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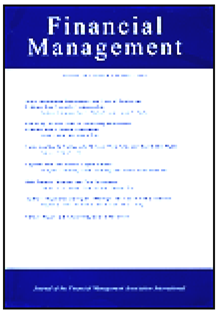

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Realized Returns and the Default and Prepayment Experience of Financial Leasing Contracts

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■ The decision to lease or buy equipment continues to be important for financial managers. Nevitt and Fabozzi [15] estimate that 80% of U.S. corporations lease assets each year and that, in aggregate, these firms lease over $100 billion in capital equipment. Because of systematic economic differences between lessees and lessors, financial managers will continue to view leasing as a viable alternative for acquiring the use of an asset.

For the most part, existing research on leasing focuses on the theoretical and analytical aspects of leasing contracts.[1] The few existing empirical studies concentrate on the ex-ante contractual yields of leasing contracts.[2] Contractual yield calculations assume that all lease payments are made as scheduled and that the estimated residual value of the leased asset is realized at the maturity date of the contract. In essence, these ex-ante yield computations assume leasing contracts are default-free.

However, as noted in Schallheim, Johnson, Lease, and McConnell [17] (SJLM), ex-ante yields reflect a

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[1]See, for example, Brealey and Young [7], Lewellen, Long, and McConnell [11], McConnell and Schallheim [12], Miller and Upton [13], Myers, Dill, and Bautista [14], Schall [16], and Smith and

Abstract

Few lease contracts are paid out strictly according to the contractual specifications. Contractual yields exceed realized returns for the full sample of leases, are less than realized returns on prepaid leases, and exceed realized returns on contracts that default. For contracts that default, the resale prices of the...

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