In the Spotlight

A Real Estate Focus on COVID-19 Accounting Considerations

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At a Glance

The coronavirus (COVID-19) pandemic has developed rapidly in 2020, with a significant global impact. Measures taken to contain it have affected economic activity, which in turn has implications for financial reporting.

COVID-19 will impact many areas of accounting and reporting for all industries, as outlined in our In depth publication Accounting implications of the effects of coronavirus.

In this Spotlight we provide a summary of accounting issues that real estate entities might face and where to find further guidance. While this Spotlight focuses on issues that are likely to be the most frequently encountered, many others are certain to arise. As the situation continues to evolve, so too will the consequential accounting issues. For these reasons, the following is not an exhaustive list of all relevant accounting considerations.

Valuation of investment property

Impact of COVID-19 on investment property valuation

COVID-19 has given rise to many significant uncertainties, including the length of time and severity of the impact of COVID-19, how effective the measures taken to control its spread will be, and how quickly activities might return to more normal conditions once the pandemic is over. In turn, these uncertainties have affected the valuation of investment property. FAQ 2.6.1 'Impact of COVID-19 on investment property valuation' looks at whether it is possible for management to determine the fair value of an investment property in accordance with IFRS 13. Further, FAQ 2.6.2 'Uncertainties in cash flows and change in valuation technique for Level 3 fair value measurement' considers how the current uncertainties should be factored into fair value measurement, and it is relevant for investment property, since these are often Level 3 fair value measurements.

FAQ 2.6.3 'Additional considerations for discount rates used in level 3 fair value measurements' and FAQ 7.7.3 'Adjusting events affecting remeasurement/impairment calculations related to assets with a measurement basis of fair value' also provide further guidance on determining discount rates and how to consider post balance sheet events in fair value measurement calculations.

Other sources of guidance

Valuation in times of market uncertainty – PwC UK valuations guidance

Dealing with valuation uncertainty at times of market unrest – IVSC guidance

Valuation Practice Alert – Coronavirus – RICS guidance

Lease accounting implications for lessors

Accounting for lease concessions granted to tenants

As a result of the COVID-19 pandemic, landlords have granted rental concessions to a number of tenants. These concessions take a variety of forms, including payment holidays, cash rebates and deferral of lease payments. On 10 April 2020, the IASB issued a document intended to support the consistent application of IFRS to lease concessions related to COVID-19. FAQ 4.1 'How should lease concessions related to COVID-19 be accounted for?' considers the accounting implications of lease concessions for both lessees and lessors. FAQ 4.6 – 'COVID-19-related modifications to operating leases: lessor perspective' explores in further detail the specific accounting issues for lessors in operating leases.

Force majeure clauses

Some lease contracts contain force majeure clauses that apply in the case of serious unforeseen circumstances beyond the control of the parties to the contract. In addition, actions of governments taken in response to COVID-19 might be accounted for in a similar way to some force majeure clauses. The nature of such clauses can differ. The existence of force majeure clauses in leasing contracts might result in payments being accounted for as variable lease payments rather than as lease modifications. FAQ 4.2 'What are the accounting implications of a force majeure clause in a lease contract in the context of COVID-19?' explores the accounting considerations further.

Impairment of lease receivables

For any financial instruments that are within the scope of IFRS 9's expected credit loss (ECL) model, the impact of COVID-19 on the ECL should be considered. Lease receivables are within the scope of IFRS 9's ECL model, including accrued receivable balances related to lease incentives. FAQ 4.3 'Impairment of lease receivables' explains the scope of IFRS 9's requirements in the context of lease receivables and how an ECL assessment is impacted where a lessor expects a lessee to pay all amounts due under the lease but later than the contractual due date.

Reassessment of lease term

In the current environment, retail tenants might need to reassess the lease term of their property leases. FAQ 4.4 'Should lease terms be reassessed as a result of COVID-19?' explores this further from a lessee perspective. However, it also notes that a lessor does not reassess lease term after the commencement date of the lease, and so it would not assess whether or not an option is now reasonably certain to be exercised by the lessee.

Recognition of lease income

As a result of COVID-19, collectability of rentals on some operating leases has become increasingly uncertain. If a lessor assesses that some rents on an operating lease will be uncollectable, FAQ 4.5 'Should a lessor in an operating lease continue to recognise lease income when its collectability is uncertain due to COVID-19?' explores the question of whether a lessor should continue to recognise the corresponding lease income.