Light Vehicle Fleet Lease Financing and Management Services

(City Council at its regular meeting held on October 3, 4 and 5, 2000, and its Special Meetings held on October 6, 2000, October 10 and 11, 2000, and October 12, 2000, struck out and referred this Clause to the Chief Financial Officer and Treasurer for report to the business portion of the Inaugural meeting of Council in December comparing lease costs with external borrowing, including in said comparison any savings from leasing; and further that the Request for Proposals deadline be extended accordingly.)

The Policy and Finance Committee recommends the adoption of the joint report (August 28, 2000) from the Chief Financial Officer and Treasurer and the Commissioner of Corporate Services.

The Policy and Finance Committee reports, for the information of Council, having requested the Chief Financial Officer and Treasurer to submit a report to the meeting of Council scheduled to be held on October 3, 2000, providing a comparison using the City’s external borrowing versus internal borrowing and whether or not there are any operational savings in actually leasing the vehicles as opposed to purchasing them.

The Policy and Finance Committee submits the following joint report (August 28, 2000) from the Chief Financial Officer and Treasurer and the Commissioner of Corporate Services:

Purpose:

To determine the feasibility of leasing the City’s light vehicle fleet requirements as an alternative to purchasing and providing vehicle management services for these leased vehicles. The primary management services under consideration are: vehicle replacement planning, vehicle acquisition, insurance administration, fuel management and billing, vehicle repair and maintenance management, information management, and disposal services.

Financial Implications and Impact Statement:

The acquisition of the light fleet replacement vehicles is already incorporated into the vehicle replacement program as identified in the ‘2000 Vehicle and Equipment Replacement Programme’ report that appeared before Council on August 1, 2000. There are no additional financial implications for, or impact on the City as a result of not proceeding with lease financing as an alternative to purchase financing.
Recommendations:

It is recommended that:

(1) the City not enter into a light vehicle fleet lease financing contract or vehicle
management service contract with any of the proponents to the Request for Proposal at
this time; and

(2) the Commissioner of Corporate Services consider light vehicle fleet lease financing and
vehicle management services when preparing the strategic plan and organizational
structure for fleet maintenance management for the Administration Committee by

Background:

Program’ report of the Chief Financial Officer and Treasurer (CFO) as presented in Policy and
Finance Committee Report No. 5 Clause 1. Therein, it was determined that there is severe
under-funding of the Vehicle and Equipment Replacement Reserve based on the projected use of
these monies over several years.

Several years of fiscal restraint had reduced new vehicle procurement, with vehicles being
replaced on an exception basis only. The average age of the light vehicle fleet is increasing and
as the fleet ages, costs to maintain it are generally increasing as well. As a result, the proportion
of the fleet that is scheduled for replacement is growing. At present, 43.8 percent of the light
vehicle fleet is overdue for replacement. In dollar terms, this equates to a replacement value in
excess of $18.7 million.

As such, it was also determined that funding for the required replacement of the City’s aging
vehicle fleet needed to be increased significantly, otherwise there would be no funds available in
the reserve after 2001. Another approved recommendation was that the Chief Financial Officer
(CFO) and Commissioner of Corporate Services look into the feasibility of leasing all or a
portion of the City’s fleet requirements as an alternative to purchasing in order to reduce the
demands on the Vehicle and Equipment Replacement Reserve.

Comments:

To consider the feasibility of leasing, a Request for Proposal (RFP) was issued for light vehicle
fleet lease financing and associated management services. The light vehicle fleet includes only
cars, pickup trucks, and vans. The RFP invited proposal submissions for one or both of two
parts: Part A dealt with the acquisition of lease financing for the replacement of light vehicles in
the City’s fleet; and Part B dealt with the acquisition of fleet management services for the City’s
replacement vehicles in the light vehicle fleet.
RFP Process:

Under the direction of the CFO and the Commissioner of Corporate Services, and in accordance with policies of the Purchasing and Materials Management Division, proposals were invited for lease financing and/or the provision of vehicle management services for the annual replacement of vehicles in the City’s light vehicle fleet (cars, pickup trucks, and vans). The planned light vehicle fleet replacement needs over the next five years total $21.7 million for 728 vehicles. Appendix A provides a breakdown of the light fleet replacement needs by year and by vehicle type.

The RFP was advertised in The Globe & Mail on May 15, 2000 and on the City’s Web site. Five proposals were received in response to the RFP.

Staff from Treasury and Financial Services, and Fleet Management Services conducted an evaluation of the proposals. The disclosure of financial and commercial information provided in the proposals is subject to the Municipal Freedom of Information and Protection of Privacy Act.

Proposal Evaluation:

Part A – Light Vehicle Fleet Replacement Financing

Two funding options are being considered for the acquisition of light fleet replacement vehicles. One is lease financing as proposed in the responses to the RFP. The other is purchase financing through internal funding from the City’s Vehicle and Equipment Replacement Reserve. An evaluation of the discounted cash flows under leasing was compared to the City’s own opportunity cost of using funds from the Vehicle and Equipment Replacement Reserve to finance vehicle purchases rather than investing these funds.

Assumptions:

Under both scenarios, vehicles would be acquired in the fall of each year from 2000 to 2004 when vehicle prices are generally lower. Therefore, it is assumed that the City’s vehicle acquisitions are made once a year on September 1. Each year’s acquisitions would be financed for a period of 60 months after which time the vehicles would be sold and replaced by new vehicles.

The lowest rate made available to the City through the RFP process was significantly higher than the rate of interest used for internal financing. The internal rate of 5.43 percent corresponds to the City’s return on both bond and money market investments for 1999 (excluding Sinking Funds). This is representative of the opportunity cost of utilizing the funds for the purchase of vehicles rather than investing the funds in the bond and/or money markets.

For comparative analysis, the interest charges under leasing have been increased by 3 percent to incorporate the net cost of GST (after municipal rebates) on the interest portion of the lease payments. Under the purchasing scenario, the interest portion of the debt payments is not subject
to GST. The purchase versus lease decision is not affected by the inclusion of this additional cost.

Findings:

The net present value of the cash flows under the purchase option is $18.1 million, while the corresponding amount under the lease option is $19.2 million. A summary of the analysis is provided in Appendix B. The analysis shows that internal financing results in net cash savings of $1.1 million in today’s dollars. Even if the City’s projected external borrowing rate of 6.38 percent were used as a benchmark, there would still be an estimated $700,000.00 in net cash savings from borrowing externally versus leasing. Therefore it is recommended that the City not enter into a lease financing arrangement with any of the RFP proponents.

Part B – Light Vehicle Fleet Management Services:

Insurance Services:

The Insurance and Risk Management (IRM) Section of the Finance Department conducted an evaluation of the insurance services contained in the proposal submissions. IRM is responsible for the administration of City of Toronto insurance claims, including automobile losses for both owned and leased vehicles. Following its review of the proposals and clarification of some insurance/claims process issues IRM commented that:

(a) there was nothing substantive presented in any of the proposals that would preclude any of the proponents from working with the City of Toronto;

(b) should the City elect to proceed with any of the Fleet Management Services proposed, any claims data reporting requirements could be accommodated; and

(c) given the current insurance/claims process already in place for the fleet operation, there is no value added to the City in any of the proposed claims administration services.

Other Services:

As part of the RFP process, other vehicle management services were considered as an alternative to in-house services for light vehicle fleet replacements only. The Fleet Management Division of the Corporate Services Department evaluated these services as submitted in the RFP proposal submissions.

Notwithstanding the recommendation(s) respecting the cost of money component quoted in Part A, interviews were conducted with two short-listed proponents respecting Part B, the provision of vehicle management services.

The Fleet Management Division analyzed the information provided by the proponents in their submissions, and took into consideration the interview process. The administrative services for which cost information was provided, would supplement the services currently provided within
the City and are not a replacement for those services. As a result, additional corporate costs
would be incurred. An additional concern was the fact that proponents are willing to take only
limited or even no responsibility for quality control for work performed by external garages. As
a result, the City would be required to provide an inspection and approvals function in order to
implement the repair and maintenance component of Part B services. This would also result in
additional corporate costs.

Furthermore, the Fleet Management Division is in the midst of preparing a strategic plan and an
organizational structure for fleet maintenance management. This information is to be reported to
the Administration Committee by February 2001 as directed by Council at its meeting of June 7,
2000 with the approval of Report 13, Clause 20(c)(2)(ii), of the Administration Committee.

Conclusions:

Part A – Light Vehicle Fleet Replacement Financing:

The net present value of the cash flows under the purchase option is $18.1 million, while the
corresponding amount under the lease option is $19.2 million. Therefore choosing the purchase
option would result in net cash savings of $1.1 million in today’s dollars.

In accordance with these findings, it is recommended that the City not enter into a lease
financing arrangement with any of the RFP proponents.

Part B – Light Vehicle Fleet Management Services:

It is unclear from the proposal submissions received, subsequently clarified with information
submitted by way of interviews with short-listed proponents, whether or not there are any
savings from accepting any of the Part B services. Therefore, it is recommended that none of the
proposals pertaining to Part B be accepted. The ongoing review, research, identification and
analysis of the full cost implications of the external provision of fleet management and
maintenance services will continue.

Contact:

Ralph Frebold, Senior Financial Analyst, Finance Department --- 392-4317
Effie Ginzberg, Manager, Amalgamation and Fleet Dev., Corp. Services Dept. --- 392-7791
Donald Altman, Manager, Financial Planning, Finance Department --- 397-4220
Len Brittain, Director, Treasury and Financial Services, Finance Dept. --- 392-5380
Lou Pagano, Director, Purchasing and Materials Mgmt., Finance Dept. --- 392-7312
### Appendix A
City of Toronto
Projected Light Vehicle Fleet Replacements

<table>
<thead>
<tr>
<th>Vehicle Type</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>Total</th>
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<tr>
<td>2 Wheel Drive</td>
<td>71</td>
<td>58</td>
<td>57</td>
<td>29</td>
<td>28</td>
<td>243</td>
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<td>4 X 4</td>
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<td>12</td>
<td>6</td>
<td>11</td>
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<td>4 X 4 Sport Utility</td>
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<td>3</td>
<td>2</td>
<td>1</td>
<td>0</td>
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<td>Compact</td>
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<td>21</td>
<td>14</td>
<td>11</td>
<td>0</td>
<td>59</td>
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<td>Crew Cab 2WD</td>
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<td>6</td>
<td>6</td>
<td>8</td>
<td>7</td>
<td>31</td>
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<td>Crew Cab 4 X 4</td>
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<td>7</td>
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<td>2</td>
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<td>20</td>
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<td>Utility</td>
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<td>2</td>
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<td>13</td>
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<tr>
<td>Total Pickups</td>
<td>101</td>
<td>97</td>
<td>100</td>
<td>59</td>
<td>50</td>
<td>407</td>
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<td>Value - $ millions</td>
<td>2.7</td>
<td>2.5</td>
<td>2.7</td>
<td>1.7</td>
<td>1.6</td>
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<td><strong>Cars</strong></td>
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<td>4 Door Compact</td>
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<td>43</td>
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<td>4 Door Full Size</td>
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<td>1</td>
<td>0</td>
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<tr>
<td>Compact</td>
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<td>4</td>
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<td>Station Wagons</td>
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<td>1</td>
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<td>Total Cars</td>
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<td>19</td>
<td>10</td>
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<td>0.5</td>
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<td><strong>Vans</strong></td>
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<td>Cargo-Full Size</td>
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<td>25</td>
<td>34</td>
<td>32</td>
<td>13</td>
<td>136</td>
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<td>Cube-Box Truck</td>
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<td>2</td>
<td>1</td>
<td>7</td>
<td>2</td>
<td>14</td>
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<td>Curbside-Bread Truck</td>
<td>3</td>
<td>4</td>
<td>4</td>
<td>3</td>
<td>0</td>
<td>14</td>
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<tr>
<td>Mini-Cargo</td>
<td>4</td>
<td>6</td>
<td>4</td>
<td>9</td>
<td>8</td>
<td>31</td>
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<tr>
<td>Mini-Passenger</td>
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<td>0</td>
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<td>4</td>
<td>5</td>
<td>15</td>
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<td>Window-Full Size</td>
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<td>8</td>
<td>6</td>
<td>2</td>
<td>33</td>
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<tr>
<td>Total Vans</td>
<td>63</td>
<td>37</td>
<td>52</td>
<td>61</td>
<td>30</td>
<td>243</td>
</tr>
<tr>
<td>Value - $ millions</td>
<td>2.1</td>
<td>1.3</td>
<td>1.8</td>
<td>2.2</td>
<td>1.0</td>
<td>8.4</td>
</tr>
<tr>
<td><strong>Total –</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All Vehicles</td>
<td>187</td>
<td>148</td>
<td>171</td>
<td>130</td>
<td>92</td>
<td>728</td>
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<tr>
<td>Value - $ millions</td>
<td>5.4</td>
<td>4.2</td>
<td>5.0</td>
<td>4.2</td>
<td>2.9</td>
<td>21.7</td>
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</table>
Appendix B

City of Toronto
Analysis of Lease Option versus Purchase Option
For Light Vehicle Fleet Replacements

Purchase Option:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
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<tbody>
<tr>
<td>Net Present Value (NPV) of Vehicle Purchases</td>
<td>$21,700,000</td>
</tr>
<tr>
<td>Less: NPV of Vehicles Sold after 5 Years (Discounted at 5.43 percent)</td>
<td>$3,600,000</td>
</tr>
<tr>
<td>NPV of Purchase Option</td>
<td>$18,100,000 (A)</td>
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Lease Option

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Present Value (NPV) of Required Lease Payments</td>
<td>$19,200,000 (B)</td>
</tr>
<tr>
<td>Purchase Option Savings</td>
<td>$1,100,000</td>
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