



Technical Director
File Reference No. 1850-100
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Re: File Reference No. 1850-100 Proposed Accounting Standards Update: Leases (Topic 840)

Dear Sir / Madame:

Taubman Centers, Inc. appreciates the opportunity to comment to the Financial Accounting Standards Board (“the Board”) on the above-referenced Accounting Standards Update (“the Exposure Draft” or “the Proposed Standard”). Taubman Centers, Inc. is a publicly traded real estate investment trust engaged in the ownership, development, acquisition, and operation of regional shopping centers and interests therein. We currently own, lease, and/or manage 26 properties in the United States.

We are a member company of the National Association of Real Estate Investment Trusts (NAREIT), a 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 and its global partners of the Real Estate Equity Securitization Alliance (REESA) are submitting separate comment letters in regards to the Proposed Standard that we fully support and respectfully request you consider in regards to our industry.

We support the Board’s objective to report relevant and representationally faithful information to financial statement users about the amounts, timing, and uncertainty of cash flows arising from leases. However we do not believe certain of the proposed requirements in the Exposure Draft fully meet this objective, most significantly in regards to the proposed lessor accounting model. Therefore, in this response letter, we wish to share certain recommendations and concerns about some of the proposed requirements. However, we are not intending to address each of the questions posed by the Boards.

Scope of Proposed Lessor Accounting

We believe that accounting for investment properties should not be included within the scope of a new standard on lessor accounting, at least not under the “performance



obligation” and/or “derecognition” approaches proposed in the Exposure Draft. By requiring a rental stream to be bifurcated between interest income and rental components, these approaches do not faithfully represent the lessor economics of investment properties, particularly shopping centers. Any approach that views the lessor as financing a lease-related asset, whether the shopping center space itself (under the derecognition approach) or a lease receivable (under the performance obligation approach) does not reflect that (1) shopping center rentals are the result of market-driven negotiations relating to the expected sales productivity of individual tenant spaces and (2) tenant leases are single components of an intensively managed and constantly changing investment asset (the shopping mall) whose value is generally indivisible to its owner – there are no residual values assignable to individual tenant spaces. In that regard, tenant leases are entirely dissimilar to financings of equipment or similar assets that are subject to “rent or buy” decisions based on the costs of capital and expected residual values.

Related Investment Properties Project

As a result of the deficiency we perceive in the Proposed Standard’s representation of lessor economics of investment properties, we urge the Board to continue its current project to consider whether entities should be given the option (or be required) to measure an investment property at fair value through earnings, consistent with the existing international accounting standard (IAS 40, *Investment Property*). We believe that the Board should urgently continue its examination of this fair value standard in order to coincide with timing of the new Leases standard and provide lessors an opportunity to report their investment properties on a more meaningful basis such as fair value.

In following the Board’s deliberations as to the scope of the potential investment properties fair value guidance, we noted that a recent tentative decision was reached to more narrowly define the entities that could be subject to the guidance. That is, one of the key scoping requirements that an entity’s business purpose for investing in real estate includes defined times or strategies for exiting the investments (i.e. that fair value must ultimately be realized through a sale). We believe this is too narrow a view of the importance of fair value to income producing properties such as our shopping centers. Our properties represent assets whose value can be realized through direct financing, sale or exchange, or creation of joint ventures through contribution of the properties. Interests in our properties are a form of currency that can be (and have been) used in varieties of ways to create shareholder value that do not necessarily rely on defined exit strategies. In that regard, in supporting the current investment properties project, we believe that it is important for the Board to



consider a broader view of the importance and relevancy of fair value to investment properties.

Alternative Lessor Recognition Model

While we ultimately recommend scoping out from the Proposed Standard lessors of investment property reported at fair value, if such a scope-out is not provided and/or investment properties are continued to be carried at cost, we would recommend an alternative lessor accounting model for investment property leases as contracts for services under the principles in the Board's Revenue Recognition Exposure Draft. That is, the service model found therein would closely reflect the economic characteristics of shopping center leases, where the lessor is continuously delivering the availability of specific physical spaces to lessees that includes access to a unique synergy of an entire property's merchandising mix, anchor tenants, physical amenities (e.g. common areas, parking areas, food courts, elevators, escalators) and other services (e.g. marketing, security, maintenance). We ultimately believe that any future lessor accounting model should produce an income stream that reflects the underlying business intention of the landlord and the economics of a shopping center leasing arrangement. Viewing the rentals as a continuous delivery of services under the Revenue Recognition guidance would seem to meet this objective, producing an income stream more akin to the straight-line recognition in current U.S. GAAP rather than the very problematic decreasing (i.e. the front-loaded) revenues that will result from application of the Exposure Draft's performance obligation model.

Recoveries of Executory Costs

For reasons similar to those we have described for rents, we support a scope-out from the Exposure Draft's lessor model of all revenues derived from investment property leases, whether rent or recoveries from tenants of executory costs, such as those for common area maintenance (CAM), taxes, or insurance. Specifically in regards to these recoveries, we believe that they should be accounted for in accordance with the principles of the Board's Revenue Recognition Exposure Draft. With that said, if the Board continues with the Exposure Draft's lessor accounting model, we believe that the Board's intention in regards to these revenues is unclear and should be clarified, most specifically as to whether the typical real estate executory charges meet the "distinct service" definition. For example, it is unclear whether the Board intends for tenants' reimbursements of real estate taxes paid by the landlord to be "services". Similarly, for individual tenants paying separate prorata shares of shopping center CAM, it is unclear as to whether the Exposure Draft is contemplating these charges as "distinct" sales of services. The latter example can be muddled further by



considering situations in which tenants only reimburse landlords for executory costs implicitly, in so-called “gross” leases where rents and other charges are negotiated together and ultimately stated as a single combined amount.

Extension Options

Not only is our company a lessor under its shopping center leases with tenants, we are a lessee of buildings, land, airspace, and/or entire investment properties. Some of these leases have very lengthy renewal periods (with total lease terms well exceeding 50 years). In practice, the definition of the lease term in the Proposed Standard as “the longest period more likely than not to occur” presents problems with these longer term leases because the decision regarding exercise of any renewal option relies on whether it is in the best interest of our stakeholders to continue to hold, maintain, and invest in the shopping center subject to the lease, which in turn is based on several different factors that are in no way even remotely estimable at inception of the lease. Simply stated, the proposed definition of the lease term creates at best, a very subjective (yet supremely important) estimate for leases with renewal periods that go beyond what most would conclude is a range in which a reasonable estimate could be made.

We believe that optional extension periods should only be included in the lease term where it is “virtually certain” that the option will be exercised, that is when structuring of the contractual terms as an option is non-substantive. While remaining consistent with the Board’s principles and goals, we believe this change would address many of our concerns, including increasing the objectivity of the standard and reducing its complexity and the frequency of reassessment changes.

Contingent Rents

In regards to the performance obligation model for lessors, as a landlord involved in several thousand leases, we believe there are considerable implementation issues related to the Exposure Draft’s requirement to initially estimate and regularly reassess a probability-weighted analysis of the “most likely lease payments” for purposes of recognizing the lease receivable and related performance obligation. For example, there are numerous provisions common in shopping center tenant leases that affect the amount of contingent rent tenants pay, based on, for example, their overall level of sales, the reaching of graduated sales milestones, and the outcome of various pricing indexes (e.g. CPI). We believe that these lease provisions are difficult (if not impossible) and costly to reliably estimate, even in the near term, for our entire portfolio on an individual lease-by-lease basis. We have had years



where we have varied (higher or lower) from our annual contingent rent budget by as much as 20% to 30% due to economic factors or specific tenant issues not in our control, suggesting that such rent is not reliably estimable even one year out.

As a lessee of buildings, land, airspace, and entire investment properties, while some of our leases are basic, others can be extremely complex with their provisions often structured to function similarly to a joint venture between the lessee and lessor. In that regard, such leases have the potential to include many features found in joint venture agreements, including rights to participate in the underlying operating performance of the leased asset (including variable participation in operating results and/or cash flows depending on the specific performance level), contingent renewal and termination features, sharing formulas for asset maintenance costs, and other contingent consideration provisions. Leases also may have very lengthy terms, especially those for the land on which shopping centers are built, which commonly have terms exceeding fifty years.

With the above in mind, the Proposed Standard's requirements that would require the estimation and regular reassessment of the "most likely lease payments" for purposes of recognizing the lease assets and liabilities under both the lessor and lessee models would often be (1) impractical and costly to prepare, (2) subject to high degrees of subjectivity, and (3) likely very unreliable. Most specifically, predicting the future operating performance of a property on which contingent/participation rentals are based, including cases where the investment property may not yet even be constructed, may not only be a difficult and unreliable exercise, but a futile one. The same can easily be said for estimating the "most likely" contingent rentals over an 80 year lease.

As we have monitored the Board's deliberations as well as preparers' and users' comments, we understand the Board has considered and rejected certain arguments that contingent rentals do not represent liabilities until the occurrence of the underlying triggering event on which the calculation of the contingent rent is based (e.g. the meeting of tenant sales thresholds). We respectfully request the Board reconsider its decisions that the obligating event for the lease liabilities is the execution of a lease, and eliminate the requirement to estimate and recognize potential future contingent rentals as liabilities upon lease commencement. However, if the Board maintains its current views, we suggest that in lieu of the Exposure Draft's requirement for a probability-weighted lease-by-lease analysis, a more efficient and effective threshold for measuring contingent rents is "management's best estimate". While remaining consistent with the board's principles and goals, we believe "management's best estimate" reduces the Exposure Draft's complexity and cost related to



the initial and ongoing estimation of contingent rents while still retaining many of the Exposure Draft's benefits without sacrificing any objectivity.

Conclusion

In advising against the lessor accounting model contained in the Exposure Draft and discouraging the introduction of additional levels of potentially unreliable estimation regarding lease term, rentals, and other contingencies, we are fundamentally commenting that we believe our management and users of our existing financial reporting are currently being well-served by many aspects of current lease accounting models, despite the technical shortcomings of existing lease accounting literature when applied to leases that are truly in-substance financings. That is, through our current public reporting, management and users have available to them (1) rental and other operating revenues that largely reflect shopping center-related lease economics, (2) clear disclosures of future rentals, rent obligations and rent expirations, (3) thoughtful analysis of key performance indicators such as rent per square foot, comparable shopping center net operating income, and funds from operations, as well as other operating information that historically has proved to be useful in managing, operating, and valuing our company's business. In that regard, we are urging caution when considering any lease accounting alternatives that re-characterize our business' revenues, alter our fundamental operating statistics, and/or do not otherwise significantly improve an understanding of our company or industry.

We thank you for the opportunity to comment on the Proposed Standard. Please contact us at (248)258-6800 if you would like to discuss our comments.

Respectfully submitted,

/s/ Esther R. Blum
Senior Vice President, Controller, and Chief Accounting Officer