COMMERCIAL REAL ESTATE SERVICES

CBRE
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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
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Financial Accounting Standards Board
401 Merritt 7
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RE: COMMENTS TO EXPOSURE DRAFT, LEASES

Dear Board Members:

CB Richard Ellis Group, Inc. (CBRE) appreciates the opportunity to respond to the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) relative to the Exposure Draft, Leases.

CBRE, headquartered in Los Angeles, is the world's largest commercial real estate services firm (in terms of 2009 revenue). We serve real estate owners, investors and occupiers through more than 300 offices (excluding affiliates) worldwide. Our business is focused on several competencies, including commercial property and corporate facilities management, tenant representation, property/agency leasing, property sales, valuation, real estate investment management, commercial mortgage origination and servicing, capital markets (equity and debt) solutions, development services and proprietary research. We consult on thousands of real estate leasing transactions each year and currently perform lease administration services for over 100,000 real estate leases.

We embrace the efforts of the FASB and IASB to drive additional clarity and transparency to the financial statements in the area of lease accounting. We also understand the numerous issues and complexities involved with developing a standard that addresses all leases. In summary we believe that the FASB and IASB should give additional consideration to:

1) The significant judgment and subjectivity that will be required initially and on an on-going basis.
2) The costs of additional staffing, systems modifications and consulting fees needed for both initial and on-going compliance.
3) The impact that the proposed standard will have on the ability of companies to comply with credit agreement covenants.
4) The potential that the standard could drive companies toward short-term leases with no options, which may not be in the best economic interests of the companies and their shareholders.

Additionally, we believe there are notable differences between leases of real property and leases of personal property, such as equipment and automobiles. We do not believe that the Exposure Draft appropriately addresses these differences.

Should the FASB and IASB move forward with the right of use approach, we offer the following comments, which we believe should be considered, particularly as it relates to leases of real property.

Question 1: Lessees

(a) Do you agree that a lessee should recognize a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?

(b) Do you agree that a lessee should recognize amortization of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?

CBRE Response:

Inherently, the leasing of real property is unique as compared to the leasing of personal property, and, as such, it is debatable whether it should be considered a form of financing in the typical sense. While most leases of personal property are for assets in which the value of the asset declines and are more easily identifiable as a financing arrangement, the leasing of real property

relates to the occupancy of space necessary to operate a business. We do not consider real property leases (particularly leases of a portion of a building) to be financing transactions.

In the case of real property leases, the "goods" (i.e., the leased premises) are essentially transferred to the lessee and available for use ratably over the term of the lease. We believe the cause-and-effect relationship between the use of the real estate and its revenue production capabilities is more appropriately measured on a straight-line basis over the lease term. Accordingly, we are not in agreement with the prescribed approach requiring the amortization of the right-of-use asset and the recognition of interest expense relating to the liability based upon the effective interest method, which results in an acceleration, or front-loading, of interest expense into the earlier periods of the lease term.

Should the recognition of interest expense based upon the effective interest method be included in the final standard, we believe the right-of–use asset should be amortized in a manner which results in the straight-line recognition of total amortization and interest expense over the lease period.

Question 2: Lessors

(a) Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?

(b) Do you agree with the boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?

(c) Do you agree that there should be no separate approach for lessors with leveraged leases, as is currently provided for under US GAAP (paragraph BC15)? If not, why not? What approach should be applied to those leases and why?

CBRE Response:

Whereas a vehicle or piece of equipment is generally leased to one lessee at a time, a single building can be leased to multiple lessees simultaneously. Leasing real property is primarily a function of the supply and demand of a unique resource that derives its value from factors well beyond its replacement cost. This presents unique accounting issues for a lessor when attempting to apply the proposed standard, which as a result could create greater complexity and confusion for the end users of the financial statements.

At this point, we do not believe the issues and complexities relative to commercial property leases have been fully vetted and are not convinced the combination of the performance obligation approach and the derecognition approach represents the best solution. As the implementation of a new standard will have a significant impact on the real estate industry, we believe further field interviews, research and testing should be conducted in this area. Furthermore, we believe the impact of the proposed standard addressing fair value accounting for investment properties should be fully vetted in conjunction with the proposed standard for lessor accounting. We support the FASB and IASB perspective on desiring comparability between lessees and lessors and creating consistency with the revenue recognition project.

We believe the current model in U.S, GAAP which measures the lease term as the initial contractual term, plus only options to renew that are reasonably assured, is the appropriate method for valuing the right-to-receive-lease-payments asset and the corresponding liability. Unlike a lessee who may be knowledgeable of its experience and may be able to project its future needs and strategic plans, a lessor has limited information on the strategy and business plans of the lessee. Consequently, requiring a lessor to effectively speculate on what a lessee may do in the future will result in the expenditure of significant time and energy while providing little benefit to the users of financial statements.

We disagree that future contingent rents should be a component of the lease liability and its corresponding asset, even to the extent they can be reliably measured. Similar to estimating the lease term, lessors may have little knowledge of the lessee's long range forecasts and strategic plans. This requirement would bring an inordinate level of judgment and estimation into the valuation of the right to receive lease payments which may require constant and substantial adjustments from period to period. We disagree that the probability-weighted approach should be used to estimate contingent rents for the lease asset and liability. We do not believe the introduction of numerous scenarios that have little likelihood of occurring serve to lessen the misstatements of the estimates. We believe the cost and time required to report and track this information is not justified by the limited, and possibly inaccurate information provided to the end users of the lessor's financial statements.

Finally, we believe the effective interest method of amortizing a right-to-receive-lease-payments asset to revenue or income does not reflect the underlying nature of the typical real estate lease. Since we do not believe the typical real property lease

represents a financing arrangement, we do not believe that recognizing greater income in the early years of a lease appropriately reflects the consistent use of the asset over a specified period of time. If the effective interest method is included in the final standard, we believe that the lease liability should be amortized in a method that records total interest and lease income evenly over the lease term.

Question 6: Contracts that contain service components and lease components

This exposure draft proposes that lessees and lessors should apply the guidance in proposed Accounting Standards Update, *Revenue Recognition* (Topic 605): *Revenue from Contracts with Customers*, to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B5¯B8 and BC47¯BC54). If the service component in a contract that contains service components and lease components is not distinct:

(a) The FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.

(b) The IASB proposes that:

(i) A lessee should apply the lease accounting requirements to the combined contract.

(ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.

(III) a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements, and the service component in accordance with the guidance in the exposure draft on revenue from contracts with customers.

Do you agree with either approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

CBRE Response:

While we understand the challenges posed to the FASB and IASB in addressing all types of leases in one standard, the Exposure Draft lacks sufficient clarity relative to the treatment of the service component (i.e., executory costs) of real estate leases. As there are a number of lease structures utilized in the commercial real estate industry, and executory costs can account for a significant portion of a lessee's total payment, it is very important that the final standard provide clear guidance relative to the treatment of executory costs as they relate to leases of real property.

Lease structures commonly used in the industry range from what is referred to as a gross lease (i.e., the lessor pays all executory costs directly) to a triple-net lease (i.e., where the tenant pays for all executory costs either directly or via reimbursement to the landlord) with numerous variations in-between.

As it relates to commercial real estate, executory costs generally include such items as insurance, real estate taxes, repairs and maintenance, utilities, landscaping, etc., which are commonly referred to as operating expenses within the real estate industry. In general, there are four typical approaches as to how executory costs are treated between the lessor and the lessee, including:

- Executory costs are paid directly by the lessor and not specifically passed through to the lessee, but rather recovered by the lessor through the "gross" rent paid by the lessee
- Executory costs are paid directly by the lessor and billed to the lessee separately for reimbursement to the lessor
- Executory costs are paid directly by the lessor and any increases in total expenses over a "base year" or "expense stop" during the term of the lease are billed to the tenant for reimbursement to the lessor
- Executory costs are paid directly to a third-party by the lessee

This basic overview of how executory costs can be handled between a lessee and a lessor, illustrates that the definition of "distinct" lease and service components as referenced in the Exposure Draft is very difficult to interpret as it relates to the commercial real estate industry. From a practical standpoint, even the determination of "distinct" would be difficult to assess as it is not always clear that the amount being paid by, or reimbursed by, the lessee is for a separately identifiable service versus a combination of multiple services. In addition, it can be argued that executory costs in commercial real estate do not fall within the classification of a service charge as defined in the Exposure Draft, which relates more accurately to personal property leases. Therefore, a requirement that they be included in the determination of the right-of-use asset and the liability to make lease payments will lead to financial statement inconsistencies as a result of different accounting treatments being applied to different lease types.

Based upon the above, it is our recommendation that executory costs related to real property leases should not be included in the determination of the right-of-use asset or the liability to make lease payments. In support of this recommendation, one need only consider the fact that the owner of a building is not required to capitalize future executory costs. Why then would a lessee be required to do so? A lessee should not be held to a different standard with regard to the treatment of executory costs than the owner of the real property.

If the FASB and IASB decide to include executory costs in the measurement of the asset and liability, it should be noted that such costs relative to real property can be subject to significant fluctuations from one period to the next as a result of changing occupancy levels and operating conditions. Thus, requiring an estimate of these costs as part of the determination of the right-of-use asset and the liability could require constant adjustments due to "significant changes in facts or circumstances" from the previous periods. This task by itself would place a significant burden on a company's resources.

Question 8: Lease term

Do you agree that a lessee or a 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? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

CBRE Response:

We do not agree that the lease term should be defined as the longest term possible that is more likely than not to occur taking into account options to extend or terminate. We are concerned that the new standard, as proposed, will lead to leasing decisions being made based primarily on accounting rules rather than economics. We believe options to extend or terminate, other than bargain renewal options, should not be included in the calculation of the lease term, as we do not think that they represent the true definition of a liability for a lessee or the definition of an asset for a lessor. Additionally, the probability of exercising such options will require speculation and lead to a lack of consistency and comparability between companies. We believe it is a more accurate representation of a company's true obligations and commitments to only use the initial lease term stated in the lease, as well as any bargain renewal option periods, for the determination of the right-of-use asset and the liability to make lease payments unless it has been officially noticed that a lease is going to be terminated prematurely or extended through the exercise of an option.

Question 9: Lease payments

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?

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?

CBRE Response:

We do not agree with the proposal to include contingent rentals (i.e., percentage rent, CPI rent increases, etc.) in the measurement of the right-of-use asset and the liability to make lease payments as this is not consistent with the definition of a present obligation of the lessee and therefore should not be treated as a contractual liability.

The requirement to include contingent rentals in the measurement of the asset and liability would impose an extreme administrative burden on companies and require a level of forecasting that in many cases would border on pure conjecture. This is especially true as it pertains to percentage rent clauses found in many retail leases. In the case of a major retailer with hundreds of locations and a percentage rent clause in each lease that has a primary lease term (not including options) ranging from 10 to 20 years, the Exposure Draft would require the retailer to project sales growth, and the corresponding percentage rent to be paid as a result of said sales growth, for the entire 10 to 20 year lease term. This is well beyond the long range forecasting period for most companies. To further complicate matters, the expected outcome approach is required in this determination, which requires taking into account a reasonable number of potential outcomes on a weighted average basis. This requirement again results in the expenditure of greater human capital and adds a layer of significant complexity to the process as multiple scenarios must be addressed and a weighted probability approach applied. As it relates to lessor accounting, the Exposure Draft requires that a lessor include contingent rent in the determination of the asset and liability to the extent that it can be "reliably measured". We see no reason why the lessee and lessor should be treated differently in this area and feel that lessors, like lessees, should not have to include contingent rent in the determination of the asset and liability.

Relative to real property leases, it is unclear in the Exposure Draft as to whether "Guaranteed Restoration Clauses", which require a lessee to return the leased premises to the lessor in a certain condition and/or with improvements removed, are to be treated as Guaranteed Residual Values. If it is determined that Guaranteed Restoration Clauses were contemplated in the Guaranteed Residual Value considerations, we would recommend the FASB and IASB exclude them from the determination of the asset and liability since, similar to contingent rentals, this would require significant estimates of future events that would have limited precision.

It is our recommendation that contingent payments and expected payments under term option penalties and residual value guarantees for both lessees and lessors be excluded from the measurement of assets and liabilities arising from a lease.

Question 10: Reassessment

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease 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 arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

CBRE Response:

We believe the current language in the Exposure Draft is very broad and allows for too much subjectivity and judgment regarding when to reassess, which will cause inconsistency in application. Further, the requirement for continuous reassessment, to determine if significant changes have occurred, will require companies to actively monitor a number of lease inputs (i.e., likelihood of exercising options, sales growth projections, etc.), which would be a significant administrative burden with limited, if any benefit.

Additionally, the analyses and documentation associated with remeasurement would be overly burdensome, especially for global companies with a significant number of property leases worldwide. Consequently, we feel the cost of remeasurement will far outweigh the benefits provided.

Therefore, it is our recommendation that lessees and lessors should only remeasure assets and liabilities upon specific reconsideration events such as a material lease modification, notice to terminate, or exercise of an option.

Question 15

Do you agree that lessees and lessors should disclose quantitative and qualitative information that:

(a) identifies and explains the amounts recognized in the financial statements arising from leases; and

(b) describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows? (paragraphs 70‾86 and BC168‾BC183)? Why or why not? If not, how would you amend the objectives and why?

CBRE Response:

We believe the proposed disclosure requirements are very onerous and the quantitative rollforward tables in particular are excessive. We find it overly burdensome that the Exposure Draft requires a maturity analysis of not only the lease liability on the balance sheet, but continues to also require the same analysis for the minimum lease obligations (i.e., the current requirement under existing lease accounting rules). It is our belief that the maturity analysis will be very difficult to comprehend and reconcile for users of financial statements. We also believe the cost and time involved in preparing the new disclosures are far greater than the benefits to be derived. As noted in previous responses, we believe that only the contractually due obligation associated with the initial lease term, as well as any bargain renewal option periods, should be capitalized as a right-of-use asset and recorded as a liability on the balance sheet. We further believe that the maturity analysis reporting requirements should be applied to the liability as reported on the statement of financial position. The footnotes could then include a qualitative discussion of how leases may affect the amount, timing and uncertainty of future cash flows, including a discussion of options and contingent payments.

The disclosure requirements as drafted do not distinguish between interim and annual periods. Given the significant cost and time involved in adhering to the provisions of the Exposure Draft, we believe the requirements would be overly burdensome on an interim basis and therefore more practical to be an annual requirement, with updates for interim reporting only if there has been a significant change during the interim period.

Lastly, given that lease obligations will be on balance sheet under the proposed standard providing greater clarity and transparency, it seems reasonable that fewer disclosures would be required than before. We encourage the FASB and the IASB to adopt this as a goal.

Question 16

(a) This exposure draft proposes that lessees and lessors should recognize and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186¯BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?

(b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?

(c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

CBRE Response:

We agree that outstanding leases at the date of adoption should be accounted for using a simplified retrospective approach. For consistency and comparability among companies, we believe that a full retrospective application should not be permitted.

Question 17

Paragraphs BC200–BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?

CBRE Response:

We do not believe, in its current form, the benefits of this new standard outweigh the costs. This is a result of the complexities and judgmental nature of the requirements proposed in the Exposure Draft, which will require significant expenditures in the areas of staffing and systems modifications, as well as consulting (accounting and legal) and audit fees. The judgment needed to comply with the many requirements of the Exposure Draft will significantly increase the burden on a company's personnel as significant input from various stakeholders will be required to assess such items as the likelihood of exercising options, estimating future sales growth and contingent rental payments, etc. These costs are then compounded further by the ongoing requirement to continuously reassess whether significant changes have occurred relative to the length of the lease term and/or the expected amount of contingent rentals since the previous reporting period. We believe the potential benefits of the proposed standard are significantly reduced by the speculative projections and assumptions, noted previously, which will be made as a result of the currently proposed requirements.

Additionally, we do not believe the FASB and IASB have adequately considered the costs that may be required to amend credit agreements to allow for additional liabilities that will now be recorded. Further, lenders may seek financial consideration to cure violations of current debt covenants and higher leverage could result in incrementally higher borrowing costs.

Question 18

Do you have any other comments on the proposals?

CBRE Response:

We believe the impact of the proposed standard on the operating metrics of a company may lead to a significant impact on leverage and capital ratios, which could result in debt covenant compliance issues. We are also concerned that once implemented, companies will not be properly aligned according to financial strength. For example, the balance sheet of a creditworthy company (i.e., with a low incremental borrowing rate) that enters into a long term lease based on rational business practices will be impacted significantly greater than a non-creditworthy company (i.e., with a high incremental borrowing rate) who enters into a short term lease simply to minimize the impact to its balance sheet.

Although it is our recommendation that options, other than bargain renewal options, not be considered in the determination of a lease term, we believe the definition of "exercising" an option needs further clarification if the FASB and IASB choose to require consideration be given to options to renew or terminate in the final standard. What is the exact definition of exercising an option? Does it mean the option is executed with no changes made to the original terms and conditions? What if all terms and conditions remain the same with the exception of the rental rate? What if a new lease is executed with the same terms and conditions of the option with the exception of a different rental rate and expense recovery structure? These subtle differences alone demonstrate the complexity of real property leases and provide additional rationale for why options to renew or terminate should

generally not be considered in the determination of the lease term. However, if it is decided that options are to be considered, further clarification and specific guidance should be provided in the final standard.

It is our understanding the FASB intends to issue an Exposure Draft in the first quarter of 2011 addressing whether entities should be given the option (or be required) to measure an investment property at fair value. The timeframe for issuance of the final standard is stated to be the third quarter of 2011. It is also understood that the FASB is contemplating allowing entities who adopt (or are required to use) the fair value approach to be "scoped out" of the new standard on lease accounting. Given the significant burden and costs associated with implementing and complying with the new standard on lease accounting that will commence with issuance of the final standard, we recommend that the final standards for both lease accounting and fair value accounting should be issued simultaneously. It would be inequitable and unnecessarily costly to require a company to prepare for full implementation and compliance with the new standard on lease accounting only to discover in the near future that a fair value standard is enacted rendering those efforts and costs for naught. If necessary, the final standard on lease accounting could be bifurcated between lessee and lessor accounting to enable the final standards for both lessor accounting and fair value accounting to be issued simultaneously.

Additionally, the transition to the new standard will place a significant burden on companies, which will be magnified further as a result of other priority projects of the FASB and IASB being implemented during the same timeframe. Many companies do not have excess capacity in their workforce given the current economic environment (which may not change in the foreseeable future); thus the transition to the new standard will place significant stress on a company's existing personnel. In addition, many companies may not even be able to fully initiate their transition efforts until third-party software vendors complete their system modifications. For these reasons, we recommend an extended period of time be granted for the transition period to allow companies to complete all the requisite tasks to be in full compliance with the new standard in a reasonable timeframe.

We would like to thank both the FASB and the IASB for affording us the opportunity to provide input on the proposed changes to lease accounting. As these changes will have a significant and far reaching impact on the entire commercial real estate industry, we appreciate your consideration of our recommendations.

Sincerely,

Arlin E. Gaffner
Chief Accounting Officer