

## Lease Here Pay Here (LPH) Has High Profit Potential

by Randall McCathren, June 21 2009

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Today's environment for franchise dealers is being called by many pundits "survival of the fittest." However, a more accurate description is "survival of the most nimble and creative." It will not be the dealerships with the greatest financial strength that weather this sales depression, it will be the dealerships that find new ways to hold on to or even gain financial strength when the old methods no longer work.

### LPH Advantages

Starting a buy here-pay here program is an excellent option for survival or even prosperity. However, a lease here-pay here (LPH) program adds some significant additional benefits that may make it more profitable for most dealers:

Much greater after-tax cash flow due to reduced upfront income tax liability and in most states no up-front sales tax;

- Greatly improved upfront after-tax cash through customer payment of a non-taxable security deposit rather than a taxable down payment;
- Greater control of the vehicle and its use both during the lease and if a bankruptcy occurs;
- Accelerated recognition of finance book income, depending on lease terms;

Tax shelter through accelerated depreciation of the vehicles (dealer is tax owner).

LPH Considerations: There are two significant impediments for franchise dealers:

- Customer and Staff resistance.
- Servicing complexity.

Staff resistance should be relatively easy to overcome: provide the education and training necessary for staff to understand the benefits to the dealership and customers and reward them for the profits they contribute to the dealership. In these times, the most motivated and savvy staff should jump at the chance to get in on a great new profit center in the dealership.

Customer resistance likewise should not be a problem: there are real benefits for the customer in terms of the sales tax and reduced trade cycle. Give the customer some of the cash flow benefits by reducing the down payment requirement and explain the general leasing benefits. Most customers will be happy to qualify for a vehicle after being turned down by finance companies.

### Overcoming Servicing Complexity

Probably the biggest impediment for a franchise dealer to start a BPH program is the initial investment and ongoing requirements/headaches/risks of a servicing infrastructure. Leasing complicates those burdens because the product entails different legal, tax, accounting and regulatory requirements. The good news is that third-party servicing programs are now available that transfer virtually ALL of those requirements and risks to entities that have the economies of scale and expertise to provide a highly cost-effective solution. The dealership can then concentrate on what it knows how to do: sell/lease vehicles to customers.

**Turnkey outsource service programs now provide everything a dealership needs to manage a leasing program:**

The LHPH Turnkey Program includes the following components: Program design: a program handbook incorporating all LHPH program parameters and requirements (pricing, credit criteria, program features, etc.) with limited customization for the dealership based on dealership staffing, customer base, inventory and program preferences. Pricing model and cash flow/P&L projections: pricing model customized to dealer program parameters and cash flow model projecting portfolio performance including tax and finance books.

**Forms and documentation:** all forms and documents necessary to originate, manage and terminate LHPH leases including an innovative new Reynolds LHPH law contract.

**Customized dealer portal:** provides dealer with credit application, lease worksheet, automated online forms and documents, payment processing records, and account tracking and status.

**Legal compliance and structure:** an overview of all legal requirements. Sales and documentation training, a PowerPoint sales training manual, which will be periodically updated, plus weekly on-line sales and administrative training.

**Marketing: marketing strategy and plan:** sample customer lease explanation; and customer brochure and sales collateral incorporating program customer features and benefits.

**Contract funding** - contracts will be boarded onto the lease accounting system for the dealers.

**Third-party collection and customer service** - services include all customer interaction post contract funding including payoff, end of term, and repossession management.

**Contingent and Excess Liability Insurance** - low-cost C&E coverage based on underlying lessee state minimum liability limits (rather than the traditional 100/300 lessee requirement).

**Lessee Liability Insurance tracking: competitively priced lessee liability insurance tracking.**

**Collateral Protection Insurance:** low-cost dealer CPI coverage without individual lessee underwriting.

**Financial Accounting:** lease accounting guidelines and documentation for the dealership CPA firm.

**True Lease Status: true lease tax guidelines and methodology for true lease residual value setting.**

The dealership may decide to develop in-house servicing when the lease portfolio size makes that option cost-effective. But in a start-up environment, outsourced servicing is a great option to gain the LHPH benefits while avoiding the major impediment.

**Randall McCathren is an attorney and consultant with more than 25 years of experience in consumer vehicle leasing. He represented industry members in the formulation of the 1998 Regulation M and has consulted with the Federal Reserve Board on leasing regulatory issues. He is the co-author of two books on vehicle leasing: The Automobile Lending and Leasing Manual and Essentials of Consumer Vehicle Leasing.**