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Dealer Insights

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Fuel economy debate

Will CAFE standards be upheld — or changed?

The Environmental Protection Agency (EPA) and the National Highway Traffic Safety Administration (NHTSA) are in the midst of a year-long review to determine whether or not changes should be made to the Corporate Average Fuel Economy (CAFE) standards. These standards require auto manufacturers to improve the fuel efficiency of cars and light trucks produced for sale in the United States.

The CAFE standards will significantly reduce U.S. oil consumption and greenhouse gas emissions when fully implemented, according to the EPA and NHTSA. But there's a cost involved in achieving the standards that some in the industry believe should be weighed against their environmental benefits.

Striving for 54.5 mpg

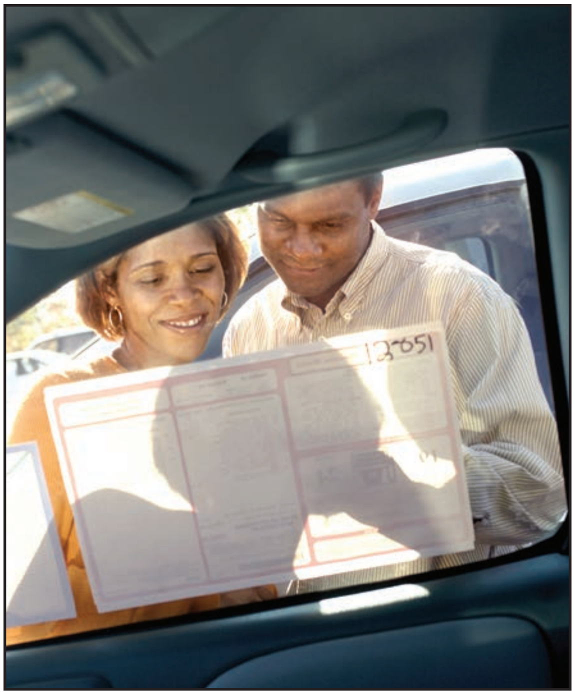
Strict CAFE standards enacted by the EPA and NHTSA in 2012 require the U.S. auto fleet to average 54.5 miles per gallon by 2025. This would double the fuel efficiency of vehicles manufactured for sale in the United States compared to 2008. As of year-end 2014 (the most current data available), the average fuel efficiency for new light-duty vehicles was 36.4 mpg.

In a technical assessment issued last summer, the EPA and NHTSA said they believed little in the standards needs to be changed. "Automakers are outperforming these standards while hitting new sales records," said an EPA spokesperson at the recently held Center for Automotive Research Management Briefing Seminar. "So we think the industry is very well-positioned to meet customer expectations while reaching significant new levels of environmental performance."

But some industry leaders disagree. And given the stance on environmental regulations taken by President Trump, his administration could have an impact on the future of CAFE standards.

At the seminar, spokespersons for groups representing manufacturers and dealerships held that the CAFE standards are too aggressive. They said the new standards will lead to higher vehicle costs that will make buying a new car even more unaffordable for most consumers than it already is.

According to a study conducted by Bankrate.com, a consumer finance website, a median-income household today can't afford the average price of a new car, which is more than $34,000. Automakers have estimated that developing and implementing the



How might the new administration impact CAFE standards?

The election of Donald Trump as president could have a significant impact on the debate over whether or not aggressive Corporate Average Fuel Economy (CAFE) standards enacted in 2012 should be changed.

During the presidential campaign, Trump expressed skepticism about climate change. In addition, he has announced plans for a comprehensive review of all federal regulations. As a result, many in the automotive industry wonder if the Trump administration will take steps to lower, or even eliminate, the CAFE standards.

Thus far, the administration has only committed to "a review of the fuel economy and emissions standards to make sure they are not harming consumers or American workers," a Trump senior policy advisor told *The Wall Street Journal* shortly after the election. "Mr. Trump will be focused on bringing jobs, including auto manufacturing, back to the U.S."

technology necessary to meet the CAFE standards could raise the price of a new car by up to $5,000. This equates to an increased payment of about $100 per month for a car financed over 60 months.

When average consumers can't afford to buy a new car, they usually end up either driving their current vehicle longer or buying a used car. Industry leaders are concerned that, if the CAFE standards are upheld and these trends materialize, new car sales could be negatively impacted.

If you build them …

According to a survey by the Alliance of Automobile Manufacturers, only 7% of consumers would be willing to spend $5,000 more for a car due to the CAFE standards. "Real-life fuel economy improvements can't be achieved until consumers actually buy those new vehicles," a National Automobile Dealers Association spokesperson said at the seminar.

For their part, the EPA and NHTSA say there's evidence that automakers are capable of meeting the higher CAFE standards. According to an EPA spokesperson at the seminar, the automobile industry has made more progress than expected toward the standards over the past four years. This proves the industry is capable of even greater improvements between now and 2025, he said.

It's worth noting that the technical assessment report concluded that automakers likely will achieve an average of only between 50 mpg and 52.6 mpg by 2025, not the 54.5 mpg target established by the CAFE standards.

Final decision pending

A final decision by the EPA and NHTSA about the standards, which is expected sometime this spring, could have a significant impact on the industry's future.

If the standards are upheld, automakers will likely concentrate on increasing fuel efficiency when designing new cars and building new electric and hybrid vehicles with longer range. Meanwhile, if the standards are rolled back — possible during the Trump administration — automakers might focus more on building the kinds of vehicles that generate the most profits, such as trucks and SUVs, for example, regardless of their fuel efficiency.

Keep a close eye in the coming months for the latest developments on the CAFE standards.

Divide and conquer

Separate real estate entities can be advantageous

If your dealership owns the building it's in and the land it's on, you might literally be sitting on unnecessary risks. But separating your business from those possessions can help protect you from an assortment of liabilities. And making it happen isn't hard.

Transfer the title

Legally, you can separate your dealership business from the building(s) and the land it owns by transferring the real estate title into a newly created legal entity such as a corporation, limited liability company (LLC) or trust. Once the separation is complete, your dealership would simply rent the space from the new legal entity in a landlord-tenant relationship.

You could, however, incur transfer or capital gains tax when you transfer real estate into the new entity — as if the real estate had been "sold" to that company. Your tax advisor can help you choose an entity type that minimizes transfer costs and maximizes tax saving opportunities generated from the lease.

Reduce your risks

When you separate real estate from other business assets, those assets are better protected from lawsuits and property claims if, say, a customer trips over something in your service area. (Even if you hold title to the business separately from your real estate, you must have adequate liability insurance for both legal entities.)

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On the flip side, if your dealership files for bankruptcy and you own the real estate separately, creditors generally can't seize the land and buildings unless they're pledged as collateral. So, you could theoretically liquidate the dealership, and then sell the land and buildings at their full market value. The real estate sales proceeds would likely escape the bankruptcy court's purview.

Think ahead

Estate planning is another good reason to consider holding real estate in a separate legal entity. This allows you to gift the interest in the *dealership* without giving up the real estate interest. Gifting of the real estate can take place at a later date, or provide retirement income as you transition out of the dealership's operations.

Or perhaps you want to award stock to a key employee as a way to incentivize performance and gradually transition ownership to him or her. Creating a separate real estate holding entity lets you transfer shares in the dealership to the key employee, again without transferring real estate ownership.

This strategy gives the employee a stake in the business's increased value but not in real estate appreciation, which is largely unrelated to employee productivity. A caveat: Discuss any employee stock transfers with franchisors — they may need to approve the new owner first.

Yet another benefit: If you sell the dealership but keep the real estate entity, you can continue to collect rent from your dealership's new owners, thus creating cash flow through rental income.

Meet a variety of objectives

When a dealership is owned by more than one person, the owners might disagree about whether to own or lease the facilities. Everyone's objectives can be met by creating a separate real estate holding company.

Not all the owners need to invest in the real estate entity. One dealer, for instance, wanted to build a new showroom that was more visible from the expressway. His older partner thought this expansion was too risky, especially because he planned to retire soon.

The younger partner had a longer investment horizon and was willing to take the risk, so he funded the expansion plan himself using a real estate LLC. Then he leased the property to the dealership using rental rates based on nearby comparables.

Time-tested strategy

Separating the legal title of your business from the building and the land where it's situated is a time-tested management strategy. If this is something you wish to explore, your tax advisor can help you map out a plan that's best for your particular situation.

Why strategic planning is crucial for your dealership

The tasks and responsibilities that go along with owning an automobile dealership can sometimes be overwhelming. Just keeping up with everything that must be done each day may consume all of your time and energy.

Unfortunately, many owners get so bogged down in their day-to-day management responsibilities that they never take time to step back and perform big-picture, or strategic, planning. This can result in "not seeing the forest for the trees" — and possibly missing out on opportunities to grow and strengthen your dealership.

Where to focus

There are a number of different matters to focus on as you conduct dealership strategic planning. Here are a few areas where you can start:

Inventory management. Strategy should play a crucial role in how you manage both new and used vehicle inventory. On the new vehicle side, you must determine how much and what type of factory inventory to keep on your lot at any given time.

This can be a balancing act. Hold too much inventory and the financing and carrying costs can eat into your profits. Conversely, if you hold too little inventory, you may not have the vehicles your customers want in stock, which can lead to lost sales. One industry benchmark is to maintain between a 45- and 60-day supply of vehicle inventory at all times.

On the used vehicle side, you must pay careful attention to vehicle aging. Cars that have been sitting on your lot for too long are taking up valuable space that more popular models could occupy. Strategically determine the right time to aggressively discount or wholesale aged vehicles to make room for better-selling models.

Most owners hope to grow their dealerships, but many haven't planned strategically for this growth.

Your competitive environment. It's always important to keep a close eye on your competitors and what they're doing. That's why your strategic plan should include a detailed competitive analysis that answers such questions as:

- What new competitors have entered your market area recently?
- What brands are these competitors selling and how do they compare from a price, quality and reliability standpoint to your brands?
- How visible are these competitors in the marketplace from an advertising and publicity perspective?

Based on the answers to these and other questions, you can devise strategies for competing successfully in your current environment.

Business succession. Have you given thought to what will happen to your dealership when you're ready to retire or do something different? Usually, the main succession options are to sell your dealership to an outside buyer, transfer it to employees or managers, or pass it on to family members or heirs. Your succession strategies will be driven largely by which of these options you plan to pursue.

Ideally, you should start succession planning at least three to five years before you want to exit the dealership. This will give you time to explore all your options and begin laying the groundwork for a smooth transition to new ownership.

Growth and expansion. Most owners hope to grow their dealerships, but many haven't planned strategically for this growth. And growing without a plan can be worse than not growing at all.

Successfully operating a $60-million dealership requires a different level of management sophistication, internal controls, and accounting and financial processes than operating a $20-million dealership does. Thus, your strategic plan should detail not only how you plan to grow your dealership, but also how you'll manage growth once it's achieved.

Perform a SWOT analysis

It can be helpful to perform a SWOT analysis as part of your strategic planning process. This exercise will examine your dealership's unique Strengths, Weaknesses, Opportunities and Threats.

Once you have a firm understanding of your strengths and weaknesses, it will be easier to formulate strategies that capitalize on your strengths and minimize the negative impact of your weaknesses. And when you have a clear picture of the potential opportunities and threats you're facing, you'll be better equipped to make tactical decisions based on them.

Set the right course

Resolve now to set aside time with your key managers and executives to conduct strategic planning. Doing so will help you set a deliberate course for your dealership's long-term direction and future.

4 questions you should ask your CPA

Many dealership owners view their external accountant simply as the "number-cruncher" who reviews or compiles financial statements and prepares tax returns. But don't forget: He or she can also help sort out other financial issues at your dealership. By expanding your view of your independent accountant, you may be able to make operations more efficient and boost your dealership's profitability.

The next time you meet with your CPA, consider asking a few broader questions. Here are four queries to get you going:

1. Should we finance equipment or purchase it outright? Often, the main consideration in finance vs. buy isn't tax savings but cash flow. Specifically, do you have enough liquid cash to pay for equipment now, or would it be better to finance the purchase and pay interest? Your accountant can help you weigh the options.

2. Are our sales compensation plans structured properly? Sales incentives should be tied to the actions you want your salespeople to take. For example, you could offer a bonus to the

salesperson who sells the most extended warranties if you want to increase extended warranty revenue. Your accountant can assist in structuring your sales comp plans.

3. Are our internal controls adequate for deterring fraud? Two of the most effective internal controls for dealerships are conducting random parts inventory counts throughout the year and segregating the cashier's duties among two or more employees. Your accountant can help establish these and other sound internal controls.

4. How can we operate more efficiently? Your CPA likely handles the financial affairs of many dealerships in addition to yours. He or she may be able to suggest overall streamlining steps your organization can take, as well as changes that improve efficiency in your various departments. Just ask.