



Effective Rent Calculation

By Richard M. Berry

***Editor's Note:** While some US readers may already be familiar with the FASB13 module in JD Edwards® Real Estate, for JDEtips international clients, this tip may prove to be quite a treat! Richard Berry, our "Singapore" correspondent, writes how this module can be used quite nicely to calculate effective rent during rent free periods. So, if you're not familiar with FASB13 at all, or if you've only used it to calculate rental revenue where actual billings follow a stepped-rent progression, this article will be of great benefit to you!*

Introduction

This white paper covers the procedure by which effective rent can be automatically calculated using the FASB13 module in the JDE Real Estate system. My main purpose in writing this is to show how effective rent can be calculated where there are rent-free periods. Although this is not the original purpose of the FASB13 module, it works smoothly. The FASB13 module is designed to calculate rental revenue where actual billings follow a stepped-rent progression, where it is known at the outset how rental billings will progress over the life of the lease. But all users of JDE Real Estate Recurring Billing can make use of this module to calculate effective rent if they give rent-free periods at any point in the lease term.

A Quick Note Before We Begin. ..

Before I begin this article, I must apologize to American readers for whom FASB 13 is a normal part of the landscape. While what is written in this article may seem quite obvious to you, for accountants working in other jurisdictions, the provisions of FASB 13 are not well known. For international users of the JDE Real Estate system, the FASB13 module is generally ignored. But, in the world outside of the Financial Accounting Standards Board (I live in Singapore), we also come across the same concept of spreading rent evenly over the financial year or over the life of the lease, although it is not mandated in any accounting standard, at least not in a prescriptive way. So, there are ways in which the features of the JDE FASB13 module can be adapted for local use. In Singapore and in other Asian countries, and I suspect elsewhere too, we have the concept of "effective rent". Effective rent could be called straight rent or accrued rental revenue. Rent-free periods are usually given at the beginning of lease terms, especially in retail situations. The remaining rental income must be spread evenly over the life of the lease or over the financial year.

So, it may seem odd to an American reader that I would have to explain this process, because, no doubt it is commonplace in the States. But most users who do not have to comply with US GAAP can quite easily ignore the FASB13 module in the Real Estate system. It is my purpose, however, to show that it can be used without effort for the calculation of effective rent.



Effective Rent Calculation

The theory

The purpose of Effective Rent is to ensure that rental revenue is spread evenly over the year. If there are periods where rent is waived, then the remaining revenue should be apportioned. It is common practice in many countries to give rent-free periods at the beginning of a lease. Some property managers give rent-free periods during the life of the lease as loyalty awards. If the rent-free periods are the first periods, then it is appropriate to spread the remaining revenue over the whole life of the lease. But the same principle applies if the rent-free periods are awarded at other times during the life of the lease.

Example

Let us say that a tenant enters into a lease for 3 years at \$1200 per month, and that the first three months are rent-free. For accounting purposes, the three rent-free months must be spread over the term of the lease. Or to put it another way, 33 months rental income must be spread over the full 36 months of the lease term.

Doing the mathematics, \$1200 spread over 33 months works out at an effective rent of \$1100 over 36 months, as illustrated in the table. This gives rise to an accrual of revenue during the first three months when there is no actual billing, and then the gradual amortisation of that accrual over the remainder of the lease term. This would amount to an amortisation or deferral of \$100 per month for 33 months, as in our example.

Year	Month	Rent	Effective (Straight) Rent	Accrual	Deferral
1	1		1100	1100	
	2		1100	1100	
	3		1100	1100	
	4	1200	1100		-100
	5	1200	1100		-100
	6	1200	1100		-100
	7	1200	1100		-100
	8	1200	1100		-100
	9	1200	1100		-100
	10	1200	1100		-100
	11	1200	1100		-100
	12	1200	1100		-100
2	1	1200	1100		-100
	2	1200	1100		-100
	3	1200	1100		-100
	4	1200	1100		-100
	5	1200	1100		-100
	6	1200	1100		-100
	7	1200	1100		-100
	8	1200	1100		-100
	9	1200	1100		-100
	10	1200	1100		-100
	11	1200	1100		-100
	12	1200	1100		-100
3	1	1200	1100		-100
	2	1200	1100		-100
	3	1200	1100		-100
	4	1200	1100		-100
	5	1200	1100		-100
	6	1200	1100		-100
	7	1200	1100		-100
	8	1200	1100		-100
	9	1200	1100		-100
	10	1200	1100		-100
	11	1200	1100		-100
	12	1200	1100		-100
Total		39600	39600	3,300	-3,300

Figure 1—Rent Progression Over the Life of a Lease

For this example, there are two methods for setting up the recurring billing.

Method 1

In the Lease master, we indicate the full 36 month lease term. But in the recurring billing, we indicate the start date for rental three months later. You can see below that the lease starts on January 1, but that rent only starts on April 1.

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