ANALYZING THE IMPACT OF LEASE ACCOUNTING ON COMMERCIAL GROUND LEASES

Among the myriad of issues that could be created by the new changes to Lease Accounting by the FASB and IASB, companies that utilize the Ground Lease in their portfolio may re-evaluate that strategy. Under current accounting, the Ground Lease is generally classified as an Operating Lease and the straight lined rent expense is charged annually over the term of the lease.

Under the new standard, the Ground Lease would be considered a Right of Use Asset, and the net present value of the rent obligations would be placed on the balance sheet. Since a Ground Lease is generally for a term in excess of twenty years, plus options, these longer term leases create a number of additional consequences:

1. Higher front end interest expenses create a negative P&L impact that could exceed current straight line rent expense by more than 25% in the first year of transition to the new standard.

2. Uneven amortization of the Asset and Liability create a negative net equity impact that can reach as much as 25% of the overall asset value for each lease at the midpoint of the term.

3. Since the expected definition of term involves “economic incentive” to include renewal options, the accounting term may be impacted by economic life of Lessee constructed improvements that revert to the Lessor at the end of the term. This could increase both the Balance Sheet values, and the front end imputed interest expense.

The most compelling reason to re-evaluate the Ground Lease strategy is that owned land is not depreciated, and therefore owned land creates no annual depreciation expense. An analysis of a variety of Ground Leases under current and new Standard provides an illustration of the variations

Please call or email Glenn Blumenthal for more information regarding ground lease and let us show you our analysis on this topic.

Glenn Blumenthal
Malvern Advisors
Gblumenthal@malvernadvisors.com
215-696-7700