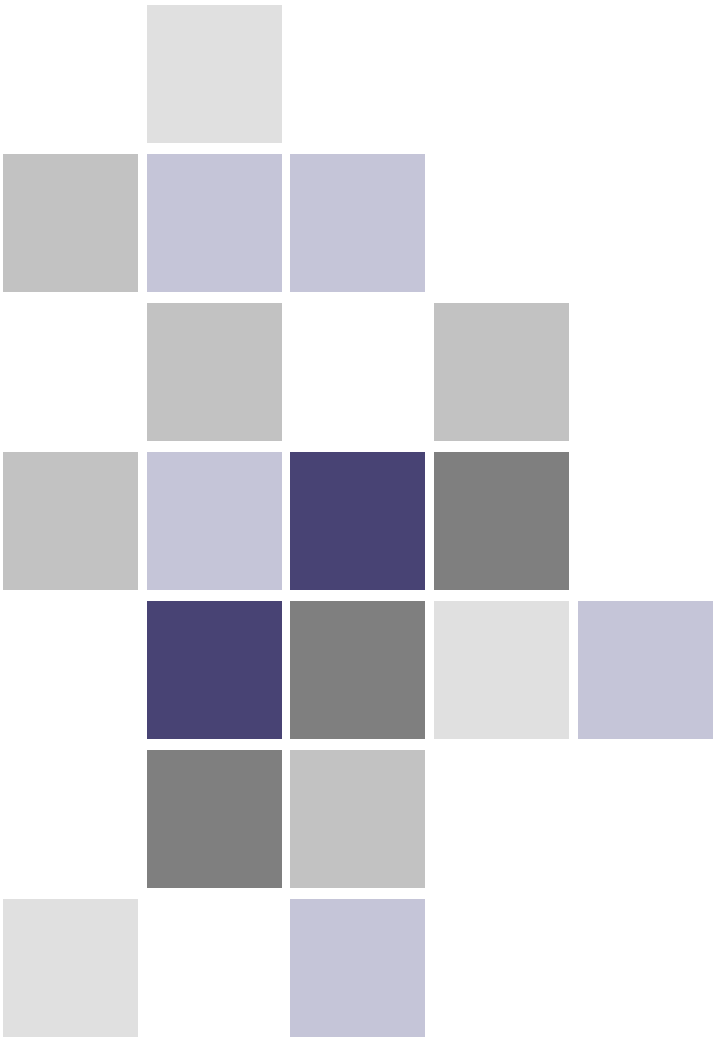
MGT CONSULTING GROUP

Analysis OF ENTERPRISE CONTRACT

CITY OF SAN MARCOS, TEXAS

Final Report

November 16, 2020



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ANALYSIS OF ENTERPRISE CONTRACT

BACKGROUND AND OBJECTIVE

- Starting in 2014, City began leasing light-duty vehicles from Enterprise
- Enterprise, headquartered in St. Louis, MO., is the largest car rental company in the US. In FY 2019, Enterprise's revenues were approximately $25.9 billion. According to Moody's, it is rated Baa1. Enterprise Holdings and its affiliates own nearly 1.7 million cars and trucks, making it the largest car rental service provider in the world as measured by revenue and fleet.
- On February 4, 2014, the City Council passed Resolution 2015-09R – the "Master Equity Lease Agreement and Maintenance Agreement"
- Enterprise leases vehicles for 5 years, then replaces with new vehicles
- The Police Department purchases most of its vehicles because of the higher mileage
- Enterprise maintains the vehicles (except for tires and damage)
- After the initial five years of the Enterprise Leasing Program, the City Council asked for an analysis of the efficiency and effectiveness of the program.

THE ENTERPRISE CONTRACT

- City leases light-duty vehicles for 60 months
- Enterprise delivers vehicles
- At end of lease, Enterprise replaces vehicle
- Charges:
  - Lump sum amounts for:
    - Licenses and taxes
    - Delivery fee ("Service Charge")
  - Monthly payments are calculated for each vehicle as follows:
    - Delivered Price of Vehicle X Monthly Depreciation % = Depreciation Amount
      - The Depreciation Percent Per Month (amortization of the purchase price less the residual value of the vehicle) is based on 75 to 80% of the Delivered Price and varies by vehicle

    + Lease Charge Per Month

    + Full Maintenance Rate Per Month

    = Total Rent Per Month

- Maintenance
  - The Maintenance Rate Per Month also varies by vehicle
  - Local garages provide much of the maintenance via service contracts with Enterprise
  - Maintenance services listed under the Enterprise contract

Maintenance Included	Maintenance Excluded
All major and minor repairs (e.g., engines, transmission, radiators)	Oil between changes
All recommended services (e.g., oil changes, tune-ups)	Gas and parking
All maintenance related towing	Insurance related repairs
Incidentals (fluid, belts, hoses, etc.,)	Car washes
Brake replacement (2 full axles)	Loaner vehicles
	Obvious neglect or abuse
	Motor vehicle safety and emissions inspections
	Non factory/dealer installed equipment
	Tires

THE CURRENT FLEET

The City currently has 191 light-duty vehicles under lease in the following model categories:

Model	Total by Model
4500 Chassis	1
Colorado	2
Equinox	1
Explorer	7
F-150	52
F-250	22
F-350 Chassis	7
Highlander Hybrid	1
Rogue	1
Santa Fe	1
Silverado 1500	4
Silverado 2500HD	14
Silverado 3500HD	2
Silverado 3500HD Chassis	7
Suburban	3
Tahoe	8
Transit-250	7
Traverse	12
Other	39
Grand Total	191

Since the lease program started in 2014, the original vehicles rotated out during 2018. The leased vehicles currently in the fleet were placed in service starting in 2016.

HOW DOES LEASING COMPARE TO THE CITY PURCHASING THE VEHICLES

The ***total*** monthly cost (leasing plus maintenance) for the current leased fleet is:

Model	Total by Model	CVB	Drainage	Electric	General	Resource Recovery	Water/Wastewater	Total Monthly Cost
4500 Chassis	1				$ 879			878.91
Colorado	2				$ 942			941.80
Equinox	1				$ 340			338.54
Explorer	7				$ 3,503			3,502.98
F-150	52		$982.63	$2,456.57	$ 13,265	$ -	$ 8,844	25,548.35
F-250	22		$1,728.70	$0.00	$ 9,220	$ -	$ 1,729	12,677.15
F-350 Chassis	7		0		$ 1,558	$ -	$ 3,895	5,452.99
Highlander Hybrid	1					$ 640		640.39
Rogue	1			362.01				362.01
Santa Fe	1				$ 326			326.27
Silverado 1500	4				$ 2,879			2,878.50
Silverado 2500HD	14				$ 9,114			9,114.10
Silverado 3500HD	2				$ 1,368			1,367.69
Silverado 3500HD Chassis	7						$ 4,909	4,909.07
Suburban	3				$ 2,325			2,325.36
Tahoe	8	$656.73	$0.00	$1,313.47	$3,283.67	$0.00	$0.00	5,253.87
Transit-250	7				$ 1,747	$ -	$ 2,329	4,075.18
Traverse	12				$ 6,290			6,290.00
Other	39				$ 23,246			23,245.51
Monthy Cost	191	$656.73	$2,711.33	$4,132.05	$80,284.07	$640.39	$21,705.10	110,129
Annual Cost		$ 7,880.81	$ 32,535.97	$ 49,584.60	$ 963,408.80	$ 7,684.68	$ 260,461.19	$ 1,321,556.04

The annualized amount is $1,321,556

Lease payments include amounts for both the leasing and the maintenance of the vehicle. It's important to separate these two components.

WHAT DID IT COST TO LEASE THE VEHICLES – EXCLUDING MAINTENANCE?

The monthly lease payment for each vehicle includes:

- Dep Amt/Mo
- Total Lease Charge/Mo
- Full Maint Rate/Mo

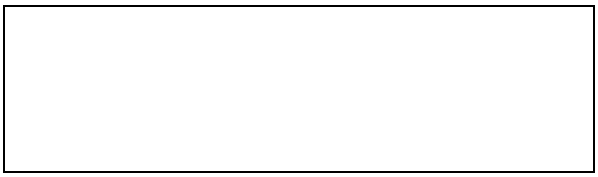
When the City leases a vehicle, it also pays one-time fees for Licenses & Taxes and a Service Charge. The City would pay for Licenses & Taxes whether it leased or purchased the vehicle. The Service Charge is probably equivalent to a documentation fee. The City would likely have these expenses under any scenario so they should have no impact on the question of whether leasing or purchasing is more advantageous to the City.

Enterprise discloses the "Delivered Price" of each vehicle. The Delivered Price of the current fleet is:

Sum of Delivered Price	
Model	Total
4500 Chassis	$44,383.20
Colorado	53,521.98
Equinox	18,199.00
Explorer	199,598.90
F-150	1,385,038.36
F-250	697,513.04
F-350 Chassis	284,601.90
Highlander Hybrid	33,977.84
Rogue	16,484.00
Santa Fe	18,449.00
Silverado 1500	159,230.70
Silverado 2500HD	525,056.74
Silverado 3500HD	78,275.31
Silverado 3500HD Chassis	275,360.04
Suburban	135,138.04
Tahoe	292,085.42
Transit-250	220,631.48
Traverse	324,134.18
Other	1,217,790.98
Grand Total	$5,979,470.11

The above includes 100% of the price of the vehicle. However, the City is only utilizing each vehicle for 75 to 80% of its useful life since the City will return the vehicle to Enterprise after 60 months. Enterprise estimates that the vehicles will retain 20 to 25% of the delivery value after the 60 months (the residual value varies by model and year).

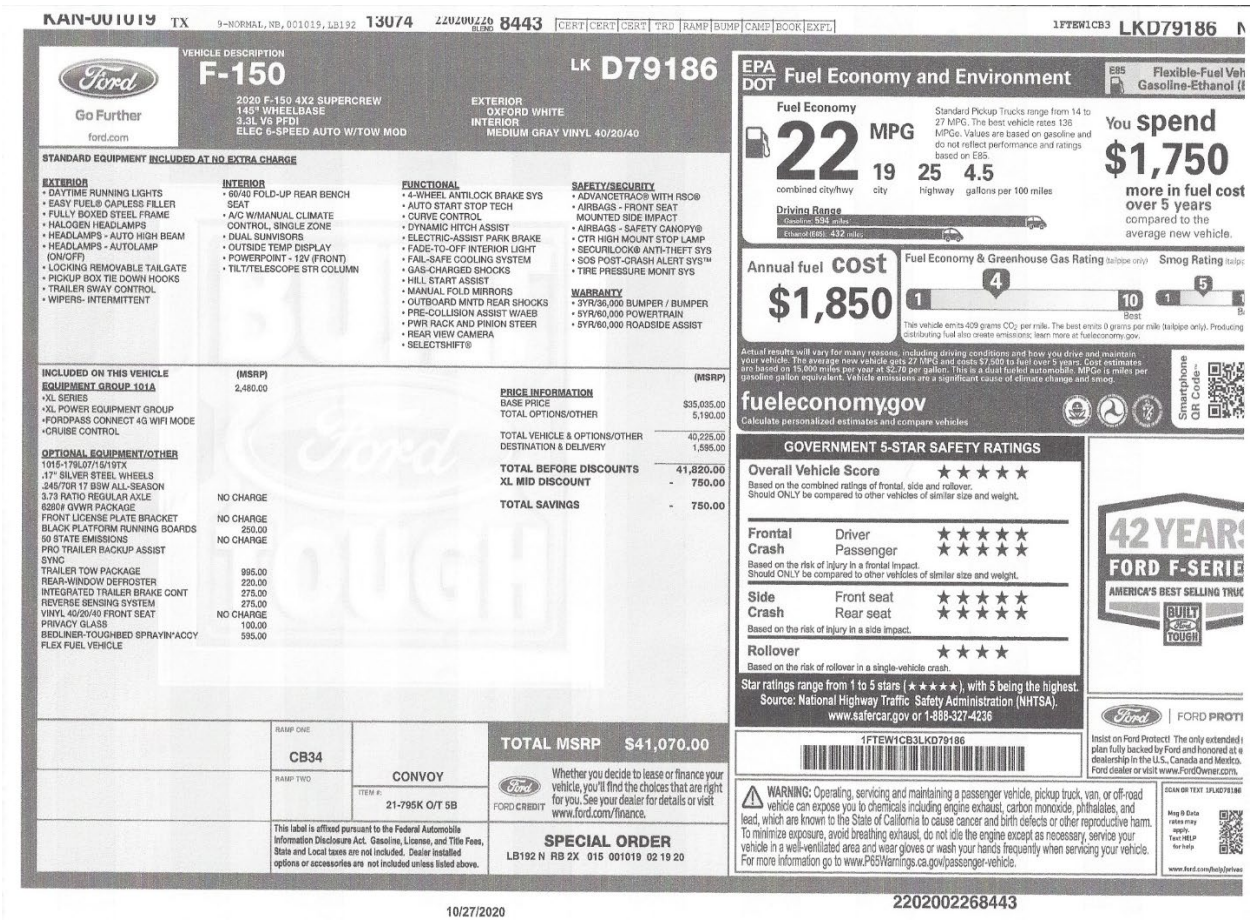
The monthly cost to the City for leasing (excluding maintenance) all of the 191 vehicles is:



The Lease Charge/Mo ranges from $56.58 to $183.02 per vehicle per month. The Lease Charge/Mo varies from 20.4 to 39.0 percent of the Dep Amt/Mo and averages 29.5% of the total Dep Amt/Mo for the entire leased fleet.

LEASE AND PURCHASE SCENARIOS

We selected one leased vehicle from the City's inventory of leased vehicles to compare the delivered price and the sticker price, We chose a Ford F-150 pick-up truck (2020 model, VIN 1FTEW1CB3LKD79186) because this model is the largest component of the leased fleet. The delivered price was $28,346.28. The monthly Depreciation Amount and Total Lease Charge are $382.67 and $108.46, respectively. By comparison, the "Total Price Before Discounts" (see Maroney sticker below) as shown on the original vehicle window sticker is $41,820, or 47.5 percent more than the Delivery Price to the City. However, the City is also paying $108.46 to Enterprise for the Total Lease Charge.



The following calculation compares the Net Present Value (NPV) of leasing versus purchasing for the above Ford F-150 pick-up truck. Enterprise delivered the vehicle at a price of $28,346 with annual lease payments (excluding maintenance) of $5,893.56 BUT the City returns the vehicle. We assumed a borrowing rate for Enterprise of 5% because Enterprise is rated Baa1. The NPV of the City's payments is $25,516.

		Discount Rates	
	5.00%	2.00%	2.00%
	20% residual		
	Ford F-150 Lease	Ford F-150 Purchase @ Enterprise Price	Ford F-150 Finance @ MSRP less 5% Dealer Discount
Year 1	-$5,893.56	-$6,013.84	-$8,263.57
Year 2	-$5,893.56	-$6,013.84	-$8,263.57
Year 3	-$5,893.56	-$6,013.84	-$8,263.57
Year 4	-$5,893.56	-$6,013.84	-$8,263.57
Year 5	-$5,893.56	-$6,013.84	-$8,263.57
Year 6		$5,669.20	$7,790.00
Year 7			
Year 8			
NPV	($25,516.03)	($23,311.91)	($32,032.70)

If the City could buy the vehicle at the same price it would also benefit from owning the vehicle outright after 5 years. Enterprise estimates residual values of 20 to 25 percent. With the City's lower borrowing rate as an AA-rated tax-exempt entity and the estimated residual value of the vehicle, the NPV of the annual loan payments and residual value would be $23,312. This is LESS than the total payments to Enterprise.

However, Enterprise buys vehicles at a substantial discount directly from manufacturers. It is unlikely that the City could buy at the Enterprise price. As noted above, the original vehicle sticker for this pick-up truck was $41,820. If the City could buy the vehicle with a 5% dealer discount, the NPV of the annual payments, and recognizing a 20% residual value, would be $32,033.

Therefore, the cheapest scenario is to buy the vehicle outright IF the City could secure the Enterprise price, but this is unlikely unless the City can secure the same fleet discount rate.

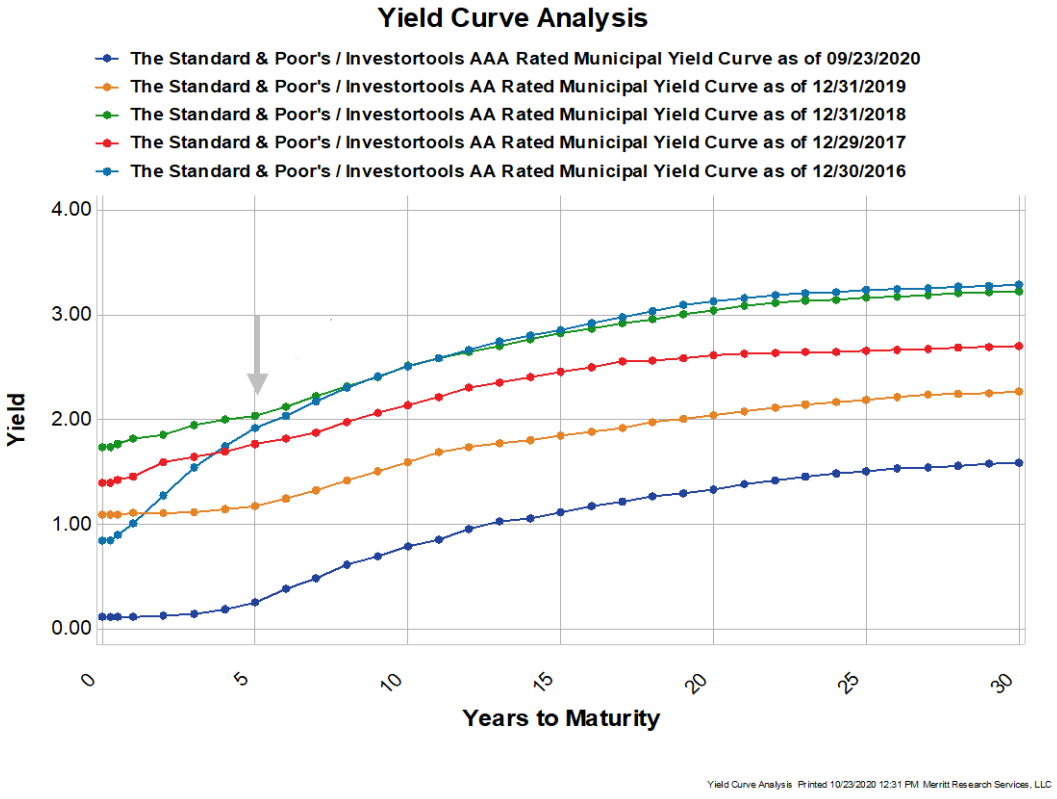
If the City had purchased the 191 vehicles at a cost of $5,979,470.11, what would it have paid? MGT estimates the payments as follows:

Interest rate		2.00%
Amount financed	$	5,979,470.11
Number of payments		60
Monthly payment		$104,806.72
Annualized		$1,257,680.61

The City would have paid $1,257,680.61 per year for 100% of the vehicles because the City would have owned the vehicles outright when the payments ended. This compares to the City making annual lease payments of $1,224,690 to lease 75 to 80% of each vehicle in the current fleet.

The City could then keep or sell the vehicles after the bonds (loans) were paid in full. While maintenance costs typically increase for older vehicles, it would be up to the City to decide if increased maintenance costs were preferable to initiating new loan payments on new vehicles.

We based our estimates on a 2% interest rate. The following chart shows interest rates for AA and AAA-rated municipal bonds of various maturities.[1] If we assume that the City had issued 5-year bonds to finance the vehicle purchases, the highest interest rate (the green line) for the 5-year maturities would have been the curve for 2018 at about 2.00 percent. The rate as of September 23, 2020 (the lower blue line) is less than .50 percent. Even if the City had to pay 4% interest, the annualized payments would have still been less than $1.4 million ($1,321,453).



[1] Standard & Poor's confirmed the City of San Marcos' underlying credit rating in September 2019. As of that date, the City's General Obligation bond rating for Standard & Poor's is: "AA".

WHAT DOES MAINTENANCE COST FOR THE LEASED VEHICLES?

The average maintenance fee charged by Enterprise for the 191 vehicles is $42.26 per month, or $507.12 per year. The total monthly charge is $8,071.68, or $96,860,16 per year. The breakdown by model is as follows: [2]

	Number of Vehicles	CVB	Drainage	Electric	General	Resource Recovery	Water/WasteWater	Monthly Cost
4500 Chassis	1				$62.62			$62.62
Colorado	2				$68.52			$68.52
Equinox	**1**				**$0.00**			$0.00
Explorer	7				$256.69			$256.69
F-150	52		$77.34	$193.35	$1,044.09		$696.06	$2,010.84
F-250	22		$133.02		$709.44		$133.02	$975.48
F-350 Chassis	7				$130.02		325.05	$455.07
Highlander Hybrid	1					$47.99		$47.99
Rogue	1			$59.20				$59.20
Santa Fe	**1**				**$0.00**			$0.00
Silverado 1500	4				$165.32			$165.32
Silverado 2500HD	14				$625.58			$625.58
Silverado 3500HD	2				$99.68			$99.68
Silverado 3500HD Chassis	7						$370.58	$370.58
Suburban	3				$106.05			$106.05
Tahoe	8	$39.00		$78.00	$195.00			$312.00
Transit-250	7				$127.23		$169.64	$296.87
Traverse	12				$496.56			$496.56
Other	39				$1,662.57			$1,662.57
Monthly Cost	191	$39.00	$210.36	$330.55	$5,749.37	$47.99	$1,694.35	$8,071.62
Annual Cost		$ 468.00	$ 2,524.32	$ 3,966.60	$ 68,992.44	$ 575.88	$ 20,332.20	$ 96,859.44

The City's Fleet Department has 9 positions (one vacancy) with total staff costs, including benefits, of $694,302. Five positions are "Master Fleet Services Technicians" with total salaries and benefits of $382,848, an average of $76,570.

There is a total of 754 pieces of fleet related equipment across all depts. That number includes both leased and city owned vehicles as well as equipment the Fleet Department must maintain. Of the 754 assets, 191 are leased. The remaining 563 assets are city owned. This total includes equipment from small engines to 100 foot ladder trucks. It is a very diverse fleet and workload.

Police Department has the largest fleet of city owned assets with a total of 151. Police patrol vehicles (151) are not part of the leasing program for several reasons: maintenance requirements are higher; and due to mileage patrol vehicles have a shorter life, thus, the resale value on a patrol vehicle is far lower than normal vehicles. Fleet and the Police Department maintain them.

[2] As of November 19, 2020, Enterprise is not charging a maintenance fee for two vehicles. Staff members are working with Enterprisse to understand this discrepancy.

The Fleet Services Manager estimated that one Technician would be needed for each 100 vehicles. If the City were to assume maintenance responsibility for the 191 leased vehicles, it would probably have to add 2 technicians at an annual salary cost of about $153,000, including benefits. Newer vehicles don't require extensive maintenance until they reach 100,000 miles. For example, Ford recommends waiting to 100,000 miles before changing spark plugs on F-series vehicles. Maintenance up to that point is primarily for oil and changes of filters. The City would pay for tire replacement whether it owned or leased the vehicles.

If the City owned the vehicles, the City would need to purchase parts for the vehicles in addition to adding staff. If parts (excluding tires) and lubricants cost $300 per year per vehicle, the additional parts and additional labor for two technicians would be about $210,300 per year, or $1,101 per vehicle per year. This compares to the average maintenance cost per vehicle per year under the Enterprise contract of $507.12. It would cost the City more than double what Enterprise is charging to provide maintenance services to the additional 191 vehicles.

However, as the fleet ages under the City's ownership, maintenance costs will increase. Older vehicles require more maintenance. Turning over the leased fleet every five years helps ensure a lower average age for the fleet. As fleet ages increase, maintenance costs will rise and the residual value of the vehicles will fall. Prior to the City entering into the leasing program, the average age of the fleet ranged from 12 to 15 years.

In addition, the City does not have the capacity at the garage facility to service more vehicles. Even with the new garage that is under construction and will have three service bays, the City would have to increase capital costs for an even larger facility.

CONCLUSIONS

Enterprise has nearly 1.7 million cars and trucks in its fleet. This purchasing power allows it to buy vehicles at much lower prices than available to small fleets. The cost to the City to lease the vehicles is less than if the City purchased the same vehicles. Over the five-year lease period, leasing is cheaper.

If the City had purchased the vehicles, it would have eliminated payments after five years, but it would have seen increased maintenance expenses. The City would have needed more Fleet personnel and a larger facility than the one now under construction.

Should the City opt to purchase a significant number of the vehicles at the end of the lease, the City should consider maintenance contracts similar to the Enterprise arrangement. The City could use outside vendors for routine maintenance. This could reduce the need to hire additional Fleet staff and the burden of addition physical capacity to the new garage.

Finance staff also commented that the City can receive Vehicle Credits if the market value of a vehicle at the end of the lease is greater than the Residual Value (Delivered Price less Depreciation) of a vehicle. If this is the case, the City should include this understanding in the Enterprise lease agreement.