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Dear Sirs,

I have spent some time reviewing your proposed standards regarding lease accounting and wanted to take a belated moment to write a brief letter that I hope will be helpful. I have been in the real estate leasing field for over 25 years and have served at the helm of two publicly-traded NYSE-listed "net lease" REITs. In total, the companies I have run have deployed a total of nearly \$10 billion in invested capital, with over 7,000 individual property locations financed. Beyond this, my original background was in the area of commercial banking and financial statement analysis. All of this should make me well qualified to provide some insights into your proposal to change the lease accounting standards that we have been operating under.

Before starting to comment specifically on your proposed accounting changes, I would like to begin by making a handful of comments about why people elect to lease real estate in the first place. It has been our experience that most tenants elect to lease their real estate locations based on the economic benefits of the lease, and not based upon any particular accounting treatment. Real estate leasing, for most companies, is effectively a substitute for both debt and equity, with the five essential reasons to lease an asset as follows:

1. Tenants realize 100% of the capital for real estate
2. Tenants receive the longest term non-equity capital available
3. Tenants receive flexible long-term capital with little to no covenants
4. Tenants benefit from the landlord's acceptance of residual real estate value risk
5. Tenants realize monthly payment constants that are below those of traditional bank financing

Real estate leasing is a part of the CFO's financial toolkit and typically will permit companies to actually lower their cost of capital relative to those companies that elect not to lease. As a result, whether the

lease is classified as on or off balance sheet has always been less relevant, since the accounting treatment has no bearing on the financial benefits of leasing.

The current accounting protocols for leasing are somewhat problematic, since they do not really take into account the true financial rationale for real estate leasing. Instead, they rely on some artificial premises regarding the expected useful life of assets, which appear nowhere in the above rationale for real estate leasing (besides, companies tend to maintain real estate assets over time which makes such static useful life estimates somewhat moot). There is also the issue of the marginal discount rate, which is also reliant upon an estimate. Still, leasing companies and tenants will tend to try their best to get operating lease treatment, given the variables of expected useful asset life and the marginal discount rate. This is logical, since companies do not wish to inflate their balance sheets by reporting assets that they do not actually own. Likewise, leasing companies do not wish to show a loan receivable when, in fact, they actually own the real estate in question and will benefit from its residual value.

From the standpoint of a user of financial statements, the current accounting, while imperfect, is generally readable. For example, I can look at a company and know what their long-term future lease commitments are from the footnotes. However, to make a company's financial statements comparable to those of a company that owns its real estate, I do not discount these future minimum payments back. Instead, I take a company's lease payments and capitalize them at what I reasonably estimate to be a prevailing market rate. The number I come up with should approximate the cost of the real estate deployed in the business, or an amount roughly equivalent to the gross book value of a competing company that owns their real estate. Part of the reason that one would not discount the future minimum lease payments back is that these payments overlook the fact that the lessor is absorbing some residual real estate ownership risk and also that the leases, upon maturity, are very likely to be renewed (or maybe replaced with alternate locations). This is all part of analyzing a company as a going concern. Just discounting leases results in a theoretical notional "unwind" obligation that is generally incorrect and is absolutely inconsistent with an essential review of a company as a going concern.

So, my question is whether the new lease standards proposed offer a better solution that will aid analysts like me in evaluating comparable real estate-intensive businesses. Here, I believe that the proposed standards are, in fact, a step in the wrong direction. First, real estate lease obligations will all have to be capitalized to arrive at (what I would call) a hypothetical "notional" liability amount. This amount will have no bearing in law or reality. For example, it would not represent the amount that would have to be remitted to a landlord to extricate oneself from a lease obligation. Neither would it represent the ability of a landlord to accelerate a lease upon default (this is essentially moot, anyway, since such accelerations are ignored in a bankruptcy court, where a lease is accepted as an executory contract). Nor would it relate to the actual cost of the real estate deployed. The offsetting asset, which is called a "right to use" likewise would bear no relation to the actual cost of the asset leased. In fact, based upon the estimates of accountants and management (looking far into the future), the value of the "right to use" may be actually more or less than the asset actually costs! Finally, the "right to use" asset is purely an accounting device and would have no real or perceived value to purchasers of companies or common stock, who are generally and rightly focused on corporate cash flows.

The rationale for capitalizing a lease obligation appears to be to render companies comparable regardless of the types of financial contracts used (mortgage versus leasing). However, such contracts are not actually comparable. As stated earlier, leases, since they are a partial equity substitute, cannot ever really be compared to pure mortgage instruments. The result of such an effort is bound to incur greater interpretive and executional difficulty than the imperfect system we now enjoy. No longer will I be able to simply capitalize lease payments to make companies more comparable. Instead, users of financial statements will be befuddled by a notional liability that has no basis in law and a manufactured asset that represents no value to anyone actually buying a business. Even more, what started as a noble attempt to capitalize a tenant liability now has to be incorporated into a landlord's financial statements in the spirit of consistency. The result will be, of course, inconsistent, since the landlord and tenant have different auditors. And the worst part appears to be that the landlord will have to create a "right to use" notional liability that will simply serve to inflate its balance sheet with meaningless numbers. Any CFO of a real estate company, in the MD&A disclosure, would then have to completely back out this non-cash, non-legal and meaningless liability (along with the offsetting asset) to talk about what really has happened.

The proposed new lease accounting will be highly dependent upon risky estimates. The use of estimates in accounting always bothers me. Sometimes it is unavoidable, but I believe that accounting should do its very best to deal in absolutes. Take ten financial analysts and they may come up with ten different conclusions. This alone should advise the accounting industry of staying far away from financial statement valuation estimates (I am fine with such estimates in the footnotes). Financial statement interpretation is achievable if the numbers can be relied upon. If the numbers are based upon estimates, backing into the reality becomes a function of the statement of cash flows, which is rapidly becoming the only part of the financial statement that can be readily read. Here, it bears noting an illustration from my own career. I have now sold two public NYSE-listed companies to two completely different types of buyers. The first was a large publicly-traded industrial and financial conglomerate that desired to maximize net income. The second was a global asset management company that desired to maximize the value of assets under management. The resultant purchase accounting, which was based upon real estate valuation estimates of similar types of assets, arrived at strikingly different results. With the first sale, our real estate assets were appraised at conservatively low levels, resulting in a high level of goodwill. The benefit was twofold: depreciation was reduced, which elevated reportable net income; and low asset carrying values presented the potential of future eventual gains to be realized from asset sales. With our second sale, elevated asset valuations were optimal and would aid in future capital raising efforts from investors focused on net asset value. Indeed, the wide potential for estimates to vary, in some cases greatly, presents a challenge for financial analysts and any accountants in favor of fair value accounting estimates. It makes me long for the days of "pooling of interest" acquisition accounting.

It is bad enough that needless estimates pose a challenge for anyone attempting to read a financial statement. But it is even worse for the accounting departments that have to continually revise such estimates and the auditors that have to sign off on them. The result for companies will invariably be elevated operating and auditing costs, all to provide an inferior product. Since estimates require such a

substantial amount of judgment, there will develop many theories on how best to make such judgments. But with no clear science as to how these judgments are made, how can these estimates be properly audited? And will the increased reliance upon estimates subject the accountants and auditing firms to even more potential liability when their estimates turn out to be incorrect?

I started this letter off with the rationales for real estate leasing. I believe that these are very important, because accounting should always be trying its best to reflect financial reality. And, as I stated earlier, the accounting pronouncements have never been (and should never be) an influence upon the delivery of a valuable financial product. However, I believe that there is the potential, with the complexity of the proposed new lease accounting rules, for this to change. By attempting to monetize as a liability an instrument that is a partial equity substitute, the results are bound to be naturally confusing, burdensome and complex. Indeed, with the very real potential that assets and liabilities can actually be booked for costs that exceed the proceeds from sale-leaseback transactions (depending again on discount rate and lease term estimates), accounting could very well be at odds with optimal real estate lease documentation. The result could very well be less leasing and the responsive creation of future creative mortgage instruments that offer some or all of the financial benefits of leasing. The business world will always operate in a rational response to any new accounting rules adopted. If accounting alterations actually serve to change the leasing landscape, then accountants will have to consider future issues, like how to value mortgages that confer some residual risk to lenders.

As a financial analyst and past President of two publicly-traded real estate companies, I very much empathize with the complex issues you face regarding off-balance sheet obligations. Personally, I have always strived for financial statement presentations and footnotes that I believed would make it easier for analysts like me to interpret. However, with respect to your prospects of altering the current lease accounting convention, I do not believe that you are taking a step in the right direction. That said, I would also like to say that I am absolutely willing to help you with my comments or time as you evaluate this very complex issue.

Sincerely,



Christopher H. Volk