

Jones Lang LaSalle 200 East Randolph Drive Chicago Illinois 60601 tel +1 312 782 5800

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Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, Connecticut 06856-5116

Subject: File Reference No. 2013-270

Dear Madam:

I am writing on behalf of Jones Lang LaSalle Incorporated to comment on the Exposure Draft of Financial Accounting Standards Board (FASB) Proposed Accounting Standards Update (Revised) *Leases (Topic 842), a revision of the 2010 proposed FASB Accounting Standards Update, Leases (Topic 840)* (the "Exposure Draft").

Jones Lang LaSalle is a financial and professional services firm specializing in real estate. The firm offers integrated services delivered by expert teams worldwide to clients seeking increased value by owning, occupying or investing in real estate. With 2012 global revenue of \$3.9 billion, Jones Lang LaSalle serves clients in 70 countries from more than 1,000 locations worldwide, including more than 200 corporate offices. In 2012, we completed over 30,000 leasing transactions worldwide representing approximately 618 million square feet of space. Jones Lang LaSalle occupies and subleases a total of approximately 3.0 million square feet related to its corporate requirements which include over 400 leases with an average of approximately 7,350 square feet per leased location. The firm is an industry leader in property and corporate facility management services, with a portfolio of approximately 2.6 billion square feet worldwide. LaSalle Investment Management, the company's investment management business, is one of the world's largest and most diverse in real estate with \$47 billion of assets under management. Jones Lang LaSalle also provides lease administration services to clients, covering over 75,000 lease contracts and over \$6.8 billion of annual rent spending around the world. Jones Lang LaSalle Incorporated is publicly traded on the New York Stock Exchange with headquarters in Chicago, Illinois, USA.

We appreciate this opportunity to provide comments to the Board on the Exposure Draft. Our comments are offered in the context of Jones Lang LaSalle's role (i) as a major service provider for owners and occupiers of real estate, (ii) as a manager of real estate investment assets, (iii) as an administrator of investor and corporate lease portfolios, and (iv) as a tenant providing office space for our corporate employees. The work of Jones Lang LaSalle and its clients will be directly affected by the Board's proposed approach to a new lease accounting standard.

### General

As suggested in our December 2010 comment letter on the 2010 Exposure Draft, and in our July 2009 comment letter on the Discussion Paper on Leases: Preliminary Views, we support the Board's efforts to address criticisms of the existing accounting model for leases to better meet the needs of users of financial statements – that is, to provide greater transparency around entities' obligations and to better reflect the economics of lease-related obligations.

However, we fear that concerns about "financial engineering" of lease accounting outcomes have needlessly complicated the proposed framework in each iteration of Discussion Papers and Exposure Drafts on Leases to recognize lease obligations on the balance sheet of lessees, and that the complicated framework will result in (a) less comparability in accounting for similar lease arrangements and (b) financial presentations that will obscure the economics and true obligations of an entity. As we note in more detail in our response to Question 2, very few lease arrangements across the universe of leasing activity are financially engineered to achieve off balance sheet treatment, as the vast majority of leased real estate fulfills requirements for space and flexibility and quite naturally achieves operating lease classification today. We believe any specific financial engineering concerns beyond off balance sheet treatment should be addressed in guidance with more narrow scope requiring enhanced disclosures of leasing arrangements, and should not be the driver of changes affecting the much broader population of preparers who have no inclination to engage in such engineering.

With respect to this Exposure Draft, we believe that certain revisions made to the 2010 Exposure Draft represent improvements that provide for (i) a more consistent application by companies as they implement and maintain the new accounting standard, and (ii) clearer understanding of the economics of lease-related obligations on the part of readers of financial statements. For example:

- We believe, for historical cost reporters, the reversion of accounting for Type B leases to the current lease accounting practice which provides for recognition of rent as an operating expense on a straight-line basis is a positive change in the Exposure Draft (see also our general comments below in regards to funds that will continue to record their investments at fair value). Straight-line expense recognition more faithfully reflects the economics of the decision by occupiers to lease real estate space for short term use rather than purchase it, and the lessee's right of use which has the same economic value, rather than declining value, throughout the contractual period of the lease.
- We believe that eliminating from lease obligation calculations certain variable lease payments that are not fixed and determinable at the effective date of the lease is an important step in enhancing the information on which users of financial statements make investment and business decisions. However, we believe the provisions of application are inconsistent with respect to standard

contingent rent types, and will require needless adjustments in lease liabilities and confuse rather than add to the understanding of lease obligations. To the extent that the right-of-use asset concept is retained in a new final standard, the proposed guidance to establish a right-of-use asset which now only includes renewal periods for which the company has a significant economic incentive to renew more appropriately reflects the spirit of the leasing arrangement.

Despite what we believe have been some significant improvements to the Exposure Draft, we still believe that in many ways the Exposure Draft does not improve financial reporting for users, and instead would introduce ongoing complexity and require substantial implementation costs that would outweigh the benefits for users. As a result, we have concerns about the following:

- We are opposed to the selection of a model that uses consumption of an underlying asset as the theoretical underpinning when risks-and-rewards and control models more faithfully reflect the economics and decision-making by occupiers of real estate. We believe that the current standards under IAS 17 that differentiate lease types have been highly effective in principle, quite workable, and, because they are reasonably well understood by preparers today, would be a more reliable approach to delineating between Type A and Type B leases.
- With respect to providing greater transparency around entities' obligations, we believe that the manner in which leases would be capitalized under the Exposure Draft would significantly impair the usefulness and comparability of information. We expect that an accounting framework that introduces so many variables and assumptions, many of which require significant judgment, will impair the quality of information it was intended to create and will be too complex and costly to implement and maintain.
- The proposals in the Exposure Draft which would require preparers to make judgments about future and/or optional events for current recognition will not serve the objectives of providing greater transparency around obligations and economics, but instead will (a) introduce additional and unnecessary complexity, (b) reduce transparency into the effects of lease contracts on a company's financial performance, and (c) reduce comparability between otherwise similar reporting entities. Examples include potentially recognizing extended lease terms beyond their contractually-obligated terms, requiring remeasurements and reassessments of these and other elements of lease agreements from period to period, as well as creating a new contract for modifications to a lease.
- The terminology used in a number of places throughout the draft is unclear and begs for guidance or illustration of its application (e.g., insignificant portion, economic incentive, major part, substantially all); we believe this lack of definition and clarity will result in disparity in practice and cause similar transactions to be accounted for differently, particularly with respect to the classification and term of the lease.

- The requirement to bifurcate the components of the lease into base rent and executory costs in the arrangements will be extremely challenging for real estate given differences in assumptions based on asset type, asset class, and market. A significant percentage of our clients are in gross lease situations. They would be required to determine the portions of the gross lease payment that are base rent and executory costs (e.g., real estate taxes, insurance, operating expenses, etc.). This requirement will demand significant resources to develop the database of assumptions to apply for each unique location and asset type on an initial and ongoing basis (as executory costs change continuously over time). It will also create divergence from the stated goal of consistency as practitioners will inevitably differ in their conclusions.
- Paragraph 842-30-35-4(c) requires a lessor to reassess the lease payments to be received if there is a change in an index or a rate used to determine lease payments during the reporting period (see our answer to Question 4 below defending the exemption for property leases from Type A treatment). We disagree with this requirement as we believe the costs for companies to constantly remeasure the receivable associated with customary forms of contingent rent based on an index (e.g. consumer price index (CPI) in the United States or retail price index (RPI) in the United Kingdom) would significantly outweigh the benefits provided to the users of the financial statements. We believe companies should not be required to reassess the lease receivable each reporting period, but rather should set the annual inflation index at the inception of the lease and reflect any changes to the index above or below the rate at the date of recognition as an adjustment to current earnings, consistent with practice today, as a reasonable and more cost-effective way to capture the changes.
- Determination of the fair value of the asset being leased in multi-tenant buildings is an arduous process, especially in situations where the tenant leases a subset of the larger office building (e.g., a floor of a 20-story building). Third party opinions of value are expensive and time consuming to obtain, and do not drive real value to the reporting and operations of an organization; as a result, they are not ordinarily requested by the lessee's management in the ordinary course of managing their business, and would only exacerbate the cost-benefit burden when applied over a large portfolio of leased properties. These opinions of value are also highly susceptible to variability, resulting in a lack of comparability.
- There are numerous real estate funds that will continue to record their investments at fair value. The prior exposure draft scoped out lessors within these funds, allowing them to reflect the true economic value of the rental payments to the investor rather than recording straight-line rent. This Exposure Draft has removed that exemption with no explanation. The following three reasons explain why the exemption needs to be included in a new standard:

- O Reporting a straight-line rent receivable asset under the proposed model on a lessor's balance sheet in addition to reporting the related investment property at fair value would, without additional adjustment, result in the double-counting of future expected cash flows from leases, a concept already recognized by users of fair value real estate fund financial statements. Contractual lease payments are the dominant input when valuing real estate under a discounted cash flow method. The creation of any additional asset or liability associated with the leases of a lessor recorded and reassessed as proposed in the Exposure Draft would introduce an additional asset or liability entry that must otherwise be offset elsewhere in the financial statements.
- Recording an asset such as straight-line rent on investments recorded at fair value would have implications for existing industry performance measures that investors rely on, as revenue would differ significantly than from existing methods. Once again, the preparer would find themselves removing the effects of straight-line rent to calculate meaningful timeweighted returns for investors.
- O The ability for the lessor to transition to recording straight-line rent is not easily accomplished. In portfolios of real estate properties carried at fair value, where the number of leases can easily enter into the thousands, preparers would have to calculate and continually monitor the effects of straight-line rent only to remove these effects from fair value measures. Whether this task is accomplished in-house or via a third-party provider, it would come with additional cost to research every lease, apply a systems application to the calculation, and continue to recalculate the amount. This additional burden is created in an environment that has the potential to reduce lease terms and therefore, increase the frequency of variation in the calculations.
- We recommend simplification in transition to the new standard for existing lease transactions. We would not suggest that existing leases be grandfathered, but rather that the current classification of operating leases and capital or finance leases be carried over in determination of Type B and Type A leases. It will be operationally challenging to evaluate existing leases as to circumstances and judgments dating back to the original lease inception, which could be decades ago in some instances. The volume of work for companies with meaningful lease portfolios would exhaust organizational resources and provide little gain or relevance of reported financial information. Furthermore, many transactions such as sale-leasebacks could reach different conclusions, potentially resulting in the failure to achieve sale recognition of existing leases under the new standard, obscuring the economics and comparability of information on restatement. Differences between the old and new standards that affect when a modification results in a new contract would have a similar impact on the reported information. We believe that a simplified transition would be a smart compromise that

achieves the Board's goal of balance sheet recognition, while providing more continuity through the transition for users, and will be more operational and much less costly to implement.

Below we will reinforce those of our concerns described above which relate to specific questions posed by the Board.

# Question 2: Lessee Accounting

Do you agree that the recognition, measurement, and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

We support the concept that recognition, measurement and presentation of expenses and cash flows arising from a lease should differ for different leases, reflecting the lessee's relationship to the underlying physical property being utilized. We do not believe, however, that the consumption model is the most useful and representational distinction between the types of leases. Two reasonable people could arrive at widely disparate conclusions on similar transactions, undermining comparability and usefulness of information amongst the user community. Rather, we prefer the risks-and-rewards model as it is applied in principle under IAS 17 as a standard that is closely aligned with the economics of lease arrangements that informs the relationship between lessor and lessee. Given the comfort level that already exists with the application of IAS 17, the transition to a new standard would be far simpler.

The vast majority of leased real estate receives operating lease classification because the leases quite naturally meet the requirements for such treatment. Companies are driven to lease real estate by basic operating needs, such as providing office space for employees or establishing retail sales locations, and they choose to lease because they desire flexibility in location, the amount of space occupied and the tenor of occupancy. There may be situations where these choices can also help preserve capital for other business purposes, but financing is not their primary objective. In innumerable locations, ownership of the underlying real estate is not an option, such as in a multi-tenant office building or in a shopping mall. Location decisions are based on access to labor pools, customers, transportation and other critical business inputs. Business cycles, merger and acquisition activity, technology as well as the fundamentals of business activity all affect the growth and contraction of demand for space. In summary, most occupiers of real estate choose to lease because it makes far more commercial sense than owning property.

While we accept the position of the Board to require capitalization of a right-of-use asset, we believe the cost of the resources required to collect what could be hundreds of data points of information used to develop the assumptions would grossly outweigh the benefit provided to users of financial statements. We estimate a typical

company with extensive leasing activity would need to significantly increase its resources to manage its leasing portfolio on an ongoing basis, not to mention the extensive resource requirements needed to apply the guidance at implementation.

### Question 3: Lessor Accounting

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

We believe that real estate leases are significantly different from most other leases in that the ownership of an underlying real estate asset nearly never transfers to the lessee, and that this difference should be a driver of different accounting between an operating lease (Type B) and financing lease (Type A).

We strongly suggest that the eventual standard defines lease term in a manner that is largely similar to the current standard of IAS 17. This standard focuses on the relationship between the term of the lease and the useful life of the underlying asset as well as total payments to the fair value of the asset. This approach would also address the mutual benefit of convergence across regions.

# Question 4: Classification of Leases

Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 842-10-25-5 through 25-8, which differ depending on whether the underlying asset is property?

Regardless of lease type, the measurement processes described here will inevitably result in inconsistent application. We believe interpretation of the classification will create divergence as preparers attempt to address the references of "more than an insignificant portion," "major part," and "substantially all," in a consistent manner across multiple companies. We request the Boards provide additional guidance to clarify the terminology.

With respect to property leases for the use of a space, if the proposed guidance continues to scope in Type B leases, we believe they should simply be Type B, without exception. If a lease exhibits characteristics of a purchase and sale agreement, we believe it should no longer be considered a lease and does not belong in Type A or Type B categorization, but rather as a seller-financed sale of an asset. The Exposure Draft allows for some extreme circumstances under which a Type B lease might be classified as a Type A. Such exceptions and varied interpretations of rules and thresholds will lead to inconsistent treatment of similar transactions.

#### Question 5: Lease Term

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

We believe the definition of lease term used in today's guidance has been highly effective and all modifications to a lease have been appropriately recognized. We are concerned that the requirement to include available extensions in which the lessee has a significant economic incentive but does not have the legal right as of commencement of the lease to continue the use of the underlying asset will again cause discrepancy in application among preparers. As a result, we believe the standard should clarify that periods for which no legal right exists cannot be included in the term.

We do agree with reassessment of the lease term for material changes in relevant factors, and we believe that carrying forward current US GAAP requiring both lessees and lessors to reassess the lease term for material modifications (extensions, expansions, etc.) would be appropriate. Reassessment is less subjective and more objective with respect to the leasing of space (i.e. property), as the parties to a lease tend to make these decisions toward the end of a lease term and prioritize market strength, location, and availability of rentable square footage, giving less regard to economic incentives like those more commonly reflected in leases of machinery or other assets.

While we believe the Exposure Draft includes various complex and confusing requirements, it does not take into account certain lease terms which we believe should be recognized as part of the leasing arrangement. For example, laws in certain countries dictate practices, regardless of the contractual leasing arrangement established between a lessee and a lessor. Additionally, paragraphs 842-20-55-32 through 55-34 give an example of how a company should treat a unilateral termination option which changes the term of the lease for calculation of the lease liability. In reality, it is not a common practice for a lessor to provide a lessee with a unilateral termination option without a significant financial penalty. The Exposure Draft does not take into consideration the other terms which will inevitably exist with such termination option. These are two examples of where the complexity of the Exposure Draft, by way of being prescriptive but silent to the nuances in these examples, will create divergence in application and the results will stray from the economic reality of the transaction.

As stated above in our response to Question 3, we would support a standard which defines lease term in a manner that is largely similar to the current standard of IAS 17. This standard focuses on the relationship between the term of the lease and the useful life of the underlying asset as well as total payments to the fair value of the asset.

### Question 6: Variable Lease Payments

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

We believe that reassessment of lease payments based on an index or a rate would require extensive work but seldom provide meaningful information to users, that the distinction between types of variable lease payments is not grounded in any fundamental principle, and that a requirement for tenants to annually reassess for increases based on an inflation or other index that are known to change every year is wholly unnecessary. We believe that recognition of changes in stated index rates through current period expense coupled with adequate disclosure will provide the required information in a much more cost-effective way. We are also concerned that the requirement to reassess the lease liability after the initial measurement date for changes in applicable discount rate will result in perpetual reassessments of the liability since discount rates are known to fluctuate from period to period, again adding cost in excess of benefit.

Similar to our response to Question 3 in regards to lessor accounting, we would propose that the inflation index be set at the commencement of the lease and any changes to the index from that set rate be recognized as an adjustment to current period lease expense.

# Question 8: Disclosure

Paragraphs 842-10-50-1, 842-20-50-1 through 50-10, and 842-30-50-1 through 50-13 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments, reconciliations of amounts recognized in the statement of financial position, and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

We are clear that the objective of the disclosure requirements is to enable users of financial statements to understand the amount, timing, and uncertainty of cash flows arising from leases. We would insist on the retention of the provisions in 842-20-50-2 and 842-30-50-2 which provide for lessees and lessors to make judgments as to the level of detail necessary to satisfy the disclosure objectives and how much emphasis to place on each of the various requirements. An entity should have the flexibility to determine what data points or significant assumptions used are important to disclose to users for them to understand the impact to the financial statements, and we believe that the requirements across all of the paragraphs referenced in this Question are overly extensive.

### **Conclusion**

We believe that if the new lease accounting standard which mandates capitalization of operating leases is issued, it should provide a simple and transparent approach. We see the value of increased comparability of information between companies and within industries to evaluate leasing practices and strategies as they impact a company's financial performance. However, we believe that a number of elements presented in the Exposure Draft will not provide meaningful new information to users of financial statements, but instead will introduce additional and unnecessary complexity into financial statements, reduce transparency into the effects of lease contracts on a company's financial performance, and reduce comparability between reporting entities, the combination of which will result in the incurrence of costs which will significantly outweigh the benefits of implementation.

We would be pleased to discuss our comments with you in further detail. If you have questions regarding our comments, please contact me at (312) 228-2316, or Mark Engel, Controller, at (312) 228-2343.

Very truly yours,

Christie B. Kelly

Executive Vice President and Chief Financial Officer

Jones Lang LaSalle Incorporated

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