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Financial Accounting Standards Board 401 Merritt 7 Norwalk, CT 06856-5116

Dear Board Members and Staff:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update ("Proposed ASU") regarding File Reference No. 1850-100: Leases (Topic 840) on behalf of Washington Real Estate Investment Trust ("WRIT"). WRIT is a real estate investment trust with a diverse portfolio of 90 properties and thousands of leases with both commercial and residential tenants. We provide from the perspective of a lessor the following responses to the questions provided in the Proposed Accounting Standards Update:

## **Question 8: Lease Term**

Do you agree that a lessee or lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease?

We do not agree that the lessee or lessor should determine the lease term that is more likely than not to occur taking into account any options to extend or terminate the lease, for the following reasons:

- 1. **Practicality:** We, as a lessor, cannot reliably estimate the likelihood that renewal options will exercised at the inception of lease. For example, at the inception of a 10-year lease with a 5-year renewal option, we would have no remotely reliable method to predict whether the lessee would exercise that renewal option. Yet the Proposed ASU would require us to record an asset and liability on our balance sheet based on speculation of what a lessee may do in ten years. Even as the lease matures, it is difficult to predict whether the lessee will exercise an option to renew unless there is a significant economic incentive to renew (e.g. prevailing market rental rates are significantly higher than the renewal rental rate). In many cases, we will not know if a lease will be renewed until the tenant gives us formal notice.
- 2. Comparability: Under the Proposed ASU, it is very likely that two identical leases with renewal options would be accounted for differently by two different lessors due to the highly subjective nature of the lease term. Where one lessor may judge the

lease to be more likely than not to be renewed, another lessor may come to the opposite conclusion. Thus the financial statements of two separate lessors may differ materially simply due to different subjective estimates of the terms of their leases. This decrease in comparability is not in the interests of investors and analysts.

- 3. Volatility: Throughout the duration of a hypothetical 10-year lease with a 5-year option to renew, it is likely that the lessor's estimate of the most likely lease term will change. Each time this judgment changes, the related asset and liability will have to be written up or down, thereby introducing unnecessary volatility to the income statement and balance sheet.
- 4. Market Distortion: The requirement to estimate the most likely lease term may have the unintended consequence of causing lessees to reject the inclusion of renewal options in their leases. Under the Proposed ASU, lessees would likely be required to record liabilities for renewal options that the lessees are not contractually obligated to accept. In order to avoid recording such liabilities, lessees may simply refuse to include renewal options in lease contracts. We believe that such a distortion of current real estate leasing practices would ultimately be harmful to our industry.

We propose that the lease term should reflect only the base lease term provided in the lease agreement, as well as any options or extensions that appear to be reasonably assured. "Reasonably assured" is the standard used to estimate lease term under current GAAP, and represents a much higher threshold than the "more likely than not" standard in the Proposed ASU. The higher threshold would be much easier to implement, as it represents a continuation of current practices in estimating lease terms. Further, the higher threshold would lead to far fewer changes in lease term estimates during the duration of a lease, substantially mitigating our concerns about financial statement comparability and volatility. Finally, we expect that using a higher threshold for including renewal options in lease terms would reduce the magnitude of any market distortions caused by the Proposed ASU.

We understand the Board's concern that ignoring the existence of options would lead to misrepresentation of lease assets and liabilities. However, we believe that using the "reasonably assured" standard would address the Board's concerns while mitigating the issues we have described in the preceding paragraphs.

## Question 3: Short-term Lease Term

This exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is 12 months or less:

(a) At the date of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of the lease payments plus initial direct costs. Such

lessees would recognize lease payments in the income statement over the lease term (paragraph 64).

(b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognize assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognize any portion of the underlying asset. Such lessors would continue to recognize the underlying asset in accordance with other Topics and would recognize lease payments in the income statement over the lease term (paragraph 65).

Do you agree that a lessee or lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

We agree that the lessor should account for leases this way. As the owner of apartment buildings, we have more than 2,000 relatively small, short-term leases. We believe that the simplified requirements described in the exposure draft would appropriately mitigate the costs associated with accounting for such leases under the Proposed Accounting Standards Update.

## **Question 9: Lease Payments**

Do you agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be reliably measured? Why or why not?

We agree that contingent rentals should only be included in the measurement of the right to receive lease payments if they can be reliably measured. We concur with the Board's rejection of a measurement approach based on the most likely lease payments. Such an approach would be very speculative and subjective, and could possibly harm the comparability and reliability of a lessor's financial statements.

However, we need to see clarification of the term "reliably measured" in the final standards. As a lessor with retail properties, we do not have access to our tenants' internal sales projections, and often have little or no data from which to make an estimate of contingent rentals. Moreover, the majority of our retail tenants are small, family owned business that do not have the resources the prepare sophisticated sales projections. Therefore, for most of our leases a reliable measurement of contingent rentals would not be possible, and no contingent rentals would be included in revenue until the underlying contingencies had actually occurred. Some additional guidance and illustrative examples in the final draft of the lease standards would be helpful in ensuring that we our interpretation of the term "reliably measured" is in line with the Board's intent.

## Reporting Investment Property at Fair Value

Under International Financial Reporting Standards ("IFRS") companies have the option to measure investment properties at fair value, an option that does not currently exist under GAAP.

We support this fair value option for investment properties, and hope that it will be incorporated into GAAP at some future time as part of the ongoing GAAP – IFRS convergence process.

The IFRS Exposure Draft on lease accounting provides a scope exclusion for leases of investment properties that are measured at fair value. As the owner of investment properties, we would not necessarily be required to adopt the new lease accounting standards for leases at our properties if the fair value option became available under GAAP. Accordingly, we urge the Board to consider the timing of the lease accounting project and the convergence project for fair value accounting of investment property, so that simultaneous adoption of both standards would be possible.

Thank you for the opportunity to comment on this Proposed ASU. If you have any questions or would like to discuss our comments and concerns, please contact Robert Fisher, WRIT's Director of Financial Reporting, at (301) 255-0825 or bfisher@writ.com.

Sincerely,

Laura M. Franklin Executive Vice President

Accounting, Administration

and Corporate Secretary