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**PHASE TWO [NEW00142.GIF](INTRODUCTION.docx)**

**EXERCISE SIX-A** House Information

**This exercise should be answered using the Phase 2 Variables Worksheet**

**[](variables2.xlsx)**

**The Impact of Changing Local Legislation**

**on Store Performance**

Recently, legislation was passed and will take effect in early 2011 that will require commercial buildings to have sprinkler systems for fire control purposes. The building *The House* occupies is 45 years old and is not equipped with a sprinkler system. Anne and Fred recently received a letter from Bill Henderson (Anne's father) informing them that he can't afford the $62,000 to install the sprinkler at the current lease rate of $3,500 monthly. The Harriots’ lease expires at the end of 2010 and Bill Henderson has presented them two options.

Option one is to extend their lease until 2015 and have *The House* pay the leasehold improvement costs, and then write off these leasehold improvements (which would increase the fixtures asset category by $62,000) over the five years of the new lease. Under this option their rent would remain at $3,500 monthly. *The House* would use its line of credit at the bank to borrow $62,000 at 10% interest. The sixty monthly principal and interest payments on this loan would be $1,317.32 and the entire amount could be written off as a business expense.

Option two would be to enter into a new annual lease at $5,000 per month.

Which option should they take?

The Variables Worksheet you will need to run this simulation can be reached by clicking the red “2” above. You will need to enter the changes on the Input Form one at a time. The financial statements and ratios will automatically be updated and shown on the bottom of the input form. You must then copy the revised income statement and ratios to the scenario columns on the Answer Sheet. This process will have to be repeated if there is more than one scenario described in the exercise. Instructions for use of the Variables Worksheet can be reached by clicking on the “Help” button at the top right of the worksheet. Be sure to save your work and print a copy once you are satisfied with its correctness. After you complete your simulation there

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are questions you need to answer. These can be answered by typing your responses below the questions, saving your work, printing a copy, and handing it in to the instructor if required.

**EXERCISE SIX-A**

**QUESTIONS**

1. What is the financial impact of the different lease options?
2. If the leasehold option is pursued, what other considerations need to be made?
3. The major difference in the two scenarios is found in the asset turnover and the return on assets? Why is this true?
4. To whom is the return on assets most important? Why is it important to Anne and Fred as owners of *The House?*