



# STAUBACH

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Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116  
Attention: Director of Research and Technical Activities  
File Reference No. 1082-200

**Re: *Comments on Exposure Draft Relating to  
Consolidation of Special Purpose Entities***

Gentlemen and Ladies:

We are writing this letter to provide comments in connection with the Exposure Draft dated June 28, 2002 on consolidation of certain special-purpose entities (the "Exposure Draft"). We appreciate the opportunity you have provided to comment on the Exposure Draft, and hope that this letter will provide you with additional information to further enhance the proposed Exposure Draft. While we share your concern with recent highly publicized accounting irregularities, we are concerned that these changes, as currently contemplated, will have an adverse impact on our clients. Our thoughts are expressed with a desire to inform the Board of these observations with the hope that the Exposure Draft will be modified as to prevent adverse consequences to our business community.

We are aware that as a result of the financial problems encountered by Enron, both the public and government have increased scrutiny of the financial accounting for transactions with special-purpose entities (SPEs). We are also aware that since early 2002, the Financial Accounting Standards Board ("FASB") has been working on a proposed interpretation of FASB Statement No. 94, *Consolidation of All Majority Owned Subsidiaries*, and Accounting Research Bulletin No. 51, *Consolidated Financial Statements*. We have been following the progress on this project closely as it impacts our clients, who in general are Publicly Traded corporate lessees of real estate. The proposal also appears to have a negative impact on private owners of real estate who often are the lessors and are also our clients and on the lenders for these transactions.

SPEs are commonly the lessor in synthetic lease transactions, which we understand are perhaps the focal point of the Board's effort regarding consolidation as it effects real estate leasing transactions. However you should be aware that SPEs in the form of single-member limited liability companies (SMLLCs) are pervasively used in our industry to hold ownership of real estate leased to corporate tenants in long-term "credit tenant lease"(CTL) transactions where *the Landlord takes the primary risk and rewards associated with ownership*. Based upon the

information in the Exposure Draft, the participants in CTL arrangements (both past and future) would appear to be adversely affected by the proposal set forth in the Exposure Draft.

### **Overview of CTL Transactions**

Over the past 7 years, we have completed in excess of \$5 billion of real estate transactions from many publicly traded companies as well as privately held organizations. We purchase the assets and lease them back long-term to corporations at rental rates that are more attractive than the company could achieve using traditional real estate mortgages to finance their real estate. The corporations then transfer all of the risks and burdens of ownership over to our limited partnership at the point of sale and leaseback. Our capital structure positions our equity as the *first dollars of loss at risk* on all of these types of transactions with any mortgage debt next. We use SMLLC's to act as the deed holder of the property with our limited partnership the member owner of the SMLLC. We have found this to be a requirement from lenders since they typically want the asset that they are lending on to be in a separate entity in case foreclosure proceedings were to occur. Once again, if a foreclosure were to occur, our limited partnership would bear any and all consequences, including but not limited to, tax effects, since we possess all the benefits and burdens of ownership. The utilization of the SMLLC is not being used to mask an ongoing tenant relationship, but rather as a vehicle to allow for borrowing at lower costs as a landlord. The transactions are truly third-party transactions and atypical to the synthetic lease since the residual risk is borne by the owner of the asset and not the tenant, and the burden of taxation is on the owner and not the tenant. Our typical lease structure ranges from 15 to 22 years, and we structure our leases to comply with the tests for operating lease treatment under FASB Statement No. 13 and sale and leaseback accounting under FASB Statement No. 98.

As a Substantial Operating Enterprise ("SOE") as defined by the Exposure Draft, and consistent with existing practice, we currently, and would continue to consolidate the assets of the SPE onto our books for both book and tax purposes. However, upon our sale of the asset, a fundamental aspect of our business, the accounting treatment would vary under the Exposure Draft depending on the SOE or non-SOE status of the purchaser and not the underlying risk and rewards associated with the transaction. This subsequent change in accounting treatment would adversely affect the lender or lessee and would not accomplish the fundamental accounting goal of consistent and accurate reporting of a company's financial position from year-to-year.

### **Analysis**

Based upon the overview noted above, we would like to present our analysis on the rules, as we currently understand them to be proposed, and offer our insights as to the consequences to our clients created by the application of these proposals.

### **Definition of an SOE in CTL Transactions**

We agree with your concept of a Substantial Operating Enterprise who would ultimately serve as the consolidating entity in CTL transactions. However, we believe the Exposure Draft should be enhanced to allow for consistent accounting application of these transactions over multiple accounting periods. One method to accomplish this would be for the accounting treatment to be

determined at inception, similar to FAS 13. In doing so, any subsequent sale of the SOE's asset or LLC to a Non-SOE would result in consistent accounting so long as the acquiring entity would have equal or greater capital at risk (i.e. no significant economic change in the substance of the transaction). Alternatively, to ensure consistency and provide more certainty in the application of the accounting rules, non-SOE's could be provided the option of a safe harbor with a 10% equity investment in CTL transactions.

### **Adverse Consequences of the Proposal on CTL Transactions**

#### **1. Retroactive Change Superseding FAS 13**

Based upon the proposed effective dates of the proposal, all existing CTL transactions not currently owned by an SOE, which can be estimated in the hundreds of billions, may require consolidation by the lender or lessee. This may require the lessees to record liabilities, which may cause a violation of debt covenants, causing financial hardships to our clients. Lenders may also be required to account for transactions in a manner that could distort their financial statements. These tenants and lenders were well advised that at the time the leases were entered into that they met the well-established criteria for an operating lease under FAS13. Yet the effects of this proposal would be to supersede FAS 13. The unintended consequences could prove devastating, since CTL transactions have been entered into for years, and there is no way for the lender or lessee to comply quarterly with an audit of the landlords' equity position. The lender or lessee does not own the asset and has no basis to make demands to determine the landlord's capital structure; which is a further indication the primary benefits and the primary risks rest with the landlord in a CTL structure.

#### **2. Inconsistent Application of Accounting Rules on Financial Statements**

The current exposure draft will allow different accounting applications for similar transactions. Two identical transactions, one with an SOE and one without could result in off balance sheet treatment for the former and on balance sheet treatment for the latter. The result could occur even though the non-SOE landlord had provided more at risk equity and better economics for the lessee. This disparity violates the fundamental principal of accounting relied on by investors, consistent application of the rules from company to company and year to year.

Further, if a property is sold from an SOE to a non-SOE, the accounting treatment could vary from year to year even though no underlying economics hence changed.

### **Recommendations**

Following are two recommendations for the Board's Consideration:

#### **1. Consistent Accounting Application on Sale of Asset to Non-SOE**

The current Exposure Draft does not provide for consistent accounting application on the sale of an asset from an SOE to a non-SOE. As drafted, the initial sale to an SOE would

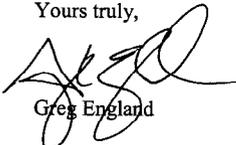
result in appropriate consolidation onto the lessor's books. However, upon a subsequent sale to a non-SOE, the transaction might then be required to be consolidated by either the lender or in the lessee. We suggest the proper accounting be determined at the inception of the lease transaction, similar to how leases are treated under FAS 13. This will then provide consistent application of the consolidation rules over multiple accounting periods.

## **2. Safe Harbor for Non-SOE's**

The current Exposure Draft does not contemplate a safe harbor equity investment requirement. Many buyers of real estate are required to use the SPE to protect the lender from unintended consequences. Many of these buyers are developers or entrepreneurs who have the primary first dollar loss risk in the transaction and are not SOE's. Without providing a safe-harbor many of these participants would be precluded from transactions when in effect they would provide more equity at risk and better economics (less risk) for the lessee. Having a safe harbor investment of 10% would allow non-SOE investors to participate in these types of transactions.

We greatly appreciate your attention to these specific issues and hope the foregoing discussion is helpful to enhancing and issuing the new accounting pronouncements. If you or your staff would like to discuss our comments you may feel free to contact me at (972) 361-5120 or my colleague John Pearson at (972) 361-5101.

Yours truly,



Greg England

cc: E. Raymond Simpson