

Learning Series: Lease Accounting Changes for Non-accountants

What potential impacts will there be to leasing space?

Arazzo Solutions, LLC

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To Lease or Not to Lease

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Will the new lease accounting guidelines have an impact on the way your company approaches leasing? You betcha! For starters, reducing the real

security of a longer term lease versus the lower lease liability on the balance sheet for short term leases.

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estate footprint will look more attractive. But in many companies, the leased space is necessary to do business. So what are some options?

Shorter lease terms may be more attractive. Remember that leases less than twelve months are excluded from the balance sheet. So rather than a 5-year lease with a 5-year renewal, it may be more attractive to do a 1-year lease with nine 1-year renewal options. Your company will have to weigh the risks of trading the

Moving to service agreements rather than lease contracts may be appealing. For example, obtaining space from companies like WeWork or Regus through service agreements won't hit the balance sheet.

The structure of leases may need to be re-evaluated. Triple net leases will be easier to account for because you don't have the extra work of breaking out services from rents like you do for gross leases. In the U.S.,

Buzz Words to Know

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Short-term Leases: Leases of 12 months or less are excluded from the balance sheet and are expensed

Service Agreement:

Contract for space and related amenities (e.g., front desk service, janitorial, maintenance, etc.) typically based on a daily or monthly rate which does not constitute a lease

WeWork:

<https://www.wework.com/>

Regus:

<https://www.regus.com/>

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leases based on an index (e.g., CPI) is beneficial because you don't have to do re-measurements unless something else on the lease changes. That's a great time saver. For leases outside the U.S., the opposite is true since IFRS 16 requires a re-measurement every time the index changes (typically annually). Structuring a lease with more variable costs as opposed to fixed payments will be attractive since most variable payments (not based on an index) are excluded from the lease accounting calculations.

There likely will be a lot of discussion around the "lease vs. buy" topic. Previously, it was better to lease because it didn't affect the balance sheet. Under the new guidelines, that's a moot point. Since the transaction goes on the

balance sheet regardless of leasing vs. buying, the benefits of each approach will need to be re-evaluated.

On the side of leasing, there are still a lot of benefits. For example, it's likely that the lease costs will still be less than the costs of raising the capital to purchase a building. You also have the flexibility to "return" the space at the end of the lease term as opposed to the effort required to sell a building you no longer need. And of course there's the benefit of utilizing a professional property management staff, including building engineers who keep the facility running smoothly, rather than having to hire internally or outsource to a third-party maintenance company when you own the building.

In summary, your company will need to invest in the time it takes to review the current leasing approach and tweak it in light of the new accounting guidelines. Brokers will need to be educated in the new leasing strategy and must understand the impacts their lease negotiations will have on your company's financial statements. It may even be wise to renegotiate existing leases to achieve better terms.

We hope you've enjoyed this Learning Series! We've had fun sharing our thoughts with you as you tackle this very significant lease accounting change. Remember that your CRE team can play a very important role in the transition to the new guidelines. Good planning and good luck!

Papers in this Learning Series (Past, Present, & Future)

Volume 1: Why did FASB and IASB change the guidelines?

Volume 2: Why is moving leases to the Balance Sheet such a big deal?

Volume 3: How do the accounting changes impact my CRE team?

Volume 4: What are the key requirements of FASB ASC 842?

Volume 5: What are the key requirements of IASB IFRS 16?

Volume 6: What are the differences between ASC 842 and IFRS 16?

Volume 7: What comes first – the chicken or the egg?

Volume 8: What do I need to consider when evaluating software systems?

Volume 9: What potential impacts will there be to leasing space? (CURRENT ISSUE)

Arazzo Solutions, LLC is a boutique professional services firm focused on the Commercial and Corporate Real Estate (CRE) industry. Having more than a combined 45 years of CRE experience, our team has a unique combination of expertise in lease administration, lease accounting, project management, and IWMS (Integrated Workplace Management System) support.

We are here to augment your internal CRE teams, assist you with ASC 842 and IFRS 16 compliance, including required data points, data management and governance, evaluation of systems, and best practices, and act as your advocate to manage IWMS vendors. Whether you have seasonal demands or need assistance year-round, we can help you meet your responsibilities and deadlines without the need to hire additional employees.

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