



## Special Series on COVID-19

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# Recording of Deferred or Waived Rental Payments

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This note focuses on private landlords' (i.e., nongovernmental landlords) response to the COVID-19 crisis by allowing for reduced or deferred rent payments (known as rentals in the international standards) to qualified tenants. It provides guidance on how these should be recorded in macroeconomic statistics. The note also considers some of the implications on key national accounts aggregates and price and volume measures.

## I. INTRODUCTION

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Private landlords (i.e., nongovernmental landlords) are allowing for reduced or deferred rental payments of cafes, shops, offices, and dwellings in response to the COVID-19 crisis. The following paragraphs explore the various options to record this in the national accounts.

This note does not consider the possible cases in which governments create specific schemes to support tenants, which may include government direct payments or other forms of government support. These schemes should be analyzed in accordance with the relevant statistical rules in System of National Accounts (SNA) and Government Finance Statistics. Particular attention should be taken for cases where social dwellings are involved, as the support arrangements may be complex.

The note also does not consider the recording of imputed dwelling services in the national accounts. It is understood that statisticians should continue to use relevant dwelling rental prices for the calculation of these services.

## II. BACKGROUND

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Payments for the use of fixed assets such as buildings are considered purchases of services (known as rentals) and the international standards specify to record such purchases on an accrual basis. The international

standards favor the accrual accounting concept because flows are accounted for at the time economic value is created, transformed, exchanged, transferred, or extinguished. This agreement allows the profitability of productive activities to be evaluated correctly (that is, without the disturbing influence of leads and lags in cash flows) (2008 SNA paragraph 3.166).

### III. RECORDING OPTIONS AND THEIR IMPACT ON KEY NATIONAL ACCOUNTS AGGREGATES

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#### 1. Recording of Rental Payment Deferrals but Payment is Still Expected.<sup>1</sup>

If the rental payments on cafes, shops, offices, and dwellings are deferred, but payment is still expected to be made at a later date, then there is no modification of the lease. There have not been any changes to the agreed amount of the contract.

##### 1.1 Production of Rentals

Following the accrual accounting concepts there should be no impact on the output of the lessor nor the intermediate consumption of the lessee if it is a business. Also, there is no impact on the gross operating surplus of the lessor or lessee.

Rental payment by households on dwellings is recorded in final consumption expenditure and, according to accrual accounting, the same payment is expected. Therefore, there is no impact on household final consumption expenditures.

##### 1.2 Financial Account and Balance Sheet

The difference between the output and the actual payments received should be recorded in other accounts receivable of the lessor and in other accounts payable of the lessee in the financial account and balance sheet.

##### 1.3 Price and Volume of Rentals

Volume estimate for rental properties are obtained by deflation. Since transactions should be recorded on an accrual basis a deferral in when the payment is made should not have an impact on price and volume measurement.

#### 2. Recording of Rental Payment Under a Full or Partial Reduction in Rental Payment<sup>2</sup>

The parties may agree upon a temporary rent reduction, which may range anywhere from a full reduction of all rent payable under the lease (i.e., including the tenant's common area maintenance, real estate tax, and insurance reimbursement obligations) to a partial reduction of base rent only. In some instances, governments are forbidding the termination of a lease (e.g. not allowing a household to be evicted from their dwelling). This

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<sup>1</sup> In the case where the landlord refuses to defer the rental payment and the tenants still occupy the premises a service is still being provided by the landlord. There is no impact on the output of the lessor. However, if the rental payment is deemed uncollectable then it needs to be removed from other accounts receivable of the lessor and treated as debt forgiveness (capital transfer) or debt write-off (other change in the volume). This recommendation is in line with ISWGNA Special Series on COVID-19 Note "The Recording of Deferred Delivery of and Payments for Goods and Services" (forthcoming).

<sup>2</sup> If the reduced rental payment is deemed uncollectable then it needs to be removed from other accounts receivable of the lessor and treated as debt forgiveness (capital transfer) or debt write-off (other change in the volume). This recommendation is in line with ISWGNA Special Series on COVID-19 Note "The Recording of Deferred Delivery of and Payments for Goods And Services" (forthcoming).

may provide incentives for landlords to modify the terms and conditions of the lease. Three options for recording may be considered.

**Option 1. The lease is deemed to be modified and the modification was not part of the original terms and conditions of the lease.**

Under International Financial Reporting Standards (IFRS) 16 COVID-19 guidance,<sup>3</sup> a change in the scope of a lease includes adding or terminating the right to use one or more underlying assets or extending or shortening the contractual lease term. IFRS guidance states that rent reduction alone is not a change in the scope of the lease. Any modifications to an operating lease should be accounted for from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease (IFRS 16 paragraph 87). Any changes to the future rental payments are accounted for on an accrual basis (e.g., on a straight-line basis over the remaining revised lease term).

**Option 2. Changes in payments that are not lease modifications.**

A lessor considers both the terms and conditions of the contract and all relevant facts and circumstances, which may include contract, statutory or other law or regulation applicable to lease contracts. For example, lease contracts or applicable law or regulation may contain clauses that result in changes to payments if particular events occur or circumstances arise. Government action (for example, requiring the closure of retail stores for a period of time because of COVID-19) might be relevant to the legal interpretation of clauses, such as force majeure, that were in the original contract or in applicable law or regulation. 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, even if the effect of those clauses (arising from an event such as the COVID-19 pandemic) was not previously contemplated. In such a case there is no lease modification for the purposes of IFRS. According to IFRS 16 COVID-19 guidance,<sup>4</sup> if a change in the lease payments does not result from a lease modification, that change would generally be accounted for as a variable lease payment. In this case, a lessee applies paragraph 38 of IFRS 16 and generally recognizes the effect of the rent concession (reduction) in profit and loss. For an operating lease, a lessor recognizes the effect of the rent concession by recognizing lower income from leases.

**Option 3. Treat reduction in rental payments as transfers regardless of whether the lease was modified or not.**

The approach could be that the lessor is implicitly making a current transfer to the lessee for the amount of the reduction in rental payment, which the lessee is then using to pay for the rental of the fixed asset. The implication is that the output of the lessor and intermediate consumption of the lessee, if a business, remain the same level as before the reduction was implemented.

**Recommendation:**

The most practical solution is to align with the business accounting treatment and follow the recommendations of the IFRS for the national accounts recording. This approach also follows the economic substance of what is happening in the economy as the decline in nominal output would also imply a corresponding decline in gross operating surplus of the lessor and is consistent with the *SNA*. If the parties are mutually agreeing to a modified contract, then the preferred solution is option 1. However, if there is no modification to the rental contract then option 2 should be followed. Option 3 is not recommended.

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<sup>3</sup> <https://cdn.ifrs.org/-/media/feature/supporting-implementation/ifrs-16/ifrs-16-rent-concession-educational-material.pdf?la=en>.

<sup>4</sup> <https://cdn.ifrs.org/-/media/feature/supporting-implementation/ifrs-16/ifrs-16-rent-concession-educational-material.pdf?la=en>.

## 2.1 Production of Rentals

**Option 1. The lease is deemed to be modified and the modification was not part of the original terms and conditions of the lease.**

The amount of the rental payment is reduced by the amount of the rental reduction as compared to the old lease spread over the remaining revised lease term. For example, if the amount of the rental payment is reduced by USD 1,200 for two months and the revised lease term expires in 2 years, then the monthly reduction (on an accrual basis) in the rental payment is USD 100 each month until the end of term.

Under this scenario, the nominal value of output for the lessor decreases and the intermediate consumption of the lessee, if it is a business, decreases. In the case where it is a rental payment by households on dwellings, final consumption expenditures of households decrease.

**Option 2. Changes in payments that are not lease modifications.**

Similar to option 1, rental payments are reduced. The difference in recording between the two options are the amounts of the reduction. Option 1 spreads the amount of the reduction over the remaining lease term, whereas option 2 recognizes all the reduction in the same time period that it occurs. Therefore, the nominal value of the output of the lessor and the intermediate consumption of the lessee, if a business, would be reduced by the full amount of the reduction in rental payment in the current period.

If it is a rental payment by households on dwellings, final consumption expenditures of households decrease by the full amount of the reduction in the current period.

## 2.2 Financial account and balance sheet

If the lessee paid the agreed amount on time, then there is no difference between the amount accrued versus paid. Thus, there is no impact on the other accounts receivable of the lessor or the other accounts payable of the lessee in the financial account and balance sheet.

## 2.3 Price and Volume of Rentals

The recommended treatment is to reflect the decrease in the value of rental payments as a price decrease. This is because the drop in nominal value is due to a price decrease as the physical size of these occupied areas remains the same. This implies that the rental volume estimates do not fall (e.g., no impact on the volume of household final consumption expenditures).

## IV. SUMMARY TABLE OF RECORDING OPTIONS AND THEIR IMPACT ON KEY NATIONAL ACCOUNTS AGGREGATES

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*\*Note that the last column reflects the direct impact in the time period it occurs, ceteris paribus, on the main aggregates (thus not reflecting the negative impact of the crisis in general on e.g., operating surplus/mixed income).*

**Table 1. Summary of Recording Options**

Action	Proposed National Accounts Recording	National Accounts Aggregates
<p>1. Landlords are offering qualified tenants a <b>deferral in when the rental payment is made</b> (either in full or partial deferral).</p> <p>The full rental payment is expected at a later date.</p>	<p>Rentals are recorded on an accrual basis.</p> <p>Landlords record output of rentals accrued. (P.1)</p> <p>Lessee (payments by businesses) record intermediate consumption of rentals accrued. (P.2)</p> <p>Lessee (payments on dwellings by households) record final consumption expenditures of rentals accrued. (P.3)</p> <p>Landlord record other accounts receivable as difference between the output and the actual payments received. Lessee record same amount in other accounts payable. (F.8, AF.8)</p>	<p style="text-align: center;">↔</p> <p style="text-align: center;">Landlord output (P.1) Landlord operating surplus (B.2)</p> <hr/> <p style="text-align: center;">↔</p> <p style="text-align: center;">Lessee (business): intermediate consumption (P.2) Lessee (business): operating surplus (B.2)</p> <hr/> <p style="text-align: center;">↔</p> <p style="text-align: center;">Lessee (dwelling payments by household) final consumption expenditure (P.3)</p> <hr/> <p style="text-align: center;">↑</p> <p style="text-align: center;">Value of other accounts receivable of landlord (F.8, AF.8) other accounts payable of lessee (F.8, AF8)</p> <hr/> <p style="text-align: center;">↔</p> <p style="text-align: center;">Rental price</p> <hr/> <p style="text-align: center;">↔</p> <p style="text-align: center;">Rental volume</p>
<p>2.a. Landlords allow for a modification of the lease that <b>was not part of the original terms and conditions of the lease</b></p> <p>IFRS guidance states that rent reduction alone is not a change in the scope of the lease.</p>	<p>Any modifications to an operating lease should be accounted for from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.</p> <p>Any changes to the future rental payments are accounted for on an accrual basis. <b>The amount of the reduction is spread over the remaining term.</b></p> <p>Landlords record output of reduced rentals accrued in current time period. (P.1)</p> <p>Lessee (payments by businesses) record intermediate consumption of reduced rentals accrued in current time period. (P.2)</p>	<p style="text-align: center;">↓</p> <p style="text-align: center;">Landlord output (P.1) Landlord operating surplus (B.2)</p> <hr/> <p style="text-align: center;">↓</p> <p style="text-align: center;">Lessee (business): intermediate consumption (P.2) Lessee (business): operating surplus (B.2)</p> <hr/> <p style="text-align: center;">↓</p> <p style="text-align: center;">Lessee (dwelling payments by household) final consumption expenditure (P.3)</p> <hr/> <p style="text-align: center;">↔</p> <p style="text-align: center;">Value of other accounts receivable of landlord (F.8, AF.8)</p>

	<p>Lessee (payments on dwellings by households) record final consumption expenditures of reduced rentals accrued in current time period. (P.3)</p> <p>Landlord record other accounts receivable as difference between the output and the actual payments received. Lessee record same amount in other accounts payable. (F.8, AF.8)</p>	<p>other accounts payable of lessee (F.8, AF.8)</p> <p>↓</p> <p>Rental price</p> <p>↔</p> <p>Rental volume</p>
<p>2.b. Changes in payments that are not lease modifications.</p> <p>Changes in payments when only rent reductions are made.</p> <p>A lessor considers both the terms and conditions of the contract and all relevant facts and circumstances.</p> <p>For example, lease contracts or applicable law or regulation may contain clauses that result in changes to payments if particular events occur or circumstances arise.</p>	<p>In this case, a lessee applies paragraph 38 of IFRS 16 and generally recognizes the effect of the rent concession (reduction) in profit and loss. For an operating lease, a lessor recognizes the effect of the rent concession by recognizing lower income from leases.</p> <p><b>The full amount of the reduction is accounted for in the period in which it takes place.</b></p> <p>Landlords record output of reduced rentals accrued in current time period. (P.1)</p> <p>Lessee (payments by businesses) record intermediate consumption of reduced rentals accrued in current time period. (P.2)</p> <p>Lessee (payments on dwellings by households) record final consumption expenditures of reduced rentals accrued in current time period. (P.3)</p> <p>Landlord record other accounts receivable as difference between the output and the actual payments received. Lessee record same amount in other accounts payable. (F.8, AF.8)</p>	<p>↓</p> <p>Landlord output (P1) Landlord operating surplus (B.2)</p> <p>↓</p> <p>Lessee (business): intermediate consumption (P2) Lessee (business): operating surplus (B.2)</p> <p>↓</p> <p>Lessee (dwelling payments by household)</p> <p>↔</p> <p>Value of other accounts receivable of landlord (F.8, AF8) other accounts payable of lessee (F.8, AF.8)</p> <p>↓</p> <p>Rental price</p> <p>↔</p> <p>Rental volume</p>