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Feb. 4, 2018

Ms. Susan M. Cospers
Technical Director
File Reference No. 2018-200
Financial Accounting Standards Board
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Delivered Electronically

Subject: File Reference No. 2018-200, FASB Exposure Draft, *Proposed Accounting Standards Update, Leases (Topic 842): Targeted Improvements*

Dear Ms. Cospers,

Nareit submitted a comment letter on Jan. 31, 2018 in response to the Financial Accounting Standards Board's (FASB or board) Exposure Draft, *Proposed Accounting Standards Update, Leases (Topic 842): Targeted Improvements* (the ED). Since our Jan. 31 letter was filed, Nareit has received questions as to the application of paragraph 842-10-15-42A (paragraph 42A) to gross leases that include embedded common area maintenance (CAM) charges. In addition, some industry participants indicate that there seems to be inconsistency between paragraph 42A(a) and paragraph BC 19, which discusses combining revenues of distinct goods and services when the accounting outcome would be the same as accounting for the revenues separately. This comment letter supplements Nareit's Jan. 31 letter.

Summary of Nareit's issue:

The issue that Nareit brought to the board is that the great majority of industry accounting professionals concluded that ASU No. 2016-02; *Leases (Topic 842)* requires that the lease revenue called for in a gross lease must be allocated between the lease component (space rent) and the non-lease component (the embedded CAM charge). To be clear, a traditional gross lease requires the lessee to pay a fixed lease payment over the lease term. The embedded CAM charge would also be fixed even as the lessor's actual costs may change over the lease term. Primarily because there is no stand-alone selling price for CAM, preparers experienced significant operational issues attempting to separate these revenue

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sources. Further, industry investors indicated that separating these revenue elements would not yield more useful information for their analyses. The board understood Nareit's issue and has responded by issuing the ED.

We also note that there are variations in gross leases in which rents are adjusted over the lease term for changes in the lessor's cost of CAM services. For these arrangements, the ED is less clear because of the inconsistency between paragraph 42A(a) and paragraph BC 19.

Nareit's Supplemental Comments on the ED:

Paragraph 42A states that:

As a practical expedient, a lessor may, as an accounting policy election, by class of underlying asset, choose to not separate nonlease components from lease components and, instead, to account for each separate lease component and the nonlease components associated with that lease component as a single lease component if both of the following are met:

- a. The timing and pattern of revenue recognition for the lease component and non-lease components associated with that lease components are the same.*
- b. The combined single lease component is classified as an operating lease in accordance with paragraph 842-10-25-2 through 25-3.*

Paragraph BC 19 indicates that under the new revenue guidance, an entity is not precluded from accounting for distinct goods and services as if they are a single performance obligation *if the accounting outcome is the same as accounting for the goods and services as individual performance obligations*. This paragraph further indicates that an entity is not precluded from accounting for multiple lease components as a single lease component if the outcome from doing so would be the same as accounting for the lease components separately.

Further support for accounting for space rent and CAM revenues called for in a gross lease as one performance obligation, is found in paragraph BC 153 of ASU No. 2016-02, *Leases* (Topic 842). Paragraph 153 states that "*an entity is not precluded from accounting for concurrently delivered goods and services that have the same pattern of transfer to the customer as if they were a single performance obligation even if they are distinct from each other because the outcome would be the same as accounting for the goods and services separately*". It is clear that occupancy of the space and the CAM services are transferred to the lessee continually during the term of the lease.



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Based on the support above, we are requesting that the board modify paragraph 842-10-15-42A to reflect the board's intention – that, because the accounting outcome of either separating the implicit CAM revenue from space rent or accounting for the combination of the two revenue sources as negotiated in gross leases would be the same, the two revenue sources are not required to be separated. Otherwise we are concerned that preparers and auditors alike will be confused by the inconsistency between paragraph 42A(a) and paragraph BC 19 and result in diversity in application.

If you have any questions on Nareit's views, please do not hesitate to contact George Yungmann at 202-739-9432 or Christopher Drula at 202-739-9442.

Respectfully submitted,

A handwritten signature in black ink that reads "George Yungmann". The signature is written in a cursive style with a horizontal line at the end.

George Yungmann
SVP, financial standards
Nareit

A handwritten signature in black ink that reads "Christopher Drula". The signature is written in a cursive style.

Christopher Drula
VP, financial standards
Nareit