ASA GROUP

NewsLetter

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Chairman's Column

Lease accounting changes – Impact on BS and Stock Price

Two months have gone by since President Trump took office. Initially, there were reports that his election would have a limited impact on the world economy. However, after taking office, he has abused his dominance as the world's strongest country, repeatedly threatening other countries with tariffs like a trial balloon. I am quite concerned and frankly already fed up that this will continue for another four years. Tesla's stock price has dropped to half of its all-time high (March 12, Nikkei Shinbun morning edition), and there has been a shakeup in the government as well.

In other news, there will be a change in lease accounting. As you may know, the change will fully apply starting April 2027. Simply put, the conventional classification between an operating lease and finance lease will be gone. For a lease contract, both a right-of-use asset and lease liability will be recorded on the balance sheet (informally called on-balance sheet).

Many of our SPC clients that own real estate as lessors will not be impacted. However, industries like airlines, real estate, and retail that tend to be lessees will be significantly affected. For example, according to our seminar, one TSE Prime food products company estimated a 28 billion yen (7.8%) increase of their balance sheet.

Like institutional investors, ETFs and other investment trusts have become large buyers of stocks with the popularity of NISA. The impact on ROA can weigh heavily in the purchase criteria of stock. In this way, accounting changes can potentially have a significant impact on stock price.

In lighter news, I currently have seasonal allergy symptoms. But perhaps with resistance developed during Covid, I can stave off symptoms this year with just a nasal spray.

by Kazuhiro Matsuzawa, Chairman

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Real Estate

The King's Real Estate – Funding for Philanthropy

During my previous work at a multi-national real estate firm, I learned that there was "King's real estate" around the world. Famous among them is England's Crown Estate and Hawaii's Bishop Estate and Queen Emma Foundation.

Crown Estate

In central London, luxury boutiques and impressive office buildings line Regent Street and St James's. Much of this land called "Crown Estate" in fact are the assets of the British Royal Family.

Crown Estate has a long history that dates back to the Norman Conquest of 1066. Since the Middle Age, the Monarch had owned vast land, but in 1760, King George III decided to have the government manage the land. In return, the Royal family would receive a fixed amount from the government treasury, which marked the start of this arrangement. Thus, Crown Estate came to be managed under a unique system, "owned by the royal family and managed by the government."

Today, Crown Estate owns not only London's prime real estate, but also vast farmland, forest, and parts of England's coastline down to 12 nautical miles to the ocean floor. Recently, they have gained attention by developing offshore wind power that has quickly increased its leasing revenue. These assets generate tens of millions of British pounds every year, which all become part of the British government treasury.

Bishop Estate and Queen Emma Foundation

Along Waikiki Beach, popular among tourists are many luxury hotels that are built on leasehold land owned by the Bishop Estate and Queen Emma Foundation, which are foundations of the former Kamehameha dynasty.

Bishop Estate was established by Princess Bernice Pauahi Bishop, one of Hawaii's last royal family members, who entrusted vast land to the foundation to assist the education of Native Hawaiians. Today, Bishop Estate is Hawaii's biggest private landowner that generates revenue from a range of properties including Waikiki's commercial properties and
forestland of Oahu which are used as funds operate Kamehameha Schools.

On the other hand, the Queen Emma Foundation was established to provide medical aid to carry on the spirit of Queen Emma. The revenue generated from the foundation's properties in Waikiki and Honolulu are donated to Queens Medical Center, which is Hawaii's biggest medical facility.

While Crown Estate, Bishop Foundation, and Queen Emma Foundation have different historical origins, they serve as sustainable philanthropic models in today's world.

by Shigeru Hirai, Knowledge Management Office

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Accounting Update

Applying the New Lease Accounting Standards – Impact on Real Estate Funds

Following last month's edition of "New lease accounting standards starting April 2027", this month we outline the impact of sale and leaseback and sublease transactions on funds.

Treatment for Sale and Leasebacks

The introduction of the new lease accounting standards will have some impact on funds for a sale and leaseback transaction. But there should not be any major changes in recording gains on the sale of property.

Funds that apply IFRS to consolidated financial statements should pay particular attention to the difference in treatment of gain on sale between consolidated financial statements and entity-level financial statements. On a consolidated basis, gain on sale tends to be smaller since the recognition under IFRS differs for right-of-use assets at the point of sale for property. However, since the new lease accounting standard employs the methodology of U.S. GAAP, there is no significant difference with conventional Japanese standards.

Treatment for Subleases

Funds may be impacted under the new lease accounting standards since bookkeeping is simultaneously required under the sublease agreement for both lessee (of the master lease) and lessor (of the sub-lease). Because sub-leases are often treated as operating leases, while the lessor recognizes income on a straight-line basis, the lessee's cost burden is higher in the early stages of the lease contract. One must be cautious of this mismatch in profit and loss for accounting purposes.

Particularly with funds, the SPC which owns property (tokutei mokuteki kaisha), and the property manager often enter into a master lease agreement. Since the master lease is regarded as a form of sublease, the sublease accounting is required.

However, the sublease treatment does not apply under an exemptive rule, if the master leaseholder essentially does not bear risk, and the only income recorded is from administrative fees. In that case, the standard accounting treatment is acceptable (i.e., recording a profit/loss for the difference between lease payments received and lease payments made). Consequently, funds that use a master lease agreement are unlikely to be subject to sublease accounting treatment.

However, in a master lease agreement that provides a rent guarantee for a fixed period, the master leaseholder bears the burden of risk. In that case, the sublease accounting treatment may be required. Moving forward, funds will need to carefully review contracts to apply the proper accounting treatment.

by Kenji Hanazawa, ASA Total Solution