
Lease vs. Buy

The Ever-Changing World of Equipment Finance

Bill Sellier

Brian Wilson

Bob Baker

March, 2008



The statements and financial information contained in this proposal have been supplied by Banc of America Leasing (“BAL”). Neither BAL and/or any of its employees or directors makes any representation or gives any warranty, express or implied, as to the reliability, accuracy or completeness of the information and projections contained herein, nor accepts any responsibility arising in any other way for errors or omissions herein, nor accepts liability for any loss or damage suffered by any person as a result of that person or any other person placing any reliance on, or acting on the basis of, the contents hereof. Consequently, the recipient should make its own independent assessments of the project without reliance on this memorandum.

This document is confidential and is provided for the sole and exclusive use of the recipient or any subsidiary of the recipient for the purpose of considering the financing proposal outlined herein. By receipt of this document, the recipient agrees to keep and to procure that its officers, employees and agents shall keep permanently confidential and not, without the prior written consent of BAL, disclose to any third party the information contained herein or information made available in connection with any further investigation of the financing proposal outlined herein.

Today's Session Will Cover

- **The evolution of the Equipment Finance Market**
- **Overview of tax and accounting aspects of leasing products and structures**
- **The Bonus Depreciation in the recently passed “Recovery Rebates and Economic Stimulus for the American People Act of 2008”**
- **The effect of energy tax credits on pricing of tax-motivated leases for qualified energy-saving equipment and projects**
- **Discussion of the possible revision of FAS 13 and IASB lease accounting rules for lessees and lessors**



The Evolution of the Equipment Finance Market

What is a Lease?

Webster's Definition

A contract conveying property to another for a specific period in consideration of rent.

Encyclopedia Britannica

A contract for the exclusive possession of property (usually but not necessarily land or buildings) for a determinate period or at will. The person making the grant is called the lessor, and the person receiving the grant is called the lessee. Two important requirements for a lease are that the lessee have exclusive possession (nonexclusive possession would call for a license) and the lessor's term of interest in the property be longer than the term of the lease (a grant involving an equal term or period would comprise a conveyance or assignment, not a lease).

The History of Leasing

Evidence of leasing dates back to 2000 B.C.

- Early records show leases of agricultural tools, land, water rights and various animals
- Greeks, Romans and Egyptians were known to lease equipment, land and livestock
- The ancient Phoenicians often chartered ships and occasionally the crew was included in the lease
- In the middle ages, farming equipment and horses were leased and knights could lease their armor

Leasing in England

- The Statute of Wales in 1284 formally allowed for the leasing of personal property
- Leasing saw significant growth with the Industrial Revolution
- The growth and expansion of the railroads resulted in leasing innovations that lead to the leasing business in the U.S.

Early Leasing in the U.S.

- 1700s - First recorded leases of horses, wagons and buggies by liverymen
- 1900s - With the expansion of the railroads, the Equipment Trust Certificate was developed
 - Known as the Philadelphia Plan- precursor to today's Conditional Sales Agreement
 - Short term leases of railroad equipment also developed- precursor to today's operating lease
- Manufacturers begin offering installment credit- the beginning of Vendor financing
- Independent leasing companies begin to offer third-party lease financing

Contemporary Leasing in the U.S.

Tax Considerations – 1950s - 1960s

- Tax aspects of leasing become prevalent with the introduction of accelerated depreciation and the Investment Tax Credit (ITC)
- IRS issues Revenue Ruling 55-540 which outlines the characteristics of a “tax lease”
- Technology revolution boosts leasing as a hedge against equipment obsolescence for companies
- Many new leasing companies spring up to meet the demand for financing of technology equipment
- Banks given permission to own and lease personal property

Tax Considerations – 1970s - 1980s

- Banks allowed to form holding companies to engage in leasing activities
- Leveraged lease is introduced – requests for private letter rulings inundate the IRS
- IRS issues Revenue Procedure 75-21- guidelines for leveraged leases
- ITC comes and goes three times since 1962
- Several tax law changes impact the tax benefits associated with equipment ownership and the definition of a lease
- **TRAC Lease** introduced with the passage of the Tax Equity and Fiscal Responsibility Act of 1982

Contemporary Leasing in the U.S.

Accounting Considerations – 1960s to Today

- Tax aspects of leasing become prevalent with the introduction of accelerated depreciation and the Investment Tax Credit (ITC)
- Rapid growth of tax-oriented leasing prompts questions about proper financial reporting
- Financial Accounting Standards Board issues FASB Statement No. 13 in 1976
 - Sets guidelines for lessor and lessee lease accounting
- Several other statements, interpretations and technical bulletins issued by FASB over the last several years

Overview of Tax & Accounting Aspects of Leasing Products and Structures

Accounting Treatment of Leases

A lease is classified by the lessee as either a capital lease or an operating lease for accounting purposes. FASB Statement 13 establishes the guidelines for determining this classification. The lessee's accounting for the lease is independent of the lessor's accounting for the same lease.

OPERATING LEASE CRITERIA PER FASB STATEMENT 13: Provided that all four tests below are met, lease may be treated as operating by lessee:

- There is no automatic transfer of ownership of the asset to the lessee by the end of the lease term.
- The lease does not contain a bargain purchase option.
- The lease term is less than 75% of the asset's estimated useful life.
- The present value of the rent payments plus any other minimum lease payments is less than 90% of the fair market value of the leased asset (most difficult test to pass).

Lessee's Accounting for an operating lease:

- Rental on an operating lease is charged to expense over the lease term as it becomes payable.
- If rents are not paid on a straight line (SL) basis, rental expense nevertheless is recognized on an SL basis unless another systematic and rational basis is more representative of the time pattern in which use benefit is derived from leased property.

CAPITAL LEASE CRITERIA: Should the lease fail any of these tests, it will be treated as a capital lease (on balance sheet).

Lessee's Accounting for a capital lease:

From a lessee perspective, the accounting for a capital lease turns on which lease classification tests have been met.

- If the lease qualifies as a capital lease due to the automatic transfer of title or bargain purchase option, the lessee books the asset and corresponding liability at the present value of the minimum lease payments, which will effectively be the fair value of the leased property in this situation. The lessee depreciates the asset in the same way as an owned asset and amortizes the liability using the interest method.
- If the lease qualifies as a capital lease under the 75% or 90% test, the lessee books the lease at the present value of the minimum lease payments, not to exceed the fair value. It then amortizes the capitalized lease asset on a straight-line basis down to the expected value to the lessee and amortizes the capitalized lease obligation using the interest method down to the stated residual value guarantee (if any).

Tax Treatment of Leases

Traditionally, tax lease financing has been used for its ability to transfer tax benefits (depreciation and interest expense) to the party who can best utilize them.

IRS CLASSIFICATION: From the perspective of the IRS, leases are classified as either tax leases (“true leases”) or non-tax leases. In a tax lease, the lessor bears the risks of ownership and, therefore, is entitled to the tax benefits associated with depreciating the equipment. The lessee deducts its rent payments.

TRUE LEASE GUIDELINES: Revenue procedures have been issued by the Treasury Department that provide guidelines which must be met in a leveraged lease for the lessor to receive an advance ruling that it will be considered the owner of the property for Federal income tax purposes. Court cases and other precedents have further refined the factors commonly considered critical for a lessor to properly claim tax ownership. The revenue guidelines set forth the following factors:

- The lessor must have a 20% minimum at-risk investment in the asset at all times during the lease (the taxpayer’s claim of tax ownership has been upheld in court cases where the lessor had less than a 20% at-risk investment).
- There can be no purchase option for less than fair market value as determined at the time of exercise (the taxpayer’s claim of tax ownership has been upheld in court cases where the lessee has been granted a fixed price purchase option at lease inception, provided the option amount is not considered a bargain based on estimated future fair market value).
- The lessee cannot have any investment in the lease, nor can it provide any loans or guarantees to the lessor or the lenders.
- The value of the asset at lease end must equal at least 20% of the asset’s original cost, and the lease term must not exceed 80% of the asset’s estimated useful life.
- The lessor must have positive cash flow from the transaction independent of the tax benefits.

UNEVEN RENT TEST – SECTION 467:

- Annual allocated rents must be within 10% of the average annual rent, in order to allocate rental amounts in accordance with the lease agreement. If this safe harbor is not satisfied, rents will be re-allocated using the proportionate or constant rental accrual method.
- If allocated rents are paid in the prior calendar year (prepaid rent), the same calendar year or the following calendar year (deferred rent), the amounts paid are recorded as rental expense/income for Federal income tax purposes.
- If cumulative cash rents paid through the end of a calendar year exceed cumulative rents allocated through the end of the prior calendar year, a portion of the rental amount will be treated as a loan (467 loan) from the lessee to the lessor. If cash rents paid are less than amounts allocated for the current and prior year, a portion of the rental amount will be treated as a loan (467 loan) from the lessor to the lessee.

Tax/Accounting Interface

A
C
C
O
U
N
T
I
N
G

Operating
Lease

Capital
Lease

TAX

Tax Lease

Non-Tax Lease/Loan

<p>Target Company</p> <ul style="list-style-type: none"> ▪ Lessor owns equipment ▪ Tax depreciation to lessor <p>▪ Tax advantaged interest rate</p> <p>▪ Off-balance sheet to customer</p> <p>Structures</p> <ul style="list-style-type: none"> ▪ Single Investor Lease ▪ Modified TRAC Lease (Vehicles) 	<p>Target Company</p> <ul style="list-style-type: none"> ▪ Customer owns equipment ▪ Tax depreciation to customer <p>▪ Loan-Like Interest Rate</p> <p>▪ Off-balance sheet to customer</p> <p>Structures</p> <ul style="list-style-type: none"> ▪ Off-balance sheet loan/Non-Tax Operating Lease
<p>Target Company</p> <ul style="list-style-type: none"> ▪ Lessor owns equipment ▪ Tax depreciation to lessor <p>▪ Tax advantaged Interest Rate</p> <p>▪ On-balance sheet to customer</p> <p>Structures</p> <ul style="list-style-type: none"> ▪ Single Investor Lease that fails FASB 13 criteria test ▪ TRAC Lease (Vehicles) 	<p>Target Company</p> <ul style="list-style-type: none"> ▪ Customer owns the equipment ▪ Tax depreciation to the customer <p>▪ Loan-Like Interest Rate</p> <p>▪ On-balance sheet to customer</p> <p>Structures</p> <ul style="list-style-type: none"> ▪ Lease Intended as Security (LIS) ▪ Secured Term Loan

The Leasing Market Today

The U.S. Equipment Financing Market

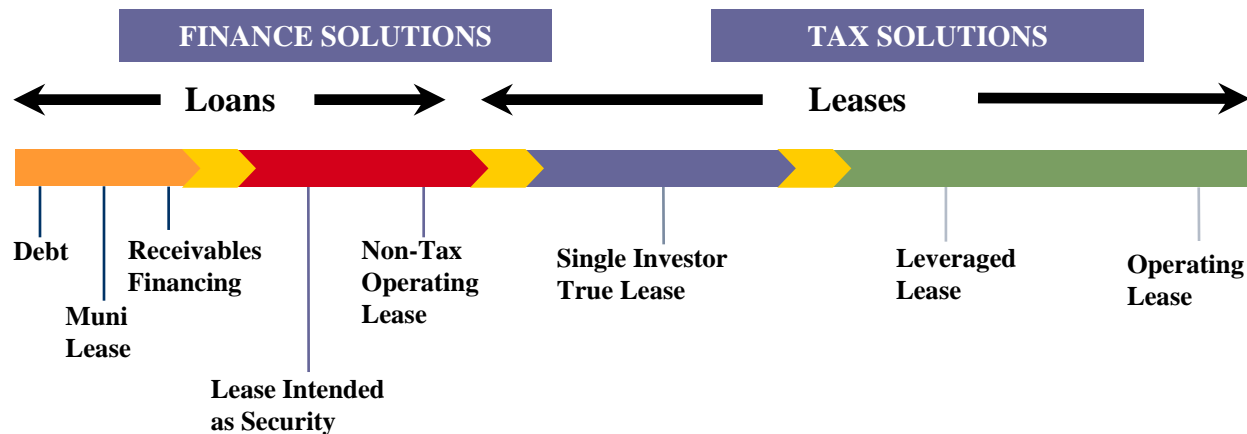
- Approximately \$1.1 trillion invested in plant, equipment, and software in 2006
- Equipment financing accounted for approximately 55%, or \$600 billion
 - Leases comprise 17% of that amount
 - The majority of the leases are likely to have been classified as operating leases
- 95% of Fortune 500 companies use some form of equipment financing
- 80% of all U.S. companies finance equipment
- The ELFA estimates that equipment financing will increase to \$625 billion in 2007
- Approximately 30% of U.S. capital goods are financed through equipment financing every year



Overview of Equipment Financing

Financing can be structured to provide the optimal solution to a wide variety of client profiles and objectives.

- Structures can be divided into two categories of financing solutions:
 - Finance Solutions – Non-Tax Operating Leases, Leases Intended as Security, and Secured Loans
 - Tax-Efficient Solutions – Single Investor and U.S. Domestic Leveraged Leases
- The economics of an equipment financing are driven by three primary sources of cash flow:
 - Payments
 - Residual value
 - Tax benefits



Why Lease?

Leasing can provide companies several benefits

CAPITAL RAISING

- 100% Financing
- Access additional sources of funding (ability to tap into a different pool of investors, for example, non-bank investors)
- Possible Net Present Value (NPV) benefit by leasing
- Monetize existing assets through Sale-Leaseback transactions

ASSET RISK MANAGEMENT

- Mitigate technological obsolescence and other equipment risk exposure
- Upgrade options
- Early buyout and other purchase options ensure lessee can regain ownership of the asset if desired and if economic

TAX MANAGEMENT

- Allocate tax benefits to the most tax-efficient party, minimizing the lessee's after-tax cost of financing
- Manage an "inefficient" tax position, i.e. Net Operating Loss (NOL) or tax loss carry forward position
- Expedite emergence from Alternative Minimum Tax (AMT) position

BALANCE SHEET MANAGEMENT

- Improve multiples and financial ratios, including leverage and Return on Assets (ROA)
- Comply with covenant constraints
- Restructure Non-Tax Operating Leases

Lease vs. Buy Analysis

Lease vs. Buy Example

- **Equipment:** Over-the-road tractors (diesel or LNG fueled)
- **Assumed Transaction Size:** \$1mm
- **Lease Term:** 5 years
- **MACRS depreciation life:** 3 years
- **Structure:** Tax lease with TRAC end position
- **TRAC Amount:** 32%
- **Lessor tax rate:** 37.5%
- **Lessor pre-tax return:** Term Treasury swap rate + 165 basis points (5.13%)
- **Lessee Incremental Borrowing Rate:** 5.13%

Lease vs. Buy Analysis-Base Case

Lessee tax rate - 37.5% (same as lessor)

Year Ending	<u>Benefit to Purchase</u>		<u>Pre-Tax Cash Flows</u>	
	After-Tax Cash Flows	Present Value	Lease	Loan
12/30/2008	(97,702.59)	(96,931.51)	148,631.34	156,650.78
12/30/2009	(113,984.55)	(109,853.66)	162,143.28	170,891.76
12/30/2010	(393.58)	(340.09)	162,143.28	170,891.76
12/30/2011	29,994.32	27,147.60	162,143.28	170,891.76
12/30/2012	60,519.31	53,023.27	162,143.28	170,891.76
12/30/2013	68,905.87	58,483.40	333,511.94	334,240.98
12/30/2014	53,333.33	43,812.20		
12/30/2015	17,777.78	14,145.16		
12/30/2016	8,888.89	6,850.33		
TOTAL	27,338.78	(3,663.30)	1,130,716.40	1,174,458.80

Result
After-tax Analysis
“Buy” is better
Pre-tax Analysis
Lease rents are \$43,742 lower than loan payments – 4.37% benefit
Accounting Treatment
Capital Lease

Lease vs. Buy Analysis-Base Case/ Operating Lease

Lessee tax rate - 37.5% (same as lessor)

Modified TRAC Structure - Lessor is “at-risk” for a portion of the residual so that PV of rents plus PV of guaranteed residual is less than 90% of the equipment cost

Year Ending	<u>Benefit to Purchase</u>		<u>Pre-Tax Cash Flows</u>	
	After-Tax Cash Flows	Present Value	Lease	Loan
12/30/2008	(97,702.59)	(96,931.51)	148,631.34	156,650.78
12/30/2009	(113,984.55)	(109,853.66)	162,143.28	170,891.76
12/30/2010	(393.58)	(340.09)	162,143.28	170,891.76
12/30/2011	29,994.32	27,147.60	162,143.28	170,891.76
12/30/2012	60,519.31	53,023.27	162,143.28	170,891.76
12/30/2013	68,905.87	58,483.40	333,511.94	334,240.98
12/30/2014	53,333.33	43,812.20		
12/30/2015	17,777.78	14,145.16		
12/30/2016	8,888.89	6,850.33		
TOTAL	27,338.78	(3,663.30)	1,130,716.40	1,174,458.80

Result
After-tax Analysis
“Lease” is better (no change)
Pre-tax Analysis
Lease rents are \$43,742 lower than loan payments – 4.37% benefit (no change)
Accounting Treatment
Operating Lease

Lease vs. Buy Analysis-AMT Lessee

Lessee tax position - Alternative Minimum Tax payer

Year Ending	<u>Benefit to Lease</u>		<u>Pre-Tax Cash Flows</u>	
	After-Tax Cash Flows	Present Value	Lease	Loan
12/30/2008	(33,400.08)	(33,140.33)	148,631.34	156,650.78
12/30/2009	(42,820.28)	(41,250.80)	162,143.28	170,891.76
12/30/2010	(16,497.69)	(15,375.35)	162,143.28	170,891.76
12/30/2011	9,894.38	8,973.08	162,143.28	170,891.76
12/30/2012	36,359.55	31,866.24	162,143.28	170,891.76
12/30/2013	33,457.76	28,418.74	333,511.94	334,240.98
12/30/2014	24,000.00	19,715.49		
12/30/2015	7,456.25	5,932.68		
12/30/2016	8,888.89	6,850.33		
TOTAL	27,338.78	11,990.09	1,130,716.40	1,174,458.80

Result
After-tax Analysis
“Lease” is better
Pre-tax Analysis
Lease rents are \$43,742 lower than loan payments – 4.37% benefit (no change)
Accounting Treatment
Capital Lease

**“Recovery Rebates and Economic Stimulus
for American People Act of 2008”
(Bonus Depreciation)**

Bonus Depreciation

The new bonus depreciation follows the form of the previous 2003 bonus depreciation regime, with 50% of the depreciable basis immediately written off in the first year, and the remaining 50% basis recovered using the standard MACRS methodology.

Conditions

- New, MACRS eligible property (with a less than 20yr recovery life), for which the lessee/user did NOT have a binding purchase contract in place prior to 2008
- Original in-service use of the property must commence with the taxpayer (BAL) in 2008 (extended to 2009 for certain aircraft, transportation property, and property with a production period longer than 1 year)
- As in 2003, there is a three month window (but must still be within 2008) from the original in-service date allowing the final lessor to be treated as the original owner, and to claim bonus depreciation (if the property is otherwise eligible) in the event of either a sale-leaseback or a post-closing lease syndication
- The original in-service date is extended through 2009 for aircraft (other than for agricultural or firefighting services) with a material non-refundable deposit, transportation property, and qualifying equipment with a construction period over 1 year

Lease vs. Buy Analysis-AMT Lessee, Bonus Depreciation

Lessee tax position - Alternative Minimum Tax payer

Tax depreciation - Bonus depreciation available

Year Ending	<u>Benefit to Lease</u>		<u>Pre-Tax Cash Flows</u>	
	After-Tax Cash Flows	Present Value	Lease	Loan
12/30/2008	(32,698.33)	(32,445.35)	146,986.62	156,650.78
12/30/2009	(41,384.88)	(39,861.27)	160,349.04	170,891.76
12/30/2010	(15,062.29)	(14,029.61)	160,349.04	170,891.76
12/30/2011	11,329.77	10,276.41	160,349.04	170,891.76
12/30/2012	37,794.95	33,128.50	160,349.04	170,891.76
12/30/2013	34,191.41	29,049.62	333,362.42	334,240.98
12/30/2014	24,000.00	19,715.49		
12/30/2015	5,886.29	4,683.51		
12/30/2016	8,888.89	6,850.33		
TOTAL	32,945.80	17,367.64	1,121,745.20	1,174,458.80

Result
After-tax Analysis
“Lease” is better
Pre-tax Analysis
Lease rents are \$52,714 lower than loan payments – 5.27% benefit
Accounting Treatment
Capital Lease

**The Effect of Energy Tax Credits on Pricing
of Tax-Motivated Leases for Qualified
Energy-Saving Equipment and Projects**

The Energy Policy Act of 2005 (Pub.L. 109-058)

- The Act was passed to accomplish several objectives, including:
 - Combat growing energy problems in the U.S.
 - Reduce dependence on foreign oil
 - Reduce urban emissions
 - Reduce greenhouse gases
- Provides tax incentives and loan guarantees for energy production of various types of alternative fuels
- Tax benefits made available for equipment that uses alternative energy or fuel

Incentives for Alternative Fuel Vehicles

- **Federal Tax Incentives for Vehicles** – also part of the Energy Policy Act of 2005. There is available income tax credits for the purchase of natural gas and certain other alternative fuel vehicles
- Formula for determining amount of tax credits based on gross vehicle weight (GVW), performance against emission standards, and a percentage of incremental cost
 - \$5,000 for vehicles up to 8,500 lbs
 - \$10,000 for vehicles over 8,500 lbs and less than 14,000 lbs
 - \$25,000 for vehicles over 14,000 lbs and less than 26,000 lbs
 - \$40,000 for vehicles over 26,000 lbs
- The credit applies only to on-the-road vehicles
- The vehicle manufacturer provides an acknowledgement letter certifying the amount of the eligible tax credit
- The tax credits are available on vehicles placed into service after 12/31/05 and before 12/31/10

Lease vs. Buy Analysis-AMT Lessee, Bonus Depreciation, Energy Tax Credit

Equipment - LNG fueled over-the-road tractors

Lessee tax position - Alternative Minimum Tax payer

Tax depreciation - Bonus depreciation available

Income tax credit - Energy tax credit available

Year Ending	<u>Benefit to Lease</u>		<u>Pre-Tax Cash Flows</u>	
	After-Tax Cash Flows	Present Value	Lease	Loan
12/30/2008	(180,344.81)	(178,943.97)	110,978.45	156,650.78
12/30/2009	11,227.23	10,984.07	121,067.40	170,891.76
12/30/2010	37,549.83	35,213.47	121,067.40	170,891.76
12/30/2011	63,941.89	57,967.71	121,067.40	170,891.76
12/30/2012	90,407.07	79,316.93	121,067.40	170,891.76
12/30/2013	83,905.00	71,402.62	330,088.95	334,240.98
12/30/2014	53,333.33	43,812.20		
12/30/2015	(122,298.12)	(97,308.35)		
12/30/2016	8,888.89	6,850.33		
TOTAL	46,610.31	29,295.01	925,337.00	1,174,458.80

Result
After-tax Analysis
“Lease” is better
Pre-tax Analysis
Lease rents are \$249,122 lower than loan payments – 24.91% benefit
Accounting Treatment
Capital Lease

Incentives for Solar Projects

- **Federal Tax Incentives for Solar*** – Under the Energy Policy Act of 2005 (as amended & extended), the following federal tax incentives are available for the financing of solar projects:
 - 30% Solar Investment Tax Credit
 - 5 Year Accelerated (MACRS) Depreciation Schedule
- **Utility Incentives** – In order to meet renewable portfolio standards (“RPS”) that have been enacted by the CPUC and other regulators, investor owned utilities must produce a certain percentage of their power from renewable sources by certain dates. The current program is called the “California Solar Initiative”, or “CSI”.
- **Renewable Energy Credits** – Renewable energy credits (“RECs”) are open-market credits available to qualifying solar and other renewable energy projects. At this time, RECs in California are voluntary, which means that these can NOT be counted towards a utility’s RPS requirements. It’s anticipated that these credits will soon be included, at which time the value will significantly increase.

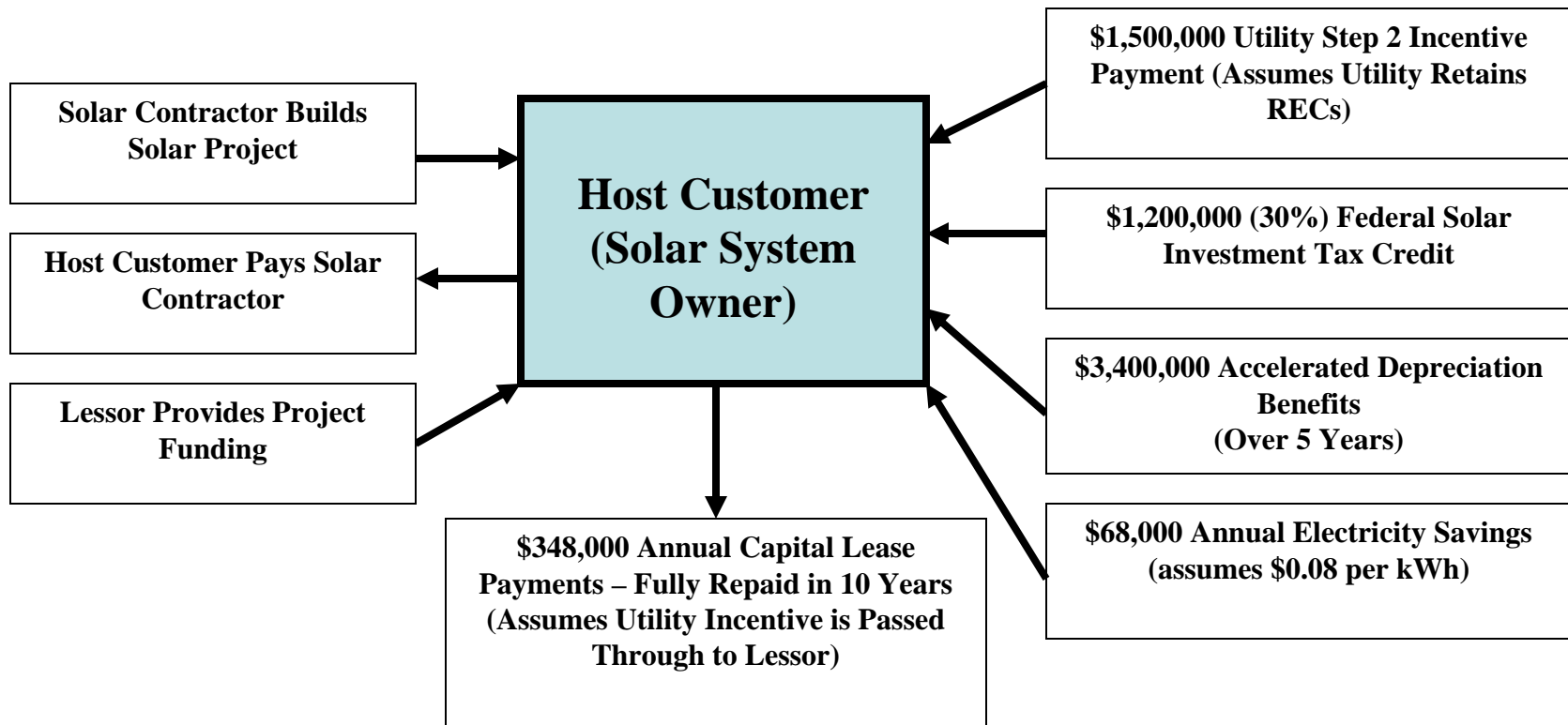
* In order to qualify for these incentives, the current law requires solar projects to be “placed in service by 12/31/08. This deadline is expected to be extended, but it has not been yet.

Case Study

- 500kW Solar Photovoltaic system.
- Installed cost of \$4MM
- 30% Federal Solar Investment Tax Credit
- \$1.5 million Utility Incentive Payment
- Estimated utility savings based on 850,000 kWh production and \$0.08 electricity costs

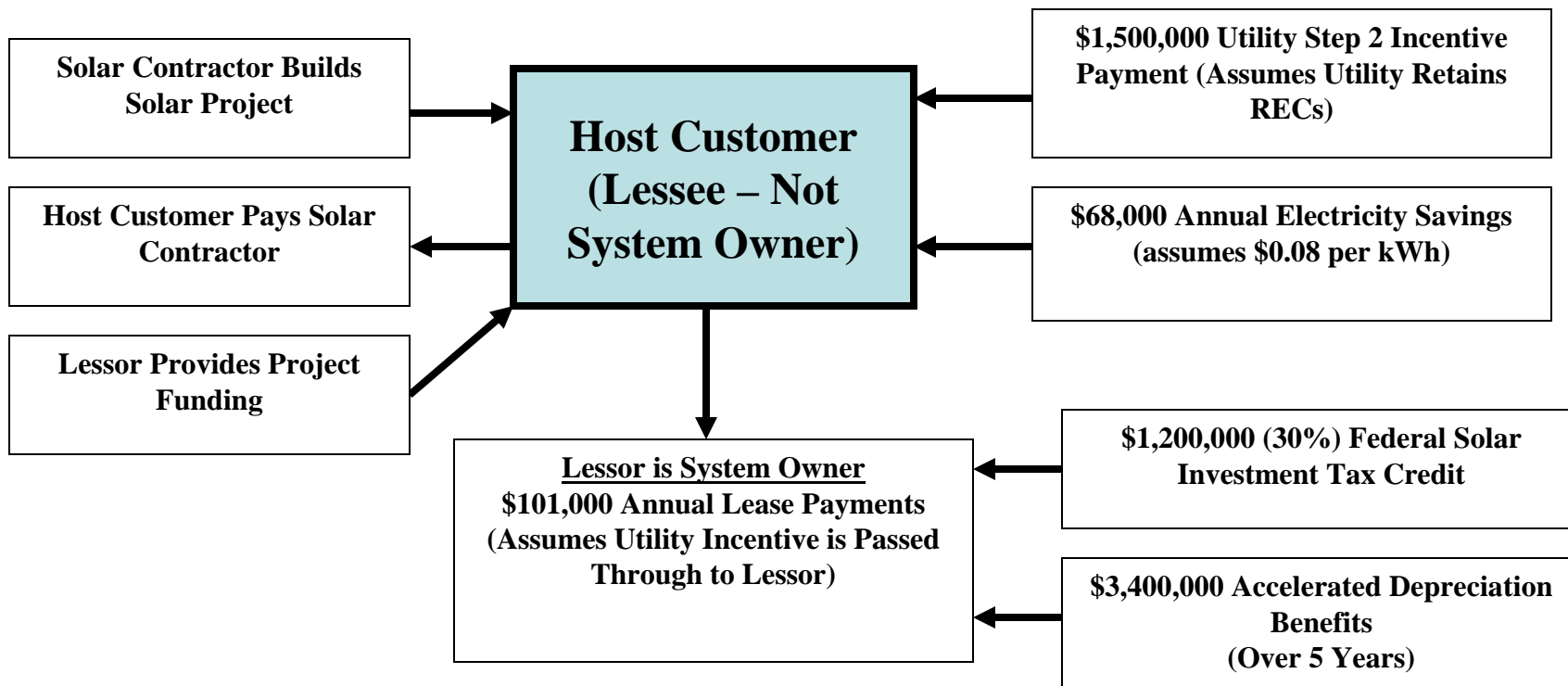
Capital Lease Example

Assumes 500 kW System – 850,000 kWh/yr Annual Production \$4,000,000 Total Installed System Cost - 10 Year Lease/Loan Term @ 7%



Tax Lease Example

Assumes 500 kW System – 850,000 kWh/yr Annual Production \$4,000,000 Total Installed System Cost - 10 Year Tax Lease Term



Accounting Update



Update on FASB/ IASB Project on Lease Accounting

History

- 1996 G4+1 Report concluded that current lease accounting standards failed to account for material assets and liabilities from operating leases
- In 2000 FASB and G4 + 1 issue Special Report on Leases covering rights and obligations
- Enron
- The SEC issues reports in 2003 and 2005 finding current accounting unacceptable
 - Deficiencies in current lease accounting include the “all-or-nothing” capitalization method and rules-based approach
 - Bright-line tests contribute to financial engineering to achieve off-balance sheet reporting
 - SEC estimates \$1.25 trillion in undiscounted operating lease obligations are reported in footnotes of public companies

Update on FASB/ IASB Project on Lease Accounting

Project Overview

- In July 2006, FASB and IASB formally add a joint project on lease accounting to their respective agendas
- The project will consider all aspects of lease accounting—lessee and lessor
- Initial progress on project
 - Formed International Working Group
 - Held joint FASB/ IASB meetings
 - Working Group meetings
- 2007 FASB meeting report

Update on FASB/ IASB Project on Lease Accounting

Initial project schedule

- 2006 – Form international working group and study issues
- 2007 – Deliberate on issues and Preliminary Views document
- 2008 – Exposure draft issued; redeliberation
- 2009 – Final standard issued

Apparent revised schedule

- 2007 – Form international working group and study issues
- 2008 – Deliberate on issues and Preliminary Views document
- 2009 – Preliminary Views document
- 2010 – Issue Exposure Draft
- 2011 – Issue final standard
- 2012/ 13 – Effective date

Update on FASB/ IASB Project on Lease Accounting

Likely New Approach

- FASB/IASB have undertaken a broad-based shift to “assets and liability” based model and fair value measurement
- The New Approach relating to lessee accounting appears
 - “Right to use” = an asset
 - Obligation to make fixed or determinable payments = a liability
- Neither lessee nor lessor will account for ownership of the asset
 - Lessee – Right to use the asset
 - Lessor – Right to receive lease payments
- 2000 report – Lessee liability equal to PV of required lease payments
 - Residual Value option? Return obligations?
- Fixed asset accounting currently under discussion by FASB and IASB

Revised Lease Accounting

Right to Use Approach

Balance Sheet Entry

- Right to Use Leased Asset 900
- Obligation to make Lease Payments 900
- Question on Income Statement entries

Update on FASB/ IASB Project on Lease Accounting

Preliminary views on Assets and Liabilities

Lessor	Lessee
<ul style="list-style-type: none"> ▪ Obligation to permit use (NOT A LIABILITY) ▪ Right to receive payments for use (ASSET) ▪ Right to get the asset back at expiry (NOT AN ASSET) ▪ Right to residual economic benefits (ASSET) 	<ul style="list-style-type: none"> ▪ Right to use asset (ASSET) ▪ Obligation to make payments for use (LIABILITY) ▪ Obligation to return asset at expiry (NOT A LIABILITY) ▪ Right to buy asset (ASSET) ▪ Right to renew lease (ASSET) ▪ Right to use asset in renewal period (NOT AN ASSET) ▪ Fair value of residual guarantee (LIABILITY)

Source: Bill Bosco, ELFA

Questions & Answers



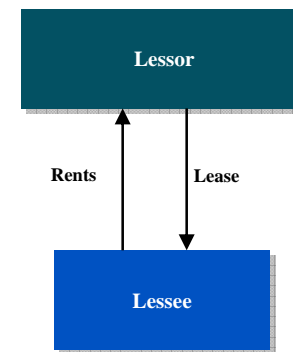
Appendix

Finance Solutions

Secured Loan/Lease Intended as Security (LIS)

Features & Benefits

- Transaction is a capital lease for accounting purposes.
- Financing is treated as a loan for tax and legal purposes but is documented as a lease.
- Lessee is considered the tax owner and takes MACRS depreciation deductions.
- Equipment serves as collateral, lender/lessor is granted a security interest.
- Lessee has an end of lease purchase option at a fixed price less than the expected fair market value of the asset.
- Lessee retains any residual value in excess of the purchase price.
- Lessor provides 100% of the asset cost, preserving lessee's working capital.
- Not typically covenant intensive.
- Can be a floating or fixed rate instrument (opportunity to lock in low rates).
- Matches financing tenor to the useful life of the equipment.



Potential Clients

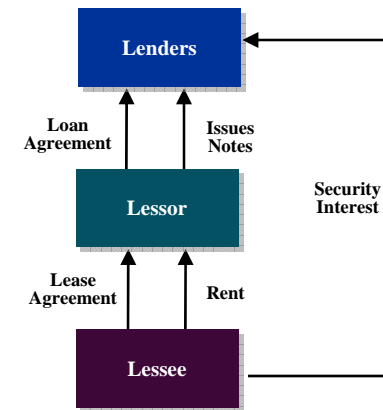
- Companies able to efficiently utilize the tax benefits associated with MACRS depreciation, i.e. full taxpaying companies.
- Companies with large capital expenditure programs.
- Companies seeking alternative funding sources (to traditional bank lines).

Finance Solutions

Construction Lease/Non-Tax Operating Lease

Features & Benefits

- Structured to qualify for FAS 13 operating lease treatment.
- Used to meet EITF97-10, FIN 46R requirements.
- Lessee retains control of the asset(s) through end of term options (purchase option or sale option).
- Lessee retains any residual value in excess of the purchase price in the event of a sale option; retains upside in purchase option.
- Lessor provides 100% of the asset(s) cost, preserving lessee's working capital.
- During the construction phase, lessor funds project costs with equity and funds advanced by lenders.
- Lessee acts as the construction supervisory agent and oversees and undertakes the design and engineering, supervises the purchase and delivery of equipment and oversees construction, among other things.
- Interest and principal normally capitalized during construction.
- Can provide loan covenant relief.
- Can be a fixed or floating rate instrument.
- Improved operating and financial ratios.
- Upon completion, asset is put under a triple net lease: Lessee pays for sales and use taxes, maintenance, insurance, and all other costs associated with the use of the property outside of the lease rentals.
- Once under lease, repayment may be a bullet or large balloon (amortizes according to projected fair market value of asset).



- The lease includes:
 - An Interim Term (Construction Phase),
 - A Base Lease Term, and subsequent Renewal Terms. The Base Lease Term does not commence until construction has been completed.
- At the end of the lease, the Lessee may purchase the property for the outstanding lease balance (the "Fixed Price Purchase Option") or assist the Lessor in selling the property (the "Sale Option").
- Under the Under the Sale Option, the Lessee retains all proceeds above the lease balance.
- A Residual Guaranty under the Sale Option is provided by the Lessee.
 - The Residual Guaranty, Lease Rentals, and other costs will be constrained to be less than 90% of the fair market value of the asset.

Tax Solutions

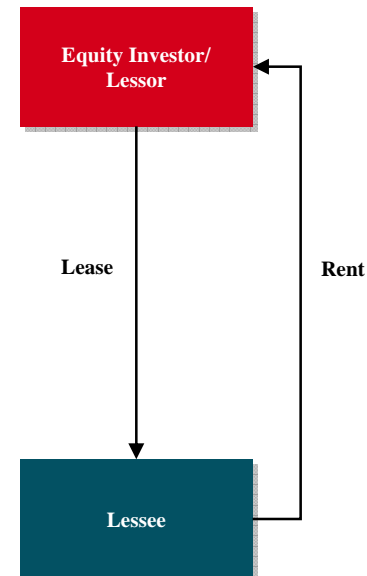
Single Investor Lease

Features & Benefits

- The lease is a “true lease” for tax purposes.
- May qualify for operating lease treatment under FAS 13.
- Lessee retains control of the asset(s) through purchase options.
- Preserves lessee’s working capital because lessor provides 100% of the asset(s) cost.
- Lessor assumes residual risk of the asset, therefore reducing obsolescence risk to the lessee.
- Provides an alternative funding source to traditional capital markets which doesn’t exhaust bank liquidity.
- Lessee has quiet enjoyment use of the asset.
- May provide favorable EPS impact and improved operating and financial ratios and may improve AMT position.
- Provides long-term financing (tenor up to 80% of the remaining useful life of the asset).

Costs

- Low lease rate because lessor takes MACRS depreciation deductions for tax purposes and passes the benefit back to the lessee in the form of lower rents. Therefore, the tax position of the lessee and the timing of the tax benefits impact the economics of the structure.
- Can be a fixed rate instrument (opportunity to lock in low rates).
- Lease is a Triple Net Lease. Lessee pays for sales and use taxes, maintenance, insurance, and all other costs associated with the use of the property outside of the lease rentals.



Potential Clients

- Companies in Alternative Minimum Tax (AMT).
- Companies with tax loss carry-forward positions.
- Companies with large capital expenditure programs.
- Transaction size: Up to \$60 million.

Tax Solutions

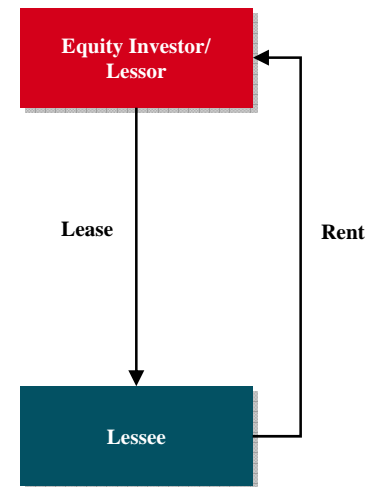
TRAC Lease – Titled Vehicles

Features & Benefits

- The lease is a “true lease” for tax purposes.
- May qualify for operating lease treatment under FAS 13.
- Lessee retains control of the asset(s) through purchase options.
- Preserves lessee’s working capital because lessor provides 100% of the asset(s) cost.
- Lessor assumes residual risk of the asset, therefore reducing obsolescence risk to the lessee.
- Provides an alternative funding source to traditional capital markets which doesn’t exhaust bank liquidity.
- Lessee has quiet enjoyment use of the asset.
- May provide favorable EPS impact and improved operating and financial ratios and may improve AMT position.
- Provides long-term financing (tenor up to 80% of the remaining useful life of the asset).

Costs

- Low lease rate because lessor takes MACRS depreciation deductions for tax purposes and passes the benefit back to the lessee in the form of lower rents. Therefore, the tax position of the lessee and the timing of the tax benefits impact the economics of the structure.
- Can be a fixed rate instrument (opportunity to lock in low rates).
- Triple Net Lease: Lessee pays for sales and use taxes, maintenance, insurance, and all other costs associated with the use of the property outside of the lease rentals.



Potential Clients

- Companies in Alternative Minimum Tax (AMT).
- Companies with tax loss carry-forward positions.
- Companies with large capital expenditure programs.
- Transaction size: \$500k-20 million.

Tax Solutions

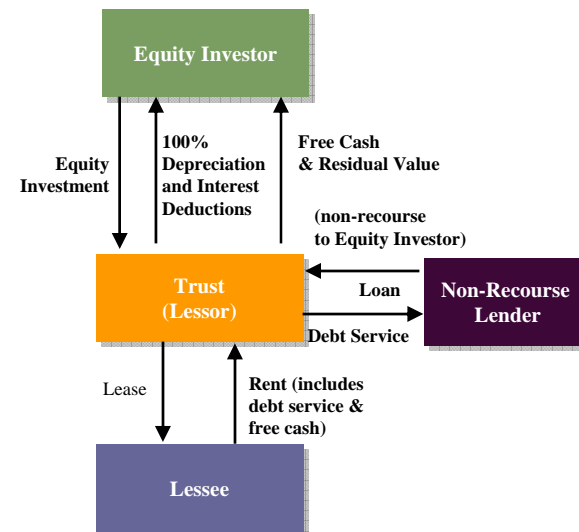
Leveraged Lease

Features & Benefits

- The lease is a “true lease” for tax purposes.
- May qualify for operating lease treatment under FAS 13.
- Lessee retains control of the asset(s) through purchase options.
- Preserves lessee’s working capital because equity investor and lender provide 100% of the asset(s) cost.
- Equity investor assumes residual risk of the asset, therefore reducing obsolescence risk to the lessee.
- May provide favorable EPS impact and improved operating and financial ratios and may improve AMT position.
- Provides an alternative funding source to traditional capital markets which doesn’t exhaust bank liquidity.
- End of Term Options – purchase, renewal, or return.
- Lessee has quiet enjoyment use of the asset.
- Provides long-term financing.

Costs

- Low lease rate because lessor takes MACRS depreciation deductions for tax purposes and passes the benefit back to the lessee in the form of lower rents. Therefore, the tax position of the lessee and the timing of the tax benefits impact the economics of the structure.
- Can be a fixed rate instrument (opportunity to lock in low rates) or floating rate at the option of the Lessee.
- Lease is a Triple Net Lease. Lessee pays for sales and use taxes, maintenance, insurance, and all other costs associated with the use of the property outside of the lease rentals.



Potential Clients

- Companies in Alternative Minimum Tax (AMT).
- Companies with tax loss carry-forward positions.
- Entities with large expenditure programs or large existing identifiable assets.
- Transaction size: \$50 million and larger.