Lease & Finance Accountants Conference

September 11-13 ▪ The Westin Charlotte ▪ Charlotte, NC

HANDOUTS

ELFA
EQUIPMENT LEASING AND
FINANCE ASSOCIATION

Introduction to the Lease and Finance Industry

What Do We Do?

2017 ELFA Lease Accountants Conference

Presenter: Rod Hurd, CFO, Bridgeway Capital Advisors
Author: Bill Bosco, Leasing 101

Accounting Terms

Book Accounting

Lessor

- Direct Finance Lease
  - Direct finance
  - Sales-type
  - Leveraged

Lessee

- Capital Lease

Lessee & Lessor

- Operating lease

Tax Accounting

Tax lease

- Tax/True lease
- TRAC motor vehicle lease

Nontax lease

- Financing
- CSA
- Loan
- Nontax lease
- Synthetic lease

Leasing Companies

Our Business – Providing leases and loans to "finance" customers' assets

– Assets that customers sell (indirect finance - vendor finance, dealer finance, franchise finance)

– Assets that customers use (direct finance)

The Lease Product may be the most complex "financing" product due to unique accounting, tax and legal issues

Leasing Companies

Leasing Company

- ***Loans***
  - **Retail**
    - CSA
    - $ Out
    - Loans
  - **Wholesale**
    - Working Capital Loans
    - Floor planning
    - Franchise financing
    - Asset Based Lending
- **Leases**
  - **Tax**
    - TRAC
    - FMV
    - Leveraged
  - **Non-Tax**
    - Synthetic
      - Non-leveraged
      - Leveraged
    - Municipal Lease

Loans

- Loan A financing for tax & accounting purposes. The obligor owns the asset, books it as a purchase and takes tax benefits.
- Retail Loan A financing of an end user customer's acquisition of a piece of equipment from a vendor or dealer. The end user is the obligor.
- Wholesale Loan A financing provided to a dealer or vendor to finance a portfolio of assets. The assets can be assets available for sale or assets that are financed to end users via leases or loans. The obligor is the dealer/vendor.

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Retail Loans

Conditional Sales Agreement (CSA)

- **What is it:**
  - A form of sales finance contract in which the seller reserves title to the goods until the buyer completes all payments for the goods and fulfills all conditions of the contract.
  - The payments include a finance component.
  - After payment has been concluded, the title to the goods passes to the buyer (total cost is known).

- **Why would a customer want this:** Small businesses who have limited access to capital & little concern about accounting or tax benefits.

Retail Loans

Dollar Out

•**What is it:** It is a lease that contains a bargain purchase option of $1 at expiry. It is considered a financing because of the bargain and the fact that the lessee is obligated for virtually 100% of the cost of the asset. The total cost is known.

•**Why would a customer want this:** A small company that has limited access to capital and is not concerned about accounting or tax benefits.

Retail Loans

Loan

- **What is it:** It is a financing where we lend the money to buy an asset to our customer. The customer repays the principal under the terms of the loan. The customer owns the asset and is entitled to the tax benefits (depreciation) from ownership of the asset.

- **Why would a customer want this:** A company that has limited access to capital, can use the tax benefits and is not concerned about the accounting impact.

Leasing Company

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Wholesale Loans

Working Capital Loan

•**What is it:**

- An loan made to a business to finance its working capital/operations.

•**Why would a customer want this:** Dealers of equipment borrow from banks and finance companies to fund their working capital needs. These companies cannot issue public debt/commercial paper.

Wholesale Loans

Floor Planning

- **What is it:**
  - Financing the inventory of a dealer in capital goods. Terms generally 90 days, interest only, followed by amortization over a fixed term.

- **Why would a customer want this:** A dealer would use this product to finance its inventory of equipment available for sale or lease.

Wholesale Loans

Franchise Financing

•**What is it:**

- Providing business loans to franchisees to allow them to buy franchises and the assets necessary to run their businesses.

•**Why would a customer want this:** Small businesses who use banks or finance companies to fund their purchase of a franchise. They do not have access to public debt markets.

Wholesale Loans

Asset Based Lending

- **What is it:**
  - Providing borrowing based secured business loans. The loan to value ratios depend on the assets being financed. Assets typically are receivables, inventory and PP&E.

- **Why would a customer want this:** Non-investment grade businesses who cannot issue public debt. They use banks or finance companies to fund their business.

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Leases

•**Lease** A contract by which the owner of property (lessor) grants to another (lessee) the right to possess and use the property for a specified period of time in exchange for a stipulated periodic payment (rent).

•**Tax lease** A lease in which the lessor takes on the risks of ownership (based on IRS criteria) and is entitled to the benefits of ownership, including tax benefits.

•**Non-tax lease** A lease in which the lessee will, is obligated or is compelled to become the owner of leased equipment, and therefore has substantially all the risks and benefits of ownership. The lessee is therefore entitled to take the tax benefits (MACRS depreciation). The IRS considers this transaction as a borrowing.

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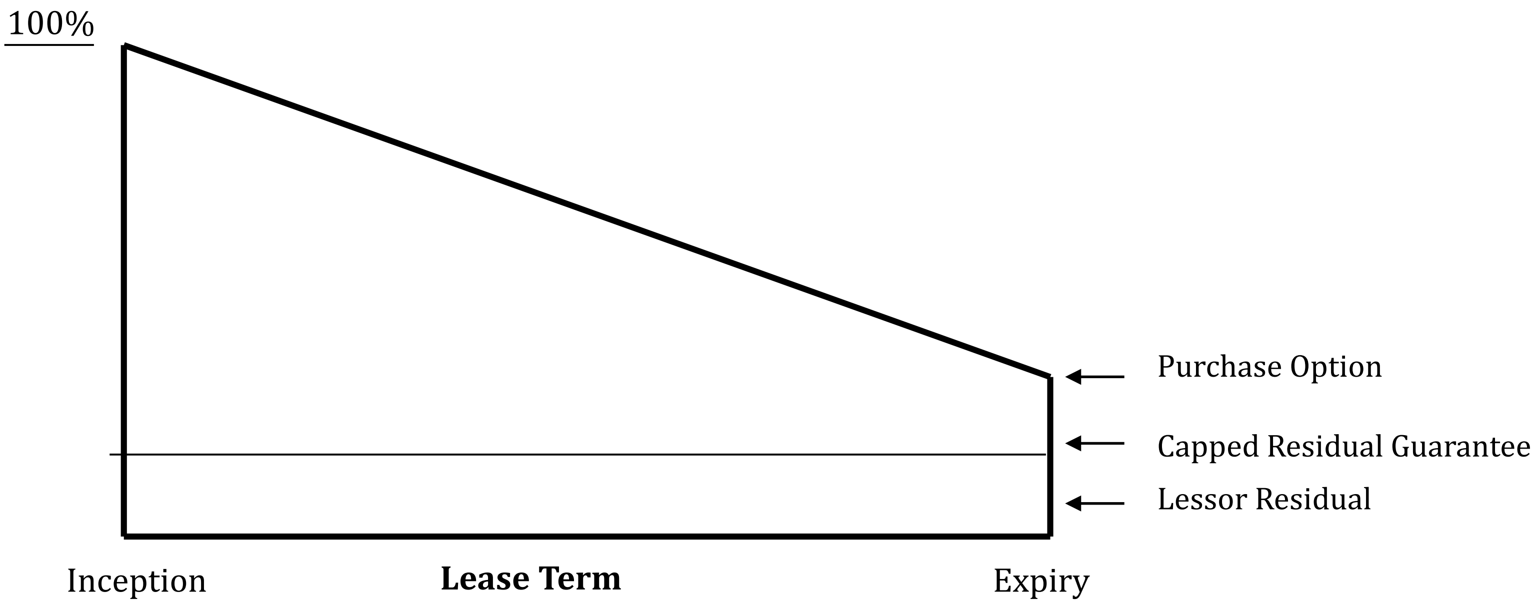
Tax Leases

TRAC/Split TRAC

- **What is it:**
  - TRAC = Terminal Rental Adjustment Clause. A tax lease in which companies acquiring over-the-road vehicles can exchange tax benefits for a low financing rate with an investor wanting tax shelter. The lessee guarantees the lessor's residual and gets the residual "upside".
  - Strictly limited by law to the financing of vehicles registered as over-the-road vehicles (autos, trucks & trailers).
  - The lessor takes the tax benefits associated with ownership of the vehicles even though the lease gives the lessee the upside & requires the lessee to "guarantee" (via a rental adjustment) a specified residual value of the vehicles at the end of the lease term. For accounting purposes a TRAC is a capital lease for lessee & finance for the lessor unless structured as a Split TRAC. A Split TRAC is structured the same as a synthetic lease & as a result is an operating lease for the lessee.

- **Why would a customer want this:** A customer who can't use tax benefits.

Split TRAC/Synthetic Lease Profile



- Operating lease achieved because the present value of the rents and residual guarantee PV is below 90% of equipment cost
- Lessee’s options:
  - Purchase at the TRAC amount
  - Sell asset & keep upside or pay 1st loss shortfalls up to capped residual guarantee (lessee “splits” the residual risk)
  - Negotiate a renewal

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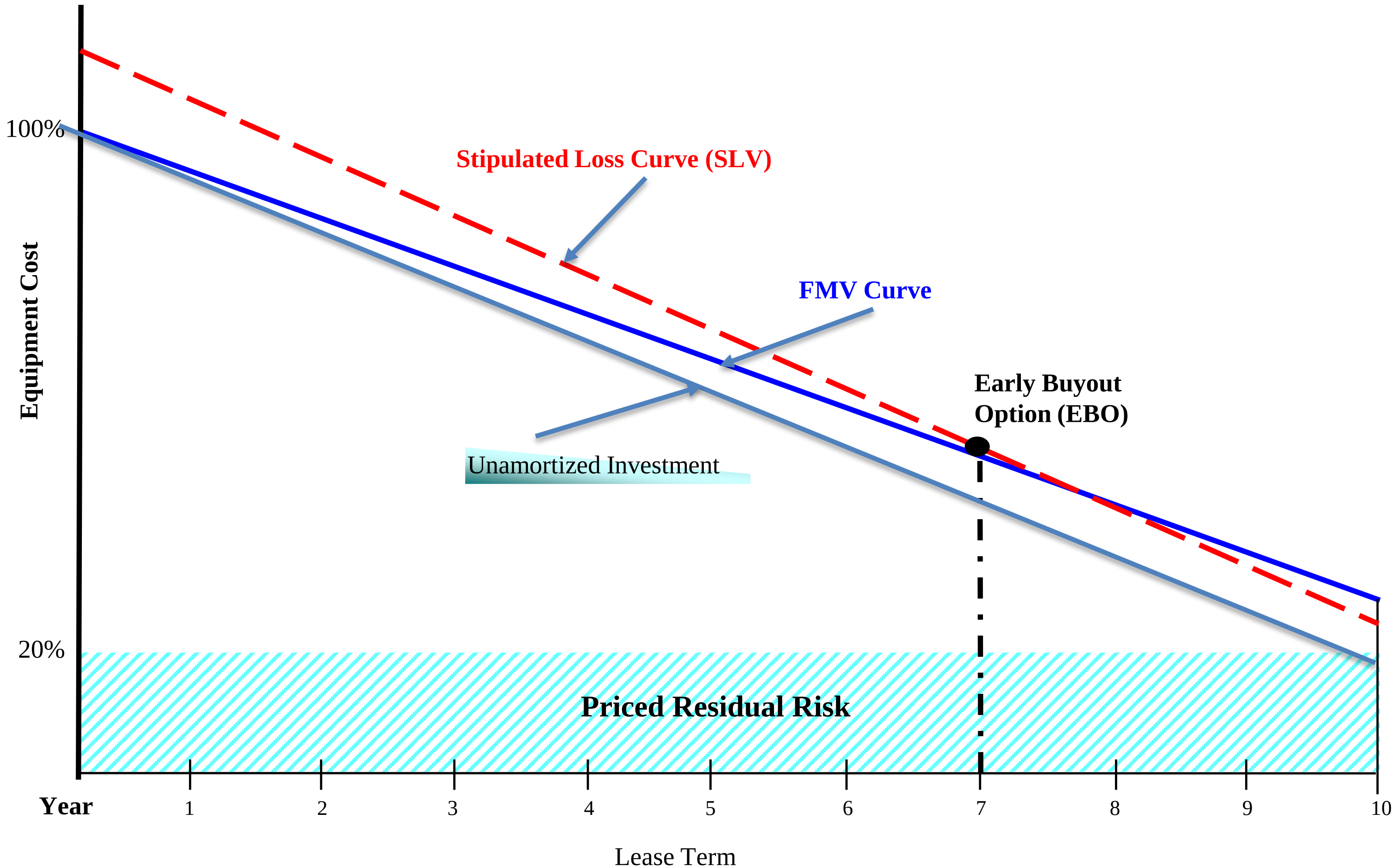
Tax Leases

Fair Market Value (FMV) Lease

•**What is it:** A lease where the lessee's options at expiry are to buy the equipment at FMV or renew at FMV rents. The lease can contain an early buyout option (EBO) or a fixed price purchase option (FPO) that is at least equal to the expected FMV. Most often the lease is an operating lease to the lessee. The lessor is the owner under commercial law and IRS tax rules.

•**Why would a customer want this:** A customer who can't use tax benefits and wants on operating lease (off balance sheet)

Tax Lease Profile



Tax Leases

Leveraged Tax Lease

- **What is it:**
  - A three-party lease transaction which involves a lessee, a non-recourse lender and a lessor (equity participant). Financing is provided by the lender and is non-recourse to the lessor (although the creditor has recourse to the leased property, rent payments and other obligations under the lease).
  - The rental stream is first used to repay debt.
  - The lessor receives the tax benefits of ownership. The lease is typically an operating lease to the lessee

- **Why would a customer want this:** For big deals as fees & costs are high. The low cost debt, tax benefits & leverage lower the rate to the lessee.

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Non-tax Leases

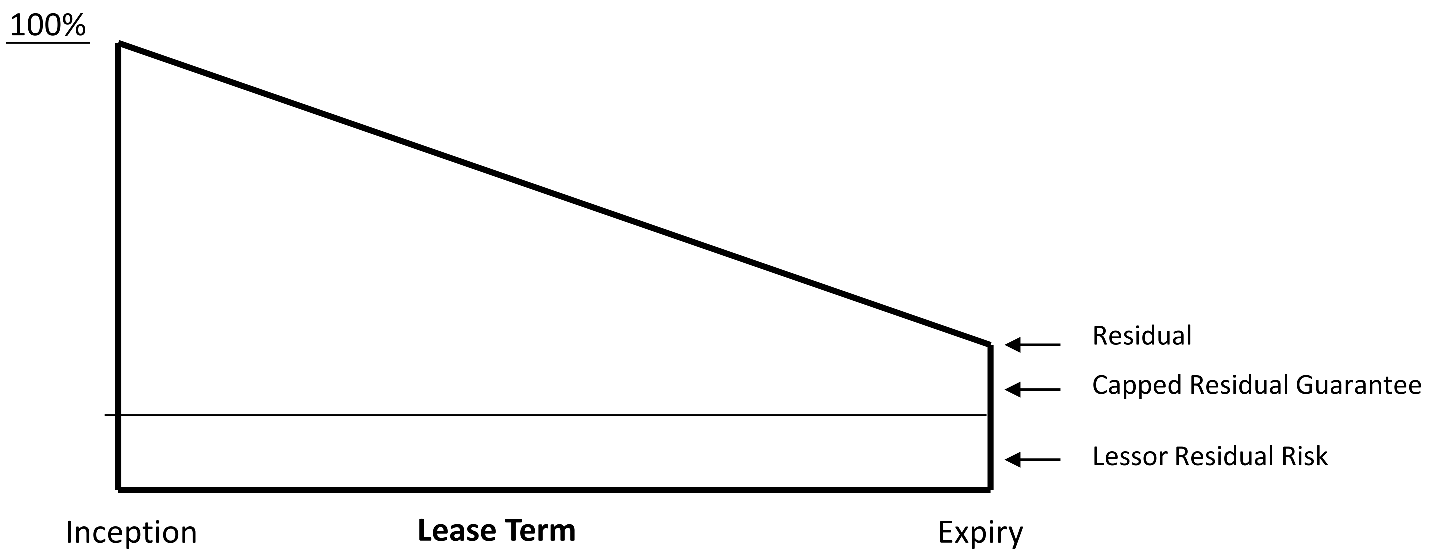
Synthetic Lease

•**What is it:**

- A synthetic lease that is an operating lease (off balance sheet) for accounting purposes, but a financing for tax purposes.
- The lessee gets the upside over the residual value from sale of the asset & gives a capped first loss residual guarantee in case the asset sells for less than the residual value. These facts mean it cannot be a true/tax lease.
- The residual guarantee amount is included in the PV classification test along with the rents and the PV must be <90% of the fair value of the asset at inception of the lease.
- Common in fleet leases as well as other equipment leases. Works best for assets that hold their value fairly well. Works well for real estate.

•**Why would a customer want this:** A customer who wants the tax benefits and off balance sheet treatment.

Synthetic Lease Profile



- Operating lease classification achieved because the present value of the rents and residual guarantee PV is below 90% of equipment cost
- Lessee's options:
  - Return asset, lessor sells asset & gives upside to lessee or lessee pays 1st loss shortfalls up to capped residual guarantee
  - In many cases lessee can purchase the asset for the residual value (not in most fleet leases)
  - Negotiate a renewal, in some cases there are fixed renewal/termination options that can effectively extend the lease term (common fleet lease structure)

Non-tax Leases

Leveraged Synthetic Lease

•**What is it:**

- A synthetic lease that it is leveraged with 3rd party non-recourse debt.
- Usually done for real estate and large ticket equipment.
- Must be a large ticket deal to justify the legal expenses.
- Fin 46 eliminated the use of SPEs as the lessor vehicle so the lessor must be a company of substance.

•**Why would a customer want this:** A customer who wants the tax benefits & off balance sheet financing. Real estate deals have interest only rents that improve the P&L treatment versus ownership.

Non-tax Leases

Municipal Lease

•**What is it:**

– A tax-exempt lease with a public entity, generally a state, town or city, where the public entity automatically becomes the owner of the property at the end of the term.

– The "interest" charge is tax-exempt for the lessor.

– A unique feature is that in the event that a public entity does not receive sufficient appropriations to make the lease payments, it can terminate the lease without recourse.

•**Why would a customer want this:** Tax exempt entities enjoy the low cost of the lease.

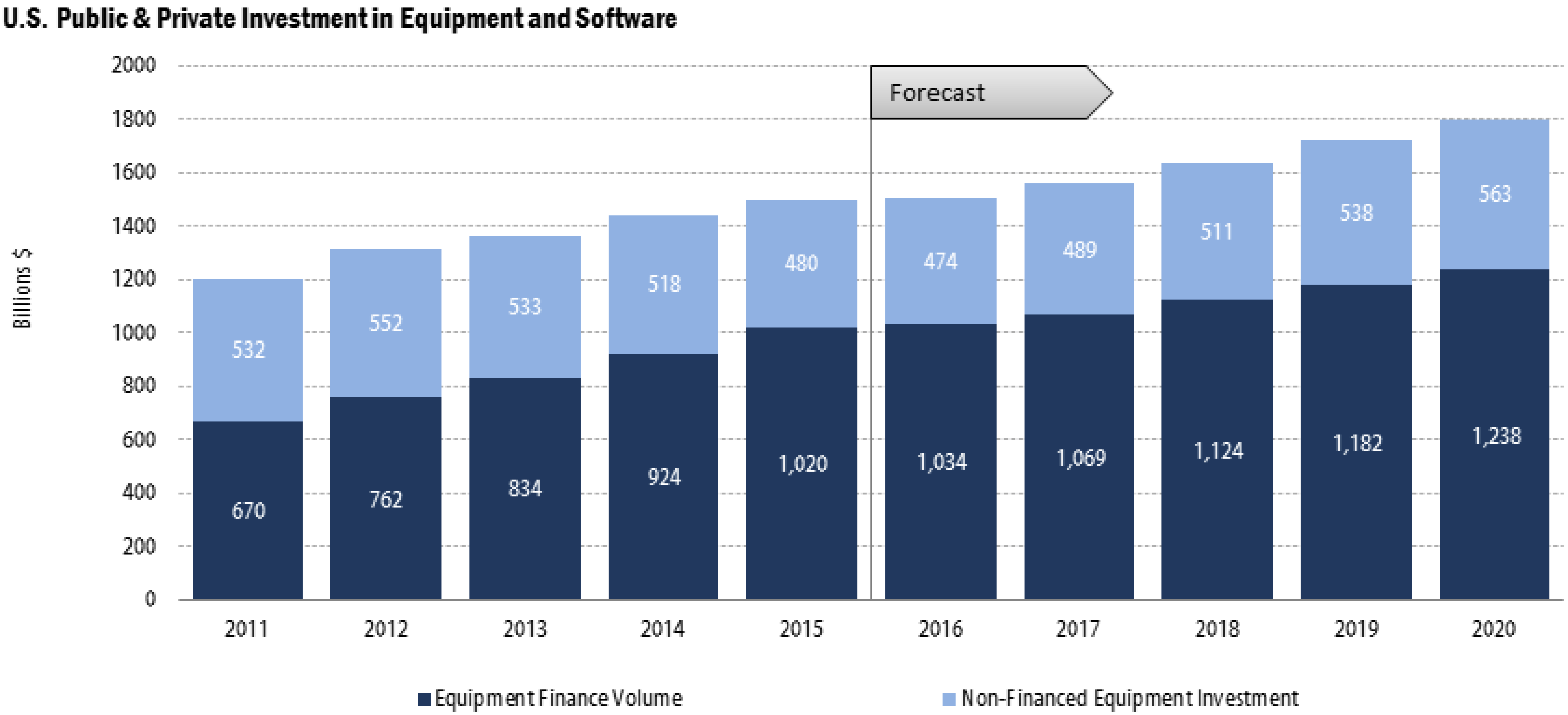
Why Customers Lease

Overview

- The Leasing Market
- Corporate Finance Needs
- Why Do Customers Lease?

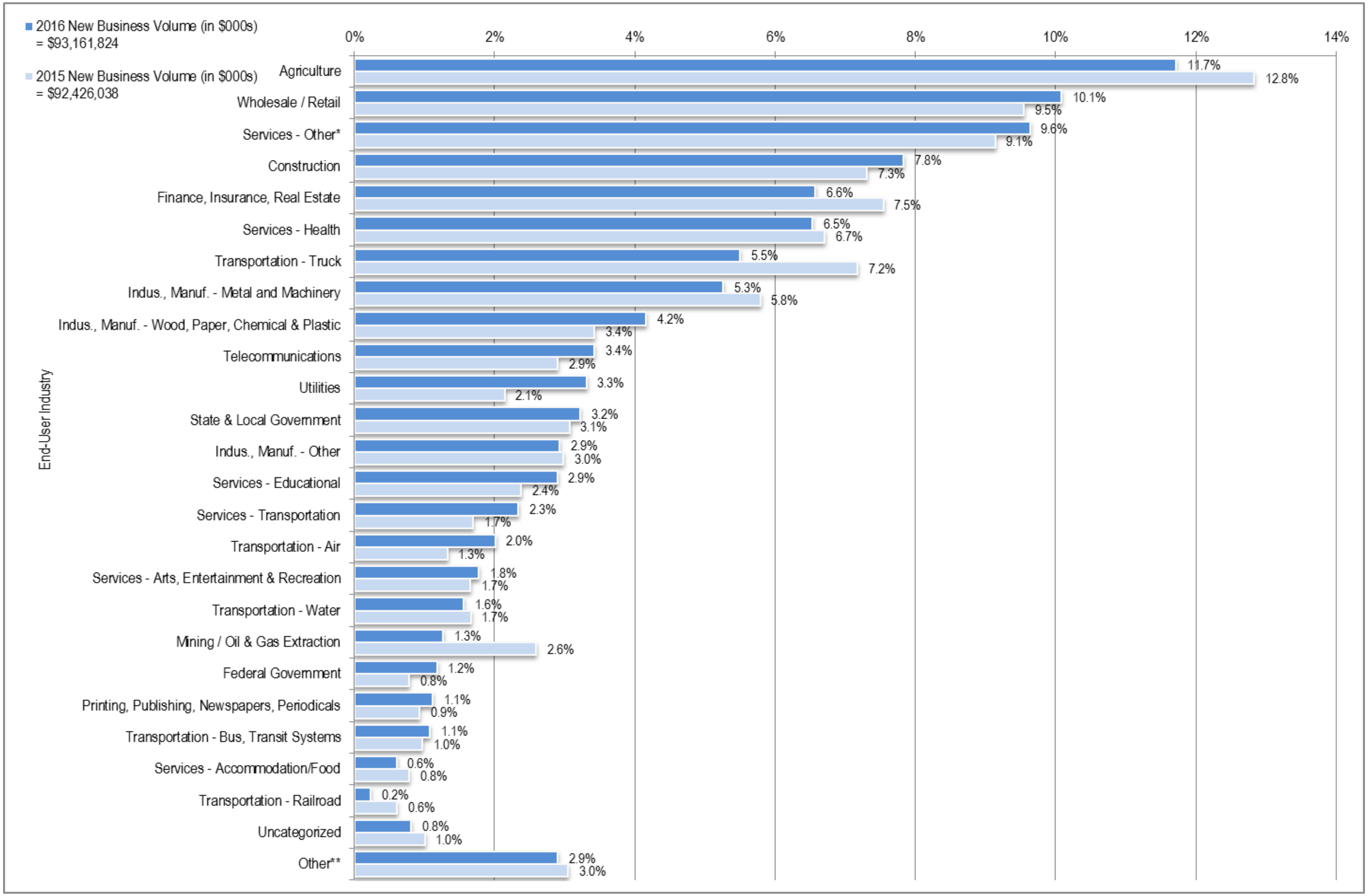
EQUIPMENT LEASING & FINANCE
FOUNDATION
Your Eye on the Future

The equipment finance market is poised for a period of modest, but steady growth.



Source: Equipment Leasing & Finance Foundation U.S. Equipment Finance Market Study: 2016-2017, Bureau of Economic Analysis and IHS Markit

What is Financed?



* 2017 Survey of Equipment Finance Activity

Corporate Finance Needs:

- Raising cost-effective capital
- Tax planning/minimization
- Financial structure management
- Efficient asset deployment
- Regulatory constraint management
- Convenience/service

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Corporate Finance Arsenal:

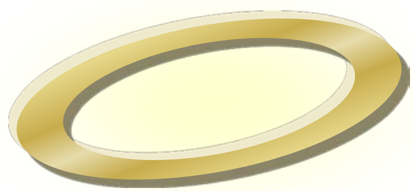
Debt

Equity

Venture capital

Revolver

Sub debt



Bonds

Leasing

Project finance

Mortgage

Securitization

Term loan

Corporate Finance Solution: Leasing

– Raise capital
– Reduce cost of capital
– Manage taxes
– Manage accounting
– Manage assets
– Manage regulatory issues
– Gain convenience/service

Why Do Customers Lease?

Raising Capital

Problem	*Leasing solution*
– Borrowing capacity	• Additional financing source
– Liquidity financing	• 100% fixed rate • Low level payments • Longer terms
– Capital budget constraints	• Costs in operating budget

Why Do Customers Lease?

Reduce cost of capital

Problem

– Unfavorable tax position (NOL/AMT)

– High equity cost

Leasing solution

- Payments reflect lessor taking tax benefits
- Off-balance sheet financing leverages capital (no asset = no capital needed)

Why Do Customers Lease?

Manage taxes

Problem *Leasing solution*

– Net operating loss (NOL)
– Alternative minimum tax (AMT)

Reduces after-tax cost of borrowing

Taxation Principles

Internal Revenue Service

– Administrative agency that enforces tax law

– Five areas of guidance to assist taxpayer to remain in compliance with tax law
  - Regulations
  - Revenue rulings
  - Revenue procedures
  - Private letter rulings
  - Court cases*

*Part of the Judicial System, not the Treasury department

Taxation Principles

- Revenue Ruling 55-540 (for all leases) IRS auditor guidelines differentiating a financing from a lease
  - Portions of the periodic payments are made specifically applicable to an equity to be acquired by the lessee.
  - The lessee will acquire title upon the payment of a stated amount of "rentals" which under the contract he is required to make.
  - The total amount which the lessee is required to pay for a relatively short period of use constitutes an inordinately large proportion of the total sum required to be paid to secure the transfer of the title.
  - The agreed rental payments materially exceed the current fair rental value.
  - The property may be acquired under a purchase option at a price which is nominal in relation to the value of the property at the time when the option may be exercised, as determined at the time of entering into the original agreement.
  - Some portion of the periodic payments is specifically designated as interest or is otherwise readily recognizable as the equivalent of interest.

Taxation Principles

- Internal Revenue Code
  - Fundamental factors used by courts and IRS to determine tax status of lease - *is it a lease or a loan used to buy the asset?*
    - Automatic and unconditional transfer of title
    - Existence of bargain purchase and/or renewal options
    - Length of term relative to asset's useful life
    - Economic substance of transaction

Taxation Principles

- Revenue Procedure 2001-28/75-21
  - Intended for leveraged leases **but** used in practice by lessors to judge all leases just to be conservative
  - If lease meets all following guidelines at inception, duration and termination, it is a "*true" lease/"tax" lease =* lessor is the owner for tax purposes. Lessor takes the tax benefits (ITC and MACRS depreciation deductions).

Taxation Principles

- Revenue Procedure 2001-28/75-21
  - Lessor must have a 20% investment
  - Must have a FMV purchase option or no purchase option
  - Can have a fixed purchase option but it must approximate FMV (decided at beginning of lease)
  - Must have at least a 20% useful life remaining at lease expiry

Taxation Principles

- Revenue Procedure 2001-28/75-21 (cont.)
  - Rents can be uneven but cannot be more than 90% - 110% of average rents on a calendar year basis, otherwise there are penalties under code section 467
  - No puts of the asset to lessee
  - No investment in the lease by lessee
  - Must have fair market value of at least 20% at lease expiry; doesn’t need to be booked but it must be there.

Taxation Principles

- TRAC Leases
  - TRAC is the only “true” lease that can have a 100% residual guarantee provided by the lessee
  - Only applies to leases of a licensed motor vehicle or trailer
  - Meets all requirements of a tax lease, except that it includes a ***terminal rental adjustment clause*** (or “TRAC”)
  - A TRAC permits an adjustment of rentals according to the amount realized by the lessor upon sale of the leased equipment (gains and losses on sale = rent adjustment)
  - Lessee must certify >50% business use of leased asset

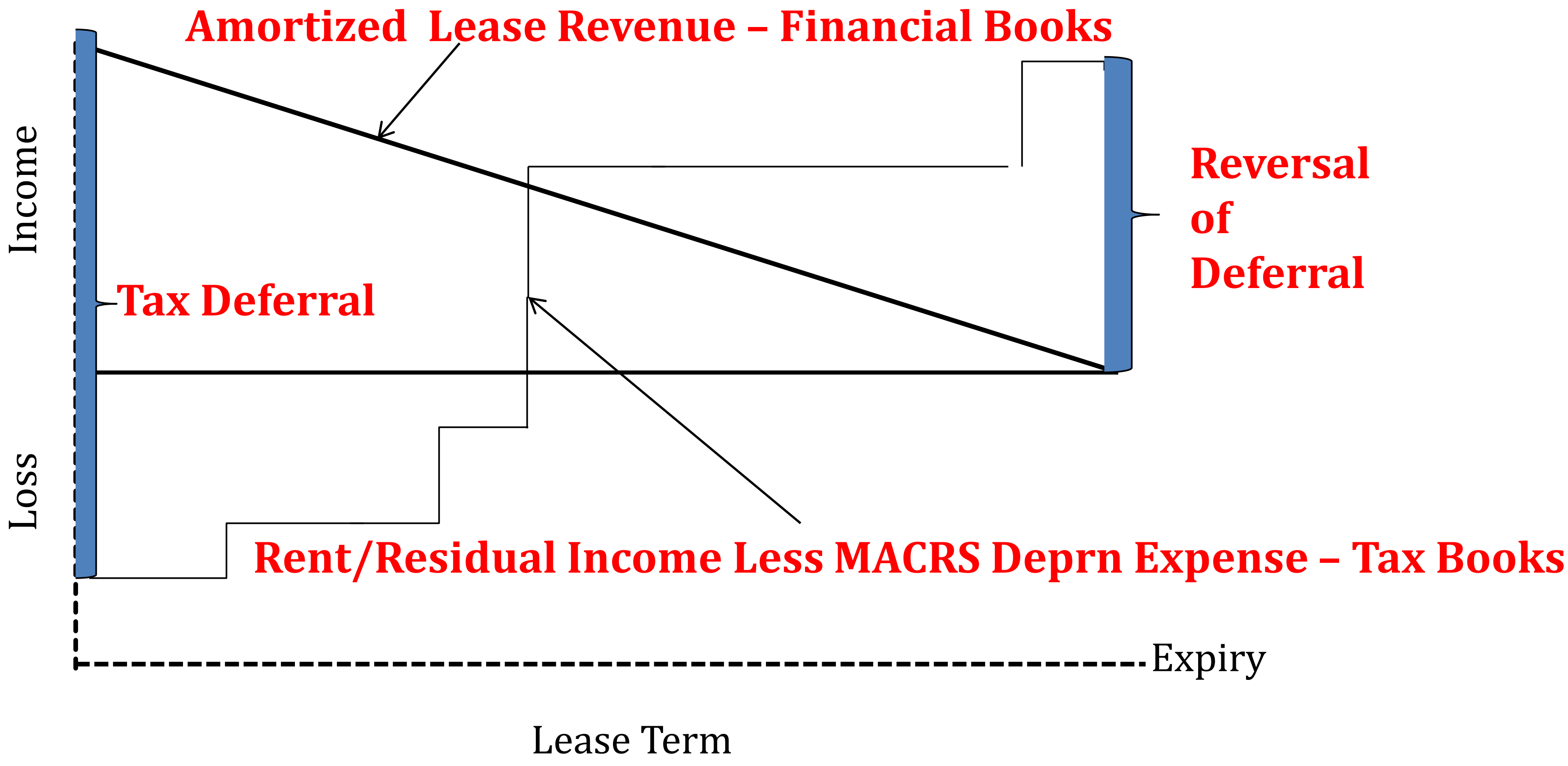
Taxation Principles

- TRAC Lease terms
  - At commencement of lease the parties agree upon the TRAC amount
  - If at lease expiry the equipment sells for more than the TRAC amount, the lessee gets a rebate of rent equal to some or all of the excess sale proceeds
  - If the equipment sells for less than the TRAC amount, the lessee must pay additional rent equal to the deficiency
  - This allows the lessee to share in the residual upside and also guarantees the residual for the lessor

Taxation Principles

- Benefits to lessor: Depreciation
  - MACRS (Modified Accelerated Cost Recovery System, AKA accelerated depreciation) causes book tax timing differences:
    - Book income is “finance” income – high is early months but declining
    - Tax income is rent and residual less MACRS – losses until MACRS declines
    - AKA tax shelter – “losses” in the early years that reverse later
    - Book and tax income in total over the lease term are the same
  - This difference creates a deferred tax balance: the lessor will owe taxes in the future but now will get tax a refund for the loss
  - For management accounting the deferred tax balance is ***usually*** netted against net risk asset, reducing lessor’s funding needs
  - Result: Cost of Funds save and higher ROA/ROE
  - Factored into pricing that can increase returns or be used to lower rates to customer to deal with price in competition

Lease "Tax Shelter"



Taxation Principles

- Benefits to lessor: ITC/Grants
  - Available for certain alternate energy assets
  - ITC is a credit against taxes payable
  - A grant is an outright cash payment (designed to attract investment where the investor has no current tax liability)
  - ITC and grants are included in lease revenue (amortized at the implicit rate in the lease)
  - Treated in pricing as a positive cash inflow in the transaction and as lease revenue

Taxation Principles

- Pricing Variables Impacting Deferral Benefits
  - Residual (higher is better)
  - Lease term (longer is better)
  - Effective Tax Rate (higher is generally better)
  - MACRS Life (shorter is better)
  - Rents: Even or variable, arrears or advance (back ended is better)
  - Operating lease or direct finance lease for lessor (DFL is better)
  - Cost of funds (higher interest rate environment is better)

Lease vs. Buy Analysis

- Analysis done by the lessee to determine if a tax lease financing is more cost-effective than borrowing to buy the equipment

- The dilemma is that the tax lease rent rate looks better than the loan rate but the lessee is giving up potentially valuable tax benefits

- The new lease accounting project adds intangible issues to the LvsB analysis as leases will be on B/S and the accounting is different than buying

Lease vs. Buy Analysis

The calculation is a discounted cash flow analysis:

- Calculates the PV of the after tax cash flows of the lease
- Rent to be paid less the tax benefit of deducting the rent
- Tax deductions are adjusted for impact of NOL & AMT

- Calculates the PV of the after tax cash flows of a loan
- Loan payments to be paid less the tax benefit of deducting the interest on the loan & the depreciation on the asset net of the after tax gain on sale of the asset
- Tax deductions are adjusted for impact of NOL & AMT
- Must assume the asset is either sold under the loan or bought under the lease assumptions to be comparable

The lowest PV of the 2 choices = the lowest after tax cost & therefore it is the best choice

Taxation Principles – Local Taxes

Property taxes

- Owner of underlying asset files tax return & pays tax based on a mill levy rate X the depreciated value of leased asset
  - DFL = Lessee is asset owner
  - OL = lessor is asset owner (lessor pays tax & charges lessee – either bills exact amount or includes an estimate in the lease rate)

Sales/rental taxes

- For DFL – Due at inception based tax rate X sales price of asset, lessor collects from lessee & pays tax
- For OL – Due on rents (each rent is considered a sale), lessor collects & pays tax

Why Do Customers Lease?

Manage accounting

Problem	*Leasing solution*
– Ratios/credit rating	• Reduce leverage, improve ROA, ROIC
– Covenant restrictions	• Operating lease vs. debt

Current Lease Accounting Models

FAS 13:

- Risk & rewards model
- Leased asset either on balance sheet or off balance sheet based on 4 classification tests
  - Auto transfer of title?
  - Bargain Purchase option?
  - Lease term =/> 75% of leased asset useful life?
  - PV of minimum lease payments =/> 90% of leased asset value?
- Lessee: either capital lease (on B/S) or operating lease (off B/S)
- Lessor: either direct finance lease (DFL) or operating lease
- Sales-type and leveraged leases are varieties of DFLs
- Sale lease back of R/E/integral property considers continuing involvement (purchase options) as classification indicator
- Gains in sale lease backs amortized or deferred

Current Lease Accounting Models

IAS 17:

- Risk & rewards model, but more judgment
- Leased asset either on balance sheet or off balance sheet based on 8 criteria
  - Auto transfer of title?
  - Bargain Purchase option?
  - Lease term = major part of leased asset useful life?
  - PV of min lease pmts = substantially all of leased asset value?
  - Asset specialized?
  - Lessee guarantees lessor's investment if lessee can cancel lease?
  - Lessee guarantees residual upside and losses at expiry?
  - Bargain renewal option?
- Lessee: either capital or operating lease
- Lessor: either DFL, sales type lease or operating lease
- Gains in sale backs can be upfront or amortized depending on lease classification

Comparing Current Lease Accounting Models

Issue	FAS 13	IAS 17
Risk & reward model	yes	yes
Lessee classification tests	4 with 2 bright lines	8 with more substance
Lessee subsequent accounting	Cap or op lease	same
Lessor accounting	DFL/LL/Sales-type or Op lease	Same ex. no LL
R/E & integral equip SLB	Considers continuing involvement	No special rule
Gains on SLB	Amortized or deferred	Upfront or amortized

THIS WILL CHANGE DUE TO LEASE ACCOUNTING PROJECT!!

Why Do Customers Lease?

Manage assets

Problem	*Leasing solution*
– Obsolescence	• Lessor assumes risk
– Uncertain need	• Terms negotiable
– Acquisition/disposition/ asset servicing	• Lessor's responsibility

Why Do Customers Lease?

Manage regulatory issues

Problem

– Financial services - capital adequacy

– Utilities - rate pressures

Leasing solution

- Off-balance sheet, frees up capital

- Equipment costs recovered as operating expenses

Why Do Customers Lease?

Gain convenience

Problem

– Small ticket size

– Multiple takedowns

– Service

Leasing solution

• Service intensive, standard documents, quick & easy tied to vendor sales process

• Master leases, lease lines, centralize control

Can include services e.g.: PC, Fleet

Who May Lease?

- **Customer profile**
  - Limited ability to borrow
  - Asset intensive, large CAPEX budget
  - Capital constrained
  - Credit rating pressure, highly leveraged
  - Tax problems

FASB/IASB Lease Accounting Project

Acronyms

- FAS 13(ASC 840)/IAS 17 – current lease accounting rules
- ASC 842 – the new FASB lease standard
- IFRS 16 – the new IASB lease standard
- FASB – Financial Accounting Standards Board
- IASB – International Accounting Standards Board
- Off-balance sheet = operating lease
- Capitalize lease = put lease on balance sheet
- On balance sheet = Value of "right to use" leased item is an asset, lease obligation booked as a loan & P&L shows depreciation & interest expense ***OR*** straight line rent expense

Project Status

Redeliberations Concluded	Drafting New Standard	New GAAP and IFRS Leases Standards Issued	Topic 842 Effective
November 2015	**Presently**	**IASB Jan/FASB Feb 2016**	**2019[1]**

[1] For public companies, 2020 for private companies **-- rules apply to all companies that issue audited financial statements**

FASB & IASB issued separate rules – differing mainly in lessee accounting

What aspect of leasing is set to change?

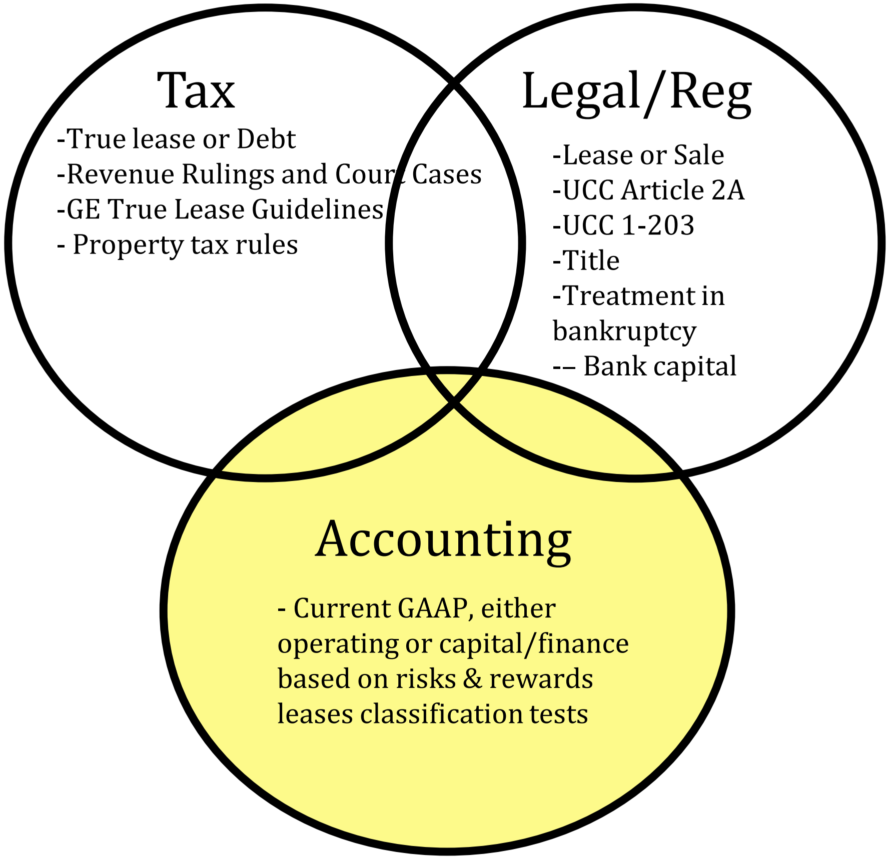
Proposals change US GAAP/IFRS ***accounting rules only***

- Bankruptcy law remains unchanged, **risks and rewards** of ownership model under Art. 2A UCC True lease vs. Art. 9 UCC secured loan

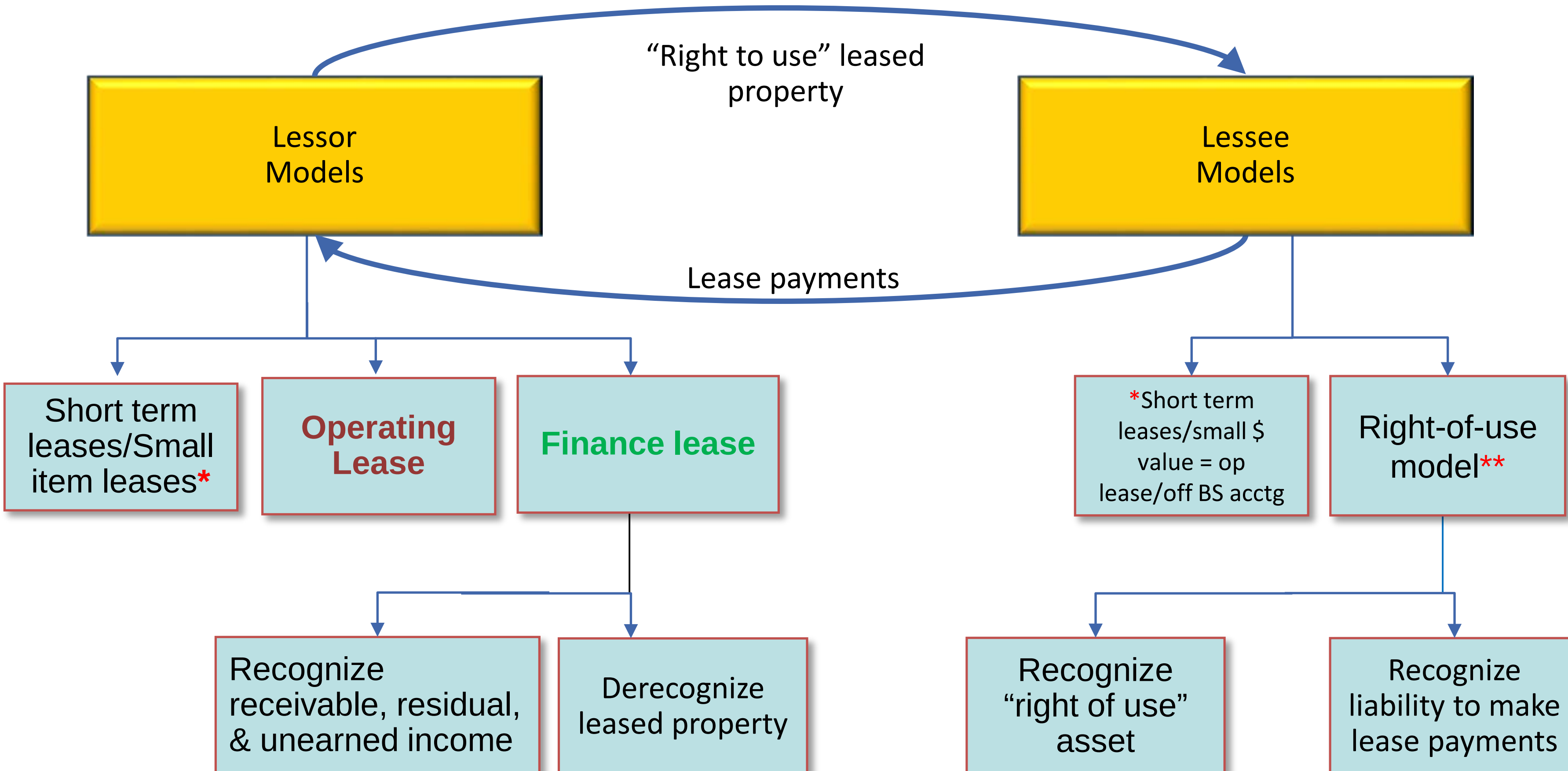
  Note: IASB will comingle capital and operating lease assets & liabilities. FASB will report separately according to legal substance, in line with: users' bankruptcy analysis, lenders' definition of debt & bank capital rules

- Tax rules remain unchanged, **risks & rewards assessment** of tax owner considering extent residual retained by lessor at end of lease

  Note: IASB = Bigger book-income tax differences; new complexity in sales/property tax. FASB in line with tax treatment.



Lease Models



***IASB also allows small value item exemption ($5,000). FASB does not.**

****FASB only =** 2 lease types: **Operating** and **Finance** leases with different P&L cost patterns + separate BS presentation. **IASB only =** all leases are finance leases

US Lessees: Key Messages

- Operating leases on balance sheet, no grandfathering
- Lease classification matters for the P&L and presentation
  - ✓ Approach similar to today
  - ✓ Operating Lease classification still has significant benefits
  - ✓ Operating lease expense is the straight line rent expense
- Operating Leases capitalized, but . . .@ <100% of cost
- Operating Lease liability is ***not*** labelled as debt
- Transitioning will be a major project . . .

What Does It Mean?

- For US Lessees:
  - ✓Final standard about as reasonable as possible
  - ✓Still have rent expense as lease cost - ***Not the IASB front-end loaded pattern***
  - ✓Still . . . operating lease assets and liabilities on balance sheet
    - *BUT* only @ the PV of the payments – ***NOT the full asset cost***
    - Operating Lease liability ***not debt*** – fewer debt limit covenant issues
  - ✓Transition: All operating leases booked, new systems/process needed
  - ✓Lots of work in transition and new processes for new leases!

Traditional reasons for leasing continue strong!

“Right-of-use” model (ROU)

- **Lessee will recognize**
  - A right-of-use asset representing lessee’s right to use the leased asset
  - A liability for its obligation to make lease payments
  - Initially measure lessee’s asset and liability at the present value of lease payments to be made over the lease term using the implicit rate in the lease (if known) or the lessee’s incremental borrowing rate.

- **Lessor accounting models retained**
  - Finance lease accounting for leases that are the equivalent to a financed purchase
  - Operating lease accounting for leases that are “rental” contracts

ELFA

Lease Classification

Lessees:

- **Both IASB & FASB exempt short term leases (use operating lease accounting)**
- **IASB allows exemption for small ($5,000) item/non-core asset leases**
- **IASB adopted a one lease model – all use capital lease accounting:**
  - The lease is capitalized & the asset is amortized straight line & interest is imputed on the liability.
  - The result is a front ended expense pattern.
- **FASB uses IAS 17 like classification tests (with the 75% and 90% bright lines as a guide) in a 2 lease model like FAS 13**
  - Finance Lease accounting as above. OR
  - Operating Lease accounting :
    - Asset & liability are capitalized, then adjusted each month to PV of the remaining payments.
    - P&L is straight line - the average rent is accrued & the rent paid is charged accrued rent payable account.
    - OR Impute interest and "plug" the asset amortization to get to a SL rent expense

Lessors:

- **Finance Lease (FL)** - Record a receivable & residual asset, recognize unearned lease income @ implicit rate. Same as FAS 13
- **Operating Lease (OL)** - Record leased asset, recognize rent income and asset depreciation. Same as FAS 13.

Lessee Analysis

Lessor Product Offerings

Product	**Impact to Lessee**
Short Term Rental (1 yr or less)	Exempt from new rules – election to continue to use operating lease accounting ***(off balance sheet)***
Operating (Tax) Lease	Capitalized, **but** ***PV lower than equipment cost***
Synthetic Lease/TRAC	Capitalize only contractual rents, compelling renewal rents & estimated residual guarantee payments – ***capitalizes far less than expected***
Capital lease	Capitalized as under current rules

Lease Project Analysis

Lessors retain basic models:

- **DFL accounting** - For leases considered "financings"
- **Operating Lease** - For leases not considered "financings" & short term leases
- **FASB only** - Leveraged Lease accounting dropped but existing leases grandfathered
- ITC accounted for as "grossed up" revenue
- Sales-type up-front gross profit allowed only for Type A leases that do not have third party residual insurance or guarantees. Those with third party involvement will amortize gross profit as part of lease revenue.
- Sale leasebacks with fixed purchase options not considered sales – rather they are "financings" – may be able to work around issues for SLBs done at or near asset delivery

Lease Accounting Project Impact

- For US Lessors
  - Few changes – Great News ex for loss of LL accounting!
  - Lessees will have fewer issues with FASB approach – Little effect on lessee behavior ex for IFRS lessees with no Type B accounting
  - Possible loss of sale accounting re fixed POs in SLBs? (new structuring ideas will be developed to avoid SLB)
- For US Lessees:
  - New assets and liabilities on balance sheet
    - BUT only @ the PV of the payments
    - Operating lease liability not debt – no debt covenant issue
  - Retain SL P&L cost
  - Reassessment/rebooking less frequent than expected
  - Bundled billed full service leases – must bifurcate service & lease components of payment to avoid capitalizing bundled payment
  - Loss of lease accounting re fixed POs in SLBs?
  - Transition: All operating leases booked, process/internal controls changes, new systems may be needed
- Traditional reasons for leasing continue!

Business Reasons for Leasing

Reason for Leasing	Details	Status After Proposed New Rules
Raise Capital	Additional capital source, 100% financing, fixed rate, level payments, longer terms	**Still a major benefit** versus a bank loan especially for SME & non-investment grade lessees with limited sources of capital
Low cost capital	Low payments/rate due to tax benefits, residual & lessor low cost of funds	**Still a benefit** versus a bank loan
Tax benefits	Lessee can't use tax benefits & lease vs. buy shows lease option has lowest after tax PV cost	**Still a benefit**
Manage assets/ Residual risk transfer	Lessee has flexibility to return asset	**Still a benefit**
Service	Outsource servicing of the leased assets.	**Still a benefit**
Convenience	Quick & easy financing process often available at point-of-sale	**Still a benefit**
Regulatory	Capital issues	**Regulators *should* still treat ROU assets as "capital free" BUT they will likely not – BUT still a partial benefit to extent PV is <cost**
Accounting	Off balance sheet	**Partial benefit if the PV < cost of the asset**, S/B true for all op leases especially hi residual assets w tax benefits. Liability is **not** debt – no impact to debt covenants

Lease Accounting Project

Q&A

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