

Will ChatGPT Replace Me, the Lease Advisor?

A case study

By I am not a robot, Bill Bosco, Leasing101

<https://www.monitordaily.com/article-posts/crunching-the-numbers-will-chatgpt-replace-me-the-lease-advisor/>

I have written a series of articles for the Monitor called CFO Chats that are slices of life sales calls in a leasing sales person's life. I heard this news that AI was going to replace us all so I tested Chat GPT versus one of my articles to see if I have to start working on a career change and here are the results:

Here is my article:

CFO Chats: Number 1

Me, the Lease Advisor: Hello, it has been a few months since we spoke. Is there anything new going on with you?

CFO: Yes, my Tax Manager says we have been so profitable that we used up our NOL (net operating loss) and we will pay federal income taxes this year. We need to add \$20 million in IT equipment and I was thinking of drawing on my bank lines to buy the assets. We should take advantage of Bonus MACRS as we can use the tax benefits of ownership of depreciable assets.

Me, the Lease Advisor: Did you consider leasing the IT equipment?

CFO: The IT vender's leasing guy is offering a "dollar out" lease where we will basically own the assets once we make all the lease payments. We'll get the tax benefits of MACRS depreciation as the "dollar out" lease is a finance lease for tax purposes. In other words the IRS considers a dollar out lease the same as a financed purchase of the assets.

Me, the Lease Advisor: It's true that the dollar our lease will give you tax ownership and 100% financing but under the Topic 842 lease accounting rules that structure (a finance lease) will be capitalized on your balance sheet as an asset and debt liability at 100% of the cost of the assets. Also, you realize that drawing under your bank lines will also result in added debt at 100% of the cost of the asset. The added debt will impact your debt ratios and may impact your debt

limit covenants. The added assets will negatively impact measures like ROA (return on assets), ROE (return on equity), and Return on Invested Capital (ROIC)

There are other lease options that will allow you to be the tax owner and should be more attractive from a financial presentation perspective. They will not cost you anymore and will allow you to control the use of the assets through purchase and renewal options.

I do have to ask one other question – are you measured by or concerned about EBITDA?

CFO: No, our focus is on EPS and ROA.

Me, the Lease Advisor: In that case I think you should do a synthetic lease as it is a financing for tax purposes (you will get all the tax benefits) yet is treated as an operating lease for accounting purposes. If properly structured it will capitalize at significantly less than the asset cost (less of a negative impact to ROA, ROE and ROIC and debt ratios and limits). The expense pattern of an operating lease is straight line as it is the average rent that gets expensed in your P&L (positive impact to EPS). Borrowing to buy or the dollar out lease will result in front loaded P&L cost equal to the sum of straight line depreciation plus interest expense that is high in the beginning of the loan and declines over the life. If you continue to ALWAYS lease leasable assets using operating lease structures (synthetic or not) the P&L, EPS and ROA benefits of lower reported assets and level P&L cost will be permanent – I have the analysis to prove it. In other words your key financial measures will be permanently better than if you buy all your leasable assets.

Additionally, and very importantly, the lease liability of an operating lease is NOT classified as debt – rather it is classified as an operating lease liability (meaning it is an operating liability and not debt as it disappears in bankruptcy) so the liability does not impact debt limits in covenants..

CFO: How do I know what lease product is the right one for my company and how to I get the right product?

Me, the Lease Advisor: I don't expect you to be an expert in lease products. I do think you should always shop around by contacting the major bank leasing companies and finance companies to ask for competing quotes and product options. There is nothing like competition to bring out the best.

You can always consult with a lease advisor, but they are hard to find.

Here is the CHAT GPT version:

I am a CFO of a publicly traded C corporation. My Tax Manager says we have been so profitable that we used up our NOL (net operating loss) and we will pay federal income taxes this year. We need to add \$20 million in IT equipment and I was thinking of drawing on my bank lines to buy the assets. We should take advantage of Bonus MACRS as we can use the tax benefits of ownership of depreciable assets. I also want to improve our EPS and ROA. Should I borrow to buy or should I lease? If I lease what type of lease would you recommend?

ChatGPT:

Deciding whether to borrow or lease IT equipment involves several factors, including your company's financial situation, tax considerations, EPS (earnings per share), and ROA (return on assets) goals. Let's break down the considerations for each option:

Borrowing to Buy:

1. **Tax Benefits:** Purchasing the equipment through borrowing allows you to take advantage of Bonus MACRS (Modified Accelerated Cost Recovery System) depreciation, which can provide significant tax benefits. Bonus MACRS allows you to deduct a larger portion of the equipment's cost in the early years of ownership, reducing your taxable income.
2. **Ownership:** Buying the equipment gives your company full ownership and control over the assets. This can be advantageous if you anticipate a long-term need for the equipment and want to retain flexibility in its use.
3. **EPS and ROA:** While borrowing increases your debt, the increased asset base can potentially improve your Return on Assets (ROA) if the equipment generates additional revenue or efficiencies. However, it may not directly impact EPS unless the increased profitability translates into higher earnings available to shareholders.

Leasing:

1. **Cash Flow:** Leasing typically requires lower upfront cash outlay compared to borrowing to buy. This can be beneficial if you prefer to preserve cash or maintain liquidity for other purposes.

2. **Tax Considerations:** Depending on the type of lease (capital or operating), you may still be able to claim tax deductions for lease payments. However, you won't benefit from Bonus MACRS depreciation since you don't own the assets.
3. **Flexibility:** Leasing provides flexibility to upgrade equipment at the end of the lease term without the burden of ownership. It also protects against technological obsolescence.

Recommendation:

Given your goal to utilize tax benefits and improve EPS and ROA, buying the equipment through borrowing seems more aligned with your objectives. However, consider consulting with your tax advisor and financial team to analyze the specific financial implications and risks associated with borrowing, including interest costs, debt covenants, and the impact on your balance sheet and cash flow.

If you proceed with borrowing, ensure that the investment in IT equipment will indeed contribute to increased revenue, cost savings, or efficiency gains to maximize the return on your investment and justify the additional debt.

Conclusion:

Whew! Thank goodness the AI/ChatGPT world has not caught up with me. It does not know lease products, or corporate finance, or accounting treatments of alternative financial products. Some of the advice on EPS and ROA improving if you borrow to buy is flat out wrong! I am wary as I heard the more you work with ChatGPT and AI, the more it learns and understands, so my strategy is to stop playing with it but keep on meeting real people (customers), probing, listening and creating the best lease structure, presented in a hard hitting way, that meets their needs.

About the Author:

Bill Bosco is the President of Leasing 101, a lease consulting company, <http://leasing-101.net>. Bill has nearly 50 years' experience in the leasing industry. His areas of expertise are accounting, tax, and financial analysis, structuring,

pricing and training. He was on the EFLA accounting committee from 1988 to 2017 and was chairman for 10 years. He is a frequent author and speaker on leasing topics. He was honored at the Monitor's 50th Anniversary celebration as the MVP Behind the scenes for his industry advocacy and writings. He has received a distinguished service award from the ELFA and was inducted into the ELFA Hall of Fame. He can be reached at wbleasing101@aol.com.