



Deloitte Finance Club  
The community for Financial  
Controllers and senior financial  
executives

Wednesday, 9<sup>th</sup> March 2016



# Deloitte Finance Club

## A few facts

- Established in **May 1997** as the *Financial Controllers' Club*, and renamed **Deloitte Finance Club** in 2013
- Provides an **annual programme of technical updates and hot topic briefings**
- Connects our members to relevant experts as well as over **2,200 members** across the country

# Deloitte Finance Club

## Upcoming programme

- **Opportunities and challenges for the Finance function of the future**  
Wednesday, 27 April 2016 – 5:30pm-7:00pm (arrivals from 5pm)
- **Summer finance checklist 2016**  
Wednesday, 6 July 2016 – 8:30am-10:30am (arrivals from 8am)
- **Holiday finance checklist 2016** (provisional)  
Wednesday, 30 November 2016 – 8:30am-10:30am (arrivals from 8am)

# Deloitte Finance Club

## Agenda

- **Trends in Real Estate**

[Will Matthews](#)

- **The impact of the new Leases Standard**

[Lucy Newman](#)  
[Peter Westaway](#)  
[Russell McMillan](#)  
[Charles Morelli](#)  
[Manmeet Kalsi](#)



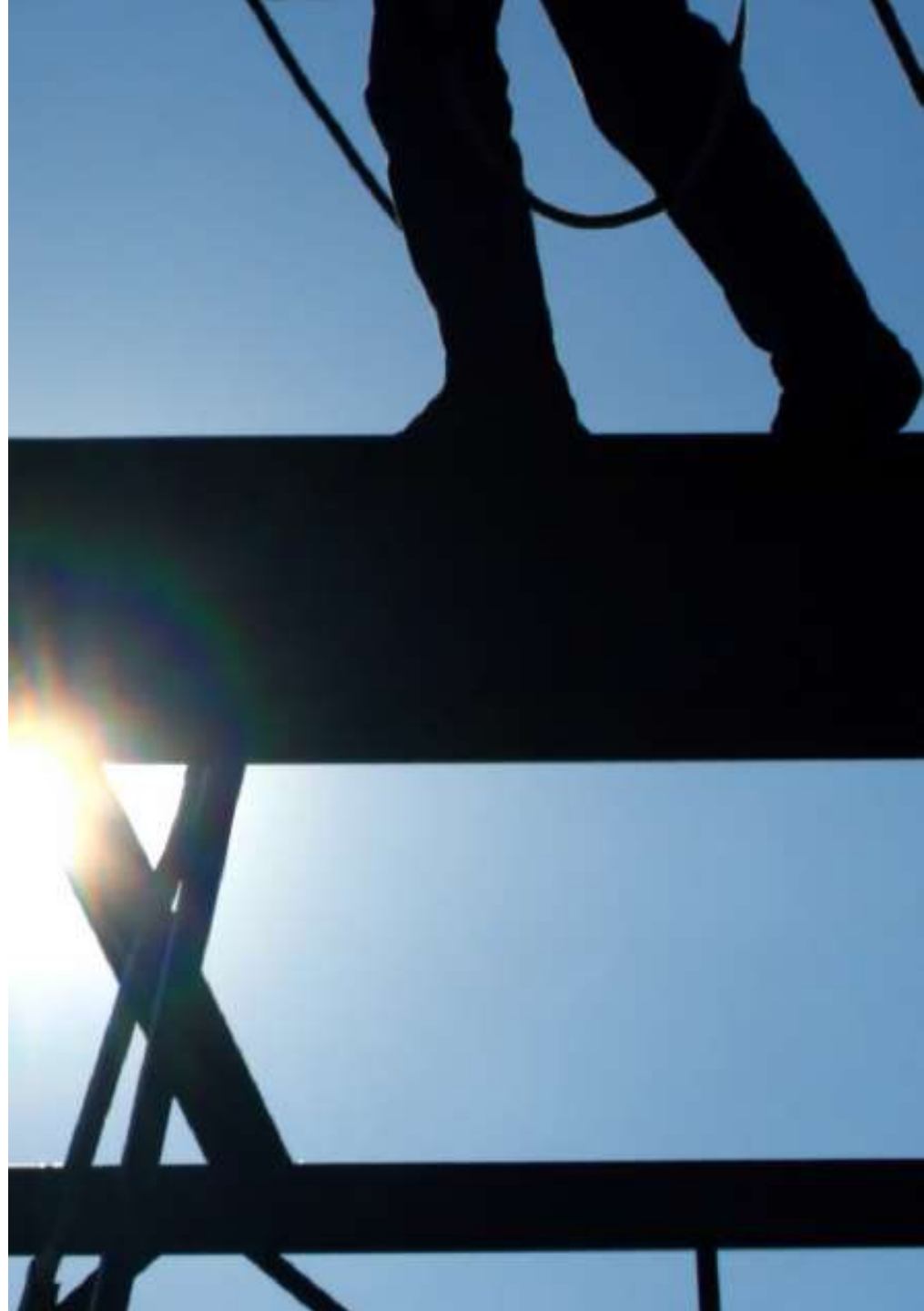
## Trends in real estate

# The London Crane Survey and the workplace

Will Matthews



**Deloitte.**



## Office construction powers ahead

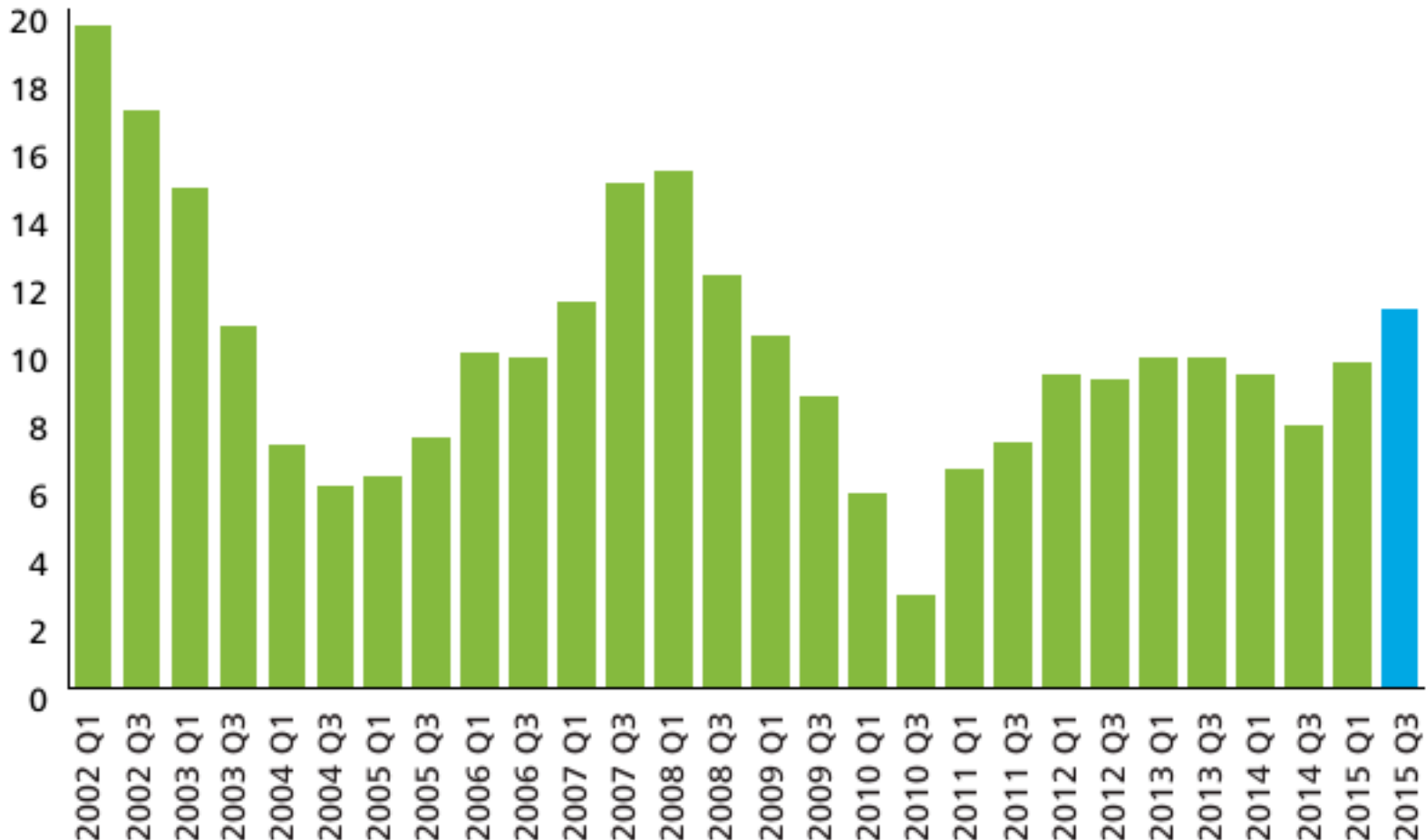
The Crane Survey shows a further strong rise in London office development



# Construction hits a post-recession high...

## ...but only after years of below average activity

Total volume under construction per survey – central London  
Million sq ft

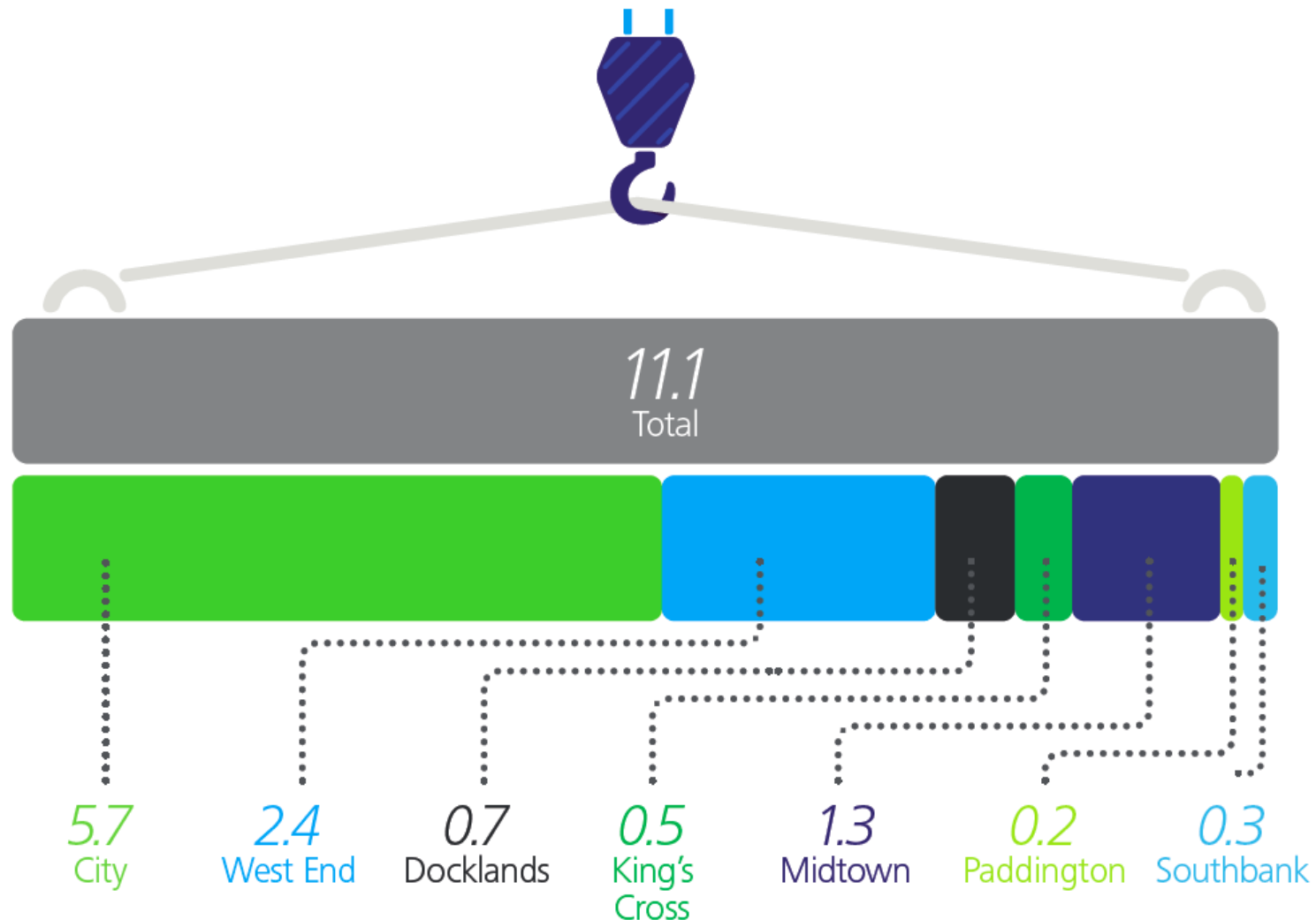


Source: Deloitte



# Core markets still see the majority of construction

## Space under construction letting up quickly

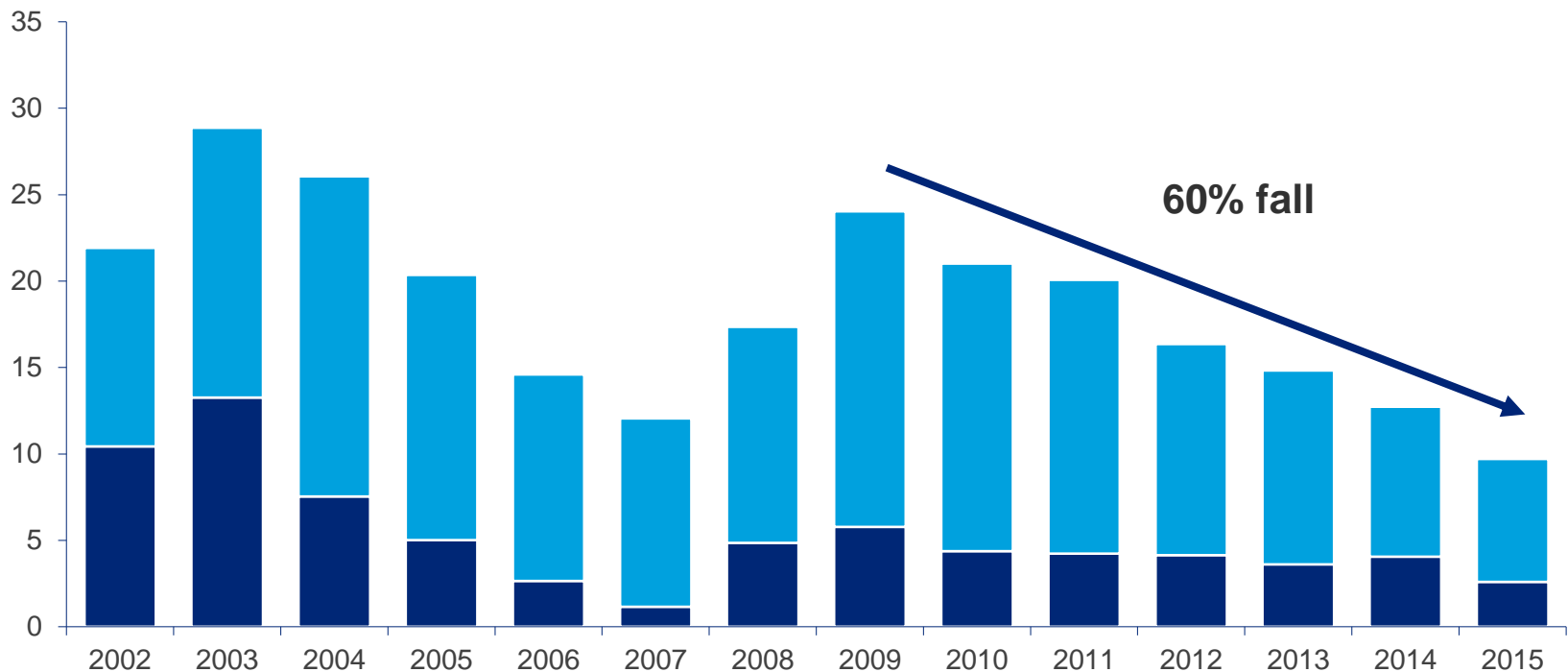


Source: Deloitte

# Office availability has tumbled in the recovery... ...to the lowest level in 15 years!

Central London availability levels by grade

Million sq ft



Source: Deloitte

# Crane survey results

## TMT continues to lead the drive for new space

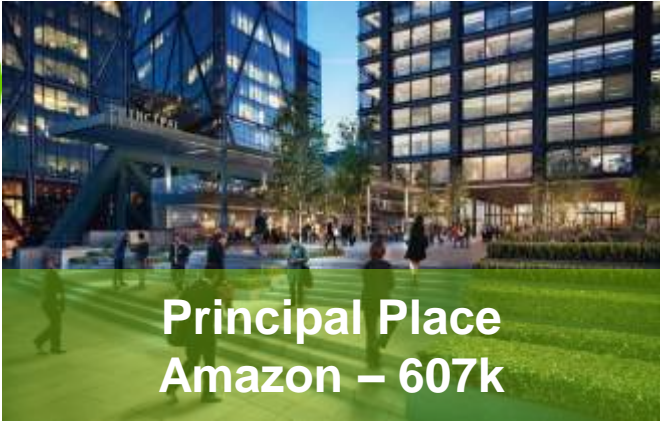
Percentage of spaces let by sector



Source: Deloitte

# Crane survey results

## Who is taking space?



**Principal Place**  
Amazon – 607k



**Pivotal  
Houzz – 26k**



**One Rathbone  
Square**  
Facebook – 216k



**4 Pancras Square**  
Universal Music – 170k



**Three Pancras Square**  
Havas Media – 163k



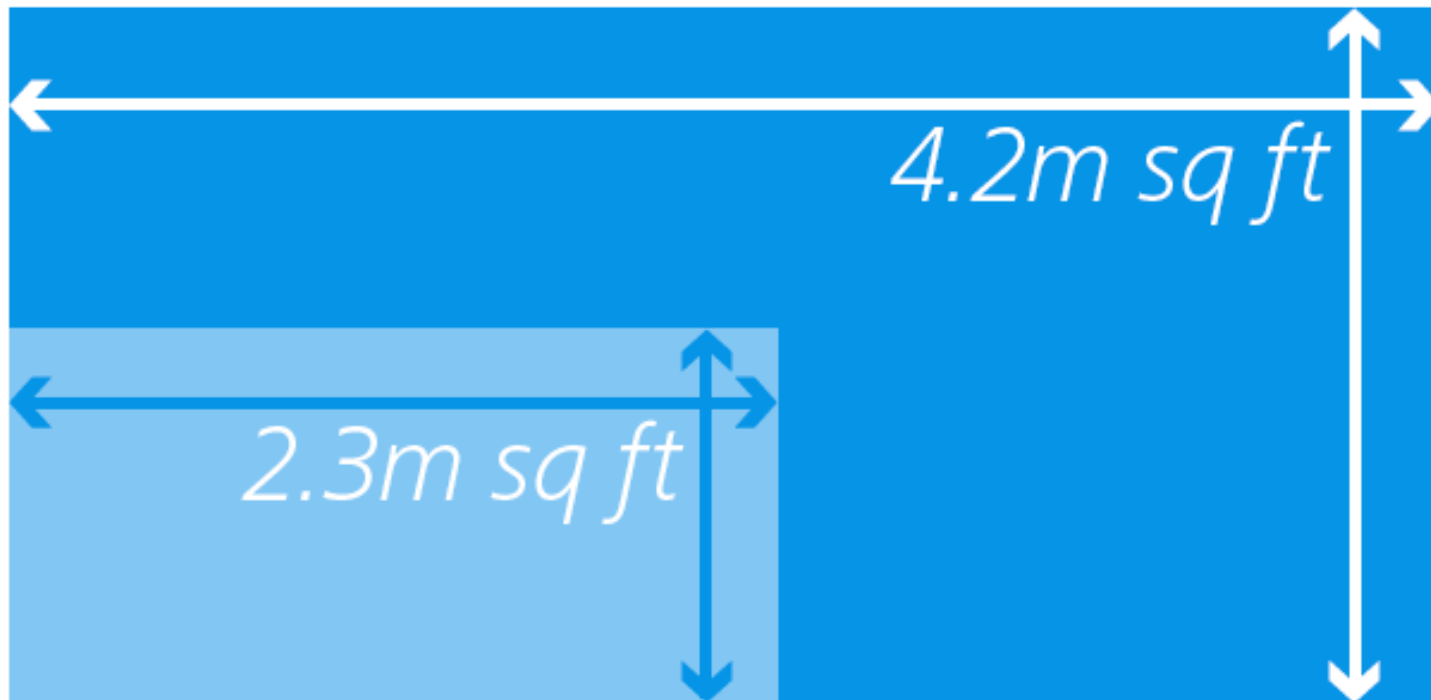
# Crane survey results

## Who is taking space?



## Tenants continue to seek more space

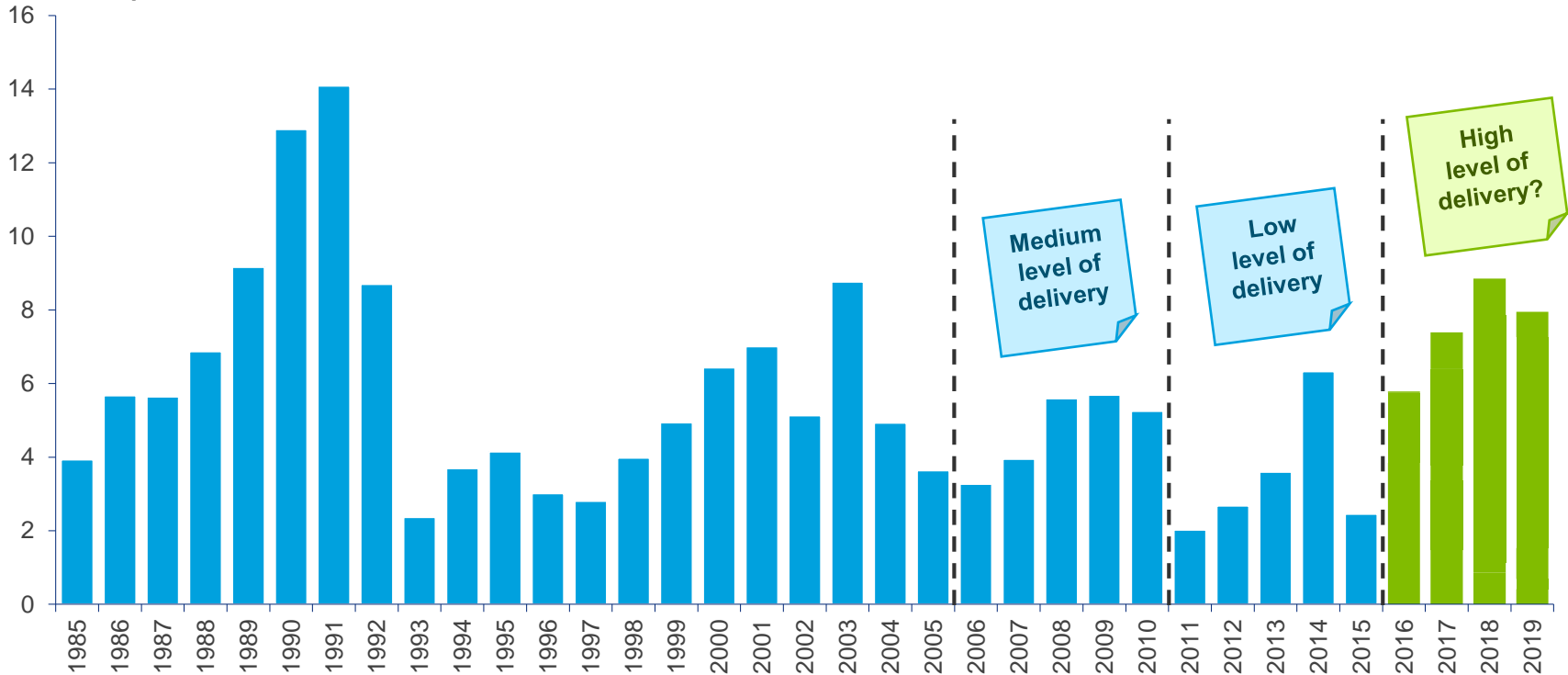
Tenants are moving from a combined 2.3 million sq ft to 4.2 million sq ft



# Future pipeline of London office space

## What are the prospects for development?

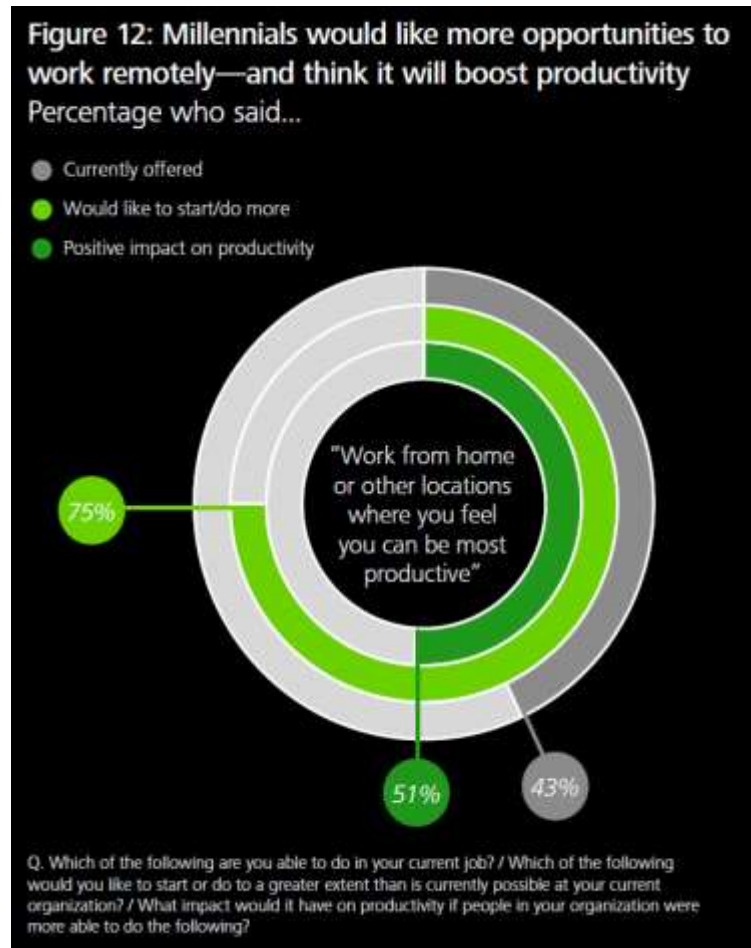
Central London development pipeline forecast  
Million sq ft



Source: Deloitte

# The Deloitte Millennial survey

## Young people want greater opportunities to work flexibly

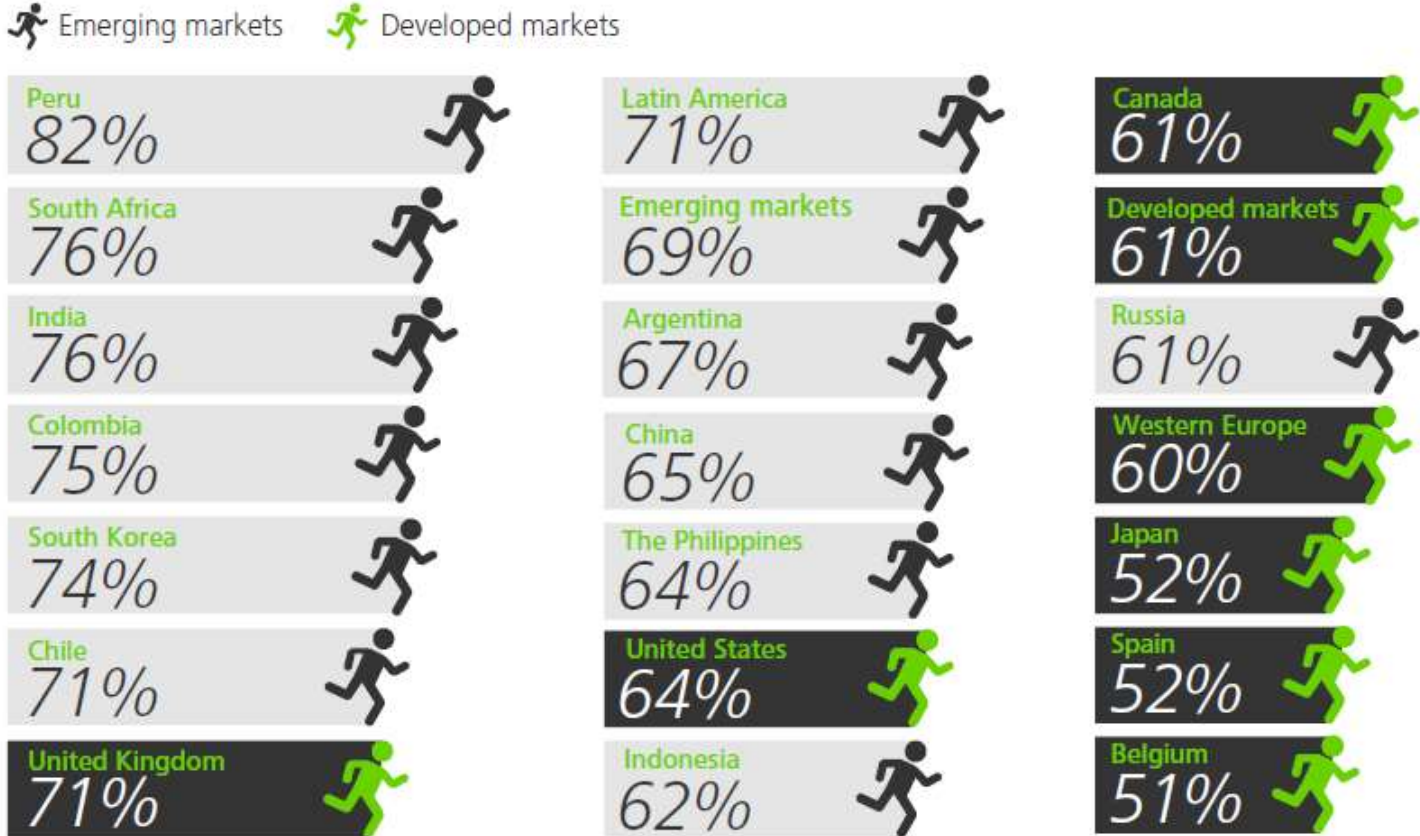




# The Deloitte Millennial survey

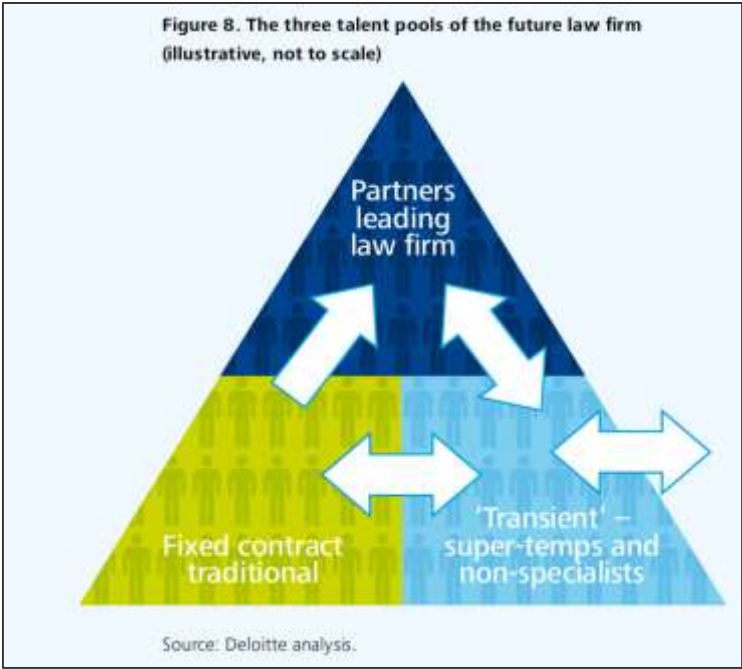
## 71% of UK millennials expect to leave their current employer in the next five years!

Figure 2: Millennials in emerging markets are the least loyal to their current organizations  
Percentage who expect to leave in the next five years



# Contingent workforces: the future for law firms?

## Greater flexibility comes with practical considerations

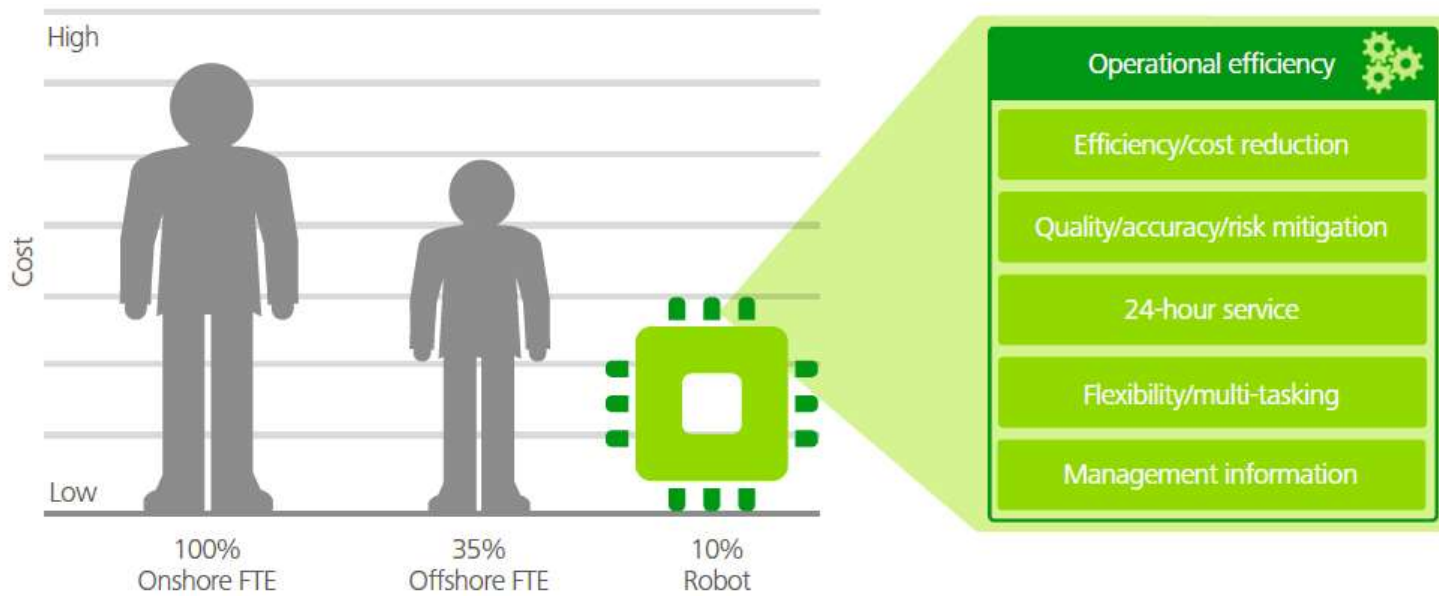


# Your future employee?

## 'Robots' can provide significant savings



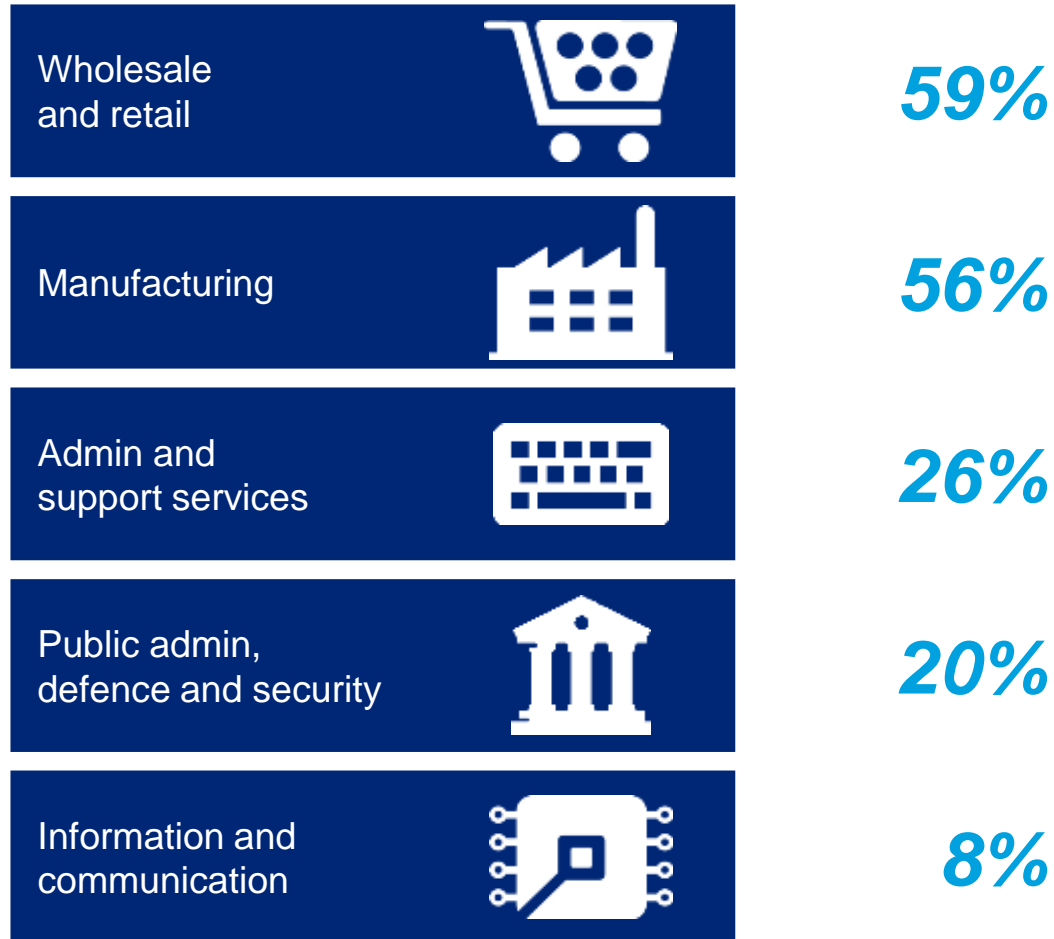
Figure 6. Expected cost savings and other benefits from robotic process automation, illustrative



Source: Deloitte analysis

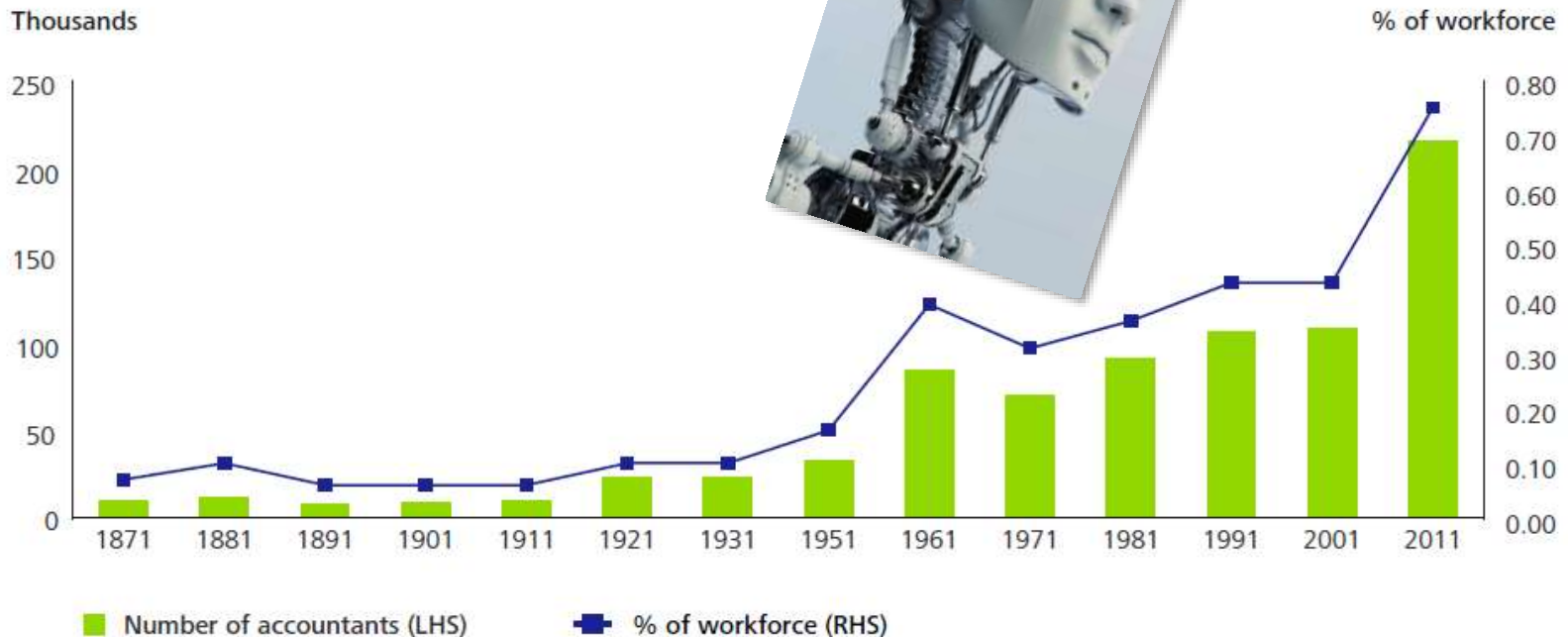
# How likely is it that jobs will be automated?

## Share of jobs at high risk of automation by 2025



# But technology also creates jobs

Chart 4. Accountants



Source: England and Wales Census records, authors' calculations

Data for 1921 and 1931 have been interpolated due to discontinuities in definitions and data

# Crane survey results

## Who is taking space?



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**One Rathbone  
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Facebook – 216k



<https://www.youtube.com/watch?v=JSzko-K7dzo>





# New Leases Standard

## What does it mean?

Lucy Newman  
Peter Westaway  
Russell McMillan  
Charles Morelli  
Manmeet Kalsi





# New Leases Standard: what does it mean?

## IASB issues IFRS 16

Long-standing project  
concluded – final  
standard now issued

Joint project with  
FASB – converged in  
some respects but  
not all

Lessees bringing  
most leases on-  
balance sheet and  
doing accounting  
similar to current  
finance leases

Lessor accounting  
largely unchanged

24 illustrative  
examples – 10 on the  
definition of a lease

Effective for periods  
commencing on or  
after 1 January 2019

# New Leases Standard: what does it mean?

## Definition of a lease

A lease conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

The customer has both the right:

- to direct the identified asset's use; and
- to obtain substantially all the economic benefits from that use

Typically identified by being explicitly specified in a contract, but can also be implicitly specified at the time made available for use by customer

No identified asset if supplier has both:

- the practical ability to substitute alternative assets throughout the period of use; and
- they would economically benefit from substitution

Identified assets include capacity portions if physically distinct (e.g. a floor of a building) but not a portion that is not physically distinct (e.g. a capacity portion of a fibre optic cable), unless it's substantially all the capacity such that the customer obtains substantially all the economic benefits



# New Leases Standard: what does it mean?

## Scope and recognition exemptions

### Leases excluded from IFRS 16 scope

- explore for or use minerals, oil, natural gas and similar non-regenerative resources;
- service concession arrangements (IFRIC 12);
- For lessors, IP licences (IFRS 15); and
- For lessees, biological assets and rights held under licensing agreements in scope of IAS 38 for items such as films, videos, plays, manuscripts, patents and copyrights.

Lessees can elect to apply IFRS 16 to leases of intangible assets, other than the above items.

### Optional lessee recognition exemptions

Can straight line expense and keep following off-balance sheet:

- i. leases with a **lease term of 12 months or less** and no purchase options – election is made by class of underlying asset; and
- ii. leases where underlying asset has a **low value** when new (e.g. personal computers or small items of office furniture) – election can be made on a lease-by-lease basis



# New Leases Standard: what does it mean?

## Unbundling services from leases

Lessees unbundle services based on estimates of relative stand-alone prices

Practical expedient allows lessees to treat entire contract as a lease, although this would increase the asset and liability

Practical challenges in terms of shared space/services in a building?

Lessors use IFRS 15 to allocate consideration

# Lessee accounting

## The balance sheet

### Right-of-use asset and liability recognised on lease commencement under single model

#### Asset

- Initially measured at amount of liability plus initial direct costs
- Adjusted for lease incentives, payments at or prior to commencement and restoration obligations
- Subsequently measured at cost less depreciation and impairment (unless investment property that is fair valued or belongs to class of PPE that is revalued)
- Test for impairment under IAS 36 (instead of onerous lease provisions)

#### Liability

- Initially measured at present value of lease payments
- Lease term similar to IAS 17 ('reasonably certain')
- Variable lease payments that depend on index or rate included in initial measurement using rate at commencement
- Subsequently remeasured (and asset adjusted) for changes in:
  - lease term and purchase option assessments – use revised discount rate; and
  - residual value guarantees and future lease payments resulting from index/rate changes, using original discount rate

# Lessee accounting

## The discount rate



Use the **interest rate implicit in the lease** if it can be readily determined

The rate that causes the present value of:

- a) the lease payments; and
- b) the unguaranteed residual value to equal the sum of:
  - i. the fair value of the underlying asset; and
  - ii. any initial direct costs of the lessor

Otherwise use the **incremental borrowing rate**

The rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment

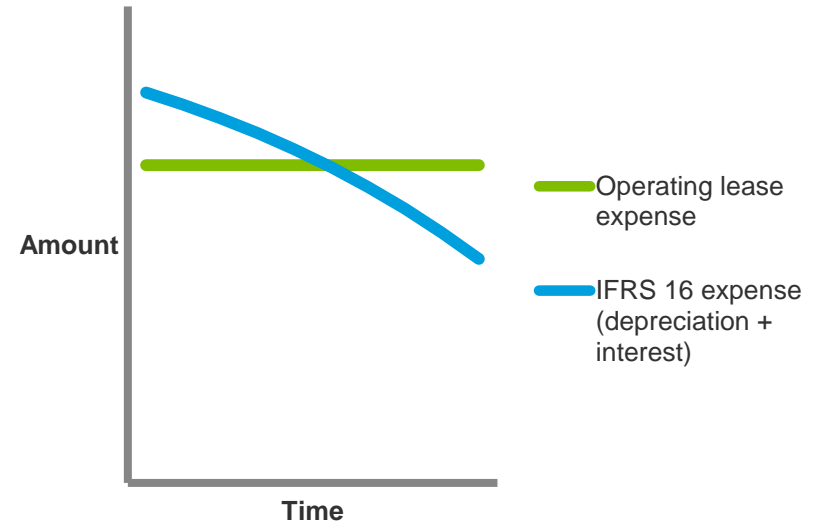
BC acknowledges property yield can be used as a starting point

# Lessee accounting

## Profit or loss and other impacts

- Straight-line operating lease expense replaced with front-loaded expense profile for any individual lease
- Portfolios with spread of maturities impacted less
- Operating lease expense replaced with depreciation and interest so EBITDA increases
- Consider impact on KPIs, lending covenants, earn-outs, bonus schemes etc
- Tax rules may change before implementation
- Stakeholder communication important

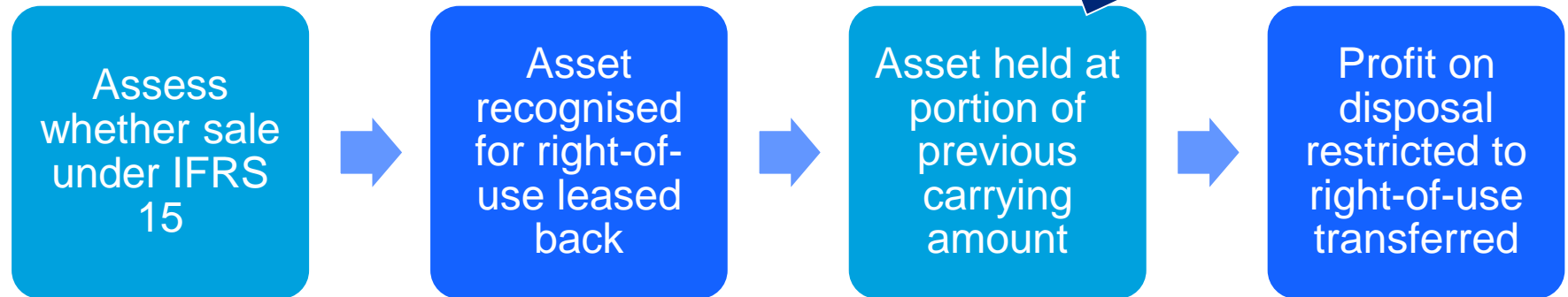
Change in overall expense profile upon adoption of IFRS 16 for an individual lease



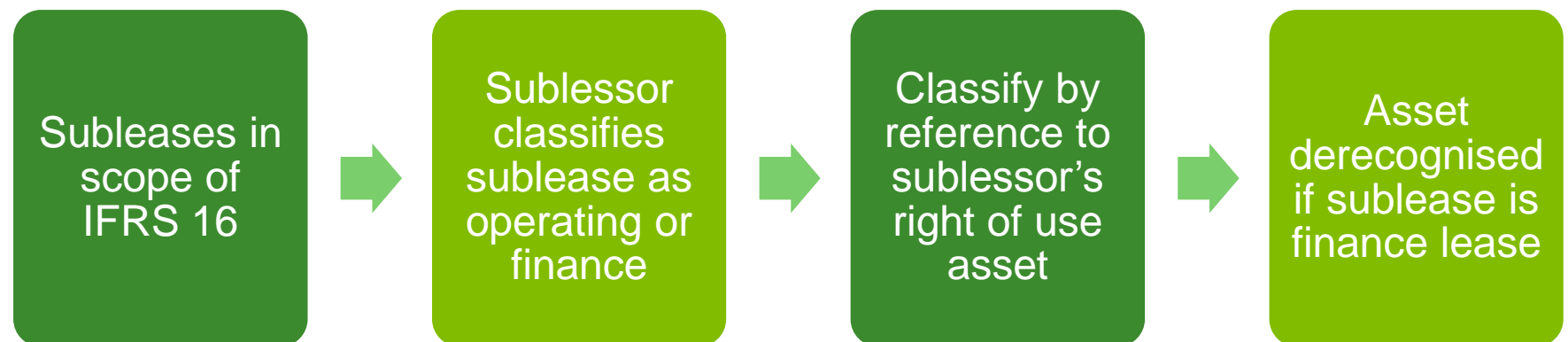
# Lessee accounting

## Other impacts

### Sale and leaseback:



### Subleases:





# New Leases Standard: what does it mean?

## Transition

Subject to EU endorsement, effective for periods beginning on or after 1 Jan 2019

Earlier application permitted if IFRS 15 has also been applied

Not required to reassess whether a contract is, or contains, a lease at the date of initial application

Challenge for systems to capture all data?

Either apply IFRS 16:

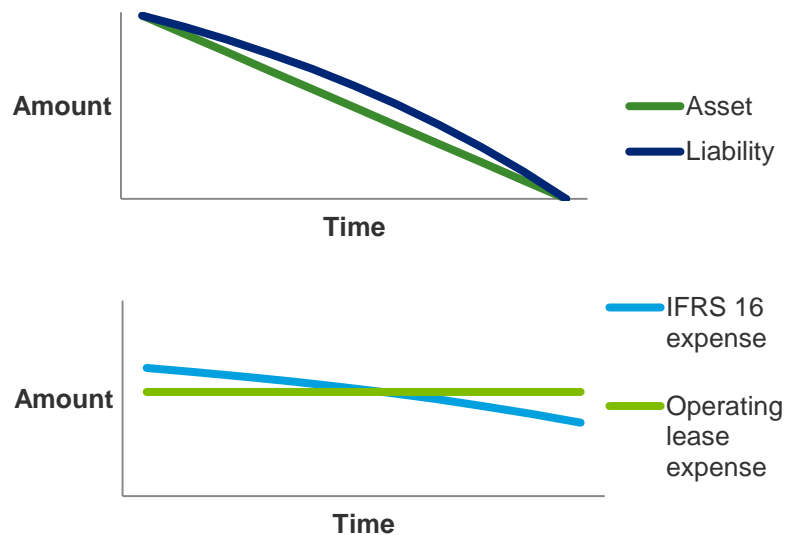
- i. with full retrospective effect; or
- ii. leave comparative information unadjusted but recognise the cumulative effect of initial application as an adjustment to opening retained earnings, measuring the liability using the incremental borrowing rate at the date of initial application and either:
  - set the asset equal to liability; or
  - calculate based on retrospective application

# Transition: a simple example

## Assuming asset would equal liability upon commencement



### Retrospective application



Reduces net assets and PBT will be higher or lower than operating lease expense depending on lease maturity

### Transitional relief

- Setting asset equal to liability would mean no effect on net assets – expense in future would typically initially be higher than operating lease expense but then drop below
- Other approach would leave comparatives unchanged and if no movement in discount rate then in simplest scenario produces same effect as retrospective application

# Lessee accounting

## Broad considerations

### Financial Reporting

- Bringing a large financial liability onto the balance sheet
- Volatility for some in the income statement and balance sheet
- Higher income statement cost in earlier years of leases
- Impact on management information needs
- Implication of the accounting process for large groups

### Board Level considerations

- Gearing and covenant compliance
- Management KPIs
- Transparency and communication
- Bring increased focus on corporate real estate costs and estates strategy
- Tax risk
- Impact on capital requirements

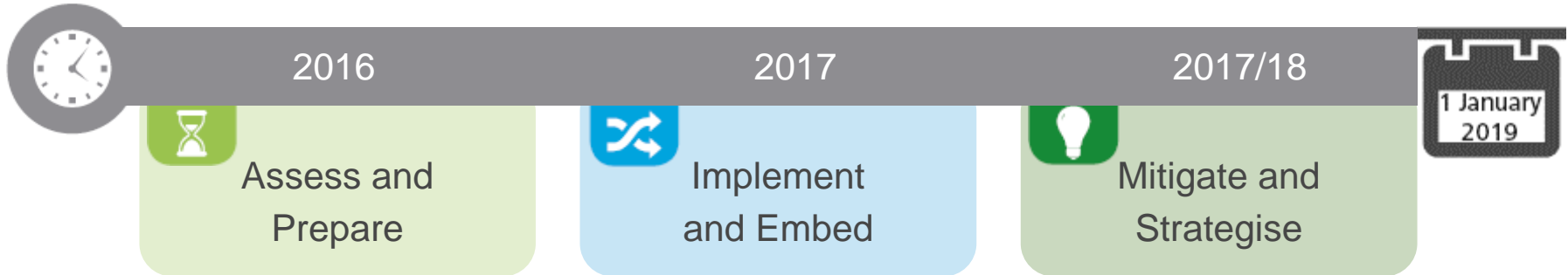
### Practicalities

- Significant workload to calculate liabilities
- Availability of information, data integrity and collection (initial and reassessment)
- Resourcing and reporting lines
- Preparing the market / shareholders



# New Leases Standard: what does it mean?

## Time to take action



Find out more on how Deloitte's IFRS 16 team, including our market-leading property advisory business, can help at [www.deloitte.co.uk/ifrs16](http://www.deloitte.co.uk/ifrs16) or by emailing [ifrs16@deloitte.co.uk](mailto:ifrs16@deloitte.co.uk)



# New Leases Standard: what does it mean?

## Questions for you

Will applying the definition of a lease be a significant challenge?

Will gathering the necessary data and having confidence in it be a significant challenge?

Will determining the discount rate be a significant challenge?

Could you see your leasing strategy changing?

# Questions and discussion

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# Deloitte Finance Club

## Contacts and resources

### Contacts

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### Resources

- Deloitte Finance Club home page: [www.deloitte.co.uk/financeclub](http://www.deloitte.co.uk/financeclub)
- UK Accounting Plus (formerly IAS Plus): [www.ukaccountingplus.co.uk](http://www.ukaccountingplus.co.uk)
- Deloitte Monday Briefing: [www.deloitte.co.uk/mondaybriefing](http://www.deloitte.co.uk/mondaybriefing)



# Deloitte Finance Club

## 2015 seminars

- [Holiday finance checklist 2015](#) – 9 December 2015
- [Tax update and Working capital and cash flow management](#) – 18 November 2015
- [How technology is disrupting the Finance Function](#) – 14 October 2015
- [Economic update and Football Finance](#) – 16 September 2015
  
- [Summer finance checklist 2015](#) – 14 May 2015
- [Business Partnering: better decision-making through Finance insight](#) – 29 April 2015
- [The rise of omnichannel: what it means for Finance](#) – 25 March 2015



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