

Lease and Loan Modifications and Restructurings in the COVID-19 Environment

Wednesday, May 27, 2020

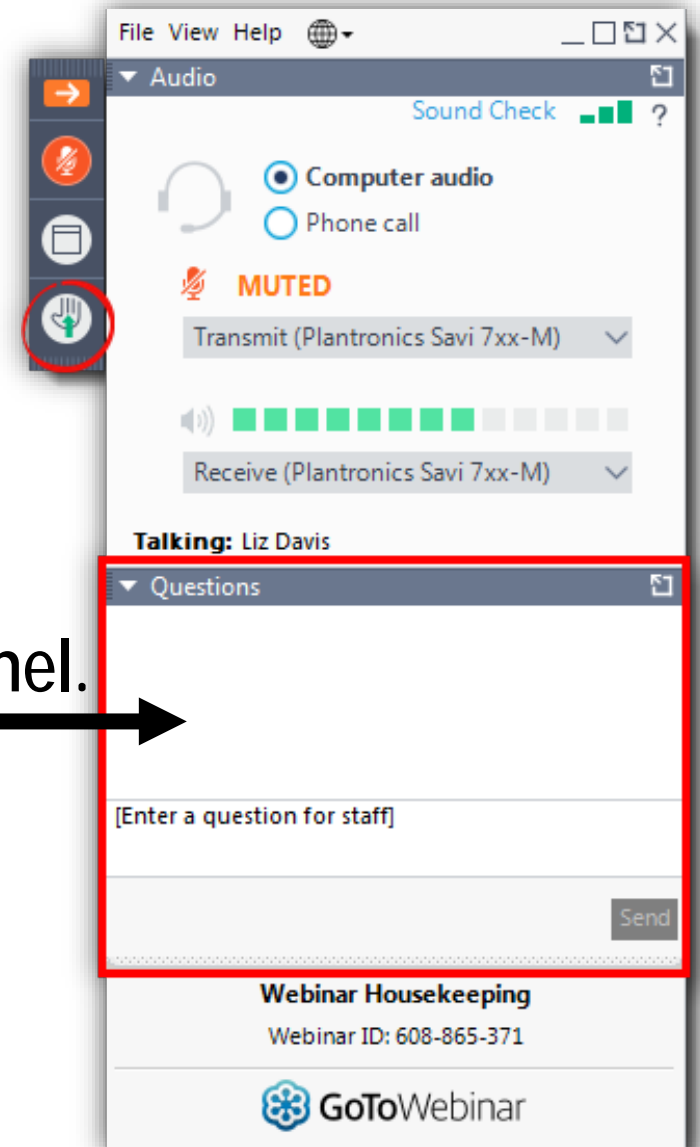


Housekeeping



Today's web seminar is being recorded.

All questions should be submitted via the Questions Panel.



Presenters



Moderator

John Bober

IXL Lease Advisory Services, LLC



Mamta Shori

Chief Financial Officer
Wells Fargo Equipment Finance



Tim Kolber

Managing Director, National Office Accounting
Services
Deloitte, LLP



Shawn Halladay

Chief Financial and Operations Officer
The Pitney Bowes Bank

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- I. The views expressed by presenters are not necessarily those of their organizations.
- II. These slides are for educational purposes only and are not intended, and should not be relied upon, as accounting or tax advice.

Agenda

- I. Navigating modification accounting or FASB relief scenarios
- II. Application of the FASB Staff's COVID-19 related relief
- III. Operational considerations when modifying contracts

Common Issues Facing Lessors

Navigating Modification or FASB Relief Scenarios

Modification Guidance Under ASC 840

General Guidance: 840-10-35-4

If at any time the lessee and lessor agree to change the provisions of the lease, other than by renewing the lease or extending its term, in a manner that would have resulted in a different classification of the lease under the lease classification criteria had been in effect at lease inception, the revised agreement shall be considered as a new arrangement over its term.

- Simple term extensions would be considered a modification
- Any change in total consideration would be considered a modification and require an evaluation of lease classification utilizing information in effect at lease inception.
- This information is typically stored in the leasing system and can be automatically calculated by most lease software packages.

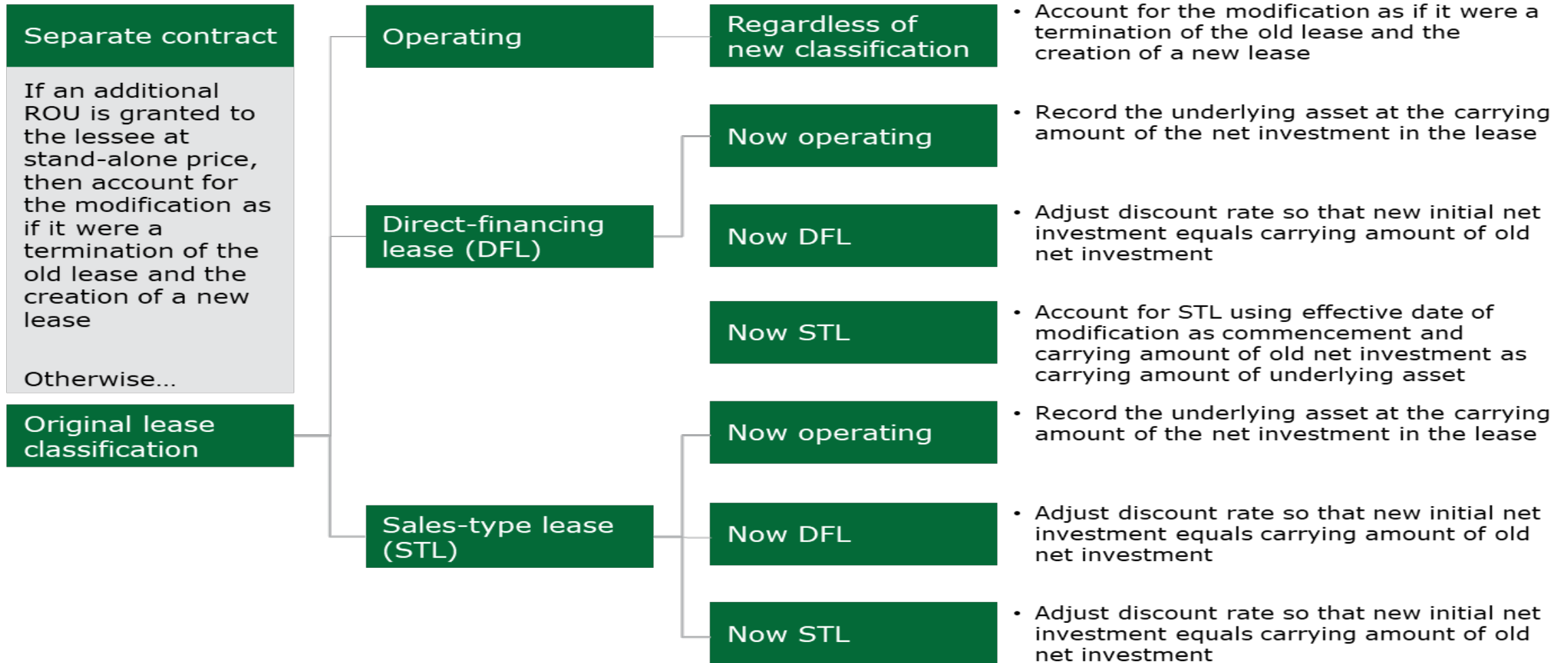
Modification Guidance Under ASC 842

General Guidance: 842-10-25-9

If a lease is modified and that modification is not accounted for as a separate contract in accordance with paragraph 842-10-25-8, the entity shall reassess the classification of the lease in accordance with paragraph 842-10-25-1 as of the effective date of the modification.

- Simple term extensions, changes in consideration or other payment restructures not contemplated in the original contract would qualify as a lease modification. Reassessment of lease classification would require updated fair value of equipment as of the effective date of the modification.
- Most equipment leases are considered non-cancellable and do not typically include force majeure clauses.
- Current fair values of equipment are not typically updated on a regular basis in leasing systems.

Key Considerations Under the Lessor Model



Applying the ASC 842 lease modification guidance may be time consuming and complex!

Accounting for COVID-19 Related Rent Concessions

Application of the FASB Staff's Relief

Setting the Stage

Common Types of Concessions



Rent Forgiveness



Rent Deferral



Rent Deferral with Term Extension

Accounting Challenges and FASB Relief

Problem #1 = Difficult to
evaluate legal terms

Problem #2 = Difficult to
apply modification
framework to large
number of concessions

Solution = Allow entities
to just elect whether or
not to treat eligible
concessions as
modifications

Scope of FASB's Relief

- Two primary scoping criteria:
 - Concession must be related to the effects of the COVID-19 pandemic
 - Concession must result in total payments in the modified contract that are substantially the same as or less than total payments in the original contract
- Not as restrictive as proposed IASB relief

Scope of FASB's Relief

Applies to*:

- Both lessees and lessors
- Current and future concessions
- Rent forgiveness and deferral scenarios
- Rent deferral with term extension scenarios

May not apply to:

- Changes in underlying asset
- Short payments

**Assumes the other scoping criteria are met*

Scope of FASB's Relief

Change in Payments Considerations



"Substantially the same or less"



Discounted vs. undiscounted payments



Variable payments



Lease term



Sequential concessions

Application of the FASB's Relief

- Portfolio of leases
 - Type of concession
 - Role in the arrangement (lessor or lessee)
 - Underlying asset class
- No reassessment of lease classification or discount rate if entity elects not to treat as modification
- Disclosure requirements

Lessor Application of the Relief

Operating leases:

- Variable Lease Income Approach
- Receivable Approach
- Account for the concession as a modification

Sales-type / direct financing leases

- Continued recognition of interest income during loan repayment holiday
- Cease recognition of interest income during loan repayment holiday

Modifying Contracts and Granting Concessions

Operational Considerations

Mutually Agreed Changes to Lease Payments

Gating questions...

- Is the **lessor offering** or is the **lessee requesting** a change to the required lease payments?
- What is the nature and structure of the change to the lease payments?
- Are there any other changes to the contract terms?

What factors might impact a lessor granting a lease concession?

- Credit quality of the customer
- Current account status
- Overall history and customer / relationship

What are the Speed Bumps?

Systems capabilities

- Technical modifications
- Operational modification process

Documentation

- Process
- Requirements

Pricing

- Maintain yield and reprice?
- Keep payment constant?

Product characteristics

- Prepay options and penalties
- Early buyout options
- Stipulated loss tables

LMS

- Front-end versus backend changes
- Flow through the net investment?
- Create variable rents?
- Residual treatment and measurement



There May be Knock-on Effects

Outside Parties

- ☐ Assignments
- ☐ Securitizations
- ☐ Fee and residual sharing

Forecasting Models

- ☐ Liquidity
- ☐ CECL
- ☐ Residual roll and remarketing

Portfolio Servicers

- ☐ Underlying capabilities
- ☐ Cost structures
- ☐ Disruptions of SLAs





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Appendix A

Additional Information

Key Considerations Under the Lessee Model

