September 12, 2013

Financial Accounting Standards Board
Technical Director - File Reference No. 2013-270
401 Merritt 7 - PO Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 2013-270, *Leases (Topic 842)*, a revision of the 2010 proposed FASB Accounting Standards Update, *Leases (Topic 840)*

Dear Board Members:

This letter represents the response of Teachers Insurance and Annuity Association of America ("TIAA") to the Financial Accounting Standards Board (the "Board") regarding the lease accounting exposure draft ("ED") issued by the Board on May 16, 2013.

OVERVIEW OF TIAA AND RELEVANCE OF PROPOSED UPDATES

TIAA was established in 1918 as a legal reserve life insurance company under the insurance laws of the State of New York and is regulated by the New York State Department of Financial Services (the "Department"). Accordingly, TIAA prepares financial statements on the basis of statutory accounting principles prescribed by the Department; a comprehensive basis of accounting that differs from generally accepted accounting principles in the United States of America ("GAAP"). The Department requires insurance companies domiciled in the State of New York to prepare their statutory-basis financial statements in accordance with the National Association of Insurance Commissioners' ("NAIC") Accounting Practices and Procedures Manual ("NAIC SAP"), subject to any deviation prescribed or permitted by the Department.

Investments in TIAA's General Account include real estate properties held in wholly-owned subsidiaries of TIAA. Under NAIC SAP, TIAA is required to account for its investments in these subsidiaries based on the audited GAAP equity of each subsidiary. Accordingly, these subsidiaries account for real estate properties in accordance with Topic 360, *Property, Plant and Equipment*, and Topic 840, *Leases.*

In addition to real estate properties held in TIAA's General Account, TIAA created The TIAA Real Estate Account (the "Account") in 1995 as a segregated investment account for the purpose of investing in real estate investments and issuing tax-exempt variable annuity contracts to policyholders. As a registrant with the Securities and Exchange Commission, the Account is required to prepare and file audited financial statements prepared in accordance with GAAP. The Account maintains the attributes of an investment company as described in

Topic 946, *Financial Services – Investment Companies,* and accordingly reports all real estate investments at fair value. The Account reports the fair value of these investments based on valuation methodologies consistent with the *Uniform Standards of Professional Appraisal Practices*[1].

Real estate investments held by TIAA and the Account have a combined carrying value of approximately $29 billion as of June 30, 2013. Collectively this investment portfolio includes approximately 340 directly-owned commercial, industrial, multi-family and retail property investments that are leased to third-party lessees under approximately 10,000 individual lease agreements, all of which will be subjected to the proposed lease accounting rules.

TIAA is also a provider of debt financing within the commercial real estate industry evidenced by a mortgage loan portfolio of $13 billion as of June 30, 2013. As a lender in the commercial mortgage industry, TIAA is concerned that the proposed rules will unintentionally result in shorter term lease agreements becoming increasingly prevalent and therefore impact the value of properties that collateralize loans that traditionally had long maturities. As described in further detail below, GAAP compliant tenants may negotiate shorter term leases, and underwriting practices will be adversely impacted by the reduction in economic certainty currently seen in long term leases.

TIAA will be further impacted as a lessee of numerous office locations throughout the United States, and as a lessee of non-property assets, such as general office equipment. Costs associated with the implementation and ongoing efforts to comply with the proposed rules are expected to be substantial while providing very limited benefit to users of financial statements.

TIAA appreciates the opportunity provided by the Board to comment on this lease exposure draft in a format that includes a detailed explanation of our concerns regarding the impact of the proposed rules.

REAL ESTATE IMPACT

Real estate is different than other leasable assets such as machinery and equipment, as each real estate property is generally leased to multiple lessees, experiences material changes in fair value over time as a result of daily active management, and provides general economic benefits to its owner. We commend the Board in acknowledging the nuances of real estate by

[1] The *Uniform Standards of Professional Appraisal Practice* (USPAP) are the generally accepted standards for professional appraisal practice in the United States for appraisal of real estate, personal property, and businesses.

proposing that property lessors classify most property leases as "Type B" leases which represent the economics associated with a property lease.

However, we request that the Board consider both the following potential consequences of the current ED in relation to real estate, and our recommendations to minimize these consequences.

Real Estate Lessors:

Property lessors would presumably classify a majority of their property leases as Type B leases. However, in various circumstances, the exception criteria of a Type B lease may apply to a property lease and result in Type A classification. Examples of such circumstances are long term ground leases, longer term multi-tenant, and single-tenant leases. We believe that in such examples, the derecognition of the property by the lessor, together with recording a profit and residual asset, would misrepresent the economics of the transaction since there was no intention of sale, or the transfer of risks and rewards associated with the asset. Furthermore, we believe the nature of the dual model presentation of property leases will unduly complicate lease presentation for users of financial statements.

Additionally, we believe the recognition of a lease receivable, residual asset and derecognition of the leased asset could inaccurately represent a lessor's financial position and borrowing capabilities, especially in cases where the leased asset being derecognized uses leverage. Such presentation will likely cause an increased proliferation of non-GAAP financial measures used for lending purposes. Furthermore, the upfront recognition of profits from Type A leases will complicate or distort the presentation of lessor earnings, further impacting underwriting activities of lenders. We recommend that property leases be classified as Type B leases.

Real Estate Reported at Fair Value:

We recommend that lessors reporting real estate at fair value in accordance with ASC 946 *Investment Companies* be scoped out of the ED and continue to record rental income on an accrual or contract basis.

As indicated above, lessors will generally classify and account for property leases as Type B leases. Under this model, property lessors record rental income on a straight-line basis. Real estate investment vehicles that satisfy the criteria of an investment company report their real estate investments at fair value. These entities, as property

lessors, generally recognize revenue on an accrual or contract basis as opposed to the straight-line basis of recognition. This accounting method is appropriate in consideration of how real estate is generally valued in accordance with the *Uniform Standards of Professional Appraisal Practice.* Under such practices the valuation of a real estate property typically includes the future effect of in-place leases and therefore the recording of rental income on a straight-line basis would result in a double-counting of this effect. As a result, the property's reported fair value and unrealized appreciation/depreciation amounts would be unduly complicated by needed adjustments for the additional straight-line rent component recorded on the balance sheet and income statement. The recording of straight-line rent with the associated adjustment for properties reported at fair value does not appear to provide additional benefits to users of financial statements, and would create unnecessary costs and could mislead investors in regard to the reported change in the property's value.

The Board appears to appreciate the concepts described above, based on the Board's conclusion regarding this matter in the ED's Basis of Conclusion paragraph BC276. Given this, we would request the Board explicitly discuss within the body of the ED the above concepts noted in BC276.

Real Estate Lessee:

The Board has proposed Type A and B leases for property lessees; however, unlike property lessors, a property lessee is required to recognize all leases on their balance sheet regardless of lease type, as well as follow an alternative expense recognition policy depending on the type of lease. We respectfully disagree with this proposal and we believe the current practice of the identification of future rental obligations in the footnote disclosures of property leases is transparent and widely understood. Such disclosure adequately informs financial statement users of the reporting entity's future lease obligations. As the Board has recognized the unique nature of property lessors and the need for separate accounting, we request the Board further this by extending the same accounting to property lessees.

Unintended Consequences

We recognize the Board seeks to achieve financial statement transparency through the issuance of the proposed lease accounting rules. However, we believe the proposed lessee accounting will have unintended consequences to the business fundamentals related to investing in real estate. Specifically the financial statement presentation will be inconsistent with the economics of a real estate lease transaction as an actual transfer of ownership has not occurred. Furthermore, financial statement metrics (i.e.

financial ratios) will be unnecessarily impacted by the additional assets and liabilities recorded by lessees. In some instances, there may be an unintended breaching of debt covenants due to an increase in reported liabilities which could further result in costly negotiations to cure such breaches.

We believe lessees will intentionally migrate to shorter term leases in order to minimize the associated cost, administrative effort, and financial statement impacts caused by the proposed on-balance sheet accounting. This migration will likely have a material effect on how real estate is currently viewed as a long-term investment as the nature of short term leases would no longer provide the expected contractual cash flows to meet long term investment objectives. The absence of contractual long term cash flows would also negatively impact a lessor's ability to obtain financing as lenders would not have the security of long term rental streams. Further, the substantial additional costs to maintain the increased complexity of the ED for real estate lessees will unduly impact the returns distributed to their investors.

LEASING OF GENERAL NON-PROPERTY ASSETS

We are concerned that leases for general office equipment such as computers, laptops, phones, postage and copy machines, etc., which are ancillary to an entity's operations and insignificant to its results ("non-core"), do not satisfy the proposed short-term lease definition (i.e. 12 months or less).

We appreciate the Board's efforts in developing the short-term lease exclusion and recognition of the potential concern for creating bright lines that would permit the structuring of leases in a manner to achieve specific accounting results. However, a bright line has been created with the 12 month maximum for a short-term lease which may lead to entities structuring leases with a term of 12 months or less to minimize the application of the proposed Type A and B lease models. While we understand the Board's concern for potential abuse of bright lines, we want to highlight to the Board the effort required to maintain hundreds of leases that pertain to non-core leased assets and contain a lease term in excess of twelve months.

Generally, large companies such as TIAA enter into numerous leases to obtain the use of various non-core assets. These assets are incidental to TIAA business objectives as an insurance and financial services provider. We ask the Board to reconsider a practical expedient or modified definition of a short-term lease that would allow entities to account for these leases in a manner that minimizes undue cost and effort without impeding financial statement transparency. The resources necessary to account for these leased assets under the

proposed ED can be put to better use in achieving business goals for investors and policyholders, while not depriving financial statement users of important information.

A possible principle-based approach would neither distinguish between core and non-core assets nor set a bright-line maximum lease term, but instead, would provide qualitative indicators or a set of conditions to assist entities in determining when a thoughtfully transparent, but simplified accounting model is appropriate. An example of such a factor could include assessment of the qualitative and quantitative significance of lease payments to the reporting entity.

Considering these factors, companies would be able to evaluate, based on their specific facts and circumstance, when to apply a simplified accounting model. When considering the cost involved in applying the proposed accounting such as systems, internal control, and human capital, we believe the cost of compliance would decrease significantly by extending the application of a simplified accounting model, while still achieving the Board's objectives. It may then be appropriate for companies to disclose the types of assets and rationale for determining when it applies the simplified accounting model.

We appreciate the opportunity provided by the Board that allows TIAA to comment on the proposed ED. Should you wish to discuss the contents of this letter, please contact either Matthew Kurzweil at 212-916-5884 or mkurzweil@tiaa-cref.org, or Phillip Goff at 704-988-5244 or pgoff@tiaa-cref.org.

Very truly yours,

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