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141,142 88-94-95 2164 88

Parent			
		134	
		74.88	31.88
Total		74.88	81.88
Gross Tax	24.04	37.28	
ITC L.I.C.	28.93	31.67	
	5.88	5.58	6.88
	5.88	5.58	6.88
Net Tax	25.88	28.54	31.38

# MODELING a Leveraged Leasing Company

by Thomas E. Schrickel

## Overview

With the advent of joint venture leasing and the frequent startup, acquisition, or divestiture of subsidiary leasing companies, the need for refined analysis of financial statements is more critical than ever before. Corporations which have taxable income and available cash often consider investment in leveraged leasing, because the tax deferral is large in proportion to the lessor's investment and the returns can be attractive. Leveraged leasing is a complex financing method in itself, however, and is further complicated because it has been subjected to much legislation and accounting regulation. Additionally, the profiles of both typical transaction and typical lessee have been subject to considerable change, due to legislation and economic fluctuations in lessee industries.

A leveraged leasing company operating in this dynamic environment faces many uncertainties which must be managed, such as: How much, and what types of, new leasing business can be funded in the next year, or in the next several years? What would the bottom line impact be from funding various amounts and types of new business? What capital structure will enable the company to attain its threshold level of return most efficiently?

There are so many elements to this complex problem that a computer model is undoubtedly the most pragmatic solution. The entire process can be thought of as a simulation to be performed many times, with a resulting

range of preferred marketing plans and volume levels from which a strategy can be chosen. This article explains how this modeling can be done, starting with tax modeling and its determination of new business volume, and concluding with financial statement modeling and capital structuring.

## Tax Modeling

As a start to the modeling effort, assume that Parent Corporation has considerable taxable income, is paying income taxes, and expects this pattern to continue on a projected basis for a five-year period. Additionally, assume that Parent's board has decided to invest in leveraged leasing because of the attractive returns, with the resulting deferral of a substantial part of its tax liability. The Parent's capacity for lease transactions can be developed through a four-step process: (1) Derive a forecast of Parent's taxable income, liability, and tax credits by year for five years; (2) determine the percentage or amount of tax liability to be sheltered; (3) decide what type(s) of lease transaction is representative of the market for new business; and, (4) estimate the amount of new leasing business which can be transacted, given the tax laws and these constraints.

Although this process is straightforward, there are pitfalls in each step. It is difficult to produce a five-year forecast of taxable income for a large corporation. The uncertainty in this type

of forecast is obvious when the ingredients are considered: A forecast of operating income, expenses and capital expenditures by each operating subsidiary of Parent, coupled with the tax department's estimate of foreign tax withholding and state tax position and financial management's interest expense/income forecast.

Step 2 could turn out to be a moving target for several reasons. First, Parent's tax liability exclusive of benefits from leasing will change with economic circumstances such as interest rates and the operating performance of each subsidiary. Second, management's position on paying taxes can have political foundations, and the company's tax policies are therefore subject to change. Finally, tax legislation has been and likely will continue to be very dynamic, due to Congress and the nature of the legislative process.

The difficulty in predicting the types of lease transaction for future business can be exemplified by two words: ERTA and TEFRA. Legislative changes, especially in the tax area, can cause drastic changes in the structure and nature of transactions, as shown by tax benefit transfers under both the 1981 Economic Recovery Tax Act (ERTA), the 1982 Tax Equity and Fiscal Responsibility Act (TEFRA) and TEFRA finance leases.<sup>1</sup> There are also vagaries of lessee industries to consider. Transactions which are common today may not be available or desirable tomorrow. As an example, four years ago not many leasing companies or railroads anticipated the severity of the recent recession, with its adverse effects on railroads or railcar builders.

*The author is a vice president of Continental Illinois Leasing Corp. and marketing manager of their tax-oriented division.*



Aware of the level of difficulty of the modeling process, an example is in order to show how modeling works. To avoid an excess of technical detail, the example will be purposely simple. For the first step—the forecast of Parent's federal taxable income and credits—assume the absence of foreign income, withholding, and taxes, and that the taxable income forecast is net of any effect from state tax deductions and credits.

For each year of the forecast, Parent's taxable income is multiplied by 46% to determine the gross tax payable.<sup>2</sup> The gross tax payable is reduced by the amount of investment tax credit (ITC), subject to the stated limitation of 85%,<sup>3</sup> to calculate the net tax payable. Table 1 shows Parent's five-year forecast of taxable income and credits exclusive of any leasing, along with the resulting federal tax liability.

Table 1

### PARENT CORPORATION FORECASTED TAX POSITION EXCLUSIVE OF LEVERAGED LEASING

amounts in millions of dollars

Year	19 x 0	19 x 1	19 x 2	19 x 3	19 x 4
Parent Taxable Income	55.00	61.00	67.00	74.00	81.00
Total Taxable Income	55.00	61.00	67.00	74.00	81.00
Gross Tax Payable at 46%	25.30	28.06	30.82	34.04	37.26
ITC Limitation at 85%	21.51	23.85	26.20	28.93	31.67
Parent ITC	4.00	4.50	5.00	5.50	6.00
Total ITC	4.00	4.50	5.00	5.50	6.00
Net Tax Payable	21.30	23.56	25.82	28.54	31.26

Note. Highlighted area shows Parent's forecasted tax payments, exclusive of any benefits from leveraged leasing.

# ALAS

## Automated Lease Accounting System

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The taxable income stream starts at an assumed level of \$55 million and increases at about 10% per year; the stream of tax liability likewise increases by about 10% annually, going from \$21.30 million to \$31.26 million over the five-year period—quite a predictable pattern.

In terms of Parent's tax policy, assume that management has placed no internal constraints on Parent's tax payments, such as a floor or a minimum percentage of company pretax income. Also assume for simplicity that management has no interest in carry-back or carryover of either operating losses or ITC. This means that when computing the volume of new leasing business for a given year, the tax benefits from that new business should be sufficient just to offset as much of that year's tax liability as is allowable, without causing excess benefits which would be carried back to prior years or carried forward to future years.

To keep the third step simple, a 20-year leveraged lease will be representative of the desired type of new business. As is typical in a 20-year transaction, deductions from five-year accelerated cost recovery system (ACRS) depreciation and interest on the nonrecourse debt exceed rental income during the first five years of the transaction, resulting in significant tax losses during that period. In this example, the lessor will receive 10% ITC and will assume a 20% residual, while funding the equipment with 60% nonrecourse debt and 40% equity. Table 2 shows the details of the assumed structure, as well as the calculation of taxable income or loss each year (rent less interest expense less depreciation) for such a transaction.

The final step of computing the amount of new leasing business works as follows: Starting with the tax payable before new leasing business, add new leasing business until that year's tax bill is reduced to its allowable minimum from the tax losses and credits due to such new business. The formula for this calculation is quite simple, and is based on the facts that the tax loss from each incremental dollar of new business reduces Parent's net tax

Table 2

### STRUCTURE AND ITEMS OF TAXABLE INCOME/LOSS 20-YEAR MODEL LEVERAGED LEASE

amounts per dollar of equipment cost

<u>Year</u>	<u>Rent</u>	<u>Principal Repayment</u>	<u>Interest Payment</u>	<u>Depreciation</u>	<u>Net Taxable Income (Loss)</u>
1	.0452	.0062	.0390	.1425	(.1363)
2	.0904	.0136	.0768	.2090	(.1954)
3	.0904	.0155	.0749	.1995	(.1840)
4	.0904	.0175	.0729	.1995	(.1820)
5	.0904	.0199	.0705	.1995	(.1796)
6	.0904	.0226	.0678	0	.0226
7-21	1.3108	.5047	.5732	0	.7376
TOTALS	<u>1.8080</u>	<u>.6000</u>	<u>.9751</u>	<u>.9500</u>	<u>(.1171)</u>

#### Assumptions:

Nonrecourse Debt/Equity:	60%/40% of equipment cost, respectively
Investment Credit:	10% of equipment cost
Depreciable Basis:	100% of equipment cost (reduced by one-half the ITC), 5-year ACRS depreciation
Fee:	None
Lease Term:	20 years, commencing at mid-year
Rental Payments:	40 consecutive semiannual payments in arrears, each in the amount of 4.52% of equipment cost
Debt Structure:	38 semiannual payments in arrears, 13% interest rate, repayment structured to minimize second investment amount and period
Residual Assumption:	20% of equipment cost at the end of the lease term
Tax Method:	100% current year, evenly paid on the four current-year tax dates on an accrual basis. In the first year of the transaction only the two tax dates after the lease funding date are used.
Lessor Rate of Return:	Approximately 9% after tax



Table 3

**PARENT CORPORATION FORECASTED TAX POSITION  
ONE YEAR OF LEVERAGED LEASING/MAXIMUM TAX REDUCTION**  
amounts in millions of dollars

liability (before applying any ITC), and only 85% of such net tax liability can be offset by ITC.

The model calculates that \$114 million of new leasing business will accomplish Parent's goal of one year's maximum allowable tax reduction, as shown in Table 3. Starting with Parent's taxable income of \$55 million in year 19x0, the tax loss from \$114 million of new leasing business reduces taxable income by \$15.54 million (from Table 2, year one tax loss of .1363 per dollar, multiplied by \$114 million) to \$39.46 million. Tax at 46% on \$39.46 million is \$18.15 million, limiting ITC to \$15.43 million (85% of the tax). Along with Parent's \$4 million of ITC, credits from leasing in the amount of \$11.4 million effectively exhaust the ITC limitation. The net tax payable of \$2.75 million in year 19x0 in Table 3 is a dramatic reduction of the comparable figure of \$21.30 million from Table 1.

Note that the stream of taxable loss/income from the new leasing business in year 19x0 also causes reductions or increases in Parent's forecasted tax bills for succeeding years, all of which must be taken into account when computing a multi-year forecast of new leasing volume. In such a multi-year forecast, the same calculations mentioned above will be applied to successive years of the forecast, and will produce leasing volumes which achieve

New Leasing Equipment Cost	114.00				
	Year	19 x 0	19 x 1	19 x 2	19 x 3
Parent Taxable Income	55.00	61.00	67.00	74.00	81.00
Leasing Taxable Income	(15.54)	(22.28)	(20.98)	(20.75)	(20.47)
Total Taxable Income	<u>39.46</u>	<u>38.72</u>	<u>46.02</u>	<u>53.25</u>	<u>60.53</u>
Gross Tax Payable at 46%	18.15	17.81	21.17	24.50	27.84
ITC Limitation at 85%	15.43	15.14	17.99	20.82	23.66
Parent ITC	4.00	4.50	5.00	5.50	6.00
Leasing ITC	11.40				
Total ITC	<u>15.40</u>	<u>4.50</u>	<u>5.00</u>	<u>5.50</u>	<u>6.00</u>
Net Tax Payable	<u>2.75</u>	<u>13.31</u>	<u>16.17</u>	<u>19.00</u>	<u>21.84</u>

Note: Highlighted area shows the reduced amounts of Parent's forecasted tax payments, due to one year of new leveraged leasing business.

Table 4

**PARENT CORPORATION FORECASTED TAX POSITION  
THREE YEARS OF LEVERAGED LEASING/MAXIMUM TAX REDUCTION**

amounts in millions of dollars

New Leasing Equipment Cost	114.00			69.00		50.00	
	19 x 0	19 x 1	19 x 2	19 x 3	19 x 4		
Parent Taxable Income	55.00	61.00	67.00	74.00	81.00		
Leasing Taxable Income	(15.54)	(31.68)	(41.28)	(43.22)	(42.23)		
Total Taxable Income	<u>39.46</u>	<u>29.32</u>	<u>25.72</u>	<u>30.78</u>	<u>38.77</u>		
Gross Tax Payable at 46%	18.15	13.49	11.83	14.16	17.83		
ITC Limitation at 85%	15.43	11.46	10.05	12.04	15.16		
Parent ITC	4.00	4.50	5.00	5.50	6.00		
Leasing ITC	<u>11.40</u>	<u>6.90</u>	<u>5.00</u>				
Total ITC	<u>15.40</u>	<u>11.40</u>	<u>10.00</u>	<u>5.50</u>	<u>6.00</u>		
Net Tax Payable	<u>2.75</u>	<u>2.09</u>	<u>1.83</u>	<u>8.66</u>	<u>11.83</u>		

Note: Highlighted area shows the reduced amounts of Parent's forecasted tax payments, due to three years of new leveraged leasing business.

maximum tax reduction in each of those years. Table 4 shows an example of three years of new leasing business, and the resulting reductions of Parent's tax bill in each of the forecasted five years. The second and third year tax bills of \$2.09 million and \$1.83 million, respectively, show significant savings from the Table 3 values of \$13.31 million and \$16.17 million, and even the fourth and fifth year projected taxes are down over \$10 million each.

The expected result of the tax planning exercise has been realized, which is the large tax savings attributable to leveraged leasing. The derivation of Parent's capacity for leasing business, based on its assumed tax position, has been shown step by step. Having completed the tax modeling, one can incorporate the results into financial statement modeling.

### Financial Statement Modeling

After determining marketing plans for new leasing business, management will want to determine the effect of this new business on Parent's reported income. A financial statement model is necessary, both to handle the range of marketing plans and to examine capital structuring alternatives. The tax law and lessee market uncertainties do not directly affect this type of modeling, since the example uses an assumed volume and type of leasing business. The uncertainties here are more company-specific, such as associating a level of operating expense to a given volume of business or deciding on a leverage ratio or capital contribution.

This model requires three steps: (1) Gathering financial statement data associated with the new leasing business plan in question, and integrating it with data from any existing leasing business; (2) estimating levels of income and expense for items which are not directly transaction-related, such as operating expense and interest rates; and, (3) deriving the capital structure which produces the best financial results for Parent and the leasing company, while meeting legal and corporate constraints.

## FINANCIAL STATEMENT MODEL ASSUMPTIONS AND DEFINITIONS



<b>Pretax Lease Income and Allocated ITC:</b>	Earnings from lease transactions by applying FASB 13 method of accounting for income
<b>Operating Expense:</b>	Assumed annual cost for general operation of the company
<b>Interest Expense:</b>	Interest on notes payable at 13%
<b>Tax Rate:</b>	Assumed to be 46%, and no benefit from any state income tax is assumed
<b>Current Provision:</b>	Actual tax benefits to be realized by Parent. Because the ITC is included in the initial year's current provision, it must also be included as an offset in the deferred provision. However, since ITC is a permanent reduction of taxes, and not a deferral, it is not included in deferred taxes payable.
<b>Dividends and Return of Capital:</b>	Dividends are paid against retained earnings to the extent available while maintaining the targeted debt to equity ratio. Contributed capital is returned only after all debt has been repaid.
<b>Net Rent Receivable:</b>	Rent to be paid to the lessor net of debt service on the nonrecourse debt
<b>Residual Value:</b>	20% of equipment cost to be realized at the end of the lease term
<b>Unearned ITC and Unearned Lease Income:</b>	The remaining income is to be earned in future years under FASB 13 method of income reporting
<b>Notes Payable:</b>	The borrowing necessary to fund the equity portion of new leasing business, not to exceed the targeted debt-to-equity ratio at any year-end
<b>Deferred Tax Payable:</b>	Income tax deferred that is payable in future years
<b>Common Stock and Contributed Capital:</b>	Initial capitalization is assumed to be \$100,000 in common stock. Contributed capital is increased as needed to fund lease transactions and maintain the targeted debt-to-equity ratio.

For the first step, the income statement effects of new leasing business are dictated by the lease accounting rules of FASB 13;<sup>4</sup> investment credit and pretax lease income are earned in proportion to outstanding investment by the multiple investment method.<sup>5</sup> Taxes must be provided on allocated pretax lease income on the income statement, whereas actual tax benefits or payments are based on rental income less interest expense less depreciation. In a leveraged lease, these timing differences result in large deferred tax provisions during the five-year period of tax losses due to depreciation, and reductions in deferred taxes due to taxable income thereafter. On the income statement, the deferred tax provisions are offset by the current tax provisions, which reflect the actual tax benefits to be realized.

On the asset side of the balance sheet, net lease investment each year is the sum of rentals and residual receivable, less nonrecourse principal and interest payable, less unearned income. The liability component of deferred taxes payable is the cumulative total of the deferred tax provisions, net of permanent tax reductions due to ITC. This financial statement skeleton is displayed in Table 5, using the first example of \$114 million of new leasing business from Table 3. Table 5 shows the balance sheet and income statement components of the assumed leveraged lease transaction in isolation. The task to be performed is the financing of this transaction within the corporate structure.

By examining the balance sheet in Table 5, the net asset which must be financed each year can be defined as the difference between net lease financing and deferred taxes payable. A combination of equity contribution and

Table 5

**LEVERAGED LEASING COMPANY  
CAPITAL STRUCTURING FRAMEWORK**

amounts in thousands of dollars

**Statements of Income**

**Leasing New Business  
(\$ million asset cost)**

	114	0	0	0	0
	<u>19 x 0</u>	<u>19 x 1</u>	<u>19 x 2</u>	<u>19 x 3</u>	<u>19 x 4</u>
Pretax Lease Income	626	807	558	298	49
Allocated ITC	1,902	2,452	1,694	906	148
Total Revenue	2,528	3,259	2,252	1,204	197
Operating Expense					
Interest Expense					
Total Expense					
Income/Loss before Tax Provision	2,528	3,259	2,252	1,204	197
Current Provision					
Deferred Provision	18,836	10,616	9,907	9,679	9,441
Total Tax Provision					
Net Income					
<b>Balance Sheets</b>	<u>19 x 0</u>	<u>19 x 1</u>	<u>19 x 2</u>	<u>19 x 3</u>	<u>19 x 4</u>
<b>Assets</b>					
Rent Receivable	200,959	190,654	180,348	170,042	159,737
Less: Borrowings	( 67,693)	( 66,139)	( 64,376)	( 62,376)	( 60,108)
Interest	(106,713)	( 97,962)	( 89,419)	( 81,113)	( 73,076)
Net Rent Receivable	26,553	26,553	26,553	26,553	26,553
Residual Value	22,800	22,800	22,800	22,800	22,800
Less: Unearned ITC	( 9,498)	( 7,046)	( 5,352)	( 4,447)	( 4,298)
Unearned Lease Income	( 3,127)	( 2,320)	( 1,762)	( 1,464)	( 1,415)
Net Lease Financing	36,728	39,987	42,239	43,443	43,640
Total Assets	36,728	39,987	42,239	43,443	43,640
<b>Liabilities</b>					
Notes Payable					
Deferred Tax Payable	7,436	18,052	27,959	37,638	47,079
Total Liabilities					
<b>Shareholders Equity</b>					
Common Stock					
Contributed Capital					
Retained Earnings					
Total Equity					
Total Liability & Equity					

Note: Amounts shown are financial statement components of the assumed leveraged lease transaction in isolation, before capital structuring is performed. Highlighted areas show the amounts needed to compute the net asset to be financed (total assets less deferred tax payable).

notes will usually be the method of financing this asset. Parent will realize a higher percentage return on its equity as it uses a greater percentage of notes for this financing, as long as the after-tax cost of the notes is less than the after-tax earnings of the total capitalization. Along these lines, the goal of this exercise is to show how a higher return on equity (ROE) can be achieved with greater leverage.

From this framework follows the capital structuring step, after making interest rate and operating expense assumptions. A constant interest rate of 13% has been chosen, and \$500,000 per year is used for operating expenses. Tables 6 and 7 show the effects of different leveraging in the three-year leasing volume projection from Table 4. These two examples differ only in the year-end targeted debt to equity ratios.

The sole effect on the income statements is in interest expense, where the higher leverage (Table 7, at 4:1) produces greater expense than the lower leverage (Table 6, at 3:1). Note the resulting net income benefit in year 19x0 for the lower leverage of \$51 thousand (\$1,199 versus \$1,148 of net income for the higher leverage). On the balance sheet, a lower note payable balance of the lower leverage is offset by a greater requirement of contributed capital, creating a greater capital base for the ROE calculation. The advantage of the higher leverage, in the form of less required total equity in year 19x0, is \$1,464 thousand (\$5,859 versus \$7,323 of total equity for the lower leverage). As the result of higher leverage, the company's average ROE in year 19x0 of 39.2% is higher by 6.5% than the 32.7% ROE of the lower leverage, at the expense of slightly lower annual profit.



Table 6

**LEVERAGED LEASING COMPANY  
NOTES TO EQUITY RATIO OF 3:1**

amounts in thousands of dollars

**Statements of Income and Retained Earnings****Leasing New Business  
(\$ million asset cost)**

	114	69	50	0	0
	19 x 0	19 x 1	19 x 2	19 x 3	19 x 4
Pretax Lease Income	626	1,186	1,321	990	474
Allocated ITC	1,902	3,603	4,012	3,006	1,439
Total Revenue	2,528	4,789	5,333	3,996	1,913
Operating Expense	500	500	500	500	500
Interest Expense	1,428	3,362	3,903	3,108	1,138
Total Expense	1,928	3,862	4,403	3,608	1,638
Income/Loss before Tax Provision	600	928	930	388	275
Current Provision	( 19,434)	( 23,247)	( 26,012)	( 21,536)	( 20,180)
Deferred Provision	18,836	22,017	24,594	20,332	19,645
Total Tax Provision	( 599)	( 1,231)	( 1,418)	( 1,204)	( 536)
Net Income	1,199	2,158	2,348	1,592	811
Beginning of Year Retained Earnings	0	1,199	-3,357	3,542	0
Net Income	1,199	2,158	2,348	1,592	811
Less: Dividend Paid	0	0	2,163	5,135	811
End of Year Retained Earnings	1,199	3,357	3,542	0	0
<b>Balance Sheets</b>	<b>19 x 0</b>	<b>19 x 1</b>	<b>19 x 2</b>	<b>19 x 3</b>	<b>19 x 4</b>
<b>Assets</b>					
Rent Receivable	200,959	312,287	383,884	362,820	341,757
Less: Borrowings	( 67,693)	(107,111)	(134,097)	(130,349)	(126,097)
Interest	(106,713)	(162,551)	(195,516)	(178,201)	(161,390)
Net Rent Receivable	26,553	42,625	54,271	54,271	54,271
Residual Value	22,800	36,600	46,600	46,600	46,600
Less: Unearned ITC	( 9,498)	( 12,795)	( 13,783)	( 10,776)	( 9,337)
Unearned Lease Income	( 3,127)	( 4,212)	( 4,537)	( 3,548)	( 3,074)
Net Lease Financing	36,728	62,217	82,551	86,547	88,460
Total Assets	36,728	62,217	82,551	86,547	88,460
<b>Liabilities</b>					
Notes Payable	21,969	29,749	30,303	17,509	0
Deferred Tax Payable	7,436	22,552	42,478	62,478	82,123
Total Liabilities	29,405	52,301	72,450	79,988	82,123
<b>Shareholders Equity</b>					
Common Stock	100	100	100	100	100
Contributed Capital	6,024	6,459	6,459	6,459	6,237
Retained Earnings	1,199	3,357	3,542	0	0
Total Equity	7,323	9,916	10,101	6,559	6,337
Total Liability & Equity	36,728	62,217	82,551	86,547	88,460
Average Equity	3,662	8,620	10,009	8,330	6,448
Average ROE	32.7%	25.0%	23.5%	19.1%	12.6%

Note. Highlighted areas show the primary results of differences in capital structuring (in this case, a 3:1 notes to equity ratio versus Table 7 at 4:1).

J K L

Note that these relationships among leverage, interest expense, and ROE hold throughout the five-year period of the example, albeit to varying degrees. Although the "greater leverage/higher ROE" example shown here is not particularly imaginative, the conceptual real-world issues of leverage and capital structure, as well as other structuring alternatives, are very accessible with financial statement modeling. To complete the set of financial information, additional statements such as changes in financial position and cash flow are simple extensions of the model presented.

**Conclusion**

Management of a leveraged leasing company faces uncertainties in planning volume and type of new business, and needs to know bottom-line impact of preferred strategies. Computerized modeling can provide insight without risk into a range of proposed marketing solutions.

Despite the simplicity of the examples used herein, the effectiveness of the modeling approach in real world situations cannot be denied. By employing modeling, the questions of how much business and how much net income can be answered for a wide range of volume levels and transaction types. Management can visualize the effects of an aggressive marketing campaign or a different capitalization without actually making a move and taking a risk. This capability can be valuable to a company considering entry into leasing, and indispensable to a company already in the business.

Table 7

**LEVERAGED LEASING COMPANY**  
**NOTES TO EQUITY RATIO OF 4:1**  
amounts in thousands of dollars

<b>Statements of Income and Retained Earnings</b>					
<b>Leasing New Business</b>					
<b>(\$ million asset cost)</b>	<b>114</b>	<b>69</b>	<b>50</b>	<b>0</b>	<b>0</b>
	<b>19 x 0</b>	<b>19 x 1</b>	<b>19 x 2</b>	<b>19 x 3</b>	<b>19 x 4</b>
Pretax Lease Income	626	1,186	1,321	990	474
Allocated ITC	1,902	3,603	4,012	3,006	1,439
Total Revenue	2,528	4,789	5,333	3,996	1,913
Operating Expense	500	500	500	500	500
Interest Expense	1,523	3,586	4,164	3,353	1,355
Total Expense	2,023	4,086	4,664	3,853	1,855
Income/Loss before Tax Provision	505	703	670	143	58
Current Provision	( 19,478)	( 23,351)	( 26,132)	( 21,649)	( 20,280)
Deferred Provision	18,836	22,017	24,594	20,332	19,645
Total Tax Provision	( 643)	( 1,334)	( 1,538)	( 1,317)	( 635)
Net Income	1,148	2,037	2,207	1,460	694
Beginning of Year Retained Earnings	0	1,148	3,185	3,333	66
Net Income	1,148	2,037	2,207	1,460	694
Less: Dividend Paid	0	0	2,059	4,727	759
End of Year Retained Earnings	1,148	3,185	3,333	66	0
<b>Balance Sheets</b>					
	<b>19 x 0</b>	<b>19 x 1</b>	<b>19 x 2</b>	<b>19 x 3</b>	<b>19 x 4</b>
<b>Assets</b>					
Rent Receivable	200,959	312,287	383,884	362,820	341,757
Less: Borrowings	( 67,693)	(107,111)	(134,097)	(130,349)	(126,097)
Interest	(106,713)	(162,551)	(195,516)	(178,201)	(161,390)
Net Rent Receivable	26,553	42,625	54,271	54,271	54,271
Residual Value	22,800	36,600	46,600	46,600	46,600
Less: Unearned ITC	( 9,498)	( 12,795)	( 13,783)	( 10,776)	( 9,337)
Unearned Lease Income	( 3,127)	( 4,212)	( 4,537)	( 3,548)	( 3,074)
Net Lease Financing	36,728	62,217	82,551	86,547	88,460
Total Assets	36,728	62,217	82,551	86,547	88,460
<b>Liabilities</b>					
Notes Payable	23,434	31,732	32,323	19,255	1,589
Deferred Tax Payable	7,436	22,552	42,147	62,478	82,123
Total Liabilities	30,870	54,284	74,470	81,733	83,712
<b>Shareholders Equity</b>					
Common Stock	100	100	100	100	100
Contributed Capital	4,611	4,648	4,648	4,648	4,648
Retained Earnings	1,148	3,185	3,333	66	0
Total Equity	5,859	7,933	8,081	4,814	4,748
Total Liability & Equity	36,728	62,217	82,551	86,547	88,460
Average Equity	2,929	6,896	8,007	6,447	4,781
Average ROE	39.2%	29.5%	27.6%	22.7%	14.5%

Note: Highlighted areas show the primary results of differences in capital structuring (in this case, a 4:1 notes to equity ratio versus Table 6 at 3:1).

- The specific effects on lease transactions of both ERTA and TEFRA have been well documented in various publications by accounting firms, banks, and other professional organizations. For example, see "The Impact of TEFRA on Leasing Transactions" by James M. Johnson, Ph.D. in Volume 1, Number 1, of this publication for a discussion of TEFRA's adverse impact on lessee rents.
- The marginal tax rate of 46%, which applies to corporate taxable income in excess of \$100,000, is assumed to apply to the entire amount of taxable income throughout all examples. Differences attributable to the actual graduated scale of tax rates on the first \$100,000 of taxable income are insignificant.
- For taxable years which begin after December 31, 1982, the taxpayer may apply ITC against the first \$25,000 of tax liability plus 85% of the tax liability exceeding \$25,000 (Internal Revenue Code, Section 46). For simplicity, the examples have assumed that the 85% limitation applies to the entire tax liability. Excess credits may be carried back to previous taxable years or carried over to future years.
- Financial Accounting Standards Board Statement No. 13, "Accounting for Leases," was issued in 1976 in an attempt to standardize the accounting treatment of leases by lessees and lessors. Statement No. 13 has been the subject of numerous amendments, interpretations, and technical bulletins by the FASB since its original issue, but leveraged lease accounting has not changed significantly.
- Statement No. 13 specifies that in a leveraged lease, income recognition is determined by allocating the anticipated cash flows between income and the decrease/increase of the lessor's investment. Because of this income recognition method, in many leveraged leases a second investment will occur after the initial investment has been recovered. The complication of this method is that the portion of cash flow allocated to income must be allocated in constant proportion to outstanding investment, which means that a computer program must be used to determine the allocation rate.