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NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

April 11, 2005

VIA E-MAIL

Mr. Lawrence W. Smith
Chairman of Emerging Issues Task Force
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856-5116

Re: Request to add a project on EITF Agenda

Dear Mr. Smith:

The National Association of Real Estate Investment Trusts® (NAREIT) requests that the FASB's Emerging Issues Task Force (EITF) add a project to its agenda related to the accounting for "tenant improvements" and "tenant allowances" in the context of operating leases. The National Association of Real Estate Investment Trusts® (NAREIT) is the representative voice for U.S. REITs and publicly traded real estate companies worldwide. Members are real estate investment trusts (REITs) and other businesses that own, operate and finance income-producing real estate, as well as those firms and individuals who advise, study and service those businesses.

As you are probably aware, on February 7, 2005, the Securities and Exchange Commission (SEC) issued a letter to the AICPA that provided the SEC's views on a lessee's/tenant's accounting for three items that could be found in operating leases. The SEC's views focused on a tenant's accounting for: 1) the amortization of leasehold improvements; 2) "rent holidays" -- periods of free rent while the tenant has possession of the space; and, 3) incentives related to leasehold improvements, including landlord reimbursements to the tenant for the tenant's cost of improvements to the space.



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Accounting for Leasehold Improvements

Since the issuance of the SEC letter, we have seen more than 200 of the lessees/tenants restate their financial statements for one or more of the issues addressed in the SEC letter, in addition to other accounting issues. As a result of these restatements, some of the lessees/tenants have capitalized the costs of improvements to the space to be occupied on their books, which our members have historically recorded and continue to record on their books as a tenant improvement asset. These lessee restatements have caused considerable confusion and concern with respect to whether the lessor/landlord or the lessee/tenant should report these space improvements as property on its books. The SEC letter did not provide explicit guidance on this question. However, the SEC letter indicated that, “the staff recognizes that evaluating when improvements should be recorded as assets of the lessor or assets of the lessee may require significant judgment and factors in making that evaluation are not the subject of this letter.”

We request that the EITF provide guidance on the factors that should be considered in making this determination as to who, the landlord/lessor or the tenant/lessee, should record a tenant improvement/property asset on their books. We believe that the resolution of the ownership issue has implications on other lease accounting issues for both lessees and lessors such as:

- Whether the agreement covers finished or unfinished space, which then determines when the space meets the agreed requirements and when the lessee obtains control/access to the space in the specified condition.
- Income statement and cash flow statement classification of payments between lessors and lessees and payments to vendors of improvements.
- Whether a lessee has involvement in construction pursuant to EITF Issue No. 97-10.

NAREIT's Views

NAREIT believes that tenant improvements that primarily benefit the landlord would generally be accounted for as property on the landlord's books and depreciated over the shorter of the related lease term or the useful life of the improvement. Some of the factors to consider in determining who should record the leasehold asset may be:

- Whether the tenant is obligated by the terms of the lease agreement to construct or install specifically identified assets (i.e. the leasehold improvements) as a condition of the lease.
- Whether the failure by the tenant to make specified improvements is an event of default under which the landlord can require the lessee to make those improvements or otherwise enforce the landlord's rights to those assets (or a monetary equivalent).
- Whether the tenant is permitted to alter or remove the leasehold improvements without the consent of the landlord and/or without compensating the landlord for any lost utility or diminution in fair value.
- Whether the tenant is required to provide the landlord with evidence supporting the cost of the improvements prior to the landlord reimbursing the tenant for the improvements.



Mr. Lawrence W. Smith

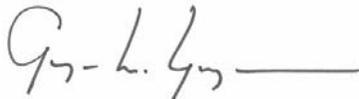
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- Whether the landlord is obligated to fund cost overruns for the construction of leasehold improvements.
- Whether the leasehold improvements are unique to the tenant or could reasonably be used by the lessor to lease to other parties.
- Whether the economic life of the leasehold improvements is such that it is anticipated that a significant residual value of the assets will accrue to the benefit of the landlord at the end of the lease term.
- Whether the landlord or the tenant has the insurable interest in the asset.
- Whether the ownership of the tenant improvement reverts to the landlord or the tenant at the end of the lease term.
- Whether the improvements are considered in the basis for assessments for property tax calculations and who is liable for the property taxes.
- Which party has legal title to the improvements under state or local law.
- Which party enters into contracts with third parties to buy or construct improvements.
- Whether the lessee or lessor are acting as the agent or the principal.

NAREIT thanks the EITF in advance for seriously considering this request. Please contact Gaurav Agarwal, NAREIT's Director, Financial Standards, at (202) 739-9442 or myself at (202) 739-9432 if you would like to discuss our request.

Respectfully submitted,



George Yungmann
Vice President, Financial Standards

