



Valuing lease contracts A real-options approach

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Abstract

Using a real-options approach to endogenously derive the entire term structure of lease rates, I develop a unified framework for pricing a wide variety of leasing contracts. The structure of the model is analogous to traditional models of the term structure of interest rates. I show how the model is flexible enough to determine equilibrium lease rates for leases of any term and practically any structure, including forward leases, leases with options to renew or cancel, lease insurance contracts, adjustable-rate leases, and leases with payments contingent on asset usage.

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...The fourth extension concerns the frictions that would arise in a non-Walrasian alternative to the standard bid rent analysis that the model employs. See Han and Strange (2015) for a survey of search models for housing, and see Grenadier (1995) for a rare instance of a non-Walrasian model of space for the commercial sector. In a search model, the tenant who occupies a given location is not necessarily the agent who would be the highest bidder from the universe of potential tenants....

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