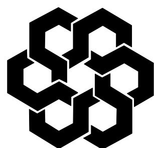

International Accounting Standards Board

Financial Accounting Standards Board

This document is provided as a convenience to observers at IASB/FASB joint international working group meeting on leasing, to assist them in following the working group's discussion. It does not represent an official position of the IASB or the FASB. IASB and FASB Board positions are set out in their respective Standards.

Note: These notes are based on the staff paper prepared for the IASB/FASB working group. Paragraph numbers correspond to paragraph numbers used in the staff paper. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Meeting: **Joint International Working Group on Leasing**
15 February 2007, London

Topic: **CHARACTERISTICS AND TERMS OF COMMON LEASE CONTRACTS (Agenda Paper 7)**

PURPOSE

1. The purpose of this memo is to provide the working group with a summary of the characteristics and terms of a number of different lease contracts. These examples will be used by the staff to analyze the accounting models described in these agenda papers. The examples are based on information received from members of the Joint Leasing Working Group. While these examples are illustrative, they do not reflect all of the many variations of leases that exist. The Boards expects to include illustrations in the preliminary views document that they plan to issue in 2008 and the examples described in this paper might be used for that purpose.

2. Working group members are asked to consider the following questions:

- **Do the summaries in this paper capture the general terms of the lease examples presented below?**

- **Are working group members aware of other examples the Boards should consider as they develop a lease accounting model?**

3. The leasing examples described in this paper are:

   a. Copier leases

   b. Earth moving equipment leases

   c. Manufacturing equipment leases

   d. Consumer aircraft leases

   e. Commercial aircraft leases

   f. Automotive fleet leases

   g. Railway equipment leases

   h. Industrial property leases

   i. Office space leases

   j. Regional shopping center tenant leases

   k. Ground (land) leases

Copier leases

4. A copier is typically leased for a non-cancelable term such as 48 months with monthly lease payments required. At the end of the lease term, the lessee can either continue the original payments on a month-to-month basis (often referred to as "evergreen payments") or terminate the lease and return the equipment in the condition specified in the lease agreement (such as in satisfactory condition considering normal wear and tear). If the lessee terminates the lease early, the lessee must pay a termination penalty (the termination penalty), generally equal to the remaining minimum lease payments due under the lease contract plus any loss

incurred by the lessor in remarketing the leased equipment (if the residual value at the date of termination exceeds the fair value of the equipment upon termination). Any gains on the remarketing of the equipment typically accrue to the lessor. As the lessor is contractually due at least the amounts that it would have received if termination did not occur, an issue to consider is if a right to terminate exist in this type of arrangement?

5. Typically, the lessor purchases residual value insurance (RVI) from an independent third-party on this type of lease to protect it against unfavorable market movements between the lease commencement and termination dates. RVI is also purchased to pass one of the tests that allows for finance lease treatment under Statement 13. The amount of RVI purchased by the lessor from an unrelated third-party will be enough to increase the minimum lease payments considered by the lessee to 90% of the fair value of the equipment at lease inception. This accounting convention has been implemented by practice subsequent to the issuance of Statement 13 and is an accounting convention that is widely accepted, that is, purchasing RVI to achieve finance lease treatment. Finance treatment allows the lessor to recognize more earnings in the earlier periods of the lease, as compared to an operating lease, as well as finance leases can be sold in transfers such as securitizations.

6. An issue to consider specific to lessors is the accounting for the residual value. For example, would the residual value continue to be recognized and measured at its present value? If so, what discount rate would be used to present value the asset? Alternatively, would the asset be recorded at its estimated fair value at the end of the lease with no depreciation, resulting potentially in a greater yield on the financing receivable?

Earth-moving equipment leases

7. Earth-moving equipment, like construction equipment, is typically leased for a non-cancelable term such as 36 months and the lessee is required to make lease payments monthly. Upon lease expiration, the lessee can either continue to use the equipment and make lease payments equal to those required during the original lease on a

month-to-month basis or terminate the lease and return the equipment in the condition specified in the lease agreement.

8. If the lessee terminates early, it must pay a termination penalty consistent with that described in the copier lease example above. Typically, the lessor purchases RVI on this type of lease for reasons documented above in the copier lease example.

9. An issue to consider is how to account for lease modifications (changes to the terms of the original contract) and equipment upgrades. For example, a lessee desires to upgrade equipment during the lease term (for example, the exchange of a 3 year old forklift in year 3 of a 6-year lease for a new forklift and execute a new 6-year lease with the termination penalty included in the lease payments of the new lease contract). Has the lessor, in substance, allowed the lessee to finance the termination penalty with interest equal to the coupon rate established under the new lease agreement? Does the lessor recognize a loan, separate from the lease, for the termination penalty amount and if so, does it have to ascertain if the associated interest rate varies from prevailing market rates for similar unsecured loans? If the interest rate does indeed differ, would the lessor recognize a discount or premium to be amortized over the life of the loan (in this case 6 years)?

Manufacturing equipment leases

10. Manufacturing equipment is typically leased for a non-cancelable term such as 36 months and the lessee is required to make lease payments monthly. At the end of the lease term, the lessee can either continue making the original payments on a month-to-month basis or terminate the lease and return the equipment in the condition as specified in the lease agreement. If the lessee terminates early, the lessee must pay the termination penalty described in the copier lease example. Typically, the lessor purchases RVI on this type of lease for reasons discussed in the copier lease example.

Consumer aircraft leases

11. In consumer aircraft leases, the equipment is leased for a non-cancelable term such as 36 months and the lessee is generally required to make payments monthly. A typical

economic life for consumer aircraft is 30 years. The lessee can exercise renewal options at the market rate at renewal to extend the term to up to 120 months.

12. If the lessee terminates the lease during the lease term, it must pay a termination penalty, generally the total of the lease payments remaining plus any unamortized costs. The penalty is generally calculated to ensure that the lessor does not have to incur a loss on its overall remaining investment in the lease. Lessors in the United States typically purchase RVI on this type of lease.

13. An arrangement that the staff will need to consider when determining the scope of this project is fractional share arrangements, where a company purchases the right of private jet service for a fixed period of time (e.g. 100 hours), which includes the use of the equipment and the right to services such as pilots, food, etc.

Commercial aircraft leases

14. The terms of commercial aircraft leases generally range between 3–12 years, although individual lease terms vary. Lease payments are typically due monthly or quarterly and may be fixed or floating in amount, with floating leases being adjusted periodically based on LIBOR fluctuations. Rent holidays (periods where the lessee does not have to make lease payments) may be provided in certain situations, such as when the lease term has commenced and the leased aircraft is not ready to enter service because the lessee has requested modifications to it.

15. The lessee is responsible for the maintenance of the aircraft. Often, as security to ensure that the lessee has sufficient funds to maintain the aircraft, leases require the lessee to fund maintenance reserves in the form of cash or letters of credit. The lessee is generally responsible for paying all other ancillary fees directly (a net lease) as compared to a gross lease where the lessor is responsible for paying the ancillary charges and is reimbursed by the lessee, usually as a separate part of the lease payment.

16. Under gross lease arrangements, a question to consider for both the lessor and the lessee is if accounting recognition consistent with that proposed for rental payments

would also be given to the obligation to receive/fund the ancillary cost, maintenance or service arrangement over the term of the lease? Alternatively, is the performance triggering the obligation substantively different for these charges when compared to core rental payments?

17. The economic life of a commercial aircraft is typically between 25–35 years, depending on the type of aircraft (regional passenger plane versus a freighter). The fair value of an aircraft is generally determined based on the cost of a similar new aircraft at lease inception, which is comprised of the total purchase price for the airframe and engine, buyer-furnished equipment, and capitalized interest, less any concessions received from vendors.

18. Commercial aircraft leases may contain renewal options at market rates at the date of renewal, rates previously paid by the lessee, or another negotiated amount. These leases also typically include lessee termination clauses that require the lessee to pay a stipulated amount for lost economic value.

19. In some instances, residual value guarantees are provided by the aircraft manufacturer of the aircraft to the lessor. Such guarantees are that the value of the aircraft at a specified point in time (typically at lease expiration) will not be less than either a specified value or a range of values. For example, if a manufacturer guaranteed the first tranche (e.g., up to $10 million) of an aircraft's residual value ($60 million at lease inception) at the end of the lease term (e.g., 12 years) and if the value of the aircraft is less than $60 million at the end of the lease term, the manufacturer would have to fund up to $10 million (e.g., if the value dropped to $50 million). Lessors sometimes purchase RVI on this type of lease.

20. An issue that will need to be addressed when considering the terms of renewal options in a lease contract is if the renewal options are substantively an extension of the original lease (when considering the economics of the transaction), and, if so, what the appropriate accounting would be (for example, the obligation is based on the extended lease term). This may occur for equipment such as commercial aircraft, as the equipment is effectively the business of the lessor (providing air travel service).

Automotive fleet leases

21. In the United States, manufacturers produced 16–17 million autos and light trucks in 2006, of which approximately 5 percent are leased to businesses under full-service fleet leases. The typical full-service fleet lease is comprised of services that include selecting the vehicle, acquiring the vehicle, titling the vehicle, providing fuel, maintenance and repairs, dealing with accidents, and selling the vehicle at lease expiration. Lessees use full-service fleet leases to eliminate fleet staff and the related drain on management resources, reduce vehicle costs, control vehicle costs, match level costs with revenues, obtain the flexibility to downsize, and for convenience/efficiency. Lessees rarely buy the vehicles at lease expiration as they view vehicles as a consumable expense item. The contractual lease term is generally 12 months with automatic monthly renewals. They replace vehicles as needed for many reasons and the ultimate term of any one vehicle lease generally is not known at inception. The average actual lease term is 30–36 months, but varies between 12–60 months. Lessors typically auction the vehicles that come off of lease.

22. There are two principal types of leases used in the commercial full-service fleet leasing business—open-end leases and closed-end leases.

Open-end leases

23. Open-end leases are similar to Terminal Rental Adjustment Clause (TRAC) leases because at lease expiration (there can be several dates stipulated in the contract when the lessee can return the equipment) the lessee is charged or credited with a rent adjustment for the difference between the sales proceeds from the used vehicle and the lessor's unamortized balance on its investment in the lease. The objective of the lessee and lessor is to minimize such adjustments so that the lease term and amortization are customized to the lessee's historical usage and expected fair market value decline curve (that is, faster in the early months/years and slower in the later months/years in the lease term).

24. A vehicle is typically leased for a minimum lease term of 12 months, followed by automatic monthly renewals until the lessee terminates the lease by returning the vehicle. The lessee pays rent monthly. During the 12-month non-cancelable lease term, the lessor typically assumes a residual risk of 20 percent of the original cost. During the renewal periods, the lessor assumes a residual risk of 20 percent of the fair market value at the inception of each 12-month renewal period. The lessee's residual guarantee is capped at the difference between the lessor's residual risk and the unamortized lease balance. For example, if the value of the vehicle at lease inception is $20,000, the lessee's maximum guarantee is $16,000 during the initial lease term.

25. Another variant of the TRAC lease structure is for the lessee to be fully responsible for the difference between the lessor's investment in the lease (or vehicle) at a renewal date and the proceeds from the sale of the vehicle, unless the fair value of the vehicle drops beneath a defined percentage of the original equipment cost. Using the same example as above, assume that the lessee chooses not to renew the lease at the end of the initial 12-month term. Also assume that if the fair value of the vehicle is 20 percent or less than its original cost of $20,000, the lessor must absorb the difference between $4,000 and the fair value of the vehicle.

26. If the fair value of the vehicle is $13,000 and the investment on the lessor's books is $16,000, the lessee must fund a shortfall of $3,000 as the fair value of the vehicle did not drop below the specified 20% of its original cost, or $4,000. If the fair value of the vehicle was $3,000, the shortfall would be $13,000, of which the lessee would fund $12,000 and the lessor would absorb $1,000. In practice, such clauses have been used to obtain off-book treatment for the lessee, even though it is highly remote that the value of the vehicle would ever drop below 20% of its original cost during the actual lease term.

27. As discussed in the commercial aircraft example, the staff believes that an issue to be considered is what the substantive lease term is albeit potentially not for the same reasons as commercial aircraft, which can be considered integral equipment. Typically, a lessee will not return a vehicle until it believes the collateral gap

(difference between the value of the vehicle and the lessor's net investment) has reduced to a de minimus amount.

28. Another feature of current leases that will need to be addressed is contingent rent. Contingent rent is generally changes in lease payments that result from changes in the factors on which the lease payments are based, other than the passage of time (for example, future sales, amount of future use, future price indices, and future market rates of interest). For example, are contingent rentals considered obligations of the lessee and a right to receive payment of the lessor at the start of the lease or, alternatively, will the contingent factor make the rentals obligations and rights to receive payments only after the specified event has occurred?

Closed-end leases

29. Closed-end leases are similar to "fair market value leases" in the equipment leasing industry. At lease expiration, the lessee can return the vehicle or negotiate a purchase or renewal. The same considerations as with open end leases are used in setting lease terms and residuals in closed end leases, but the precision is not the same as the lessor is exposed to residual risk. Predictable residuals based on the depth and breadth of the used vehicle market, coupled with mileage adjustments and return conditions, cause the precision to approach that of an open end lease.

30. At the expiration of the lease, unless the lessee negotiates a fair market value purchase or renewal, the vehicle is returned to the lessor. The lessor may charge a rental adjustment at termination to reflect excess mileage or damage beyond normal wear and tear and the required condition that the vehicle is to be returned pursuant to the lease agreement. The lessor will remarket the vehicles and has the full risk and reward in the vehicles.

31. As the lessor typically has the right to demand payment under the contract for equipment not returned in the condition specified in the contract (not just limited to fleet vehicles, but generally all equipment/property), the staff will need to consider whether the obligation to return the equipment/property in a specified condition

constitutes a liability of the lessee, when the liability would be recognized, and how it would be measured. In addition, the staff will need to consider whether an asset retirement obligation should be recognized for costs to be incurred to return the equipment (such as dismantling and shipping).

Railway equipment leases

32. There is no standard lease in the railway industry. Terms differ based on different financing needs. Leases of railway can be as short as 1 month to as long as over 20 years. Lessee payments vary by contract and can be monthly, quarterly, or annually and interest rates are either fixed or floating. Rent holiday or escalation clauses generally do not exist. Many freight car leases are full service agreements that include a maintenance agreement. Freight cars have useful lives up to approximately 50 years, while locomotives are generally 35 years. Other leased equipment such as containers, reefers, and dry vans have shorter useful lives.

33. The fair value of the equipment at lease inception is generally the original equipment cost to the lessor. It is not uncommon in the United States or Canada for a company to acquire railway equipment and then subsequently finance it through a sales-leaseback arrangement with a financial institution, with the company/purchaser becoming the lessee.

34. Sales-leaseback transactions will be analyzed in this project, with a particular emphasis on revenue recognition related to these transactions (and for all types of equipment/property). For example, should revenue recognition differ on these transactions based on the item being sold and leased back, as is the case today with different requirements for real estate and equipment under US GAAP?

35. If renewal options exist, they are usually subject to renegotiation (at market rates existing at expiration of the original lease). Termination clauses are common in these lease agreements and usually require the lessee to fund the lessor's outstanding investment amount (a "make-whole payment") along with loss values stipulated in the lease contract for damaged equipment that is returned at termination.

36. It is not uncommon for the lessee of railway equipment to provide a residual value guarantee for a portion of the residual value estimated at lease inception. Additionally, the lessor often purchases RVI on this type of lease.

Industrial property leases

37. Industrial properties typically are leased for a period of 5–10 years (although the terms of industrial leases can be far ranging), with built-to-suit leases averaging closer to 15 years. Monthly lease payments are generally required, and rent holidays and escalation clauses (specified future fixed or variable increase in rent) are common. Industrial leases can be either gross or net leases.

38. The lessee has the option to renew, for example, in five-year increments, at market rates existing at the renewal date. Many industrial leases do not provide for termination or cancellation. If this right is available, the lessee generally has a one-time option to terminate the lease at a specified point in the lease (for example, after 5 years in a 10-year lease) for a substantial penalty (such as 2 years of future required lease payments plus unamortized tenant improvements, allowances, and lease commissions).

39. When such a substantial penalty exists to cancel a lease, does a termination option actually exist? Does the stipulated termination option provide for any future economic value to the lessee when a substantial penalty exists or would it be probable that the lessee will lease the property for the full term (the penalty effectively causes "compulsion" to renew)?

40. Generally, the lessee does not provide a residual value guarantee, and the lessor does not purchase RVI.

Office space leases

41. Office space in a large office building is typically leased for initial terms between 5–15 years. A few leases are for a shorter term (such as 3 years) or a longer term (up to 20 or more years).

42. At lease inception, the lessee pays a security deposit or provides evidence of a line of credit. Rental payments are due monthly or annually and the lease may provide for rent holidays and/or escalation clauses. Base rent typically increases annually on a percentage basis. Ancillary charges may be included in the lease payment amount depending on whether the lease is a net or gross lease. Examples of "additional rent" charges payable under a net lease include the following: common area maintenance charges, janitorial expenses, property taxes, property insurance, management fees, parking charges, utilities, heating, ventilation and air conditioning (HVAC), porter services, tenant work-order requests, and over-standard utilities. Thus, if the lease payment includes charges for the aforementioned services, revenue recognition will be a major consideration for the lessor. Additionally, determining the appropriate split between payments for services and payments for the right to use may be an issue for the lessee that may need to be addressed.

43. Many leases include one or more options to extend the term for a specified period (for example, five years per option period). During extension options, rental rates are typically set to the fair market rate existing as of the commencement of the option term. Often, a rental "floor" is negotiated so that, regardless of the fair market rate, in no event shall the option rent be lower than the specified floor amount (which is typically equal to either the rent payable immediately preceding the option term, or that amount increased by the annual percentage escalation employed through the then-existing term). Some renewal options are at a percentage of fair value (i.e., 90 percent of the fair market value), while others may be at fixed rates.

44. Certain leases of office space contain tenant termination clauses that typically require the tenant to provide written notice of termination election well in advance of the termination date (e.g., 12 months in advance). Concurrently with the termination election notice, tenants are required to pay a termination fee equal to the then-unamortized costs expended by the landlord in connection with leasing costs, brokers' fees, commissions, and construction costs relating to the terminating tenant's occupancy. Additionally, the termination fee usually includes an additional "down time" component (the period required to re-lease the space) in an amount equal to a

specified number of months' rent. Consequently, the same question applies to this example as the industrial property example regarding if the cancellation provision would require recognition of an asset by the lessee, as a significant penalty exists.

45. Office leases can vary based on the region as well as the types of leases:

    a. In a "turnkey" lease, the lessor provides the space to the lessee in "as-is" condition in exchange for lower base rent.

    b. Leases may include expansion space or provide the tenant with expansion rights.

    c. Leases may be structured as either gross or net leases.

    d. Some leases provide for reimbursement of operating expenses in excess of base year expenses.

    e. U.S. Government leases generally provide for a fixed reimbursement of operating expenses increased annually based on increases in the Consumer Price Index.

    f. Retail leases contain a percentage rent (additional rent) component which may vary from 3 to 15 percent of gross sales.

Regional shopping center tenant leases

46. In leases of space in a regional shopping center, payments are generally due monthly and those payments typically increase over the term, either in fixed steps or to reflect increases in the consumer price index. Additional rent also may be required based on an amount above a "breakpoint" specified in the contract (such as a percentage of tenant sales above the breakpoint). Monthly payments also are required for the tenant's budgeted share of common area maintenance charges, property taxes, utilities, and a promotional fund (such charges are adjusted periodically for actual expenditures). The tenant's share typically is based on its square footage leased relative to the total square footage leased, although variations in practice exist. The lessee is responsible for the required lease payments even if the lessee's store does not open on the date specified in the lease agreement.

47. Renewal options on this type of lease are not common, and upon expiration, a new agreement must be negotiated. However, when renewal options exist they generally provide for an expected market rate at renewal. "Kickout rights" are a common feature in shopping center leases, wherein one or both of the parties (lessor/lessee) has the right to terminate the lease based on a defined metric, such as sales performance. That right is typically accompanied by the lessee's obligation to reimburse the lessor for any unamortized tenant allowance (cash paid by the lessor to the lessee for construction of leasehold improvements).

48. For leases of office space and shopping centers, including malls, most real estate investment trust entities (REITs) prefer to have operating lease treatment whereby the property is an asset of the REIT. This is for a variety of reasons, including how the REITs are measured in the capital markets. A question to consider is if the lessee does not have the option to purchase the item that it leases (at the point when a lessee generally makes the decision to lease or purchase equipment or property), should that result in a different accounting treatment for the lessor? For example, would the lessor continue to recognize equipment as opposed to a right to receive future rental payments when accounting for a lease contract?

49. For example, if an entity leases space in a shopping mall (e.g. pet store) for a non-cancelable term of 5 years with no stipulated renewal option, and the REIT that owns the mall solely leases space, that is, it does not sell space, would that change the assets and liabilities that the staff is proposing to be recognized? For informational purposes, anchor stores such as Nordstroms, Macy's, Saks Fifth Avenue, etc. may have an option to purchase the lease or to enter into leases with a longer term than non-anchor stores/shops.

GROUND (LAND) LEASES

General

50. This example concerns the land on which a hotel is located and operated and is leased to the hotel owner for a noncancelable term (e.g., 99 years). For the majority of the time, the lessee is responsible for the construction of the structure and holds title to

the improvements to the structure (the hotel in this case). The minimum lease payments include a fixed base rent with subsequent annual increases of a fixed percentage of prior year's rent through the 30th year of the lease (also referred to as an escalation clause). The minimum lease payments also include a percentage of annual rent related to room revenues of the hotel. After a defined period, for example, the 30th year, the current rent, excluding the percentage of room revenues, will reset every 10 years thereafter to the greater of (a) the base rent charged in the preceding lease year, or (b) a fixed percentage (for example, 7 percent) of the appraised value of the land. That base rent will continue to increase by 3 percent per year until the next reset date.

51. The lessee pays 100 percent of all ancillary charges (also referred to as impositions) incurred with respect to the property. Those charges consist of real estate taxes, assessments (usually the most significant component), and fees levied by governmental authorities.

52. In some leases, the costs related to the land and improvements (e.g., parking lots, landscaping, and signage) are the sole responsibility of the lessee, while in other lease contracts, the charges are allocated based on the value of the unimproved land relative to the total fair value of the land and improvements. The lessee may contest impositions with the lessor, but first must deposit cash or securities in the amount of the contested impositions with the lessor. The lessee is responsible for the maintenance of the hotel.

53. The lessee must operate the premises as a hotel under a specified brand for a portion of the lease term, for example, the first 40 years of the lease. Subsequently, the lessee may operate a hotel under a different brand pursuant to a management agreement with another operator, subject to the lessor's approval. Typically, there are not any economic minimum operating standards such as occupancy or a certain level of revenues.

54. Except during the last five years of the lease term, the lessee must rebuild after a casualty regardless of insurance proceeds. If the proceeds are insufficient to restore, the lessee must provide the lessor with a surety bond covering the difference.

55. In the event the property is condemned by a governmental authority (such as for widening a road), the lessor is to be paid a share of any condemnation award equal to the present value of the rent from the date the property is transferred to the government through the end of the term (plus, if the taking occurs within the last 20 years of the term, an amount equal to the fair market value of the lessor's reversionary interest in the property at the expiration of the term). The lessee receives the remainder of the award.

56. If a small portion of the property is condemned/taken to expand a highway that does not affect the hotel's operations, the lease usually stays in effect without a rent adjustment and the landlord keeps the condemnation award. If a larger portion of the property is taken, which may include the land under a portion of a parking garage, the lessee will be obligated to build another garage to meet that city's minimum parking requirements, which may lead to a three-way negotiation between the lessee, lessor, and the city over whether, and if so, how the loss of value and the costs to rebuild will be shared. The lessee usually ends up with enough cash to rebuild the garage and the lessor ends up with a portion of the proceeds to compensate it for its lost value in the form of reduced rent from the lessee or the loss of the condemned portion of the land based on the land's value at condemnation or, alternatively, the present value of the anticipated fair market value of the land at the lease's expiration (the reversionary interest).

57. The lessee can assign the lease to any party that can demonstrate that it can pay base rent for a defined period, such as three years, or has a tangible net worth of a contractually agreed-upon amount and either is an approved operator or enters into a management agreement with an approved operator.

58. Title to improvements is held by the lessee during the term of the lease. It is not uncommon for the structure (in this case the hotel) and the associated improvements

to transfer to the lessor at the end of the 99 year lease term for a de minimis amount or zero consideration.

Hong Kong

59. There are some unique aspects to ground leases in Hong Kong. Hong Kong has three main parts: Hong Kong Island, Kowloon, and the New Territories. Hong Kong Island and Kowloon were possessions of Great Britain from the mid-nineteenth century and that sovereignty was recognized by the government of China. Great Britain also had a 99-year lease from China on the New Territories, and that lease expired in the 1990s, at which time it also transferred ownership of Hong Kong Island and Kowloon back to China. While the British government owned Hong Kong Island and Kowloon, it granted many 999 year leases, many which still exist and are still recognized under the Basic Law agreed upon between Great Britain and China.

60. The lease terms for land leases in Hong Kong now can be for no longer than 50 years with no cancellation penalties or termination clauses. The lessor pays the entire lease premium as a single payment at the commencement of the lease and renewal is at the sole discretion of the Hong Kong government.

61. Under both the 999 year leases mentioned above and the current land leases in Hong Kong, the full amount of the lease premium is paid upfront by the initial lessee. All of the land is legally owned by the government of Hong Kong. The leases are transferable and the original lessor does not have the right to prevent transfers from being executed and generally only regains use of the property upon lease expiry.