NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

September 18, 2013

Technical Director
File Reference No. 2013-270
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

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

Submitted via electronic mail to director@fasb.org

Re: FASB File Reference No. 2013-270, *Leases (Topic 842)*, a revision of the 2010 proposed FASB Accounting Standards Update, *Leases (Topic 840)* & IASB Exposure Draft – *Leases* (ED/2013/6)

Dear Sir/Madam:

This letter is submitted in response to the request for public comment by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively, the Boards) with respect to the FASB Proposed Accounting Standards Update (Revised) on *Leases (Topic 842) Leases* and the IASB Exposure Draft - *Leases* (ED/2013/6) (collectively, the Revised Proposed Updates).

NAREIT is submitting these comments on behalf of the following member organizations of the Real Estate Equity Securitization Alliance (REESA):

- Asia Pacific Real Estate Association (APREA)
- British Property Federation (BPF)
- European Public Real Estate Association (EPRA)
- National Association of Real Estate Investment Trusts in the United States (NAREIT®)
- Property Council of Australia (PCA)
- Real Property Association of Canada (REALpac)

♦ ♦ ♦
1875 I Street, NW, Suite 600, Washington, DC 20006-5413
Phone 202-739-9400   Fax 202-739-9401 REIT.com

REESA is a global alliance of representative real estate organizations and seeks to promote equity investment in real estate on a securitized basis. Together, the members of REESA represent the vast majority of constituent companies in the FTSE EPRA/NAREIT Global Real Estate Index. REESA focuses on cross-border investment, international taxation, financial reporting standards initiatives and education outreach to investors. REESA members represent major operating real estate companies (including REITs) – companies that acquire, develop, lease, manage and opportunistically sell investment property.[1]

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

We thank the Boards for the opportunity to provide further input on the Revised Proposed Updates. If you would like to discuss our comments, please contact George Yungmann, NAREIT's Senior Vice President, Financial Standards, at 202-739-9432, or Christopher Drula, NAREIT's Vice President, Financial Standards, at 202-739-9442.

Respectfully submitted,

George Yungmann
Senior Vice President, Financial Standards

Christopher Drula
Vice President, Financial Standards

[1] REESA's broad mission is to improve the opportunities for investment in securitized real estate equity around the globe. The purpose and activities of REESA are discussed further in Appendix I.

REESA comments and recommendations on FASB File Reference No. 2013-270, *Leases (Topic 842)*, a revision of the 2010 proposed FASB Accounting Standards Update, *Leases (Topic 840)* & IASB Exposure Draft – *Leases* (ED/2013/6)

Preserve the Type B Lease Accounting Model for Property that Recognizes Lease Income on a Straight-line Basis

REESA commends the Boards for their extensive consultation and thoughtful response to our comments. We strongly support the Revised Proposed Updates to allow most lessors of property to continue to recognize the full rental income and underlying property. Total lease income and the visibility over the underlying property are fundamental for investors to be able to assess the performance and investment quality of property companies. This view has been communicated via a submission to the Boards from global real estate investors and industry analysts, and is included as Appendix II to this letter. Removing these metrics would adversely impact the information that property companies communicate to investors, financial analysts and other users of financial statements and would represent a major step backwards in the global industry's efforts to provide meaningful information to financial statement users. In this respect, the proposed model for property is a clear improvement on the model originally proposed in the first exposure draft.

The Revised Proposed Updates would provide financial statement users with information that faithfully represents the underlying economics of *most* property leases for lessors/landlords. As outlined in previous submissions[2] as well as discussions with the Boards and staff, we do not believe that the receivable and residual lessor accounting model is operational for investment property.

Our discussions with real estate analysts reveal that analysts would be forced to unwind the accounting results from the receivable and residual model to effectively evaluate the investment quality of our member companies. This is a significant concern, as analysts would be making buy or sell recommendations based on unaudited financial information provided by our member companies.

We therefore urge the Boards to collaborate on a converged accounting model for property that preserves:

- the property as a single unit of account on balance sheet;

- the recognition of lease income on the income statement generally on a straight-line basis; and,

- the option to present the fair value of right-of-use assets that meet the definition of investment property on the balance sheet in accordance with International Accounting Standard 40 *Investment Property*.

[2] http://www.reit.com/Portals/0/PDF/REESACommentLetter07112011.pdf

We understand that certain of the Boards' constituents may advocate that all leases be accounted for under a single approach. REESA would not object to this conclusion and would fully support it so long as the single approach mirrors the currently proposed approach for Property or Type B leases. In addition, we believe that the vast majority of financial statement preparers and users support the straight-line lease expense pattern yielded by the approach proposed for Type B leases.

We caution the Boards that a conclusion to provide only one approach to accounting for all leases that would require the proposed accounting for Type A leases would not be operational for lessors of multi-tenant investment property. The basis for this view is thoroughly discussed in REESA's July 11, 2011 submission to the Boards[3].

Additional Enhancements to the Revised Proposals

REESA recommends that the Boards consider the following enhancements to the Revised Proposals:

Clearly articulate the definition of "lease term"

REESA concurs with the Revised Proposal that defines the lease term as the non-cancellable period for which a lessee has the right to use the property.

However, we recommend that the current concept of 'reasonably certain' be retained because:

- the Board has acknowledged in BC 140 that the current concept works well in practice and the threshold is expected to be similar to the current concept of 'reasonably certain'; and,

- the definition of 'significant economic incentive' may be less clear than 'reasonably certain.'

We understand that the Boards are concerned that entities would structure shorter term leases with more renewals. However, there is an economic disincentive for lessees to do this as lessors would be able to reset rental payments to the then-current market rent, which would generally increase the fixed rental payments.

In addition, it is common for new lease incentives to be negotiated when the terms of a renewal are being negotiated. In our view, recognizing the lease incentive on a straight-line basis beyond the non-cancellable period of the lease is inappropriate.

Further, REESA is concerned about the continuous reassessment of the lease term. While the

[3]http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175822733314&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs

Revised Proposals only require reassessment when a lessee has, or no longer has a significant economic incentive to renew, or terminate a lease, we question whether practically this is any different to requiring a reassessment at each reporting date.

Classify leases based on the comparison of lease term to the total economic life, rather than to the remaining economic life

REESA agrees with the Revised Proposal that would require the comparison of the lease term to the economic life of the property and the lease payments to the fair value of the property as an appropriate basis for determining whether or not a lessor should apply Type B accounting**.** However, the lease term should be compared to the total economic life, rather than the remaining economic life of the property.

While this scenario is unlikely to arise frequently in the real estate industry, it is not appropriate for a five year lease of property with a ten year remaining economic life to be recognized differently from a five year lease of property with a five year remaining economic life (where the total economic life of both properties was originally 50 years).

Rental payments made by the tenant to the landlord relate partly to the floor space being occupied, but also more significantly to the location of the property. This is demonstrated through different rates per square metre being charged for properties of the same quality in different locations. The value of the location continues to exist at the end of the building's economic life and the landlord holds the residual interest in the property. This enables redevelopment should the landlord choose which would further extend the economic life of the building.

It would therefore not be appropriate to reflect a five year lease of property with a five year remaining economic life (where the total economic life was originally 50 years) as a type A lease, unless the present value test is met.

Assessment of land and buildings together

We agree with paragraphs 842-10-25-9 (FASB exposure draft (FASB ED)) and 33 (IASB exposure draft (IASB ED)) that land and buildings should be assessed together for the purpose of determining the appropriate classification of a lease. However, we are concerned that the Revised Proposed Updates would require the economic life of the building would always be considered to be the economic life of the underlying asset for the purposes of classifying the lease. There are circumstances in which the land element is significantly more valuable than the building. In these cases, it is incorrect to default to the remaining economic life of the building because the land is the more valuable underlying asset and represents the primary asset.

Therefore, we recommend that the guidance in paragraphs 842-10-25-10 (FASB ED) and 33 (IASB ED) be deleted from the final standards. This would ensure that preparers are able to apply the principles in paragraphs 842-10-25-9 (FASB ED) and 33 (IASB ED) in making the determination of the primary asset when a lease contains multiple elements.

Consistently apply the consumption principle to long-term land leases

It is common for real estate companies to lease land under land-only leases, especially in central business districts and other areas where land is owned by local governments. Many of these long-term leases may meet the proposed criteria that define a Type A lease based on the relationship between the present value of the lease payments and the fair value of the land at the lease commencement date. Classifying these long-term land leases as Type A leases is clearly contrary to the overarching consumption principle in the Proposal.

The conclusion that a lease of land should invariably be classified as a Type B lease is also supported by the following discussion taken from the Snapshot: Leases published by IFRS in May 2013[4]:

> *A lessee that enters into a Type A lease, in effect, acquires the part of the underlying asset that it consumes, which is typically paid for over time in the form of lease payments. Accordingly, a lessee would present amortization of the right-of-use asset in the same line item as other similar expenses (for example, depreciation of property, plant, and equipment) and interest on the lease liability in the same line item as interest on other, similar financial liabilities.*
>
> *In contrast, the lease payments made in a Type B lease would represent amounts paid to provide the lessor with a return on its investment in the underlying asset, i.e., a charge for the use of the asset. That return or charge would be expected to be relatively even over the lease term. Accordingly, those payments for use are presented as one amount in a lessee's income statement and recognized on a straight-line basis.*
> *The presentation of cash outflows in the cash flow statement is consistent with the presentation of expenses in the income statement. For Type A leases, the principal portion of cash payments is presented within financing activities and the interest portion within operating or financing activities. Cash payments for Type B leases are presented as one.*

REESA believes that the accounting described above supports the conclusion that land leases represent Type B leases based on the consumption principle.

Further, under current US GAAP, land only leases are considered operating leases unless it is probable that a purchase option would be exercised. One indication that this would occur would be the existence of a bargain purchase option at the end of the lease term.

We understand that the Boards discussed the accounting for long-term land leases at some point in the process of developing a converged leases standard. We believe that the conclusion reached at that time was made prior to the Boards' conclusion to use the consumption principle to distinguish Type A and Type B leases. We urge the Boards to reconsider its conclusion with respect to accounting for land-only leases and strongly recommend that the final standard

[4] http://www.ifrs.org/Current-Projects/IASB-Projects/Leases/Exposure-Draft-May-2013/Documents/Snapshot-Leases-May-2013.pdf

require that all land leases be classified and accounted for as Type B leases consistent with the Proposal's consumption principle.

At the same time, REESA strongly supports the lessee requirement in the IASB ED for leases to be reported as investment property under IAS 40. Paragraph 35 of the IASB ED makes clear that a lessee shall not classify a lease as a Type A or a Type B lease if it chooses to measure the ROU asset in accordance with the fair value model in IAS 40.

REESA – The Real Estate Equity Securitization Alliance

REESA is made up of seven real estate organizations around the world grounded in one or more facets of securitized real estate equity. REESA's broad mission is to improve the opportunities for investment in securitized real estate equity around the globe. The REESA member organizations are:

- Association for Real Estate Securitization in Japan (ARES)
- Asia Pacific Real Estate Association (APREA)
- British Property Federation (BPF)
- European Public Real Estate Association (EPRA)
- National Association of Real Estate Investment Trusts in the United States (NAREIT®)
- Property Council of Australia (PCA)
- Real Property Association of Canada (REALpac)

REESA has responded positively to the challenges presented by the developments in the global economy and, in particular, the global real estate markets. The benefits of collaboration on a global scale are increasingly valuable on major industry issues such as the sustainability of the built environment, tax treaties, corporate governance and research.

The formation of REESA was, in part, a direct response to the challenge and opportunity presented by the harmonization of accounting and financial reporting standards around the world. Given the size and importance of the real estate industry, our view is that there are considerable benefits to be gained by both accounting standard setters and the industry in developing consensus views on accounting and financial reporting matters, as well as on the application of accounting standards.

Since its formation REESA members have exchanged views on a number of accounting and tax related projects and shared these views with regulators and standards setters. These projects include:

- FASB *Investment Companies*
- FASB *Investment Property Entities*
- IASB *Investment Entities*
- FASB *Consolidation: Principle versus Agent Analysis*
- IASB *Agenda Consultation 2011*
- FASB/IASB *Accounting for Leases*
- FASB/IASB *Financial Statement Presentation*
- FASB/IASB *Reporting Discontinued Operations*
- FASB/IASB *Revenue from Contracts with Customers*
- FASB/IASB *Effective Dates and Transition Methods*
- IASB *Fair Value Measurement*
- IASB *Income Tax*

- IASB *Real Estate Sales – IFRIC D21*
- IASB *Capitalization of Borrowing Costs – IAS 23*
- IASB *Accounting for Joint Arrangements – ED 9*
- IASB *Consolidated Financial Statements – ED 10*
- IASB *2007/2008/2009 Annual Improvements to IFRS*
- OECD developments on cross border real estate flows and international tax treaties

Appendix II

EUROPEAN PUBLIC
REAL ESTATE ASSOCIATION

13 September 2013

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: FASB File Reference No. 2013-270, *Leases (Topic 842)*, a revision of the 2010 proposed FASB Accounting Standards Update, *Leases (Topic 840)* & IASB Exposure Draft – *Leases* (ED/2013/6)

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 Draft: 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) these financial statement users have a strong interest in ensuring that the reporting related to investment property is relevant and transparent.

Recognition of investment property and rental income in line with current IFRS

We are fully supportive of the conclusion reached by the Boards to allow lessors of investment property to continue to recognise the investment property on the lessor's Balance Sheet and full rental income on the lessor's Income Statement for the vast majority of leases. The proposed accounting provides decision-useful information on which to base our evaluation of the investment quality of investment properties and companies that own and operate portfolios of investment property. In addition, the proposed accounting is broadly consistent with current accounting guidance for most commercial real estate leases under both IFRS and U.S. GAAP.

As stated in our letter of November 2010, information regarding the full amount of rental income is fundamental to investors in assessing the performance and investment quality of investment property companies. That is why International Accounting Standard No 40 *Investment Property* (IAS 40) is well supported by industry financial statement preparers reporting under IFRS and industry financial statement users. It requires a property company to disclose the fair value of its property and reports full rental income in the profit and loss account.

We acknowledge the Boards' recognition of IAS 40 in the proposed guidance for accounting by lessees that control property through leasehold interests. Under the proposed accounting, companies that lease property that qualifies as investment property under IAS 40 would be accounted for as investment property. This would include the choice to report these properties at fair value.

Finally, we want to reiterate our previously expressed view that removing the visibility over the investment property, as well as the full rental income, would represent a step backward in terms of investment property companies communicating effectively the profitability and financial position of the company to investors, analysts, and other users.

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 Andrew Saunders at andrew.saunders@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)	E-mail
John Robertson	RREEF	36,700	CONTACT DETAILS PROVIDED SEPARATELY
Guido Bunte	Cornerstone Real Estate Advisers	29,600	
Roger Lees	Aviva Investors	28,500	
Rafael Torres Villalba	All Pension Group (APG)	25,000	
Marc Halle	Pramerica/Prudential	23,400	
Rogier Quirijns	Cohen & Steers	22,300	
Alex Jeffrey	M&G Real Estate	19,000	
Simon Robson	CBRE Clarion Securities	17,400	
Hans Op 't Veld	PGGM Investments	15,400	
Timothy Pire	Heitman	15,300	
Patrick Sumner	Henderson Global Investors	13,000	
Theodore Bigman	Morgan Stanley Investment Management	12,100	

Investment institutions contd.

Bill Hughes	Legal & General Property	10,900	CONTACT DETAILS PROVIDED SEPARATELY
Andrew Jackson	Standard Life Investments	10,400	
Craig Mitchell	Dexus Property Group	9,400	
Saker Nusseibeh	Hermes Real Estate Inv Management	6,500	
Robert Oosterkamp	AEW Global Advisors	6,030	
Stephen Tross	Bouwinvest REIM	6,000	
James Rehlaender	European Investors, Inc	5,100	
Jan Willem Vis	BNP Paribas Investment Partners	3,000	
Jos Short	Internos Global Investors	2,000	
Mark Townsend	Asset Value Investors	1,800	
Frank Haggerty	Duff & Phelps Investment Management	1,400	
Steven Brown	American Century Investments	1,400	
Matthijs Storm	Kempen & Co	1,100	
Vincent Bruyère	Degroof Fund Management Company	250	
Charles Fitzgerald	V3 Capital Management LP	190	

Investment analysts

Name	Organisation	Email
John Lutzius, Mike Kirby	Greenstreet Advisors	CONTACT DETAILS PROVIDED SEPARATELY
Harm Meijer	JP Morgan	
Bart Gysens	Morgan Stanley	
Jan Willem van Kranenburg	ABN AMRO	
Alex Moss	Consilia Capital	
Nick Webb	Exane BNP Paribas	
Steven Sakwa	ISI Group	