



## Fact Sheet

### ***Economic Impacts of the Proposed Changes to Lease Accounting Standards***

Highlights of new study published by the Equipment Leasing & Finance Foundation

**Background:** Most companies, across a wide spectrum of industries, lease equipment or real estate to gain access to vital assets, typically at a lower overall cost when compared to directly purchasing those assets. Because lessees do not assume ownership of the assets, the value of these operating leases currently does not appear on a company's balance sheet.

**Proposed Changes to Lease Accounting:** The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have proposed a new model under which the value of operating leases would be capitalized and added to a company's balance sheet (as both an asset and a corresponding liability). In addition, income statements would be modified to replace current rent payments with implied interest and amortization expenses.

The Equipment Leasing & Finance Foundation, an organization committed to providing independent, future-focused research for and about the equipment finance industry, commissioned IHS Global Insight to assess the potential economic consequences for the new lease accounting standards.

**Consequences of Changes:** Headline findings of the study include:

- Capitalizing operating leases will add an estimated \$2 trillion -- and 11% more reported debt -- to the balance sheets of US-based corporations.
- The front loading of lease interest expenses would act as a 9.6% surcharge and would result in an aggregate reduction in pre-tax net income of 2.4% in the first year of the new regime.
- The changes may increase the cost of leasing (through a de facto increase in the cost of debt) which could negatively impact GDP and jobs. Every 50 basis point increase in the cost of debt translates to a potential \$10 billion in lost GDP and 60,000 fewer jobs by 2016.
- The proposed changes could result in a permanent reduction of \$96 billion in equity of US companies.

**Study Methodology:** IHS Global Insight combined financial data for more than 1,800 US companies from Standard & Poor's CompUSA database with its own proprietary data to develop pro forma financial statements to model the magnitude of the impact of the new accounting standards on specific companies as well as major sectors of the US economy. The modeling effort was augmented and enhanced by a qualitative review of 105 representative comment letters submitted to FASB (in response to an Exposure Draft of the proposed rules) as well as a general literature meta-study.

**Practical Applications of Proposed Changes:** The seemingly-simple income statement changes trigger a front-loaded cost pattern that has permanent implications on the equity of US companies. Equity, which is the difference between assets and liabilities on a balance sheet, is a measure of the net worth of a company. The transition to the front-loaded cost structure will initially increase liabilities faster

than assets, thereby reducing equity -- the net worth -- of companies. Had the new rules been implemented in 2010 (the latest year for which financial information is available), Walgreen's would have lost \$418M of equity; while United Continental would have lost \$373M. Indeed, the 10 companies featured in the report would have lost a combined \$2.4 billion in the equity they reported in 2010.

Extending the analysis to include leases initiated beyond 2010, IHS Global Insight modeled the permanent, or "steady state" equity impact, which amounted to a loss of \$96 billion to US companies. Nearly one-half of the loss of equity will occur in three industry sectors that heavily rely on operating leases – retail, financial services and healthcare. The most heavily affected is the retail sector, which stands to lose \$21 billion, or 2.7% of its equity

**Wider Economic Impacts:** Beyond the financial statement mechanics, the new rules could potentially shift the lessee-lessor dynamic. Lessees may opt for shorter lease terms or simply purchase assets outright. This could result in making leasing less desirable for businesses – both large and small – who rely to a great extent on the flexibility of leasing to acquire their capital equipment. While this directly affects lessors, it would also have far-reaching indirect impact on industries that supply the equipment finance industry (e.g., construction, manufacturing).

Another potential implication of the lessee-lessor dynamic is that equipment lessors may incur more risk, which could exert upward pressure on lease rates. IHS Global Insight leveraged its U.S. Macroeconomic Model to assess the impact of changes to the cost of debt. Assuming the new rules cause a 50 basis point increase beginning in 2013, the study estimates a peak loss of 60,000 U.S. jobs by 2016 as companies seek ways to offset the extra interest expenses by cutting back on capital investment and employment.

#### Impact of Lease Accounting Changes on Equity by Industry Sector

Industry Sector	Estimated Permanent Change in Equity (\$ billion)	Percentage of 2010 Equity
Retail Trade	-21.0	-2.7%
Financial Services	-16.0	-0.7%
Healthcare	-9.9	-1.9%
Transportation and Warehousing	-6.9	-1.3%
Manufacturing	-6.8	-0.3%
Professional and Technical Services	-6.4	-1.2%
Information	-6.3	-1.2%
Accommodations and Food Services	-6.3	-1.2%
Other Services, Except Public Admin.	-4.6	-0.9%
Wholesale	-3.1	-0.6%
Educational Services	-2.3	-0.4%
Construction	-1.9	-0.3%
Arts, Entertainment and Recreation	-1.8	-0.3%
Mining	-1.0	-0.2%
Utilities	-0.9	-0.3%
Administrative, Support and Other Services	-0.7	-0.1%
<b>Total</b>	<b>-95.8</b>	<b>-0.9%</b>