

# *The new IFRS lease accounting standard will have business implications for all real estate landlords*

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The International Accounting Standards Board ("IASB"), who is responsible for International Financial Reporting Standards ("IFRS"), is undertaking various projects to improve financial reporting while also aligning U.S. and international accounting standards. One of these improvement projects will address lease accounting.

In layman's terms, the proposed changes to lease accounting would have practically all leases recorded on the balance sheet of lessees, removing the distinction between operating and financing leases. Lease obligations will be reflected as liabilities on the balance sheet with a corresponding 'right-to-use' asset. The consequences of the proposed lease accounting changes are far reaching, and are likely to be the most profound accounting change in decades.

The proposed changes particularly will impact lessees (i.e., tenants) with significant real estate leases including leased buildings, or space in a building, head offices and retail premises.

The real estate industry (as a lessor) is proposed to be exempt from the new lease accounting standard. Notwithstanding this exemption, landlords will still be directly affected by these changes as the framework under which tenants will approach their leasing decisions and negotiation will change.

In a global PwC survey conducted in cooperation with the Rotterdam School of Management, Erasmus University, where 3,000 companies in fourteen industries participated, 40% of the respondents indicated that they will no longer lease real estate properties in the same way as before this change, and 22% expected to move to shorter leases.

## **How may landlords be impacted?**

- The fair value of the landlord's investment properties may directly be impacted as tenants will likely wish to negotiate different rental arrangements, which may include:
  - lower base rents and more variable based rents;
  - shorter lease terms and fewer/shorter renewal terms; and/or
  - longer rent free periods.
- As a result of significantly more estimation involved in the proposed accounting standard, rental income may become more volatile and may affect the attractiveness of real estate organizations for investors.
- Since lease obligations will be reflected on the balance sheet, tenants may prefer to purchase the asset outright rather than enter into a lease agreement.
- As tenants will likely require additional information to calculate their lease liability, landlords should consider inventorying existing leases and identifying existing data gaps that will need to be filled prior to transition.

Although a final standard is not expected to be issued any earlier than the second half of 2012, we think it is important that real estate landlords start considering the potential impacts now. Given the term of a lease can span many years, tenants will be considering the impact of the changes in lease accounting on the lease arrangements they are negotiating today.



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