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International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
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Financial Accounting Standards Board  
401 Merritt 7, PO Box 5116  
Norwalk, Connecticut 06856-5116

Re: **File Reference: No. 1850-100, Exposure Draft: Leases and  
Exposure Draft, Leases, ED/2010/9**

Ladies and Gentlemen:

We are writing you on behalf of an ad hoc group of participants in the real estate net lease investment market – including our firm and some of the nation’s leading institutional fixed income investors – in connection with the above-referenced Exposure Draft “Leases” (the “ED”) provided by the Financial Accounting Standards Board and the International Accounting Standards Board (collectively, the “Boards”).

Based on our review and consideration of the observations expressed among the numerous Comment Letters to the ED that FASB and IASB (the “Boards”) have already received to date, we have our own considerable concerns with respect to commercial real estate leases and real property transactions (collectively, “CRE”) which transcend the more technical reviews articulated by others. Accordingly, we are limiting our comments to highlighting material and fundamental concerns over the applicability of the ED to CRE, and are refraining from adding to the already significant responses you have received to the various questions posed by the Boards.

As both users of financial statements and as investors of capital for corporate and governmental CRE transactions, we do not believe that the changes proposed in the ED will accomplish the desired (and appropriate) objectives of greater financial transparency, particularly with respect to commercial real estate assets which have properties materially different than those attributable to equipment and other personal property. Quite frankly, it appears to us that the sweeping changes proposed in the ED are being proposed based on factors specific to depreciating and shorter life assets such as equipment, while ignoring and distorting the financial parameters associated with longer life and (over long periods of time) appreciating assets such as real property.



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About Us

Our group does not constitute a formal “trade association“ or industry lobby, but does include institutional market participants which collectively manage over \$3 trillion and have participated in over \$25 billion of real property net lease financing transactions over time.

Our firm – CGA Capital Corporation (including its affiliates, collectively “CGA”) – is a Baltimore-based company focused exclusively on structuring and providing debt and equity for assets net leased to corporate, governmental and 501(c)(3) users throughout the United States. Founded in 1989 as Legg Mason Mortgage Corporation, CGA’s efforts include over \$11 billion in net lease debt and equity financings originated, structured and closed over the past 20 years. CGA’s principals have completed net lease transactions for office, retail, industrial, governmental, healthcare, manufacturing, and other property types involving more than 50 separate corporate and governmental tenants in over 40 states. In addition to investing for its own account, CGA provides debt financing and equity investment services for institutional and high-net worth commercial real estate equity investors and developers. CGA also has served as the exclusive real estate net lease financing effort for RBS Global Banking & Markets, Americas (part of The Royal Bank of Scotland Group plc), and provides advisory services for debt and equity investments in excess of \$1.5 billion through its loan servicing and asset management affiliates.

Our Consideration of the Exposure Draft

We obviously have tracked closely the efforts of the Boards to materially modify the manner in which leases are accounted for and reported by lessees (tenants) and lessors (landlords). Our review has included consideration of not only the Exposure Draft, but also certain of the various Comment Letters and industry publications, many of which have been generated by accounting firms, specialty trade groups and similar organizations).

Given the numerous comments to the ED received by the Boards, rather than attempt to add to what appears to be fairly exhaustive commentary provided to you thus far on various technical concerns (e.g., determination of appropriate discount rate for right of use, misalignment of “depreciation” of Right of Use asset vs. liability, etc.), our focus instead rests on the “core observations” of our group that the changes proposed by the Exposure Draft appear to emanate primarily from issues and concerns related to personal property (equipment) rather than those related to CRE, when the financial and legal differences between these asset classes are so striking as to suggest that the Exposure Draft not apply to CRE at all, or be materially modified with respect to considerations specific to CRE vs. equipment/personal property.



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In fact, the differences between equipment/personal and real property (including CRE) assets are striking, and belie use of one common set of lease accounting guidelines for both asset types:

Consideration/Factor	Commercial Real Estate (CRE)	Personal Property /Equipment
Value/utility	Appreciates or constant.	Generally depreciates.
Residual value	May be equal if not greater than value at inception.	Typically written down to <50%, often <10%, of original value.
Market rental value vs. lease constant rate	Market value generally appreciates over time. Renewals generally “market-based”.	Market value generally declines as asset depreciates and utility value declines.
Legal considerations/ bankruptcy of lessee/ tenant (U.S. law)	CRE leases treated in same manner as executory contracts, rejectable by and at sole option of lessee/tenant. Lessee/tenant liability reduced to 15% of remaining lease contract rents, subject to “floor” of 1 year and “cap” of 3 years of rent. Remaining liability is <i>pari passu</i> with other senior unsecured debt of lessee/tenant (i.e. may be subject to further “cram down”).	<u>Not</u> rejectable under U.S. Bankruptcy code. Liability remains 100% of remaining lease contract rents. Treated same as the form of comparable lessee/tenant debt i.e. senior secured or unsecured debt.

If the intent of the changes proposed in the ED is to promote financial transparency and increase a financial statement user’s understanding of ongoing CRE occupancy cost, then the ED’s “front loading” of operating expense (in the form of “interest”) and non-aligned treatment of lease liability seems incongruous in the context of a lease of a CRE asset whose utility, residual and leasehold estate values likely will increase rather than decrease over time. The very essence of



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the “Right of Use” approach proposed by the Exposure Draft arguably rests on an assumption that the utility value of the leased asset to the lessee/tenant declines over time – arguably true for any equipment transaction, but conversely untrue for most CRE transactions. “Front loading” the charge to the operating income reported by a CRE lessee/tenant implies that the utility value of the leased asset to the lessee/tenant declines over time; history is replete with examples where the opposite has proven true. For example, had the ED been in place in the late 1990s, companies such as Kmart might have shown lower operating income and greater CRE lease-related liabilities than they actually reported at the time, further distorting the reality that the leasehold estates represented by those long term leases had appreciated since inception, as the profoundly positive difference between market and lease contract rental rates actually increased materially over the terms of the subject leases.

Moreover, capitalizing renewal options as if automatically exercised at inception of a lease overstates the liability to the CRE lessee, since by its very definition the “option” to renew truly represents a “call right” – not a lessor/landlord “put” obligation – which a CRE lessee/tenant can exercise or not at its own volition, with fairly widespread ability to simply lease another CRE asset if the subject asset proves inadequate for lessee’s use, or features renewal terms (i.e. price and other cost considerations) which are not as favorable as those lessee/tenant can secure elsewhere. The ability of a lessee/tenant to easily secure other CRE assets for lease arguably often transcends that associated with major items of integral and/or installed equipment.

In addition, under current GAAP accounting, for “book” purposes all lease contract rents must be recognized as a straight line average of the total lease contract rent required to be paid over the entire lease term. Consequently, current GAAP guidelines consider lease payment obligations in their totality, and intentionally prevent understating overall CRE lease obligations which often start at a lower rate and then increase based on fixed or variable schedules throughout the lease contract term. The ED, however, would cause lessee/tenants to misstate not only actual lease obligations, but the economic direction of the lease obligations themselves – materially overstating the early years and understating the later years, as lease obligations presumably would be accounted for book purposes at their highest level at the inception of the lease and at their lowest level towards the end of the lease. While we fully appreciate that lease payments for book purposes must reflect overall lease obligations, the approach proposed in the ED instead results in reporting that could be completely misleading to any investor or other professional looking at the financial statements of any company engaged in meaningful CRE-related leasing transactions. By way of example, in the final years of a traditional 15 year CRE lease, a lessee/tenant may be paying at the peak cost levels of its lease contract obligation for cash purposes, while for book purposes that same lessee/tenant would report the lowest cost level of its CRE lease obligation in those same years. We do not see how this approach can benefit any of the parties involved, whether lessee/tenant, lessor/landlord, or any investor or other use of lessee/tenant’s financial statements.



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If the intent of the changes proposed in the ED is to promote financial transparency and increase a financial statement user's understanding of potential claims against the assets of the subject company following a default, then the ED's failure to consider the ability of a CRE lessee/tenant (as opposed to an equipment lessee) to diminish if not extinguish its lease liability following a default and rejection of an undesired lease could prove extremely material. Typically, CRE leases where contract rents are higher than market, and the subject assets are not critical to lessee/tenant operations, are rejected by the CRE lessee/tenant – hence, the net liabilities associated with those rejected CRE leases would be far less than the amounts shown on the lessee's balance sheet under the ED. Conversely, CRE leases where market rents are higher than contract rents are accepted by the CRE lessee/tenant – hence, the net asset values associated with those accepted CRE leases would far exceed the values shown on the balance sheet under the ED. Again citing Kmart as an example, the ED effect would have been to overstate the negative balance sheet implications of the CRE leases which ultimately were rejected, while vastly understating the net asset value of those CRE leases which ultimately were accepted – and which drove significant shareholder value to the private equity firm which ultimately wrested control of Kmart from bondholders who lacked information regarding the net leasehold estate values, a knowledge gap which would have been exacerbated had the ED changes been in effect at the time.

Finally, we also note that significant commentary has been provided to the Boards regarding the appropriate discount rate. In the context of CRE leases – which generally are materially longer in term than personal property (equipment) leases – even slight differences in discount rates can lead to considerable distortions. It seems incongruous at best that a company with a lower credit profile, or a company with a deteriorating credit profile, might have a better “net result” from an ROU vs. liability perspective than comparable companies with stronger credit profiles; we suspect this anomaly may lead to a disproportionate number of weaker corporate credits to seek leasing transactions, while ballooning the balance sheets, lowering return on equity, driving higher occupancy costs (via higher rents generally associated with shorter term leases), and generally consuming available capital (at the margin) for those companies with better credits which are motivated to eschew long term leasing arrangements.

Conclusion

We concur that the current approach to lease accounting fails to accurately depict true leasehold value and liability, and that change is warranted. However, absent a true “mark to market” or other approach for CRE leases, the Exposure Draft will actually serve to further distort – and likely understate asset value and overstate liability, while increasing occupancy costs – lease accounting from a CRE lessee/tenant perspective. Creating incentives for users of CRE to own



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rather than lease will serve to decrease creditworthiness through increased use of capital, increase covenants, increase occupancy costs, dilute shareholder equity, divert equity to lower returning assets (i.e. CRE) and away from investments in core business activities, and diminish overall financial performance.

Accordingly, we strongly urge you to reconsider whether the ED guidelines which appear to emanate from factors specific to equipment and other personal property should be materially revised before their application to CRE assets, and we stand prepared to provide any additional commentary or analysis the Boards may desire to further explain the concerns of those firms which invest in CRE transactions.

We greatly appreciate this opportunity to comment on the ED, and hope that you do not hesitate to contact us with any comments or questions you may have regarding our observations.

Sincerely,

A handwritten signature in blue ink, appearing to read "W. Gore", with a large, stylized flourish at the end.

W. Kyle Gore  
Managing Director

A handwritten signature in black ink, appearing to read "R. Jacobs", with a long horizontal line extending to the right.

Richard A. Jacobs  
Managing Director

cc: [CRE Net Lease Institutional Investor Group]