Jones Lang LaSalle®

How Will *Changes* in Lease Accounting Affect You?

Mindy Berman
Managing Director
September 2010

What is changing?

Comprehensive overhaul of lease accounting standards under FAS 13 and IAS 17

Objectives are to:

- Capitalize operating leases
- Create economic transparency

Real estate will be most heavily affected representing 70% of leases

Effect on corporate occupiers:

- Change in financial reporting
- Potential changes in leasing strategy and terms
- Change in the work that corporate real estate practitioners do

When is it changing?

Exposure Draft released	August 17, 2010
Comments due	December 15, 2010
Final issuance	July 2011 (estimated)
Effective date	To be determined; best guess is January 2013

What is the current state?

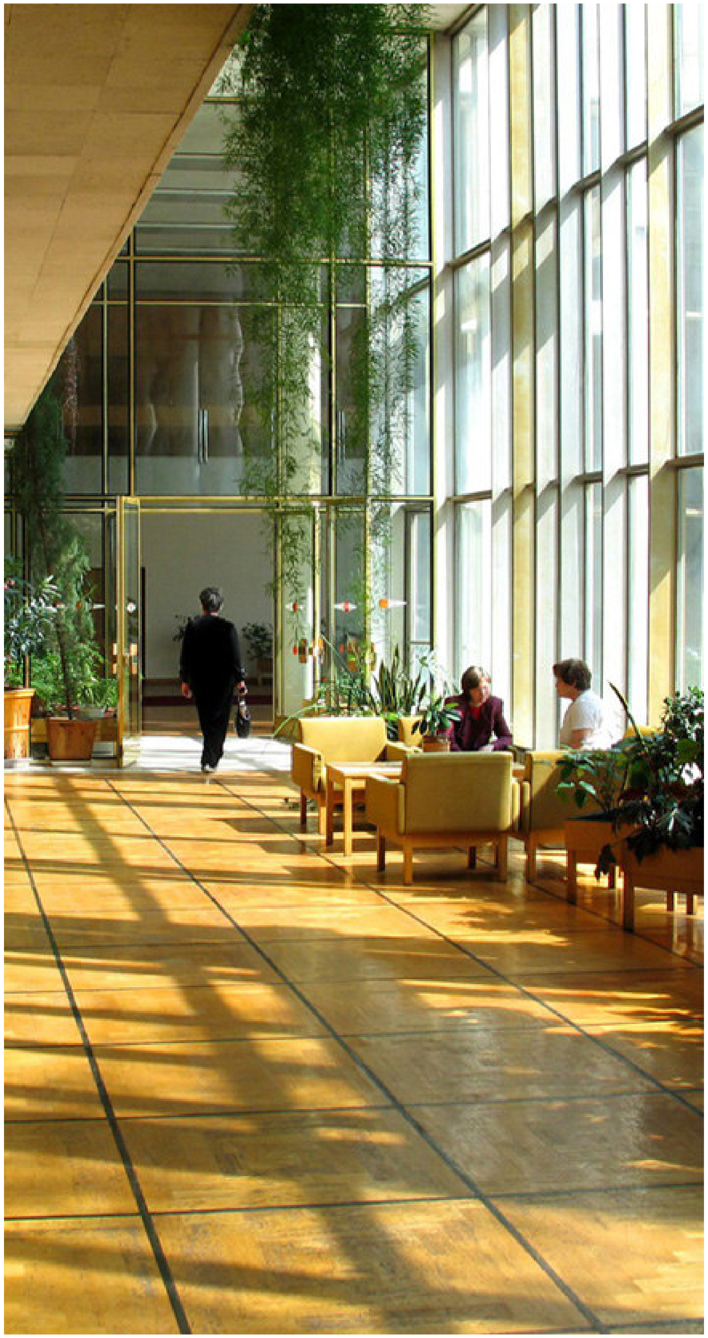
Statement of Financial Accounting Standards No. 13
“FAS 13” lease accounting

Financial statement	Operating lease	Capital lease
Balance sheet	• None, except prepaid rent	• Leased asset • Capital lease liability
Income statement	• Rent expense	• Depreciation • Interest expense

JONES LANG LASALLE®

What are the basic changes?

- All leases will be reported on balance sheet
  - Liability for obligation to pay rent
  - Corresponding “right-of-use” asset
- Scope
  - All leases as defined under FAS 13 and IAS 17, including leases embedded in service contracts
  - Existing and future leases, regardless of location – no grandfathering
  - Leases that are not a purchase or sale
  - Simplified accounting guidance for short-term leases (< 12 months)



How are the asset and liability to be determined?

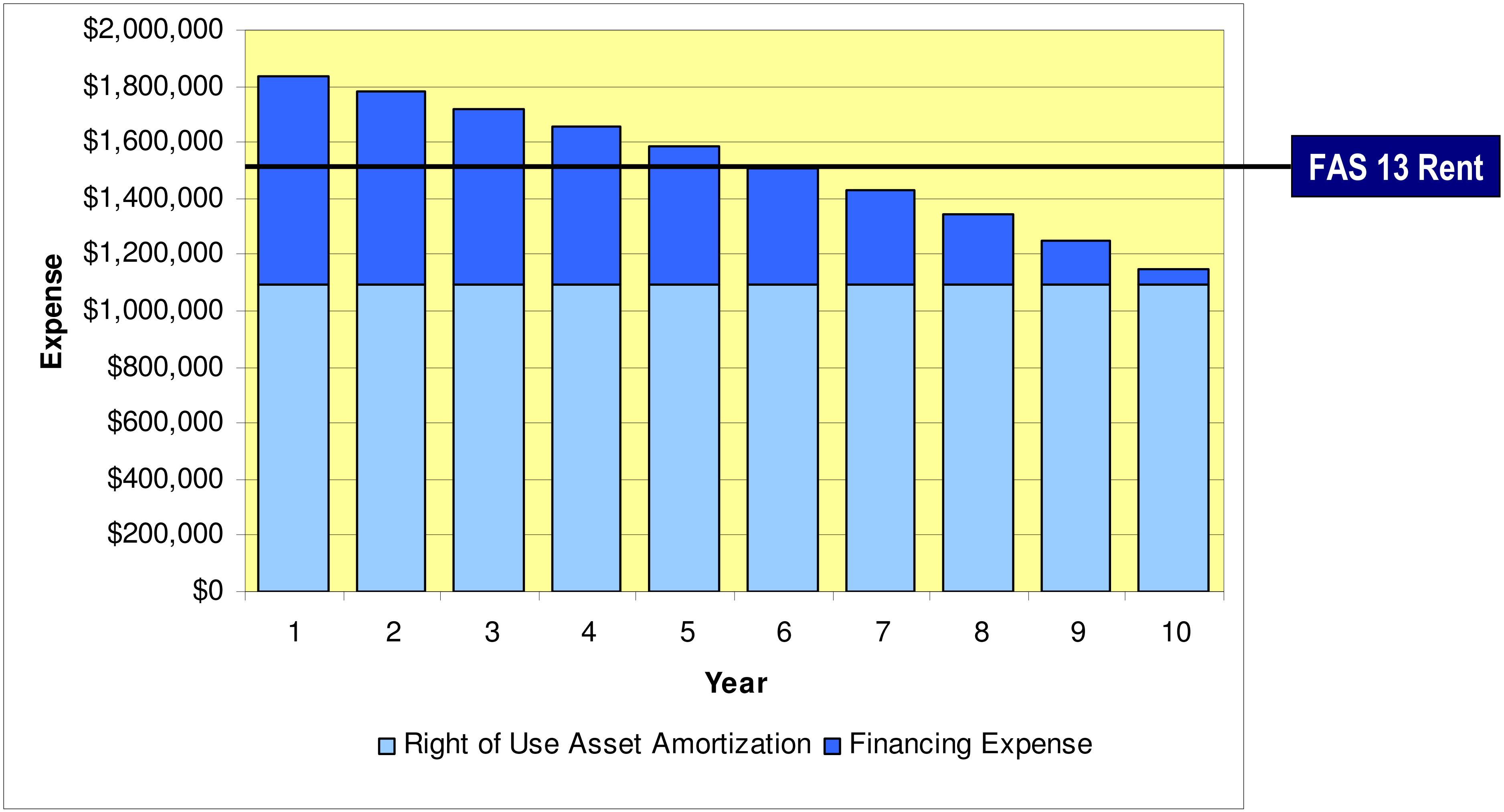
- Lease obligation
  - Present value of lease payments discounted using the lessee’s incremental borrowing rate
    - Rent for the most likely lease term (including non-contractual renewals and terminations)
    - Include expected value of contingent rent and any other payment amounts
    - Exclude operating expenses and taxes
- Right-of-use asset
  - Cost (present value of the lease payments plus any initial direct costs incurred by the lessee)
  - Starting amount the same as liability

How will expense be calculated?

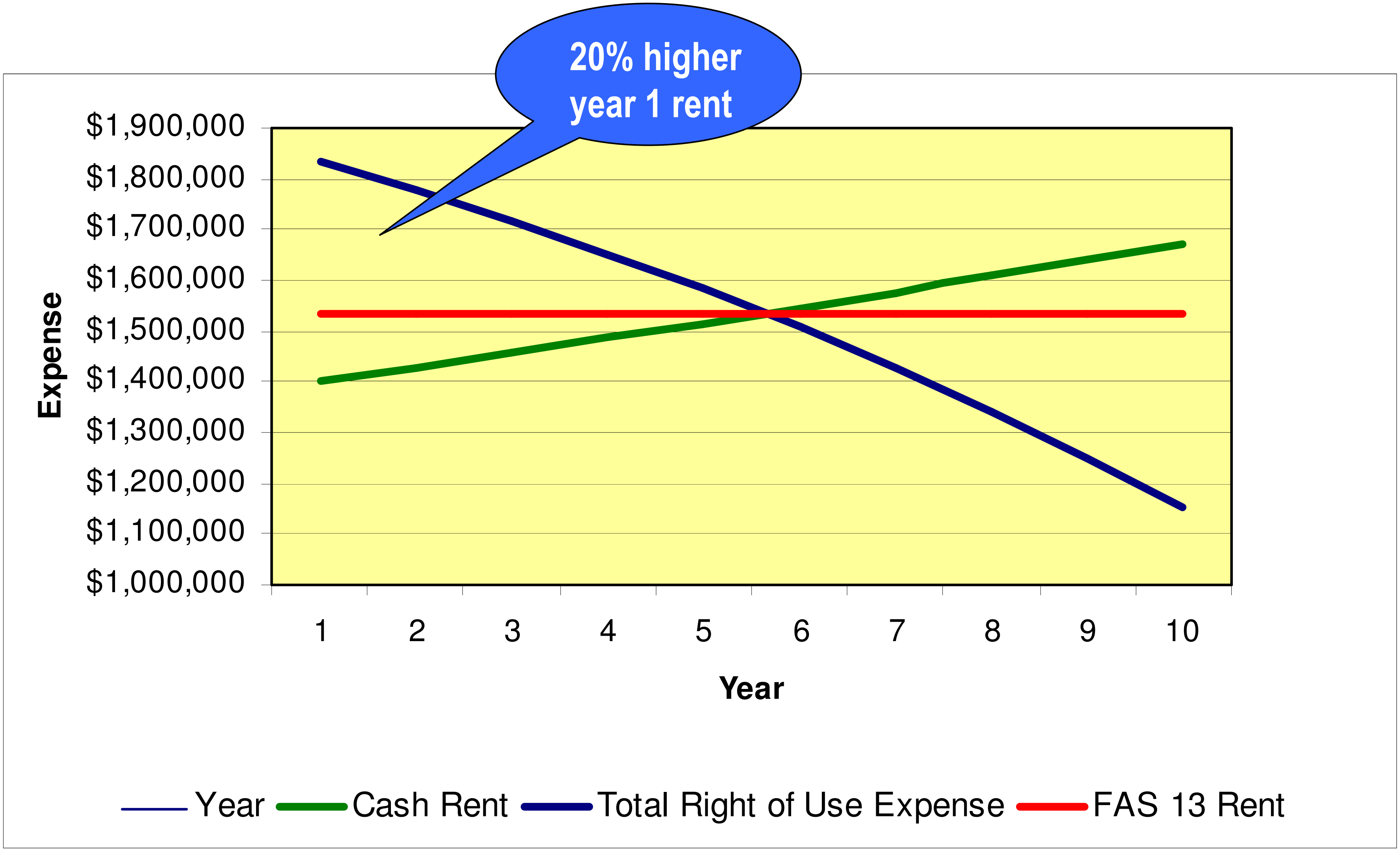
- Asset
  - Amortized on straight-line basis
- Obligation
  - Amortized cost using the effective interest method
- Assumptions updated each reporting period
  - Review estimates of likely lease term, contingent rent
  - Allocate changes to asset, obligation and net income

What does right-of-use expense look like?

100,000 s.f. lease for 10 years; $14 NNN rent; 2% annual escalators, 7% corporate borrowing rate



How does rent compare to the current situation?



What other issues affect corporate real estate?

- Subleases
  - Continue to recognize primary lease obligation
  - Account for sublease arrangement separately
  - Uncertain as to whether there is gross or net treatment on the balance sheet
- Sale-leaseback arrangements
  - Determine whether financing or sale
  - Immediate gain recognition for sale
- Build-to-suit arrangements
  - Outside the scope of leasing project

What are the implications for corporate real estate executives and their companies?

- Substantial increase in corporate balance sheets
- Loss of straight-line rent expense in exchange for high-low expense profile
- Improved EBITDA
- Higher reported capital spending
- Potential violation of financial covenants
- No expected change in credit ratings

- Change in expense allocation to business units
- Greater regulatory capital for financial services companies
- Increase in financial reporting burden
- Change in desired lease terms and structure
- Change in lease vs. own decision-making

What are implications for transaction managers?

- Increased complexity in financial reporting of leases will place a new burden on transaction managers and brokers
- Need to understand shifts in desired lease terms and structures of client in light of proposal
- Must obtain additional information in conjunction with lease acquisition, authorization and execution
  - Net rent amounts
  - Likely lease term inclusive of renewals
  - Estimate of any contingent payment amounts
  - Added disclosure requirements for financial statements
- Other impacts
  - Allocation of “occupancy expense” to business unit
  - Greatly increased internal communication requirements
  - More work!

How should you prepare?

- Become familiar with proposals
- Quantify and evaluate financial impact
- Alert key stakeholders
- Reconsider lease structure and lease vs. own decision-making
- Begin planning for implementation and changes in financial reporting

Questions?

Contact:

Mindy Berman

Mindy.berman@am.jll.com

+1 617 316 6539