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Why Congress should be concerned about floorplan interest

By Peter Welch
NADA President

WASHINGTON — Congress is deep into the process of rewriting the tax code for a first time in a generation, and the stakes for our industry and the economy couldn't be higher.

One issue still under debate is whether to change the tax code to reduce the deductibility of interest on floorplan financing. Such a change could put automobile and truck dealers at serious risk of paying higher taxes even when the dealership does not show a profit.

When this issue first arose in the House of Representatives, members of Congress recognized the important distinction between general business interest and specialized floorplan interest. They passed a bill that preserves full deductibility of floorplan interest for retailers who rely on floorplan financing to make inventory available on Main Streets across the country.

This is a very positive step because, as those of us in the automotive industry know, floorplan financing is the lifeblood of auto retail. It's what allows big and small dealerships across the country to finance the purchase of expensive showroom inventory from the OEMs.

With the average selling price of a new vehicle almost $35,000, even relatively small dealerships have inventory financing borrowings of more than several million dollars. As a result, interest expense historically has been one of the top three expenses at a typical dealership.

What's more, inventory in showrooms across the country stimulates retail demand for vehicles in thousands of markets nationwide. In this regard, floorplan financing is the foundation of the entire U.S. auto industry — both in terms of the sales it helps facilitate and the jobs it helps provide.

However, the Senate Finance Committee bill would limit the deductibility of

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Reports of demise of auto retail have been greatly exaggerated

By Ryan Kerrigan
Kerrigan Advisors

A recent Automotive News edition was filled with countless anecdotes and opinions, largely coalescing around the demise of auto retail as we know it. No question, we are seeing historic technology and business model disruption on the horizon, and dealers need to be thinking deeply about how to stay relevant, competitive, and profitable in the paradigm to come.

With that in mind, I think it is important that we recognize that dealers do not face a "light switch." Specifically, no one's going to flip the switch and put dealers out of business anytime soon. This is just another set of challenges and changes that will confront this hundred-year-old business model, much as prior disruptions have confronted auto retail.

All industries, and all business models, are evolving. And if you take a long enough view, all business models are, in effect, "going away".

In this regard, the future facing auto retail is not unique. We are simply facing the same disruption, technologies, and shifts in consumer preferences that most industries confront every year and every product cycle.

Imagine the enormous bets placed every year by companies in consumer electronics, fashion and other retail oriented business models. These industries face the need to reinvent themselves regularly.

Right here in our own industry, our automotive OEMs are betting billions of dollars on each major product roll out, and each major technology initiative, to stay current in this highly competitive market space. And the volatil-

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Carmakers look to future at this year's Los Angeles Auto Show

The 21st-century U.S. auto industry is performing a skilled juggling act, and that performance is on stage Dec. 1-10 at the Los Angeles Auto Show.

Automakers are serving multiple masters. They are investing billions in self-driving technologies that many predict are the future of ride-sharing services and daily commutes. Yet, they also must maintain full-line product portfolios for driving customers on course to buy 17 million new vehicles for the third year in a row.

The vast majority of those vehicles will be powered by cheap gas, yet carmakers also must meet the demands of governments such as California that are forcing carmakers into a regulated future of battery-powered vehicles.

Things got started Nov. 28 with the AutoMobility LA conference that brought together automakers, designers, computer engineers, academics, investors and others to share their visions of an autonomous future.

Executives from Panasonic, BMW and Waymo spoke on topics including "Redefining Mobility in a Connected World" and "Roadside Ransomware: Fact or Fiction?"

Their visions are hardly hypothetical. Automakers are already building self-driving chariots. Uber has announced a partnership with Volvo to put 24,000 Uber-bots on the road by 2019. The agreement puts the company on a "path toward mass-produced self-driving vehicles at scale," said Jeff Miller, Uber's chief of auto alliances. Google-owned Waymo and Lyft have entered into partnerships with Chrysler (the Pacifica minivan) and Chevrolet (Bolt EV).

On the convention center's floor, automakers rolled out their visions for an electric-car future. Using California's clout as the largest auto market in the U.S., regulators there have set hard EV sales quotas — and state politicians are soon expected to follow the lead of European governments including France and Britain to eliminate the gas engine within the next two decades.

Luxury automakers BMW and Mercedes are displaying new, EV-focused product lines — the i-line and EQ-line, respectively — as they try meeting government requirements and compete with California electric start-up Tesla. Even retro-brand Mini Cooper debuted an EV concept.

Yet, Tesla's inability to make a profit despite an average transaction price of $100,000 on its Model S and Model X electrics speaks to the difficulty of the industry's challenge.

In California, rich with EV incentives and a battery-friendly weather, hybrid-electric/plug-in electric/pure electric vehicles make up just 9 percent of the market. Automakers aren't ignoring the other 91 percent of customers and the profit-generating vehicles they covet.

The auto show doors opened to the automakers' consumer masters and they have plenty of good ol' driver-focused, gas-guzzling toys to ogle.

Detroit automakers rolled out new versions of some of the most iconic vehicles ever made: the 755-horsepower ZR1 and off-road star Jeep Wrangler. Lincoln is showcasing its Navigator on the LA stage for the first time.

GM unveils its driverless cars, aiming to lead the pack

SAN FRANCISCO — For more than a year, General Motors has tantalized investors with plans to build its future around self-driving cars.

It has regularly announced big investments and progress reports, but the company has kept its prototype vehicles largely under wraps — until now.

GM on Nov. 30 demonstrated its growing fleet of computer-operated, battery-powered Chevrolet Bolts in San Francisco to dozens of investment analysts, who are eager to evaluate the automaker's advanced test vehicles.

The event represents a critical step for GM as it seeks to establish leadership in the hotly contested race to bring driv-

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2018 documentary fee maximum announcement expected Dec. 13

The maximum documentary service fee that may be charged in Illinois in 2018 is expected to be announced by the state's attorney general's office Dec. 13. The CATA will issue special notice following any announcement.

The increase is tied to the federal Consumer Price Index for the 12-month period ending Nov. 30. Later this month, the CATA will mail to dealers two copies of a poster regarding the 2018 DOC fee that they can post in their dealerships.

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Natural gas options for CATA members

With the heating season upon us, businesses have decisions to make about natural gas options. Utility Management Group, a CATA allied member, has programs that can both reduce and stabilize a dealership's natural gas cost.

Energy customers in the Chicago market have three options for purchasing natural gas, each with benefits: a variable rate, a fixed rate, and a rate for gas pre-purchased during non-winter months to be used the subsequent winter. Supplier programs and rates vary, and some suppliers offer only one option; others allow customers the flexibility to choose any or all of the options.

• **Variable Rates:** The current rate market is favorable, with rates averaging about 35 cents per therm last winter, then dropping to the low 30s since April. Under the variable rate program, costs drop when the market is low. UMG has negotiated a program that consistently beats the utility rates. Last winter, its customers saved an average 21 percent compared to customers of Nicor, 20 percent compared to People's Gas, and 38 percent compared to North Shore Gas. The downside: When the market spikes, as it does every few years, customers who buy 100 percent of their gas under a variable rate program are exposed to those spikes.

• **Fixed Rates:** Under this program, customers agree to pay the same rate per therm for predetermined terms and volumes. Some suppliers offer the flexibility to lock whatever percentage of use and whatever months are desired, while other suppliers offer only the option of locking 100 percent of use for predetermined terms. Fixed rates offer price certainty, as spikes in the market will not impact customers under this program. It is not a savings guarantee, and when the market is low, fixed-rate customers tend to pay a premium.

• **Storage:** Customers using this program purchase additional gas between April and October, and the utility stores the energy for use from November to March. The benefits of storage are twofold. First, natural gas rates generally are lower during non-winter months, so storage programs offer cost savings. Second, customers achieve a level of budget certainty. The average customer can store about 33 percent of the gas they use during the winter. Since that gas is already paid for, it is immune from potential winter spikes. And since the gas is paid for at the time it's stored, summer gas bills will be somewhat higher, with winter gas costs dropping due to less gas being purchased during those months.

The natural gas industry is not a one-size-fits-all industry. Things to consider when reviewing options include what rates are offered, as many suppliers offer rates higher than the utility; what your budgetary goals are; and what flexibility suppliers offer.

UMG's approach is to review a customer's budgetary goals and, only after understanding those goals, recommend a supplier and a program. For more information on the programs that can benefit CATA members, call UMG at (630) 279-0117.

Driverless

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erless cars to market.

And although GM has been reluctant to show off the cars it has developed through a subsidiary, Cruise Automation, the company now wants to prove that self-driving models are getting closer to general use.

"Everything we are doing is geared to speed," GM President Daniel Ammann told journalists at a Nov. 28 event showcasing the cars.

To emphasize the company's progress, Ammann said the cars would be ready for consumer applications in "quarters, not years."

Meeting that goal would probably give GM, the nation's largest automaker, a jump on other companies developing self-driving models.

Industry analysts say autonomous vehicles could generate billions of dollars in additional revenue and profit for automakers and technology companies, primarily by selling or leasing them to ride-hailing services, taxi fleets and delivery companies.

For GM, the self-driving program is a cornerstone to long-term growth that is not dependent on simply selling vehicles to individual drivers.

"GM has changed the narrative of the company's future," Adam Jonas, a Morgan Stanley analyst, said in a research report on Nov. 28.

Other automakers, such as Ford Motor, Volkswagen and Toyota, are pushing to accelerate their own electric and autonomous-vehicle programs.

The field is also crowded with competitors from Silicon Valley, such as Google, Apple, Uber and the electric-car maker Tesla.

GM has a blend of financial resources, automotive experience and management resolve that position it strongly to compete with other automakers and big tech companies. But it also has a legacy of failures to overcome — none bigger than its collapse into bankruptcy in 2009.

The leadership of the company's chief executive, Mary Barra, was tested soon after she took over in 2014 when it was revealed that GM had produced millions of small cars equipped with faulty ignitions responsible for 124 deaths.

The scandal slowed GM's comeback, but it also galvanized its executives to focus on making its cars safer, and ultimately to pursue development of fully autonomous vehicles.

Member-discounted tickets to 2018 auto show on sale now

Tickets and vouchers that admit the holder to the 2018 Chicago Auto Show free or at a reduced price can be ordered by CATA members using the order form posted at www.CATA.info.

The passes promote goodwill with customers and even can help persuade a prospect to close a deal. Two kinds of passes are available, General Admission ticket and Weekday Discount voucher. The former, which costs CATA members $600 for 100 tickets, admits the holder to the auto show free, without a box-office wait. The Weekday Discount voucher costs members $100 for 100 and admits the holder for $7 during the week.

Regular admission is $13. A minimum 100 passes must be requested with either order.

Floorplan

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business interest, which would create an entirely new tax burden on dealerships by limiting their ability to deduct as a necessary business expense the interest paid on floorplan loans. That would be bad for floorplan financing in good times — including at today's low interest rates —and terrible in a downturn.

In addition to freezing working capital that dealers need to run their stores, hire additional workers and expand their operations, if franchised dealers cannot continue to fully deduct floorplan interest, there is a risk they could be forced to order and stock fewer cars and trucks, which could put a drag on factory orders.

The ripple effects that fewer orders would have up the OEM supply chain, on the assembly line and across the economy could be severe.

While the NADA certainly supports the goals of tax reform, we will not support a bill that does not distinguish between floorplan interest and general business interest.

The Senate bill aims to limit interest deductibility for companies that choose debt over equity for tax purposes. But almost all auto, RV, farm-equipment and other dealers are closely held family businesses with no access to public equity markets. For these businesses, floorplan financing isn't a tax-driven decision; it's the only practical way they can acquire and maintain high-cost inventory.

The Senate should follow the House approach and ensure that interest on floorplan financing remains 100 percent deductible for small business automobile dealers. Not only is it good tax policy, it's pro-growth economic policy because franchised new-car dealers are the source of 1.1 million American jobs and 18 percent of retail sales in America.

Every member of both the House and Senate needs to understand that the stakes for everyone aligned with the auto industry are simply too high for Congress to get this wrong, and we will continue working with leaders in Congress to make sure they get it right.

Retail

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ity of their earnings tells the story of how challenging it is to stay competitive in automotive.

Auto dealers are simply joining the long list of other entrepreneurs and business people facing constant strategic choices, and calculated risks.

So, the big question is not really around change, or even the business model eventually going away. The questions are the same as they've always been: What are the expected cash flows for the foreseeable future? Can dealers expect to earn good returns from their businesses, and from investments they are making in their businesses?

I think the answer, clearly, is yes.

Precisely to this point, in a conversation with the recent buyer of a large group of dealerships, he painted the picture this way: "We agree it [the dealership business model] may well go away. We just don't think it's going to go away nearly as fast as some might think, and there are few places where you can earn this kind of return. So we are quite happy buying dealerships and allocating capital, even if we ultimately may not be able to sell them for today's prices."

So, for the readers of Automotive News, don't panic. Continue to read, and educate yourself on this fascinating new world that we are entering. And, certainly think about how you position your business, and the investments that you make into the auto retail model of today.

But don't lose too much sleep. The massive automotive industry business is completely reliant on the franchise dealer system to sell $800 billion dollars' worth of cars this year, and that's not going to change next year, the following year, or the year after that. The near term outlook for continued cash flow is strong.

But in your decision-making, make sure you position your business to sell tomorrow's products to tomorrow's customers, and in the manner that those customers want to be served.

Certainly, our industry faces change, and the winners of tomorrow are positioning themselves today. This has always been true of successful auto retailers.