

ARCHSTONE SMITH

August 16, 2005

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VIA E-MAIL

Mr. Lawrence W. Smith
Director-Technical Applications and Implementation Activities and EITF Chair
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856-5116

Re: Accounting for Rental Costs Incurred during a Construction Period

Dear Mr. Smith:

Archstone-Smith welcomes this opportunity to respond to the request for comments from the Financial Accounting Standards Board (FASB or Board) on the proposal contained in FASB Staff Position FAS 13-b, *Accounting for Rental Costs Incurred during a Construction Period* (13-b). Archstone-Smith (NYSE: ASN), an S&P 500 company, is a recognized leader in apartment investment and operations. As of June 30, 2005, Archstone-Smith owned or had an ownership position in 227 communities, representing 78,038 units, including units under construction and had a market capitalization of approximately \$13 billion. In our business it is relatively common to buy an operating community that is subject to a long-term ground lease or develop a community on land that is subject to a long-term ground lease. In the case of a development project, the preference is to buy the land outright. However, for a variety of reasons the landowner may not be willing to sell the land but be willing to enter into a long-term ground lease arrangement. In effect, the execution of the ground lease arrangement is one of the many costs incurred to enable the development of the real estate asset. The development could not occur without securing rights to the land through the ground lease.

We respectfully disagree with the 13-b conclusion that ground lease payments incurred during the construction of a real estate asset should be expensed during the construction period for the following reasons:

(1) The fundamental premise of 13-b is that a ground lease is an operating lease, and should be expensed in all circumstances under FAS 13. This conclusion is inconsistent with the accounting treatment of other costs that are normally expensed but capitalized under FAS 67 during the construction of a real estate asset, if certain specific criteria are met. These costs include:

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|-------------------------------------|--------------------|
| Pre-acquisition costs | Paragraphs 4 and 5 |
| Taxes and Insurance (holding costs) | Paragraphs 6 |
| Project Costs | Paragraphs 7 |
| Income from incidental operations | Paragraph 10 |

Per FAS 67, once the asset is ready for its intended use, capitalization ceases and the costs above prospectively are expensed. Physical completion of the asset also triggers commencement of depreciation. We believe there are significant similarities between the costs listed above and costs incurred for ground lease payments. Accordingly, we believe the accounting treatment should be consistent.

We believe that expensing costs related to a real estate development prior to the point that it is ready for its intended use is illogical. We would also note that under FAS 67, actual income generation from the asset is not the criteria for ceasing capitalization, but rather when the asset is ready for its intended use. We therefore agree that operating costs (including ground rentals) incurred while a building is empty, yet complete from a construction standpoint, should be expensed as incurred.

(2) Ground lease costs, like land holding costs such as taxes and insurance (which are capitalized during the construction phase under SFAS 67 paragraph 6), incurred during construction are essential to the creation of probable future benefits; hence they meet the asset definition outlined in Statement of Financial Accounting Concepts No. 6. Without entering into the ground lease, it is impossible to construct improvements on the land. The ground lease is therefore a critical prerequisite to produce an asset that has the capacity to generate probable future benefits, every bit as much as the tangible building materials.

(3) Ground lease costs, like financing costs (which are capitalized during the construction phase under SFAS 34), are avoidable. An entity interested in developing a real estate asset would not enter into the ground lease but for the fact the entity wanted to develop an asset. Accordingly, these operating costs are as avoidable as the costs associated with financing a land purchase. You have to either buy the land and secure the related financing or enter into a ground lease, if you want to do a development on a particular parcel of land.

(4) It is clear from SFAS 67 paragraph 7 that indirect project costs are capitalizable as a cost of a real estate development project. One of the qualifying examples provided in SFAS 67 Appendix A is the cost associated with a field office at a project site. The physical field office is often a rented trailer or other structure that can be removed upon completion of the project. It would be inconsistent to conclude these rental costs would be capitalizable whereas other rental costs related to such a project would not. Furthermore, we believe the definition of indirect project costs as provided in SFAS 67 was intended to be principles-based rather than a bright line test applied only to the specific examples given.

(5) We believe a reasonable analogy can be drawn between development of an operating community and the production of inventory in a manufacturing environment, the major conceptual difference being one is held for use by the producing entity whereas the other is intended for sale to third parties in the near-term. Under ARB 43, Chapter 4, full-absorption costing of inventory includes indirect production costs, including rent. It would follow, that ground rent would logically be included in the cost of newly developed real estate project.

Furthermore, it is clear that oil and gas companies capitalize ground lease costs under SFAS 19 paragraph 15, whether the underlying property is proven or unproven.

We believe it would be problematic to have different accounting results between industries for transactions with fundamentally similar characteristics.

6) Finally, if the FASB chooses to disregard analogies to SFAS 67 and SFAS 34, and instead look solely to SFAS 13, we believe it would be appropriate to reconsider the nature of a long-term ground lease and the related accounting. Under SFAS 13 *Accounting for Leases* it is not uncommon to capitalize a simple office copier lease, yet it is clear under the current standard that a 40-plus year ground lease does not meet the existing capitalization criteria. These examples help demonstrate that the bright-line tests prescribed by SFAS 13 seem to produce an illogical result in accounting for ground leases. In our view, having unrestricted ownership rights and responsibilities of a piece of land through a long-term ground lease arrangement should impact the balance sheet. On the one hand, the right to use the land over the lease term has all of the attributes of an asset – probable future economic benefits (unrestricted use of the land) resulting from a past transaction or event (entering into the lease agreement). In addition, the obligation to make lease payments meets the conceptual definition of a liability – probable future sacrifices of economic benefits (lease payments) arising from present obligations to transfer assets to another entity as a result of past transactions or events (signing the lease contract with a third party). Keep in mind that in the case of an apartment ownership company, the ground lease term typically equals or exceeds the 40-year depreciation period often assigned to the building and other improvements. Furthermore, the lease payments are often tied to the cash flow produced by the improvements. Like a capital lease, the treatment

of a long-term ground lease in the manner described would result in earnings charges to depreciation expense and interest expense rather than rental expense. Conceptually, interest expense recognition under this approach would be consistent with a financed land purchase. There would be no debate over the treatment of rental costs if long-term ground leases were afforded the treatment described. In the case of our company, the interest expense would be subject to capitalization under SFAS 34 during the development period and expensed once the asset becomes ready for its intended use. At the point the asset becomes ready for its intended use, amortization of the capitalized lease would commence over the remaining lease term. It is our understanding that the Securities and Exchange Commission has also recognized some of the inherent problems with our current lease accounting standards and has suggested that the FASB, possibly in collaboration with the IASB, should reconsider standards for accounting for leases¹. As such, we believe it would be prudent to allow sufficient time for the thought process on lease accounting to evolve prior to making an illogical mid-stream change that could be reversed in the near future.

We understand that standard setters are striving for greater transparency in financial reporting and we applaud that objective. In the case of ground lease payments, we would hope that this objective would translate into greater visibility of the economic realities of a long-term ground lease on the balance sheet in contrast to the limited visibility afforded under the current standard.

Conclusion:

For the reasons outlined above, until the lease accounting standards can be more broadly reevaluated, we believe the costs associated with a ground lease should continue to be capitalized under SFAS 67 as part of the basis of the community during the development period and expensed when the community becomes ready for its intended use.

Archstone-Smith thanks the FASB for this opportunity to comment on the proposal. Please contact Ash Atwood, Archstone-Smith's Group Vice President of Corporate Accounting, at (303) 792-8081 or myself at (303) 792-8080 if you would like to discuss our views.

Sincerely,



Mark A. Schumacher
Chief Accounting Officer and Controller

CC: Chaz Mueller, Chief Financial Officer,
Bob Herz, Chairman, FASB
Scot Taub, Deputy Chief Accountant, SEC
Wayne Upton, Director of Research, IASB
George Yungmann, Vice President of Financial Standards, NAREIT

¹Please reference Section VI A of the SEC's recent "Report and Recommendations Pursuant to Section 401c of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and the Transparency of Filings by Issuers"