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NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

September 12, 2013

Ms. Susan Cosper
Technical Director
File Reference No. 2013-270
Financial Accounting Standards Board
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Delivered Electronically

Re: File Reference No. 2013-270, Leases (Topic 842), a revision of the 2010 proposed FASB Accounting Standards Update, Leases (Topic 840)

Dear Ms. Cosper:

This letter is submitted by the National Association of Real Estate Investment Trusts® (NAREIT) in response to the Proposed Accounting Standards Update (Proposed ASU or the Proposal) from the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) combined (the Boards) *Leases*.

NAREIT is the worldwide representative voice for real estate investment trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other businesses throughout the world that own, operate and finance income-producing real estate, as well as those firms and individuals who advise, study and service those businesses.

REITs are generally deemed to operate as either Equity REITs or Mortgage REITs. Our members that operate as Equity REITs acquire, develop, lease and operate income-producing real estate. Our members that operate as Mortgage REITs finance housing and commercial real estate, by originating mortgages or by purchasing whole loans or mortgage backed securities in the secondary market.



A useful way to look at the REIT industry is to consider an index of stock exchange-listed companies like the FTSE NAREIT All REITs Index, which covers both Equity REITs and Mortgage REITs. This Index contained 189 companies representing an equity market capitalization of \$670.4 billion¹ at June 30, 2013. Of these companies, 150 were Equity REITs representing 90.7% of total U.S. listed REIT equity market capitalization (amounting to \$608.3 billion). The remainder, as of June 30, 2013, was 39 publicly traded Mortgage REITs with a combined equity market capitalization of \$62.1 billion.

This letter has been developed by a task force of NAREIT members, including members of NAREIT's Best Financial Practices Council (the Council). Members of the task force include financial executives of both Equity and Mortgage REITs, representatives of major accounting firms, institutional investors and industry analysts. The financial executives representing Equity REITs are involved in all property sectors of the REIT industry – regional malls, shopping centers, multi-family residential, office, health care, lodging/resorts and industrial. These task force members have a working knowledge of leases related to all of these property types.

NAREIT is a member of the global Real Estate Equity Securitization Alliance (REESA) and supports the views expressed in this organization's comment letter submitted to the Boards.

Executive Summary

NAREIT and its global partners represented in REESA have been active in the Boards' process toward developing a high quality converged standard for accounting and reporting for leases. We have provided input to the Boards and staff on several occasions, through face-to-face meetings with the Boards, through meetings of the Boards, through participation on the Boards' leases working group and via comment letters on the Boards' various proposals. Additionally, NAREIT and REESA have provided support for the Boards' staff on tentative decisions during the Boards' re-deliberations process.

All of this input to the Boards has had one purpose – to achieve an accounting and reporting model that would provide enhanced decision-useful information to our industry's global financial statement users.

The Boards' Response to this Global Real Estate Industry Input

We acknowledge the Boards' thoughtful response to all of the input provided by NAREIT and REESA. While we have a number of suggested modifications to the proposed accounting and reporting model, we strongly support the Boards' conclusions with respect to the property, Type B, model. We believe that this model would provide financial statement users with information that faithfully represents the underlying economics of a landlord's economic position in the great majority of property leases.

¹ <http://returns.reit.com/reitwatch/rw1307.pdf> at page 21



The Possibility of One Approach to Lease Accounting

We understand that certain constituents of the Boards may advocate that all leases be accounted for under a single approach. NAREIT would not object to this conclusion and would fully support it so long as the single approach mirrors the currently proposed approach for Property or Type B leases. We believe that the vast majority of financial statement preparers and users support the straight-line lease expense pattern yielded by the approach proposed for Type B leases.

We caution the Boards that a conclusion to provide only one approach to accounting for all leases that would require the proposed accounting for Type A leases would not be operational for lessors of multi-tenant investment property. The basis for this view is thoroughly discussed in REESA's July 11, 2011 submission to the Boards².

Recommended Modifications to the Proposed ASU

Accounting for Land-Only Leases

It is common for real estate companies to lease land under land-only leases, especially in central business districts and other areas where land is owned by local governments. Then, real estate companies typically develop buildings and related improvements that they lease to third parties. Many of these long-term land-only leases may meet the proposed criteria that define a Type A lease based on the relationship between the present value of the lease payments and the fair value of the land at the lease commencement date. However, classifying these long-term land leases as Type A leases is clearly contrary to the overarching consumption principle in the Proposal.

A conclusion that a lease of land should be accounted in accordance with the guidance provided for Type B leases is fully supported by the following discussion taken from the *Snapshot: Leases* published by IFRS Foundation in May 2013³:

A lessee that enters into a Type A lease, in effect, acquires the part of the underlying asset that it consumes, which is typically paid for over time in the form of lease payments. Accordingly, a lessee would present amortization of the right-of-use asset in the same line item as other similar expenses (for example, depreciation of property, plant, and equipment) and interest on the lease liability in the same line item as interest on other, similar financial liabilities.

In contrast, the lease payments made in a Type B lease would represent amounts paid to provide the lessor with a return on its investment in the underlying asset, i.e. a charge for the use of the asset. That return or charge would be expected to be relatively even over the lease term. Accordingly, those payments for use are presented as one amount in a lessee's income statement and recognized on a straight-line basis.

²<http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175822733314&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs>

³<http://www.ifrs.org/Current-Projects/IASB-Projects/Leases/Exposure-Draft-May-2013/Documents/Snapshot-Leases-May-2013.pdf>



The presentation of cash outflows in the cash flow statement is consistent with the presentation of expenses in the income statement. For Type A leases, the principal portion of cash payments is presented within financing activities and the interest portion within operating or financing activities. Cash payments for Type B leases are presented as one.

NAREIT believes that the accounting described in the IFRS Foundation *Snapshot: Leases* above supports the conclusion that land leases represent Type B leases based on the consumption principle.

Recommendation

NAREIT understands that the Boards discussed the accounting for long-term ground leases at some point in the process of developing a converged leases standard. We believe that the conclusion reached at that time was made prior to the Boards' conclusion to use the consumption principle to distinguish Type A and Type B leases. We urge the Boards to reconsider their conclusion with respect to accounting for land-only leases and strongly recommend that the final standard require that all ground leases be classified and accounted for as Type B leases consistent with the Proposal's consumption principle.

Accounting and Reporting for Tenant Reimbursements of Landlord Costs

A significant issue raised by the Proposed ASU is how the Proposal would impact the accounting for *tenant reimbursables* paid to a landlord for the landlord's costs of maintaining *landlord's property* – property required to allow tenants to benefit from space leased from landlord. These costs represent a portion of the tenant's total cost to occupy his/her specific space – the right-of-use asset. The Proposed ASU defines *lease payments* as *payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term*. Tenant reimbursements of landlord's costs to maintain the common elements of a commercial real estate property are directly related to the tenant's right to use the tenant's space. For example, a tenant could not achieve the economic benefits of his specific space in a retail center without the property's parking lot, common areas of the center, elevators and the like. None of these tenant reimbursables represent payments for services to the tenant or to the tenant's space – the asset underlying the ROU. NAREIT therefore believes that these tenant reimbursements of landlord's costs to maintain common elements of the property represent *lease payments* and should be reported as lease income.

These tenant reimbursables of landlord's costs to maintain the landlord's property would not include payments to the landlord for non-lease services. For example, payments by the tenant for landlord services to maintain *tenant's space* (the underlying asset) or to provide services that are not directly related to the tenant's occupancy of space would represent non-lease income and be accounted for under the Boards' revenue recognition standard.



Recommendation

There has been significant debate among industry participants and accounting firms as to the accounting for tenant reimbursables of landlord costs under the Proposed ASU. We, therefore, suggest that the Boards clarify the accounting for these reimbursements of *landlord's costs associated with landlord's property*.

Reporting under Both Type A and Type B Leases

While the great majority of property leases would qualify as Type B leases, a real estate company may lease some properties under leases that meet the definition of a Type A lease. This situation raises two significant issues.

First, the model of applying the receivable and residual approach to a simple multi-tenant office building, which we created and shared with the Boards' Leases staff, clearly illustrated to us and to the staff that this approach to lessor accounting would not be operational for multi-tenant properties. This situation would be exacerbated if the investment property is carried at fair value.

Second, the reporting for leases based on two lessor accounting models in a company's financial statements would be very confusing to financial statement users.

Recommendation

We recommend that the Boards eliminate this potential reporting issue by requiring that all leases of property be considered Type B leases.

Further Consider the Definition of Property

We believe the Boards have narrowed the definition of *property* to a significant extent. We recommend that the Boards further consider its definition in the Proposed ASU and clarify the Proposal's definition.

Under current U.S. GAAP, "integral equipment" that is subject to a lease is treated as real estate. The FASB Codification Manual Master Glossary defines integral equipment as "any physical structure or equipment attached to real estate that cannot be removed and used separately without incurring significant cost⁴." Therefore, structures such as cell towers are treated as real estate under current U.S. GAAP.

The Proposal introduces a new definition of *property* that would represent a fundamental change to the revenue recognition pattern for leases related to cell towers and similar property. Because these assets would not be considered "land, building, or parts of a building," leases of this property would be classified as Type A leases. In our view, leases of these types of assets should be accounted for as property – not equipment; they are long-lived permanent structures that are

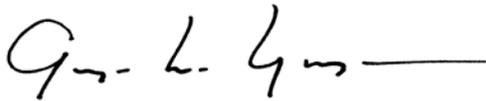
⁴ <https://asc.fasb.org/glossary&letter=I>



attached to the ground. We believe that clarifying the definition of “property” to include “integral equipment” would provide a more principles-based approach to lease classification.

NAREIT continues to support the Boards’ efforts to develop a converged global standard for lease accounting and would welcome an opportunity to discuss our views on the Proposed ASU with the Boards. If there are questions regarding this comment letter, please contact either George Yungmann at 202-739-9432 or gyungmann@nareit.com or Christopher Drula at 202-739-9442 or cdrula@nareit.com.

Respectfully submitted,



George L. Yungmann
Senior Vice President, Financial Standards



Christopher T. Drula
Vice President, Financial Standards

cc: Paul Beswick, Chief Accountant, Securities and Exchange Commission

