NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

June 3, 2016

Mr. David R. Bean
Director of Research and Technical Activities
Project No. 3-24E
Governmental Accounting Standards Board
401 Merritt 7
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Norwalk, CT 06856-5116
director@gasb.org

Delivered electronically

RE: *Exposure Draft: Proposed Statement of the Governmental Accounting Standards Board - Leases*

Dear Mr. Bean:

This letter is submitted by the National Association of Real Estate Investment Trusts® (NAREIT) to provide input on the *Proposed Statement of the Governmental Accounting Standards Board – Leases* (the 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 real estate businesses throughout the world that own, operate and finance commercial and residential real estate. NAREIT's members play an important role in providing diversification, dividends, liquidity and transparency to investors through their businesses that operate in all facets of the real estate economy.

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 219 companies representing an equity market capitalization of $972 billion at April 29, 2016. Of these companies,

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177 were Equity REITs representing 94.4% of total U.S. stock exchange-listed REIT equity market capitalization (amounting to $918 billion)[1]. The remainder, as of April 29, 2016, is represented by 42 stock exchange-listed Mortgage REITs with a combined equity market capitalization of $54 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.

NAREIT's interest in responding to the Proposal relates to some of our members that are landlords to state and local governments. Our comments in this comment letter are focused on the Exposure Draft's single approach to lessee accounting.

NAREIT's recommendation: Adopt the FASB's new Leases Standard

NAREIT understands that lease accounting was converged between Financial Accounting Standards Board (FASB) and Governmental Accounting Standards Board (GASB) prior to the FASB's work with the International Accounting Standards Board (IASB) to improve lease accounting standards globally. A primary driver for the FASB and IASB efforts to amend lease accounting was based on concerns that operating leases represented a form of off balance-sheet financing. After ten years of work, we believe that the FASB addressed these concerns by:

- Requiring that all lease liabilities be recorded on the balance sheet;
- Recognizing that there is more than one type of lease; and,
- Maintaining a dual approach to lease accounting.

We acknowledge that the FASB and IASB did not reach a converged lessee accounting model largely based on differing views among financial statement users in the U.S. and the rest of the world. However, we find it odd that the GASB would pursue a lessee accounting model more akin to IFRS than U.S. GAAP since GASB reporters will be reporting in the U.S. In our view, it would be incongruent to have economics of an identical lease transaction be recorded differently within the same jurisdiction. Therefore, we believe that it would be prudent for GASB to follow the FASB's lead in acknowledging that there are different types of leases that require different accounting.

While some long-term leases are, in substance, a means of financing the purchase of an underlying asset, other leases are more akin to obtaining a right to access and use an asset. The fallacy of accounting for all leases as financings can be best illustrated with leases of real estate. For example, a single floor of a ten story office building cannot be purchased; rather the space

[1] https://www.reit.com/sites/default/files/reitwatch/RW1605.pdf on page 21.

can be rented for a certain period of time (*e.g.*, 5 or 10 years). In such cases, an expense pattern consistent with operating leases (*i.e.*, straight-line over time) better reflects the underlying economics of the transaction as the right to use the asset for a period of time as opposed to accounting for the transaction as a hypothetical asset purchase and incurrence of debt.

Further, while the period over which the space would be used would be consistent with the term of the lease, accounting for the transaction as a form of debt would result in a front-end loaded expense recognition pattern. Consistent with the financing model, higher expenses would be reported in the earlier years of the lease and lower expenses in the later years. We contend that accounting for a lease as a financing would misrepresent the underlying economics of the transaction, as title to the leased asset would not pass to the lessee. Rather, at the end of the lease, the underlying asset is still the lessor's asset.

NAREIT strongly believes that maintaining a dual approach to lessee accounting would provide the GASB with three fundamental benefits:

- The dual approach would meet the GASB's underlying objective to recognize most leases as assets and liabilities;

- The dual approach would benefit financial statement users who are familiar with the current approach to lease accounting; and,

- Most importantly, acknowledging different types of leases would more faithfully represent the underlying economics of leasing transactions.

NAREIT supports the GASB's efforts to improve financial reporting. 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,

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