

Contents

- Introduction
 - Increased Costs of Capital
 - Changes in the Lending Environment
 - Evolving Real Estate Demands and Preferences
- Accounting Considerations
 - Real Estate Owners, Operators, and Developers
 - CRE Lenders
 - Investors in Commercial Mortgage-Backed Securities
- Financial Reporting Considerations
 - Going Concern
 - Disclosure Considerations
 - Internal Controls and Fraud Risk Assessment
- Contacts

Financial Reporting and Accounting Considerations Related to the Current Commercial Real Estate and Banking Macroeconomic Environment

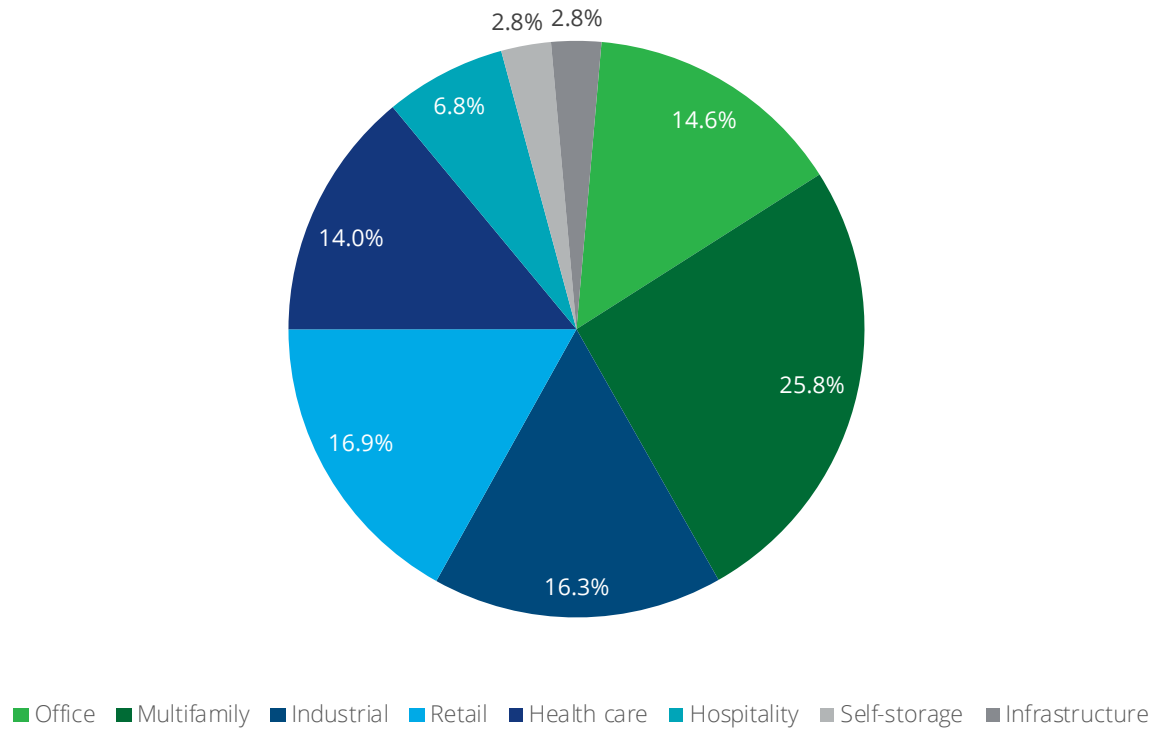
Introduction

As discussed in Deloitte's May 22, 2023, *Financial Reporting Alert*, the macroeconomic environment has created ongoing challenges and uncertainty in the commercial real estate (CRE) and banking industries. Many CRE entities have encountered increased costs of capital and tightening lending standards while also dealing with higher levels of maturing debt; reductions in the volume of real estate transactions; and evolving real estate demands and preferences related to the way people work, live, and shop. Nonetheless, despite the uncertainty related to the number and timing of interest rate cuts, relief could arrive in the form of declining interest rates and the possible allocation of committed, yet unspent, capital intended for equity and debt CRE investment.

The CRE industry comprises not only owners and operators of real estate (e.g., in subsectors such as retail, multifamily, office, industrial, senior housing, and homebuilding) but also investors and lenders. The present and long-term impact of the current macroeconomic environment on CRE assets will vary on the basis of asset-specific factors such as subsector, geographic location, asset quality, leverage levels, tenant-specific operations, and in-place lease terms. Accordingly, CRE entities should continually monitor, evaluate, and update their

accounting and reporting as necessary. While office assets have been the focus of the press and media, CRE encompasses many other asset classes; in fact, as illustrated in the graphic below, office assets represent only about 14.6 percent of CRE.¹

Gross Values of U.S. CRE by Asset Class



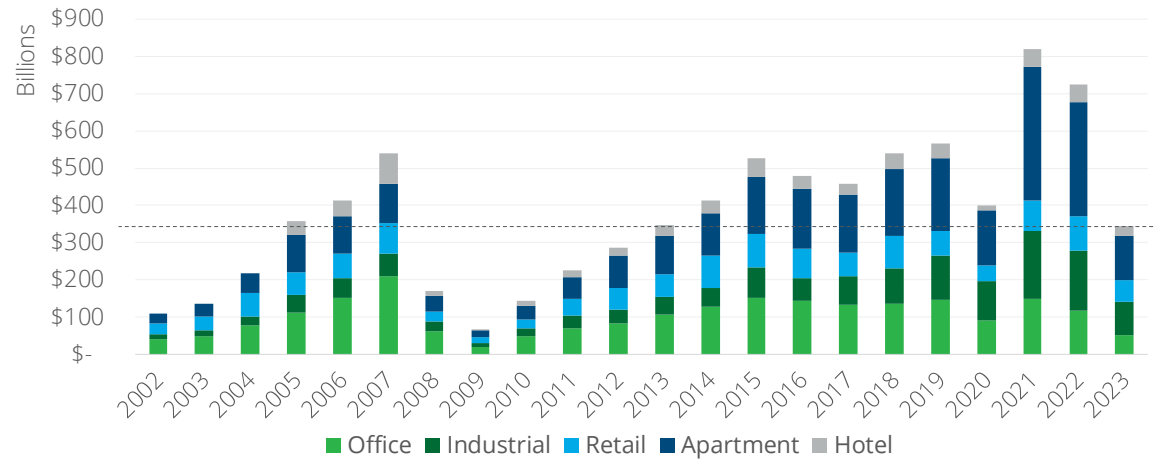
The sections below summarize some of the challenges faced by CRE entities — as well as by investors and lenders with assets backed by CRE — in the current macroeconomic environment.

Increased Costs of Capital

Mortgage interest rates for CRE financing have increased since the beginning of 2022. Higher borrowing costs, combined with market uncertainty, have led to a decline in real estate transactions. In 2023, U.S. CRE transactions decreased by 53 percent compared with 2022, representing the lowest transaction volume since 2012. Increased costs of capital may also limit a real estate entity's ability to fund redevelopment projects. A prolonged reduction in real estate transaction activity could hinder an entity's ability to follow through on its asset acquisition or disposition plans. Moreover, the impact of a prolonged period of relatively higher interest rates is unknown and could hinder an entity's ability to execute its long-term strategy.

¹ Data in graph below based on article by Bradley Ball and Jonathan Woloshin, "Commercial Real Estate Exposure at US Banks" — UBS; February 6, 2024.

CRE Transaction Volume

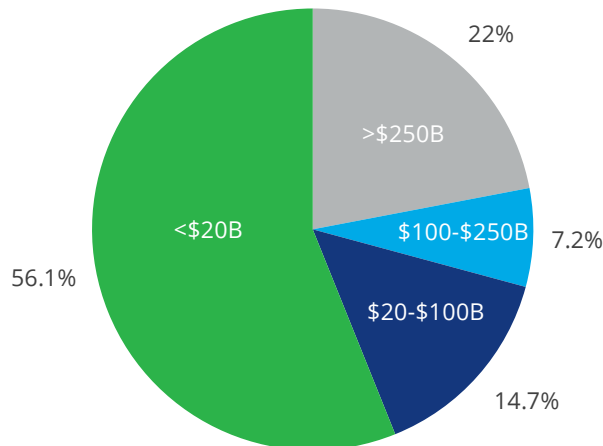


Source: MSCI Real Capital Analytics; data accessed January 26, 2024.

Changes in the Lending Environment

In addition to higher costs of capital, CRE companies may also be experiencing tightened lending standards as lenders and investors evaluate and manage their loan and debt investment portfolios, respectively. According to the Mortgage Bankers Association,² nearly \$929 billion of the \$4.7 trillion of outstanding commercial mortgages will mature in 2024. A significant amount of CRE debt balances in the United States is held by smaller banks with total assets of \$20 billion or less, many of which are navigating their own challenges associated with recent banking sector developments.

Percentage of CRE Debt Held by U.S. Banks, by Total Bank Assets



Adapted from "The U.S. Banks With the Highest Exposure to Commercial Real Estate" — Visual Capitalist; data as of March 13, 2024.

² Mortgage Bankers Association — 2023 Commercial Real Estate Survey of Loan Maturity Volumes.

Financial institutions have emphasized monitoring their exposure to CRE within their portfolios, as observed in financial reporting disclosures and quarterly earnings presentations.

Higher interest rates and widening bond spreads have led to a decline in issuances of CRE mortgage-backed securities (CMBSs). In response, some real estate companies have resorted to shorter-term financing, typically at higher financing costs, to replace maturing long-term debt. According to Jones Lang LaSalle, a shortfall exists between the funding available to refinance CRE debt and pending CRE debt maturities in the range of \$270 billion to \$570 billion for CRE assets.³ Despite this shortfall, more than \$400 billion of committed, yet unspent, capital is available for CRE. Eighty percent of this capital is concentrated in value-added and opportunistic investment strategies, which are investment types aimed at driving returns from CRE assets with minimal cash flows through value-added investment and development.⁴

Evolving Real Estate Demands and Preferences

Real estate demands vary by asset class and location; preferences in the way people work, live, and shop are evolving. Demand for real estate may also be affected by recent renovations and redevelopments as well as the incorporation of technology and sustainability infrastructure. In the long term, asset quality is expected to play a key role in the ability of real estate entities to withstand changes in tenants and related demands.

Economic uncertainty, combined with expectations related to hybrid-work approaches, has led to increased vacancy rates for office properties in certain locales. According to CRED iQ,⁵ a real estate data provider, only 26 percent of the \$35.8 billion of office CMBS loans that matured in 2023 was actually paid off in full. Similarly, the extent and magnitude of e-commerce competition in the retail real estate sector have been thought to drive down performance in the subsector. While the retail real estate sector's performance has steadied, uncertainties remain. Accordingly, CRE companies should continue to monitor the evolving landscape and consider how such changes may affect their portfolios.

Accounting Considerations

The sections below address accounting considerations that apply to various types of entities involved in the CRE industry — specifically owners, operators, and developers; lenders; and investors. However, certain topics, such as those related to the current expected credit loss (CECL) model, may apply to all entities.

Real Estate Owners, Operators, and Developers

While some challenges in today's macroeconomic environment will have a broad impact on the CRE industry, others may be limited to specific account balances, transactions, or disclosures. These challenges could result in operational and financial uncertainties, often with unique accounting, financial reporting, and internal control implications such as those discussed in the sections below.

Impairment of Real Estate Assets and Fair Value Measurement

Test for Recoverability

When economic conditions deteriorate, the likelihood of identifying an impairment indicator increases. Entities should evaluate whether changes in results and conditions lead to a "triggering event" that requires an evaluation of their CRE and other long-lived assets for impairment. When a triggering event has occurred, the entity assesses whether the asset is recoverable on an undiscounted cash flow basis. In performing this assessment, management

³ Natalie Wong, "There's Finally Hope for the Commercial Real Estate Market" — Bloomberg News; January 11, 2024.

⁴ PitchBook; data as of November 27, 2023.

⁵ Carol Ryan, "What Mortgage Bonds Say About the Office Meltdown" — *The Wall Street Journal*; February 12, 2024.

must use asset-specific cash flow projections, which should be based on management's intended use of the asset.

Entities will need to make good-faith estimates, challenge the assumptions underlying those estimates for reasonableness, prepare comprehensive documentation supporting the basis for such estimates, and provide appropriate disclosures. In developing cash flow estimates, an entity needs to use reasonable assumptions. Such assumptions may include those related to residual value, revenue growth rate, leasing assumptions, and probability-weighted holding periods. Certain assumptions may depend on market information that is evolving in the current environment, is more difficult to ascertain in times of decreased market activity, or both. Entities should regularly assess the reasonableness of assumptions in the current environment, especially those that are material to recoverability analyses or that may result in a wide range of conclusions. Even when there is a wide range of possible outcomes, the assumptions should be consistent with other relevant internal and external information. For example, probability-weighted holding periods should be aligned with management's maturing debt plans and asset disposition plans. Management should challenge the reasonableness of those assumptions and should consider incentives, opportunities, and pressures as well as the risks of fraud associated with determining management's good-faith estimates.

Determination of Fair Value

If an entity determines that the carrying value of a real estate asset is not recoverable on an undiscounted cash flow basis, an impairment loss is recognized for the difference between the asset's fair value and carrying value. The fair value of an individual asset or asset group is measured in accordance with ASC 820⁶ on the basis of an orderly transaction between market participants as of the measurement date. Fair value estimates need to reflect the current views of market participants. In the current environment, entities should evaluate whether market information used in determining fair value is timely, incorporates the nature and geography of the asset, is free from bias, and reflects the view of an independent market participant. An entity must consider the highest and best use of the asset, even if that use differs from the entity's intended use.

While long-lived assets may be subject to nonrecourse debt, the fair value of such assets should be determined without regard to the nonrecourse provisions. If the carrying amount of the asset that is reverted back to the lender is less than the amount of the nonrecourse debt extinguished, a gain would be recognized on extinguishment. Regardless of whether the entity recognizes an impairment loss, it should consider whether (1) early-warning disclosures regarding the asset value are appropriate and (2) there has been a change in the remaining useful life or salvage value because of the nature of the triggering event that occurred.

For additional considerations related to impairment of long-lived assets, see [Chapter 2](#) of Deloitte's Roadmap *Impairments and Disposals of Long-Lived Assets and Discontinued Operations*.

Held-for-Sale Assets

Real estate assets are sometimes classified as held for sale. While the held-for-sale impairment model differs from the held-and-used impairment model, the method for determining fair value under ASC 820 is the same as that described above. When a real estate asset meets the held-for-sale criteria under ASC 360, impairment is evaluated by comparing the carrying amount of the real estate asset with its estimated fair value less cost to sell.

See [Section 3.3](#) of Deloitte's Roadmap *Impairments and Disposals of Long-Lived Assets and Discontinued Operations* for further discussion of the held-for-sale criteria.

⁶ For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's "[Titles of Topics and Subtopics in the FASB Accounting Standards Codification](#)."

Assets in Receivership

In certain circumstances, a receiver may be appointed to take possession of or sell the asset on behalf of a secured creditor or another party. When an asset is transferred to a receiver, the borrower under the secured financing arrangement may need to use judgment in determining how to continue to account for the secured asset. This determination is based on whether the borrower has transferred control of the asset to the receiver. If the asset is included in a legal entity, the borrower must first perform an assessment under ASC 810 to determine whether it has a controlling financial interest in the legal entity. If the borrower concludes that it does not have a controlling financial interest in the legal entity, it should apply the derecognition guidance in ASC 610-20, which refers to the control framework under ASC 606. (Note that the derecognition guidance in ASC 610-20 would also apply if the asset is not included in a legal entity.) ASC 606 identifies certain indicators of control transfer, including whether the significant risks and rewards of ownership of the asset have been transferred. While a borrower may transfer the day-to-day control of an asset to a receiver, the existence of a right to repurchase the asset may prevent the receiver's ability to direct the use of and obtain substantially all of the remaining benefits from the asset. While the terms of the receivership may differ on the basis of the terms of the receiver agreement, a borrower's ability to repay the secured financing and reassume control of the asset may represent a call option on the asset. When a call option exists, the borrower should generally continue to consolidate the real estate asset.

Troubled Debt Restructurings

As real estate owners, operators, and developers work with financial institutions and lenders in the current macroeconomic environment to refinance or modify existing debt, entities should consider whether such restructured debt meets the definition of a troubled debt restructuring (TDR). A debt restructuring qualifies as a TDR if both of the following criteria are met: (1) the debtor is experiencing financial difficulties and (2) the creditor, for economic or legal reasons related to such difficulties, has granted the debtor a concession that it would not otherwise consider. If a TDR involves the modification of debt terms, such as a reduction of the stated interest rate, a reduction of the principal amount of the debt, or an extension of the maturity date, the accounting depends on the total amount of undiscounted future cash payments required by the modified terms compared with the debt's net carrying amount.

If the total amount of undiscounted cash payments required by the modified terms exceeds the debt's net carrying amount, a restructuring gain is not recognized and the effective interest rate is adjusted to reflect the modified terms. After the TDR, interest expense is recognized by using the adjusted effective interest rate. On the other hand, if the debt's net carrying amount exceeds the total amount of undiscounted cash payments required by the modified terms, a restructuring gain is recognized and the effective interest rate is reset to zero. Thereafter, the debtor accounts for any cash paid as a reduction of the net carrying amount and no interest expense is recognized.

Sometimes, the terms of the restructured debt specify contingently payable amounts. For instance, the debtor may be required to pay additional amounts of principal or interest if its financial condition or financial performance improves. ASC 470-60 precludes the recognition of a restructuring gain if the restructured debt specifies contingent payments and the maximum possible amount of contingent and noncontingent payments equals or exceeds the net carrying amount of the debt, without consideration of the likelihood that contingent payments might need to be paid. Therefore, the debtor must reduce the amount of any restructuring gain that would otherwise have been recognized up to the maximum total undiscounted amount of any contingent payments.

On March 31, 2022, the FASB issued [ASU 2022-02](#),⁷ which eliminated the accounting guidance on TDRs for creditors given the required accounting for credit losses under the CECL model.

See [Chapter 11](#) of Deloitte's Roadmap *Issuer's Accounting for Debt* for further discussion of evaluating and accounting for TDRs.

Equity Method Investments and Joint Ventures

Real estate companies should consider whether the current macroeconomic environment has negatively affected equity method investments and joint ventures in such a way that the ASC 323 impairment factors are present. An equity method impairment is recognized when the estimated fair value of the investment is below its carrying value and such an impairment loss is concluded to be other than temporary.

See [Section 5.5](#) of Deloitte's Roadmap *Equity Method Investments and Joint Ventures* for further discussion of the assessment of equity method investments for other-than-temporary impairments.

Changes in liquidity and market transactions in the environment may lead to an increase in unique transactions structured as unconsolidated investments and joint ventures. To the extent that an entity enters into any nonstandard or unusual transactions, the entity should consider the nature and purpose of the transaction in determining the appropriate accounting, classification, and disclosure. An entity should also consider consulting with its legal or accounting advisers in such situations.

Debt Covenants

Certain debt agreements may include financial or operational covenants. Failure to comply with such covenants may give the creditor the right to accelerate the maturity date. Debt that has become payable on demand or that will become payable on demand within one year after the balance sheet date because of a covenant violation must be classified as a current liability (for entities that present a classified balance sheet) unless (1) the settlement will not require the use of current assets or the creation of other current liabilities or (2) a specific exception applies. Entities should also consider the impact of such acceleration clauses on their ability to continue as a going concern and should understand the judgments and estimates used in the calculation of the financial or operational covenants to make sure they are free from bias. In addition, entities should provide clear financial statement disclosures regarding any failures to comply with covenants as well as early-warning disclosures related to an upcoming inability to do so. See the [Going Concern](#) section for further considerations.

Leases

Lease Collectibility

In addition to the impairment considerations described above, lessors should be aware that net investments in leases (arising from sales-type and direct financing leases) are subject to the CECL impairment model, which is based on expected losses rather than historical incurred losses. See [Section 5.3](#) of Deloitte's Roadmap *Current Expected Credit Losses* for further discussion of the application of the CECL model to lease receivables.

Lessors with outstanding operating lease receivables must apply the collectibility model under ASC 842-30. Entities should apply this collectibility model in a timely manner in the period

⁷ FASB Accounting Standards Update (ASU) No. 2022-02, *Troubled Debt Restructurings and Vintage Disclosures*. For more information about ASU 2022-02, see Deloitte's April 4, 2022, [Heads Up](#).

in which amounts under the lease agreement are due. Under the ASC 842-30 collectibility model, an entity continually evaluates whether it is probable that future operating lease payments will be collected on the basis of the individual lessees' credit risk. When collectibility of lease payments is probable, the lessor will apply an accrual method of accounting. When collectibility is not probable, the lessor will limit lease income to the cash received, as described in ASC 842-30-25-13. Entities should continue to assess the impact of the current environment when determining whether to move tenants either to or from this cash basis of accounting and the accrual method of accounting. For more information about assessing the collectibility of operating lease receivables, see [Section 9.3.9.2](#) of Deloitte's Roadmap *Leases*.

Reduction in Lease Term and Partial Termination

In the current environment, tenants may negotiate with lessors to exit early from a leased space, decrease the amount of leased space, or terminate the lease in its entirety. The accounting for these lease transactions differs depending on the facts and circumstances. It is critical to determine whether, for accounting purposes, the changes to the lease represent a lease modification or a lease termination. If the lease termination occurs on a future date, for accounting purposes, the change represents a lease modification rather than a termination and remaining payments will be recognized as income by the lessor (or expense by the tenant) over the remaining lease life.

A contractually agreed-upon reduction in the lease term should be accounted for as a modification in which the lessor (and lessee) must remeasure and reallocate the consideration in the contract and reassess lease classification by using the relevant assumptions as of the modification date. A lease termination agreement that terminates a portion of an asset, such as one of several leased floors in an office building, would be accounted for not as a termination but as a modification since the remaining floors continue to be leased. Lease termination guidance is applicable when the lessee's right of use ceases contemporaneously with the execution of the lease termination agreement (e.g., the space is immediately vacated). When a lease modification is not accounted for as a separate contract, such as a partial lease termination, the termination income must be reallocated and recognized over the lease term of the remaining lease components in the contract. An important difference between the lessee and lessor requirements is that the lessor should not update its lease-term assumptions made at lease commencement unless a contractual modification has occurred.

Evaluation of Lease Options

When determining the lease term at lease commencement, an entity should determine the noncancelable period of a lease, which includes tenant option periods whose exercise is believed to be reasonably certain. The likelihood of whether a tenant will be economically compelled to exercise or not exercise an option to renew or terminate a lease is evaluated at lease commencement. In performing this assessment, an entity would consider contract-based, asset-based, entity-based, and market-based factors (e.g., the market rental rates for comparable assets), which may be affected by changes in the macroeconomic environment. A lessor may only reassess the lease term upon modification of the lease when the modification is not accounted for as a separate contract.

CRE Lenders

As discussed above, lenders of CRE, including banks, insurance companies, and real estate investment trusts (REITs), will also face challenges in the current macroeconomic environment. CRE lenders may need to consider whether the changes occurring in this environment affect the impairment of these loans.

Unit of Account

Under the CECL impairment model, entities are required to evaluate financial assets within the scope of the model on a collective (i.e., pool) basis if the assets share similar risk characteristics (e.g., collateral type, interest rate, and geographic location). Because of the changes in the macroeconomic environment, a lender should evaluate whether a loan or subset of loans in a pool continues to exhibit risk characteristics similar to those of other loans in the pool. Entities should consider whether real estate loans in the pool need to be further disaggregated on the basis of the property type (e.g., office, retail, industrial, residential) or property class (i.e., Class A, Class B, or Class C) of the underlying asset. Furthermore, changes in expected credit loss patterns or reasonable and supportable forecast periods could mean that the risk characteristics exhibited by certain loans are no longer similar to those demonstrated by the remainder of the pool. As a result, the lender would remove loans from its current pool and either (1) move a subset of loans into a new pool or (2) evaluate loans individually if they no longer share risk characteristics with any other loans.

See [Chapter 3](#) of Deloitte's Roadmap *Current Expected Credit Losses* for further discussion of the unit of account used.

Measurement of Expected Credit Losses

An entity's estimate of expected credit losses should reflect the losses that occur over the contractual life of the financial asset. Although the entity is required to estimate expected credit losses over the contractual life of an asset, it must consider how prepayment expectations will reduce the term of a financial asset. Given the current economic environment and the potential changes in voluntary loan prepayments, lenders may need to consider whether to adjust their prepayment expectations when determining the contractual life of CRE loans.

An entity must consider all available relevant information when estimating expected credit losses, including details about past events, current conditions, and reasonable and supportable forecasts and how they affect expected credit losses. That is, while the entity can use historical charge-off rates as a starting point for determining expected credit losses, the conditions that existed during the historical charge-off period may differ from those that exist in today's environment. As a result, the entity would need to adjust its historical loss information when measuring its estimate of expected credit losses. For example, interest rates that continue to remain elevated in the current economic environment may lead to an increase in the likelihood of customer defaults. As a result, in determining its expected credit losses, a lender may need to upwardly adjust historical loss rates to reflect the difference between the interest rates in the current economic environment and the interest rates related to the period represented by the historical information.

Further, some lenders may need to consider whether to shorten the reasonable and supportable forecast period for certain portfolios because of the forecast uncertainty that results from interest rates that continue to remain elevated and other changes in the economic environment. In these situations, when a lender shortens the reasonable and supportable forecast period, it would most likely also increase the reversion period.

Lenders may also execute loan modifications or restructurings to reduce their exposure to credit losses, particularly in an environment in which the likelihood of defaults may increase (e.g., as a result of increasing interest rates). Upon the adoption of [ASU 2022-02](#), the entity's estimate of expected credit losses will no longer be able to take into account expected extensions, renewals, and modifications when the entity reasonably expects, as of the reporting date, that a TDR will be executed with the borrower. As a result, entities may need to consider whether the inability to include such events that extend the contractual term of a financial asset would affect their estimate of expected credit losses.

See [Chapter 4](#) of Deloitte's Roadmap *Current Expected Credit Losses* for further discussion of the measurement of expected credit losses.

Collateral-Dependent Financial Assets

If economic conditions deteriorate, there may be additional pressure on a borrower's ability to perform under the terms of the loan, which could cause loans to be more likely to be considered collateral-dependent. Under U.S. GAAP, a financial asset is considered collateral-dependent if repayment is expected to be provided substantially through the operation or sale of the collateral.

In accordance with ASC 326, entities are required to measure the allowance for credit losses (ACL) on the basis of the fair value of the collateral when they determine that foreclosure is probable. The fair value of the collateral must also be adjusted by the estimated costs to sell if the entity intends to sell rather than operate the collateral once it determines that foreclosure on the loan is probable. In the current environment, lenders should evaluate whether market information used in determining fair value is timely, incorporates the nature and geography of the asset, is free from bias, and is based on the view of an independent market participant. Lenders must consider the highest and best use of the asset, even if that use differs from the reporting entity's intended use.

See [Section 4.4.9.1](#) of Deloitte's Roadmap *Current Expected Credit Losses* for further discussion of collateral-dependent financial assets.

Information Received After the Reporting Date

Information obtained after the reporting date may be useful for entities that are estimating expected credit losses as of the reporting date. Entities should use judgment when evaluating whether information received after the reporting date should be included in the estimate of expected credit losses.

At the 2018 AICPA Conference on Current SEC and PCAOB Developments, Kevin Vaughn, senior associate chief accountant in the SEC's Office of the Chief Accountant, shared the SEC staff's views on how an entity should perform subsequent-event evaluations in estimating expected credit losses. The staff indicated that it would object to excluding loan-specific information about conditions that existed as of the balance sheet date. In contrast, for forecasted information received before the completion of the estimation process, a registrant is permitted, but not required, to include such information in its estimation process, whereas for forecasted information received after the completion of the estimation process, the registrant would not normally include such information in its process.

See [Section 4.9](#) of Deloitte's Roadmap *Current Expected Credit Losses* for further discussion of subsequent events with respect to estimates of credit losses.

Investors in Commercial Mortgage-Backed Securities

Investors in many industries, including banks, insurance companies, investment companies, and REITs, purchase CMBSs, which are backed by mortgages on commercial properties. Some of these companies have been shifting investments away from offices and into multifamily and industrial properties instead. The current macroeconomic environment and this shift in investments has resulted in a less liquid market for certain CMBSs, as well as downward pressure on the value of the securities. The prices of CMBSs have generally declined slightly over the past year, with mezzanine tranches in CMBSs continuing to show a lack of investor confidence through the fourth quarter of 2023 and increasing valuation uncertainty resulting from reduced liquidity. Further, the estimated volatility in potential future returns on CMBS investments has continued to increase.

Impairment and Valuation Considerations

ASC 326 includes the U.S. GAAP impairment model for financial assets other than equity investments.

Held-to-Maturity Debt Securities

Because of the rising interest rates and current conditions for CMBSs, the fair value of held-to-maturity (HTM) debt security portfolios may be below their amortized cost basis. This difference between the fair value and amortized cost basis is not recognized in the financial statements. However, an investment in an HTM debt security is accounted for under ASC 326 in a manner similar to other financial assets carried at amortized cost. See the [CRE Lenders](#) section for guidance on estimated expected credit losses.

In addition, in light of the current macroeconomic conditions, in combination with recent bank failures, companies may have reevaluated their liquidity as well as the potential need to reclassify debt securities from HTM portfolios to ones that are available for sale (AFS). Under ASC 320-10-35-8, a sale or transfer of a security classified as HTM that occurs for a reason other than certain exceptions calls into question (taints) the entity's intent for all securities that remain in the HTM category.

Available-for-Sale Debt Securities

An investment in an AFS debt security is impaired if the fair value of the investment is less than its amortized cost basis. An entity must assess impairment at the individual security level. Subsequent accounting for an AFS debt security also depends on the investor's intention to sell the security or whether it is more likely than not (MLTN) that it would be required to sell it. If the investor intends to sell the security or it is MLTN that it would be required to sell it, the investor must write down the security's amortized cost basis to its fair value, write off any existing ACL, and recognize in earnings any incremental impairment. An entity that does not intend to sell an impaired security, or would not MLTN be required to sell it, must determine whether a decline in fair value below the amortized cost basis resulted from a credit loss or from other factors. Any portion of the impairment attributable to credit losses is recognized through net income, with the remainder recorded through other comprehensive income. See [Chapter 7](#) of Deloitte's Roadmap [Current Expected Credit Losses](#) for further discussion of AFS debt securities.

Fair Value Measurement and Disclosure

ASC 820 emphasizes that fair value is a market-based measurement based on an exit price notion and is not entity-specific. Therefore, a fair value measurement must be determined on the basis of the assumptions that market participants would use in pricing an asset or liability, regardless of whether those assumptions are observable or unobservable.

Even in times of extreme market volatility for CMBSs, entities cannot ignore observable market prices on the measurement date unless they are able to determine that the transactions underlying those prices are not orderly. In accordance with ASC 820-10-35-54I, in determining whether a transaction is orderly (and thus whether it meets the fair value objective described in ASC 820-10-35-54G), an entity cannot assume that an entire market is "distressed" (i.e., that all transactions in the market are forced or distressed transactions) and place less weight on observable transaction prices in measuring fair value. See [Section 10.7](#) of Deloitte's Roadmap [Fair Value Measurements and Disclosures \(Including the Fair Value Option\)](#) for more information about identifying transactions that are not orderly.

In addition to considering whether observable transactions are orderly, entities should take into account the following valuation matters that could be significantly affected by the current CRE market:

- An evaluation of the inputs used in a valuation technique and, in particular, the need to include the current market assessment of credit risk and liquidity risk. This may also involve the need to change valuation techniques or to calibrate valuation techniques to relevant transactions.
- An assessment of whether an entity can rely on data from brokers and independent pricing services when determining fair value.

The ASC 820 disclosure requirements are extensive, particularly those related to fair value measurements involving significant unobservable inputs (i.e., Level 3). An entity may need to consider whether the current CMBS market would affect a financial instrument's level in the fair value hierarchy. ASC 820 also requires an entity to (1) describe the valuation techniques and inputs used to determine fair values (by class of financial assets and liabilities) and (2) disclose a change in valuation technique and the reason for that change.

Financial Reporting Considerations

The financial reporting considerations discussed in the sections below primarily apply to CRE entities, regardless of their sector or nature of investment. Other entities should also consider the concepts below on the basis of their particular association with CRE.

Going Concern

In the current environment, some entities may need to consider whether, in their specific circumstances, they are able to continue as a going concern within one year after the date on which the interim or annual financial statements are issued or available to be issued, when applicable. In performing this assessment, the entity would need to consider, among other things, contractual obligations due within one year (including the impact of debt covenant compliance on those obligations) and access to existing sources of capital. In the current lending environment, it may be difficult to determine compliance with debt covenants within one year of the financial statements and future access to capital may be difficult. This area is subject to management judgments and bias given the significance of an entity's receiving a going-concern opinion from its auditors. An entity can only base this assessment on information that is available as of the issuance date of the financial statements.

If there is substantial doubt about an entity's ability to continue as a going concern, this substantial doubt may be alleviated if it is probable that (1) the entity's plan will be effectively implemented and (2) when implemented, the entity's plan will mitigate the conditions that are creating such doubt within one year after the issuance of the financial statements. Irrespective of whether the entity's plan alleviates the substantial doubt raised, the entity must provide comprehensive disclosures in its annual and interim financial statements. Registrants are encouraged to provide company-specific disclosures that allow investors to evaluate the current and expected impact of the macroeconomic environment through the eyes of management; registrants should also proactively revise and update these disclosures as facts and circumstances change.

Disclosure Considerations

The SEC expects registrants to clearly disclose material risks, trends, and uncertainties related to the current environment. As a result, most entities should consider the need to disclose the impact of the current environment in various sections of their SEC filings, including the risk factors section, MD&A, the business section, legal proceedings, disclosure controls and procedures, internal control over financial reporting, and financial statements. For risk factors, while many registrants may already disclose their general macroeconomic risks, they should

consider whether to update the disclosure to clarify that the risk is no longer hypothetical and to elaborate on the actual and potential impact of recent macroeconomic events (e.g., banking failures, changes in interest rates, covenant noncompliance) on the company.

In SEC guidance related to COVID-19 (e.g., [CF Disclosure Guidance \(DG\) Topic 9](#) issued on March 25, 2020, and [DG Topic 9A](#) issued on June 23, 2020), the SEC staff provided a series of illustrative questions for registrants to consider when developing disclosures related to the then current and expected future impact of COVID-19. The questions cover a broad range of topics but highlight a consistent theme: improving disclosures related to liquidity, capital resources, and going-concern considerations. Such principles-based considerations are also applicable in the current environment.

Over the past [reporting season](#) (i.e., Form 10-K filings of Fortune 500 companies for fiscal year 2023), we have observed notable increases in national banks' ACL associated with their CRE lending activities, including office properties. In addition, in December 2023, the SEC staff sent comment letters to [regional banks](#) to request that they further disaggregate their CRE portfolios and risk management strategies. Although the letters were issued only to regional banks, registrants with exposure to CRE may wish to consider them as well.

Non-GAAP Measures and Metrics

Registrants should consider the impact of the current environment on non-GAAP measures and metrics, specifically the impact of adjustments related to the current economic conditions. Non-GAAP measures should not be more prominently presented than GAAP measures, should be reconciled to a GAAP measure, should be clearly labeled, and should be accompanied by appropriate purpose and use disclosures. Registrants should (1) clearly define the metrics used and how they are calculated, (2) describe the reasons why the metrics provide useful information to investors, and (3) describe how management uses the metrics in managing or monitoring the performance of the business.

When evaluating whether an adjustment to a non-GAAP measure is appropriate, the registrant should consider several factors, including whether the adjustment is:

- Directly related to such conditions or to the associated economic uncertainty.
- Incremental to normal operations and nonrecurring (for example, an operating expense is considered "recurring" when it occurs repeatedly or occasionally, including at irregular intervals).
- Objectively quantifiable rather than an estimate or projection.
- Not interpreted as misleading or involving the use of tailored accounting principles.

For instance, an entity should evaluate adjustments for impairment of real estate assets, impairment of equity method investments, and changes in the CECL model to determine whether they are consistent with the above factors and are free from bias.

To the extent that new adjustments or changes to non-GAAP measures and metrics are made in response to the current economic environment, they should be clearly labeled and transparently disclosed. When making such changes, registrants should disclose clearly (1) the nature of the changes (e.g., specific details regarding the components that have changed and the way the measure or metric is calculated or presented), (2) the reasons for such changes, (3) the effects of any changes on other information being disclosed or previously reported, (4) information recasted to conform prior periods to the current presentation in accordance with [Question 100.02](#) of the SEC staff's Compliance and Disclosure Interpretations (C&DIs), and (5) any other information about the changes that would be relevant to the company's trends or results. For non-GAAP measures, in addition to the above items, registrants should update their discussion of how the new measure is used by management and why it is useful to investors. In addition, management, the audit committee, and others, as applicable, should

evaluate the appropriateness of any changes to non-GAAP measures and metrics, including the reasons for and timing of such changes. See Deloitte's Roadmap [SEC Comment Letter Considerations, Including Industry Insights](#) for current trends in SEC comment letters and Deloitte's Roadmap [Non-GAAP Financial Measures and Metrics](#) for more information about SEC requirements and interpretations related to such measures and metrics.

Management's Discussion and Analysis

In a manner similar to how entities updated their disclosures to discuss the impact of the COVID-19 pandemic and other macroeconomic and geopolitical events, entities should provide timely disclosures about the impact of the current environment, as applicable, throughout all their SEC filings (including Form 10-K, Form 10-Q, Form 8-K, and registration statements). To the extent that there are multiple relevant macroeconomic conditions (e.g., lending environment, inflationary and interest rate environment, other real estate environment factors), entities should discuss the potential impact of each condition separately so that an investor can understand the magnitude of each of these impacts.

Financial statement disclosures about the risks and uncertainties associated with an entity's operations should discuss how uncertainties may affect its accounting estimates. Entities may need to use greater judgment in estimating future results and the potential range of reasonably likely outcomes, especially in areas such as impairment of real estate assets, assessment of the collectibility of future lease payments, and the corresponding ACL. To the extent applicable, registrants should consider expanding their disclosures about key assumptions used within these significant estimates and the sensitivity of such assumptions.

The MD&A should address any effects on operational metrics (including changes in occupancy levels), liquidity, and lease collectibility, as well as any early-warning disclosures related to upcoming impairments, including any impairment triggers. In addition to discussing the impact on historical results, registrants are expected to disclose, in accordance with SEC Regulation S-K, Item 303,⁸ "any known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact" on their financial condition, results of operations, or liquidity (including their expected ability to comply with their debt covenants). Forward-looking disclosures are especially critical in times of economic uncertainty. Early-warning disclosures regarding impairment may be appropriate as management considers changes to (1) holding periods associated with real estate assets, (2) geographic market conditions, and (3) strategy and use of the real estate asset. The SEC could use hindsight after a material impairment is announced to question why no early-warning disclosures about upcoming impairments were provided in the periods leading up to such an impairment.

The challenges in the current macroeconomic and interest-rate environment, along with limited access to cash through debt or equity markets, may significantly affect liquidity. Within their MD&A disclosures about liquidity, registrants should consider discussing their working capital or other cash flow needs, anticipated changes in the amount and timing of cash generated from operations, the availability of other sources of cash along with potential limitations associated with accessing such sources, debt covenant issues, related regulatory risks, and the possible ramifications of their inability to meet their short- or long-term liquidity needs.

In summary, a registrant should discuss in its MD&A all relevant material quantitative and qualitative impacts of the current environment on its business. Although MD&A disclosures are typically included in a Form 10-K or Form 10-Q, because of the rapidly evolving impact of the current environment, registrants sometimes may also file current reports on Form 8-K to update investors on the current and potential future impact of such events on their business.

⁸ SEC Regulation S-K, Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Internal Controls and Fraud Risk Assessment

Entities should consider whether they need to identify new controls or modify existing controls in response to new or modified risks that have emerged within impairment of real estate assets, going concern, or other financial reporting risks associated with the items discussed above. Given the changing market for real estate assets and the significance of real estate assets for many entities, a company's internal control evaluation should include the consideration of new or emerging fraud risks as part of management's fraud risk assessment. SEC registrants must disclose in their quarterly or annual filings any changes in internal controls that have materially affected, or are reasonably likely to materially affect, their internal control over financial reporting in Item 4 of Form 10-Q or in Item 9A of Form 10-K (or in Item 15 of Form 20-F for foreign private issuers).

Contacts



Brandon Coleman
Audit & Assurance
Partner
Deloitte & Touche LLP
+1 312 486 0259
brcoleman@deloitte.com



Kristine Obrecht
Audit & Assurance
Partner
Deloitte & Touche LLP
+1 414 977 2241
kobrecht@deloitte.com



Pat Scheibel
Audit & Assurance
Partner
Deloitte & Touche LLP
+1 312 218 3781
pscheibel@deloitte.com



Hero Alimchandani
Audit & Assurance
Managing Director
Deloitte & Touche LLP
+1 202 220 2834
halimchandani@deloitte.com



Mike Foley
Audit & Assurance
Senior Manager
Deloitte & Touche LLP
+1 215 282 1215
mifoley@deloitte.com



Max Kravet
Audit & Assurance
Senior Manager
Deloitte & Touche LLP
+ 1 571 766 7435
mkravet@deloitte.com

Financial Reporting Alert is prepared by members of Deloitte's National Office as developments warrant. This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

The services described herein are illustrative in nature and are intended to demonstrate our experience and capabilities in these areas; however, due to independence restrictions that may apply to audit clients (including affiliates) of Deloitte & Touche LLP, we may be unable to provide certain services based on individual facts and circumstances.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. In the United States, Deloitte refers to one or more of the US member firms of DTTL, their related entities that operate using the "Deloitte" name in the United States and their respective affiliates. Certain services may not be available to attest clients under the rules and regulations of public accounting. Please see www.deloitte.com/us/about to learn more about our global network of member firms.