EPRA
EUROPEAN PUBLIC
REAL ESTATE ASSOCIATION

International Accounting Standards Board
30 Cannon Street
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United Kingdom

Technical Director
File Reference No. 1820-100
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

14th December 2010

Re: Leases Exposure Draft

Dear Sir/Madam:

We are pleased to submit this comment letter in response to the International Accounting Standards Board's (IASB) and the Financial Accounting Standards Board's (FASB) joint Exposure Draft: *Leases*. We are submitting these comments on behalf of the members of the Real Estate Equity Securitization Alliance (REESA). These members include the following real estate organizations:

Asia Pacific Real Estate Association (APREA)
British Property Federation (BPF)
European Public Real Estate Association (EPRA)
National Association of Real Estate Investment Trusts (NAREIT)® (U.S.)
Property Council of Australia (PCA)
Real Property Association of Canada (REALpac)

Members of the organizations identified above would be pleased to meet with the Boards or staff to discuss any questions regarding our comments.

We thank the IASB and the FASB (collectively, the Boards) for the opportunity to comment on the proposal with respect to this important project. If you would like to discuss our comments, please contact Gareth Lewis, EPRA's Director of Finance, at gareth.lewis@epra.com or +32 2739 1014.

Respectfully submitted,

European Public Real Estate Association
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Comment Letter Submitted by the

European Public Real Estate Association (EPRA)

On behalf of the following members of the
Real Estate Equity Securitization Alliance (REESA):

Asia Pacific Real Estate Association (APREA)
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Real Property Association of Canada (REALpac)

In response to the

Exposure Draft

Leases

Issued by the International Accounting Standards Board and
Financial Accounting Standards Board

August 2010

International Accounting Standards Board
30 Cannon Street
London
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File Reference No. 1820-100
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Re: Leases Exposure Draft

Dear Sir/Madam:

REESA is the global representative voice for publicly traded real estate companies and Real Estate Investment Trusts (REITs). Members of REESA organisations are real estate companies and other businesses throughout the world that primarily develop, own, operate and finance investment property, as well as the institutions who invest in these businesses and the firms and individuals who advise, study and service the sector.

REESA strongly supports the harmonisation of global accounting and financial reporting and understands the importance of achieving a high quality universal set of accounting standards. We have been fully engaged in the IASB and FASB's (the Boards) discussions on major convergence projects and have actively participated in meetings with the Boards and their staff with respect to these projects. REESA greatly appreciates the opportunities to express our global views through these meetings and comment letters.

Whilst we do observe and support a general trend towards disclosing property at fair value in financial statements around the world, REESA members include companies that report their investment properties at fair value and companies that use a cost model, whether by choice (under IAS 40 – Investment Property), or because the local GAAP does not permit fair value reporting. This letter therefore accommodates the views of these various constituents, all of whom will be affected in different ways under the proposed Leases Exposure Draft (ED).

Executive Summary

REESA's views on the Leases ED can be summarised as follows:

Related to investment property reported at fair value

- We are fully supportive of the conclusion reached by the IASB to exclude from the proposed standard, lease income from investment property reported using the fair value option in IAS 40.
- We urge the FASB to accelerate the examination of a standard under U.S. GAAP that would mirror IAS 40.

Related to investment property reported at cost

- We have serious concerns that the proposed new reporting framework will not address the Boards' concerns related to the faithful representation of leasing transactions, the complexity of existing lease accounting and the comparability of information. This is particularly the case for property lessors who report their property at cost and the lessees of investment property. The proposed standard will increase complexity and confuse preparers and users and consequently adversely affect the usefulness of financial statements.
- We acknowledge the determination of the Boards to capitalise lease obligations 'on balance sheet' rather than via improved disclosures. On this basis, our strong view is that the proposals will only offer a workable framework for lessors and lessees of property if the new standard:
    - Excludes from the measurement of lease assets and liabilities, any amounts due under contingent rentals
    - Measures lease assets and liabilities only with reference to rentals to the first renewal/break date in the lease and excludes renewal options
    - Amortises the right of use asset at the same rate as the capitalised lease liability, except for impairment and initial direct costs. Similarly, amortises the lessor's performance obligation at the same rate as lessor's receivable
    - Continues to allow both the performance obligation and partial derecognition approaches for lessors of investment property so that property owners can show the underlying asset as a continuing, indivisible, economic resource of the lessor whilst also allowing the appropriate accounting for 'in substance' disposals
    - Results in the faithful representation of income and expenses related to lease transactions between property owners and tenants, by reporting total rental income pursuant to the lease.

- More generally, we have concerns regarding the business implications that the new model will have for property tenants. A survey[1] of major retailers, commissioned by EPRA, found that a majority of retailers interviewed believe that:
  - the proposed lease accounting is not aligned with how a tenant views its property leases;
  - renewal options and contingent rentals do not represent liabilities and would reduce the usefulness of financial information to users;
  - the proposed lease accounting would impose significant compliance costs to implement; and
  - borrowing costs would increase as a result of the inclusion of contingent rentals and rent options, which would inflate the balance sheet and could be misrepresented by credit agencies as 'new risks'.

  Finally, the survey also highlights an alarming lack of awareness of the pervasive impacts of the proposed lease accounting model.

The above points, including our specific comments on the proposed model, are covered in more detail below and the attached Annexes.

Detailed comments

Our comments in this letter are primarily focused on our members' perspective as property lessors. REESA represents companies that own and manage investment property and the investors in those companies. As participants on one side of the tenant/landlord relationship, our members are in regular communication with tenants and have a clear interest in understanding how such a major change in the reporting framework will impact their business. Accordingly, where appropriate, we have also expressed our views on the application of the leasing model to property tenants in their position as lessees.

Exclusion for investment properties at fair value

We are fully supportive of the scope exclusion for lessors who report their investment property at fair value, subject to clarification with respect to the wording of the exclusion for investment property reported at fair value (discussed in Annex I). We commend the Boards for their considerable efforts to listen and respond to the views of preparers and users in this regard. As detailed in our previous response to the Discussion Paper and our subsequent discussions with the Boards and staff, IAS 40 and the existing operating lease model in IAS 17 are well supported by IFRS financial statement preparers in the real estate industry and the users who rely on those statements. It allows a property company to report the fair value of its property and facilitates the reporting of full rental income in profit or loss. In this respect, we draw your attention to the letter submitted to the Boards on 5th November 2010 on behalf of major property investors and analysts (attached as

[1] Survey undertaken by PwC on behalf of EPRA – headline findings as included in Annex II
http://www.epra.com/media/Leasing_-_impact_on_tenants_-_Exec_Summary.pdf

Annex III). These important users of property company financial statements comprised investors collectively responsible for over €325 billion of property assets under management and included all of the major investment analyst teams. In their letter to the Board these users stated that:

"the full amount of rental income is fundamental to investors in assessing the performance and investment quality of investment property companies. Removing this metric pursuant to the proposed leases standard would represent a step backward in terms of investment property companies communicating effectively to investors, financial analysts and other financial statement consumers."

Development of an IAS 40 equivalent by FASB

REESA strongly supports the FASB's examination of a standard under U.S. GAAP that would mirror IAS 40 and recommend that the Boards develop such a standard as a matter of urgency to coincide with the implementation of the new Leases standard. We believe that the scope of such a standard should be broadly the same as IAS 40.

The accounting framework for the recognition and measurement of rental income and expenses, including lease incentives and service income, is brought into focus by the Board's development of a new standard for revenue recognition, the exclusion for leases of investment property measured at fair value from the Leases ED, the consequential amendments required in IAS 40 and the development of a new IAS 40 equivalent standard in the US. Given the importance we place on the development of a relevant and useful global reporting framework for investment property reporting, in due course we intend to address, and share with the Boards, REESA's views on the recognition and measurement of rental income and expenses for investment property, as they relate to all of the above interconnected projects.

Specific comments on the proposed leasing model

The comments below reflect our views on the leasing model under the assumption it will apply to companies that measure their investment property using a cost model, and also as it will apply to tenants on the other side of the tenant/landlord business relationship.

Contingent rents

We believe that the proposal for contingent rentals to be included in the measurement of the lease receivables and liabilities does not faithfully represent the rights and obligations which arise from a property lease contract; and that contingent rents based on usage do not meet the definition of a liability.

In addition, estimating contingent rents would involve a high degree of subjectivity and complexity which compromises the comparability and usefulness of financial information. In this respect, we agree with the comments of Stephen Cooper outlined in paragraph AV7 of the Leases ED. We do not support the use of the Expected Outcome approach which would be onerous and would not result in more useful information than using management's best estimate.

We believe that estimated contingent rents based on usage do not meet the definition of a liability because the lessee controls the obligating event - that is, the additional usage of the leased asset. Our view is that usage-based contingent rents should only be reflected as triggered based on periodic usage. The proposed recognition approach does not reflect the flexibility provided in such contracts and assumes rights and obligations at the inception of the lease which are beyond the true commitments of the parties.

Estimating contingent rents which are based on the performance of the lessee would be very subjective; particularly for long-term leases that include contingent rents based on the future operating results of the lessee. For example, it would be very subjective to estimate the amount of contingent rent due under a 15 year lease where the contingent rent is based on the annual sales of a retail tenant. This could result in preparers reporting widely different values for the same lease contract and undermine comparability between financial statements.

There are substantive economic reasons why many leases include contingent rentals elements - namely to reduce risk for the property owner and the lessee. The proposed Leases ED distorts the economic effect for both lessors and lessees in the form of a front loaded cost/revenue model. Consider, for example, the lease of space in a retail mall that has a term of 10 years and calls for minimum rents of CU1 million per year plus 10% of all sales above CU10 million in any given year. This arrangement reduces the risk to the property owner of setting the minimum rent too high in the early years of the term and too low at the back end of the term. It also reduces the tenant's risk by allowing the rent to grow only if sales grow. In addition, the property owner captures 10% of the tenant's sales even if the sales exceed all expectations and the tenant's rental expense grows only if and as the tenant's sales grow.

It would misrepresent the economics of this lease transaction to accrue the present value of all rents, including contingent rents, under this lease and amortise the performance obligation/right-to-use asset on a straight-line basis into income/expense before the triggering event – sales growing to more than CU10 million in any one year. This is exacerbated by front ending total income/expense under the lease – the aggregate of the straight-line amortisation of the performance obligation/right-of-use asset and the interest element related to the lease receivable/payable.

The proposed lease accounting requires the use of a probability-weighted average approach in measuring the lease receivable and performance obligation. We do not support this proposal on the basis that it would require a large number of mechanistic calculations without resulting in more useful information. For example, a company with 5,000 leases each with contingent rent elements and taking account of 5 outcomes for each revenue element would need to consider 25,000 possibilities in order to complete the 5,000 weighted average calculations at each reporting date. We believe that a best estimate of cash flows would reflect the most probable scenario and result in more relevant estimates. It would also have the benefit of requiring fewer re-measurements.

Recommendation:
We strongly urge the Boards to exclude contingent rentals from the measurement of the lease assets and liabilities aside from those based on rate or index. All other contingent rents should be recognised when the contingent triggering event occurs.

Lease renewals

We disagree with the Boards' proposals that the lease term should be the 'longest possible term that is more likely than not to occur' taking into account the effect of any options to extend or terminate the lease. We do not believe that extension options represent liabilities unless the option is virtually assured of being exercised because the option is not substantive (i.e. it must be exercised).

Accordingly, we believe that lease renewal options should not be included in the measurement of lease receivables and liabilities other than those that are bargains, create compulsion to exercise or create a substantial penalty for failure to renew as they are not liabilities of the lessee at lease inception. In this respect we agree with the comments of Stephen Cooper outlined in the Basis for Conclusions of the Leases ED. The liability should not be capitalised because the lessee controls the obligating event – the exercise of the option.

Compounding this issue, the recognition of lease renewal options as proposed in the Leases ED distorts the economic effect for both lessors and lessees in the form of a front loaded revenue/cost model. The periodic reported lease revenue/cost is increased as a result of assuming the renewal, even if the renewal would occur many years into the future. To illustrate, while revenues generated from the use of the leased asset would generally be higher during renewal periods, a large portion of the cost of using the leased asset would have been reported during the initial lease term.

Estimating renewals will reduce comparability as preparers are likely to have different assumptions in accounting for the same contract. The estimation of possible renewals becomes less reliable the longer the period of time involved and the more exaggerated the front-end lease/revenue cost pattern.

Recommendation:
Our recommended approach would be to exclude lease renewals from the measurement of the lease receivables and liabilities and define the lease term by reference to the first lease break or renewal option -- unless the option is virtually assured of being exercised because the option is not substantive.

Model for lessors – Hybrid Approach

Although REESA has significant concerns with the proposed accounting for lessors, our strong view is that, of the two models presented by the Boards, the performance obligation model, which views the underlying asset as a continuing, indivisible, economic resource of the lessor, more accurately represents the economic substance of most leases of investment property than the partial de-recognition approach. There are occasions - for example, with the grant of very long term leases in a single-tenant building- where the partial derecognition approach may be appropriate. We therefore believe that the Boards should continue to allow both the performance obligation and partial de-recognition approaches.

An investment property company sees the property it owns (and the lease contract with its tenants) in a very different light from that of a lessor of a depreciating piece of equipment. It sees the in-place lease as only part of a constantly changing, indivisible

property asset, representing opportunities to create and enhance value for stakeholders. The indivisibility of the real estate asset is reflected in how the industry operates in practice - the sale of an investment property is not apportioned between different elements of the property, and certainly not apportioned between the in-place leases separate from the other tangible and intangible components of the property. In addition, the property owner will generally retain certain rights to manage the asset whilst the lease is in place - but which have a longer lasting impact on the asset value. Examples include the ability to inspect, take action to protect or enhance the value of the asset in certain circumstances and to develop and enhance surrounding real estate and infrastructure.

In REESA's view, the application of the partial de-recognition approach would not be operational for an investment property having many tenants such as regional retail centers and major multi-tenanted office buildings. They would face the complexities of determining the cost-of-sale related to a lease in a multi-tenanted property and measuring the residual value of that lease.

Finally, the partial de-recognition approach is inappropriate for investment property because the residual interest in an investment property will generally represent a much higher percentage of the value of the whole asset compared to that of leased equipment. A survey recently undertaken in the UK[2] showed that 72% of commercial real estate leases granted to businesses were less than 5 years in length, whereas investment property companies who grant these leases, will typically own either the freehold interest in the property or a head lease equivalent to ownership in perpetuity.

Recommendation:
Of the options that have been presented and discussed by the Board's, we favour the hybrid approach which would at least allow the vast majority of investment property to remain on the balance sheet under the performance obligation model, while allowing "in substance" disposals to be appropriately accounted for under the partial de-recognition approach.

Amortisation of right of use/front-end loading

REESA believe that the right-of-use asset should be amortised at the same rate as the capitalised lease liability, except for impairment and initial direct costs. This would recognise the accounting for the lease contract and not its components and reflects the pattern in which the lessee consumes the economic benefits from the lease. In most leases, the lessee pays for its right to use the leased item at the same time it receives the right and consumes its benefits. Using straight-line amortisation of the right-of-use asset makes the lease contract appear to be "under water" immediately, since the book value of the asset amortises more quickly that the liability.

We believe that the asset and liability in a lease contract are inextricably linked and that relationship should hold true in subsequent accounting periods, absent impairment. We

[2] BPF/IPD Annual Lease Review 2010:
http://www.bpf.org.uk/en/files/bpf_documents/BPF_Annual_Lease_Review_2010_13082010.pdf

note that a linked approach has been considered previously by the Boards and dismissed. However, we believe it is not only simpler, but that it would give the user of financial statements better information regarding the value of the lease contract on the balance sheet and revenue/costs in profit or loss.

Business implications for property tenants

REESA members are in regular contact with tenants and have a clear interest in understanding the implications of the proposed changes on these tenants. One of our main concerns is the lack of awareness among tenants who will be significantly impacted by the new rules. This is particularly the case for retail businesses who are typically large tenants with many leases.

In order to better understand the implications for property tenants, EPRA commissioned a survey of leading retailers[3] which was undertaken by PWC. The results of this survey, which included in-depth interviews with eighteen leading retailers and two representative organizations, highlights that major retailers believe that the proposed lease accounting model is not aligned with how property tenants view their property leases. They do not consider their leases to be financing arrangements but a means to secure selling space and cost and operational flexibility - factors which are reflected in the contract. Also, like REESA, the majority of retailers do not support the inclusion of contingent rents and many are concerned that 'inflated' balance sheets would result in higher borrowing costs. The headline findings of this survey are detailed in Annex II.

Conclusion

REESA is fully supportive of the scope exclusion for lessors who report their investment property at fair value and appreciate the Boards' considerable efforts to understand the relationship between lease income with respect to investment property and the measurement and reporting of these properties at fair value.

At the same time however, we do not believe that - for those leases that will be covered by the proposal - the proposed accounting model will faithfully represent the economic substance of the business transaction underlying a property lease. Most significantly, we believe that:

- Contingent rents should be excluded in the measurement of lease assets and liabilities
- Rents during periods of possible lease extensions should not be included in the measurement of lease assets and liabilities
- The amortisation of the right-of-use asset and the lessee's liability should result in an aggregate straight-line charge to earnings over the term of the lease. A similarly linked approach should be used to amortise the lease receivable and

[3] Survey undertaken by PwC on behalf of EPRA – headline findings as included in Annex II
http://www.epra.com/media/Leasing_-_impact_on_tenants_-_Exec_Summary.pdf

performance obligation that would result in aggregate straight-line periodic revenue over the term of the lease

- Unless the Boards conclude that all investment property leases should be scoped out of the proposed lessor accounting, the Leases standard should continue to allow both the performance obligation and partial derecognition approaches for lessors of investment property reported at cost, so that property owners show the underlying asset as a continuing, indivisible, economic resource of the lessor and can appropriately account for 'in substance' disposals.

We appreciate the opportunity to share our views with the IASB and FASB and welcome the Boards' questions on our comments.

Respectfully submitted,

Asian Public Real Estate Association
Singapore

European Public Real Estate Association
Belgium

British Property Federation
United Kingdom

Property Council of Australia
Australia

National Association of
Real Estate Investment Trusts
United States

Real Property Association of Canada
Canada

Additional Comments

Exclusion for lessors at Fair Value – text of ED does not reflect this intention

We understand that the Boards' intention is an exemption from the scope of the Leases ED for investment property lessors measuring their investment property at fair value. However, the text of the Leases ED does not appear to reflect this intention. Paragraph 7 states that 'an entity shall apply this IFRS to investment property that it holds under a lease' which would seem to exclude owned investment property. We therefore suggest that IASB clarify the wording of the exclusion of all investment property.

Accounting for leased investment property – inconsistent with existing IAS 40

The Board has included guidance on how to account for leased investment property in a way that seems inconsistent with the current IAS 40, without clarifying whether and how IAS 40 is going to be amended.

Under current IAS 40, property held under an operating lease can be treated as a finance lease if it meets the characteristics of investment property. Accordingly, the lessee recognises the investment property at fair value (equal to the fair value of the net lease contract plus the lease liability) - with fair value adjustments going through the Statement of Comprehensive Income - and the liability at amortised cost, in accordance with the current IAS 17.

In contrast, para 7(a) of the Leases ED would require the lessee of investment property to recognise a right-of-use asset at fair value. However, the lease liability would be accounted for according to the Leases standard – including renewals and contingent rents - with changes to estimates going through the profit and loss.

The differing standard for the asset and the liability and a different measurement basis will lead to significant inconsistencies in the accounting for investment property held under a lease and a misstatement of the fair value of the lease contract. Fair valuing the lease liability is not allowed and would not solve the whole inconsistency.

ANNEX II

Proposed Lease Accounting Standard - impact on retail tenants

Executive Summary

Headline results from EPRA's interviews with leading tenants:

EPRA commissioned research to raise awareness and understand the impact of the proposed lease accounting standard on major European tenants. This research was carried out by PwC and was based on interviews with approximately 18 large retailers and two tenants' representative bodies during the period from October 01, 2010 to November 30, 2010[4]. The main findings are as follows:

1. **The proposed lease accounting model is not aligned with how a tenant views its property leasing arrangements:**

   - Retailers interviewed regard their property leases in a fundamentally different way to other depreciating leased assets such as vehicles and (office) equipment. They do not view their property leases as a financing arrangement but a way to secure selling space and operational and cost flexibility for their retail formulas. Many properties leased by them in high-end streets and malls are not available for purchase and the desired contractual flexibility or flexibility provided by statutory tenant protection laws is priced into the base arrangement (while the proposed accounting could include the gross value of base rents and contingent rents for renewal periods as liabilities).
   - According to retailers interviewed, the pricing of lease rentals is in some cases independent of the fair value changes of the underlying property due to statutory tenant protection laws. Often changes in the fair value of the underlying property will be adjusted in the key money related to the property, an element which has not been considered in the proposed lease standard.
   - The majority of retailers interviewed had conceptual concerns with the front-loading of costs under the proposed model, which is inconsistent with how they view their property leases and assess the performance of leases. Store revenue generally tends to increase over time as well as costs associated with operating the store business (e.g. payroll, general and admin expenses, rental costs), while under the proposed model, the costs for a store lease would now be front-loaded and decrease over the lease term which is counter-intuitive to how a retailer assesses store performance and the underlying economics of a retailer's business model.

2. **The majority of retailers interviewed disagree with the inclusion of renewal options and contingent rentals because they do not believe these are liabilities and would also reduce the usefulness of financial information to users:**

[4] The research findings and views presented in this summary do not necessarily represent those of the PwC Global network or EPRA. These findings reflect a summary of the observations from interviews with retailers and tenants.

- According to retailers interviewed, almost 100% of their leases include explicit and implicit (by law) renewal options and often contingent rentals based on (store) performance. Some retailers indicated that when they evaluate investment decisions, they model out in business planning up to the first break point in a lease which is within their control (i.e. the end of the base lease term). Decisions to renew a lease are often taken in the last 1-2 years of a property lease when a retailer's formula or store performance and contributions are evaluated.
- Retailers interviewed believe that including renewal options based on a 'longest possible lease term that is more likely than not' approach is not in line with their economic decision making, and this will require them to estimate the likelihood of exercise for accounting purposes well beyond their normal business planning cycles which normally range from 1-5 years - which questions the (decision) usefulness of this information.
- The majority of retailers interviewed questioned the reliability of financial information from the proposed lease standard and its relevance to users. In particular, they raised significant concerns about the judgments required in measuring long-term leases based on the accounting defined lease term, their ability to produce reliable estimates for these leases and the resulting volatility in earnings from the true-up of these future estimates.
- Retailers interviewed consider that including renewal options and performance based contingent rentals in the right-of-use asset and lease liability is not in line with the underlying economics of their lease arrangements which would also further exaggerate the mismatch between store revenues and costs over time (i.e. front-loading of lease costs).
- Some retailers have raised concerns around comparability and relevance of financial information to users stemming from the discount rate to be used. Some retailers question comparability among entities when the discount rate applied is based on the specific terms of each individual lease (for example, the accounting lease term) and the fact that some retailers use general financing for their owned assets.

3. **The proposed lease accounting model will require significant compliance costs and resource for implementation, particularly in relation to the accounting for renewal options and contingent rentals including periodic re-assessment and true-up of these estimates:**

- The retailers interviewed participate in between 100 and 6,000 individually unique leases with different landlords in different countries. Almost 100% of their leases contain flexibility in the form of explicit renewal options or implicit renewal options by statutory tenant protection laws and often contingent rentals based on store sales. None of their existing property or financial systems capture the data required for the proposed lease standard, and retailers would have to review each individual lease agreement and negotiate with each individual landlord to obtain missing data (for example, bifurcation of lease payments in lease and service-related payments).
- According to most retailers, the bifurcation of lease and service payments (e.g. for shop-in-shop concessions in department stores, leases in malls) will be challenging if not impossible for them as they would be required to obtain this information from each individual landlord. Even if possible, this would require significant staff costs and potentially legal expenses to modify lease agreements where needed.
- Most retailers have indicated that they do not have standard leases with landlords and their leases are often individually material. This makes a portfolio approach to the implementation and periodic re-assessment of

estimates virtually impossible. The amount of staff time and costs that would be needed to review leases and account for them on an ongoing basis, taking into account the periodic re-assessment of estimates, are expected to be highly significant.

- All retailers interviewed expected to have to modify their property or ERP system or implement an IT solution to capture the necessary information for the proposed lease standard.
- Although retailers expect significant costs for the modification of their IT environment, they expect that the most significant implementation costs will result from the required changes in processes and controls around leases, more particularly around renewal options and contingent rents and their periodic re-assessment.
- Some retailers interviewed did not agree with measurement of the right-of-use asset and liability to make lease payments using a probability-weighted average. This would result in significant practical issues and costs for retailers to consider reasonable scenarios and assign probabilities for each of their individual lease agreements. This would cause significant administrative efforts and results in practical implementation concerns for retailers with hundreds or thousands of individual leases. Furthermore, some have indicated that they do not believe this will result in decision-useful information. The probability-weighted average of the renewal options and contingent payment will result in the reporting of amounts that by definition will not be the amounts that will be paid.
- Most retailers have indicated that they will continue dual reporting efforts for leases for some period of time, or permanently, after transition either due to bank reporting requirements (covenants), internal performance measurement, and remuneration plans given current performance metrics and/or tax requirements.

4. **The majority of retailers interviewed fear an increase in their borrowing costs due to the significant changes to their financial information:**

- Retailers interviewed fear a potential increase in their borrowing costs. Although their users adjust retailers' financial information today, this is often based on minimum / fixed lease payments. Including renewal options based on a 'longest possible lease term that is more likely approach' and contingent rentals (which in their view do not meet their users definition of liabilities) will result in significant over statement of retailers' right-of-use assets and lease liabilities. They are concerned that this 'over statement' of retailer's balance sheets and leverage in practice would not be just a form-over-substance change, but would potentially be misrepresented by lenders' credit committees and credit rating agencies as 'new' risks. This would potentially result in a re-definition of acceptable leverage ratios for the entire industry with pressure on negotiations and borrowing costs for individual retailers.

5. **Lack of awareness of the pervasive impact of the proposed lease accounting standard among tenants:**

- The majority of retailers interviewed was unaware of the comprehensive impacts of the proposed lease accounting standard and/or had not yet discussed these potential impacts with their board of directors.
- Only one of the 18 retailers interviewed had already carried out a detailed assessment of the impact of the proposed lease standard on their business organisation and discussed the potential impacts with their board of directors.
- The main challenge for the majority of retailers interviewed was to find time and resources to raise awareness with the wider functions within their entity (e.g. IT, Treasury, Tax, Real Estate) and to dedicate resource to the assessment of the implications.

ANNEX III

Investors/analysts letter to IASB and FASB

5 November 2010

International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
United Kingdom

Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Re: Exposure Draft - Leases

Dear Sir/Madam,

We are pleased to submit this letter on the International Accounting Standards Board's (IASB) and Financial Accounting Standards Board's (FASB) (collectively "the Boards") Exposure Drafts; Leases. We are submitting these comments on behalf of the undersigned investors and property sector analysts. As major investors into property and investment property companies (including REITs) we have a strong interest in ensuring that the reporting of financial information related to investment property is relevant and transparent.

Exclusion for lessors of investment property reported at fair value

We are fully supportive of the conclusion reached by the IASB to exclude from the proposed lease accounting standard companies that report investment property at fair value. Further, we support the FASB's examination of a standard under U.S. GAAP that would mirror International Accounting Standard No. 40, *Investment Property* (IAS 40). Such a standard would enable convergence of standards for accounting for investment property world-wide; and ensure relevant, comparable and transparent reporting by investment property companies globally.

The current IFRS for investment property accounting, IAS 40, is well supported by industry financial statement preparers reporting under IFRS and industry financial statement users who rely on those statements. It requires a property company to disclose the fair value of its property and reports full rental income in the profit and loss account. The full amount of rental income is fundamental to investors in assessing the performance and investment quality of investment property companies. Removing this metric pursuant to the proposed leases standard would represent a step backward in terms of investment property companies communicating effectively to investors, financial analysts and other financial statement consumers.

The investors identified below would be pleased to meet with the Boards or staff to discuss in more detail the views of users of the financial statements of investment property companies.

If you would like to discuss this matter with us, please contact either Gareth Lewis at gareth.lewis@epra.com or George Yungmann at gyungmann@nareit.com.

We thank the FASB and IASB for the opportunity to comment on the Boards' Exposure Drafts with respect to this very important project.

Respectfully submitted,

Investment institutions

Name	**Organisation**	**Property AUM (€million)**	**Email**
John Robertson	RREF	35,500	CONTACT DETAILS PROVIDED SEPARATELY
Marc Halle	Prudential Real Estate Investors	31,100	
Guido Bunte	Cornerstone Real Estate Advisers	25,300	
Marcus Shepherd	Aviva	25,100	
Roger Quirijns	Cohen & Steers	22,300	
Martin Moore	PRUPIM Real Estate Investment Management	19,000	
Rafeal Torres Villalba	APG All Pension Group	18,000	
Mark Abramson	Heitman	15,300	
Hans Op 't Veld	PGGM Investments	13,400	
Rod O'Connor	Colonial First State	12,900	
Theodore Bigman/ David Smetana	Morgan Stanley Investment Management	12,100	
Matthijs Storm	ING Clarion Real Estate Securities	12,000	
Patrick Sumner	Henderson Global Investors	10,900	
Bill Hughes	Legal & General Property	10,900	
Andrew Jackson	Standard Life Investments	10,400	
Craig Mitchell	Dexus	9,800	
Emily Mousley	Hermes Real Estate Inv Management	6,500	
Stephen Tross	Bouwinvest	5,300	
James Rehlaender	European Investors, Inc	5,100	
Danny Agnoletto	ING Real Estate Investment Management	5,000	
Jan Willem Vis	BNP Paribus Investment Partners	3,000	
Stuart Martin	First State Investments (UK)	2,850	
Graham Burnett	Universities Superannuation Scheme (USS)	2,300	
Mark Townsend	Asset Value Investors	1,800	
Daniela Lungu/ Jeremy Anagnos	CBRE Investors Global Real Estate Securities	1,600	
Jos Short	Internos Real Investors	1,500	

Investment institutions contd.

Barden Gale /Michael McGillis	JER Partners	1,450	CONTACT DETAILS PROVIDED SEPARATELY
Adrian Pozzo	CBUS	1,400	
Simon Hedger	Principal Global Investors	1,300	
Steven Brown	American Century Investments	866	
Chris Turner	Thames River Capital	860	
Vincent Bruyère	Degroof Fund Management Company	250	
Martin Allen	REECH	100	

Investment analysts

Name	Organisation	Email
John Lutzius, Mike Kirby	Greenstreet Advisors	CONTACT DETAILS PROVIDED SEPARATELY
Harm Meijer	JP Morgan	
Dirk Boer	Kempen & Co	
Bart Gysens	Morgan Stanley	
Jan Willem van Kranenburg	Royal Bank of Scotland	
Paul Pulze	Evolution Securities	
Kai Klose	Berenberg Bank	
Alex Moss	Macquarie Capital (Europe) Limited	
Bruno Duclos	Credit Agricole Cheuvreux	
Steve Bramley-Jackson	Credit Suisse	
Ruud van Maanen	ABN AMRO	
Michael Slater/Frank Haggerty	Duff & Phelps Investment Management	
Quentin Freeman/Kim Wright	UBS	
Andrew Cox	Numis Securities Limited	
Valerie Guezi	Exane BNP Paribas	
Simon Wheatley	Goldman Sachs & Partners Australia Pty Ltd	
Leigh Gavin	Frontier Investments	