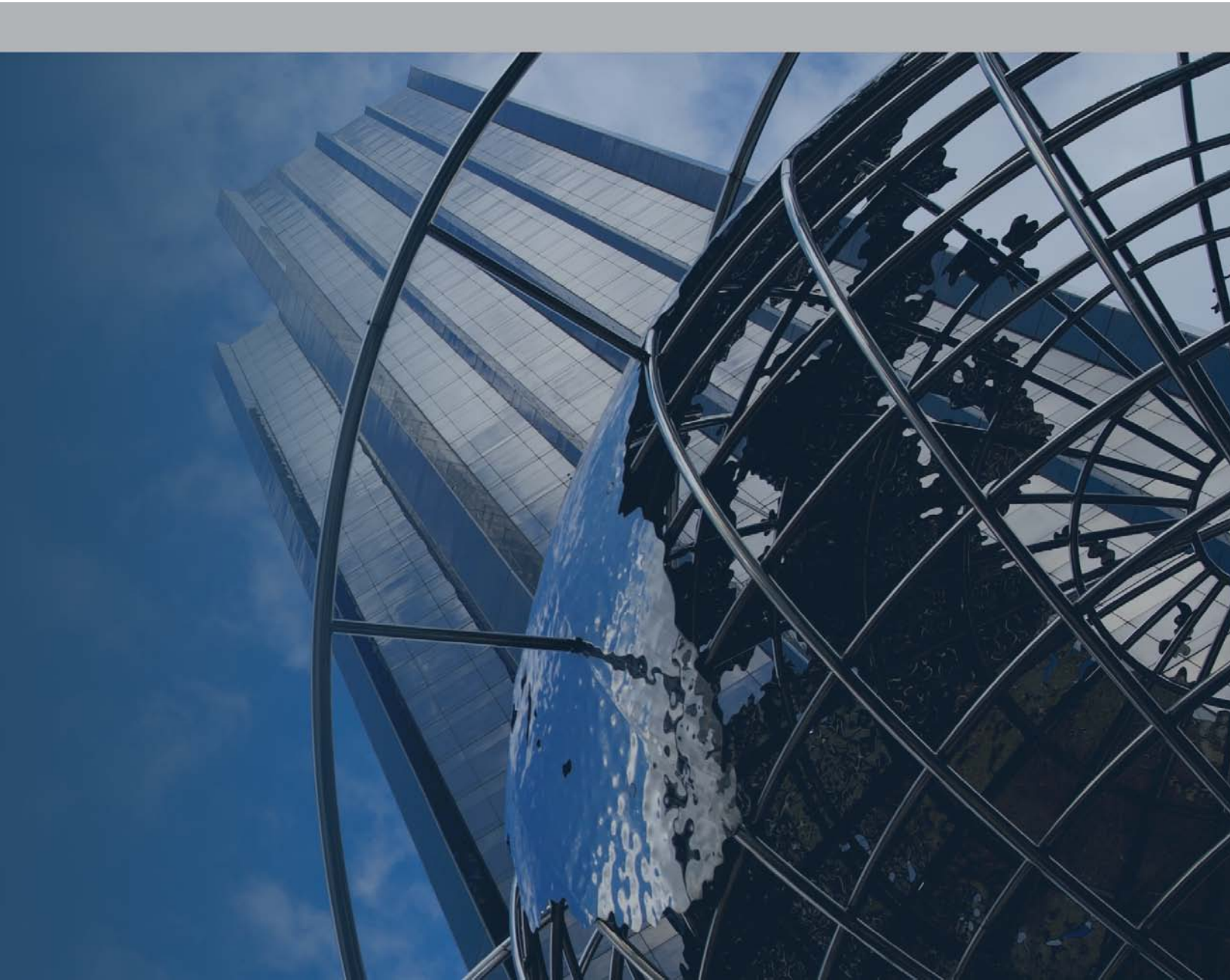


Building a Game Plan for Lease Management

Preparing for Changes to Lease Accounting



Overview

The proposed change to the Lease Accounting Standards by the FASB and IASB has generated significant interest regarding the potential impact to public companies as well as private businesses that follow GAAP accounting. While much of the preliminary discussion has revolved around the impact to financial statements, ratios and debt covenants, the practical impact on staffing, systems and compliance could have an even more significant impact on business.

Since early in the 2000's with the inception of Integrated Workplace Management Systems (IWMS) many companies have begun to manage their leased and owned properties in order to gain better control of overall occupancy costs. For those businesses that have a good handle on Lease inventory, the implementation of these new guidelines will be a bit easier to manage. For those businesses that are not as far along in the process, or have decentralized real estate and procurement functions, there will be significant work to be done to prepare for the new regulations.

For all companies, the development of new Lease approval and reporting processes, not only for real estate, but also for equipment, fleets or other assets will need to be created or modified. In particular, the requirement for quarterly reporting, change management and identification of impairments will generate a need for an ongoing Lease Management and Accounting function within the organization.

The unique combination of skills in accounting, contract law, capital budgeting, systems and real estate will generate a demand for a cross functional team that will most likely include internal and external resources. This paper is intended to provide a preliminary checklist of the functions and activities that will need to be addressed prior to the commencement of the new rules. While there may still be changes to the final guidelines, many of these activities can be undertaken in preparation of the final standards.

Strategic Implications

One major consideration in this process has been the cost of compliance. From a real estate perspective, the benefit from improved process, better systems and timely information has been a significant reduction of occupancy costs across the portfolio. These efficiencies will be key to offsetting the cost of compliance with the new regulations.

Over the long term, these new guidelines will also compel a re-evaluation of Lease vs. Purchase decisions, particularly as it relates to strategic or core assets of the business. One of the many challenges that management will face will be defining the "likely to exercise" criteria related to options to renew or purchase that will affect the accounting for Leases. Since the net present value of the rental payments is amortized over the expected term, not the term certain of the lease, a decision to extend that was not accounted for initially will lead to a re-calculation of the new obligation. This will lead to a "saw tooth" effect on total expenses, which will negatively affect Net Income.

For companies that have a heavy reliance on real estate, there will be significant variance in Net Income impact based on decisions to continue to Lease most properties. This could also lead to different forms of ownership vehicles including Joint Ventures, Corporate REITs, or other structures.

Preliminary Assessment

For all organizations, the best starting point is an objective evaluation of the Lease approval and management process across the organization. Here is a preliminary checklist of areas to evaluate:

- **Existing Lease Inventory “Universe”**
 - o How many and where are they?
 - o Lease Categories: Real Estate, Equipment, Fleet, Other Assets
 - o Document Inventory / Location / File Condition / Backup
 - o Rent Payment Schedules, including Options, End of Term Rights and Obligations
 - o Segregation of Base Asset Cost and Operating or Service Components
- **Systems & Technology**
 - o Changes to ERP Accounting Systems
 - o Developing / Integrating Lease Administration System(s)
 - o Data Interchange between Systems
 - o Template for Assembling Required Data
 - o Financial Modeling for Impact Tests
 - o Impairment Rules
- **Capital Approval Process**
 - o Buy vs. Lease Decisions
 - o Consistent Process
 - o Levels of Authority
 - o Auditable Controls (SOX)
- **Lease Management Process**
 - o Preferred Term
 - o Defining “Likely to Exercise” Options
 - o Flexibility vs. Net Income Impact
 - o Impact of Intra-term Changes
 - o Communication Between Business Units & Finance
 - o Defining Strategic Assets
 - o Change Management
 - o Quarterly Review
- **Staffing and Skills – Multi-Discipline**
 - o Treasury, Finance and Tax
 - o Procurement
 - o Real Estate
 - o Legal
 - o Technology
 - o External Support
 - o Ongoing Management, Maintenance and Reporting

About Jackson Cross Partners

Jackson Cross Partners, LLC is a real estate service company based in King of Prussia, Pennsylvania outside of Philadelphia. The firm specializes in commercial real estate brokerage, advisory services, property management and finance. Although based in Philadelphia, the company has serviced client requirements across the country and around the world.

A unique aspect of the Jackson Cross service platform is the Advisory Services Group that employs a team of attorneys, paralegals, law students and experienced property administrators. The team is comprised of full time staff and independent contractors that allows for scalability for large, fast turnaround projects. Over the past seven years the JCP Advisory Group has reviewed over 30,000 property files for a number of large corporate clients.

JCP has developed detailed processes utilizing Six Sigma methodology to assist clients in finding, reconciling and reviewing property files and critical documents, building document inventory databases, scanning and digitizing files for collaboration and disaster recovery and populating portfolio administration and IWMS databases. Using a combination of proprietary systems and a broad range of commercially available systems, this “platform independent” approach has provided clients with an objective and skilled resource team that can adapt to their systems and platforms.

As companies evaluate external resource options to assist in the significant undertaking of compliance with the proposed Lease Accounting guidelines, Jackson Cross Partners is uniquely qualified to provide assistance based on the accumulated experience of the Partners, Associates and Contractors of the firm. The convergence of training and experience in legal contract review, process development, database and imaging technology, real estate valuation and negotiation and corporate finance is truly rare in the industry. Traditionally real estate service companies focus primarily on transactional services, accounting firms may not have the cross-functional practices or depth of experience, and law firms may not possess the finance, process or technology skill sets. The complexity and nuance of lease contract language make this work difficult to outsource to foreign service providers.

With experience in portfolios from 10 properties to over 16,000, JCP has established processes for the following critical areas:

- File & Document Review and Abstraction
- IWMS Implementation
- Intelligent Imaging
- Sarbanes-Oxley Compliance Audits
- Financial Analysis
- FMV Opinions

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