

AN INVESTMENT LESSON FROM THE CAREER OF AN AMERICAN SPORTS HERO

In 1946, when Joe Louis won the rematch of his famous fight with Billy Conn, he endorsed the check for the \$1 million winner's prize to a charitable relief fund for survivors of war victims. This patriotic and compassionate gesture turned out to be costly in unanticipated ways.

The signature on the check turned the \$1 million into taxable income for Mr. Louis. This created a tax liability that he did not have the assets to satisfy. Under the highly progressive tax rates in effect following the Second World War, there was no way for Mr. Louis to accumulate enough aftertax income to satisfy the liability. When he died 35 years later, he still had a large outstanding tax debt.

Mr. Louis could have avoided this fate by arranging with the promoters of the second Louis-Conn fight to make his check out to the war relief fund rather than to him. Then he would never have received the prize money and it would not have created a personal tax liability.

This sad tale illustrates the importance of a cautionary reminder for investors: *asset ownership consists of a bundle of rights and obligations. Investors frequently expose themselves to unanticipated risk by focusing on economic benefits generated by the ownership rights to the exclusion of the obligations.*

A general investment principle follows: *if you don't expect any economic benefits from asset ownership, it is generally not a good idea to acquire the asset.* This is particularly true if there is an alternative way to accomplish your objective, as there was in the case of Joe Louis' charitable donation.

Surprisingly, investors in leveraged leases ignore this principle all the time. They acquire single-lessee property from which they expect to receive no income during the current term of the existing lease. They assign income from the lease to a fixed-income investor in return for a mortgage loan that reduces their net cash outlay when they acquire the asset. The only income they expect to receive from the property will be generated by future leases (possibly including extension terms of the existing lease) once the current term of the existing lease expires.

By purchasing the entire property, investors routinely make the same mistake made by Joe Louis: they acquire an asset from which they do not plan to receive any economic benefits. In this case, the asset from which they will not receive benefits consists of ownership rights and obligations associated with income from the current term of the existing lease. The investors incur the risk that accompanies this acquisition in order to acquire their actual investment objective: the ownership rights and obligations associated with income from future leases.

The investors could frequently accomplish their objective without violating the above-cited general investment principle. With the aid of proprietary financial technology developed by Electrum Partners, the investors could arrange with the seller to split the asset into two legally and

economically separate assets: ownership rights and obligations associated with income from the current term of the existing lease, and ownership rights and obligations associated with income from future leases.

The investors could further arrange for a fixed-income investor to purchase ownership of the first asset directly from the seller at the same time that the investors purchase the second asset. In this way, the investors would acquire ownership of the income from future leases while avoiding ownership of an asset from which they do not plan to receive any economic benefits.

Advantages to this course of action over a conventional mortgage loan are significant. For example, investors acquire an ownership interest that is free of debt. It follows that a lessee default cannot trigger a foreclosure on the investors' asset, because the ownership interest is unburdened by liens. In addition, the investors avoid liabilities during the current term of the existing lease to which conventional asset ownership would expose them.

Electrum Partners is ready to work with leveraged lease investors to implement this superior alternative to leveraged leases. Additional information on this financial technology may be found on the Electrum Partners synthetic debt resource web site at www.syntheticdebt.com, and in financial technology patents issued to Richard Graff on the U.S. Patent and Trademark Office web site at www.pto.gov.