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A New Take on FASB Rules from Richard L. Podos

By Jonathan Hipp
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Mention the acronym "FASB" in the halls of commercial real estate and you may start a veritable shouting match. Like some impending disaster, the fear that FASB will turn the CRE world upon it head (while leaving no prisoners) is rampant and pervasive. Fortunately for us, it's simply not true. Unfortunately, many have not got the memo.

Here are concerns that are often voiced in connection with the proposed FASB rule changes and why they will NOT have the disastrous effects envisioned:

Calkain: Two major marketplace impacts being posited are shorter-term leases and more corporate ownership. Are either or both going to become the trend?

RLP: In a word, NO (with certain exceptions at the margin). First, lease term from a tenant's perspective is about occupancy strategy and economics. No major tenant is going to start doing large leases for 5 year terms, with all of the expense entailed in tenant improvement (TI) and moving, not to mention issues such as employee attraction and retention, customer proximity, risk of exposure to landlord leverage on renewal, etc. That said, will a low-cap ex renewal be short… yes, probably. As to corporate ownership, there has been an inexorable worldwide trend towards leasing over the last 20 years based on core competency and capital deployment drivers… accounting doesn't change any of that.

Calkain: How will the industry build the proposed new standard into pricing?

RLP: Believe it or not, it's been happening for years. Just because the lease accounting changes haven't been officially formalized doesn't mean the industry is keeping its head in

the sand. Again, economic drivers are paramount. We've all seen a move towards shorter lease terms by occupiers with greater uncertainty; on the other hand, certain tenants, especially retailers, make long-term commitments because they *know* they will remain at a given location for a long time. And again, deals involving heavy amounts of tenant improvements (TI) suggest longer terms to deal with amortization, whether funded by landlord or tenant or my firm. Renewals with minimal capital investment will tend towards short, but that's about it.

Calkain: What (if any) unintended consequences will result from the standard?

RLP: It certainly won't have a major impact on tenants' financials… with certain exceptions (e.g., retail, airlines), the impact on corporate reporting and ratios will be de minimus. Most importantly, the credit ratings agencies and the equity analysts have been capitalizing leases for over 20 years, actually around 2X of what the new lease accounting will require, so no major impact. The largest unintended consequence we foresee will be the impact on sale-leasebacks. Over the next two years, we expect to see a slow-down in those transactions, simply due to uncertainty, except where there are strategic concepts driving portfolio re-positioning (a big concept for another day). However, once the new standards are better digested, that trend will level off, and transaction velocity will resume.

The key thing to remember with the proposed lease accounting is that it does not change the strategy and business drivers that underlie tenants' real estate deals. Our motto? "Economics trumps accounting".

Richard Podos is the CEO and President of Lance LLC, a New York-based finance and investment firm focused on TI funding and asset-intensive build-to-suits, and is a thought leader at CoreNet Global regarding lease accounting.

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