Valuation Of The Embedded Option In A Non-Cancelable Lease: Theory And Application

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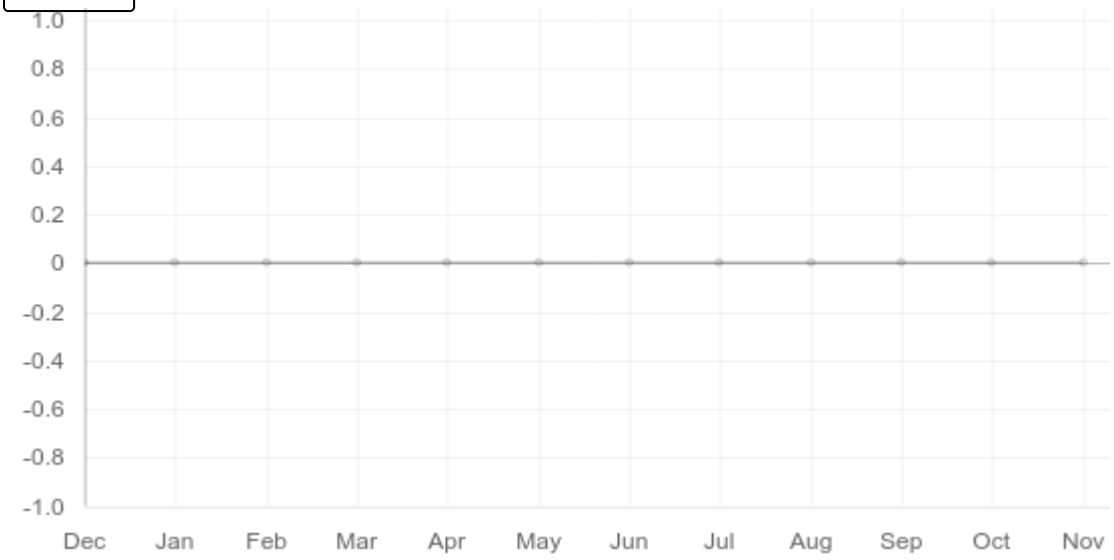
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Keywords

Abstract

This paper applies a “real” option literature based model to valuing the option element of a non-cancelable lease without an early exercise provision. The model is applied to a common lease type – the closed-end automobile lease. The findings show that the value of the option inherent in an automobile lease is approximately two to six percent of the original asset cost. The analysis discusses ways in which the option value can be captured through the lease contract terms. Management decision makers can use these concepts in evaluating lease/purchase decisions.

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