

LEASE FINANCING

01. A company is thinking of installing a computer. It is to decide whether the computer is to be purchased outright 14% borrowing or to be acquired on lease rent basis. The firm is in the 50% tax bracket. Maintenance costs are included in lease charges. The other data are:

Purchase of computer:

Purchase price	Tk. 20,00,000
Payment of loan (year-end equal)	Tk. 5,14,271
Annual maintenance	Tk. 50,000 per year
Life	6 years
Depreciation	Straight-line method
Salvage value	Tk. 2,00,000

Leasing of computer:

Lease charges (to be paid in advance)	Tk. 4,50,000
Maintenance costs	To be borne by lessor

You are required to advise the company as to whether it should purchase the computer or acquire it on lease.

02. Roberts Company, a small machine shop, is contemplating acquiring a new machine that costs \$24,000. Arrangements can be made to lease or purchase the machine. The firm is in the 40% tax bracket.

Lease The firm would obtain a 5-year lease requiring annual end-of-year lease payments of \$6,000. All maintenance costs would be paid by the lessor, and insurance and other costs would be borne by the lessee. The lessee would exercise its option to purchase the machine for \$1,200 at termination of the lease.

Purchase The firm would finance the purchase of the machine with a 9%, 5-year loan requiring end-of-year installment payments of \$6,170.3. The machine would be depreciated under MACRS using a 5-year recovery period. The firm would pay \$1,500 per year for a service contract that covers all maintenance costs; insurance and other costs would be borne by the firm. The firm plans to keep the machine and use it beyond its 5-year recovery period.

Which alternative lease or purchase would you recommend? Why?

03. Ayan Inc. needs to acquire an asset costing Tk.2,60,000. The asset has a useful life of 6 years. At the end of assets useful life salvage value will be Tk.35,000. Depreciation will be charged on straight line basis. The company is trying to decide whether it is better to finance the asset with lease financing or purchasing it by borrowing money from Dhaka Bank Ltd. The company has to pay 15% interest on borrowing and loan installment of Tk. 59,740 will be paid in advance. If the asset is acquired through lease, the company will have to pay lease rental of Tk. 50,000 per year and payment will be made in the beginning of each year. The company is in 40% tax rate.

Suggest which method of financing should be taken and why?

