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Submitted via electronic mail

Brussels, May 8, 2020

Reference: Exposure Draft: Covid-19-Related Rent Concessions

Dear Mr. Hoogervorst,

Thank you for the opportunity to comment on the International Accounting Standards Board's Exposure Draft on Covid-19-Related Rent Concessions - *Proposed amendment to IFRS 16*. This submission is provided on behalf of the European Public Real Estate Association's (EPRA) Reporting & Accounting Committee.

EPRA is the voice of the publicly traded European real estate sector. With more than 270 members, covering the whole spectrum of the listed real estate industry (companies, investors, and their suppliers), EPRA represents over EUR 600 billion of real estate assets and 94% of the market capitalisation of the FTSE EPRA Nareit Europe Index. EPRA's mission is to promote, develop and represent the European public real estate sector. We achieve this through the provision of better information to investors and stakeholders, active involvement in the public and political debate, promotion of best practices and the cohesion and strengthening of the industry. Find out more about our activities on www.epra.com.

EPRA's Reporting & Accounting Committee is composed of 14 listed real estate companies, Big 4 Audit firm representatives and 5 Institutional Investors. The committee is responsible for providing guidance on financial & accounting matters relevant to the listed real estate sector, including financial policy and accounting matters.

EPRA welcomes the opportunity to provide commentary on the Exposure Draft ([ED2020/2 Covid-19-Related Rent Concessions](#)). Our comments are specifically focused on question 1 of the draft amendment to IFRS 16, which is connected to paragraph BC3 of the Exposure Draft as well as paragraph 23 of IASB's Staff Agenda Paper Ref 32B ([AP32B](#)).

Question 1 – Practical expedient (paragraphs 46A and 46B of the [Draft] amendment to IFRS 16)

Paragraph 46A of the draft amendment to IFRS 16 proposes, as a practical expedient, that a lessee may elect not to assess whether a covid-19-related rent concession is a lease modification. A lessee that makes this election would account for any change in lease payments resulting from the covid-19-related rent concession the same way it would account for the change applying IFRS 16 if the change were not a lease modification.

Paragraph 46B of the draft amendment to IFRS 16 proposes that the practical expedient applies only to rent concessions occurring as a direct consequence of the covid-19 pandemic and only if all of the following conditions are met:

- (a) the change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;

- (b) any reduction in lease payments affects only payments originally due in 2020; and
- (c) there is no substantive change to other terms and conditions of the lease.

Do you agree that this practical expedient would provide lessees with practical relief while enabling them to continue providing useful information about their leases to users of financial statements? Why or why not? If you disagree with the proposal, please explain what you propose and why:

Response

Although we do support IASB's proposal to provide lessees with practical relief for rent concessions arising as a direct consequence of the COVID-19, we consider that the practical expedient should be also applicable to lessors. Meaning that a lessor may also, optionally, elect not to assess whether a COVID-19-related rent concession is a lease modification. To that end, we strongly encourage the Board to reconsider its original position and expand the scope of the amendment so that the equivalent practical relief is provided to lessors on the basis that IFRS 16 clearly did not contemplate a health pandemic that would have the effect of changing thousands of lease contracts. Having said that, our concerns in relation to ED2020/2 are revolving around two main areas:

- (i) Disconnection between the economic reality and the accounting treatment as a result of revenue recognition; and
- (ii) Complexity in defining whether the lease concession qualifies as a lease modification or not.

We consider it beneficial to elaborate on the above two points in order to outline the challenges faced by the lessors during the recent COVID-19 pandemic.

(i) The first area of concern is revenue recognition. In our view, the impact from COVID-19 should be recognised in the accounting period that COVID-19 occurred, rather than being deferred over a much longer remaining lease term. Under the current proposal, there is a clear disconnection between the economic reality and the accounting treatment.

For example, if a company grants a relief for a material portion of rent through waivers or discounts, then this could, or expected to, lead to materially lower EPS in 2020 (and possibly parts of 2021). It appears that IFRS 16 would require the effect of rent waivers to be treated in the same way as rent-free periods and recognised on a straight-line basis over the lease term.

Hence, if a company has a lease with annual rental income of 100 and with a 5-year remaining lease term, but there is a 100% discount granted for 2Q20 and 3Q20, then:

Annual cash flows would be:

2019 = 100

2020 = 50

2021 = 100

2022 = 100

Etc

However, the lease revenue recognised in the income statement would be:

2019 $100 - 0 = 100$

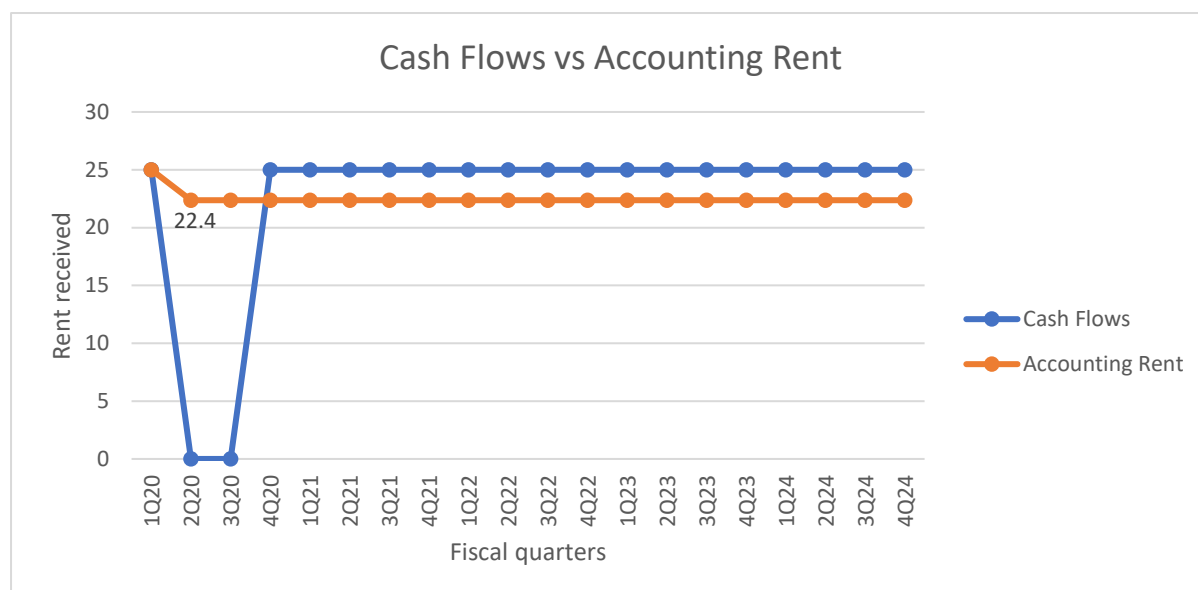
2020 $100 - 7.9 = 92.1$

2021 $100 - 12 = 90$

2022 $100 - 12 = 90$

Etc

The below graph further illustrates the discrepancy between the actual cash flows and the accounting treatment, on a quarterly basis. It is worth noting that this example is in its simplest form, assuming a one-time negotiation. However, as the pandemic unfolds, it is probable that there may be multiple negotiations for lease modifications, instead of just a one-off negotiation.



The above means that COVID-19 will distort EPS for many years (for those companies that have to offer material discounts), complicating dividend cover, a key metric for investors. In addition, the graph and revenue recognition patterns clearly show that, although investors expect revenues of lessors to substantially decrease in 2020 and a significant recovery for the subsequent years, IFRS 16 requires lessors to report otherwise. Last, the above issue becomes even more prominent when the differences in the length of lease are taken into consideration. For example, in the scenario where there is a substantial amount of lease modifications in a jurisdiction where shorter lease terms are more common, then the impact on the future EPS is more significant, when compared with jurisdictions where longer lease terms are prevalent. As such, comparability between real estate companies will be further complicated.

Complementing the above, we note that a large number of lessors have entered discussions or have been requested to grant (based on local decisions by government and/or parliament) a substantial number of rent concessions as a consequence of the recent pandemic and the global lockdown. However, there has been no precedent where a real estate lessor has granted rent concessions of three months (or more) in its entire portfolio at a given point in time. As a result, the **magnitude** of the rental forgiveness, when compared with rent concessions granted during the ordinary course of business (i.e. pre COVID-19), triggers a clear **misalignment** between the economic reality and the accounting treatment, jeopardising the readability and value for the users of financial statements.

Overall, we consider that the aforementioned issues rise from the massive scale and impact of COVID-19 on future rental income, which, in turn, need to be aligned with the accounting treatment. The proposed approach outlined in the Exposure Draft ([ED2020/2 Covid-19-Related Rent Concessions](#)), would, or expected to, inflate 2020 and/or future results, which would diverge both from the economic and cash reality and would, therefore, not only affect the credibility of lessors, but also may result in potential **erroneous** financial information provided to investors. In fact, the potential practice of the same waivers or discounts being treated differently in lessees' and lessors' accounts adds further complexity to the matter. Meaning that, under the current proposal, there may be cases where the lessor assesses that a lease modification has occurred and accounts it as such, while the lessee applies the practical expedient exemption and does not account the rent concession as a lease modification. As such, it is likely that there will be a misalignment between lessors' revenue recognition and lessees' lease payments.

(ii) The second issue revolves around paragraph BC3 of the Exposure Draft ([ED2020/2 Covid-19-Related Rent Concessions](#)) as well as paragraph 23 of IASB Staff Agenda Paper Ref 32B ([AP32B](#)), which outline the rationale behind the recommendation that “the Board should not consider any amendment to lessor accounting”.

These reasons are clearly not supported by the facts of a real estate lessor’s business and/or accounting. In fact, we have found limited evidence in support of the proposal of not considering any amendment to lessor accounting. Connected to this, following are the Staff’s four reasons and the actual facts of a lessor’s operation with respect to each:

Reason (a) -- Leasing is part of a lessor’s core business - lessors have processes and systems in place for their leasing activities, including when changes are made to lease payments.

The Facts -- Leasing is indeed part of a lessor’s core business and is generally true that lessors have processes and systems in place for their “regular course of business” leasing activities, however the impact of COVID-19 is an exceptional situation. Assessing all rent agreements at the same time to determine whether there is a lease modification in a period of heavy market turbulence and economic uncertainty (e.g. tenant issues, covenants, valuation with disclaimer) is a substantial challenge. Even though lessors have certain processes and systems in place for managing their leasing activities, they do not have the resources to deal with those exceptional changes to almost 100% of their contracts in a very short timeframe. For example, some EPRA member companies have up to 12,000 leases across 14 European countries.

Reason (b) -- Lessors typically use one, or a small number of, standard lease contracts for leases of similar assets within a jurisdiction. Lessors are also likely to offer similar rent concessions to many lessees. On this basis, a lessor may often be able to apply one assessment of whether a rent concession is a lease modification to many of its contracts.

The Facts -- While it is generally true that some landlords may apply, in normal times (i.e. pre COVID-19), standard contracts (or at least standards by asset class and jurisdiction), the industry is trying to provide tenants with tailor-made solutions, which are breaking the standardisation of the approach. On that basis, each company is dealing with thousands of tenants and providing individualised solutions. As such, the existing processes with regards to classifying leases are not operational, meaning that each lease needs to be considered individually. The reality is much more complex than assessed by the Staff, with standard lease contracts not being the norm in the current circumstances. This is especially relevant for commercial leases where there is not often one/small number of standard contracts in the first place and then, on top of that, rent concessions are negotiated at an individual tenant level, creating even more complexity.

Reason (c) -- Need for relief is less significant for lessors as IFRS 16 substantially retained the lessor accounting model in IAS 17 Leases.

The Facts -- IFRS 16 did carry forward IAS 17, however the most critical issue – i.e. “assessment of lease modification” - was newly introduced with IFRS 16. Therefore, dealing with this aspect of IFRS 16 is new for lessors. Having said that, the accounting itself is not the real issue but the highly complex assessment, in the COVID-19 environment, is. For example, the question whether rents are still legally owed (not only based on the specific lease agreement but also under applicable law and regulation) during a lock-down is highly discussed and, in many cases, highly political. Hence, an assessment if a concession is a lease modification is, in many cases, quite a complex matter – in some countries, it is questionable as to whether a force majeure clause can be used in the context of COVID-19. On a last note, rent concessions granted (sometimes forced by political decisions or pressure) under these circumstances are not comparable with rent concessions incurred to secure a new lease agreement, which was covered under IAS 17.

Reason (d) -- Accounting required by IFRS 16 for lease modifications, operating or finance leases, is not expected to be complicated.

The Facts -- As mentioned in bullet point (c) above, we do agree that the accounting itself for lease modifications under IFRS 16 is not the underlying reason behind the challenges faced by lessors. Instead, the practical challenges for lessors are, primarily, revolving around the highly complex assessment in determining whether a substantial amount of rent concessions qualify as lease modifications in the current uncertain environment.

To elaborate further, the processing of all these modifications (negotiation, internal validation, in particular by legal teams, IFRS analysis of the nature of these modifications, processing in the system) is a significant challenge, considering the time constraint and the large scope of lease contracts impacted. It is also worth noting that the agreement process may also be longer in where joint venture arrangements are in place or debt covenants requiring banks' approval. Further, as the pandemic unfolds, it is highly probable that there may be multiple negotiations, rather than just a one-time negotiation. Complementing the above:

- i. Assessment is highly complex if there is a lease modification as it involves local legal assessment on a high volume of contracts within a short time frame.
- ii. Assessing if there is a lease modification involves legal analysis of a situation with no precedent cases available; often it is not clear (opposing opinions) if rent is still due during a lockdown. Therefore, there is a risk of diversity among real estate companies, which in turn may affect the credibility of lessors and could potentially generate misunderstanding from investors.
- iii. Lease concessions are individualised on a tenant by tenant basis and vary heavily from country to country or asset class.
- iv. Rent negotiations are expected to be initiated when the lockdowns have been lifted and trading is resumed. As the lease re-negotiations are mostly customised, it is quite a lengthy process which could take a longer period than the one estimated by the Board. On that basis, EPRA notes the uncertainty that lessors are currently facing regarding lease modification accruals over the next 12 months. In our view, the cost in terms of time and resources in relation to applying the current IFRS 16 lease modification standard for lessors, where no practical relief is granted, is not justified given the massive scale and impact of the recent pandemic on lessors.

Concluding Remarks

Considering the various practical challenges outlined in this letter that lessors face as a result of the recent COVID-19 pandemic and global lockdown, we strongly encourage the Board to reconsider its original position and expand the scope of the amendment so that the equivalent practical relief is provided also to lessors, in the same manner that ED2020/2 proposes for lessees. We do hope that this paper has provided some further clarity on those challenges and we would appreciate if the Board acknowledged those issues.

On a last note, it is worth mentioning that FASB has provided uniform accounting relief for both lessors and lessees, hence acknowledging the challenges faced also by lessors. As such, we strongly believe that in these uncertain times of COVID 19, lessors are heavily impacted, however they have not received the same relief under IFRS. Further to this, alignment with FASB's approach will not only result in comparable outcomes for both IFRS and US GAAP preparers but will also assist users of financial statements due to the comparable treatment between the two reporting standards.

We thank the Board for the opportunity to provide our input on the Exposure Draft related to Covid-19-Related Rent *Concessions - Proposed amendment to IFRS 16*. If you would like to discuss our comments, please contact EPRA's Finance Department at randa@epra.com.

Best Regards,

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