

GASB 87 – APPLICATION OF STANDARD TO LESSOR LEASE AGREEMENTS

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Why Is GASB 87 Such a Big Deal for Airports?

- Most lessor lease agreements will be covered by the standard.
- Will have a substantial impact on balance sheet presentation. Lease receivable with an offset to deferred inflows.
- Cumbersome calculations that require consideration and potential inclusion of options, as well as future period rent increases.
- Detailed disclosure requirements, similar to debt disclosures.
- Unknown impact on rating agency and investor evaluations of airports, industry and individual.

Initial Implementation of Standard

B124. This Statement requires that leases be recognized and measured using the facts and circumstances that existed at the beginning of the period of implementation. The Board believes that it would not be practical to require governments to return to the commencement of each lease term and determine what the balances would have been if this Statement had been in effect from that time.

Walk – through a scenario to apply standard. Rental car agreement, rent vs. privilege fee. Scenario facts.

- Lease effective date – July 1, 2016
- Implementation of standard – July 1, 2019 (lease receivable valuation June 30, 2019)
- Rent effective July 1, 2019 per lease agreement
- CPI – effective July 1, 2019 based on December 31, 2018
- Interest rate – July 1, 2019
- Evaluation of options at July 1, 2019

Determine lease term – evaluating options

Lease term = 48 months

Remainder of original lease term July 1, 2019 – June 30, 2020, 24 months

Option 1, assume lessee will exercise July 1, 2020 – June 30, 2021, 12 months

Option 2, assume lessee will exercise July 1, 2021 – June 30, 2022, 12 months

Determine lease term – evaluating options

14. At the commencement of the lease term, the lessee and the lessor should assess all factors relevant to the likelihood that the lessee or the lessor will exercise options identified in paragraphs 12a–12d, whether these factors are contract based, underlying asset based, market based, or government specific.

- A significant economic incentive
- A significant economic disincentive
- The history of exercising options to extend or terminate
- The extent to which the asset underlying the lease is essential to the provision of government services.

Determine lease term – evaluating options

Scenario factors considered in determining whether lessee would exercise their lease option:

- History, no rental car company has ever not exercised a lease option available to it
- Rental car sales are stable or continue to grow
- Airport passenger levels continue to grow
- Impact of TNC's on rental car activities has been minimal
- Number of years remaining on original lease
- Short duration of option periods

Calculate rent (lease) amount for each future reporting period in GASB 87 lease term

Scenario values used for calculation:

Fiscal Year Ending	Year	CPI December 31	GASB 87 CPI	Actual Rents	GASB 87 Rents
June 30	2017	2.61%	N/A	5,729.17	N/A
June 30	2018	2.72%	N/A	5,878.70	N/A
June 30	2019	2.45%	N/A	6,038.60	N/A
June 30	2020	2.91%	2.45%	6,186.55	6,186.55
June 30	2021	2.65%	2.45%	TBD	6,338.12
June 30	2022	2.68%	2.45%	TBD	6,493.40
June 30	2023			TBD	6,652.49

Calculate beginning lease receivable – determine interest rate June 30, 2018

47. The future lease payments to be received should be discounted using the interest rate the lessor charges the lessee, which may be the interest rate implicit in the lease. Lessors are not required to apply the guidance for imputation of interest in paragraphs 173–187 of Statement 62 but may do so as a means of determining the interest rate implicit in the lease.

Establish a policy that can be used at implementation as well as for future reporting periods.

Scenario policy used, interest rate based on LIBOR rates associated with GASB 87 lease term + 50 basis points, i.e.

1-5 years uses 3 year Libor
6-10 year uses 7 year Libor
>10 years uses 15 year Libor

Calculate beginning lease receivable – calculate NPV of future lease payments

Scenario values utilized

- Number of GASB 87 lease periods – 48
- Interest rate – Libor 5 year at June 30, 2019 + 50 basis points, $2.65\% + .50\% = 3.15\%$
- Monthly payments (variable based on CPI adjustment)
- NPV of future lease payments = \$ 288,798.97

Lease recognition and journal entry year 1

Rent Period	GASB 87 CPI	GASB 87 Rent	Interest	Principal	Lease Receivable	Actual Rents
6/30/2019					288,798.97	
07/01/19	2.45%	6,186.55	758.10	5,428.45	283,370.52	6,186.55
08/01/19		6,186.55	743.85	5,442.70	277,927.82	6,186.55
09/01/19		6,186.55	729.56	5,456.99	272,470.83	6,186.55
10/01/19		6,186.55	715.24	5,471.31	266,999.52	6,186.55
11/01/19		6,186.55	700.87	5,485.68	261,513.84	6,186.55
12/01/19		6,186.55	686.47	5,500.08	256,013.76	6,186.55
01/01/20		6,186.55	672.04	5,514.51	250,499.25	6,186.55
02/01/20		6,186.55	657.56	5,528.99	244,970.26	6,186.55
03/01/20		6,186.55	643.05	5,543.50	239,426.76	6,186.55
04/01/20		6,186.55	628.50	5,558.05	233,868.71	6,186.55
05/01/20		6,186.55	613.91	5,572.64	228,296.07	6,186.55
06/01/20		6,186.55	599.28	5,587.27	222,708.80	6,186.55
FYE 06/30/2020		74,238.60	8,148.43	66,090.17	222,708.80	74,238.60

Annual Adjustment	DR	CR
Rental income	8,148.43	
Deferred inflows resources	70,047.68	
Interest income		8,148.43
Lease receivable		70,047.68

Lease recognition and journal entry year 2

Rent Period	GASB 87 CPI	GASB 87 Rent	Interest	Principal	Lease Receivable	Actual Rents
06/30/20			3.15%		222,708.80	
07/01/20	2.45%	6,338.12	584.61	5,753.51	216,955.29	6,366.58
08/01/20		6,338.12	569.51	5,768.61	211,186.68	6,366.58
09/01/20		6,338.12	554.37	5,783.75	205,402.93	6,366.58
10/01/20		6,338.12	539.18	5,798.94	199,603.99	6,366.58
11/01/20		6,338.12	523.96	5,814.16	193,789.83	6,366.58
12/01/20		6,338.12	508.70	5,829.42	187,960.41	6,366.58
01/01/21		6,338.12	493.40	5,844.72	182,115.69	6,366.58
02/01/21		6,338.12	478.05	5,860.07	176,255.62	6,366.58
03/01/21		6,338.12	462.67	5,875.45	170,380.17	6,366.58
04/01/21		6,338.12	447.25	5,890.87	164,489.30	6,366.58
05/01/21		6,338.12	431.78	5,906.34	158,582.96	6,366.58
06/01/21		6,338.12	416.28	5,921.84	152,661.12	6,366.58
FYE 06/30/2021		76,057.44	6,009.79	70,047.68	152,661.12	76,398.96

Annual Adjustment	DR	CR
Rental income	6,009.79	
Deferred inflows resources	70,047.68	
Interest income		6,009.79
Lease receivable		70,047.68

Lease recognition and journal entry year 3

Rent Period	GASB 87 CPI	GASB 87 Rent	Interest	Principal	Lease Receivable	Actual Rents
06/30/21			3.15%		152,661.12	
07/01/21	2.45%	6,493.40	400.74	6,092.66	146,568.46	6,535.29
08/01/21		6,493.40	384.74	6,108.66	140,459.80	6,535.29
09/01/21		6,493.40	368.71	6,124.69	134,335.11	6,535.29
10/01/21		6,493.40	352.63	6,140.77	128,194.34	6,535.29
11/01/21		6,493.40	336.51	6,156.89	122,037.45	6,535.29
12/01/21		6,493.40	320.35	6,173.05	115,864.40	6,535.29
01/01/22		6,493.40	304.14	6,189.26	109,675.14	6,535.29
02/01/22		6,493.40	287.90	6,205.50	103,469.64	6,535.29
03/01/22		6,493.40	271.61	6,221.79	97,247.85	6,535.29
04/01/22		6,493.40	255.28	6,238.12	91,009.73	6,535.29
05/01/22		6,493.40	238.90	6,254.50	84,755.23	6,535.29
06/01/22		6,493.40	222.48	6,270.92	78,484.31	6,535.29
FYE 06/30/2022		77,920.80	3,744.02	74,176.81	78,484.31	78,423.48

Annual Adjustment	DR	CR
Rental income	8,148.43	
Deferred inflows resources	70,047.68	
Interest income		8,148.43
Lease receivable		70,047.68

Lease recognition and disclosure year 4

Rent Period	GASB 87 CPI	GASB 87 Rent	Interest	Principal	Lease Receivable	Actual Rents
06/30/22			3.15%		78,484.31	
07/01/22	2.45%	6,652.49	206.02	6,446.47	72,037.84	6,710.44
08/01/22		6,652.49	189.10	6,463.39	65,574.45	6,710.44
09/01/22		6,652.49	172.13	6,480.36	59,094.09	6,710.44
10/01/22		6,652.49	155.12	6,497.37	52,596.72	6,710.44
11/01/22		6,652.49	138.07	6,514.42	46,082.30	6,710.44
12/01/22		6,652.49	120.97	6,531.52	39,550.78	6,710.44
01/01/23		6,652.49	103.82	6,548.67	33,002.11	6,710.44
02/01/23		6,652.49	86.63	6,565.86	26,436.25	6,710.44
03/01/23		6,652.49	69.40	6,583.09	19,853.16	6,710.44
04/01/23		6,652.49	52.11	6,600.38	13,252.78	6,710.44
05/01/23		6,652.49	34.79	6,617.70	6,635.08	6,710.44
06/01/23		6,652.49	17.42	6,635.07	0.01	6,710.44
FYE 06/30/2023		79,829.88	1,345.61	78,484.30	0.01	80,525.28

Annual Adjustment	DR	CR
Rental income	1,345.61	
Deferred inflows resources	78,484.30	
Interest income		1,345.61
Lease receivable		78,484.30

Leases – Variable Rents and Minimum Annual Guarantees (MAG)

45. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included in the measurement of the lease receivable. Rather, those variable payments should be recognized as inflows of resources (for example, revenue) in the period to which those payments relate. However, any component of those variable payments that is fixed in substance should be included in the measurement of the lease receivable.

MAGs represent a component of a lease payment that is fixed in substance

Leases – Privilege Fees

Are concession revenues not associated with specific assets or locations; leases? That is do privilege fees on sales charged to rental car companies that allow them to do business on the airport campus meet the definition of a lease below?

4. For purposes of applying this Statement, a lease is defined as a contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction.

Leases – Privilege Fees - continued

5. To determine whether a contract conveys control of the right to use the underlying asset, a government should assess whether it has both of the following:

- a. The right to obtain the present service capacity from use of the underlying asset as specified in the contract.
- b. The right to determine the nature and manner of use of the underlying asset as specified in the contract.

7. As used in the definition of a lease, a nonfinancial asset is an asset that is not a financial asset as that term is defined in Statement No. 72, Fair Value Measurement and Application. Examples of nonfinancial assets include land, buildings, vehicles, and equipment.

Leases – Calculation of Lease Receivable for Variable Rents with Minimum Annual Guarantees (MAG)

Scenario for rental car privilege fee

Fiscal Year Ending	Year	Payment (MAG)	Interest Income	Principal	Lease Receivable	Sales	Privilege Fees
			3.15%		7,971,395		
June 30	2017	1,100,000	251,099	848,901	7,122,494	12,000,000	1,200,000
June 30	2018	1,155,000	224,359	930,641	6,191,853	13,000,000	1,300,000
June 30	2019	1,225,000	195,043	1,029,957	5,161,896	13,750,000	1,375,000
June 30	2020	1,300,000	162,600	1,137,400	4,024,496	12,500,000	1,250,000
June 30	2021	1,360,000	126,772	1,233,228	2,791,268	11,500,000	1,150,000
June 30	2022	1,425,000	87,925	1,337,075	1,454,193	10,250,000	1,025,000
June 30	2023	1,500,000	45,807	1,454,193	-	11,000,000	1,100,000
		9,065,000	1,093,605	7,971,395		84,000,000	8,400,000

Leases – Calculation of Lease Receivable for Variable Rents with Minimum Annual Guarantees (MAG) - continued

<i>Journal Entry</i>							
		Debit		Credit			
Fiscal Year Ending	Year	Deferred Inflows of Resources	Rental income	Interest Income	Lease Receivable	Revenues	Inflows Not Recorded in Measurement of Lease Receivable
June 30	2017	848,901	251,099	251,099	848,901	1,200,000	100,000
June 30	2018	930,641	224,359	224,359	930,641	1,300,000	145,000
June 30	2019	1,029,957	195,043	195,043	1,029,957	1,375,000	150,000
June 30	2020	1,137,400	162,600	162,600	1,137,400	1,300,000	
June 30	2021	1,233,228	126,772	126,772	1,233,228	1,360,000	
June 30	2022	1,337,075	87,925	87,925	1,337,075	1,425,000	
June 30	2023	1,454,193	45,807	45,807	1,454,193	1,500,000	
		7,971,395	1,093,605	1,093,605	7,971,395	9,460,000	395,000

Regulated , Aeronautical (Aviation) Leases

42. Certain leases are subject to external laws, regulations, or legal rulings. For example, the U.S. Department of Transportation and the Federal Aviation Administration regulate aviation leases between airports and air carriers and other aeronautical users. Lessors should not apply the provisions in paragraphs 44–59 of this Statement to leases that meet the provisions of paragraph 43.

Examples of lease components that fall within the regulated lease exception:

- Ticket counters
- Holdrooms
- Baggage systems and storage
- Hangar leases
- FBO's

Aeronautical (Aviation) Leases - continued

43. Lessors should recognize inflows of resources (for example, revenue) based on the payment provisions of the lease contract and provide the disclosures in paragraph 60 for leases for which external laws, regulations, or legal rulings establish all of the following requirements:

- a. Lease rates cannot exceed a reasonable amount, with reasonableness being subject to determination by an external regulator.
- b. Lease rates should be similar for lessees that are similarly situated. c. The lessor cannot deny potential lessees the right to enter into leases if facilities are available, provided that the lessee's use of the facilities complies with generally applicable use restrictions.
- c. The lessor cannot deny potential lessees the right to enter into leases if facilities are available, provided that the lessee's use of the facilities complies with generally applicable use restrictions.

Aeronautical (Aviation) Leases - continued

What you need to know about regulated/aeronautical leases.

- The applicability of the standard is very broad.
- It does not exclude these leases from all of the requirements of GASB 87
 - ❑ Not required to record lease receivable and related revenue recognition requirements under standard (i.e. interest vs. principal)
 - ❑ Still required to apply all the criteria of the standard, perform calculations and disclose in notes to financial statements
- ACI-NA General Counsel Tom Devine, developed a whitepaper that discusses the background on how exclusions for regulated aeronautical leases was developed. Available from ACI-NA

Required Disclosures

57. A lessor should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases and certain regulated leases:

- a. A general description of its leasing arrangements, including the basis, terms, and conditions on which any variable payments not included in the measurement of the lease receivable are determined.
- b. The total amount of inflows of resources (for example, lease revenue, interest revenue, and any other lease-related inflows) recognized in the reporting period from leases, if that amount cannot be determined based on the amounts displayed on the face of the financial statements.
- c. The amount of inflows of resources recognized in the reporting period for variable and other payments not previously included in the measurement of the lease receivable, including inflows of resources related to residual value guarantees and termination penalties.
- d. The existence, terms, and conditions of options by the lessee to terminate the lease or abate payments if the lessor government has issued debt for which the principal and interest payments are secured by the lease payments.

Required Disclosures - continued

59. In addition to the disclosures in paragraphs 57 and 58, if a lessor's principal ongoing operations consist of leasing assets to other entities, the government should disclose a schedule of future payments that are included in the measurement of the lease receivable, showing principal and interest separately, for each of the five subsequent fiscal years and in five-year increments thereafter.

60. A lessor with one or more regulated leases, as described in paragraphs 42 and 43, should disclose the following about those lease activities (which maybe grouped for purposes of disclosure), other than short-term leases:

- a. A general description of its agreements
- b. The extent to which capital assets are subject to preferential or exclusive use by counterparties under agreements, by major class of assets and by major counterparty.

Required Disclosures - continued

c. The total amount of inflows of resources (for example, lease revenue, interest revenue, and any other lease-related inflows) recognized in the reporting period from these agreements, if that amount cannot be determined based on the amounts displayed on the face of the financial statements.

d. A schedule of expected future minimum payments under these agreements for each of the subsequent five years and in five-year increments thereafter.

e. The amount of inflows of resources recognized in the reporting period for variable payments not included in expected future minimum payments.

f. The existence, terms, and conditions of options by the lessee to terminate the lease or abate lease payments if the lessor government has issued debt for which the principal and interest payments are secured by the lease payments.

Summary

- Substantially all of your lessor lease agreements will be subject to GASB 87.
- Implementation of standard requires evaluation of lease characteristics at time standard is adopted not effective date of lease.
- Option periods must be evaluated for inclusion or exclusion in lease receivable calculations.
- Lease receivable and disclosure requirements generally do not need to be reassessed and recalculated each accounting period. “Set it and forget it.”
- Annual adjustment for financial statement reporting only.
- Aeronautical/aviation (regulated leases) broadly defined under standard.
- Aeronautical/aviation leases require same calculations and disclosures in notes to the financial statements.

RULE 15c2-12 AMENDMENTS: WHAT YOU NEED TO KNOW

Airports Council International-North America
2019 Business of Airports – Accounting & Financing Working Group
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Background

- Rule 15c2-12 was adopted by the SEC in 1994
- Indirectly regulates issuers and obligors through underwriters
- Requires issuer to enter into continuing disclosure agreement (CDA) for the benefit of bondholders
- CDA must require annual disclosure – audited financial statements and additional information
- CDA must require filing of event notices – within 10 days
- Proliferation of bank loans and private placements led to amendments



Two New Events

- August 20, 2018, SEC adopted amendments to Rule 15c2-12
- Add two new events that must be disclosed within 10 days of occurrence
- Amendments are effective as of February 25, 2019
- New events relate to debt and related obligations that are not publicly offered



Text of 2 New Events

- Event 15: “Incurrence of *a financial obligation* of the obligated person, *if material*, or agreement to covenants, events of default, remedies, priority rights, or *other similar terms* of a financial obligation of the obligated person, any of which affect security holders, *if material*.”
- Event 16: “*Default*, event of acceleration, termination event, modification of terms, *or other similar events* under the terms of *a financial obligation* of the obligated person, any of which *reflect financial difficulties*.”



Unpacking Critical Terms: “Financial Obligations”

- “Financial obligations” include (1) debt (including “debt-like instruments”), (2) related derivatives (e.g., swaps), and (3) a guarantee of either (1) or (2)
- Does not include bonds for which an Official Statement has been filed with EMMA
- Proposed amendments included “leases”; leases not included in final amendments
- But, SEC guidance indicates that a financing lease should be treated as debt
- Considerable lack of clarity as to scope of definition



Unpacking Critical Terms (2): “Material”

- SEC relies on *TSC v. Northway* decision: a factor is material if a reasonable investor would consider it important in making an investment decision
- SEC has steadfastly refused to provide further guidance
- But see results of the SEC’s Municipal Securities Disclosure Cooperative (“MCDC”) initiative for examples
- SEC relies on a “facts and circumstances” analysis



Unpacking Critical Terms (3): “Other Similar Terms”

- No clear SEC guidance
- Extrapolate from Rule and from purpose of the amendments: any terms that give lender an advantage or additional rights over bondholders?
- Bolsters argument in favor of disclosing all terms
- May conflict with lenders’ desire to maintain terms in confidence



Unpacking Critical Terms (4): “Default”

- Use of term is deliberate – many commentators sought use of “event of default” instead
- Typically occurs before cure period
- Gives investors an earlier head’s up, but may result in over disclosure
- Materiality determination will be crucial – type of default and likelihood of prompt cure



Unpacking Critical Terms (5): “Reflecting Financial Difficulties”

- Term used in Rule, e.g., w/r/t draws on reserves, but in Event 16, much wider potential scope
- Any filing under this event is likely to cause market concerns
- Example: Agreement with lender to change financial covenants for a period of time -- likely meets test
- Example: Failure to update notice address – likely does not meet test
- Issue: How to resolve gray areas?
- Consider using a materiality standard



Timing

- Applies to all new debt issued on or after February 25, 2019
- New CDA must include 2 new events
- Does *not* require retroactive disclosure of existing privately placed financings
- *Does* require disclosure of issues “reflecting financial difficulties” any time after new debt issued



What to Disclose?

- Anything that could be a “financial obligation” or only those obligations that clearly meet the test?
 - Consider your facts & circumstances
- File redacted copies of full agreements, or summary of terms?
 - Full copies are lengthy but complete
 - Be sure that all material terms disclosed
- When is a change due to “financial difficulties”?
 - Note limited time to make decision to disclose

Remember – Underwriters will scrutinize your decisions before your next deal



Recommendations for Issuers

- Become familiar with new events and how they apply to you
- Update (or create) disclosure policies and procedures
- Designate disclosure officer and other responsible staff
- Train disclosure staff and others that may incur financial obligations on behalf of your organization
- Maintain a complete list of your “financial obligations”
- Establish process to inform disclosure officer of incurrance of new financial obligations or changes to financial obligations – in advance if possible!
- If in doubt, consult with counsel



Impact on Financings

- Significantly increases underwriters' due diligence responsibilities
- Issuer's certification is not sufficient
- Difficulty – proving a negative: How to assure no missed filings of event notices?
- Issuer's documentation likely to be of substantial assistance
 - Records of outstanding financial obligations and date incurred
 - Summary of terms of financial obligations
 - Records of any changes to terms and date of such change



Conclusion

- Amendments to Rule 15c2-12 are effective now; become familiar with them
- Update or adopt disclosure processes and procedures
- Train staff
- Maintain up-to-date roster of all debt and debt-like instruments and relevant terms
- Don't wait for your next financing!
- If in doubt, consult with experienced counsel



Questions?

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