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Via E-Mail (director@fasb.com)

December 15, 2010

International Accounting Standards Board
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Financial Accounting Standards Board
Technical Director, File Reference No. 1850-100
401 Merritt 7
PO Box 5116
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Re: Comments on Proposed Accounting Standards Update (Leases Topic 840)
FASB File Reference No. 1850-100

Dear Board Members and Staff:

On behalf of Majestic Realty Co., thank you for the opportunity to comment on the proposed changes to the accounting standards on leases presented in the August 17, 2010 Exposure Draft jointly issued by the Financial Accounting Standards Board and the International Accounting Standards Board. We are writing concerning issues raised by these proposed changes specifically with respect to real property leases.

These comments are provided in connection with our participation in the Roundtable to be held on January 5, 2011 in Chicago.

I. Introduction

We have followed the development of the FASB and IASB joint project on leases with keen interest. We appreciate that a premise of the proposed changes to lease accounting is that the existing system of classifying leases as either capital leases or operating leases should, to the extent possible, convey information about rights and obligations under leases that meet the definitions of assets and liabilities in the Boards' conceptual framework. We also appreciate two important priorities of the joint project are to enhance the comparability of accounting for leases, and to reduce undue complexity in lease accounting. Moreover, we fully agree that a *sine qua non* of improved accounting

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treatment for leases is that it should better serve the interests of users of financial statements.

While the proposed changes to lessor and lessee accounting may address these fundamental concerns more successfully in other areas, they do not achieve the stated mission of FASB and IASB to create an accounting model that will faithfully represent real estate leasing transactions. Rather than leading to greater transparency and clarity, in the area of real estate leases, the proposed standards may well have the opposite effect. In particular, as it would apply to real estate leases, the proposed guidance would result in disclosure based on subjective speculation, which would seriously undermine the Boards' objective of consistency of application.

We further note that until a proposed standard on investment property is made by FASB, a key component is missing from the discussion.

We are also concerned that the implementation of these standards may have unintended consequences. In particular, certain aspects of the proposed standards, as they would apply to real estate leases, would require the perpetual engagement of large numbers of consultants to navigate the complex requirements and provide on-going prognostication. In addition, because of the prevalence of loan covenants that would be triggered by implementation of the proposed standards for real estate leases, the proposed standards could create significant havoc in the for-lease real estate industry.

II. Majestic Realty Co.

Majestic Realty Co. was started in 1948 by my late father, Edward P. Roski, Sr. Over the decades we have employed a conservative, stick-to-the-fundamentals, build-and-hold approach to real estate development. It is with this business model that we have not only weathered numerous real estate downturns that destroyed many of our competitors, but we have thrived. Today Majestic Realty Co. is the largest privately held developer of commercial and industrial real estate in the nation. Headquartered in Southern California, we have regional offices in Atlanta, Dallas, Denver, Las Vegas and Bethlehem, PA. The portfolio of buildings that we have built and continue to own, manage and lease is approximately 70 million square feet. Our tenants include over half of the Fortune 500 and many of the largest importers and exporters in the United States. We have numerous long-standing capital market relationships, ranging from regional and national banks to mutual and life insurance companies as well as REITs and fund managers. As you can tell, we live and breathe "for-lease" commercial real estate.

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III. Application of the Proposed Standards to Real Estate Leases Would Decrease Transparency

In their application of a single accounting approach to leases of all kinds, the proposed standards as they would apply to real estate leases would add significant complexity for landlords and tenants, and significant confusion for users of financial statements. For instance, accounting for the "longest term more likely to occur than not," including renewal options that may or may not be exercised ten or twenty years in the future, can be no better than a guesstimate at best in the context of real estate leasing markets. Rather than introducing transparency and clarity to financial statements, this would make financial statements less comprehensible and less reliable.

In addition, each company's determination of "more likely to occur than not" will vary, producing inconsistency in reporting. Not only will this inconsistency lead to confusion among users of financial statements and widely varying reporting for similarly situated entities, but it will also open the door to potential manipulation. Moreover, even in the case of honest and well-intentioned guesses, companies would be exposed to criticism if their estimates prove incorrect. While the theory of determining the probability of exercise for a particular option is sound, and while for non-real estate leases it may be comprehensible, the practical implementation of this in the area of real estate leasing would be merely to codify uncertain fortune telling.

Unlike other areas of accounting in which the unavoidable hazards of estimation are tolerated because of the undeniable usefulness of the estimates, in the case of real estate options the product of such estimation is essentially useless. One important reason for this is that the likelihood of exercise of a non-marketable real estate lease option is as much a function of the lessee's future space needs as it is of the future prices of rents, making estimation completely idiosyncratic, subjective, and unreliable. Companies negotiate options into their commercial real estate leases in order to obtain flexibility, precisely because of their own uncertainty about the future and their need to prepare for vastly different eventualities. It stands this reality on its head to then force them nonetheless to artificially calibrate an option exercise as if it is more or less likely to occur. Such a faux crystallization of an entirely unknown future would also require immediate disclosure of a company's intention to exercise a real estate lease option, or not to do so. This would simultaneously mislead investors and, depending on which of two wrong answers is selected, unfairly distort the relative bargaining power of landlord and tenant in lease negotiations.

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Similarly, in the case of real estate leasing, an estimate of variable rents based on adjustments to CPI, future sales, and/or fair market value rents 10 to 20 years in advance is fraught with speculation. Such estimates not only would provide users of financial statements with little value, but they would very likely be misleading in the majority of cases.

No other area of financial accounting requires placement of such remote speculation on the balance sheet, and for good reason: to do so would undermine, not enhance, the accuracy and clarity of the information presented.

In economic reality, a real property lease is a significantly different set of rights than outright ownership of real property. A lease of real property has a declining utility each year, and ends in no residual value, whereas ownership of real property typically includes capital appreciation and residual value, both real and accounting (one reason that land is never depreciated). For the same reason, a real property lease is also significantly different from a lease for equipment or other kinds of depreciable assets. To recognize these important differences, differential accounting treatment is appropriate. This is why for real estate leases, the income statement has proven to be the appropriate reporting mechanism for operating lease income and expenses. Equally appropriately, existing standards for capital leases, which are really no more than a financing mechanism, already provide for balance sheet treatment.

IV. Unintended Consequences

The proposed standards, as they apply to real estate leases, will not only require extensive speculation and assessment, but they will also apply the vague standard of remeasuring when "changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments." This would institutionalize a gray area of reporting, elevating prophecy to the level of accounting truth, and inviting unwarranted litigation.

Information and ERP systems for real estate leasing designed to meet the extensive needs of the proposed standards have not yet been created and must be developed. These costly information systems, as well as new process/controls changes, will be required to implement the proposed standards and to provide maintenance and reporting on an ongoing basis. All of this effort will be required to produce disclosure that, in the area of real estate leasing, will be more confusing and less clear than exists today. The many consultants that will be required will be performing a great deal of work to no useful end.

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Real estate leases, the lifeblood of much of commercial real estate development, are generally used when a company's long-term property needs are unclear, operational flexibility is highly desirable, and access to acceptable alternatives to ownership is good.

In a normal market, leasing is often faster and more efficient than purchasing real estate, with a dramatically lower up-front cash outlay. One of the major unintended consequences of the proposed lease accounting standards will be to alter these fundamentals by shortening lease terms or eliminating altogether tenants' desire to lease.

Tenants will have strong incentives to opt for shorter term real estate leases in order both to reduce their reported liabilities, and to avoid the complexity of constantly estimating and re-estimating whether and when future real estate lease options will be exercised. They will also be incited to avoid real estate lease renewal options, and to negotiate leases with no contingent rent. For some companies, the perpetual expense of information and ERP systems, consultants, and constant monitoring that would be required for real estate lease accounting will eliminate leasing as a viable alternative.

Real estate lenders evaluate the cash flow and credit quality of tenants to justify loans on projects, in the case of both initial funding and refinancing. Longer-term leases with financially strong tenants carrying low leverage ratios support higher property valuations and lower rents. Faced with less-certain long term cash flows, lessors will be forced to seek higher rents. This would inflict further injury on tenants whose balance sheets, earnings, and financial ratios would have already been weakened as a result of the new accounting. The prospect of higher rents, in turn, would deter those tenants at the margin from leasing at all.

Because all of the predictable behavioral responses to the proposed standards would represent very real changes in the underlying economics of real estate lease transactions, they would have significant impacts on property valuations. The widespread agreement that the proposals would result in declines in property values stems particularly from the likelihood that tenants will be forced to press for shorter term leases, for leases without renewal options, and for leases without contingent rent, and that at the margin some companies that otherwise would lease will instead avoid leasing.

The proposal as it relates to real estate leasing would also deeply disturb the existing contractual relationships between banks and other lenders, on the one hand, and real estate lessees, on the other hand. The very large amounts that would be required to be capitalized would immediately trigger the violation of many loan covenants. This would unfairly alter the bargained-for rights and responsibilities of banks and borrowers, provoking loan accelerations and giving banks a windfall option to refuse to adjust the

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existing covenants if they so chose. Alternatively, banks could demand new compensation for agreeing to revise the covenants. In most cases, at a minimum, companies' debt agreements would have to be renegotiated, at great (and wasteful) expense, to protect against these unintended consequences. Both FASB and IASB have traditionally taken great care to ensure that accounting standards fairly reflect the underlying economics of a transaction, and do not distort them. But these unintended consequences would violate that principle.

The balance sheet gross-up and acceleration of expenses relative to straight-line rent expense typical of an operating lease today will also be significant to brokers and other regulated entities whose capital ratios and other metrics are closely monitored and would be adversely affected if computed under the proposed model.

In summary, the unintended negative consequences of the application of the proposed standards to real estate leases include:

- (i) volatility of key ratios resulting from on-going prognostication,
- (ii) declines in building and property values,
- (iii) breaches of existing loan covenants, particularly those relating to EBIDTA ratios,
- (iv) a decline in lending,
- (v) a reduction in build-to-suit-for-lease development, and
- (vi) consequent further job losses in construction, leasing, property management and related industries. This, in turn, will threaten market instability for lessors, lessees and the financial services sectors that provide support for these transactions.

V. Conclusion and Recommendation

The important work of the FASB and IASB to review the current standards for lease accounting and provide greater clarity, transparency, and consistency of application requires great care in appreciating the fundamental differences between real estate leases and other kinds of leases.

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When the Boards initiated this joint project to develop a new approach to lease accounting, one of the chief concerns was the prevalence of off-balance sheet accounting and special purpose vehicles, which had contributed to well-known problems, rather than the distinctions among different kinds of leases. However, these issues can, and should be, treated with sensitivity to the differences between real estate leases and other kinds of leases.

In recognition of the differences among different kinds of leases, the current proposal would exclude from the scope of the proposed standards (a) leases of intangible assets, (b) leases to explore for or use natural resources (such as minerals, oil, and natural gas), (c) leases of biological assets, and (d) leases of investment property measured at fair value under IAS 40. The maintenance of these exclusions, which have long appeared in IFRS, is founded in the conviction that the nature of the underlying leased asset is relevant to its financial statement treatment. Particularly since FASB has not yet adopted an investment property model similar to IAS 40, a gap exists in the proposal that can be filled by similarly excluding leases of real property (other than those that meet existing capital lease criteria). We strongly recommend that the Boards adopt this approach. Excluding real estate leases from the scope of the proposed standards would eliminate the many unintended negative consequences outlined above, and it would solve the problems in the proposal as it relates to real estate lease options, contingent rents, and remeasuring.

As a complement to this recommendation, the Boards should also consider requiring enhanced disclosures surrounding a company's future real estate lease obligations, summaries of real estate lease option terms, and other key information in order to provide financial statement users with more accurate, consistent and objective financial representations of real estate leases.

Thank you again for the opportunity to comment on the proposed changes in the Boards' Exposure Draft on Leases as they relate to real estate leasing.

Sincerely,



Edward P. Roski, Jr.
Chairman and CEO
Majestic Realty Co.