Technical Director
File Reference No. 1820-100
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Re: Leases Exposure Draft

Dear Sir/Madam:

Vornado Realty Trust (NYSE: VNO “Vornado”) and SL Green Realty Corp. (NYSE: SLG “SL Green”) are among the largest publicly traded real estate investment trusts (“REITs”) in the United States and are active members of the National Association of Real Estate Investment Trusts (“NAREIT”). Vornado and SL Green are two of the largest New York City office landlords and Vornado is also one of the largest Washington, DC office landlords. Together, Vornado and SL Green own and manage in excess of 130 million square feet of real estate with many thousands of in-place space leases. All references to “we,” “us,” and “our” in this letter refer to Vornado and SL Green together.

We have prepared this joint comment letter to emphasize our shared views related to the leasing exposure draft (“Leasing ED”). We sincerely appreciate the opportunity to express our views to you.

We understand the importance of converging on one comprehensive set of global accounting and reporting standards to improve comparability and transparency in financial statements and related disclosures. We agree that the current lease accounting framework has its limitations and support the issuance of a new lease accounting standard to fully reflect the economic substance of lease transactions, bring all operating leases onto the balance sheet of lessees, improve the quality of earnings and reduce complexity. However, we do not believe that the Leasing ED, in its current form, will achieve these objectives.
REITs are dedicated to owning and operating income-producing real estate, such as office buildings, shopping centers, apartments and warehouses. Publicly traded REITs currently own in excess of $500 billion of commercial real estate, representing ten to fifteen percent of total institutionally owned commercial real estate in the United States.\(^1\) To qualify as a REIT under Internal Revenue Service rules, greater than 90% of taxable income must be distributed to shareholders each year. In 2009, publicly traded US REITs paid out over $13.5 billion in annual dividends.\(^1\) Dividends, therefore, are fundamental to the REIT industry. Real estate valuations are also fundamental to the REIT industry. Valuations are driven primarily by the amount of cash rents received under real estate lease agreements over an expected holding period. In order to understand these fundamentals, REIT investors must understand the economic substance of real estate leases, or the contractual cash flows over the non-cancelable lease term, in order to make investment decisions.

What investors want and need is for GAAP accounting to represent economic reality. Currently, GAAP net income includes: (i) lease rental income on a straight-line basis over the non-cancelable lease term, (ii) adjustments to rental income from the amortization of lease assets and liabilities (above/below market leases) recognized as a result of property acquisitions and (iii) real estate depreciation expense on a straight-line basis over an estimated useful life (approximately 40 years per building is standard in the industry – as opposed to the economic reality which would have been achieved if the FASB’s proposed fixed asset accounting standard requiring cost componentization was promulgated). Consequently, GAAP net income is not representative of economic reality and, therefore, REITs provide supplemental disclosures of non-GAAP performance measures that represent economic reality, including net operating income (“NOI”), funds from operations (“FFO”) and adjusted funds from operations (“AFFO”).

Under the proposed lease accounting framework which converts the economic reality of leases to the uneconomic accounting for fixed assets, income recognition from leases includes rental income from the amortization of the lease liabilities on a straight-line basis and interest income from the amortization of the lease asset using the effective interest method, which results in the front-loading of income. This proposed income recognition creates an even larger divergence than exists currently between GAAP financial results and economic results as, in most cases, payments under leases of real estate increase over the lease term. We believe this is a step in the wrong direction.

We believe the FASB should consider terminating the progression of this Leasing ED as the proposal does not represent economic reality. We believe that rental income should be recognized on a contractual basis as cash payments are received rather than on a front-loaded basis or straight-line basis. A lessor’s rental income and a lessee’s corresponding rental expense should be reflective of increases in contractual rental payments during the term of a lease – economic reality. This would eliminate a substantial portion of the divergence between current GAAP and economic financial results that are of critical importance to users of financial statements.

\(^1\) Source: NAREIT REITWATCH, November 2010.
Given the choice between adopting the proposed Leasing ED or adopting a proposed Investment Properties accounting standard (fair value reporting), we would choose the Investment Properties accounting standard because REIT fundamentals are focused on valuation and cash flow. To be clear, in the absence of the proposed lease accounting framework, we would not be supportive of moving to Investment Properties (fair value) accounting until the convergence of US GAAP and international financial reporting standards. We therefore urge the FASB to provide a scope-exclusion for REITs that report investment property at fair value if this Leasing ED progresses further. We believe that although fair value reporting for investment property has limitations, it is well supported internationally under IAS 40, *Investment Property*, by both preparers and users of financial statements and more fully represents economic reality.

**Earnings Quality**

We believe that a new leasing standard designed to capitalize all leases should have objective measurement guidelines and provide for greater quality of earnings (timing, comparability, etc).

Real estate leases are complex agreements that contain income attributes including: base rent, contingent rent, reimbursements for real estate taxes, operating expenses and common area maintenance charges. These items are usually subject to contractual increases over the lease term either through stipulated fixed increases, increases in a specified index, such as Consumer Price Index or Porters’ Wage, or based on lessee performance thresholds, such as the achievement of specified sales volumes. In addition, real estate lease terms span multiple years and typically include extension or renewal options and, in certain cases, purchase options and other rights and obligations.

Under the proposed lease accounting framework, an extensive amount of judgment will be required to measure a real estate lease asset and liability given the complexity of these agreements. Determining the length of a lease term that is “more likely than not going to occur” or the probability that lessee sales volumes will be achieved in each year of a ten, fifteen or twenty year lease, will result in unreliable estimates of value which will not represent the ultimate economic reality of the leases. We struggle to understand how contingent rents can be considered assets or liabilities in the presence of FASB 5 (probable and estimable) and SAB 101 (recognition of income only after all contingencies have been removed). Finally, we observe that the “more likely than not” standard for determining the estimated lease term will result in recognizing obligations for future lease payments that do not meet either the GAAP or IFRS standards for recording liabilities. These hypothetical liabilities exaggerate the front loading of rental income by landlords and rental expense by tenants.

Given the inherent amount of uncertainty in the estimation process, we believe that the value determined for a particular lease by one entity could be significantly different if the same lease was measured by another entity, thereby diminishing the quality of earnings and real comparability of earnings between periods and among industry peers.

Accordingly, we believe that value from the inclusion of option periods and contingent rents should be excluded from the measurement of a lease asset and liability until such options are actually exercised and such contingencies are removed.
**Adverse Business Impact**

We believe that bringing additional assets and liabilities on to the balance sheets of lessee’s and the variability in these assets and liabilities given the significant judgement concerning contingencies and extension options and the continual reassessment of those measurements could influence the leasing decisions of lessees and, therefore, adversely affect the lessor’s business model. Focusing on leverage ratios, lessees may elect to lease space for shorter periods of time and eliminate option periods in order to minimize their balance sheet lease liabilities. Given that a real estate property’s credit profile is based on the average in-place lease term, among other factors, which provides an indication of the stability and predictability of the property’s cash flows, the credit profile of operating real estate could be negatively affected, resulting in an increased cost of capital for real estate investors, among other adverse business effects. We believe that a proposed Leasing ED should not dictate or influence business decisions.

**Derecognition Approach for Lessors**

While we believe that the current accounting for lessors is more appropriate than the proposed dual model provided in the Leasing ED, if the dual model were to be disregarded, we would not be supportive of the derecognition approach as the sole method for lessor accounting. We do not believe that the derecognition model as described in the Leasing ED is an improvement to the current lessor accounting requirements for real estate leases, substantially all of which do not transfer asset ownership to the lessees. We believe that derecognizing an asset (or a portion of a building) and recognizing income at the inception of the lease is very misleading and not representative of economic reality.

**Administrative Burden**

We believe that the benefits of a new lease accounting standard should be considered in relation to the administrative burden. As stated above, measurements requiring significant judgement concerning contingencies and extension options and the continual reassessment of those measurements each period for thousands of leases is administratively burdensome and costly. New systems, processes and controls, will be required, but even more costly will be the amount of time involved to manage the ongoing measurement process. We believe that much of this administrative burden could be eliminated by excluding contingencies and option periods from the measurement process.
Conclusion

We believe that a comprehensive lease accounting proposal which impacts virtually every company in existence should be carefully studied before implementation. For the reasons we outlined above, we believe that the proposed Leasing ED requires significant revisions before it can be considered practical and sufficient to achieve its intended objectives.

We appreciate the opportunity to share our views with the FASB and welcome any questions on our comments.

Respectfully submitted,

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CFO of Vornado Realty Trust

James E. Mead,
CFO of SL Green Realty Corp.