NAIOP
COMMERCIAL REAL ESTATE
DEVELOPMENT ASSOCIATION

December 10, 2010

Ms. Leslie Seidman
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

**Subject: File Reference: No. 1850-100, Exposure Draft: Leases and Exposure Draft, Leases, ED/2010/9**

Dear Chairman Seidman:

NAIOP, the Commercial Real Estate Development Association, is the leading organization for developers, owners and related professionals in office, industrial and mixed-use real estate. NAIOP comprises 15,000 members in North America. On behalf of our members, I am writing to provide comments on the Financial Accounting Standards Board's ("FASB") proposed changes to current lease accounting standards.

Our members appreciate the importance of greater transparency in financial reporting to investors, and to the domestic and international capital markets as a result. We commend FASB for its efforts in this regard, and support the goal of reducing complexity in existing accounting requirements. We have serious concerns, however, that the results of the proposed lease accounting standards for the commercial real estate industry will in fact be to increase complexity and reduce the usefulness of financial statements to investors, while leading to potentially harmful effects upon the availability of capital for our industry. At the same time, the administrative costs imposed on our members by the new lease accounting procedures, which would necessitate widespread changes in internal controls and management systems, would be substantial.

We are very concerned that the unintended negative impact of FASB's changes to lease accounting standards will be felt at a time when the industry will still be recovering from one of the most challenging economic times in our nation's history. A healthy real estate economy is vital to a prosperous U.S. economy and produces an immense ripple effect with job creation and personal earnings that quickly roll over into increased consumer spending. A recent study by the NAIOP Research Foundation shows that total real estate construction spending in 2009 reached $900 billion — approximately 6.4 percent of the nation's Gross Domestic Product. Commercial development supports 2.4 million full-time equivalent jobs in the United States, and generates personal earnings of $89.1 billion. These numbers show that, even as the industry remains fragile, its importance to our nation's overall economic recovery should not be discounted.

Consequently, we believe that FASB should proceed with implementation of the proposed lease accounting standards only after analyzing and adequately addressing the concerns raised by the commercial real estate industry, and suggest that the current implantation dates be delayed until alternative approaches that will achieve FASB's goals of increased transparency in financial reporting of lease transactions are developed.

Our major concerns are set forth and explained below.

**Effect on Duration of Lease Terms.** The proposed lease accounting standards would require the lessee/tenant to account for a lease contract's rights and obligations as assets and liabilities. All operating leases for real estate will have to be capitalized on corporate balance sheets. Lessees will have to estimate all likely lease payments, including estimating lease renewals, contingent rents, purchase options, and record their present value (using the lessee's incremental borrowing rate). Rental payments, currently treated as an operating expense, would be treated as a loan, with imputed interest expense. The result would be that total lease costs would be front-ended as compared to their current treatment.

Our concern is that FASB's proposed lease accounting standard would result in lessees strongly incentivized to choose shorter lease terms, with no renewal options or contingent rent provisions. To do otherwise would increase their front-end costs and reduce their earnings, with a negative impact on their stock value. The lessee would understandably want to reduce the liability that it will be required to record for the lease transaction. In addition, the practical reality of the proposed accounting standards would be that lessees would have to document and disclose their future renewal intentions and what rents they expect to pay, affecting their negotiating posture with their landlords. This, coupled with the added complexity and the increased subjectivity inherent in the proposed standard (see below), will very likely encourage a trend toward the use of much shorter lease terms in the commercial real estate industry with adverse economic consequences.

**Impact on Availability of Capital.** The proposed lease accounting standards could result in an unintended reduction in the availability of capital for both lessees and lessors, and therefore unnecessarily harm the commercial real estate development industry. In general, property developers work hard to attract creditworthy tenants and sign them to long-term leases in order to obtain better financing and valuation terms. Because the strong incentive created by the proposed standards is for lessees to enter into shorter term leases to protect their own reported financial condition, the developer's financing challenges will be increased. In addition, investors (such as pension funds, insurance companies, and others) choose real estate in order to match assets to their long-term obligations, and shortened lease terms will undermine the attractiveness of real estate assets for these purposes. Ironically, lessors may ultimately have to respond by increasing contractual rents, resulting in added expense to the lessees.

Because of the front-ending of costs required under the proposed standard, most lessees and lessors could see immediate, large enough increases in their reported liabilities on their balance sheets to trigger violations of debt covenants in their various contractual agreements. Some lenders may possibly forego any actions, understanding that the violations are the result of accounting changes and not due to substantive deterioration in economic position of the borrower. But some lenders could also use the violations to accelerate loans, renegotiate terms, or charge additional fees to adjust the debt-covenant ratios. In addition, the immediate increase in liabilities may trigger credit rating downgrades for corporations with large real estate activity, further affecting their ability to access capital and debt markets.

**Increased Accounting Complexity and Subjectivity.** Under the proposed standards, lessees will need to estimate the likelihood of lease renewals and the exercise of options that may take years if not decades into the future under existing lease arrangements. This includes estimated payments and contingent rents that are not true current liabilities. Assumptions on what the economic landscape may be in five years, and therefore what business decisions will be made at that time, are extremely subjective at best and potentially misleading to investors. In fact, rather than making financial disclosures more useful to investors, such information will provide little meaningful information to the investor who is aware of its intrinsic conjectural nature. Yet those charged with complying with the proposed standards will still need to be engaged in an exercise that will require much hypothesizing as to future trends, and these assumptions of course will vary for every business entity. It is difficult to see how this inherent subjectivity, and resulting lack of comparability among different reporting entities as regards their financial information, would further FASB's goals of increasing transparency and helping investors in their assessment of the true financial condition of firms. It will do little to help investors compare the financial statements of different entities entering into similar lease transactions, for example.

**Administrative Costs.** We anticipate that the administrative and operating costs of complying with the proposed standards will be substantial. Lessees and lessors of investment real estate with a multitude of lease transactions will face added costs in terms of changes or additions to their information technology systems, increased complexity in their financial accounting and reporting processes and their internal controls. Existing lease systems lack computational ability for many of the critical activities called for by the proposed standards, and the determination of what is "most likely" to occur in terms of future business decisions will require additional time and effort and the judgment of senior management, increasing costs in terms of the organization's human capital. Tools for tracking leases and projections will need constant review and modification, and estimates will need repeated modifications as economic conditions (or assumptions) change. The proposed lease standards will require the continuous updating of estimated future lease payments based on these changes to estimated lease terms, renewals, or contingent rental payments.

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In summary, we believe that the proposed lease standards as currently drafted will encourage lessees to choose shorter lease terms for financial reporting purposes and not for any substantive economic reasons. We fear this will have far-reaching negative implications for the commercial real estate development industry in terms of reducing the availability of capital. Moreover, the proposed lease standards will do little to improve the transparency or usefulness of the reported information to investors, instead increasing complexity, injecting added subjectivity, and all at increased administrative and compliance costs to lessees, lessors and the real estate investment community.

We thank you for the opportunity you have provided us to express our concerns and to comment on FASB's proposed lease accounting standards.

Sincerely,

Thomas J. Bisacquino
President and CEO