

*New Lease Accounting Standards and the  
Potential Impact on your Company  
and Real Estate Strategies*

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**CBRE**

## *Administrative*

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- ◆ Questions can be submitted to today's speakers by entering your question in the box at the bottom left of the screen and clicking on "Submit."

## *Polling Question:*

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How familiar are you with the new lease accounting standards and their requirements?

1. Very familiar
2. Somewhat familiar
3. Not at all familiar

## *Agenda*

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Overview of the new standards.

What could you be doing now to prepare for the changes?

How might the new standards affect your real estate strategies?

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## *Overview of the new standards*

## *What is the new lease accounting model for a lessee?*

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### BALANCE SHEET

- ◆ Virtually all leases coming on balance sheet (except short-term leases)
- ◆ Asset & obligation (similar to a capital lease) – measured based on the present value of the lease payments over assumed term

### P & L

- ◆ Dual recognition model
- ◆ Interest & amortization (Finance Leases) versus single lease expense (Operating Leases)

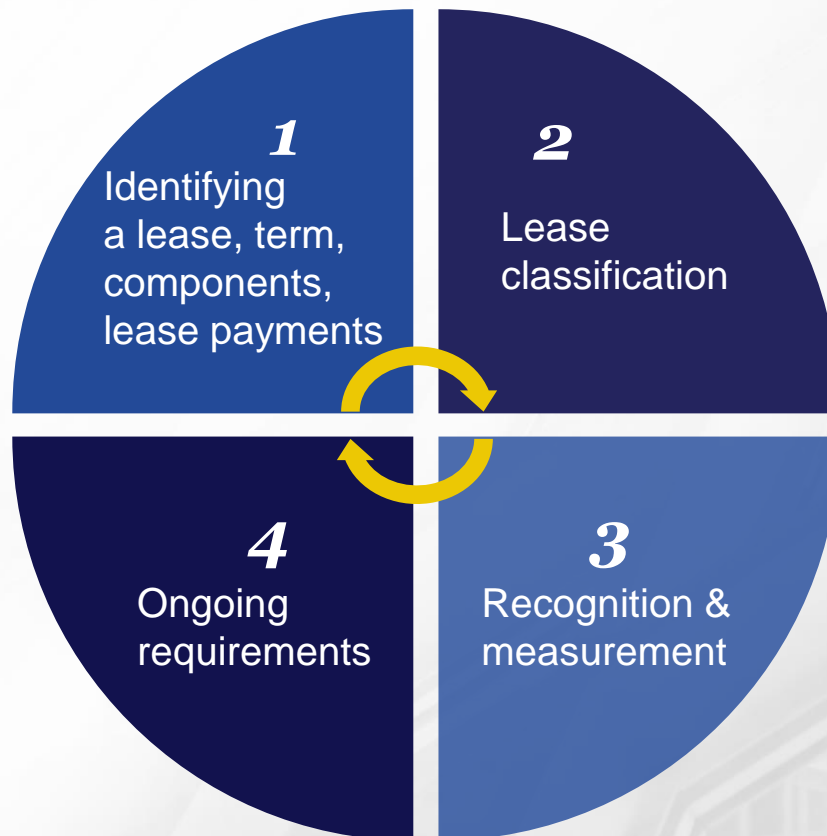
## *What is the impact on a lessee's financial statements?*

	<b>Finance</b>	<b>Operating</b>
<b>Balance sheet</b>		
RoU asset	✓	✓
Lease liability	✓	✓
<b>Income statement</b>		
Interest expense (front-loaded)	✓	-
Amortization expense (straight-line)	✓	-
Lease expense (straight-line)	-	✓
<b>Statement of cash flows</b>		
Interest portion of liability	Operating	Operating
Principal portion of liability	Financing	Operating

## *Lifecycle of a lease*

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A lease is an arrangement that conveys a right to use an identified asset for a period of time.





# When is a lease present?

Lease is present in a contract if the contract includes both:

**An identified asset**

Is explicitly or implicitly specified	Supplier has no practical ability to substitute or would not economically benefit from substituting
	



**Customer's right to control use of the identified asset**

Decision-making authority over the use of the asset	The ability to obtain substantially all economic benefits from the use of the asset
	

## *How is lease term determined?*

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### **Non-cancellable lease period plus:**

- ◆ Renewal periods “reasonably certain” of exercise
- ◆ Periods covered by a termination option reasonably certain not to be exercised
- ◆ Renewal periods (non-termination periods) controlled by lessor

## *How should a lessee separate components of a contract?*

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- ◆ **Identify separate lease and nonlease components**
- ◆ **Allocate consideration to the separate lease and nonlease components on a relative standalone price basis**
  - Use observable standalone prices
  - Use estimated standalone prices if observable not readily available (maximize the use of observable standalone prices)
  - Residual estimation permitted if estimated standalone price for a component is highly variable or uncertain
- ◆ **May elect to not separate lease and nonlease components by class of underlying assets and account for each separate lease component along with the associated nonlease component as a single lease component (accounting policy)**

## *What are typical payments in real estate leases?*

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### NET LEASES

- Tenant pays their share of real estate taxes, insurance and CAM
- Generally “variable” and will be excluded from lease payments and expensed as incurred

### MODIFIED GROSS OR “BASE YEAR” LEASES

- Tenants pay their share of increases in real estate taxes, insurance and CAM over a base year amount
- Part fixed and part variable
- Fixed piece gets included in lease payments for real estate taxes and insurance
- Fixed piece for CAM is excluded from lease payments and is expensed as incurred
- Variable portions – i.e., the “excess” amount over base year is excluded from lease payments and expensed as incurred

### GROSS LEASES

- Tenants pay a fixed amount which includes all components
- Fixed piece gets included in lease payments for real estate taxes and insurance
- Fixed piece for CAM is excluded from lease payments and is expensed as incurred

## How should a lessee classify a lease?

Evaluate if any of following criteria are met:

Lease transfers ownership of asset to lessee

Lease grants lessee a purchase option reasonably certain of being exercised

Lease term is for major part of asset's remaining economic life\*

PV of lease payments (incl. lessee RVG) is substantially all the asset's fair value

Asset is so specialized it is expected to have no alternative use to lessor

**YES**

*Finance lease*

*Operating lease*

**NO**

\*Not applicable if commencement date falls at or near end of asset's economic life

## *Classification considerations – lessee*

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### **Lease commencement**

- ◆ The date a lessor makes an underlying asset available for use to a lessee
- ◆ The date for classification and initial measurement

### **Discount rate**

- ◆ Rate the lessor charges the lessee, when determinable; otherwise, the lessee's incremental borrowing rate

### **Initial direct costs**

- ◆ Incremental costs
- ◆ Only those costs incurred as a result of signing the lease

## *Classification considerations – lease payments*

### FIXED PAYMENTS

#### **Variable payments (contingent rent)**

- ◆ Include payments that depend on index or rate, using index or rate at commencement
- ◆ Include in-substance fixed payments
- ◆ Exclude payments that change due to factors after commencement (other than passage of time)

#### **Purchase or termination options**

- ◆ Include payments for purchase, renewal or termination options consistent with lease term

#### **Residual value guarantees**

- ◆ Include the full amount of the residual value guarantee

### LESS

#### **Lessor-provided incentives**

- ◆ Payments made to, or on behalf of, the lessee
- ◆ Loss incurred by lessor resulting from assuming a lessee's pre-existing lease from 3<sup>rd</sup> party

## *What's coming on the lessee's balance sheet?*

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**At the commencement date, a lessee must record the following for all leases (except short-term leases):**

### LEASE LIABILITY

- ◆ PV of lease payments due over the lease term
- ◆ Discounted at lease implicit rate (if available), or lessee's incremental borrowing rate

### RIGHT-OF-USE ASSET

**Initially equal to the lease liability, plus**

- ◆ Lease payments made before commencement date (less any lease incentives received)
- ◆ Initial direct costs incurred



## *What are the lessee's reassessment requirements even if there is no lease modification?*

CAUSE	Changes in assessment of renewal, termination, purchase options based on triggering events within lessee's control	Change in amounts probable of being owed under a lessee provided residual value guarantee	Contingency resolved such that some or all variable payments become fixed
EFFECT	<ul style="list-style-type: none"> <li>◆ Reclassify the lease</li> <li>◆ Remeasure liability using updated discount rate</li> </ul>	<ul style="list-style-type: none"> <li>◆ Do not reclassify the lease</li> <li>◆ Remeasure liability using original discount rate</li> </ul>	
	<ul style="list-style-type: none"> <li>◆ Remeasure &amp; reallocate consideration to remaining lease &amp; non-lease components</li> <li>◆ Remeasure lease liability using appropriate rate above and revised lease payments (index or rate based variable lease payments are remeasured using index or rate at remeasurement date)</li> <li>◆ Adjust the right-of-use asset (potential P&amp;L impact)</li> </ul>		

## *Effective date and transition*

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### ADOPTION DATE

- ◆ Effective January 1, 2019 for calendar-year public companies
- ◆ Other entities have an additional year for annual filings
- ◆ Early adoption permitted

### TRANSITION METHOD

- ◆ Modified retrospective approach
- ◆ May apply hindsight to existing leases for lease term and asset impairment
- ◆ Change in classification (between operating and capital / finance)

### RELIEF PACKAGE

At adoption do not reassess:

- ◆ Whether an arrangement is, or contains, a lease
- ◆ Lease classification

# *US GAAP vs. IFRS*

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## ASC 842 vs. IFRS 16

	ASC 842	IFRS 16
Lessee accounting	Dual model for Profit and Loss: <ul style="list-style-type: none"> <li>• Finance lease (Interest/Amortization)</li> <li>• Operating lease (Straight-line lease expense)</li> </ul>	Single model <ul style="list-style-type: none"> <li>• All leases (Interest/Amortization)</li> <li>• Recognition/Measurement exemption for low-value assets (\$5K or less)</li> </ul>
Lessor accounting	<ul style="list-style-type: none"> <li>• Upfront profit recognition in sales-type leases only</li> <li>• Two additional lessor classification criteria (Collectability &amp; Amt. required to satisfy Residual Value Guarantee)</li> </ul>	<ul style="list-style-type: none"> <li>• No distinction between sales-type and direct finance lease (allow upfront profit recognition for both)</li> <li>• No additional lessor classification criteria</li> </ul>
Measurement of RoU asset	<ul style="list-style-type: none"> <li>• Generally, Right of Use asset = Lease liability (subject to certain adjustments)</li> </ul>	<ul style="list-style-type: none"> <li>• Allows alternative measurement bases for Right of Use asset (e.g., IAS 40 or IAS 16)</li> </ul>
Reassessment of variable lease payment	<ul style="list-style-type: none"> <li>• In general, no reassessment (however required if lease is reassessed for other reasons, or contingency resolved such that some or all variable payments become fixed)</li> </ul>	<ul style="list-style-type: none"> <li>• Required for variable lease payments that depend on an index/rate</li> </ul>
Subleases	<ul style="list-style-type: none"> <li>• Classification of sublease refers to an underlying asset</li> </ul>	<ul style="list-style-type: none"> <li>• Classification of sublease refers to Right of Use asset arising from head lease</li> </ul>
Sale-leaseback	<ul style="list-style-type: none"> <li>• Gain/loss on sale is accounted for consistently with guidance in ASC 606</li> </ul>	<ul style="list-style-type: none"> <li>• Gain/loss limited to the amount that relates to the buyer-lessor's residual interest in underlying asset</li> </ul>

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*What could you be doing now  
to prepare for the changes?*

## *Polling Question:*

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Which of the following best describes the primary system used by your company for tracking leases?

1. Third-party software
2. Internal custom-built system
3. Spreadsheet-based
4. None of the above
5. I don't know

## *What could you be doing now to prepare for the changes?*



## *Lease administration considerations*

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**Properly structured, lease administration can mitigate risk**

**Proper alignment with Finance and Accounting is essential**

**Lease Administration is a foundational element of the new lease standard**

**A Lease Administration & Technology review may be required**

**Early and full abstraction is vital**



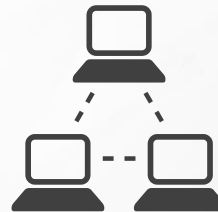
## *Lease administration systems impacts*

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**Lead time for system RFPs, data migration and user acceptance testing, means you should start thinking about this element now**



Easily accessible & indexed electronically stored supporting documentation



Existing systems likely do not have sufficient functionality for re-measurement & disclosure



Investigate whether systems require interface into Accounting / Finance platforms, and file layout



Understand key event notifications functionality, like “what if” analyses, workflow management to support decision making

## *Lease administration process impacts*

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**Need for a strong PMO with an effective governance structure**



**Lease Administration team communication and training**



**Reexamination of internal controls and processes**



**Transactions, Lease Admin and CRE meeting cadence**



**Exception/Status Reporting on key IASB / FASB fields**

# Roadmap to the new standard

	1 – 6 months	6 – 12 months	12 – 18 months
<b>Category</b>	<b>Discovery/Pre-Planning</b>	<b>Transition/Implementation</b>	<b>Full Cutover to New Standard</b>
<b>Database</b>	<ul style="list-style-type: none"> <li>Define Business Requirements/Scope</li> <li>Issue RFP for Tech &amp; Award</li> </ul>	<ul style="list-style-type: none"> <li>UAT and Implement</li> <li>Interface Mapping</li> </ul>	<ul style="list-style-type: none"> <li>Populate Transaction Module of System</li> </ul>
<b>Lease Administration</b>	<ul style="list-style-type: none"> <li>Locate all Leases</li> <li>Assess and Map Current Processes</li> </ul>	<ul style="list-style-type: none"> <li>Abstraction and Query Resolution Process</li> <li>Update Current Lease Administration Playbook</li> </ul>	<ul style="list-style-type: none"> <li>Business As Usual – Lease Admin</li> <li>New Data Points Recorded</li> </ul>
<b>Rent Management</b>	<ul style="list-style-type: none"> <li>Assess and Map Current Rent Mgmt. Processes</li> </ul>	<ul style="list-style-type: none"> <li>Refine Processes for Rent Management Lease Finance</li> </ul>	<ul style="list-style-type: none"> <li>Rent Management Playbook v1.0</li> </ul>
<b>Analysis &amp; Strategy</b>	<ul style="list-style-type: none"> <li>Obtain Data and Preliminary Modelling of Financial Impacts</li> </ul>	<p><b>Primary Deliverables:</b></p> <ul style="list-style-type: none"> <li>✓ Reporting Roadmap Defined</li> <li>✓ Interface to Finance Team Produced</li> <li>✓ Playbooks &amp; Best Practice Manuals</li> <li>✓ Program Mgmt. Transition Schedule</li> </ul>	<ul style="list-style-type: none"> <li>Refined Data Points for Financial Impacts</li> <li>Engage Auditors to Review Processes</li> <li>Embed the Reassessments / Strategy Review</li> </ul>

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*How might the new standards  
affect your real estate strategies?*

## *How might the new standards affect real estate strategies?*

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**More options  
and analysis**

**Minimizing balance sheet impact  
clashes with practical realities of  
leasing**

**Own  
vs.  
Lease**

**Sale/leasebacks:  
Not much  
change**

**New priorities –  
on-balance  
sheet lease  
financing**

**Old structures  
rise – synthetic  
leases**

**Smart move:  
rationalize and  
right-size  
portfolios**

## *Additional resources*

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**For additional material and resources on this topic please go to:**

**[FASB-IASB | CBRE](#)**

**[Lease Accounting - PwC](#)**

**The CBRE & PwC lease accounting survey results will be published in late May.**

## Contact information

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### JEFF BEATTY

Senior Managing Director  
Financial Consulting Group  
Director, Global Task Force  
CBRE

[Jeff.Beatty@cbre.com](mailto:Jeff.Beatty@cbre.com)

602-735-5608

### TOM WILKIN

Partner, U.S. REIT and RE  
Lifecycles Leader  
PwC

[Tom.Wilkin@pwc.com](mailto:Tom.Wilkin@pwc.com)

646-471-7090

### ASHIMA JAIN

Managing Director  
National Office  
PwC

[Ashima.Jain@pwc.com](mailto:Ashima.Jain@pwc.com)

408-817-5008

### JEFF SHELL

Executive Vice President  
Corporate Capital Markets  
CBRE

[Jeffrey.Shell@cbre.com](mailto:Jeffrey.Shell@cbre.com)

313-417-2100

### PHILLIP KELLOFF

Americas Leader  
Portfolio Services & Lease  
Administration  
CBRE

[Phillip.Kelloff@cbre.com](mailto:Phillip.Kelloff@cbre.com)

415-772-0276

*Thank you*

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# *Appendix*

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# *Separating Components: Examples*

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## *Separation & allocation example – variable property tax & insurance payment*

### FACTS

#### **Lessee and Lessor enters into a 5-year net lease for a building**

- ◆ The annual lease payments are fixed at \$10,000 per year
- ◆ In addition, Lessee is required to separately pay property tax and insurance on the building as billed (these would be owed by Lessor regardless of the lease)

### ANALYSIS

#### **Property taxes and insurance are not separate components; contract contains one component – lease component**

- ◆ Lessee's payment of property tax and insurance is reimbursement of Lessor's costs and not payment for goods or services
- ◆ \$50,000 total lease payments (\$10,000 per year x 5 years) are included in the measurement of lease liability
- ◆ Because property tax and insurance payments are variable and do not depend on an index or rate, they are:
  - Excluded from measurement of initial lease liability
  - Recognized in income statement if and when incurred

## *Separation & allocation example – fixed property tax & insurance payment*

### FACTS

#### **Lessee and Lessor enters into a 5-year gross lease for a building**

- ◆ Annual lease payments are fixed at \$13,000 per year, itemized as follows:
  - Rent: \$10,000
  - Property tax: \$2,000
  - Insurance: \$1,000
  - Property tax and insurance would be owed by Lessor regardless of the lease

### ANALYSIS

#### **Property tax and insurance are not separate components; Contract contains one component – lease component**

- ◆ Lessee's payment of property tax and insurance is reimbursement of Lessor's costs and not payment for goods or services
- ◆ Because property tax and insurance payments are fixed, \$65,000 lease payments (\$13,000 per year x 5 years) would be included in the measurement of the lease liability

## *Separation & allocation example – common area maintenance*

### FACTS

#### **Lessee and Lessor enters into a 5-year lease for a space within a building**

- ◆ Annual lease payments are fixed at \$13,000 per year, which covers:
  - Use of space
  - Lessor's performance of common area maintenance (CAM) activities such as cleaning common areas, parking maintenance, etc.

### ANALYSIS

#### **CAM activities are a separate component; the contract contains two components – lease component and non-lease component (i.e., CAM services)**

- ◆ Lessee receives a service from Lessor in the form of the CAM activities it would otherwise have to undertake itself or pay another party to provide
- ◆ Contract consideration of \$65,000 (\$13,000 per year x 5 years) would be allocated between lease and non-lease component (CAM)