



*Real value in a changing world*

# Perspective on FASB *lease* accounting changes

Occupiers, owners and investors weigh in at JLL seminar

San Francisco, CA  
June 2010

# Lease accounting overhaul to change financial reporting standards

June 2010

## Real estate bears the brunt of financial impact; will it be a game-changer for leasing decisions?

Jones Lang LaSalle recently held a seminar for large occupiers, owners, and investors of real estate to discuss the looming changes to lease accounting rules that will affect every business, whether public or private. The U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) are on course to jointly issue proposed new lease accounting rules in 2010 that will be finalized in 2011 and anticipated to take effect by 2013.

These standards will dramatically change how real estate and equipment leases are reported financially. Off-balance sheet reporting will be extinguished in favor of more transparent lease obligation treatment. All existing and future leases will be treated as owned assets. Consequently, new assets and liabilities will be added to balance sheets and lease rent costs will be front-loaded as interest expense and amortization that is recorded below the EBITDA line. Further details on the proposed FASB lease accounting rules are provided in Jones Lang LaSalle's recently published "Perspectives on Corporate Finance."

Jones Lang LaSalle's survey revealed divergent opinions from occupiers and landlords:

- While most occupiers expressed some knowledge of the proposed changes to their lease accounting, not a single occupier has fully considered the impact and more than half (56%) of the respondents were uncertain of the impact that these changes would have on their balance sheets. Landlords believed that most tenants (77%) were largely unaware of the topic, but they indicated tenants are starting to raise concerns now.
- A majority of the occupiers (88%) responded that they would likely seek different lease terms. If those different terms included shorter leases, landlords (64%) said that they are willing to consider it and anticipate occupiers seeking such shorter terms after the lease accounting changes take effect.
- Neither occupiers (72%) or landlords (64%) believed that a shift toward ownership versus leasing of commercial space would occur. However, if one-third favor ownership, it could make an impact on the market.
- Although occupiers are still mostly unaware what impact lease accounting changes will have on financial reporting, they expect (89%) administrative requirements will have significant workload impacts on internal finance teams.

### Financial impact is unclear, but changes to future lease terms are almost certain

- Occupier Perspective

### More owner-users could create opportunities, but will shorter term leases impact asset values?

- Landlord Perspective

Clearly, awareness and understanding of the new FASB/IASB lease accounting rules is growing, but there is a long way to go before the industry gains a robust understanding. The resulting impact on commercial real estate behavior and trends has yet to be fully determined. The vast majority of respondents to this survey represent the larger and typically more informed industry set and just over half of the respondents had specific knowledge of the new rules and its effect. The current consensus that leasing strategies would materially change should firm up as details of the rules and corresponding implications come into sharper focus.

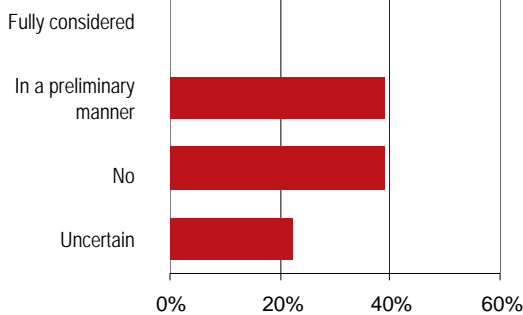
While changes in ownership rates among occupiers may not be dramatic, it could reverse the current trend of occupiers monetizing assets during the downturn to raise cash and take advantage of high investor demand for leased assets, according to the firm's first quarter 2010 North American Occupier Outlook. Either way, it will take an extended period of time to impact market trends with more than one billion square feet of commercial real estate in the Bay Area and only 14 percent currently owner occupied.

Jones Lang LaSalle's analysis of corporate real estate holdings and operating leases within the U.S. indicates that the retail, banking, and airline industries will be most impacted by the new lease accounting rules. The firm recommends taking steps now to prepare for the new rules by: understanding and quantifying the impact; preparing finance teams for new reporting; testing how negotiated lease terms drive balance sheet and earning results; and reassessing own vs. lease decision making.

# Occupier Perspective

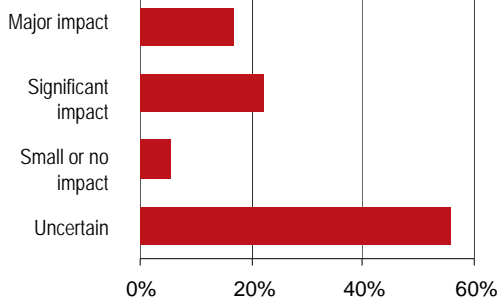
Financial impact is unclear, but changes to future lease terms are almost certain

1. Has your company evaluated the impact of the proposed changes on the balance sheet and profit and loss statement?



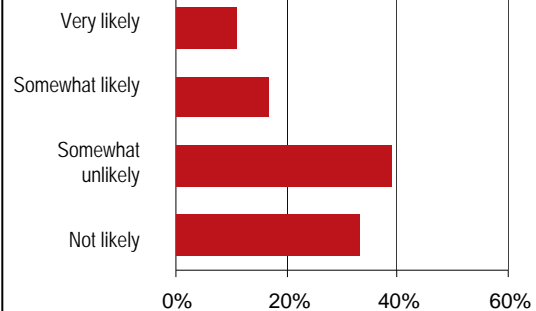
**Comment:** Not a single occupier has fully considered the impact.

2. What is the estimated impact that capitalizing leases would have on your company's balance sheet?



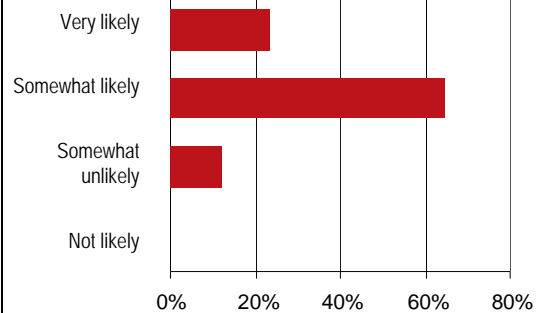
**Comment:** More than half of the respondents were uncertain of the impact. Occupiers need to become more educated soon.

3. If this standard takes effect, it will influence my company's lease-versus-own decisions (in favor of owning versus leasing)



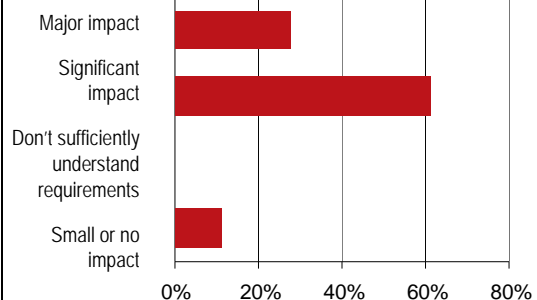
**Comment:** Lease vs. own decision making and preferences not expected to significantly change.

4. How likely are you to change the terms and desired structure of your leases as a result of these changes?



**Comment:** Expect term sheet changes to be put on the lease negotiation table.

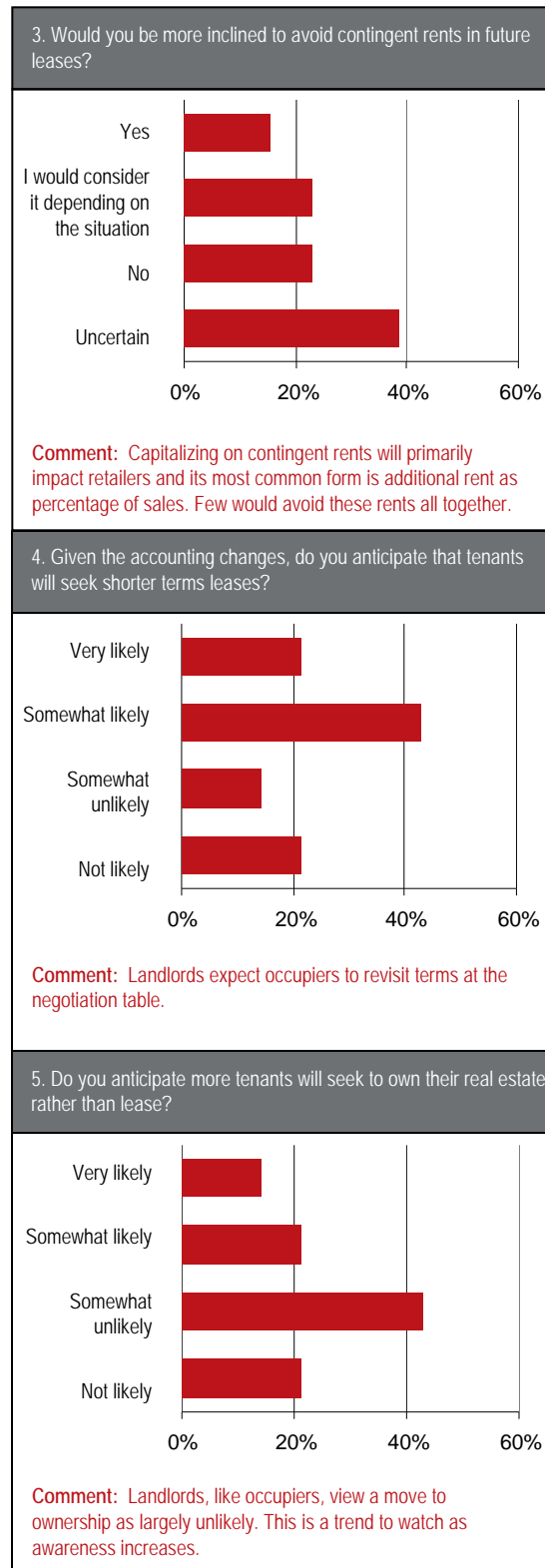
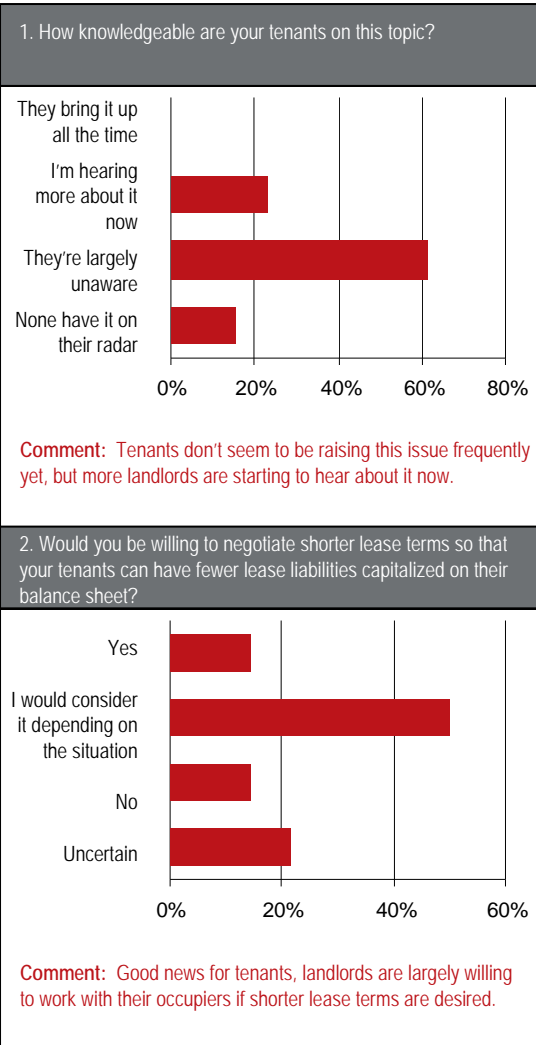
5. How would you characterize the administrative requirements the proposed lease accounting changes would pose to your company?



**Comment:** Capitalizing leases on balance sheets will be a big change and that will alter a company's reporting burden.

# Landlord Perspective

More owner-users could create opportunities, but will shorter term leases impact asset values?





*Real value in a changing world*

For further information, please contact:

Mindy Berman  
Managing Director  
Corporate Capital Markets  
+1 617 316 6539  
[mindy.berman@am.jll.com](mailto:mindy.berman@am.jll.com)

Elizabeth Hearle  
Market Director  
Northwest Region  
+1 415 395 4919  
[elizabeth.hearle@am.jll.com](mailto:elizabeth.hearle@am.jll.com)

One Front Street  
Suite 1200  
San Francisco, CA 94111  
+1 415 395 4900

[www.us.joneslanglasalle.com](http://www.us.joneslanglasalle.com)

©2010 Jones Lang LaSalle IP, Inc. All rights reserved. All information contained herein is from sources deemed reliable; however, no representation or warranty is made to the accuracy thereof.