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Companies will have to report their real estate leases as a financial asset and liability— a change that is more than just bookkeeping

Premium content from Washington Business Journal - by Sarah Krouse

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New national accounting rules, expected in the coming weeks, could alter the way companies record their real estate leases in financial reports. The highly anticipated change, which for now is foggy on the details, has ramifications for future real estate decisions.

The new Financial Accounting Standards Board rules would require real estate leases to be categorized as “capital leases,” which means that they must appear on a company’s balance sheet as an asset and a liability. Until now, real estate leases have been logged as off-balance sheet costs.

The new policy’s tentacles will likely stretch well beyond one additional figure on a company’s quarterly reports.

“The fundamental impacts are potentially huge,” said **Barbara Schmitt**, a Goulston & Storrs PC attorney who is teaching a course on the proposed changes at The Master of Professional Studies in Real Estate program at Georgetown University. “There’s been a lot of back and forth in terms of what’s actually going to happen. … Companies really need to prepare for the new rules, but they don’t know what they will look like.”

For one, experts say, the new rules would require companies to make real estate predictions that range from challenging to near-impossible, such as projecting how much rental rates will increase or, for some retailers, anticipating retail sales revenue.

Because leases must be listed an asset and liability, companies might opt for shorter-term leases to make them appear less risky and capital-intensive, according to some real estate and legal experts. That could hamper landlords who not only prefer longer-term leases, but also need stable occupancy to secure their own financing.

The rules carry another implication for publicly traded companies, which would be forced to show their hands and reveal in their public filings how long they intend to stay in a given space.

Companies would have to detail their decisions to grow, shrink or move offices, based on likely outcomes of their other corporate activities.

Listing that information publicly is a fast way for landlords and brokers to determine just how hard it will be to keep a tenant.

FASB has written two drafts of its proposed changes to generally accepted accounting principles and plans to release a final version by the end of the second quarter. The policy changes will likely be implemented sometime between 2013 and 2015.

However confusing for the reporting companies, the revised rules could also create something of a cottage industry for real estate companies, law firms and accounting businesses as clients look for guidance.

The policy changes could also spawn third-party consulting opportunities for brokerage firms and research groups that track the local real estate market and project economic trends such as rent growth, employment and vacancy rates.

“The changes will require a lot better coordination between the business units, accounting group and the real estate groups at companies,” said **Brad Flickinger**, senior managing director of CB Richard Ellis Group Inc.’s Northern Virginia and suburban Maryland offices. “You need to get all of the people on the same page.”

As a result of the proposed FASB changes, Flickinger said, some companies without a dedicated real estate team would have to start investing more resources into that aspect of the business.

"Strategically, I think people need to start thinking about how the real estate decisions are made in their organization," he said. "They'll have bigger implications than they used to."