GRUBB & ELLIS
From Insight to Results
TENANT**ADVISORY**GROUP

Tenant Talk

Commercial Real Estate Newsletter

May 2010 • Issue 102 •

FASB's Changes to Bring About a New "Lease" on Accounting for Leases

Article written by:
Amie D. Sweeney, CPA
Senior Financial Analyst, Corporate Finance

Consumer Price Index (CPI-U):	Unemployment Rate:	The Fed (U.S.) Prime Rate:
+0.1% in Mar. 2010	9.7% in Mar. 2010	3.25% Dec. 16, 2009 (The Current U.S. prime rate)
0.0% in Feb. 2010	9.7% in Feb. 2010	4.00% Oct. 29, 2008
+0.02% in Jan. 2010	9.7% in Jan. 2010	4.50% Oct. 8, 2008
Source: www.bls.gov	*Source:* www.bls.gov	*Source:* www.wsjprimerate.us

The need for a single global accounting standard is the impetus for the convergence of United States Generally Accepted Accounting Principles and International Financial Reporting Standards. The Financial Accounting Standards Board and the International Accounting Standards Board are also working together to issue joint guidelines on accounting for leases which will likely eliminate operating leases. The underlying premise behind the lease accounting changes is that leasing is really a form of financing, and should be portrayed as such on a lessee's balance sheet. The weight of this new presentation is expected to exceed $1 trillion for publicly traded companies. The revised standard on accounting for leases is slated for issuance next year, with implementation in 2012 or 2013. Convergence appears to be on a slower track as the Securities and Exchange Commission hasn't really put this issue on its radar. A timeline for GAAP and IRFS convergence will not be determined until sometime in 2011.

These changes will elicit myriad questions from corporate occupiers and the commercial real estate industry. For example:

• Will lease accounting changes drive tenants to favor shorter-term leases in order to minimize the balance sheet effect? If so, how will this affect asset-based loans to landlords? Will lenders perceive greater risk and modify loans accordingly? How does this impact the willingness and pricing from landlords to fund relatively high costs of office improvements?

• What will be the effect of the additional debt on lessees' balance sheets due to the lease accounting changes as it relates to corporate finance? In other words, the additional debt burden brought about as a result of these proposed changes may trip debt covenants in existing corporate finance instruments. How will lenders respond?

• Will tenants attempt to trade shorter lease terms or lower rental rates for self-funded tenant improvements? This will allow a tenant to capitalize TIs as fixed assets and depreciate them over their useful lives rather than the life of the lease. It will also minimize the weight of the lease on the balance sheet.

• What other industry changes might arise out of the new lease accounting rules? For instance, could a company requiring distribution space avoid additional balance sheet debt by using 3PL service contracts that include real estate in lieu of directly leasing distribution space?

There are many unanswered questions regarding the impending changes to lease accounting. Even in the simple example presented in this paper, it's clear to see the material balance sheet impact these changes will bring to companies with significant amounts of leased space. With many companies in precarious financial positions, adding additional debt could be detrimental to lending covenants and/or credit ratings. Understanding the mechanics of the changes and how they will affect companies will put you ahead of those who will simply react. Anticipating these changes in upcoming transactions will lead to a smoother transition for existing leases once compliance begins.

OFFICE MARKET – FIRST QUARTER 2010

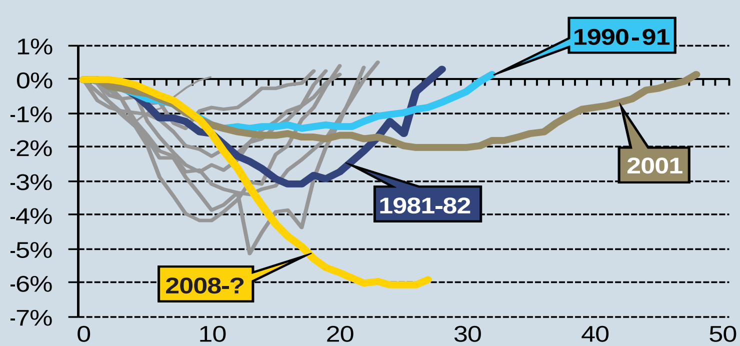
Market	Class A Vacancy %	Class A Asking Rents	Total Net Absorption
Atlanta	23.5%	$23.59	(127,812)
Boca Raton	24.8%	$32.60	(86,915)
Boston	14.2%	$36.49	106,747
Chicago	21.0%	$29.90	(756,027)
Columbus	19.6%	$18.88	(129,349)
Dallas	21.9%	$23.71	(257,958)
Denver	17.3%	$23.75	(115,281)
Detroit	20.7%	$22.09	(317,315)
Houston	15.2%	$29.65	(729,633)
Los Angeles County	17.0%	$36.36	(1,133,138)
Miami	18.9%	$35.41	(161,264)
New York – Midtown	10.0%	$68.78	(34,347)
New York – Downtown	9.8%	$47.78	(1,731,365)
Oakland	17.4%	$24.96	(134,347)
Orange County	21.5%	$28.44	(761,607)
Philadelphia	13.9%	$28.01	(26,033)
Phoenix	24.4%	$25.80	303,132
Portland	14.8%	$23.65	204,936
San Antonio	16.4%	$26.03	113,583
San Diego	17.1%	$32.52	128,740
San Francisco	15.3%	$32.94	(571,725)
San Jose	26.7%	$33.72	365,209
Overall U.S. Market	**17.9%**	**$31.10**	**(7,315,918)**

Vacancy: The vacancy rate is the amount of physically vacant space divided by the inventory and includes direct and sublease vacant. **Asking Rent:** The dollar amount asked by landlords for available space expressed in dollars per square foot per year. Office rents are reported full service where all costs of operation are paid for by the landlord up to a base year or expense stop. **Net Absorption:** The net change in physically occupied space over a period of time.

For more information on the Tenant Advisory Group or how we might assist your organization

Please contact:

Maury Gentile	Sean O'Leary	Heather Goyan
maury.gentile@grubb-ellis.com	sean.oleary@grubb-ellis.com	heather.goyan@grubb-ellis.com
310.491.2090	310.491.2010	310.491.2085



Job Losses Related to Post-War Recession

Job losses appear to have bottomed out thanks to the creation of 162,000 net new payroll jobs last month including 123,000 in the private sector. Moreover, January and February data were revised higher by a combined 62,000. But it will take a long time to regain the 8.4 million jobs lost in 2008 and 2009. The last three recessions – 1981-82, 1990-91 and 2001 – were followed by progressively longer recovery periods before employment returned to neutral. Measured from the beginning of the recession, the labor market required 28 months to recoup its losses after the 1981-82 recession. The convalescent periods from the 1990-91 and 2001 recessions lasted for 32 and 48 months, respectively. In the current cycle, total payroll employment did not hit bottom until December 2009, 24 months after the losses began, and it is unlikely to return to equilibrium for at least another three years. This recovery span understates the pain because the labor market needs to generate 100,000 to 125,000 net new jobs per month to accommodate the growing labor force, which is why the unemployment rate, currently 9.7 percent, will decline painfully slowly even as employers begin to hire again. Nevertheless, the 162,000 new jobs in March are a welcome change and suggest that the labor market is finally headed in the right direction. Renewed hiring will boost commercial real estate leasing activity in the second half of 2010 with vacancy rates expected to peak by year-end.

Source: U.S. Bureau of Labor Statistics, Grubb & Ellis

GRUBB & ELLIS.
From Insight to Results