

7 May 2020

The Board
International Accounting Standards Board
Columbus Building
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UNITED KINGDOM

By email: commentletters@ifrs.org

Dear Board Members

Exposure Draft ED/2020/2 Submission

The Property Council welcomes the opportunity to provide comments to the Board in relation to its Exposure Draft ED/2020/2 *Covid-19-Related Rent Concessions - Proposed amendment to IFRS 16*.

The Property Council of Australia represents a broad group of members, including owners, managers and developers of commercial, industrial, residential and tourist accommodation. Many of those members have diversified business operations that span across more than one asset class with thousands of individual leases with tenants large and small.

Like many countries around the world, Australia has been responding to COVID-19, our biggest health crisis in a century. The swift actions taken to protect the health of Australians, including travel bans, limits on large gatherings, social distancing requirements, have given rise to significant economic consequences for a broad range of businesses and industries.

The Property Council welcomes the IASB's response to this global event and the Board's initiative to ease the financial burden on businesses and provide relief to lessees. However, this guidance has not been extended to lessors, who are also currently facing significant challenges.

Situation faced by commercial landlords in Australia

Commercial landlords – including retail, office and industrial sectors – want to do the right thing by their tenants and have a strong interest in helping them through this crisis. Australian state and territory governments are in the process of legislating a 'code of conduct' that sets out good faith leasing principles to guide discussions between commercial landlords and tenants who are significantly affected by the COVID-19 crisis.

The code broadly applies to small and medium size tenants and requires landlords to provide rental relief (in the form of rent waivers and rent deferrals) in proportion to the loss suffered by the tenant. Critically, the code requires these discussions take place on a case by case basis having regard to the financial position of the tenant.

This will be a significant process that involves at a minimum, waiting for the legislation to be finalised in each jurisdiction, identifying tenant eligibility, gathering the necessary financial information to

support the tenant's claim for rent relief, negotiations on the rent relief and finally documentation and execution of the agreed amended lease terms.

Many landlords have also received rent relief requests from larger tenants who fall outside the scope of the code – these are also being negotiated on a case by case basis.

Impact of not extending the Exposure Draft amendments to lessors

If commercial landlords in Australia are all required to assess each of these tenancy negotiations as to whether they meet the definition of a modification or not, and do not have the same optionality as lessees to elect to apply an exemption, we are concerned that:

- **For reporting entities, there is concern that despite the significant effort required, important information on the impacts of these rental abatements may not be clear in the financial statements.** For example, the net movement in the statutory profit for real estate entities recognising investment property at fair value, remains the same under either treatment, but important information about the financial impact of the COVID-19 related abatements could be obscured.
- Depending on the individual circumstances of each reporting entity, they could be required to undertake **significant manual calculations or implement extensive system changes** to account for the lease variations on a straight-lining basis, imposing additional time, cost and complexity.
- Due consideration has not been given to the **numerous 'non-standard' leases within each leasing portfolio, and the overlay of legislative requirements** set out by Australia's eight state and territory governments.
- Given the short period of time until the 30 June 2020 reporting period (which is the end of the Australian financial and tax year, unless entities adopt a substituted accounting period), there is a **significant risk that real estate entities will not have sufficient time to assess, recalculate, renegotiate and implement all amended leases** where concessions are given and make the required system changes to appropriately include these concessions in straight-lining calculations.

We discuss these concerns in further detail in the attached Appendix 1.

Industry recommendation

We strongly recommend that the provision to have the option to elect an exemption to *IFRS 16* and specifically, the definition of a lease modification be extended to lessors in the same way that the current Exposure Draft proposes for lessees.

This would allow each reporting entity to assess the concerns noted above in light of their particular leasing portfolio and achieve the optimal reporting outcomes for the users of their financial statements.

If you would like to discuss any aspect of this submission further, please contact Collin Jennings on cjennings@propertycouncil.com.au or myself on bngo@propertycouncil.com.au.

Yours sincerely



Belinda Ngo

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APPENDIX 1 - Submission

Background

On the 17 April 2020, the International Accounting Standards Board (IASB) approved the release of *Exposure Draft ED/2020/2 Covid-19-Related Rent Concessions - Proposed amendment to IFRS 16* for comment. The Exposure Draft seeks to give lessees relief from assessing whether rent relief granted as a result of the COVID-19 pandemic constitutes a lease modification.

The Exposure Draft does not, however, provide any relief for lessors, the IASB's reasoning for the exclusion is included in the Basis for Conclusions section at the end of the Exposure Draft which notes:

The proposal does not address lessor accounting because lessors are not expected to face the same practical challenges as lessees in accounting for covid-19-related rent concessions. For many lessors with a large volume of leases, leasing is a core part of their business.

We agree with the IASB's assessment that lessees will require financial assistance due to the challenges that they will face during the pandemic, however, the Property Council does urge the Board to consider expanding the scope of the relief to include lessors.

While it can be agreed that corporate lessors negotiate many leases, the vast quantum of leases that would be required to be reviewed, renegotiated and executed prior to 30 June 2020, (which is the end of the Australian financial and tax year, unless entities adopt a substituted accounting period) coupled with the new requirements under the code of conduct is placing extra strain on the resources of landlords in managing requests for rent relief. Additionally, landlords are concurrently dealing with a significant amount of other complex financial, social, economic and resource issues as a result of the impact of COVID-19, some of which are expected to continue for some time.

Treatment of statutory profit remains the same

The result of treating COVID-19 related rental concessions as lease modifications is that the revenue impact of these concessions will be included in straight-lining and spread over the life of the lease. Many users of financial statements may expect to see the impact of these rental concessions in the period in which the concessions are being given. During the IFRS Board discussions of the ED, this was raised as an expectation of users of lessees' accounts. However, this reasoning equally applies to lessors.

Additionally, should the rent relief measures within the exposure draft be treated as lease modifications, and included in straight-lining, any unrecognised portion of these concessions will increase the value of the straight-lining asset, which forms part of the Investment Property balance for real estate entities on the Statement of Financial position. As these assets are carried at fair value and revalued each reporting period, the movement in the straight-lining asset brought about by the inclusion of the COVID-19 related abatements will therefore be included within any revaluation movement (as a decrement) recorded for these assets. As a result, despite the significant effort required, the net movement in the statutory profit for real estate entities remains identical under either treatment, but important information about the financial impact of the COVID-19 related abatements may be obscured with reduced transparency of the impact presented in the financial statements.

The majority of real estate entities in Australia report "Funds from Operations" (FFO) as a key management earnings measure due to the desire of users of their accounts to see an earnings measure which more closely aligns to cash earnings and provides some consistency throughout the real estate industry. FFO is then reconciled back to the statutory profit result. As this reconciliation already includes an adjustment for the revaluation of investment property, the COVID-19 rental abatements will be included as part of this revaluation number, and users of financial statements will not be able to see the quantum of this one-off impact as a stand-alone disclosure in the financial statements. This information is then likely to be presented outside the financial statements in supplementary information, and therefore may be unaudited.

Failure to show these concessions as reductions in revenue in the current period may mislead users, and could potentially create reputational damage to real estate entities, as governments have made it clear that they expect landlords to “share in the pain” of their tenants. Media may incorrectly point to only marginally reduced reported revenue in the current period as evidence that landlords have not treated their tenants in a fair manner during this difficult time.

Separate systems for billings vs lease straight-lining

Section BC3 (b) states that “*Lessor accounting for modifications to operating leases requires no remeasurement of amounts recognised in a lessor’s statement of financial position*”. However, were abatements given to tenants regarded as a lease modification, the straight-lining asset recognised by the lessor would need to be adjusted.

Additionally, section BC3 (a) of the exposure draft assumes that the accounting systems of lessors allow for automatic straight-lining of lease payments. However, this is not the case. Most leasing systems are simply billing systems, and do not perform lease straight-lining as required by IFRS 16.

For many lessors, these calculations are performed either off-system or in other systems using data from the billing system. Rental abatements prior to the COVID-19 pandemic were generally immaterial to real-estate lessors, and therefore current systems are not configured to include these in straight-lining calculations.

Depending on the individual lessor’s circumstances, this means that either significant manual calculations would need to take place, or systems would need to be re-configured to allow for the inclusion of these concessions within these calculations at significant cost and dedication of time to these organisations. This is in addition to other system changes required as a result of the pandemic, such as introducing functionality for payment plans, which prior to the pandemic had been relatively rare, and automating systems to allow for large volumes of rental abatements to be processed. These additional costs are being incurred in an environment of significantly reduced revenue and cashflow, as the Australian government has mandated rental concessions for a large volume of tenants.

Numerous non-standard leases and impact of legislation

A view was expressed by the IASB that leases issued by lessors would be largely standard in nature, and therefore the effort to assess whether concessions represented modifications would not be significant, however the majority of commercial leases in Australia are individually negotiated, and therefore each lease is unique. For example, some leases may contain force majeure clauses, thus anticipating rental reductions in times of significant disruption. In these cases, concessions granted would be regarded as variable consideration within the terms of the lease. Significant time and effort would be required to examine all lease documents to consider whether the proposed concessions were anticipated within the original lease, often requiring technical advice as often these clauses are not specific enough to cover COVID-19. As clauses within leases across lessors would be very different, the consideration and application of force majeure clauses would result in inconsistent treatment of the rental abatements across the real estate industry.

Further the IFRS 16 educational material released in relation to COVID-19 rent concessions also states that “*Changes in lease payments that result from clauses in the original contract or in applicable law or regulation are part of the original terms and conditions of the lease*” (emphasis added). This is being interpreted by some audit firms and reporting entities as meaning that where concessions are mandated by law, these concessions should be treated as variable and recognised in the current period as a reduction in revenue. However, Australian regulations only cover a sub-set of tenants, while the granting of rental concessions is likely to be far more broadly applied. If non-legislated reductions were to be regarded as lease modifications, but legislated reductions were not, this would result in inconsistent treatment of concessions granted. This would both increase the difficulty of

classification as well as tracking and calculation of these concessions by landlords and create confusion for users of financial statements.

Impact on 30 June 2020 reporting periods

Given the short period of time until the 30 June 2020 reporting period, there is a significant risk that real estate entities will not have sufficient time to assess all leases where concessions are given and make the required system changes to appropriately include these concessions in straight-lining calculations. Given the quantum of expected concessions, these will be material in the financial statements of real-estate entities this reporting period. This may result in these entities mis-stating their accounts or accounts potentially receiving qualified audit opinions. This would clearly not be in the best interests of either the real estate entities, or the users of their financial statements.