



EUROPEAN PROPERTY  
FEDERATION

International Accounting Standards Board  
30 Cannon Street  
London, EC4M 6XH  
United Kingdom

Brussels, 14 July 2009

Dear Sirs,

**Discussion Paper DP/2009/1: Leases – Preliminary Views**

We welcome the opportunity to comment on the joint IASB and FASB discussion paper entitled “Leases – Preliminary Views” (the “Discussion Paper”).

EPF represents all aspects of property ownership and investment: residential landlords, housing companies, commercial property investment and development companies, shopping centres and the property interests of the institutional investors (banks, insurance companies, pension funds). Members own and manage property assets valued at € 1.1 trillion.

**Executive summary**

We have had the opportunity to review the response to the Discussion Paper submitted to you by the Real Estate Equity Securitisation Alliance (“REESA”). The EPF strongly concurs with the views presented in that response, and urges the IASB to exclude accounting for investment properties from the scope of any proposed new standard on lessor accounting (Question 28 in the Discussion Paper). We agree with all of the reasons set out, in support of that view, in the REESA response, but this letter briefly highlights what we regard as the most important reasons.

**Further detail**

Real estate is fundamentally different from other leased assets such as leased aircraft, cars and plant and machinery, because of essential features such as the perpetual, immobile and irreplaceable nature of land. Investment property companies create value by actively managing, financing and developing property to provide an environment which is desirable for those seeking accommodation. Active management of real estate is essential to maximise its attractiveness to potential customers and optimise value for investors. In contrast to leased equipment, it is often not possible for prospective occupiers to purchase, rather than lease, premises (particularly where the premises are units in a shopping centre or floors in an office block). It is not therefore generally appropriate to regard leasing premises as equivalent to a financing transaction.

A lease is an essential and indivisible element of the constantly changing real estate asset, and there is strong support – both among property investment businesses and among



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analysts, investors and other stakeholders – for IAS 40, the existing standard which recognises the particular characteristics of real estate and allows investment property leases to be accounted for differently from the way leased equipment is accounted for by lessors.

The approach of the property investment industry to real estate assets is most apparent from the valuation methods it uses. A key metric in comparing the price of interests in, and the performance of, property investment businesses is net asset value (NAV), which focuses on the value of the whole asset and is primarily driven by expected cash flows from it (and which cannot be reliably estimated based solely on either leases in place or the cost of the physical building).

Another key performance indicator in the real estate industry, fair value, also views the asset as a whole, and there is no apportionment on the disposal of a real estate asset between value attributable to in-place leases and other tangible or intangible components of the asset. It would be artificial and difficult to try to divide up real estate assets into different elements, separately identifying and valuing cash flows under a lease and the residual value at the end of the lease.

Another reason why IAS 40 is widely supported is that it respects the importance in the real estate sector of rental income, and the relationship between that and direct operating expenses, and thus also net property income and fair value. It would be arbitrary and inconsistent with the reality of property investment business to require accounts to identify a financing income component within rental income.

In summary, IAS 40 delivers decision-useful information that enables property performance to be understood and meaningful financial analysis to be undertaken. It would be inappropriate for investment property businesses to report their performance in a way that obscures the fair value of their assets and presents their income as arising from a financing activity.

To the extent that the proposals set out in the Discussion Paper are implemented in a new accounting standard for lessees, we consider that a symmetrical approach applicable to property investment lessors would not be appropriate. Even if symmetry is appropriate for other lessors, real estate investors should continue to apply a separate standard that recognises the fundamentals of the real estate investment business.

The motivations and perspectives of real estate lessors and lessees are very different. A key distinction is that the lessee is only interested in the right of occupation for which he is paying for an agreed period, whereas the lessor not only enjoys the running income from the property but is also concerned with the opportunities for optimising market rental growth through lease renegotiations and re-letting, redevelopment of the property and/or other nearby property, and the scope for capturing market pricing advantage by selling the property to another investor (rarely the occupier).

There are numerous examples in IFRS of cases where symmetry is not imposed on the two sides of a transaction (impairments, provisions and distressed debt are examples). We consider the case of investment property leases to be one for which it would be particularly inappropriate to impose a requirement for symmetrical treatment.



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## Conclusion

The agreement of a lease between a property owner and a lessee is a property market driven negotiation which is closely related to demand and supply for physical property. It is not a financing arrangement, and the terms of leases of investment property are not related to the cost of money (which is what would be implied by a designation of investment property as a financial asset and the reporting of investment property income in terms of a financing charge). Meaningful and decision-useful information, including the key metrics around fair value, net asset value and gross and net rental income, is provided under IAS 40; it would be rendered far less accessible if accounting for investment properties were to be included within the scope of any proposed new standard on lessor accounting along the lines set out in the Discussion Paper.

For the reasons outlined above, and for the reasons elaborated on in greater detail in the REESA response, the EPF does not support either of the proposed approaches to lessor accounting outlined in the Discussion Paper, and urges the IASB to exclude lessor accounting of real estate investment leases from the scope of the proposed new model.

Yours sincerely,

Michael MacBrien  
Director General

cc: Mr Jeroen Hooijer, Head of Accounting, European Commission