

ALERT

NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS[®]

FASB Votes to Allow the Continued Capitalization of Rental Costs Incurred During Construction for Most Properties Developed by NAREIT Member Companies

SUMMARY

On July 19, 2005, the Financial Accounting Standards Board (FASB or Board) issued a proposal that would have required that all rental costs incurred during the construction of a related asset be expensed. NAREIT and a number of member companies strongly opposed the proposal, maintaining that rental costs incurred during the development of real estate represent direct and integral costs of the property. In a significant switch, at its Sept. 21 meeting the FASB voted to allow the continued capitalization of rental costs incurred during construction of properties covered by Financial Accounting Standard No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects* (FAS 67). The great majority of properties developed by NAREIT member companies are covered by FAS 67. Therefore, rental costs incurred during the development of most property developed by NAREIT member companies may continue to be capitalized.

BACKGROUND

In response to the Securities and Exchange Commission (SEC) letter dated Feb. 7, 2005

discussing certain lease accounting issues, a number of companies (primarily retailers) raised the question with the SEC as to whether rental costs associated with ground and building leases that are incurred during the construction of a related asset may be capitalized. Consequently, in response to a request by the SEC, on July 19, 2005, the FASB issued an exposure draft of a Financial Statement Position (FSP) that would require that all rental costs incurred during construction be expensed as incurred.

Most NAREIT member companies today capitalize rental costs directly related to the construction of a property. Under the proposed July 19 approach, NAREIT members that currently capitalize rental costs during construction would have been required to expense these costs. Neither ground rents nor space rentals incurred during the construction of a related asset could have been capitalized under the proposed rule. Consequently, under the current FFO definition, the proposed July 19 change in accounting would have reduced both FFO and net income for these companies.

NAREIT, as well as Archstone-Smith, Forest City Enterprises, Inc. and Taubman Centers, Inc., filed comment letters with the FASB, providing a compelling rationale, within the context of GAAP, that convinced a majority of Board members that the proposed rule should not be applicable to rental costs associated with the development of property held for sale or rent. These comment letters are available [HERE](#).

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At its Sept. 21 meeting, the FASB voted to allow the continued capitalization of rental costs incurred during construction of properties covered by FAS 67. Since the great majority of property developed by NAREIT member companies is covered by FAS 67, our member companies will continue to be able to capitalize rental costs incurred during the development of a property.

SEC Proposes Changes to the Definition of an Accelerated Filer and Deadlines for Filing Periodic Reports:

On Sept. 21, 2005, the Securities and Exchange Commission (SEC) voted to propose for comment amendments to filing deadlines for periodic reports and changes in accelerated filer definitions, as well as to postpone for an additional year the compliance date for filing internal control reports by companies not designated as accelerated filers. Under the proposed rules, issuers that meet the existing definition of an accelerated filer and that also have a worldwide public float of at least \$700 million would be considered “large accelerated filers.” These filers would be required to file

10-Ks within 60 days of year-end and 10-Qs within 40 days of each quarter-end. Accelerated filers, those with public floats of \$75 million but with a worldwide float of less than \$700 million, would be required to file 10-Ks within 75 days of year-end and 10-Qs within 40 days of each quarter-end. These filing requirements are 15 days and five days respectively later than deadlines currently scheduled to become effective. No changes in the filing requirements for non-accelerated filers are proposed. The proposal also eases restrictions on the process for exiting accelerated filer status.

Click [HERE](#) to access the SEC release.

Any questions regarding this matter should be directed to [George Yungmann](#) at 202-739-9432 or [Gaurav Agarwal](#) at or 202-739-9442.

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The existing (assuming the final stage of acceleration is completed as currently scheduled) and proposed filing schedule is summarized as follows:

Public Float Threshold	Form 10-K		Form 10-Q		
	Current*	Proposed	Current*	Proposed	
Large accelerated filers	\$700 million	60 days	60 days	35 days	40 days
Accelerated filers that are not large accelerated filers	\$ 75 million	60 days	75 days	35 days	40 days
Non-accelerated filers	<\$75 million	90 days	90 days	45 days	45 days

*Currently, the filing deadlines for all accelerated filers are scheduled to be 60 days for Form 10-K for fiscal years ending on or after December 15, 2005 and 35 days for Form 10-Q for fiscal quarters of fiscal years ending on or after December 31, 2006.