of dollars in additional expense, reducing (over time) the ultimate net cash flow effect of the sale/leaseback. Either way, sales tax can put a noticeable crimp in the positive impact of using a sale/leaseback to generate cash.

Ultimately, no matter how administrative and sales task expenses are addressed, the cash generated by a sale/leaseback transaction will be not be equal to the sum total of the asset values.

However, some lessors help reduce these burdens. "We take care of license and title services for most of our clients to alleviate the hassles and reduce overall costs," explains Singer of Merchants Leasing. "We find providing these types of services makes the transition easier for our clients."

Review Factors Thoroughly

Before embarking on sale/leaseback arrangement a company should thoroughly review the circumstances, the benefits, and the costs.

Will the cash generated by the sale be material, given the negative considerations?

Similarly, will any desired balance sheet effect be material to a company that counts its assets and liabilities in the billions of dollars?

How cooperative will an existing lessor be — the lessor who is losing the company's business? Will the exiting lessor promptly provide endorsed titles and other necessary paperwork attendant to the sale of a vehicle?

How will the company handle sales tax and administrative costs?

Not surprisingly, most often the company initially does not raise the possibility of a sale/leaseback. The circumstances usually surround the award of the business to a new supplier who encourages the sale/leaseback to quickly implement the supplier change. Less often, the company, in a search for cash, "notices" its fleet is worth millions and subsequently seeks a buyer.

In either case, the fleet manager must make certain everyone involved in the decision understands the costs attendant to the move and, equally important, the administrative and fleet management issues that will need resolution.

Changing lessors is a difficult and time-consuming process under any circumstances. Doing so via a sale/leaseback can address two needs at once: the company's need for cash and the fleet's need to complete a difficult change quickly. Selling a company-owned fleet and leasing it back is no less advantageous. However, the transaction involves a sea change in procedures and processes with which both the fleet manager and drivers must become familiar.

Whatever the reason for the change, as with most every fleet management decision, a carefully thought-out implementation plan is the quickest road to success. The company needs cash, it is willing to bear the sales tax and administrative costs that go along with it, so the fleet manager must be prepared.

If an existing lessor is involved, obtain in writing and by name its commitment to cooperate fully with the replacement. Without that cooperation, the process can drag out far longer than necessary, incurring additional costs.

All fleet stakeholders must be fully informed before the first steps are taken. Management, drivers, HR, legal, and risk should all be included. Drivers and their immediate supervisors, in particular, need to know exactly what will happen, how it will happen, and when. If possible, they should know specifically who may be contacting them and who they should contact if confusion or problems arise.

Each of these points should be part of a well thought-out project plan; a timeline, individual and group responsibilities, and lines of communication, if outlined in advance, will keep the process moving smoothly.

Sale/leasebacks have a place in the fleet world. However, the timing of instituting such an arrangement must be carefully reviewed. If such an arrangement is undertaken, the fleet manager must plan how the process will proceed. AF