NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

July 17, 2009

Mr. Russell Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Subject: File Reference No. 1680-100 – Discussion Paper, *Leases: Preliminary Views*

Dear Mr. Golden:

The National Association of Real Estate Investment Trusts® (NAREIT) welcomes this opportunity to respond to the request for comments from the Financial Accounting Standards Board (FASB or Board) on the proposal contained in the FASB Discussion Paper, *Leases: Preliminary Views* ("the Discussion Paper or Proposal").

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.

NAREIT is strongly committed to improving the relevance and usefulness of financial reporting and routinely provides input on FASB, International Accounting Standards Board (IASB) and Securities and Exchange Commission proposals. NAREIT commends and supports the FASB's efforts to continue to develop high-quality accounting standards that improve the transparency, usefulness and credibility of financial reporting. In particular, we support the efforts to achieve additional convergence between U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS).

In support of the additional convergence between U.S. GAAP and IFRS, NAREIT has submitted several comment letters on joint FASB and IASB (the Boards) proposals with its global partners of the Real Estate Equity Securitization Alliance

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(REESA). Please refer to REESA's most recent submissions on this Discussion Paper and the Discussion Paper, *Preliminary Views on Revenue Recognition in Contracts with Customers* ("the Revenue Discussion Paper").

As discussed further below, NAREIT and its global partners are especially concerned that the Boards' preliminary views on lessor accounting would not provide financial reporting that faithfully reflects the economic characteristics of owning and operating investment property. In REESA's response to this Discussion Paper, REESA asserts its strong view that lessor accounting for leases of real estate held for investment should be excluded from the scope of the Boards' current Leases Project and specifically from the scope of the two approaches to lessor accounting discussed in Chapter 10 of the Discussion Paper. REESA further conveys that lessors should account for investment property leases as contracts for services under the general revenue recognition concepts proposed in the Revenue Discussion Paper and that such accounting should be incorporated within the scope of International Accounting Standard 40, *Investment Property* (IAS 40). While IAS 40 primarily addresses the measurement of the carrying amount of investment property, it also provides a description of the characteristics of such property. REESA believes, therefore, that accounting for leases of investment property in the context of IAS 40 would result in accounting that fully reflects the unique economic and business characteristics of investment property.

In this letter, NAREIT and its member companies reassert the global views of REESA, as well as provide specific NAREIT views on the Discussion Paper. NAREIT has addressed the Discussion Paper with a task force of its members, including financial statement users and preparers, to determine their views and the industry-wide impacts that this Discussion Paper would have on the real estate industry.

NAREIT supports REESA's position to exclude lessor accounting for leases of investment property from the proposed leasing model and to account for investment property leases as contracts for services using the general revenue recognition concepts proposed in the Revenue Discussion Paper. NAREIT's support of the overall concepts in the Revenue Discussion Paper as they would apply to the accounting of investment property by lessors is subject to the Boards' further development of the proposed revenue recognition model, including that which would be applied to contingencies, participation features and other terms commonly found in investment property leases.

NAREIT recommends that lessor accounting for leases of investment property should be excluded from the scope of the Discussion Paper for the following reasons (refer to the REESA comment letter for further discussion of these views):

- ***The suggested lessor accounting for leases would obfuscate information required by users to calculate key industry metrics used to measure investment property performance and to value both investment property and companies that own and operate investment property***

  Under the proposal, the total amount of rental payments under leases of investment property would no longer be recognized as rental revenue, since a portion of rental payments may be recognized as interest income. Additionally, the "derecognition approach" (Approach A) described in Chapter 10 of the Discussion Paper would derecognize the investment property asset – removing real estate from the statements of financial position of real estate companies and a portion of rental payments from rental revenue in the statements of comprehensive income. Alternatively, the "new rights approach" (Approach B) would inflate the assets and liabilities in the statement of financial position, while also precluding a portion of rental payments from being recognized as rental revenue in the statement of comprehensive income. As a result, under both of these approaches, information necessary to develop the key industry metrics currently utilized by investors and analysts, including net property income (NPI)[1] and net asset value (NAV), would not be reflected directly in the financial statements.

There is a clear link between rental revenue, NPI and the fair value of investment property. This link is critical to those investors and other users of financial statements in assessing the performance and value of investment property companies that account for their investment properties at cost, as well as to those entities that report the fair value of investment property in IFRS financial statements under IAS 40.

NPI is the difference between two elements on the statement of comprehensive income (that are required to be disclosed under IAS 40): 1) rental revenue from investment property; and, 2) direct expenses of operating the investment property. NPI is the basis for measuring the fair value of an investment property. The fair value of an investment property is measured by either capitalizing a given year's NPI or discounting projected NPI at current investors' yield requirements. The fair value of investment property is a significant factor in measuring the NAV of companies that own and operate portfolios of investment property. In turn, NAV is a significant factor used to price securities of these companies and to evaluate whether share prices are set at premiums or discounts relative to an entity's NAV. See Attachment I for an illustration of this relationship between 1) rental revenue; 2) NPI; and, 3) the fair value of investment property.

NAREIT urges the Boards to preserve this important link in any modifications to lessor accounting or revenue recognition standards. Financial statements that fail to present investment property assets and the entire amount of rental revenue generated from leasing contracts on an appropriate basis over the lease term would fail to provide the necessary information for users to evaluate and assess the economic results of entities that own and operate portfolios of investment property. Further, the exclusion of real estate from a real estate company's statement of financial position would be analogous to the exclusion of airplanes from an airline's statement of financial position.

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[1] NPI is a supplemental non-GAAP measure that is currently referred to as "net operating income" or "NOI".

- ***The real estate lease is an integral part of an indivisible asset***

  A property lessor views the "in-place" lease as an embedded component of the constantly changing, indivisible property asset. The indivisibility of real estate is best illustrated through the sale of investment property. Upon the sale of investment property, the investment property is not apportioned among different, individual elements of the property, including the separation of in-place leases from other property components. The separation of receivables under in-place leases from the property assets generally would not provide decision useful information to the users of real estate financial statements.

  In addition, the value of in-place leases is an integral part of an investment property's fair value. Therefore, the value of in-place leases is currently recognized on the statements of financial position of real estate companies that report investment property at fair value under IAS 40. NAREIT strongly believes that reporting the value of in-place leases separate from the value of the residual interest in an investment property would diminish the usefulness of financial statements.

- ***The characteristics of real estate leases are fundamentally different from those of equipment leases***

  There are several factors that inherently distinguish real estate leases from leases of equipment. Most importantly, the lessors of real estate are actively involved in the strategic, as well as the continuous, asset management of the leased properties. This asset management is far different than financing the acquisition of equipment by means of a lease. Real estate rentals depend primarily on the on-going management of the asset – changing the tenant mix, moving tenants to fully utilize space and reconfiguring and renovating space. In contrast to lessors of other leased assets, such as a depreciating piece of equipment, lessors of real estate have the ability to maximize investor returns by taking advantage of value-enhancement opportunities available through active and constant asset management.

  Secondly, leasing real estate is an investment activity and not a financing activity. A real estate lease agreement between a lessor and a tenant is the result of a market driven negotiation, which is closely related to the demand and supply for physical property. There is generally no interest rate implicit in a real estate lease and no residual value is assigned to individual leases.

  Thirdly, a real estate lease agreement will generally cover only a small portion of the useful life of the leased asset, since the useful life for real estate typically far exceeds the useful life for other types of leased assets such as equipment. Multiple leases will be executed over the useful life of the investment property, since real estate assets are longer lived assets. This factor is in significant contrast to leases that are of a financing nature where the lease covers a substantial portion of the useful life of the shorter lived asset. Further, the residual value of an entire investment property generally represents a much greater portion of the carrying value of the leased asset than does the residual value implicit in equipment leases.

Furthermore, the perpetual and irreplaceable nature of land, coupled with its immobility, is yet another key feature that distinguishes real estate leases/ground leases from leases of other assets. See NAREIT's specific comments below regarding the use of estimates involving leases that cover long periods.

Because of the significant differences between the business and economic characteristics of real estate leases and equipment leases, NAREIT believes that the lessor accounting for real estate leases should be distinguished from the accounting for equipment leases so that the accounting would reflect the unique economic characteristics of real estate leases and provide critical information on the face of the financial statements of companies that own and operate portfolios of investment property.

In addition to the REESA views summarized above, NAREIT has the following additional views on the Discussion Paper. While our member companies that own, operate and finance income-producing real estate are primarily concerned with lessor accounting, our members may at the same time be lessees of buildings, land, airspace or even entire investment properties. Therefore, the following comments may represent the views of lessees and lessors in the event that the Boards were to eventually analogize to lessees when forming their views on lessor accounting.

- ***Use of estimates may provide unreliable information***

  NAREIT believes that the frequent use of estimates under the Boards' preliminary views would sacrifice the reliability of the information provided in the financial statements, especially when estimates cover an extended period of time and involve complex lease terms that may result in significant variable outcomes. The Discussion Paper proposes that a lessee would estimate the present value of the most likely lease payments over the most likely lease term discounted using the lessee's incremental borrowing rate.

  As discussed further below, this requirement would involve a high degree of uncertainty and variability that could result in reporting unreliable and potentially misleading information to financial statement users. The estimates of the most likely lease payments and the most likely lease term, as well as the continuous reassessments of those estimates for each reporting period, would: 1) increase the risk of unreliable measurements in the financial statements; 2) cause complexity for users; 3) impose a substantial amount of costs to preparers; and, 4) subject companies to heightened litigation exposure.

  Most likely lease term

  The determination of the most likely lease term would be problematic for leases covering extensive periods. Many real estate leases have initial terms ranging from 10-20 years with various renewal, extension, co-tenancy and/or termination options. Ground leases may have initial terms of over 30 years with renewable options that extend well beyond 50 years. The assessment and reassessments of all contractual, noncontractual and business factors over such extended periods of time would involve a high level of uncertainty that may not provide reliable information to financial statement users.

In addition, leases are often amended during the term of the lease, which may take extended periods of time to negotiate. Thus, numerous assumptions would be made with respect to the potential impact of lease amendments.

Further, providing reassessments of the most likely lease term may reveal confidential information in the financial statements prior to the transaction being finalized. Under the proposal, companies that are in the midst of negotiations may be required to release information that is sensitive to their business plans. This information could impair a company's ability to negotiate and expose companies to potential negative legal consequences.

Most likely lease payments

Similar to NAREIT's concerns in estimating the most likely lease term for investment property leases, significant variable outcomes would result from estimating the total most likely rental payments under a real estate lease. A number of factors must be considered in the determination of the most likely rental payments – option periods, recapture rights, termination rights, co-tenancies and percentage rent. As a result of these factors, the estimates of the total most likely lease payments would involve a considerable amount of subjectivity and uncertainty, especially in times like today when forecasts of future economic activity are cloudy at best.

Additionally, the inclusion of contingent rents in the estimate of the obligation to pay rentals is difficult to conceive, because contingent rents depend on the occurrence of a complex set of future events. As indicated above, leases of real estate may include terms that extend for more than 30 years, and may require the lessee to pay rents based on future operating results. Estimates of these contingent rental payments could require estimating operating revenues and expenses over long periods of time and would, therefore, be very subjective. These estimates may not provide useful information to financial statement users and, in the worst cases, provide misleading information.

An example of the complexity involved in determining the most likely lease payments over the most likely lease term would be the terms specified in participating real estate leases. A participating lease agreement provides rights similar to those in a joint venture arrangement, in which the parties to the agreement may participate in the operating results of the property, uneven cash flows to achieve a preference or contingent management fees. The estimates of the most likely lease term and lease payments for participating leases would require sophisticated models in determining the participants' share of forecasted net income or cash flows for the next several years. It would not only be extremely complicated and costly to perform these calculations, but futile in terms of the reliability of these estimates.

- ***Lack of certain guidance***

The Discussion Paper does not provide the Boards' views as to guidance on the accounting for reimbursable costs (*i.e.*, common area maintenance, taxes and insurance) required under many leases and, for real estate leases, tenant improvements and tenant allowances. In particular, the Discussion Paper is not clear on how reimbursements of this kind would be measured separately from space rental amounts or included as part of the rental payments.

In addition, the Discussion Paper is not clear as to the accounting for multiple leases of portions of a larger asset – for example, over 200 tenant leases in one retail center. The residual value of an investment property is based on all of the potential cash flows from leasing currently vacant space, as well as the space vacated by current in-place tenants. This methodology raises the question as to whether the leased asset is the entire investment property or each tenant's space in the property. If residual values would be assigned to each of the 200 leases, this accounting would be contrary to the way in which investment property is evaluated by investors and other financial statement users. Further, this discussion leads to a question as to how the carrying amount of the property would be allocated to leases under the derecognition approach, which would require further guidance.

Finally, real estate lease agreements involve terms specific to the real estate business that are not typically included in equipment leases, such as co-tenancy clauses. These co-tenancy clauses may provide rental payment relief to other tenants, if the lead or anchor tenant(s) vacates the property. Co-tenancy clauses would present additional complexities in determining the most likely lease term and payments required by the Discussion Paper.

These more granular issues raised by NAREIT members reinforce the view that accounting by lessors of investment property would be more effectively developed separately outside of the Leases Project.

If the Board or its staff would like to discuss NAREIT's views as expressed in this comment letter, please do not hesitate to contact George Yungmann at gyungmann@nareit.com or (202) 739-9432 or Sally Glenn at sglenn@nareit.com or (202) 739-9442.

Respectfully submitted,

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Attachment I

Results of Various Approaches to Accounting for Leases of Investment Property, NOTE 1

The measurement of operating performance, the fair value of investment property and the pricing of shares are linked in simple and direct relationships. Rental income less direct property operating costs provides "net property income" (NPI). Projected NPI discounted at current investor yield requirements or the capitalization of a given year's NPI provides the property's fair value -- a factor in determining net asset value (NAV). Multiples applied to Income from Operations (IFO) provide indications of the price of the company shares.

Results of Various Approaches to Lessor Accounting

	Current Actg.	NOTE 2 PVD Approach A	PVD Approach B
Income Statement Caption:			
Lease/rental revenue	$ 12,370	none	$ 9,378
Total lease income	$ 12,370	none	$ 9,378
Direct operating costs	(4,000)	$ (4,000)	(4,000)
Net Property Income	$ 8,370		
Meaningless subtotal		$ (4,000)	$ 5,378
Administrative costs	$ (2,000)	$ (2,000)	$ (2,000)
Interest on lease receivables	none	3,370	2,992
Interest expense	(4,370)	(4,370)	(4,370)
Income From Operations	$ 2,000		$ 2,000
Meaningless subtotal		$ (7,000)	
Property Fair Value:			
Net property income	$ 8,370	Data not available	Data not available
Capitalization rate	9%		
Property fair value	$ 93,000		
Debt outstanding	(65,000)		
Net Asset Value	$ 28,000		
Share Price:			
Income From Operations	$ 2,000	Data not available	$ 2,000
Earnings multiple	13		13
Implied Share Price	$ 26,000		$ 26,000
Share Price Discount to NAV	7.14%		Data not available

NOTES:

1 - Where similar information is used in this illustration, amounts are taken from IASB Agenda Paper 11A presented at the May, 2009 IASB meeting and also presented at the May 18, 2009 FASB meeting as FASB Memorandum No. 30.

2 - The illustration of Approach A excludes the recognition of revenue or gain that may be recognized at the inception of the lease.