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Volume double 2011 rate, record car leasing could rise even higher

Consumers are leasing nearly one of every three new cars manufactured in the U.S. — record levels that are keeping industry sales at all-time highs.

Leasing accounted for more than 31 percent of new-car transactions in the first half of 2016, according to the latest available data from Experian Automotive. Once reserved mainly for luxury vehicles, leasing of mainstream vehicles has taken off.

Car-shopping website Edmunds.com said 2.2 million vehicles were leased in the first half of 2016, double the volume of the same period in 2011 and up 13 percent from the first half of 2015. Edmunds.com predicts consumers will lease 4.5 million vehicles this year, led by growth from millennials and those 75 and older.

Steven Szakaly, chief economist for the National Automobile Dealers Association, believes there is plenty of room for growth. "I think this could easily be 40 percent of the market," he said. The reason is simple: monthly payments are cheaper. Lease payments on average are 23 percent less than monthly auto loan payments, according to Edmunds.com.

Jessica Caldwell, Edmunds.com senior analyst, said leases are attractive to young people because it's a lot like a cellphone plan: payments are relatively low and they know in two years they can get a new model with the latest features.

"I think it (leasing) has propensity to go higher because consumers really like it," she said.

Monthly lease payments are based on residual values, or the predicted value of cars at the end of leases. When cars retain a larger proportion of their value at the back-end of leases, dealers can offer lower monthly payments. Leases typically

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Proposed regulations would limit valuation discounts for gift, estate taxes

By Marv Hills and Joe Magyar
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The IRS has issued proposed regulations that are intended to disallow or significantly curtail many valuation discounts. These discounts are one of the most effective methods used by dealers in estate planning.

The proposed rules would apply to the valuation of gifts to family members and the value of any dealership or related business owned at death if the entity is controlled by members of the same family. The proposed rules would apply when family members own either more than 50 percent of the voting rights or 50 percent of the equity of the entity. Attribution rules apply for stock or partnership interests held inside other corporations, partnerships, or trusts.

Under the proposed rules, members of the same family include:

• the donor of a gift (or decedent at death);

• the donor's spouse;

• ancestors and lineal descendants of either the donor or spouse;

• the brothers and sisters of the donor; and

• any spouse of an ancestor, lineal descendant, brother, or sister.

Under the proposed rules, certain provisions that limit the rights of an entity's owner would be disregarded and ignored when determining the value of the entity. Another type of provision that would be ignored under the proposed regulations is one that limits the value of an entity to an amount less than what the IRS calls the "minimum value." The "minimum value" is the net equity of the entity (fair market value of the assets minus liabilities) multiplied by

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Nominations being accepted for 2017 BBB Torch Awards

Nominations are being accepted to honor exceptional businesses with the Torch Awards from the Better Business Bureau serving Chicago and Northern Illinois. The awards are presented annually to outstanding businesses in recognition of their commitment to high standards in relationships with their customers, employees, suppliers, competitors, and the surrounding communities.

Like the BBB Torch logo, the Torch Awards honor and help to illuminate the importance of a corporate conscience and the responsibility for creating a fair and honest marketplace.

The Torch Awards nomination process is open to all for-profit Chicago and northern Illinois based businesses. Nominations can come from individuals or businesses.

An individual may nominate the company he or she works for, owns or is affiliated with; as well as any company that individual does business with, or any company, which the nominating individual believes, meets the Torch Award criteria.

Candidates for the 2017 Better Business Bureau's Torch Award for Marketplace Ethics will be evaluated by a prestigious independent panel of judges from the business and academic communities against these criteria:

• High ethical standards of behavior toward customers, suppliers, shareholders, employees, and communities.

• Demonstrated ethical practices surrounding their buyer/seller relationships.

• Marketing, advertising, communications, and sales practices which reflect a true representation of what is being offered in the market place.

• Acknowledgment of ethical marketplace practices by industry peers and in the communities where they do business.

• Management practices and policies that give long-term value to shareholders, customers, employees, and vendors.

• Training programs that assist employees in executing ethics policies.

Companies are judged in five categories based on the following employee numbers: 1-9; 10-99; 100-999, 1,000-7,499 and 7,500+. A recognition and awards ceremony will be held Dec. 1 at the Chicago Marriott O'Hare Hotel.

To nominate a company, or for detailed information on judging criteria, go to www.bbb.org/chicago/torch-awards. Entries must be postmarked no later than Friday, Sept. 30. Winners will be notified by phone following the completion of judging.

NADA fundraising to help flood victims in Louisiana

In the wake of the worst U.S. natural disaster since Hurricane Sandy in 2012, initial estimates indicated that more than 1,500 dealership families in Baton Rouge and surrounding areas in Louisiana were flooded out of their homes and desperately in need financial assistance.

The Emergency Relief Fund of the NADA Foundation helps dealership families after natural disasters.

"At the NADA, we view our dealerships as one big family. When a member of our family hurts, we all hurt," NADA President Peter Welch said. "That's why it's time to come together and help our dealership family members who are hurting in Louisiana by contributing to the NADA Foundation's Emergency Relief Fund."

Dealership employees affected by the flooding can apply for financial assistance through the NADA Foundation's Emergency Relief Fund. (Lost wages or commissions are not eligible for reimbursement from the fund.)

The NADA is calling on its members to donate online to the Emergency Relief Fund. Checks can be made payable to NADCF Emergency Fund, c/o NADCF, 8400 Westpark Drive, MS 7, Tysons, VA 22102. For more information, call (703) 821-7233 or visit www.nada.org/emergencyrelief.

Established in 1992, the fund has provided more than $5 million to more than 8,700 families.

Many leaders in Louisiana criticized the national media for lack of media coverage of the floods, especially compared to other major natural disasters. This seems to have happened because of the heavy coverage of the 2016 Summer Olympics and the 2016 U.S. presidential election, along with the fact that the storm did not have a name since it was not a tropical storm.

Initially, presidential candidates Hillary Clinton and Donald Trump also faced criticism for paying little to no attention to the floods.

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Delinquencies rise on riskier auto loans

More people are defaulting on high-risk auto loans, and a credit rating agency predicts the trend could continue through the end of 2016 as prices of used cars are beginning to fall.

The percentage of people who qualified for subprime (FICO score of 600 or lower) auto loans but are 60 days or more behind on payments reached 4.59 percent in July, a 17 percent increase from a year earlier, according to Fitch Ratings.

Delinquencies among prime auto loan borrowers also rose, but remain at a manageable 0.4 percent, or 21 percent higher than a year ago.

But these loans are packaged into bundles which are sold to investors, much like mortgages were packaged into bundles a decade ago before rising interest rates caused many of them to default, eventually triggering the deepest economic crisis since the Great Depression.

The annualized net loss rate — the percentage of those subprime loan bundles regarded as likely to default — rose 7.39 percent in July, up 28 percent from July 2015.

"We've seen an increase across the board. It's nothing unexpected given that over the last two or three years lenders have loosened up credit standards," said Hylton Heard, senior director at Fitch. "It's manageable and it is more exacerbated in the subprime sector."

While the major automakers have said their captive finance arms (Ford Credit and GM Financial) have not moved aggressively into subprime lending, Ford executives did acknowledge last month that rising delinquencies were one of several factors causing them to warn that business would be more difficult in the second half of 2016.

In a quarterly filing with the Securities and Exchange Commission, Ford reported in the first half of this year it allowed $449 million for credit losses, a 34 percent increase from the first half of 2015.

General Motors reported in a similar filing that it set aside $864 million for credit losses in that same period of 2016, up 14 percent from a year earlier.

TransUnion, a credit research firm that also tracks the auto finance market, recently reported that 1.11 percent of auto loans (prime and subprime) were 60 days or more past due in the second quarter of this year.

But the rate varies among regions of the U.S. Michigan is almost identical (1.12 percent) to the national average. But Louisiana and Mississippi, both reliant on the oil and gas industry, have delinquency rates of 2.26 percent and 2.16 percent, respectively.

The lowest rates are in New England and the Pacific Northwest.

Another factor that could impact the auto loan market soon is a decline in used-car values, which is beginning to happen among passenger cars, the Fitch report said.

"The strength in the wholesale used vehicle market diverges immensely by vehicle segment, with strength in larger segments, while the car segments trail and values are currently depressed," it said, adding that Fitch expects used vehicle values will "be pressure in the latter stages of 2016 and come down from current levels."

That means consumers will need to borrow more money for a new car or truck because they will receive less for trading in their current vehicles. Leasing, which now accounts for 30 percent of new-vehicle transactions, will also drive down used-car values because as those leases end the supply of vehicles that are sold at auction is expected to increase in the next two or three years, Heard said.

What prompts customers to shop at, buy from certain dealerships?

Nearly a fifth of adults surveyed by SalesFuel said they would be buying a new vehicle in the next year.

It's not incentives that are driving them to dealer lots. And they're not choosing one store over another because of charity involvement.

In a whitepaper titled "Drive Automotive Marketing Messaging — 2016-17 Automotive Shopper Profile," delved into why consumers pick certain stores.

When asked the factors that are most important in choosing a dealership, 59 percent pointed to dealer reputation, which was the top driver.

"(But) don't rely strictly on social media to reinforce reputation. It's very rare that we see any social media clicks in a buyer's purchase path. This doesn't mean, however, it wasn't an influence on the buyer's decision," Clarivoy chief executive officer Steve White said in a news release. Clarivoy is a marketing technology firm that also provided analysis in the whitepaper.

Next was selection of vehicles available (51.8 percent), willingness to deal/negotiate (43.1 percent), and the location being close to home or work (33.3 percent).

What wasn't important? The dealership supporting an important cause or charity, which the survey/whitepaper found to be the least important. Just 5.3 percent cited this as a reason they chose a dealership.

Kindness, quality matter

Once the shopper is at the store, helpfulness and friendliness from the salesperson goes a long way. SalesFuel noted that 47.6 percent of respondents said they "make a point of shopping where salespeople are helpful and friendly."

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run for three years or less and require a down payment. Drivers must stay within certain mileage limits or face fees.

Patrick Min, senior industry analyst for ALG, a TrueCar company, said automakers have taken advantage of elevated residual values created by a depleted supply of used cars coming out of the economic recession.

"We've seen automakers really kind of leverage heightened residuals and look to leasing as a new sales outlet," Min said, adding carmakers are using leasing to mitigate price increases on cars.

Average loan amounts for new vehicles hit a record $30,032 in the first quarter, while the finance term also hit a new record of 68 months, Experian said. The average monthly payment for a new-car loan reached a new record of $503 in the first quarter.

A low monthly payment convinced Shari Stein of Michigan to lease a 2016 Chevrolet Trax LS subcompact crossover for her daughter, Hannah, 17.

"This was the best option for us without putting a lot of money down," said Stein, who wanted a safe and reliable car for the high school senior. "When we compared it to the used cars, this is a much better deal."

Stein wouldn't say how much they are paying monthly for the two-year, 10,000-mile-a-year lease. The selling dealership is advertising a lease special for the Trax LS for as low as $77 a month with $999 down.

"Everybody wants a lower payment," said dealership sales consultant Brittany Danna, who said 95 percent of her business is leases.

Owner Greg Brown said the dealership retains a high percentage of lease customers and can sell the returned vehicles as certified pre-owned vehicles. Those cars usually are a bit more expensive, but have gone through extensive evaluations and include warranties.

While leasing is aiding sales now, some in the industry are worried a glut of leased cars will hit the used-car market and drive prices downward. "They'll swamp the market, they'll force residuals down," said Sean McAlinden, chief economist for the Center for Automotive Research, during an automotive conference in August.

And that, in turn, will reduce leasing's popularity because monthly payments will go up, making it less attractive.

Edmunds.com said used-vehicle values already are starting to soften because of increasing lease returns and the relative unpopularity of cars. Tom Webb, chief economist for Cox Automotive Inc., said 2.55 million vehicles came off lease last year. That figure is expected to grow to 3.1 million this year and to more than 4 million by 2018. He thinks new leasing has likely peaked.

With the high numbers of vehicles coming off lease, automakers may have to take additional measures to sell them and to increase car values.

Luxury carmakers may increase their certified pre-owned sales and choose to lease used cars to keep residual values up, Szakaly said. Lexus, for example, already is offering two- to five-year leases on certified pre-owned vehicles through Lexus Financial Services.

General Motors Co. also has been reducing sales to rental car fleets to boost residual values. It's also putting some used vehicles into its Express Drive program, allowing Lyft drivers to rent vehicles on a short-term basis. The Detroit automaker earlier this year also launched a "factory pre-owned collection" of used vehicles — former company cars, leases and rental vehicles.

Congratulations!

Six area dealers are winners of the 2016 Nissan Award of Excellence: **Al Piemonte Nissan** (Melrose Park), **Glendale Nissan** (Glendale Heights), **Hawkinson Nissan** (Matteson), **Kelly Nissan** (Oak Lawn), **Nissan of St. Charles**, and **Woodfield Nissan** (Hoffman Estates).

Al Piemonte Nissan and **Woodfield Nissan** also won the 2016 Nissan Global Award, which is presented to an elite group of Nissan dealers from around the world.

In the award's inaugural year, winners of FCA's Customer First Award for Excellence include **Prescott Brothers, Inc.**, in Mendota; and **Wickstrom Chrysler Jeep Dodge Ram**, in Barrington.

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the percentage ownership. These provisions have the effect of disallowing discounts for lack of control ("minority discount") or lack of marketability with respect to an ownership interest.

The proposed regulations also contain a provision that would increase the value of a decedent's estate if, within three years prior to death, the decedent engaged in a transaction that had the effect of changing the decedent's ownership from a majority control to a minority ownership position.

If adopted, the proposed rules will take effect after they are finalized. An IRS hearing on the proposed regulations is scheduled for Dec. 1, 2016, which means the effective date is likely to be sometime in 2017. Therefore, taxpayers who are considering making gifts of family owned dealership or related business entities that would be eligible for valuation discounts should consider acting quickly to make those transfers prior to the regulations being finalized.

The authors are CPAs and partners at Crowe Horwath.