



## INFORMATION SHEET

### RATE OF RETURN ON INVESTMENT – EVERGREEN CONTRACT MODEL

#### PURPOSE

The purpose of this information sheet is to provide contractors clarification on how the Rate of Return on Investment (ROI) is calculated in context of the Evergreen Contract.

#### BACKGROUND

In its simplest terms the money you invest into your new bus is called capital. The capital you put into the purchase of the vehicle will either be equity ie you are using your own money or borrowings ie a loan from a financial institution.

The return of capital to a contractor is achieved through the payment of depreciation over the useful life of the vehicle ie 10 years for Class A, D buses and 15 years for Class B, C buses.

Return on capital to a contractor is achieved through the payment of ROI. This is essentially covers the costs of borrowings and reflects the opportunity cost lost because your money was invested in on the bus and not in another asset such as a government bond, debentures, or another business etc.

For contractors operating under the Composite rate Model (CRM) Contract, an ROI rate of 10.5% was in the 2004 contract offer. As part of the Economic Regulation Authority Inquiry on School Bus Operators Charter Bus Operations in 2007<sup>1</sup>, the Economic Regulation Authority reviewed ROI. This was part of an overall review looking at the impact of charter work by school bus operators on general commercial charter operators who did not have government subsidised buses to operate. The Economic Regulation Authority reaffirmed the rate of ROI at 10.5%.

On the basis of this research the ROI rate of 10.5% was maintained and has been transferred to the new Evergreen Contract.

#### DEFINITIONS

You will find in the Evergreen Contract under *Schedule 3, Part 2 Service Charge Calculations* the definitions for Return on Investment.

#### Return on Investment

ROI is an annual amount, being the amount which is 10.5% of the Class Bus Price at the time the amount is determined. This amount divided by the Total School Days

<sup>1</sup> Inquiry on School Bus Operators' Charter Bus Operations - Economic Regulation Authority (5 July 2007)

See cost calculations below.

### **Explanation**

The example below (which is design to example how depreciation and ROI work) is based on a contractor purchasing a typical Class C vehicle costing \$350,868 and utilising the vehicle for 15 years. A contractor will either purchase the vehicle out right or be under some finance lease. The financial arrangements are based on industry standards but specific variables will be different for each contractor depending on their business circumstances.

The example shows in both case scenarios, whether the bus is financed or not, that the contractor will receive depreciation payments of \$333,325 (based on straight line depreciation of 5%) with a residual value of \$17,538. This effectively reimburses the contractor the cost of utilising the vehicle to provide the service under contract.

As the ROI payment is calculated on 10.5% of the school bus Class Bus Price, the Class Bus Price is also indexed annually as the cost of new buses generally increase every year due to higher input costs such as labour and materials. In essence the value of ROI is indexed annually to keep pace with inflation. The example below applies a Consumer Price Index (CPI) of 2.5% per annum (pa) resulting in the total amount of ROI paid to a contractor over the 15 year period being \$660,633.

Whether the vehicle purchase is financed or not the example used clearly shows that the monies paid to a contractor covers the costs of financing and interest paid by the contractor.

Viewed in another way, the Evergreen Contract is in effect providing contractors with a guaranteed return (ie locked in by a legally binding contract) of 12.55% pa on the original investment of the school bus before any financing considerations are taken into account.

This return has been calculated as follows:

ROI Paid:	\$660,633
Divided by:	15 yrs
ROI Paid per annum:	\$44,042
Divided by original investment:	\$350,868
Return per Annum:	12.55%

## HOW THE RATE OF RETURN ON INVESTMENT WORKS ON A TYPICAL SCHOOL BUS CONTRACT

### Lease Option

Capitalised Cost (A1)	\$350,868.00	(vehicle price);
Trade In (A2)	0.00	(reduction in the capitalized cost in the form of a cash down payment, a trade-in allowance, or rebate, the amount may be \$0);
Subtotal (A3)	\$350,868.00	(capitalized cost - capitalized cost reduction if any) (A1-A2);
Acquisition Fee (A4)	400.00	(similar to a loan fee used to cover the administrative costs of the lesser, this amount is determined by the originator);
Security Deposit (A5)	6,565.83	(amount you may be required to pay upfront, which usually is the total of the first and last monthly lease payment);
Total Payment Due at the signing of the Lease (A6)	\$6,965.83	(acquisition fee + security deposit + capitalized cost reduction) (A2 + A4 + A5);
Residual Value Percentage (A7)	5.00%	(a percentage of MSRP (Window Sticker Price);
Residual Value (A8)	17,543.40	(residual value percentage) (Cells A1 x A7);
<b>Term Depreciation (A9)</b>	<b>333,325</b>	(subtotal - residual value) (Cells A3 - A8);
Interest Rate (A10)	8.70%	(interest rate charged for the term of the lease) ;
Money Factor (A11)	0.00363	(interest rate % / 2400) or expressed as (.000 / 24);
Monthly Lease Rate (A12)	\$1,335.49	(subtotal + residual value) x money factor (A3 + A8) x A11 ;
Lease Term in Months (A13)	180	(number of months which the lease runs);
Monthly Depreciation (A14)	\$1,851.80	(term depreciation / lease term) (A9 / A13);
State Sales Tax Rate (A15)	3.00%	(state sales tax rate);
State Sales Tax (A16)	\$95.62	(monthly lease rate + monthly depreciation ) x state sales tax rate;
Estimated Monthly Lease Payment (A17)	<u>\$3,282.91</u>	(monthly lease rate + monthly depreciation + state sales tax) (A12 + A14 + A16);
Estimated Annual Lease Payment (A18)	<u>\$39,394.96</u>	
<b>Total Payments</b>	<b>\$590,924</b>	<b>(lease term x estimate monthly payment) (A13 x A17)</b>

### Money Factor:

A small fraction which is used to calculate the average monthly lease charges. When multiplied by 2400, the money factor approximates the equivalent annual percentage rate of interest being charged on a lease.

### Disclaimer:

The accuracy of the lease option calculator and how it applies to individual circumstances is not guaranteed. The calculator's purpose is to provide an estimation only.

### Current Depreciation Charge

<b>Bus Price</b>	\$350,868	
<b>Scrap Value</b>	\$17,543	
		Annual Depreciation
	Year 1	\$22,222
	Year 2	\$44,443
	Year 3	\$66,665
	Year 4	\$88,887
	Year 5	\$111,108
	Year 6	\$133,330
	Year 7	\$155,551
	Year 8	\$177,773
	Year 9	\$199,995
	Year 10	\$222,216
	Year 11	\$244,438
	Year 12	\$266,660
	Year 13	\$288,881
	Year 14	\$311,103
	<b>Year 15</b>	<b>\$333,325</b>

### Current ROI - (2.5% CPI)

Year	Indexed Class Bus Price	Annual ROI
1	\$350,868	\$36,841
2	\$359,640	\$37,762
3	\$368,631	\$38,706
4	\$377,846	\$39,674
5	\$387,293	\$40,666
6	\$396,975	\$41,682
7	\$406,899	\$42,724
8	\$417,072	\$43,793
9	\$427,499	\$44,887
10	\$438,186	\$46,010
11	\$449,141	\$47,160
12	\$460,369	\$48,339
13	\$471,878	\$49,547
14	\$483,675	\$50,786
15	\$495,767	\$52,056
	<b>Total ROI</b>	<b>\$660,633</b>