Asset-based Financing, Vehicle and Equipment Leasing in Canada[1]

Compiled from information prepared for the Canadian Finance and Leasing Association by Robin Somerville, Director, The Centre for Spatial Economics (C4SE), Milton, Ontario

CANADIAN INDUSTRY OVERVIEW

In 1998, the federal (MacKay) Task Force on the Future of the Canadian Financial Services Sector reported that the assets of the asset-based financing and leasing industry in 1997 totaled $50 billion[2]. By 2007, the value of assets financed had risen to $105.4 billion. But, with the worldwide economic crisis of 2008-2009, total assets financed in Canada declined by the end of 2009.

According to Statistics Canada, total public and private sector spending on machinery and equipment in 2010 was expected to rise 2.8% to $100.7 billion. Significant capital spending increases from the public sector for infrastructure projects, mining and oil and gas extraction sector as well as the manufacturing sector were behind that anticipated increase.[3]

The market size estimates generated based on the *2010 CFLA Survey of Industry Activity* (industry data as at December 31, 2009) indicate that the value of finance assets shrunk 15% from $103.5 billion in 2008 to $87.7 billion while new business fell 23% to $29.6 billion in 2009. [4]

Asset-based Financing Market in Canada

	2009	2008	08-09 %ch
New Business Total ($billions)	**29.6**	**38.3**	**-23%**
Commercial Equipment	10.7	15.6	-31%
Commercial Vehicles	2.4	2.9	-16%
Retail Vehicles	16.5	19.8	-17%
Assets ($billions)	**87.7**	**103.5**	**-15%**
Commercial Equipment	34.4	42.4	-19%
Commercial Vehicles	6.9	11.7	-42%
Retail Vehicles	46.4	49.4	-6%

Note: figures may not add perfectly due to rounding

The recession and lack of liquidity stifled retail vehicle leasing activity with new business and finance assets falling 17% and 6% respectively. Equipment and commercial vehicles new business fell 30% and 27% respectively in 2009. Commercial equipment finance assets fell 19%, commercial vehicles fell 42% while retail vehicle finance assets slipped 6% in 2009.

The current market estimates indicate that about 13.4% of new business equipment purchased in Canada is financed by the industry; down from 16.3% in 2008. This sharp decline was a result of the lack of liquidity for the industry and is expected to be partially reversed in 2010. Consumer vehicle leasing slumped in 2009 to just 7% of the retail new vehicle market (down from 45% in 2005) as major companies temporarily exited the leasing market and consumer and commercial demand was hampered by the recession.

Survey respondents' expectations for 2010 are mixed, with equipment lessors new business growing 20% but vehicle lessors remaining flat. While business may not be 'normal', the industry has survived the financial crisis – albeit with fewer participants – and is poised for renewed growth.

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[1] *CFLA Annual Survey of Industry Activity*, September 2010, The Centre for Spatial Economics

[2] *Report of the Task Force on the Future of the Canadian Financial Services Sector*, September 1998, at page 43

[3] *Private and Public Investment in Canada, Intentions 2010*, Statistics Canada, March 2010

[4] Readers are cautioned that the true market for leasing is larger than these estimates because marine, rail and other equipment that is financed offshore has not been included. These figures do, however, include an estimate from Ascend's CASE database of the value of fixed wing aircraft assets in Canada financed by foreign leasing companies.

CANADIAN MARKET OVERVIEW

Introduction

The Canadian economy was mired in recession in 2009 and shrunk 2.5% after crawling along at 0.5% in the previous year. The economy in 2009 was affected by a severe slump in exports and both residential and non-residential investment. Government current and investment spending was the only source of significant positive activity as the consumer retrenched with spending growth of just 0.4%.

As expected, 2009 was an awful year for the economy and the asset-based financing industry. In 2009, equipment lessors and commercial vehicles new business shrunk by 29% and finance assets fell by 24%.[5]

The outlook for 2010 is, however, still positive. Stimulus spending is providing a significant boost to economic activity and the partial recovery of many commodity prices is boosting the fortunes of Canada's resource sectors. Most lessors are optimistic about activity in 2010 as public and private spending on machinery and equipment is expected to grow 2.8%.[6]

This article provides a review of recent trends, the outlook for and highlights of major trends in the leasing sector, and ends with a summary of the key issues facing the asset-based financing and leasing industry in Canada.

Economic Capital Investment Outlook 2010

Looking forward, the Canadian economy is expected to grow by 3.3% in 2010 and by a further 3.0% in 2011. While all expenditure categories are expected to grow this year, the economy will be led by both public and private investment spending as government stimulus spending continues to exert an influence on the economy.

Business investment in Canada is expected to rise 6% in 2010, comparable to the 8% increase expected in the U.S, and follows declines of 16% in 2009 in both countries. The economic environment is, however, far from settled. Interest rates are at record lows and governments have run up huge deficits. Major concerns about future performance revolves around how and when governments will exit from the current stimulus packages; how and when massive trade imbalances between the US and China will be addressed; and how sovereign debt crises will be addressed. How these will impact inflation, interest rates, exchange rates and, ultimately, economic growth around the globe are key concerns for business. The recovery may also be challenged by not-fully-healed financial systems and high levels of consumer debt – particularly as interest rates start to rise again.

Economic activity shrunk in every province in 2009 as the global recession slashed the demand for Canada's natural resources and manufactured goods. All provinces are expected to experience positive growth in 2010. British Columbia, Ontario, and Newfoundland and Labrador register the strongest while Saskatchewan will have the weakest performance in 2010 due to a sharp decline in agriculture associated with severe flooding in the province. Over the next few years, British Columbia, Alberta, and Newfoundland and Labrador will experience the fastest growth. Quebec and the Atlantic provinces, with the exception of Newfoundland and Labrador, are expected to have the weakest growth, due, in part, to the fact that they experienced a relatively modest reduction in output during the recession.

The chart below shows the C_4SE's forecast for growth in business spending on new machinery and equipment[7] rising 6% in 2010 and another 3% in 2011. The infrastructure projects funded by government stimulus spending will have their biggest impact in 2010 and will still exert some influence on spending in

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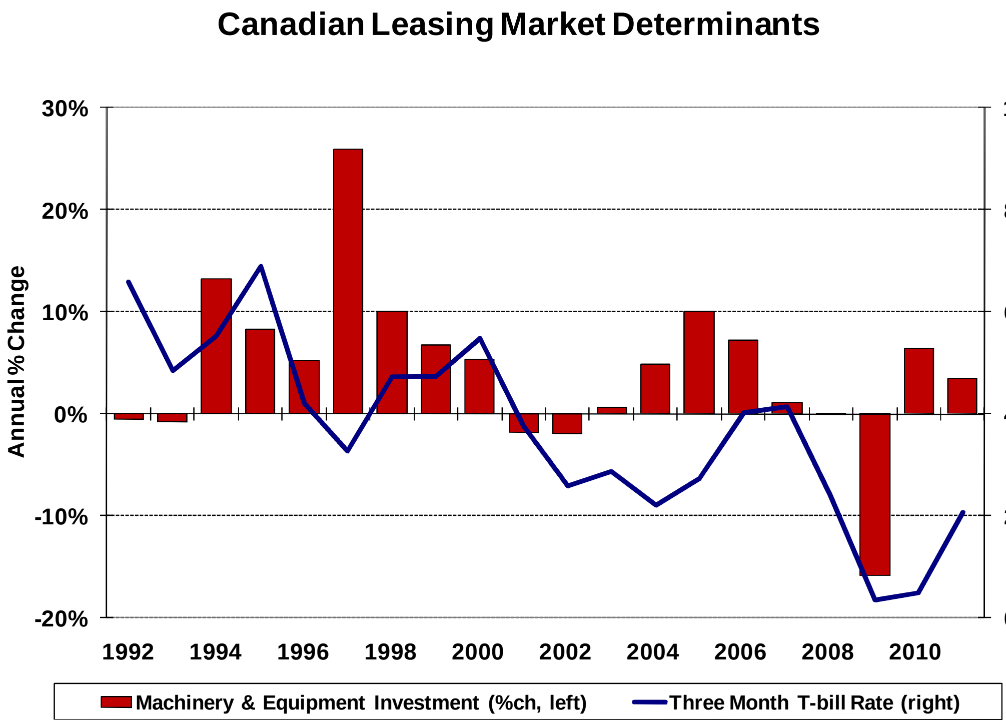
[5] Based on estimates derviced from a survey of member companies of the Canadian Finance and Leasing Association.

[6] 2010 Private and Public Investment in Canada, Intentions, *Catalogue no. 61-205-X*, Statistics Canada, February 2010.

[7] This data excludes the public sector spending which is included in Statistics Canada's public and private investment intentions data. The C_4SE's projection for 2010 is also based on more recent information than was available to the participants in Statistics Canada's intentions survey.

2011. A general slowdown in government spending starting next year will, however, reduce economic activity over the medium-term.



Source: The Centre for Spatial Economics

The Statistics Canada survey of public and private investment intentions for 2010 anticipates a rise in capital spending over 2009. Public and private spending on new machinery and equipment was expected to rise 2.8% or C$2.8 billion this year following the 14.1% decrease in 2009. CFLA survey respondents are, however, significantly more optimistic about new business in 2010, anticipating an increase in new equipment and commercial vehicle leasing business of 18%.

Statistics Canada's survey reported that the public sector, particularly by public administration for infrastructure projects, is expected to account for two-thirds of the increase in capital spending in 2010. In the private sector, increases in capital spending are expected from the mining and oil and gas extraction sector as well as the manufacturing sector particularly petroleum and coal manufacturing products and primary metal manufacturing.

Spending on new machinery and equipment is expected to rise in all provinces but Alberta and British Columbia in 2010. Those two provinces also experienced the largest declines in investment in 2009 as a number of projects in the oil and gas extraction industry were postponed or cancelled.

Financial Market Developments

Short and long-term interest rates are expected to remain low in 2010 reflecting the need to keep the recovery in North America going. While rates rise over the medium term as the Federal Reserve Board and the Bank of Canada react to stronger economic growth, short term rates as measured by the 3 month treasury bill rate will still only average 2% in 2011. The gap between short and long term rates will remain wide as the yield on 10-Year Government of Canada bonds is expected to average 4.5 percent in 2010 and just 25 basis points higher in 2011. Continued low interest rates reflect expectations of continued low inflation, a reduction in deficits by the federal and provincial governments, and slowing economic growth.

The Canada-U.S. exchange rate is expected to appreciate from $US 0.88 in 2009 to 0.95 in 2010 and 2011 reflecting rising commodity prices and less confidence in the performance of the United States economy. The appreciation of the Canadian dollar will slow export growth – and the whole economy – over the next couple of years.

Following extensive lobbying efforts by the CFLA, the Canadian Secured Credit Facility (CSCF) was created in 2009 by the Government of Canada to purchase up to $12 billion of asset-backed securities (ABS) backed by loans and leases on vehicles and equipment. Its objectives were (i) to stimulate economic activity by helping businesses and consumers access financing for these products and (ii) to rebuild confidence in the Canadian ABS market.

The Business Development Bank of Canada (BDC) was assigned responsibility for establishing and managing the CSCF on behalf of the federal government. The program was criticized for primarily serving large companies with smaller leasing companies unable to benefit directly from the program. The program was terminated on March 31, 2010 with about $3.4 billion of the $12 billion of available funds utilized.

Although the CSCF was not widely accessed, it did contribute to establishing a pricing benchmark and thus to the stability of the Canadian ABS market during a challenging period. To address concerns advanced by CFLA over access to funding for smaller finance companies, the 2010 federal budget established the Vehicle and Equipment Finance Partnership (VEFP) program to expand financing options for small- and medium-sized finance and leasing companies. The VEFP is again administered by the BDC and is part of the Business Credit Availability Program (BCAP). Its initial allocation of $500 million is to be disbursed and administered in partnership with experienced lenders and investors in the private market for asset-backed financing.

Asset-based Finance Market in Canada

The leasing cycle is typically coincident with the equipment expenditure cycle. As a result, the outlook for leasing this year and next is positive provided the global economy avoids any detours. The Government of Canada is continuing its support of the ABS market and while business may not be ‘normal’, the industry has survived the financial crisis – albeit with fewer participants – and is poised for renewed growth.

The market size estimates generated based on the CFLA’s 2010 Survey of Industry Activity indicate that the value of non-consumer finance assets fell 24% to C$41.3 billion while new business volume fell 29% to C$13.2 billion in 2009.

The current market estimates indicate that 13.4% of new business equipment purchased in Canada is financed by the industry; down from 16.3% in 2008. This marks the fourth consecutive year of declines in this proportion. Survey respondents, however, expect new business to grow 18% in 2010 which will push the proportion of investment spending financed by the industry back up to 15%.