Technical Director
File Reference No. 1820-100
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Re: Leases Exposure Draft

Dear Sir/Madam:

Colonial Properties Trust is a multifamily-focused self-administered and self-managed equity real estate investment trust (REIT). Accordingly, we are engaged in the acquisition, development, disposition, ownership, and operation of multifamily communities and other commercial real estate properties. As of September 30, 2010, the company owned or managed 33,911 apartment units and 17.8 million square feet of commercial space. Headquartered in Birmingham, Alabama, Colonial Properties is listed on the New York Stock Exchange under the symbol CLP and is included in the S&P SmallCap 600 Index.

Colonial is pleased to provide its comments with regard to the Exposure Draft regarding Lease Accounting.

Executive Summary

Colonial's views on the Exposure Draft (Leases ED) can be summarized as follows:

- We have serious reservations that the proposed new reporting framework will not, for property lessors and lessees of real estate, address the stated reasons for the revised lease accounting model. In particular, the framework will not address the Board's concerns with the faithful representation of leasing transactions, complexity of existing lease accounting and comparability of information. We also have concerns that the proposed new standard will increase complexity and confusion amongst preparers and users and hence adversely affect the usefulness of financial statements. We are not only concerned about the impact of this proposed standard on our own financials but also concerned about the impact on our business as lessees re-evaluate their leasing decisions. We cannot therefore support the proposed new model.
- Having said that, we acknowledge the Board's determination to capitalize lease obligations 'on balance sheet' rather than via improved disclosure. On this basis, our view is that the proposals will only offer a workable framework for lessors and lessees if the new standard:

  - Excludes amounts due under renewal options and contingent rentals from the measurement of lease assets and liabilities
  - Measures lease assets and liabilities only with reference to rentals to the first renewal/break date in the lease

- We understand the Board is examining the possibility of a new standard under U.S. GAAP that would mirror International Accounting Standard No. 40, *Investment Property* (IAS 40) that would then scope out lessors from the proposed leasing standard to the extent they report lease income from investment property at fair value. As a company that actively operates real estate, we believe a more appropriate treatment would be to require the application of the general revenue recognition principles for lessors of real estate that operate the properties that they own.

Detailed comments

Contingent rents

We believe that the proposal for contingent rentals included in the measurement of the lease receivables and liabilities does not provide an appropriate "hurdle rate" for lessees in particular. In fact, we believe that there is a very strong case that contingent rents do not meet the definitions of a liability. In this respect, we agree with the comments of Stephen Cooper outlined in paragraph AV7 of the Leases ED.

Our concern is that estimates of contingent rents under the proposal in the Leases ED will be unreliable due to uncertainty and the long time between inception and the triggering event date. This is especially true for long-term leases that include contingent rents based on the future operating results of the lessee. For example, it would be very subjective to estimate the amount of contingent rent due from a 15-year lease where the contingent rent is based on the annual sales of a retail tenant. In addition, the recognition of contingent rents as proposed in the Leases ED distorts the economic effect for both lessors and lessees. Estimating contingent rents will create lack of symmetry between lessees and lessors in accounting for the same contract, as well as lack of comparability amongst lessors and amongst lessees. The estimation of contingent rents also becomes less reliable the longer the period of time involved and the longer the lease term, the more exaggerated the front-end lease cost pattern.

Estimated contingent rents based on usage do not meet the definition of a liability because the lessee controls the obligating event - that is, the additional usage of the leased asset. Our view is that usage based elements should only be reflected as incurred. This would be consistent with the treatment of contingent interest payments on debt instruments accounted for in accordance with IAS 32 Financial Instruments: Presentation where performance based measures (e.g., such as sales based "percentage rents") are not in the control of the lessee and would be included in the liability. The obligating event may occur in the future but it has not occurred at inception of the lease. The proposed front-ended lease cost model causes the current month lease cost to increase if a usage based contingent rent is assumed, even if it is estimated to occur years in the future. The revenues generated from the use of the leased asset related to the contingency are not reported in the same periods as the lease costs.

We therefore assert that contingent rentals should be excluded from the measurement of the lease receivables and liabilities and that contingent rents should be recognized when the contingent event occurs.

Lease renewals

We disagree with the Board's proposals that the lease term should be the 'longest possible term that is more likely than not to occur' taking into account the effect of any options to extend or terminate the lease. We do not believe that extension options represent liabilities unless virtually assured of exercise because the "option" is not substantive (i.e., it must be exercised).

Accordingly, we believe that lease renewal options should not be included in the measurement of lease receivables and liabilities, other than those that are bargains, create compulsion to exercise or create a penalty

for failure to renew are not liabilities of the lessee at lease inception. In this respect we agree with the comments of Stephen Cooper outlined in the Basis for Conclusions.

We therefore assert that lease renewals should be excluded from the measurement of the lease receivables and liabilities and define the lease term by reference to the first lease break or renewal option.

Scope exception for certain lessors

The characteristics of real estate leases are fundamentally different from leases of other assets. A real estate lease will generally cover only a small portion of the useful life of the leased asset, since the useful life for real estate typically far exceeds the useful life for other types of leased assets such as equipment. Real estate can accommodate multiple leases simultaneously unlike equipment that has one lease at a time. And the longer life of real estate allows numerous leases to be executed over its useful life while leases that are of a financing nature cover a substantial portion of the useful life of the shorter lived asset. Further, the perpetual and irreplaceable nature of land, coupled with its immobility, is yet another key feature that distinguishes real estate leases from leases of other assets.

Differences also exist with respect to the on-going management of real estate. Lessors of real estate are actively involved in the operation and management of its properties. We spend a significant amount of effort and resources towards leasing, maintenance and customer service. We utilize revenue optimization software and lease expiration schedules to help us make daily pricing decisions. We continuously improve the asset to maximize return on investment.

Real estate companies do not typically own properties for their entire useful lives. We invest capital through acquisition and development while disposing in an effort to maximize returns. Within the REIT industry, we commonly recycle capital whereby we dispose of properties and use the proceeds to immediately reinvest via acquisitions. These strategic decisions are driven by determining the markets where we want a presence, discerning the desired quality of our product and monitoring current as well as future demand and supply conditions.

Because of the differentiating characteristics of real estate leases, Colonial believes that the lessor accounting for real estate leases should be distinguished from the accounting for leases of other assets. Real estate companies are operating companies and not financing companies.

We therefore assert that real estate companies should fall within the purview of the general revenue recognition principles just like any other operating company. To provide relevant revenue information and to avoid the re-characterization of a real estate company's revenue as financing income, real estate lessors should account for all lease income (including reimbursements of costs such as common area maintenance and security) in accordance with the proposed revenue recognition principles set forth in the FASB/IASB joint project *Revenue from Contracts with Customers*. Real estate leases should be accounted for as a service contract in a manner that reflects the continuous transfer of services to the customer over the term of the contract.

Applying the proposed lessor accounting under the performance obligation approach to real estate would bifurcate rental payments into a rent component and an interest component on the income statement. This will distort the revenues of lessors and frustrate users of their financial statements. Rental income is a key driver to real estate valuation and, therefore, a key element of information.

In addition, straight-line amortization of the performance obligation versus an effective interest method of amortization of the lease receivable would generally result in decreasing revenue over the term of a lease. This would misrepresent the underlying business intention of the landlord and tenant, as well as the economics of the lease arrangement. Further, including potential contingent rents and revenues during lease extension periods would exacerbate this anomaly (see discussion above).

Conclusion

The Board has pursued the objective of developing a framework that capitalizes the assets and liabilities arising from a lease transaction because it argues that users need to be provided with better information relating to these liabilities. We believe the Board would have more success in achieving its objectives by developing a simpler standard, which follows the broad objective of capitalizing lease obligations but also provides all users and preparers with a framework for comparable and reliable reporting for lessors and lessees. We believe these objectives would be achieved by adopting the modifications suggested in this letter.

We appreciate the chance to share our views with the FASB and welcome the opportunity to expand on our comments.

Respectfully submitted,

Brad Sandidge
EVP – Accounting
Colonial Properties Trust

Reynolds Thompson
President and CFO
Colonial Properties Trust