NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS®

June 30, 2015

Ms. Susan Cosper
Technical Director
File Reference No. 2015-250
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116
director@fasb.org

Delivered Electronically

Re: Proposed Accounting Standards Update *Revenue from Contracts with Customers (Topic 606) Identifying Performance Obligations and Licensing*

Dear Ms. Cosper:

This letter is submitted by the National Association of Real Estate Investment Trusts® (NAREIT) to provide input on the Proposed Accounting Standards Update *Revenue from Contracts with Customers (Topic 606) Identifying Performance Obligations and Licensing* (the Proposal or ED). This letter provides comment only on the issue of clarifying the guidance on when promised goods and services are distinct for purposes of identifying performance obligations.

NAREIT agrees that the Financial Accounting Standards Board (FASB or Board) should clarify the guidance for identifying performance obligations. However, we do not believe that the proposed clarifications (or the original language in Topic 606) provide sufficient clarity on an issue of great importance to our member companies – whether commitments by the lessor/landlord to pay property taxes, maintain insurance, and provide common area maintenance related to leased real estate should be treated as being distinct from the obligation to provide the leased space to the lessee. We therefore request that the FASB clarify that such obligations are not distinct from the leased space either through an example or revised wording as it finalizes the amendments proposed in the ED, and make corresponding changes for the accounting guidance on separating lease and non-lease components that is included within the Proposed *Leases* standard.

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 U.S. All REITs Index which covers both Equity REITs and Mortgage REITs. This Index contained 221 companies representing an equity market capitalization of $926 billion at April 30, 2015. Of these companies, 180 were Equity REITs representing 93.3% of total U.S. stock exchange-listed REIT equity market capitalization (amounting to $864 billion)[1]. The remainder, as of April 30, 2015, is represented by 41 stock exchange-listed Mortgage REITs with a combined equity market capitalization of $62 billion.

NAREIT Comments

NAREIT concurs that the guidance in Topic 606 on determining whether promised goods or services are "distinct in the context of the contract" would benefit from additional clarity. NAREIT's main focus relating to the identification and separation of performance obligations has been voiced in previous comment letters submitted in response to both the *Revenue Recognition* and *Leases* Proposals. The issue that NAREIT identified deals with whether lessor commitments to pay property taxes, maintain insurance and perform common area maintenance should be bifurcated from revenue from space rent. Preparers and auditors have questioned whether this was the Board's intention when the Board deliberated the separation of performance obligations in the new *Revenue from Contracts with Customers* standard as well as the separation of lease and non-lease components in the new *Leases* proposal.

Based on our reading of the current *Leases* revised exposure draft, lease revenue may be required to be separated between lease and non-lease components. Lease components would be subject to the new *Leases* accounting guidance, while non-lease components would be subject to the new *Revenue from Contracts with Customers* standard. Because Topic 606 may require that revenue within its scope be presented separately from other revenue, separation would effectively result in a need to present lease revenue separately from revenue from the related tax, insurance and CAM services.

In our view, commitments to pay taxes, maintain insurance, and perform common area maintenance that are included in a lease agreement are highly interdependent and highly

[1] https://www.reit.com/sites/default/files/reitwatch/RW1505.pdf at page 21.

interrelated[2] with the use of the leased real estate. The lessee would not be able to use the leased space in an office building or a shopping center if the real estate:

- was subject to a tax lien,
- did not have an active insurance policy to satisfy its debt agreement on the property, or
- was not properly maintained.

The purpose of the transaction is to lease space in exchange for market rent. Lessees cannot go to the market and separately contract for tax collection services, separate insurance contracts for the structure of a specific office space on/within a floor of a building, or contract with cleaning and maintenance services to clean the common area contiguous to the tenant's space. Given the highly interrelated nature of the tenant reimbursements and the space rent, we believe that the income statement should reflect all of these payments in a single line item[3]. While we believe that the application of the principles of Topic 606, as issued, does not require that such promises be treated as performance obligations distinct from the leased space, some audit firms have espoused different views. As such, while we believe the language in the Proposal also would not require tax, insurance and CAM commitments to be treated separately, we are concerned that differing views will continue.

In order to ensure proper application of the new *Leases* and *Revenue from Contracts with Customers* standards, NAREIT recommends that the Board include an illustrative example that demonstrates how the standards would apply to lease agreements containing tenant reimbursements. NAREIT would be happy to assist the Board in developing an illustration consistent with market realities for inclusion in the final standards.

We thank the FASB for the opportunity to comment on the Proposal. If you would like to discuss our views in greater detail, please contact George Yungmann, NAREIT's Senior Vice President, Financial Standards, at gyungmann@nareit.com or 202-739-9432, or Christopher Drula, NAREIT's Vice President, Financial Standards, at cdrula@nareit.com or 202-739- 9442.

[2] http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176166005104&acceptedDisclaimer=true at paragraph 606-10-25-21(c).
[3] In order to meet the needs of investors, NAREIT believes that components of lease revenue that vary directly with related costs (as is often the case is a so-called "net lease", in which a fee is stated for the leased space, with allocations of applicable costs paid in addition to that stated fee) should be disclosed in the notes to the financial statements. To the extent that the lease agreement includes a single rental payment, with no additional amounts paid for allocation of common costs, NAREIT believes the needs of investors would be met with disclosure of the costs incurred for these items, as opposed to requiring an artificial bifurcation of revenue. In our view, these disclosures would adequately convey information about the risks either taken on by the lessor, or passed on to the lessee.

Respectfully submitted,

George L. Yungmann
Senior Vice President, Financial Standards

Christopher T. Drula
Vice President, Financial Standards

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NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS®
1875 I Street, NW, Suite 600, Washington, DC 20006-5413
Phone 202-739-9400 Fax 202-739-9401 REIT.com