You Should Know

The new lease accounting rules will impact asset finance strategies

Key issues in the new rules (topic 842) impact lease vs buy decisions:

- Rules became effective in 2019 for public companies (2022 for private cos)
- Operating leases are capitalized (put on balance sheet as an operating lease right of use (ROU) asset and an operating lease liability) at the present value of the lease payments, BUT:
    - The amount capitalized will be less than cost when borrowing to buy
    - The P&L cost will be level vs front loaded if borrowing to buy
    - The impact to ROA/ROE will be significantly lower than borrowing to buy
    - The operating lease liability will ***<u>not be</u>*** classified as debt avoiding debt limit covenant defaults
    - Financial ratios and measures will be better vs borrowing to buy

Lease Structuring Opportunities:

- Operating lease classification still very important for financial presentation
- The lowest capitalized amount (less than 90% of the asset cost is capitalized as an asset and liability) is more important due to on BS treatment
- Lessee partial residual guarantee structures (like synthetic leases) result in lower capitalized amounts
- Operating leases can be tax or non-tax leases to manage tax benefits

- Traditional reasons for leasing are still strong: additional financing source, lower cost of capital, fixed rate level payment low cost payments, transfer residual risk, tax benefit management
- Operating lease capitalization negatively impacts EBITDA, but leases can be structured to be finance leases (EBITDA favorable) that capitalize at less than the full asset cost