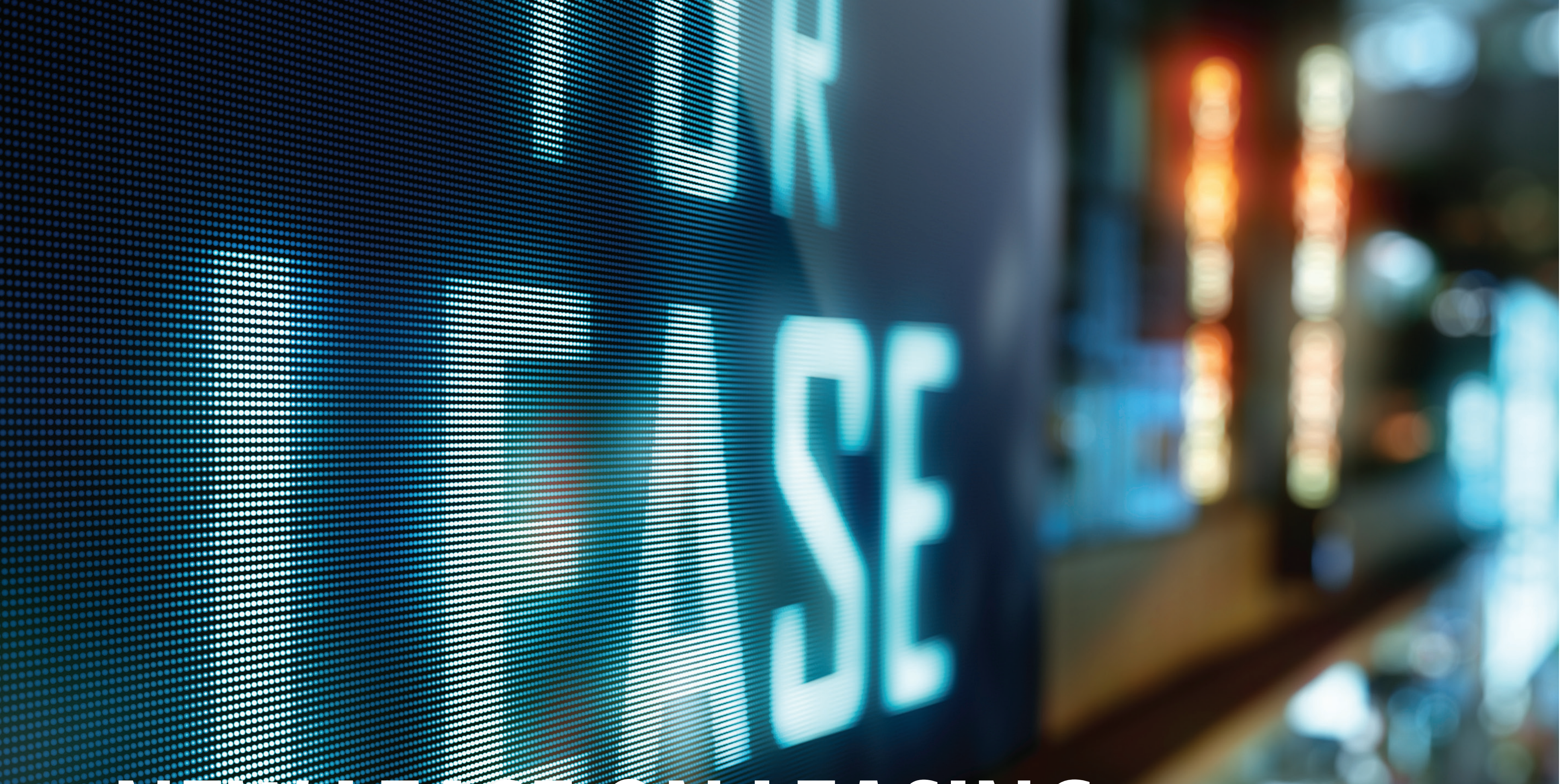


NEW LEASE ON LEASING:

Breaking down FASB's new standards

After nearly a decade of drafts and rewrites, a new lease accounting standard was adopted by the Financial Accounting Standards Board. The changes aren't expected to have a significant impact on lessors, but lessees will need to adjust accordingly.

BY BRANDI SMITH

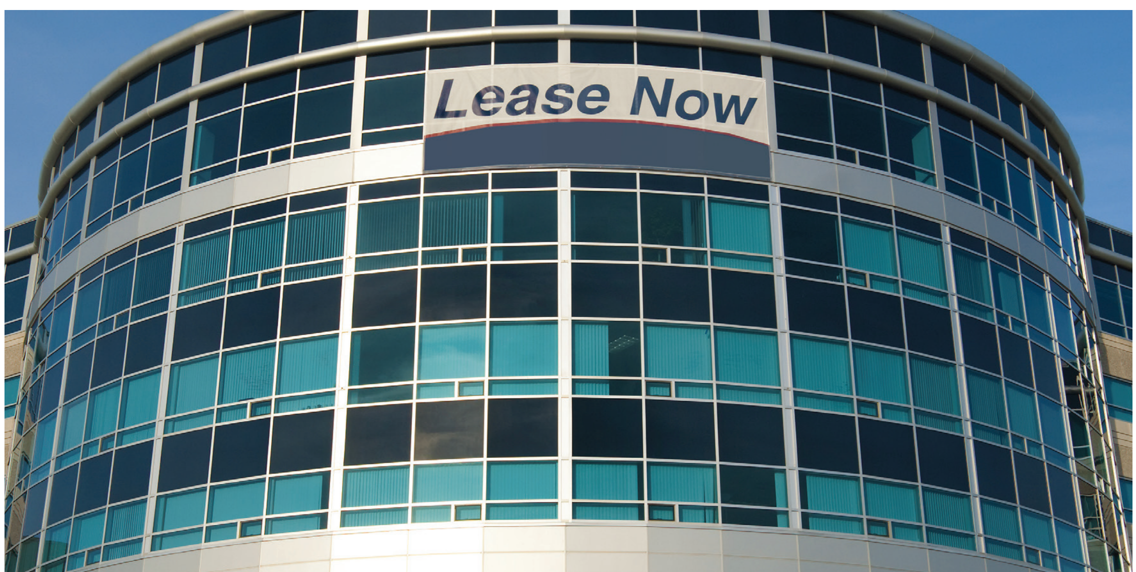
The goal of FASB's new standard is to increase transparency and comparability among organizations that lease assets, according to FASB Chairman, Russell Golden. During a conference held in November 2015, Golden said the rules will provide a means of recognizing assets and liabilities that arise from lease transactions. Currently, companies can cloak lease costs to appear more stable.

As of Jan. 1, 2019, companies that lease property or equipment will be required to identify on their balance sheets assets and liabilities for leases with terms of more than 12 months.

"When a company shows that they don't have that many liabilities, then the perception is that they are stronger, because they have so much liquidity," said Randy Dishongh, president of Dishongh, Jankowski, & Eubank.

FASB's change will allow a more apples-to-apples comparison when reviewing different companies, whether they lease property or own it.

"The FASB lessee accounting model continues, like today, to account for two types of leases," Golden said. "One type of lease – the capital lease – will be accounted for in substantially the same manner as capital leases are accounted for under existing GAAP. The other type of lease – the operating lease – will be accounted for in a manner similar to operating leases under existing GAAP, except that



lessees will recognize a lease liability and a lease asset for all of those leases."

"It will change the way they plan deals to be done," he said.

The new policy applies to both equipment and property, which means companies may opt to purchase property instead of leasing it since there is little financial advantage to a long-term lease.

"If more companies were to begin leaning toward buying property over the option of leasing it, that could have a trickle-down effect into the commercial real estate industry."

"Generally, if you own an asset, you control it. You can get a little bit better pricing, because you paid for it," said Dishongh.

"If you're the CFO of the company and you know suddenly that your $8 million remaining liability on this lease space is going to go on your balance sheet and is going to impact your liquidity, you might go to the real estate director and say, 'Are we using all that?'" said Brandi McDonald, the executive managing director at Newmark Grubb Knight Frank, during a recent CREN meeting in Houston. "Idle space is going to come into question and real estate directors are going to get the mandate to densify space."

Dishongh recommends companies start planning ahead for the new standards, which don't go into effect for nearly three years.

"You keep track of a lot of the information in the notes already," he said. "You're already examining leases. It's already part of the audit process, so that you have all of the background information in order to make the changes."

One way in which firms can prepare is by having a conversation with their financial institutions.

"The key would be to make sure that you go back and meet with the lenders and confirm that this change in accounting will not affect the debt-to-equity calculation," said Dishongh.

Skipping that conversation could result in companies inadvertently violating some provisions in their loan agreements. Because leases have not been included on the balance sheet, their sudden appearance in 2019 could be a red flag for banks that a company's liabilities are beyond what is allowed. If a covenant is violated, banks can demand immediate payment in full, despite the change being a technicality.

"As more companies start accounting according to the new FASB standards, we will have to wait to find out just how significant an impact they will have on the future of commercial property leasing," Dishough concluded.