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Editors/Reporters

• Click on link to view and download Avison Young White Paper: "The Big Change to the Lease Accounting Standards – New rules will significantly impact a company's enterprise value unless firms act now"
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• Click on link to view and download "Infographic: The New Lease Accounting Standards"
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Most companies unprepared for lease accounting rule changes

Avison Young's latest white paper says new FASB and IASB standards will have dramatic impact on corporate balance sheets if firms do not structure their leases correctly today

Toronto, ON – Most companies are not on track to comply with new real estate lease accounting rules when they begin to take effect in 2018. The U.S.-based Financial Accounting Standards Board (FASB) will implement new standards on Dec. 15, 2018 and the International Accounting Standards Board (IASB) will follow on January 1, 2019. Many firms are struggling to collect the necessary lease accounting data that must be gathered beforehand. Although the effective dates seem far away, they are rapidly approaching – but few companies have analyzed how the rules will impact their financial statements.

These are some of the key findings noted in the new **Avison Young** White Paper: **"The Big Change to the Lease Accounting Standards – New rules will significantly impact a company's enterprise value unless firms act now"**, released today.

"This white paper emphasizes that there are many things that real estate lessees and lessors can, and should, be doing today with respect to their lease structures, business operations and financial reporting processes," comments Avison Young Chair and CEO **Mark E. Rose**. "By planning and starting early, companies can more effectively manage the process – and minimize the surprises."

Avison Young Principal **Sean Moynihan**, the white paper's author, says the new FASB and IASB standards will require leases with a maximum term of more than one year to be capitalized; most importantly, no leases will be grandfathered in. Therefore, in many cases, the impact will be immediate and material to tenants' financial statements.

“The main point about the FASB changes is this: How you negotiate the financial terms and conditions of a real estate lease will impact the financial success of your company,” explains Moynihan. “By getting proper advice, from an advisor, who deals with the lease on the front end before the lease is done, your firm can control the impacts to your balance sheet and income statement. Many companies will be scrambling to gather the necessary information in 2018 if they don’t start preparing now.”

As the white paper notes, the new lease accounting rules pose dramatic changes for tenants globally. For lessors of real estate, the FASB and IASB are, generally, leaving in place a model similar to today’s lease accounting requirements, with income statement and balance sheet treatment similar to the way that leases are currently accounted for.

However, the same does not hold true for tenants; the new lease accounting standard creates significant changes to the presentation and measurement of the lease obligation on the financial statements of almost every company.

“Under the forthcoming lease accounting standards, a lease will create a right-of-use asset and a lease liability, to be placed onto the corporate balance sheet,” states Moynihan. “Under the FASB’s model, leases will be evaluated and categorized as either Finance (similar to capital leases today) or Operating (similar to operating leases today). Under the IASB’s proposed model, all leases will be classified as a Finance lease. Under both models, leases will be capitalized onto a firm’s balance sheet, but with very different effects on shareholder equity, EBITDA (earnings before interest, taxes, depreciation and amortization) and overall profitability.”

He adds that seemingly insignificant factors, such as tenant improvement allowances and lease renewal options, will have important implications for financial statements.

Since existing leases will not be grandfathered under the new rules, every lease in a company’s real estate portfolio could negatively impact its financial statements. All public companies listed on U.S. stock exchanges, which must include comparative financial data in their financial statements, will effectively be required to transition to the new rules in advance of 2018 to stay compliant with U.S. Security and Exchange Commission (SEC) regulations, according to the white paper.

“One of the key challenges for corporate decision-makers is that using discounted cash flow to compare, analyze and structure real estate leases, which has been the common practice for more than 30 years, does not provide enough information to make an informed business decision,” adds Moynihan. “Executives should take a much more active role in the negotiation process by consulting with their tenant advisor, auditor and colleagues in the finance department to ensure that the impact is fully understood – before a lease is signed.”

The white paper, which is aligned with Avison Young’s risk-mitigation strategy, recommends that companies’ top executives take three immediate actions:

1. Identify the right team members – particularly finance and real estate specialists – to help your company transition to the new standards.

2. Conduct a strategic evaluation of the existing lease portfolio, starting with the largest leases, and assess how they will be accounted for under the new rules. Assess the impact on

EBITDA and other key financial ratios and evaluate whether there is any potential impact on loan covenants.

3. Consider renegotiating leases now, even if they are not up for renewal, in order to mitigate some of the less favourable impacts that would otherwise occur. Throughout the negotiation process, work closely with your tenant advisor to address areas of concern with an eye toward protecting financial statements.

Avison Young is the world's fastest-growing commercial real estate services firm. Headquartered in Toronto, Canada, Avison Young is a collaborative, global firm owned and operated by its principals. Founded in 1978, the company comprises 2,400 real estate professionals in 80 offices, providing value-added, client-centric investment sales, leasing, advisory, management, financing and mortgage placement services to owners and occupiers of office, retail, industrial, multi-family and hospitality properties.

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