APPENDIX 2

FLEET PROCUREMENT OPTIONS

The UK fleet supply chain is very large and mature. Over the years many options for commercial fleets have been developed which need to be considered carefully:

There are material differences in what is normally included in the various packages, the overall cost and payment profiles, additional services and the implications for various types of risk.

The difference between a good and an indifferent process can amount to many hundreds of pounds per vehicle. With pressure on all overhead costs, it is important that the overall situation is reviewed on a regular basis to ensure that the arrangements actually do maximise the opportunities within the fleet environment of the Council.

There are 5 main forms;

- Outright purchase – Own funds
- Conditional Sale/Hire Purchase
- Contract Purchase
- Finance Lease
- Contract Hire

Each of these main forms has many derivatives, often with quite subtle differences in payment terms and risk position.

Purchasing

Option	Appraisal	Pros	Cons	Indicators
Outright purchase	• This appears to be the simplest method of all, but is not necessarily the cheapest or the most efficient.	• The vehicle can be used as required and sold at our discretion into the relevant used-vehicle market when no longer required.	• With full ownership further ongoing financial responsibilities arise. • These include overall depreciation, total	Outright Purchase route may be appropriate for larger fleets where there is a fully operational in-house workshops or a well developed 3rd party supply chain (maintenance, tyres, inspections, testing, and

	• In basic terms, it means selecting the vehicle(s) we want and acquiring the vehicle together with all rights and responsibilities. • Funds will need to come from either cash reserves, bank overdraft facility, or fixed loan / Public Works Loan Board (PWLB). • All other aspects of operation, disposal, maintenance, Vehicle Excise Duty (VED), administration are OUR responsibility. • For many years, this was the funding method of choice for most public sector organisations. However, it requires ready availability of the full capital sums of the purchase price, and puts the vehicle on the ‘balance sheet’ of the authority, as an asset.	• All the disposal proceeds come back to the authority as the owner. Assuming the total required capital is available, there are no further funding costs for purchase. • The council owns the assets from day one • Complete flexibility on retention of the asset. • Complete flexibility on disposal or upgrade of the assets • Vehicle / equipment can be significantly modified without third party consent.	management and administration, VED and retention of all the risks (residual value, reliability, maintenance). • The council has a debt liability • The council must instigate process management for the disposal of assets and absorb the associated costs. • The council is liable for the cost of disposal of the asset • The council is liable to achieve the sales proceeds anticipated for the vehicle asset at the end of the retention period.	replacements). This is not the case in Southwark. It may also be the only commercially-suitable method for very expensive / specialised / unusual vehicle types where external supplier expertise is very limited. The risk premium demanded by external funders may be a prohibitive element of cost.
Summary Vehicles purchased outright belong to the Council from Day1. Other services such as maintenance, repairs, tax and insurance all have to be procured and managed separately however, There are risks around interest rates that will change from time to time, residual values and the need to				

manage and co-ordinate the external providers of the supporting services. Finally, the decision as to whether to purchase or not will depend on the council's existing capital budget position and its ability/desire to borrow compared to its other priorities.

Option	Appraisal	Pros	Cons	Indicators
Hire Purchase / Conditional Sale	The popularity for this method of fleet funding has varied considerably over the years due to concerns over VAT and balance sheet considerations. The overall principles are identical to outright purchase, but payments against the capital cost are made monthly/quarterly to the Finance-House lender, to repay an amount of the capital cost and interest, which is normally quoted at a fixed, flat rate. As this is essentially only a cash-flow variation on outright purchase the pros/cons. Indicators are the same. However, there is an additional disadvantage in that early disposal of the vehicle before the end of the agreement period may incur a termination cost.			

Summary
The vehicle becomes the council's asset upon completion of the payment term. As with outright purchase the council would need to procure, manage and co-ordinate other supporting services for maintenance, repair, tax etc. There will be an additional cost as the interest charged by the finance house will be greater than what the council can achieve itself but the council does not need to find the full purchase price when the vehicle is first obtained.

Option	Appraisal	Pros	Cons	Indicators
Lease Purchase (AKA Contract Purchase / Balloon HP	• This is essentially a development of the options above, but here the full capital cost is not paid off during the period of operation. At the start, recognition is made of the likelihood of a material residual value to be achieved when the vehicle is sold, so that payments only cover the anticipated depreciation and funding charges.	• Using an external guarantor for the residual value for 'standard' vehicle types (mostly cars and smaller vans), there is the possibility of using the supplier to carry the residual value risk. • This method may also offer advantages where vehicles are required for relatively short fleet lives. The	• The disadvantages reflect the impact of flexibility for the client who retains full ownership responsibilities. • These include overall depreciation, total management and administration, VED and retention of all the risks (residual value, reliability, maintenance).	• As with the outright purchase route may be appropriate for larger fleets where there is a fully operational in-house workshops or a well-developed 3rd party supply chain (maintenance, tyres, inspections, testing, and replacements). This is not the case in Southwark. • The absence of a need for capital funding provides flexibility to tailor the fleet to requirement

	• This brings reduced outlay and better cash flow. The greater ‘borrowed balance’ throughout, means higher interest charges for any given interest rate. • The anticipated residual value can be dealt with in either of two ways. A final ‘balloon’ payment (set broadly to equate with the expected disposal value at the end of the fleet life) can be built into the calculations, with the risk of the actual residual value staying with the local authority (LA). Ownership/title is passed to the client with the final payment, who may retain the vehicle, or dispose of it at, or hopefully over the ‘balloon’ value. • Any shortfall must be made up by the LA. Conversely any surplus is retained by the LA, essentially reducing the overall cost of depreciation.	benefit of the residual value risk transfer is much higher for vehicles sold relatively young. • However, there remains the issue of availability of capital budget. It is also necessary to ensure by careful checking that any residual value risk transfer is to a commercial entity that is likely to be able to honour its obligations, possibly some years down the line.	• If the lease is terminated, there will normally be a penalty to recover a large proportion of the outstanding finance and profit elements of the lease.	• This is a form of simple funding and the vehicle operator retains all the responsibilities. So while it provides access to revenue-based funding, those without still need to arrange the management resource and infrastructure to monitor and maintain vehicles and control costs
Summary This option results in lower monthly payments but with a requirement to purchase the vehicle at the end of the agreement period at an agreed price.				

Other services need to be procured separately as with outright purchase and hire purchase/conditional sale. There is a risk if the actual residual value is lower than the agreed figure but also a benefit if the actual figure is higher. This option retains an element of uncertainty for the council.

Leasing

Option	Appraisal	Pros	Cons	Indicators
Finance Leasing	• This is comparable to Hire Purchase but title in the vehicles can never be passed to the user (‘Lessee’). • The owner (‘Lessor’) claims such corporation tax allowances as are available, and (in theory at least), uses them to ‘subsidise’ the funding costs. At the end of the agreed period, the vehicle is sold by the Lessee through any of the normal channels, at a ‘fair market price’. The sales value should go to the Lessor as the ‘owner’, but most (typically 95%) of the disposal proceeds are then returned to the Lessee as a rebate of rentals. • ‘Peppercorn’ rental extensions are also available, to permit the continued use of the	• Provides access to the use of the vehicles and the associated funding, but with maximum flexibility for the client. Essentially similar to Hire Purchase but using revenue budgets rather than capital. • The rental profile and term can be matched to an asset(s) working life • The council enjoys the risk and rewards of ownership with total cost of ownership known at the outset. • If the council wishes to extend the lease beyond the preferred retention period, it is at nominal peppercorn levels	• The disadvantages reflect the impact of flexibility for the client who retains full ownership responsibilities. • These include overall depreciation, total management and administration, VED and retention of all the risks (residual value, reliability, maintenance). • If the lease is terminated, there will normally be a penalty to recover a large proportion of the outstanding finance and profit elements of the lease • The council has a debt liability and the expenditure is on balance sheet.	• This method may be very suitable where there is a relatively large established fleet with an existing infrastructure including workshops and transport expertise. The absence of a need for capital funding provides flexibility to tailor the fleet to requirement • This is a form of simple funding and the vehicle operator retains all the responsibilities. So while it provides access to revenue-based funding, those without still need to arrange the management resource and infrastructure to monitor and maintain vehicles and control costs.

	vehicle after the end of the original Agreement term for a nominal annual rental.	• The council can (if required) take title to assets for a nominal sum at the end of lease	• The council is liable for the cost of disposal of the asset. • The council is liable to achieve the sales proceeds anticipated for the asset at the end of the retention period, and must account for these accordingly. • A third party owns the assets during the lease term.	

Summary
Finance leasing means that the risks sit with the lessor who will charge the council accordingly. The cost to the council is met from revenue budgets, not capital. This option still requires the Council to procure, manage and co-ordinate supporting services.

Option	Appraisal	Pros	Cons	Indicators
Contract Hire With Maintenance	• This is a highly specialised lease, now the most common form of supply in the overall UK fleet market. • In general the method includes the Lessor sourcing and providing the vehicles (of any kind) from its own supply network, together with	• Contract Hire provides a highly developed solution to vehicle provision, with a high level of fixed costing and risk transfer to an external supplier. • The supplier's economies of scale reduce their costs.	• Whilst negotiable this approach can be inflexible in terms of contract terms (periods / mileages) with some rigidity on the range of cycles on which they will offer terms. • The inflexibility can also extend to	• The product has evolved so that is has extremely wide applicability. • The potential for fixed costs for with minimal risk has significant attraction. • Mixed fleets can use the one-stop shop opportunity offered by many. The additional integration of other

	funding, administration, VED, and tailor-made system for maintaining the vehicles. • All costs go to the Lessor, who also recovers the vehicles for disposal at Lessor's risk at end of period. • No in-house maintenance, workshop or specialist staff provision is required. • Commercial vehicle lessors focus on specific areas of the market (waste management / cleansing; parks/agricultural; tippers etc.) Although there are a few organisations which cover the full spectrum of vehicle types required by Southwark. • The scale of operations extends to economies of scale on vehicle discounts and lower-cost funding (often through a parent bank). • Most have well-developed large-scale IT resources with specialist	• Most suppliers are large enough to absorb realistic levels of risk transfer across all cost types. • Most suppliers offer a range of makes / models. This provides a one-stop solution for most (if not always all) vehicle types required by an LA • The risks and rewards of ownership are with the lessor • The residual investment is incorporated into the rentals payable, so the council pays rentals based on the depreciation of the asset(s), rather than their full cost • The council has no cost obligations to sell the asset or recognise loss/surplus on sale proceeds • Promotes a discipline to replace assets regularly at the end of	premature terminations where contract cancelations can incur material costs. • Also needs care over specification of the period / mileage. A low-mileage contract will be cheaper than a high-mileage one, but excess mileage charges can become expensive – and payable in a lump sum. • Assets need to be returned and therefore potentially tracked during their life • The council must ensure the assets are returned in a saleable state and if they do not comply with the return conditions specified in the contract, the council could be liable for charges • If the council decides to purchase assets at the end of lease, the	• These agreements have manageable and auditable Service Level arrangements in any agreement to monitor supplier on a regular basis • Supplier IT/MIS system reduces the need for internal administrative resource. • LBS can expect some technical support (like in-house consultancy) on areas of their transport policies. • As a mixed fleet user Southwark may need more than one specialist / semi-specialist supplier to deal with all our needs. • LAs undergoing major / long-term changes might face significant costs for vehicle changes and early terminations.

	applications to collect asset and operational data and report this as management information.	the preferred retention period	total cost of ownership will be more than that of borrowing or a Finance Lease	

Summary
Contract hire with maintenance is the most prevalent arrangement for providing vehicles to local authorities and other similar organisations in the UK. Contract hire companies provide vehicles from many manufacturers and are expert in vehicle purchase and management. Costs are met from the council’s revenue budgets. This arrangement provides a “one stop shop” for the council and allows the Fleet Management Service to focus on customers’ needs and corporate management of the vehicle fleet. There is no need for the council to procure, manage and co-ordinate supporting services.

Overall Conclusion
The first three options focus on the financing of the cost of the vehicles with the vehicles themselves becoming owned by the council at the start or end of the arrangement. Capital budgets are used to finance the purchase which may or may not be seen as the best use of the council’s capital receipts.

Under finance leasing and contract hire with maintenance the vehicle never becomes the property of the council. The cost is met from revenue budgets. Contract hire with maintenance has the advantage of being offered by vehicle management organisations rather than financial institutions and means that they understand the market, have relationships with the vehicle manufacturers and suppliers. They also offer support services, such as maintenance and repair, as part of one contract.