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February 14, 2012
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2011-210

Dear Ms. Cosper:

The Financial Reporting Executive Committee (FinREC) of the American Institute of Certified Public Accountants and the Topic 973 Comment Letter Task Force (the Task Force) are pleased to offer comments on the proposed FASB Accounting Standards Update (ASU), "Real Estate—Investment Property Entities (Topic 973)".

We would like to offer the following general observations in connection with this proposed ASU.

We believe that investment properties held by investment property entities should be measured at fair value, as this provides investors with the most relevant, comparable and decision-useful information. We support the Board's entity-based approach because it would limit the investment property fair value measurement requirement to those entities for which substantially all of their business activities are investing in real estate properties. For other entities, such as diversified companies, fair value measurement of investment properties may be costly, complex to implement, and operationally difficult, particularly during interim reporting periods, and for small private diversified entities, such costs may be burdensome or even prohibitive. Furthermore, we believe the operating results of a diversified reporting entity that holds a small portion of its assets in investment property are not evaluated based upon the movement in the fair value of these investment properties and that the cost versus the benefit of obtaining such information on a quarterly basis may not be warranted.

In addition, we agree with the Board's decision in the proposed ASU with respect to certain GAAP accounting requirements that would be inconsistent with measuring investment properties at fair value. These include the recognition of rental income on a straight-line versus contractual basis and the assignment of values to in place leases and other intangibles at acquisition of an investment property. The recognition of separate assets under GAAP is inconsistent with existing fair valuation methodologies for investment properties, which currently account for these factors in arriving at the estimated fair value of the investment property. As discussed below, we believe there are additional accounting requirements that should be addressed.

A minority of FinREC members and majority of the Task Force, including those representing investors, disagree with the entity-based approach in the proposed ASU. They emphasize the primary purpose of financial statements is to provide investors with relevant transparent, comparable, and consistent information in order for them to appropriately value assets and make capital allocation decisions within and among entities. The economic value of assets, including investment property assets, does not differ depending upon what enterprise



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owns them. Accordingly, they question the benefit to investors of only measuring investment property at fair value that is "housed" within an investment property entity (IPE). They believe the general principle of allowing entity-specific guidance is detrimental to investor interests, as it does not allow for comparable financial reporting and economic decision-making across entities.

The minority believes the scope of the proposal should be extended to include all investment properties and it should be a requirement, not an option, to measure investment properties at fair value. In addition to more comparable financial presentation in U.S. GAAP, they believe this will more closely align with the requirements of IAS 40 *Investment Property* than the proposed ASU and, therefore, be more likely to achieve the objective of convergence of International and U.S. accounting standards. Their understanding is that the option decision by the IASB was partially predicated on the lack of available valuation resources in certain emerging markets covered by IASB standards at the time of IAS 40's issuance which is not the case in the jurisdictions where U.S. GAAP is applied. Some who hold the minority view believe an option would lead to different measurements by entities with similar investments. These inconsistencies would lead to financial statements received by investors that are not comparable, an undesirable result. They believe the FASB should require fair value measurement of all investment properties regardless of whether the IASB does; however they also believe the IASB should revisit this provision in IAS 40. Others, however, would support an option to measure investment properties not held by an IPE at fair value.

However, the FinREC and Task Force members holding the minority view agree with those holding the majority view that there are a number of areas where modification or additions to the guidance are warranted. We recommend these changes should be considered in the final ASU. They include:

- A focus on broader application of fair value measurement at the entity level to ensure the reporting of a meaningful net asset value to investors,
- An expansion of the scope criteria that would ensure entities, such as Real Estate Investment Trusts (REITs), would clearly be within scope,
- Further development of a financial reporting model for IPEs, and
- Clarification of the interaction between this guidance and guidance in *Financial Services—Investment Companies* (Topic 946).

The remainder of our letter discusses these recommendations in more detail.

## Net Asset Value

To appropriately meet the needs of investors in real estate investment entities, we believe it is critical for the IPE to provide a high quality net asset value (NAV) measure which we define as simply the amount investors would receive if all investments of the real estate investment vehicle were sold at their respective fair values. In today's global capital markets, there are a wide variety of non-exchange traded real estate investment vehicles that invest in a wide range of real estate and real estate related investments spanning the spectrum of public and private debt and equity investments as well as everything in between. Such investments include a diverse array of controlling, non-controlling and partial interests in various types of real estate.



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The importance of a high quality NAV measure that is comparable among investment vehicles cannot be overemphasized because of the manner in which the NAV measure influences capital flows in the capital markets. The measurement of NAV ultimately determines the measurement of net income for such vehicles, and net income is used to calculate investment returns for a vehicle. Investment return is one of the most important metrics investors use to make decisions regarding which investment management firms will be selected to manage investor capital, as well as to make decisions regarding the overall allocation of capital to real estate versus other investment asset classes. We believe any proposed accounting standard that reduces the quality of the NAV measure, because a portion of an entity's investment assets or liabilities is not reported at fair value, will be poorly received by the investment community due to the perception that such a proposal will negatively impact the proper functioning and efficiency of the capital markets. This would also be a change from the method of accounting used today by most private institutional real estate investment entities.

## Scope

We believe it is important to reexamine the scope criteria to ensure the guidance includes entities within its scope whose investors view the fair value of real estate investments as critical to their evaluation of individual real estate investments and their ability to make comparisons among real estate and other investment entities.

***Nature of Business Activities***

Substantially All Criteria

We suggest removing limitations on the real estate investments that satisfy the “substantially all” requirement by removing the words “property or properties”. As currently written, the scope of the proposal would exclude certain types of entities that should qualify as IPEs.

Non-controlled Investments in Real Estate Properties

Certain operating real estate companies, including many equity Real Estate Investment Trusts (REITs), would not meet this criterion due to the proposed exclusion of real estate properties held and managed in non-controlled entities. Many operating real estate entities own and operate real estate through these structures. This is a way to expand their exposure to investment properties through diversification of risks across a larger number of properties. Others may hold real estate investments in this manner because a prior owner effected a partial sale of the property due to tax considerations. In any event, from the investor’s perspective, the entity is investing indirectly in real estate properties and the investor would want fair value measurements consistent with other IPEs that may wholly own or control similar properties. However, under the proposed ASU’s criteria, if the real estate entity participates in a number of these non-controlled entities and *substantially all* includes only real estate *properties* owned directly or indirectly through investments in controlled IPEs, a substantial number of these entities may not meet this criterion. Thus, the real estate investment entity would not qualify as an IPE and may be precluded from measuring its investment property investments at fair value.



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Investments in Real Estate Mortgages

As currently provided in proposed ASU paragraph 973-10-55-5, investments in mortgage note receivables are not considered eligible investments for purposes of the *substantially all* analysis. As part of its investment strategy, a real estate entity may originate or buy and service a real estate mortgage note. It may be doing this to ultimately convert the mortgage note into an equity position or it may be investing in real estate through a debt versus equity position. In either case, we believe the investment in the mortgage note receivable should be considered when evaluating the *substantially all* requirement.

We understand that the Board may have added the words "property" or "properties" to avoid inclusion of passive investments such as real estate mortgage-backed securities. However, we believe that a real estate investment entity should not be precluded from being an IPE because it has significant investments in real estate mortgage securities.

We believe a focus on all types of real estate investments, including debt, would lead to including entities within the IPE scope that would be consistent with investors' expectations and lead to greater consistency in reporting. This approach would be preferable to the existing language which, in addition to potentially excluding many entities, such as REITs, that were intended to be scoped into the guidance, leads to the potential for implicit optionality through interpretation of the *substantially all* requirement.

Right of Use Assets

It is unclear whether right of use assets, such as a ground lease of the land underlying an investment property, would be included in evaluating the *substantially all* criterion. We believe these types of assets represent another form of real estate investment and should be considered as such in determining if an entity is an IPE.

Specialty Property Types

We believe it would be beneficial to revisit a conclusion expressed in the Basis for Conclusions of the proposed ASU. In paragraph BC15, the Board states: "For example, an entity that operates a hotel that is located on its investment property may be investing in a real estate property, but the activities related to operating the hotel are not considered investing in a real estate property." This statement could be interpreted to mean that hotel properties would never be considered investment properties.

While we agree that engaging in significant business activities other than investing in real estate would call into question whether an entity is an IPE, we believe the decision should be based on the nature of the investing activity rather than the nature of the asset. Many institutional investors invest in hotels, seniors housing and other specialty real estate property types. The intent of this investing is to balance the investment risks and returns in their real estate portfolios, rather than to engage in operating businesses. Typically, the entity owning the property hires an experienced manager of these types of properties, with an established brand, to operate the property. The entity is not involved in daily



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operations, but rather manages the overall interest and positioning of the real estate asset. From the entity's perspective, a hotel is a real estate asset that is rented on a daily basis, rather than a monthly or longer term basis. As such, it reacts quickly to market and economic changes and is essential to a balanced real estate investment portfolio. This is an investment asset, just as interests that might be held in a multi-tenant office building or retail shopping mall are investment assets. Each provides ancillary services to its "tenants", but the entity's primary purpose is to invest in that particular real estate asset class. To distinguish based on the asset versus investment nature would lead to investors receiving reporting of what they believe are real estate investments that is inconsistent with that for their other real estate investments.

We recommend that the business activities criterion not be restricted based on the nature of the asset but focus on the nature of the investing strategy. For example, we suggest that the Board establish a test based on the significance of leasing income (including hotel room and parking rentals) and capital appreciation to the overall return on the property for purposes of determining whether an asset is an investment property. We believe that real estate assets for which leasing income and capital appreciation are expected to produce a majority of the return on the property are investment property assets.

We do agree, however, that companies whose principal business activities involve using their real estate assets to provide goods or services, or for administrative purposes should not be IPEs. As an example, several years ago Marriott split into two companies, one to hold the real estate properties, Host Marriott, and one to market and manage the Marriott brand and operate hotel assets, Marriott International. We believe the comments included in paragraph BC15 of the Basis for Conclusions should refer to the nature of the investment and that any exclusion example be such that an entity, such as Host Marriott, would be considered to meet the nature of business activities criterion and Marriott International would not.

***Express Business Purpose***

Real Estate Investments Used for Internal Purposes

We recommend modifying the guidance in proposed ASC paragraph 973-10-55-8 to state that real estate investments held by an entity predominantly for (a) the entity's own use in the production or supply of goods or services or for administrative purposes, or (b) development for sale in the ordinary course of business upon completion would not meet the express business purpose criterion. Using the word *predominantly* in the guidance would help to ensure that the guidance doesn't essentially become optional by allowing entities that use a small portion of a property in their operations or for administrative purposes not to apply the IPE guidance. Alternatively, we recommend that the Board consider making this guidance consistent with paragraph 10 of IAS 40 to indicate that an entity that holds investment properties for which an insignificant portion is used in the production or supply of goods or services or for administrative purposes would meet the express business purpose criterion.

Exit Strategy

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We recommend that an IPE should not be required to have an exit strategy for its investments. During discussions of the Investment Property Entities Project, some Board members expressed the view that investment property generally held as a long-term investment should not be within the scope of the standard, but rather part of the leasing standard as the investors' primary focus was on operating income. Their belief appeared to be that, if the property was going to be held for a long period of time, the fair value would not be relevant to financial statement users.

Owners and operators of investment property portfolios invest and operate properties to maximize total return. Returns include operating cash flows from the properties, as well as capital appreciation. Whether or not an investment property is going to be sold in the near or long term, the value of the property is relevant to shareholders, as well as to lenders. The fair value of a portfolio of investment properties is a significant factor in determining the share price or unit value of the entity. The fair value of the portfolio is also a critical factor in determining the degree to which lenders will provide capital in the form of debt. The entities often do not have a defined exit strategy, as disposition timing is opportunistically driven by the maximization of total return. To exclude these entities from the scope of an IPE standard would lead to inconsistencies in application and not meet the needs of investors. In addition, the exit strategy criterion provides a perceived optionality to the application of the IPE guidance.

As currently written, the proposed FASB Accounting Standards Update (ASU), "Financial Services—Investment Companies (Topic 946): *Amendments to the Scope, Measurement, and Disclosure Requirements*" would not require an entity to have an objective of investing solely for capital appreciation and, therefore, would not require an exit strategy (the proposed ASU would require an investment company entity's only substantive activities to be either investing for capital appreciation, current income, or both). If an investment company is not required to invest for capital appreciation (and therefore is not required to have an exit strategy), we see no conceptual (or financial statement user) basis for requiring an IPE to invest for capital appreciation (and therefore to have an exit strategy). We recommend that the FASB allow similar flexibility in the investment objectives of an IPE to that allowed for an investment company.

If the Board retains the exit strategy requirement, disposal of real estate investments only upon liquidation of the entity or to satisfy investor redemptions should qualify as valid exit strategies. Real estate investment entities commonly own the majority of their real estate property investments indirectly through controlling financial interests in single member LLCs (or similar special-purpose entities) that hold the title to the property and issue related indebtedness. This is commonplace to address legal and risk management concerns.

The single member LLC is typically liquidated upon the disposition of the property and repayment of the related debt (i.e., single member LLCs are usually not "recycled" to be used for ownership of real estate properties other than those they were originally created to hold). In order for the parent of the single member LLC to be an IPE, the proposed ASU would require the LLC to have an exit strategy for its investment property investments. However, the LLC could not satisfy the proposed exit strategy requirement if it is designed to be liquidated contemporaneously with the disposition of the real estate



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property or properties that it holds and, therefore, its parent would not qualify as an IPE. This would effectively require IPEs to hold their investment property investments directly, which would severely limit the population of entities that could qualify as IPEs. We do not believe this is what the Board intended. From an investor perspective, the exclusion of sales upon liquidation from valid exit strategies is illogical since there is a capital appreciation impact to the investor regardless of whether an investment is disposed of before or upon liquidation of the investment entity. We believe the exclusion of sales to satisfy investor redemptions from valid exit strategies is similarly illogical from an investor perspective.

In addition, we believe the Board should include a provision in the final ASU that if an entity does not have an express exit strategy for realizing the appreciation in its investment property, but has a history of monetizing such appreciation, the requirement for an exit strategy would be met. We believe appreciation may be monetized through sale of the property or an interest in a property, contribution of a property to a joint venture, or refinancing a property.

### *Reporting Entity*

Proposed ASC paragraph 973-10-15-2(a) would require an entity to provide financial results about its investing activities to its investors in order to be an IPE. We recommend that the final ASU include a statement that if an entity is a wholly owned subsidiary of an IPE, the entity would not be required to provide financial results about its investing activities to its sole investor in order to be an IPE (similar to the exemptions to the unit ownership and pooling of funds criteria already included in the proposed ASU) because its investor would be able to obtain information about the financial results of the entity's investing activities from its underlying accounting records.

## Financial Reporting Model for IPEs

### *Financial Statement Presentation*

We agree with the Board's conclusion that gross financial statement presentation by real estate investment funds where assets, liabilities, income and expenses are separately reported on a consolidated basis generally is most meaningful to investors in IPEs where a significant component of the total return is from income. However, there are circumstances where a net presentation of the real estate investment may be more useful to such entities' investors than gross presentation.

Consolidation of investees by real estate investment entities, while theoretically allowing for better transparency of financial information, may have unintended consequences under certain circumstances. For example, a real estate investment entity investing globally may be faced with practical difficulties in obtaining financial information from its investees prepared under U.S. GAAP. In addition, application of the U.S. GAAP consolidation requirements by a real estate investment entity to its investees that are IPEs in some situations may detract from its investors' ability to analyze and compare the entity's performance with that of other investment vehicles in which they currently invest or may consider investing.

As previously discussed in this response, in order to balance the risk and diversity of their portfolios, investors invest in a variety of real estate investments with a wide range of risk/return scenarios. For example, an investor may invest in a lower risk core real estate fund or REIT that invests in high quality, highly leased investment properties in desirable markets. These types of investments would typically generate a significant portion of their total return from operating income complemented by a lower portion related to capital appreciation. From an investor perspective, it is important to see a gross presentation of the balance sheet and income statement for the parent and any controlled IPEs to understand how the entity is performing with respect to the income component of the return. This is used by the investor to evaluate the performance of the investment as well as to make a comparison with other investments with similar risk/reward characteristics.

At the other end of the risk/reward spectrum would be an investment with an opportunistic strategy. For example, an investment may be made in an investment property that needs significant renovation and repositioning in the marketplace and has few, if any, tenants. The primary purpose of the investment is ultimately to generate a large capital return upon disposition of the asset over the period of years it takes to maximize and realize the enhanced value. During the lifecycle of this investment, there may be some income generated; however, the timing and level of that income generation is modest in relation to the capital appreciation. In this situation, consolidation of the investee by the parent IPE would yield little additional information of benefit to investors, while potentially requiring significant effort to provide the requisite financial detail necessary for that consolidation. That is, the consolidated financial detail would provide little, if any, additional information of value to investors that would not be derived from a fair value measurement of the net investment in the underlying investee. In addition, these types of opportunistic investments may compete for investors with alternative investment vehicles that are required to apply the investment company accounting and financial reporting requirements, such as private equity investment entities, under which investments generally would be presented on a net basis. Accordingly, presentation of the fair value of the net investment in the investee versus consolidation in these situations may facilitate investors' ability to analyze and compare the entity's performance with that of other investment vehicles they currently invest in or may consider investing in.

The NAV of an entity presenting the fair value of common equity in an investee may not necessarily equal the sum of consolidated assets less liabilities of such an investee, particularly when certain assets and liabilities (such as debt) may not be measured at fair value. Even if the investment assets and financial liabilities were to be measured at fair value in accordance with our recommendations, differences in U.S. GAAP principles impacting the fair value measurement of the gross assets and liabilities, versus a net investment in the investee, may result in additional variances impacting the NAV (i.e., the fair value of an equity interest in an investee is unlikely to equal the fair value of the investee's consolidated net assets, even if all underlying consolidated assets and liabilities are measured at fair value). NAV measures that are comparable between real estate investment vehicles, such as opportunity funds, and investment vehicles with similar risk/reward characteristics in other asset classes, would

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enhance investors' ability to make efficient capital allocation decisions between real estate and these other asset classes.

We recommend that the FASB provide a mechanism in the final standard for an IPE to follow the financial presentation that would best facilitate its investors' ability to analyze and compare the entity's performance with that of other investment vehicles in which they currently invest or may consider investing. In order to accomplish this, we believe that where substantially all of an IPE's return is anticipated from capital appreciation, the Board should provide for an accounting policy determination to report using a net presentation model (similar to investment companies) as consolidation of investees with minimal annual income may provide little in value of information to investors, while requiring significant effort on the part of the preparer. Alternatively, we believe the Board could provide for such an accounting policy determination by entities that meet both the definition of an IPE and the definition of an investment company.

***Financial Liabilities at Fair Value***

Investment properties as described in the proposed ASU often have debt associated with them. The debt is typically of one of two forms or a combination of both: non-recourse mortgage debt secured by one or more of the investment properties or entity level debt that supports the purchase of the properties. In some cases, the latter represents a line(s) of credit drawn upon to facilitate the purchase of the properties and then repaid when subsequent equity capital commitments are funded by the investors. In other cases, the entity level debt is not specifically collateralized by investment properties, but rather by the entity's assets. However, unlike other investment vehicles, IPEs would be required to have substantially all of their assets invested in real estate. Therefore, all of the debt would effectively be secured directly (through non-recourse financing) or indirectly (through entity-level financing) by the real estate investment assets that would be measured at fair value.

As discussed above, we believe that a fair value NAV is the relevant measure for investors evaluating their real estate investments. Measuring financial liabilities associated with such real estate investments at amortized cost does not provide investors and other users of the financial statements with decision-useful information. While investors certainly want to understand the required anticipated cash outflows necessary to meet the obligations of the entity – just as they would desire to understand the cash flows being generated by the associated investment properties – they may not be willing to invest in an entity at book value if the interest rate on the debt exceeds market interest rates. They would want to pay less than book value as this fixed commitment no longer reflects market conditions. Similarly, investors would be willing to pay more to invest in an enterprise that has secured fixed-rate financing at below current market rates.

While some may argue that reflecting a "gain" in net income (and equity) due to an increase in market interest rates (due either to an increase in real interest rates or credit spreads) is counterintuitive, we believe that the appropriate question to be asked is: "Would an investor pay more for the shares (or an equity interest) in an entity that has secured below market financing?" When cast in this light, it does not



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appear counterintuitive that equity should rise as the market interest rate on debt increases above the contractual interest rate on the debt.

If an IPE reports a NAV measuring the assets at fair value and the liabilities at amortized cost, and investors subscribe and redeem interests at this value, this has the effect of inappropriately valuing an enterprise that has debt at above or below market rates. Said differently, two IPEs with identical investment property investments measured at fair value, but financed with debt carrying different interest rates (e.g., Entity A with 8% debt and Entity B with 5% debt), will report identical NAVs in their financial statements. However, if current market rates are 6%, the carrying amount of Entity A's debt will be less than its fair value and the carrying amount of Entity B's debt will be greater than fair value. As a result, Entity A will be overvalued and Entity B will be undervalued.

Although many argue that debt should not be measured at fair value because it will not or cannot be settled at fair value, it is common to refinance debt in periods of declining interest rates. The effect of refinancing is– on a net present value basis – to settle the obligation at current market rates. Many companies have refinanced their debt in a declining interest rate environment so as not to suffer future economic losses due to higher than market rates (that is, to avoid future economic losses). Similarly, organizations with below market rates seek not to refinance so as to allow the benefits of below market rates to inure to the enterprise over time (i.e., an economic gain).

For the aforementioned reasons, we believe that the proposal should require an IPE to measure its financial liabilities at fair value. Under the current proposal, an IPE would measure investment properties at fair value and measure any associated debt at amortized cost unless the entity elects to measure the debt at fair value under the fair value option. Consequently, these entities would have accounting mismatches if they do not elect the fair value option for the debt. We believe fair value is the appropriate measure for debt of an IPE because fair value reflects investment assets and financial liabilities without regard to when they were acquired, increasing comparability across financial statements and appropriately reflecting the value relative to current market conditions. Failure to measure investment assets and financial liabilities at fair value omits information from the financial statements needed by investors to determine a fair value NAV for purposes of comparison to other investment they have made, as well as industry performance indices and other metrics. Fair value measurement of financial liabilities provides useful information to financial statement users about the consequences of past decisions to borrow and the implications of current decisions to maintain or refinance a borrowing.

While we recommend that all financial liabilities of an IPE be measured at fair value, at the very least, we urge the Board to require both real estate investments and any debt directly or indirectly associated with these investments to be measured at fair value to ensure the appropriate valuation of IPEs.

***Treatment of Equity Interests***

We agree that IPEs should measure equity investments for which they have significant influence at fair value. However, we believe that IPEs with equity interests in other IPEs over which they have



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significant influence should report their share of the IPE investees' operating income for the period as a separate component of earnings in the income statement, with any remaining change in value of the investment reported in the income statement as an increase or decrease in unrealized gain or loss on the investment. We note that this is a presentation issue only and has no effect on net income. If the investee income is not separately reported it would flow through unrealized gain or loss.

We believe separately reporting the IPE's share of such investee operating income would better meet the needs of investors who, in addition to investing for capital appreciation, also consider the income component of the appreciation to be significant. This would enable investors to see the operating income from consolidated IPEs, as well as the IPE's share of operating income from unconsolidated IPE joint ventures and other IPE investees where the reporting entity has significant influence. We believe the increase or decrease in unrealized gain or loss reported in the income statement should include the effects of any distributions from the investee entity during the reporting period.

We further believe it would be beneficial to investors for IPEs to disclose a reconciliation of the change in value in the investments described in the previous paragraph from the beginning to the end of the reporting period. We would expect this to include any realized gain or loss, share of operating income earned during the period, distributions received from the investee entity and other increases or decreases in the unrealized gain or loss on the investment for the period. Alternatively, if all of the reconciling items, other than distributions, are reflected separately on the income statement, distributions could be disclosed in lieu of a separate schedule.

For other investments for which an IPE can exercise significant influence, as well as for all investments for which an IPE cannot exercise significant influence, we believe the IPE should measure its investments at fair value. This is consistent with our belief that the investors in an IPE desire to see their investment in the IPE reported at a fair value NAV. We believe distributions received for such investments should be recorded as income, unless they represent a return of capital, consistent with existing U.S. GAAP, and remaining changes in fair value should be presented as unrealized gains and losses in the income statement.

***Other Investment Assets***

We recommend that the final ASU require or permit an IPE to measure its other investment assets at fair value.

***Realized Gains***

We recommend the guidance specify how realized gains should be computed to avoid disparity in those calculations. We believe realized gains should represent the sales price, net of sales costs, reduced by the accumulated cost basis in the property. The accumulated cost basis would be the original cost, including transaction costs, and any subsequent capital improvements or capitalization associated with the property. The guidance should include discussion as to whether other capitalization, such as interest capitalization (Topic 835) and capitalization of other costs (Topic 970) should be required. The basis of

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the investment properties would not be adjusted for depreciation or other GAAP that affects the measurement of property, plant, and equipment that is not measured at fair value.

***Investment Losses***

Guidance should also be provided with respect to equity investments as to the treatment of the funding of any investment losses at the investee level by the investor IPE entity. We believe such funding should represent an increase in the investor's cost basis of the investment.

***Advisor Incentive Fees***

The final ASU should include accounting and reporting guidance for accounting for advisor incentive fees that are based upon the ultimate realized gain or net asset value of the entity, such as, clarification whether IPEs which are managed outside of the entity are required to report investment advisor fees within the IPE's financial statements when such amounts are paid directly by the investor to the investment manager; whether recognition of real estate fund incentive fee liabilities should be based on a hypothetical liquidation at fair value approach or an ASU 450, *Contingencies*, approach; and lastly, whether in the statement of operations incentive fees should be presented as a component of net investment income or within realized and unrealized gains (losses).

***Impairment Measurements***

Consistent with the guidance in IAS 16 and IAS 36, we believe the final ASU should clarify that the impairment guidance of ASC Subtopic 360-10 does not apply for purposes of determining realized gains and losses of an investment property that is measured at fair value. That is, we believe any excess of an investment property asset's cost basis over its fair value should be reported as an unrealized loss rather than an impairment loss that results in a permanent adjustment of the cost basis that affects the amounted of reported realized gain or loss upon disposition of the property.

***Effect of Sales Costs on Fair Value Measurement***

Real estate fair value estimates are commonly performed using discounted cash flow (income) analyses to estimate the existing owner's selling price of the real estate assuming a sale at the measurement date. Such discounted cash flow (DCF) analyses typically assume a sale by the buyer of the real estate investment at the end of the buyer's holding period, and include transaction costs that are assumed to be incurred (by the buyer) at the end of the holding period in order to reflect the perspective of a buyer in the marketplace. It is not intended to analyze the existing owner's future cash flows and does not generally consider the sale transaction costs that would be incurred by the existing owner if the property were sold at the measurement date. Accordingly, the objective of the DCF analysis is to estimate cash flows and costs that a buyer would earn and incur if the buyer were to evaluate the purchase price for the investment.



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We believe the Board should clarify in the final ASU that a fair value estimate for a real estate investment performed using a DCF analysis appropriately may be reduced by the transaction costs assumed to be incurred by a buyer when the buyer ultimately sells the investment at the end of the assumed holding period. We believe the Board should also clarify that such an estimation methodology would not be inconsistent with the requirements of ASC 820-10-35-9B if it reflects a market participant perspective. For example, consider a DCF analysis for a real estate investment that assumes a sale of the property in ten years for a price of $1 million less transaction costs of $50 thousand along with operating cash flows during the 10-year holding period that produce an overall fair value estimate of $1.5 million based on the present value of the discounted cash flows. The owner estimates that transaction costs of $75 thousand would be incurred to sell the property at the measurement date. In this example, we believe the Board should clarify that it is appropriate to reduce the estimated cash flows included in the DCF analysis by the $50 thousand of estimated transaction costs to sell the property at the end of the assumed holding period if doing so reflects the perspective of a buyer in the marketplace. Conversely, under the guidance in ASC 820-35-10-9B, it would not be appropriate to reduce the $1.5 million fair value estimate by the $75 thousand of estimated transaction costs to sell the property at the measurement date.

***Disclosures***

As currently written, the proposed ASU includes only limited guidance on disclosures by an IPE. In addition to our disclosure recommendations for equity investments detailed above, we feel additional disclosure clarifications in the proposed guidance would be beneficial.

We do not understand the reason for the differentiation between properties that generated rental revenue during the period and those that did not in proposed paragraph ASC 973-360-50-1 and suggest that the Board further clarify such distinction.

The proposed ASU would require contractual obligations related to an investment property to be disclosed. Many operational obligations, such as maintenance, cleaning and other contracts are entered into in the normal course of managing and operating investment property. We recommend the Board differentiate contractual obligations related to operating expenditures that are commonplace in the course of managing the property from other obligations and exclude them from this disclosure requirement.

If the Board decides to exclude IPEs from the scope of its standard on accounting for leases, we recommend that the Board consider the disclosure requirements of that standard that would be useful to an IPE's investors and include them as requirements of the IPE standard. We also believe that certain disclosure guidance currently contained in IAS 40 may be helpful.

Some of the above issues are described more specifically in "Summary of Real Estate Fund Inquiries" prepared by the AICPA Real Estate Funds Task Force. That summary was developed in connection with previously issued AICPA Statement of Position 07–1, *Clarification of the Scope of the Audit and Accounting Guide* Investment Companies *and Accounting by Parent Companies and Equity Method Investors for Investments in*

*Investment Companies*, which was deferred to allow the Board time to consider certain implementation issues arising from application of the SOP. We recommend that the Board revisit this guidance and considers it for the final ASU.

In summary, we are concerned that a comprehensive financial reporting framework for IPEs was not included in the proposed ASU and recommend that the Board consider:

a. developing accounting and reporting guidance for IPEs, including financial statement presentation, debt valuation and treatment of equity interests,
b. requiring or permitting measuring IPEs' investments in other investment assets at fair value.
c. including illustrative examples of such presentation and disclosures in the final ASU,
d. allowing an accounting policy determination as to the financial presentation model for IPEs, or alternatively, of which financial reporting model to apply for entities that qualify as both an IPE and an investment company.

## Interaction with Investment Companies Guidance (Topic 946)

There are currently similarities in the IPE proposed guidance and the investment company guidance both in scope and in presentation of investment properties in the financial statements that might be viewed as a reason to combine the two proposals into one standard. However, based upon the various comments we have provided both in this letter and our comment letter on the Investment Company guidance, we believe there are significant issues remaining to be addressed as to appropriate scope criteria, the issue of consolidation of investments, and other financial statement presentation issues that are likely to cause these two projects to diverge in ways that warrant separate standards.

Investment properties with active operations generally generate a significant portion of their returns from operating cash flows. These real estate entities may be involved directly, or through third party vendors, in activities such as acquiring, marketing, leasing/re-leasing, financing, actively managing the investment properties' operations and strategically disposing of investment property. As part of their evaluation of the performance of management, investors in real estate entities evaluate detailed information about an investment property portfolio including rental revenue and operating costs, as well as current investor yield requirements. Investors also utilize this data as they evaluate the fair value NAV of the entity. As a result, financial statement users' needs are often different for these types of real estate entities as compared to the unconsolidated, net investment presentation generally utilized by investment company entities. As previously discussed, other real estate entities, such as opportunistic investment entities, where the capital return is the predominant component of total return, are evaluated by investors in ways that are comparable to those for investment companies. While following investment company financial reporting for the latter may provide investors with appropriate information, we are concerned that following Topic 946 guidance for the former would not meet certain needs of many investors in those types of real estate entities. These needs include:

- Consolidation of controlled investees to provide the financial statement users information necessary to evaluate the income return generated by operations of the underlying investment property portfolio.

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*(Note: While the current exposure draft for Topic 946 would require consolidation of these entities, FinREC's response letter on this topic expresses support for consolidation only when such entities are wholly owned; in any event, as we have discussed earlier in this letter we believe it is necessary to establish consolidation guidance for real estate investment entities that is different than the consolidation guidance that would apply to investment companies),*

- Presentation of the entity's share of income from equity investments in real estate investment entities over which the reporting entity can exercise significant influence to enable financial statement users to understand the portion of the total change in fair value of those investments that is derived from income return on investment properties, and
- Fair value measurement of the entity's debt, as we have proposed, to enable financial statement users to effectively evaluate the impact of debt associated with the investment properties and its impact on NAV.

We have detailed other guidance elsewhere in this letter that may be different than that ultimately required for Topic 946 entities. We believe these differences in needs by investors and other users of these real estate entities' financial statements are significant and warrant maintaining two separate ASC Topics. In addition, there are current scope differences between the two projects that would need to be resolved were the guidance to be incorporated in one ASC Topic. This may prove difficult without impacting other investment company accounting.

One of the significant concerns that some of the Board's constituents have raised should the FASB elect not to finalize a separate ASC Topic on IPEs is the possibility of changes in regulation and taxation for entities (such as certain REITs) that would newly be considered investment companies for financial reporting purposes as a result of the guidance in the final investment companies ASU. We believe these concerns also provide an appropriate basis for the Board to establish a separate ASC Topic on IPEs.

We recommend the Basis for Conclusions of both the IPE and investment company ASUs clearly explain why the Board created separate ASC Topics, if the Board proceeds in that direction, or alternatively, why one ASC Topic is appropriate. In addition, we believe it is critical for the FASB to describe the significant differences in the accounting and financial reporting by IPEs versus investment companies, and its rationale for those differences (i.e., the primary financial statement user considerations, investor needs and other objectives that prompted the need for the different accounting and financial reporting models). In addition, as previously discussed, we believe the FASB should develop a more comprehensive financial reporting framework specific to IPEs. For example, the final IPE ASU should clearly indicate whether an IPE would be required to present a schedule of investments and financial highlights.

Lastly, given the uncertainty surrounding how the IPE proposal will progress, the types of investments that may ultimately be held by an IPE (see above comments in this regard), and the accounting and financial reporting guidance that will be provided relative to investment properties, we are unable to form a view as to whether we agree with the aspect of this proposed ASU that would require application of Topic 973 to take precedence over Topic 946 for an entity that meets the criteria to be both an IPE and an investment company.

The Appendix to this letter includes our responses to the questions raised in the proposed ASU.



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We appreciate the opportunity to comment on the proposed ASU. Representatives of FinREC and Topic 973 comment letter task force are available to discuss our comments with Board members or staff at their convenience.

Sincerely,

| | |
|---|---|
| Richard Paul | Roy Rendino |
| Chairman | Chairman |
| Financial Reporting Executive Committee | Topic 973 Comment Letter Task Force |



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**Appendix**

Questions for Respondents

Scope

**Question 1:** The proposed amendments would require an entity that meets the criteria to be an investment property entity to measure its investment property or properties at fair value rather than require all entities to measure their investment properties at fair value. Should all entities measure their investment properties at fair value or should only an investment property entity measure its investment properties at fair value? Why? Is fair value measurement of investment properties operational? Please describe any operational concerns.

**A majority of FinREC members support the entity-based scope outlined in the proposed ASU because they believe only entities whose real estate investments comprise substantially all of their business activities should be required to measure investment properties at fair value. For other entities, such as diversified companies, fair value of investment properties may be costly to develop, complex to implement, and operationally difficult to comply with, particularly during interim reporting periods, and for small private diversified entities, such costs may be burdensome or even prohibitive.**

**A minority of FinREC members and majority of the Task Force, including those representing investors, believe that all investment properties, regardless of the nature of the entity that owns them, should be measured at fair value. Some believe an option would lead to different measurements by entities with similar investments. Others, however, would support an option to measure investment properties not held by an IPE at fair value.**

**However, as further discussed above, the Task Force and FinREC agreed that there are a number of scope and financial reporting issues related to the proposed amendments that should be addressed prior to issuing the final standard.**

**Question 2:** The proposed amendments would require an investment property entity to measure its investment property or properties at fair value rather than provide an option to measure its investment property or properties at fair value or cost. Should fair value measurement of investment properties be required or permitted? Please explain.

**A majority of FinREC members believe that fair value measurement of investment properties held by an IPE should be required. As mentioned above, a minority of FinREC believes such requirement should be extended to all investment properties, including those held outside of an IPE.**

**Question 3:** Do the criteria in the proposed amendments appropriately identify those entities that should be required to measure their investment property or properties at fair value, and, therefore, should be excluded from the scope of the lessor accounting model in the proposed Update on leases? If not, what changes or additional criteria would you suggest, and why are those criteria more appropriate?

**We believe there are substantial revisions that should be made to ensure that entities whose investors are investing principally due to the real estate investments held by the entity, such as REITs, are not excluded from the scope. We have provided detailed recommendations on improving the scope criteria in our response.**

**Question 4:** The proposed amendments would require an entity to reassess whether it is an investment property entity if there is a change in the purpose and design of the entity. Is this proposed requirement appropriate and operational? If not, why?

**We believe that the proposed requirement for reassessment is appropriate. We agree that an entity should reassess whether it is an IPE in certain instances; however, we believe the Board should provide additional guidance about what would constitute "a change in the purpose and design" of an entity.**

**Question 5:** An entity that would be an investment property entity under the proposed amendments would be required to follow the accounting requirements in the proposed amendments even if that entity also would be an investment company under Topic 946. Is it appropriate for an entity that would meet the criteria to be both an investment property entity and an investment company under Topic 946 to be subject to the amendments in this proposed Update? If not, what alternative approach would you recommend if an entity would meet the criteria to be both an investment property entity and an investment company? Should the form of the entity (real estate fund versus real estate investment trust) dictate whether an entity should be an investment company or an investment property entity for accounting purposes? If yes, please describe the difference between the business activities of a real estate fund and a real estate investment trust to support your view.

**We have commented on our views about the interaction between the IPE standard and the investment companies standard in our interaction with investment companies guidance discussion in the body of this letter. Given the uncertainty surrounding how the IPE proposal will progress, the types of investments that may ultimately be held by an IPE, and the accounting and reporting guidance that will be provided relative to investment properties, we are unable to form a view as to whether we agree with the aspect of this proposed ASU that would require application of Topic 973 take precedent over Topic 946 for an entity that meets the criteria to be both an IPE and an investment company.**

Nature of the Business Activities

**Question 6:** To be an investment property entity, the proposed amendments would require substantially all of an entity's business activities to be investing in a real estate property or properties. Should an entity's business activities be limited to investing in a real estate property or properties rather than investing in real estate assets in general (such as real-estate-related debt securities and mortgage receivables) to be an investment property entity? If not, why? Is this requirement operational? Please describe any operational concerns.

**We believe that the 'substantially all' test should consider all real estate investments and not just those related to real estate property or properties. Investors in real estate recognize that real estate investments take a number of different forms. These include full ownership, controlled interests, non-controlling interests, and debt interests (including beneficial interests in securitizations backed by real estate**

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**collateral). It is common for a real estate investment entity to pursue a variety of different investment types to meet the risk and return parameters of the investor. We do not believe that holding a particular subset of these investments should preclude the real estate investment entity from being considered an IPE. To do so would preclude investors from receiving comparable information on these investments and not enable them to properly evaluate the investment performance returns among their various real estate holdings.**

**Question 7:** The implementation guidance in this proposed Update specifies that when evaluating whether substantially all of the parent entity's business activities are investing in a real estate property or properties, the parent entity would not consider real estate properties held indirectly through investments in which the parent entity does not have a controlling financial interest. Should the evaluation of an entity's business activities consider properties held through noncontrolling financial interests (for example, investments in which the entity can exercise significant influence)? Why or why not?

**As discussed in question 6, we believe that all real estate investments should be included in the 'substantially all' test. Many real estate companies finance operating properties through joint ventures with financial partners, where control may not exist. Without considering these properties, many such entities may not meet the "substantially all" test.**

Express Business Purpose

**Question 8:** To be an investment property entity, the proposed amendments would require that the express business purpose of an entity is to invest in a real estate property or properties for total return with an objective to realize capital appreciation, for example, through disposal of its real estate property or properties. Real estate properties held by an entity for either of the following purposes would not meet this criterion:
a. The entity's own use in the production or supply of goods or services or for administrative purposes
b. Development for sale in the ordinary course of business upon completion (such as land developers and home builders).

Should an entity whose express business purpose is to hold real estate properties for the reasons listed above be excluded from the amendments in this proposed Update? If not, why? Is the express-business-purpose criterion operational? Please describe any operational concerns.

**We generally agree with this conclusion. However, we would suggest a change in the wording of the second sentence to "real estate property or properties held predominantly". This would allow for instances where an internally managed entity may occupy a portion of the property for administrative or operating purposes. Alternatively, we recommend that the Board consider aligning the definition of investment property with the guidance in paragraph 10 of IAS 40, which provides an exception for use of an insignificant portion of the property by its owner in the production or supply of goods or services or for administrative purposes:**



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> ***"Some properties comprise a portion that is held to earn rentals or for capital appreciation and another portion that is held for use in the production or supply of goods or services or for administrative purposes. If these portions could be sold separately (or leased out separately under a finance lease), an entity accounts for the portions separately. If the portions could not be sold separately, the property is investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes."***

**Question 9:** To meet the express-business-purpose criterion, the implementation guidance in this proposed Update would require that an investment property entity have an exit strategy to dispose of its real estate property or properties to realize capital appreciation to maximize total return. An entity that invests in a real estate property or properties to collect rental income long term and does not have an exit strategy for its real estate property or properties would not be an investment property entity under the proposed amendments. Should those entities be excluded from the amendments in this proposed Update? If not, why? Is the exit strategy requirement operational? Please describe any operational concerns.

**As stated above, we believe an IPE should not be required to have an exit strategy for its investments. Owners and operators of investment property portfolios invest and operate properties to maximize total return. The entities may not have a defined exit strategy as disposition timing may be opportunistically driven by the maximization of total return. To exclude these entities from the scope of an IPE standard would lead to inconsistencies in application and not meet the needs of investors. In addition, the exit strategy criterion provides a perceived optionality to the application of the IPE guidance.**

**If the Board decides to retain this requirement, we believe disposal upon liquidation and to satisfy investor redemptions should be considered valid exit strategies, otherwise we do not believe that the requirement is operational. In addition, we believe the Board should include a provision in the final ASU that if an entity does not have an express exit strategy for realizing the appreciation in its investment property, but has a history of monetizing such appreciation, the requirement for an exit strategy would be met. We believe appreciation may be monetized through sale of the property or an interest in a property, contribution of a property to a joint venture, or refinancing a property.**

Unit Ownership and Pooling of Funds

**Question 10:** To be an investment property entity, the proposed amendments would require an entity to have investors that are not related to the entity's parent (if there is a parent) and those investors, in aggregate, must hold a significant ownership interest in the entity. Is this criterion appropriate? If not, why?

**We believe that, as currently written, this criterion is unclear and may imply that more than two unrelated investors must hold a significant ownership interest in the entity. We recommend changing this proposed requirement to "an entity that has one or more investors that are not related to the entity's parent (if there is a parent) and that investor or investors, in aggregate, must hold a significant ownership interest in the entity". This revised wording is consistent with paragraph BC26 of the proposed ASU.**

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**Question 11:** To be an investment property entity, the proposed amendments would provide an exemption from the unit-ownership and pooling-of-funds criteria for a subsidiary entity that (a) has a parent entity that is required to account for its investments at fair value with all changes in fair value recognized in net income in accordance with U.S. GAAP or (b) has a parent entity that is a not-for-profit entity under Topic 958 that measures its investments at fair value. Should this exemption be available only to a subsidiary entity with a parent entity that is (a) required to account for its investments at fair value in accordance with U.S. GAAP or (b) a not-for-profit entity under Topic 958 that measures its investments at fair value? If not, which entities should be permitted to apply the exemption and why?

**We support providing an exemption from the unit-ownership and pooling-of-funds criteria for a subsidiary entity whose parent accounts for its investments at fair value in accordance with U.S. GAAP. We also believe the Board should provide an exemption to the reporting entity criterion's requirement for an entity to provide financial results about its investing activities to its investors when the entity is a wholly owned subsidiary of an IPE.**

Measurement

**Question 12:** The proposed amendments would require real estate properties other than investment properties that are held by an investment property entity to be measured in accordance with other U.S. GAAP. Should an investment property entity be required to measure those properties at fair value with all changes in fair value recognized in net income instead of applying other U.S. GAAP? Why or why not?

**We believe that all real estate properties held by an IPE, other than those used predominantly for the production of goods or services, or for administrative purposes, should be considered investment properties and measured at fair value. As discussed above, we believe all other investment assets and all financial liabilities should also be recorded at fair value.**

**Question 13:** The proposed amendments would require a right-of-use asset in which the underlying asset meets the definition of an investment property to be measured at fair value with all changes in fair value recognized in net income. Should those right-of-use assets be measured at fair value with all changes in fair value recognized in net income? If not, why and which measurement attribute would you recommend for those right-of-use assets?

**Yes, such right-of-use assets should be measured at fair value with changes in fair value recognized in net income. However, as previously discussed, it is unclear as to whether right-of-use assets would be included in evaluating the *substantially all* requirement of the nature of business activities criterion. We believe these types of assets should represent a qualifying form of real estate investment for purposes of that test.**

Interests in Other Entities

**Question 14:** The proposed amendments would require an investment property entity to evaluate whether an interest in (a) another investment property entity, (b) an investment company as defined in Topic 946, or (c) an



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operating entity that provides services to the investment property entity should be consolidated under Topic 810. Should an investment property entity consolidate controlling financial interests in those entities? If not, why? Should an investment property entity consolidate controlling financial interests in other entities? If yes, why?

**We believe an IPE should not be required or permitted to consolidate investees that are not IPEs, and should measure all non-consolidated investees at fair value. Given the substantially all requirement of the nature of business activities criterion, an investment company investee in which an IPE holds a controlling financial interest could not, by definition, be significant to the IPE. As a result, we believe presenting an investment company investee in which an IPE holds a controlling financial interest on a consolidated basis would reduce, rather than increase, the transparency of the IPE's financial statements to its investors. The Board has already acknowledged that an IPE is different from a commercial entity by concluding that an IPE should not consolidate a non-IPE or non-investment company investee. We believe a similar rationale for not consolidating an investment company investee is applicable.**

**We have commented on our views on consolidation of IPEs in our financial statement presentation discussion in the body of this letter.**

**Question 15:** The proposed amendments would prohibit an investment property entity from applying the equity method of accounting in Topic 323 unless the investee is an operating entity that provides services to the investment property entity. Is that exception to the equity method of accounting requirements in Topic 323 appropriate for investment property entities? If not, why?

**We agree that IPEs should not apply the equity method of accounting to investees over which they have significant influence unless the investee is an operating entity that provides services to the IPE. However, we believe that IPEs with equity interests in other IPEs over which they have significant influence should report their share of the IPE investee's operating income for the period as a separate component of earnings in the income statement, with any remaining share of the change in value of the investment reported in the income statement as an increase or decrease in unrealized gain or loss on the investment. We believe the increase or decrease in unrealized gain or loss reported in the income statement should include the effects of any distributions from the investee entity during the reporting period.**

**We further believe it would be beneficial to investors for IPEs to disclose a reconciliation of the change in value in the investments described in the previous paragraph from the beginning to the end of the reporting period. We would expect this to include any realized gain or loss, share of operating income earned during the period, distributions received from the investee entity and other increases or decreases in the unrealized gain or loss on the investment for the period. Alternatively, if all of the reconciling items, other than distributions, are reflected separately on the income statement, distributions could be disclosed in lieu of a separate schedule.**

**Question 16:** The proposed amendments would require an investment property entity to measure investments in which it does not have a controlling financial interest or cannot exercise significant influence in accordance with U.S. GAAP. For example, that would currently require held-to-maturity debt securities to be measured at

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amortized cost and would permit certain equity securities to be measured using the cost method, unless the fair value option in Topic 825, Financial Instruments, is elected. Should an investment property entity be required to measure those investments at fair value with all changes in fair value recognized in net income instead of applying other U.S. GAAP? Why or why not?

**As indicated in our previous comments, we believe the importance of a high quality NAV measure cannot be underestimated because of the manner in which the NAV measure influences capital flows in the capital markets. Requiring certain investments to be measured using the cost method will reduce the quality of the NAV measure and will negatively impact the proper functioning and efficiency of capital markets. Accordingly, we recommend that an IPE be required to measure all of its investments at fair value because it would improve the quality of the NAV measure reported to the investors.**

Financial Liabilities

**Question 17:** The proposed amendments would require an investment property entity to measure its financial liabilities (such as its own debt) in accordance with other U.S. GAAP, which currently requires amortized cost measurement unless the fair value option in Topic 825 is elected. Should an investment property entity be required to measure its financial liabilities at fair value with all changes in fair value (including changes in an entity's own credit) recognized in net income instead of applying other U.S. GAAP? Why or why not?

**As described above, we recommend that an IPE be required to measure its financial liabilities at fair value. Unlike other investment vehicles, IPEs must have substantially all of their assets invested in real estate. Therefore, all of the debt is effectively secured directly or indirectly by the real estate investment assets that would be measured at fair value. We believe that a fair value NAV is the relevant measure for investors evaluating their real estate investments. Measuring financial liabilities associated with such real estate investments at amortized cost would not provide investors and other users of the financial statements with decision-useful information.**

Rental Revenue Recognition

**Question 18:** The proposed amendments would require an investment property entity to recognize rental income on investment properties subject to a lease when lease payments are received or as the lease payments become receivable in accordance with the contractual terms of the related lease rather than on a straight-line or other basis. Is that basis of recognizing rental revenue appropriate for investment properties measured at fair value? If not, why?

**We agree with the proposal for IPEs to recognize rental income as the lease payments become receivable in accordance with the contractual terms of the related lease rather than on a straight-line or other basis. However, we do not agree that income should necessarily be reported when lease payments are received. To do so would be to follow a cash basis accounting concept for income, which would deviate from the accounting for the contractual terms of the lease which is used in appraisal theory. An appraiser utilizing a discounted cash flow model to determine the fair value of an investment property, which is common in valuing real estate, would base the future cash flow stream on lease payments contractually due under**



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**the lease agreement. Any difference in the timing of payments would result in a prepaid rent liability (if rent is paid prior to the contractual requirement) or as accounts receivable (if rent due under the contractual terms was not yet paid) and would be separate from the determination of fair value by the appraiser. We recommend further clarification that the amount of income recorded in the income statement be in accordance with the contractual terms, which would be consistent with the assumptions used by the appraiser in arriving at fair value for the investment property at the period end.**

Practical Expedient for Measurement of an Interest in an Investment Property Entity

**Question 19:** The proposed amendments would permit, as a practical expedient, an entity to estimate the fair value of its investment in an investment property entity using the net asset value per share (or its equivalent) of the investment if the entity would transact at the net asset value per share. Are there investments that currently qualify for the practical expedient that would no longer qualify for the practical expedient because of the proposed amendments? If so, please identify those types of investments.

**Based on guidance included in the proposed ASU, we believe there are investments that would no longer qualify for the practical expedient (e.g., IPEs with non-investment property investments that are not measured at fair value or with debt measured at amortized cost for which the carrying amount and fair value are significantly different). If the Board accepts our recommendations regarding measurement of an IPE's financial liabilities and non-investment property investments, we believe investments that currently qualify for the practical expedient would continue to qualify.**

Disclosure

**Question 20:** Are the proposed disclosures appropriate for an investment property entity? If not, which disclosures do you disagree with? Should any additional disclosures be required? If so, why?

**We do not understand the reason for the differentiation between properties that generated rental revenue during the period and those that did not in proposed paragraph ASC 973-360-50-1 and suggest that the Board further clarify such distinction.**

**The proposed ASU also would require contractual obligations related to an investment property to be disclosed. Many operational obligations, such as maintenance, cleaning and other contracts are entered into in the normal course of managing and operating investment property. We recommend the Board differentiate contractual obligations related to operating expenditures that are commonplace in the course of managing the property from other obligations and exclude them from this disclosure requirement.**

**As described in our general observations on the financial reporting model above, we believe it would be beneficial to investors for IPEs to disclose a reconciliation of the change in value of the investments from the beginning to the end of the reporting period. We would expect this to include any realized gain or loss, share of operating income earned during the period, distributions received from the investee entity and other increases or decreases in the unrealized gain or loss on the investment for the period.**

**Alternatively, if all of the reconciling items, other than distributions, are reflected separately on the income statement, distributions could be disclosed in lieu of a separate schedule.**

**If the Board decides to exclude IPEs from the scope of its standard on accounting for leases, we recommend that the Board consider the disclosure requirements of that standard that would be useful to an IPE's investors and include them as requirements of the IPE standard. We also believe that certain disclosure guidance currently contained in IAS 40 may be helpful.**

Effective Date and Transition

**Question 21:** Should an entity recognize the effect of adopting the requirements in this proposed Update as an adjustment to the beginning balance of retained earnings in the period of adoption? If not, what transition requirements would you recommend and why?

**We agree with the transition requirements.**

**Question 22:** How much time would be necessary to implement the proposed amendments?

**We recommend two years for implementation of the proposed amendments to provide the affected entities with sufficient time to set up valuation systems and controls for reporting of fair value.**

**Question 23:** The proposed amendments would prohibit early adoption. Should early adoption be permitted? If yes, why?

**We agree that early adoption should be prohibited.**

Nonpublic Entities

**Question 24:** The proposed amendments would apply to both public and nonpublic entities. Should the proposed amendments apply to nonpublic entities (such as private companies and not-for-profit organizations)? If not, how should the proposed requirements differ for nonpublic entities and why?

**We do not believe that the proposed guidance should apply differently to public and nonpublic entities. Investors invest in investment properties via a variety of forms of ownership, both public and private. Different reporting by private entities would lead to inconsistencies in reporting to investors.**

**There are small, private closely-held real estate investment entities for which the proposed accounting may be of little benefit to their investors. We considered whether an asset threshold in the scope might reduce the burden on these entities. However, we concluded there are other factors, such as the nature of the investor that would also need to be considered to determine the appropriate reporting for the investment entity and, ultimately, such a test may not be a workable solution.**