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Technical Director

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File Reference No. 1680 - 100

Re: *Discussion Paper: Leases – Preliminary Views (Response to Lessor/Landlord Aspects)*

Thank you for the opportunity to provide comments on this Discussion Paper.

Founded in 1957, the International Council of Shopping Centers (“ICSC”) is the premier global trade association of the shopping center industry. Its nearly 65,000 members in 90 countries include shopping center owners, developers, managers, marketing specialists, investors, retailers and brokers, as well as academics and public officials.

For purposes of this letter, we are responding to the aspects of the Discussion Paper that relate to lessors. In the case of malls and shopping centers, lessors are considered the landlords or owners of investment property.

Our landlord members include mall owners who own a wide variety of malls, from the small local shopping center to a large outdoor mall such as the Woodbury Premium Outlets in Harriman, NY to an enclosed mall such as the Danbury Fair Mall. Please refer to our letter pertaining to tenants/ lessees to further understand the nature of this business.

Background on the Mall/Shopping Center Industry

Background

For purposes of this response to the Discussion Paper, we use the term “mall” to represent enclosed malls, open-air malls and shopping centers. Also for purposes of this letter, we refer to lessees as tenants and lessors as landlords so as to properly convey the tone of the relationship between the two parties. We also prefer to describe the asset as the property, conveying the composition of a mall as consisting of many rentable store sites, common areas, food courts and parking facilities.



Larger malls are owned by corporations or partnerships which elect to be taxed under U.S. tax law as a Real Estate Investment Trust (REIT). REITs are not taxed separately provided the REIT distributes at least 90% of its taxable income. Under US federal tax law, the REIT itself is not taxed however the stockholders are taxed on dividends received and capital gains distributed.

Although rents are the major source of revenue for a mall, a significant portion a mall's gross revenue also comes from tenant reimbursements and overage rent charges. For instance, Simon Properties, one of the largest REITs, typically has generated 60 - 65% of its gross revenue from rents, 30% from tenant reimbursements and 5% from overage rent.

Tenant reimbursements represent expenses associated with common charges and mall maintenance allocated to tenants, usually based on their relative square footage. Common areas, facilities and other components of the mall, such as parking areas, food courts, elevators and escalators are available for use by all mall tenants and customers. Overage rent charges represent rents due as a percentage of the tenant's sales after the sales have reached a specified level. Both tenant reimbursements and overage charges are generally considered contingent rent.

Executive Summary

The operating characteristics of a mall described above and the current US and IAS GAAP, accounting practices and options available should all be considered when formulating appropriate lease accounting standards for this business segment.

Summary ICSC Conclusions

- We do not believe that *either* proposed lessor accounting model properly reflects the economic characteristics of tenant leases or the nature of owning and actively managing a mall. In fact we believe that if adopted, the proposals would distort the presentation of the true financial results and business metrics used for investment property such as a shopping mall.
- Revenues from malls are generated from the services provided by the landlord in addition to the base rents for the space itself. The overall level of rents and other revenues that can be charged is directly related to the management of the mall, including the design, servicing and character of the mall, as well as the mix of tenants in the mall.
- Unlike equipment leasing, a lease of an individual store is not a financing either *for* the tenant or *by* the landlord, but an agreement whereby the landlord provides space and services in exchange for receiving rent from the tenant with the tenant complying with the occupancy standards established by the mall owner.
- The fair value of mall property is substantially related to the value of the total of all the in-place leases, which are influenced by the active management of the mall by its landlord. A single store lease in a mall does not have any intrinsic value of its own



and is dependent on the overall value of the mall, which is also dependent on the other existing leases. For instance, a lease for space in a mall on the decline has a substantially different value than a lease for the same space in a mall that is on the rise because it just added a premium anchor tenant.

- Unlike most equipment leasing, which is based on a financing, landlords of investment property do not provide tenants with the right of “quiet enjoyment”. Rather, the tenants must also comply with the landlord’s standards of performance with respect to hours of operation and operating practices.
- Malls are universally considered to be real estate investment property and the landlord actively manages all aspects of the mall. The business of mall ownership and management should be accounted for as such.
- We believe that in the development of a new lessor accounting standard, the FASB should *exclude* investment property from the standards and instead recommend applying the general revenue recognition criteria proposed in the Discussion Paper “*Preliminary Views on Revenue Recognition in Contracts with Customers*” (the “Revenue Recognition Discussion Paper”) as it relates to real estate leases and taken in the context of IAS 40, “*Investment Property*.”
- Our discussion below is meant to analyze the lessor alternatives initially proposed and attempts to apply them in the context of a mall and its tenant leases. After such analysis, it becomes clearer why investment property should be excluded from the scope of the Discussion Paper and from any lessor lease accounting standard being developed.

Detailed Discussion of ICSC Response

- *Evaluating Alternative Lessor Lease Accounting Models*
 - We believe that the operating business of the landlord, the terms and conditions of the lease, the nature of the property being leased and the business model which defines the tenant lease should all be considered when determining which lease accounting model or alternative model is appropriate. Since neither accounting model presented represents the landlord’s economic model, an alternative approach should be developed, ostensibly an approach akin to the current operating lease model but adjusted to reflect considerations included in the Revenue Recognition Discussion Paper as well as IAS 40.
 - We believe that the underlying investment property business model should not be ignored for the sake of simplicity, standardized treatment or lessee/lessor accounting synchronization.



- *Existing U.S. GAAP Lease Accounting Rules and Industry Practices*
 - Often the initial mall owner is the developer of the property who constructs it, capitalizing construction costs, related legal costs, debt issuance fees and construction interest costs incurred during the construction of the property, until it is available to be occupied.
 - Malls are continuously maintained and upgraded by the landlord. The landlord is responsible for all repairs and maintenance of the property. Often major repairs, improvements and reconfiguration costs are capitalized into the overall property value when they extend the useful life of the property.
 - Under current US GAAP, a mall landlord is treated as a lessor and subject to lease accounting standards under FAS 13. Virtually all tenant leases have previously been classified as operating leases by the landlords, because the leases do not qualify for direct finance lease accounting in accordance with any of the four classification tests found in FAS 13 ¶7. Classifying mall tenant leases as operating leases is similar to treating them as service arrangements.
 - Malls are largely considered to be one contiguous property consisting of individual spaces leased to a large number of separate stores over many different lease terms. Unlike the leasing of a single asset to a single lessee at one time, a mall is divided up into many different sites that can be leased, resulting in many different individual revenue streams of varying durations. The configuration of these individual sites can also change, often with relatively little construction effort.
 - The landlord treats tenant reimbursements as revenue because the landlord is directly responsible for the services or expenses on which the reimbursements are based. That is, the tenants are not directly responsible for arranging or paying for the underlying services because only the landlord is authorized to do that. The tenants are charged a pro rata share of the costs as one component of their lease.
 - Tenant allowances (such as rent holidays) and other non-cash inducements are generally capitalized and amortized over the tenant lease term so as to produce overall straight-line revenue recognition. Tenant improvements reimbursed or paid by the mall owner are capitalized and depreciated over the life of the tenant lease term.
 - Under IAS GAAP, mall property is most often classified as investment property wherein the landlord may elect a cost approach or a fair value approach for accounting for the property value. Under the cost approach, the property is capitalized at historic cost and depreciated on a straight-line basis based on the individual useful lives of its components. Under



the fair value approach, the property is periodically valued at fair value and gains or losses from changes in fair value are recognized in income.

- *Investment Property Accounting Considerations*
 - In examining the investment property accounting methodology found under IAS and in light of the general trend towards fair value accounting, we believe consideration should be given to utilizing the revenue recognition criteria found in the *Revenue Recognition Discussion Paper*, taken in the context of the IAS 40 investment property accounting standard, particularly with regards to the definitions included in IAS 40, as an alternative to requiring landlords to adopt one of the proposed standards that we believe are inappropriate for mall property.
 - Since many such real estate properties are owned by REITs which seek income from capital appreciation as well as rental income, we believe that the IAS 40 fair value election should also be explored for use however considered in light of the complex US tax rules that guide REITs.
- *Applicability of Transfer Model*
 - We believe that the *Transfer Model* discussed below clearly is *inappropriate* for the landlord to follow when the landlord has leased multiple individual stores within a mall. As discussed below, a mall is a single indivisible property leased out under multiple different leases wherein the landlord provides many services beyond simply supplying space. As such a landlord cannot realistically divide up a mall into separate measurable transaction units and identify the estimated portion of the mall transferred with each lease, nor estimate a realistic residual value for any individual lease. Any transfer would theoretically include a portion of common areas.
 - We believe that assigning a separate residual value to indivisible property each time a store site is leased in accordance with the *Transfer Model* and recognizing *only* finance income over each lease term *does not represent* the true economic model of these tenant leases for the landlord. Rather, these leases are viewed as short-term rentals combined with extensive landlord services and property management. A portion of the usable life and functionality of the property is not transferred to the tenant per se; rather the landlord has provided a range of services to the tenant, including providing occupancy space.
 - We also believe that the *Transfer Model* is *inappropriate* for the lease of a *standalone single-tenant building* within a mall perimeter. Since even a standalone building property is integral to the mall taken as a whole, its value is dependent on the overall value of the mall. Such property may be



leased out to several tenants several times for relatively short periods of time over its life, and remains under the control of the mall landlord. We

believe that a lease of such property should also be considered in light of the Revenue Recognition Discussion Paper and IAS 40 Investment Property standards already in existence.

- *Applicability of New Rights Model*
 - We believe that the *New Rights* model for landlords renting out space in malls is also *inappropriate* because it does not reflect the economic arrangement between the landlord and the tenant, nor reflects a true picture of the landlord's revenue model or investment.
 - Reporting the lease receivable asset due from tenants on the balance sheet in addition to the asset itself *does not provide* any additional transparency for financial statement readers and obscures the balance sheet of the landlord by presenting two interrelated assets (the leases and the property). This suggested presentation might even result in "double-counting" of the same values, since the value of the leases directly influences and is included as part of the value of the property itself. That is, if a landlord acquires an existing mall with in-place leases, the price paid for the mall is determined by reference to the property's tangible value as well as the value of the underlying leases. Recording the leases separately would be double-counting the same values. Essentially a mall with in place leases is viewed as an existing business, not simply as property being leased.
 - We believe that a financial statement reader can understand the gross future contracted cash flows that the landlord is expected to receive based on existing information contained in the footnotes to the financial statements. Placing a new, single value on the face of the balance sheet leads the reader to conclude that two separate assets exist while in fact only one asset exists, namely investment property.
 - Bifurcating the rental amounts into a finance income component and straight-line revenue component from providing the property is not a true representation of the landlord's revenue and is an arbitrary dividing of the revenue stream; since the landlord nor does tenant believe that a financing has been provided. Rather the landlord and tenant both believe that services are being provided and that such services are properly reflected on a straight-line basis.
- *Initial Direct Costs*
 - For those leases included within the scope of the Discussion Paper, we disagree with the expensing of initial direct costs associated with entering such agreements. We believe that such costs would otherwise be capitalized if the transaction was structured as the acquisition of any asset, whether the asset



being acquired is a physical asset or an intangible asset and thus should also be capitalized as part of the value of the asset.

- We also believe that costs associated with entering into a new tenant lease should be considered initial direct costs and that these costs should be allocated over the lease term to match the timing of the delivery of the services.

Analysis of Discussion Paper Lessor Proposal

- The Discussion Paper explores applying the *right-of-use* model being proposed in lessee accounting, to the lessor in either of two distinct approaches.
 - *Transfer Model* – Wherein the lessor transfers the leased asset (or in the case of a mall, a portion thereof) to the lessee.
 - *New Rights Model* – Wherein a new right and obligation are created for the lessor as a result of the lease, while the lessor’s existing rights to the asset remain unchanged except for the effect of these new rights.
- The Board acknowledged that a model for lessors of real estate¹ and owners of investment property (such as that described in IAS 40 “*Investment Property*”²) might need to be considered separately when formulating the lessor accounting approaches.
 - The Board did not provide for any different consideration for *lessees* of real estate, indicating that lessees of real estate property would be subject to the standard as it is now being developed.
- *Transfer Model* – Under the *Transfer Model*, the lessor bifurcates the lease contract into two distinct components by *derecognizing* the leased item itself (or a portion thereof) and recognizing a financial asset (the lease receivable) and a non-financial asset (the residual value). This model is similar to the current direct finance lease model found in existing US GAAP.
 - Under the *Transfer Model* as applied in the context of a mall, the landlord would have sold or transferred a portion of the leased asset’s functionality to the lessee for the period of the lease term.³ Since the landlord has sold⁴ or transferred its own rights to use this designated property during the lease term, the landlord *derecognizes* all or a portion of the property in exchange for a lease receivable and then records a residual value equal to the future value of the portion of the functionality that they retain after the lease ends. The landlord’s new assets are recorded at their present value by also recording an offsetting unearned finance income credit amount.

¹ Discussion Paper ¶ 10.29

² Discussion Paper ¶ 10.45

³ Discussion Paper ¶ 10.6

⁴ Discussion Paper ¶ 10.6



- Under the *Transfer Model* the landlord would *not* report an *obligation* to provide the future use of the asset to the lessee since it does not result in the outflow of future economic benefits.⁵ Once the lessor has sold or transferred the portion of the property usage to the tenant, it has delivered the asset being leased and thus has *satisfied its performance obligation* to the tenant.⁶ This approach is viewed as being consistent with the lessee approach in the Discussion Paper⁷.
- The FASB's reference to the accounting for a direct finance lease indicates that *all of the income from the lease is considered finance income* and would be recognized over the lease term using an interest amortization approach. *All finance income* from the lease is recognized on a weighted average yield basis using a finance income methodology.
- The residual value portion of the lease and the receivable portion of the lease are effectively recorded at their present values by offsetting them with a single unearned finance income amount in the manner followed under direct finance lease reporting under FAS 13.
- The residual value is reported at the value the landlord expects to receive for that portion of the property at a future date. As stated above, during the lease term the residual value of the property is implicitly carried at its present value because it is unavailable to the landlord during the lease term. The residual value earns *finance income* that is accreted to its value until such value is equal to the future residual value as recorded at the end of the lease. Effectively the residual value portion is treated as if it were a "zero coupon bond" during the lease term.
- The receivable portion of the lease is also implicitly reported at its present value by reporting the gross lease receivable amount net of unearned finance income. The present value of the receivable portion is amortized down over the lease term until the balance of this portion of the lease investment is equal to zero, leaving only the residual value remaining.
- The lease receivable and the residual value both implicitly earn finance income at the *same rate* over the lease term despite the fact that they represent distinctly different risks. The lease receivable represents a credit risk and the residual value represents a future asset value risk.
- The FASB's reference to a sales-type lease and the Discussion Paper's description of the *Transfer Model* describe a transfer or sale of the *right of use*. This would raise the question as to whether the transfer or sale of the

⁵ Discussion Paper ¶ 10.9

⁶ Discussion Paper ¶ 10.9

⁷ Discussion Paper ¶ 10.10



right of use could also result in a gain, for instance when the property's carrying value transferred is less than the present value of the lease receivable plus the residual value received in exchange. For instance if a property is fully depreciated and then placed under lease, the present value of the lease (lease receivables plus residual value) would always be greater than the carrying value of the property. Effectively this might result in the recording of a sale and a profit.

- The Discussion Paper addressed the lease of a single asset to a single lessee but did not address the lease of parts of a single asset to multiple lessees over multiple different terms, as is found within a mall when many stores are leased. If the *Transfer Model* were applied to this situation, it would appear as if individual portions of a mall would be derecognized and replaced with individual lease receivables and residual values.

Example – The example below reflects an interpretation of the proposed landlord (lessor) accounting under the *Transfer Model* as applied to a single store location in a mall.

A landlord acquires a mall property for \$100,000. One month later, a store site within the mall is leased for 60 months at \$135 per month. The store site represents about 10% of the rentable space in the mall and has been assigned a “value” of \$10,000. Allocating a portion of the total mall based on a pro rata share of rentable space effectively derecognizes a portion of common areas along with the rentable space. The landlord assumes the entire mall will be worth \$50,000 in 5 years and thus assigns a future value of \$5,000 for the store based on its 10% rentable space. The landlord determines that these factors result in an 8.00% implicit interest rate for this lease.

This approach to measuring the current and future value of the store site itself is not at all consistent with how a landlord determines rents or views a lease of such property. A mall landlord examines market rents per square foot and determines if that lease and tenant will complement and add to the overall value of the mall. For instance, a particular restaurant may draw more customers to the mall, so the rent for that restaurant may be less to attract it to the mall.

Note that most landlords would project that the future value of the mall would be worth *more than* what it is worth today. Landlords do not view a mall as a depreciable asset per se, but as an investment asset that will grow in value as they manage the tenant and lease portfolio and grow the revenue streams. REITs invest in such properties for income plus capital appreciation.

Nonetheless, the landlord records the following entries:

Mall property	100,000
Cash	100,000

To record the purchase of a mall.



Depreciation expense	833	
Accumulated depreciation		833

*To record the 1st month of depreciation expense for the mall.
(((\$100,000 -50,000)/60 months)*

Gross lease receivable (\$135 x 60)	8,100	
Residual value (mall store)	5,000	
Unearned finance income		3,100
Mall property	10,000	
Accumulated depreciation	83	
Gain on sale from placing store under lease		83

To record placing one store under lease and derecognizing the pro rata portion of the mall site and accumulated depreciation associated with that portion. Since that portion of the mall was valued at \$10,000 but had a carrying value of \$9,917, a gain of \$83 was recorded.

Gross lease receivable (\$135 x 60)	8,100	
Residual value (mall store)	5,000	
Unearned finance income		3,100
Mall property	10,000	
Accumulated depreciation	83	
Gain on sale from placing store under lease		83

To record placing one store under lease and derecognizing the pro rata portion of the mall site and accumulated depreciation associated with that portion. Since that portion of the mall was valued at \$10,000 but had a carrying value of \$9,917, a gain of \$83 was recorded.

Cash	135	
Gross lease receivable		135
Unearned finance income	67	
Finance income earned		67

To record rents received and finance income recognized.

It would appear that applying this lease accounting methodology to a mall property would result in a substantial number of allocations based on very theoretical assumptions as well as subjective management measurements.

Note that the calculated implicit interest rate is dependent on the rents obtained and the very theoretical projected value of the property at the end of the lease. If a mall is very popular and has a lot of customer traffic, in theory the rents charged could be very high, resulting in a very high interest rate. As stated above, most mall landlords would project the future value of the mall to be *more* than its current value since it represents investment property that should *appreciate* in value as the mall lease portfolio is managed. Thus the implicit interest rate calculated could be very



high, indicating that the income expectation is not solely based on a financing but also on investment appreciation.

For example, in the model above if the mall landlord assigned a future “value” of 150% of the property’s current value to the property, the implicit interest rate calculated above would be 22%, a return which clearly indicates profits other than simply finance income. This example is further support for excluding Investment Property from the scope of this Discussion Paper.

At any point in time after the commencement of the lease, the net investment of the lease is equal to the present value of the remaining anticipated cash flows from the rents plus the residual value. That is, after one month the lease for the store site is reported on the landlord’s balance sheet as follows:

Gross lease receivable	7,965
Residual value	5,000
Unearned finance income	<u>(3,033)</u>
Net investment in lease	<u>9,932</u>

The mall is reported on the landlord’s balance sheet as follows:

Mall	90,000
Accumulated depreciation	<u>(750)</u>
Net mall asset	<u>89,250</u>

As the mall space is rented, the mall asset is gradually replaced by lease investments. When a lease ends and space becomes available again, the residual value is reclassified to mall property again, for instance as “Mall property available to rent.” This process may be repeated many times over the life of a mall, as tenants come and go over the years.

The revised mall asset value would require that the landlord continuously calculate revised depreciation expense as the mall value changes as a result of changing tenants. At the end of the depreciable term, the mall has been depreciated down to zero, even though it is probably worth more than when it was originally opened. (This model would be very confusing to executive management and investors. We have concerns with the subjectivity and judgment that would be utilized in establishing residual values and the resultant implicit interest rates.)

- *New Rights Model* – Under the *New Rights* model, the existing asset remains on the landlord’s balance sheet and the *right to receive the lease payments* is recorded on the balance sheet as a financial asset, with an offsetting “*performance obligation*” representing the landlord’s obligation to deliver the store space to the tenant. The *New Rights* model is also viewed by the FASB as being consistent with the lessee models proposed in the Discussion Paper.⁸
 - Under the *New Rights* model, the landlord is viewed as providing a service to the tenant over the lease term by granting the right to use the space in exchange for rental payments. A new asset and obligation is recorded on

⁸ Discussion Paper ¶ 10.18



the landlord’s balance sheet equal to the present value of the lease payments and representing the landlord’s *right to receive rents* offset by their *performance obligation* to provide the space to the tenant over the lease term.⁹

- The Discussion Paper is not specific on how the *performance obligation* would be amortized or recognized over the lease term. Since this obligation to provide space and services appears to be delivered at a constant rate over the lease term and appears to be similar to an operating lease under existing FAS 13, we believe that the FASB would suggest amortizing this item on a straight-line method as the *performance obligation* is satisfied. Further, although the FASB has indicated that this is a *performance obligation*, it does not appear that amortizing it represents the reduction of an obligation as much as it represents the recognition of income. Perhaps this item is better described as deferred income rather than as a performance obligation.
- The landlord also recognizes finance revenue over the lease term representing the financing of the lease receivable.¹⁰ If this approach was to be used, we believe the landlord would calculate the finance income using the tenant’s incremental borrowing rate, since the landlord has no mechanism to calculate any other rate.
- The existing total property value remains on the landlord’s balance sheet at its historical cost and is depreciated using a straight-line depreciation methodology over its useful life without regard to the individual underlying tenant leases.

Example – The example below again reflects our interpretation of the proposed lessor accounting under the *New Rights Model* as applied to the landlord of a mall property.

A landlord acquires a mall property for \$100,000. One month later, a site within the mall is leased for 60 months at \$135 per month. The landlord estimates that the tenant’s incremental borrowing rate is 8%.

The landlord would record the following entries:

Mall property	100,000	
Cash		100,000
<i>To record the purchase of a mall.</i>		
Depreciation expense	833	
Accumulated depreciation		833
<i>To record 1st month of depreciation expense for mall.</i>		
Gross lease receivables (\$135 x 60)	8,100	
Unearned finance income		1,442

⁹ Discussion Paper ¶ 10.25

¹⁰ Discussion Paper ¶ 10.25



Obligation to provide store space under lease 6,658
(Present value of \$135 @ 8% for 60 months)
To record entering into a lease.

Cash 135
Gross lease receivables 135
To record cash received.

Unearned finance income 44
Finance income earned 44
To record amortization of finance income of the lease.

Obligation to provide store space under lease
(\$6,658 / 60) 111
Revenue for providing store space 111
To recognize income from providing store space.

Note that total income to be recognized over the lease term (\$8,100) is equal to the unearned finance income (\$1,442) plus the income from fulfilling the obligation to provide the asset (\$6,658). Note also that if the landlord determined that the lessee had an excellent credit rating, the finance income amount would have a lower value however the obligation to provide the store space would have a higher value, even though the delivery of services was the same as between the average credit lessee and the excellent credit lessee.

General Comments on Discussion Paper

General

- Our comments herein are directed to the application of the Discussion Paper with respect to the landlords (lessors) of mall properties. Although the Discussion Paper did not address landlord (lessor) accounting to the extent it did tenant (lessee) accounting, we have assumed that the approach to landlord accounting would attempt to be consistent with the approaches followed for tenant accounting. That is, we have assumed that the FASB would approach lessor accounting in a manner that is complementary to and synchronized with tenant accounting when it pertains to judgments, such as the most likely lease term, contingent rent measurements, renewal rents to be included and residual value guarantees provided. Hence our comments with respect to landlord accounting are consistent with those provided for tenant accounting.
- Since we believe that tenants in malls should treat their leases as service agreements, we likewise believe that landlords should treat the leases to the tenants also as service agreements or alternatively operating leases as under existing US standards found in FAS 13.
- *Subjective Nature of Judgments Required*
 - If the Discussion Paper *as written* is applied to landlords and follows the guidelines outlined in the sections pertaining to lessees (tenants), we believe



that it requires the landlord to apply judgments which are prone to being subjective to measure key values and variables of a lease and the values that would be capitalized. For instance, determination of the *most likely* lease term requires management to arrive at a conclusion of a future decision that they are not usually prepared to make at the inception of a lease. This fact is particularly relevant to store leases, which are designed to be flexible for both the landlords and the tenants and which often may provide for several renewal option periods to provide that flexibility. It is very difficult for a landlord to arrive at a reasonable conclusion at the inception of lease as to whether a lessee will renew a lease in the future or not.

- We believe that the lease term for any type of lease should be selected based on the same definition of lease term as contained in the existing FAS 13 accounting literature on leases. The lease term should be based on the contractual minimum lease term adjusted for any early termination options or economic compulsion factors that are known at the inception of the lease and included if they are reasonably certain to be exercised. In today's environment, any lease term selected by a lessor for accounting purposes other than the minimum contractual lease term, must be validated with the lessor's auditors. For instance, if a lessor states that a renewal option is considered a bargain for the lessee, the lessor must provide evidence to support this position in order to incorporate this fact into establishing the lease term for financial reporting purposes.
- Further we believe that accounting for contingent rent, lease renewals and residual value guarantees should be consistent with the approach suggested in the response letter pertaining to tenants (lessees) and believe that the approaches followed currently by FAS 13 and FIN 45 as applicable are appropriate.
- *Selection of Interest Rate for Discounting*
 - We do not believe that a landlord can reasonably calculate their implicit interest rate as defined within FAS 13 for any lease of a mall store property, because (i) landlords do not view the lease as a financing, (ii) many other factors affect their profitability and (iii) landlords do not utilize a projected residual value when entering such leases. If it is necessary for a landlord to incorporate a interest rate to discount any lease, we believe that the landlord should either;
 - estimate the tenant's incremental borrowing rate or
 - if a lease contains a fixed price purchase option (which never occurs with mall store leases but may occasionally occur for a standalone building) utilize an interest rate that would be calculated by assuming the tenant exercised the fixed price purchase option. In this way the implicit interest rate is that rate which the tenant would actually pay when acquiring the property. This practice can also be considered for



leases of other assets when the lease contains a fixed price purchase option.

- *Sale-leaseback and Sublease Accounting*
 - - While the Discussion Paper briefly dealt with sale-leasebacks and subleases, we should point out that both approaches are used to some extent by the landlord for financing the underlying mall property or improvements to the property. Tenants may use a sale-leaseback for financing leasehold improvements but not the mall stores themselves. Subleases by tenants exist however are only acceptable if the landlord approves them given their desire to maintain the character and quality of the mall.
- *Conclusion*
 - We believe that one lease model cannot be crafted that is suited for all the different forms of leases, types of assets and property leased and the numerous leasing structures that exist. Most real estate property and real estate leases are substantially different from equipment assets and equipment leases. The FASB should recognize that the economics, terms and conditions and rights and privileges found in real estate leases vary greatly and are interrelated to the economic nature of the lease. Thus we suggest that the FASB consider the nuances of each significant type of asset and approach and consider an alternative for investment property that represents the underlying nature of the transaction.

We appreciate the opportunity to present our views on landlord accounting for leases and would offer our assistance to the FASB for purposes of furthering the FASB's understanding of this industry.

Sincerely,

Betsy Laird
Senior Vice President
Office of Global Public Policy

Attachment A – Matrix of ICSC Tenant/Landlord Lease Positions
Attachment B – Discussion Paper Questions and Answers