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February 15, 2012

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

Re: Proposed Accounting Standards Update, “Real Estate - Investment Property Entities (Topic 973)” (File Reference No. 2011-210)

Dear Technical Director:

We appreciate the opportunity to comment on proposed Accounting Standards Update, *Real Estate – Investment Property Entities (Topic 973)* (the Proposed ASU).

We support the Board’s proposal to require real estate investment entities to measure investment properties at fair value as we believe this provides their investors with the most relevant, comparable and decision-useful information. However, we believe that the guidance on accounting and financial reporting by real estate investment entities should be consistent with, and included in, ASC Topic 946, *Financial Services—Investment Companies*, rather than creating a separate ASC topic on investment property entities (IPEs).

Although we believe it would be preferable for the Board not to establish a separate ASC topic on IPEs, we have included recommendations in this letter for the FASB’s consideration should the Board choose to move forward with a separate IPE Topic. Many of these recommendations relate to matters that we believe the Board should address for real estate investment entities and are applicable even if the Board includes guidance on such entities in ASC Topic 946 on investment companies as we recommend. In particular, we believe that guidance is needed on the overall financial reporting model for investment entities that hold real estate investments, whether they are considered to be investment companies or IPEs. In addition, if the Board decides to retain separate investment company and IPE models, the Board will need to clarify the interaction between the guidance on IPEs and the guidance in ASC Topic 946 for investment companies.

The remainder of this letter provides our specific recommendations on each of the items noted above as well as our responses to the proposed ASU’s questions for respondents.

Interaction with Investment Companies Guidance

We believe the measurement and financial reporting requirements that apply to real estate investment entities should be consistent with those that apply to other investment entities. As a result, we believe the Board should include the guidance on accounting and financial reporting by real estate investment entities within ASC Topic 946 as part of the investment companies accounting and financial reporting guidance rather than creating a separate IPE Topic. We believe a single model that covers all investment entities



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would be preferable, as a single model will result in consistent financial reporting requirements that better allows investors to compare performance among alternative investment asset classes. The information provided to investors would not be as useful if they are not able to easily compare these types of entities, even though the nature of their activities is similar. We also believe that two different models for investment entities would add unnecessary complexity to the overall financial reporting system. For example, the possibility that an entity holding real estate might be an operating company, an investment company, or an investment property entity would be complex and confusing to financial statement users.

As noted in the remainder of this letter, there are a number of measurement and presentation issues applicable to real estate that is measured at fair value that do not arise for other types of investments. We believe it is important for the Board to address these issues within Topic 946 (regardless of whether it establishes a separate ASC Topic on IPEs), as we believe the issues will arise for real estate investment entities that meet the Board's proposed definition of an investment company. If the Board establishes a separate IPE Topic, those issues will need to be addressed within the IPE Topic and Topic 946.

In our comment letter on the proposed ASU on Topic 946 we have provided recommendations on the scope criteria and financial reporting requirements for investment companies. If the Board accepts our recommendation to include the guidance on accounting and financial reporting by real estate investment entities within ASC Topic 946 rather than creating a separate IPE Topic, we believe that real estate investment trusts (REITs) should not be excluded from potentially meeting the definition of an investment company because investors in at least some REITs may view investment company accounting as the most relevant reporting model.

If the FASB chooses to establish a separate ASC Topic for IPEs, we believe it is critical for the Board 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 or 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 if it chooses to move forward with a separate ASC Topic on IPEs. For example, the Board should clearly indicate whether an IPE would be required to present a schedule of investments and financial highlights. If the Board proceeds with a separate ASC Topic for IPEs, we recommend that all real estate investment entities be included in the scope of that topic rather than including some real estate investment entities within the scope of Topic 946 and others within the scope of the IPE Topic.

Our remaining comments reflect our recommendations if the Board chooses to move forward with a separate IPE Topic. Many of these recommendations relate to matters that we believe the Board should address for real estate investment entities and are applicable even if the Board includes guidance on such entities in ASC Topic 946 rather than establishing a separate IPE Topic.

Application of Fair Value Measurement by IPEs

In order to meet the needs of investors, we believe it is critical for an IPE to report a net asset value (NAV) that reflects the fair value of all its investments (real estate and otherwise) and



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financial liabilities. There are a variety of non-exchange traded real estate investment vehicles in the market that hold controlling, non-controlling, and partial interests in a wide range of real estate, real-estate related, and non-real-estate related investments. Without a requirement for a NAV that reflects the fair value of all of an IPE's investments and financial liabilities, the investors will be left with a mix of historical cost and fair value measurements in the IPE's financial statements that do not facilitate comparisons of their investment in the IPE to investments in other alternative investment vehicles (e.g., those that follow investment company financial reporting).

Requiring an NAV measure that is comparable among investment vehicles also is critically important because those NAV measurements may influence capital allocation in the market. Measurements that affect NAV ultimately determine the net income for such vehicles, and net income is used to calculate an investment vehicle's investment return. Investment return is one of the most important metrics investors use in making decisions about the allocation of capital to real estate versus other investment asset classes. If the final ASU does not require an IPE to measure all of its investment assets and financial liabilities at fair value we believe it will not be as useful to investors. Many real estate investment entities measure all of their investment assets and financial liabilities at fair value under current U.S. GAAP, which we believe provides investors with useful information.

Scope

We believe the criteria to determine whether an entity is an IPE should generally be the same as the criteria to determine whether an entity is an investment company, with guidance provided on how those criteria should be applied by entities that hold real estate investments and how to determine whether an investment entity holding real estate is an IPE or an investment company. Following are our specific recommendations for each of the scope criteria.

Nature of Business Activities

Substantially All Test

We recommend that real estate investments included in the proposed ASC paragraph 973-10-55-2 substantially all test not be limited to real estate properties because excluding other real estate investments in performing that test would inappropriately limit the definition of an IPE as discussed in more detail below. Accordingly, we suggest that the Board remove the words "property or properties" from proposed ASC paragraph 973-10-55-2.

Non-controlling Interests in Real Estate Properties

Many real estate investment entities hold non-controlling interests in other entities that own and operate real estate properties as a way of expanding their exposure to investment properties through diversification of risk across a larger number of properties. Others may hold real estate investments in this manner because a prior owner entered into a partial sale of the property for tax or other reasons. Under the proposed ASU's criteria, if the *substantially all* test includes only



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real estate *properties* owned directly or indirectly through investments in controlled IPEs, a substantial number of real estate investment entities may be excluded from the definition of an IPE simply because they hold a significant portion of their investments in non-controlled investees. We do not believe an entity should be excluded from being an IPE simply because it holds its real estate investments through non-controlling interests. Fair value may be the most relevant measurement attribute for their real estate investments and investors may use that information to facilitate comparisons to other entities that may wholly own or control real estate properties.

Real Estate Mortgage Investments

Proposed ASC paragraph 973-10-55-5 indicates that investments in mortgage note receivables would be excluded from qualifying investments for purposes of the *substantially all* test. It is not unusual for real estate investment entities to hold a significant portion of their investments in real estate mortgages. In some cases such investments may be held with the objective of ultimately converting the mortgage into a controlling interest in the underlying collateral. We believe a test that includes all types of real estate investments, including debt, would make the definition of an IPE more consistent with investors' expectations and lead to greater comparability in financial reporting. This approach would be preferable to the proposed language because it would reduce the potential for implicit optionality in the applicability of the guidance through application of the *substantially all* requirement.

As previously indicated, if the Board proceeds with a separate ASC Topic for IPEs, we recommend that all real estate investment entities be included within the scope of that rather than including some real estate investment entities within the scope of Topic 946 and others within the scope of the IPE Topic. We understand that the Board may have added the words "property" or "properties" in proposed ASC paragraph 973-10-55-2 to avoid including entities that hold a significant portion of their investments in mortgage-backed securities, such as CMBS vehicles, in the definition of an IPE. We believe that the other proposed scope criteria would preclude such entities from meeting the definition of an IPE. However, if the Board remains concerned about the potential that CMBS vehicles may be considered IPEs, we believe a more effective solution would be to change the *substantially all* test to exclude entities that hold *substantially all* of their investments in debt instruments from the definition of an IPE.

Right of Use Assets

Proposed ASC paragraph 973-360-25-1 indicates that a right-of-use asset would be recognized as an investment property at the commencement or acquisition of the lease if the underlying asset meets the proposed definition of an investment property in the ASC Master Glossary. Such assets would be subject to the fair value measurement requirements that apply to investment property if they are held by an IPE. However, it is unclear whether they would be considered qualifying investments for purposes of the *substantially all* test. We believe these assets represent another form of real estate investment and should be included as qualifying investments in the *substantially all* test.



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Specialty Property Types

Proposed ASC paragraph 973-10-55-2 states that substantially all of [an IPE's] business activities should be investing in real estate property or properties." Although not explicitly stated, this paragraph seems to imply that the real estate property investments should be investment properties. Paragraph BC15 of the proposed ASU 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." We agree 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. However, the statement in paragraph BC15 could be interpreted to mean that most entities that invest in hotel properties and certain other specialty property types cannot be IPEs, a result that we believe may be inappropriate. We recommend that the final ASU include an alternative test to determine whether a real estate property is considered an investment property.

We agree that engaging in significant business activities other than investing in real estate should call into question whether an entity is an IPE. However, the evaluation should be based on the nature of the investing activity; not the nature of the real estate asset. Many real estate investment entities include investments in hotels, seniors housing and other specialty real estate property types in their investment portfolios to balance their investment risks and returns. Their primary objective is not to engage in operating businesses. Typically, the entity that owns these properties hires an experienced property manager to operate the property. The investment entity often is not involved in daily operations, but rather manages the overall interest and positioning of the real estate asset. We believe these are investment assets, just as interests in multi-tenant office buildings or retail shopping malls may be investment assets.

It is unclear how the guidance with respect to IPEs performing services that support their investing activities is intended to be applied. The Board should provide additional examples to clarify the types of services and activities that would be permissible versus those that would not be permissible, as well as to demonstrate the extent of the investees' activities an IPE may be permitted to be involved in directing. SOP 07-1 provided guidance in that regard that may be useful to retain for real estate entities. Although we agree that providing certain services to investees should not necessarily preclude an entity from being an IPE, we also believe that an entity that only provides services to its investees is not necessarily an IPE. We believe the nature of services provided to investees should be just one of the factors to be considered in the overall evaluation of all of the facts and circumstances about the entity's activities and business purpose, including the needs of the financial statement users that determine whether an entity is an IPE. An alternative approach to this issue that the Board may wish to consider is 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. For example, the Board might determine that assets for which leasing income and capital appreciation are expected to produce a majority of the return on the property are investment property assets.



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Express Business Purpose

Exit Strategy

Consistent with our recommendations on proposed ASU, *Financial Services—Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements*, we recommend that an exit strategy be considered an indicator that an entity is an IPE rather than a requirement. Real estate investment entities invest in and operate real estate properties to maximize total return. The entities often do not have a definitive exit strategy; timing of disposition may be opportunistically driven to maximize total return. (Note that we believe an opportunistic style of asset disposition should qualify as an exit strategy but it is not clear from the proposed ASU that it would.) To exclude entities from the scope of an IPE standard simply because they do not have a defined exit strategy for their investments could lead to diversity in practice.

As currently written, the proposed ASU on Topic 946 would not require an investment company to have an objective of investing solely for capital appreciation, and therefore would not require an entity to have an exit strategy to be an investment company. (It would require an investment company's only substantive activities to be either investing for capital appreciation, current income, or both, and an investment company that has an express business purpose of realizing capital appreciation would be required to have an exit strategy whereas an exit strategy would not be required for an investment company whose express business purpose is only to invest for returns from investment income). We believe the information that is relevant to an investment company's financial statement users is similarly relevant to an IPE's financial statement users and, therefore, recommend that the FASB allow similar flexibility in the investment objectives of an IPE to that proposed for an investment company. That is, if an investment company is not required to have an exit strategy we see no conceptual (or financial statement user) basis for requiring an IPE to have an exit strategy. In addition, the exit strategy criterion appears to create an element of optionality to the applicability of the IPE guidance.

Our understanding is that one of the reasons the Board originally chose to include an exit strategy requirement for IPEs is because of the proposed lessor accounting requirements in its joint project with the IASB on the accounting for leases. At one time during their redeliberations on the leases project, the Boards had proposed accounting by lessors of investment property not measured at fair value that would have been significantly different than their proposed accounting by lessors of investment property measured at fair value. Some Board members expressed the view that investment property generally held as a long-term investment should not be within the scope of the IPE standard, but should be within the scope of the leasing standard as the investors' primary focus was on operating income. However, more recently the Boards have decided that lessors of investment property not measured at fair value should apply accounting similar to lessors of investment property that is measured at fair value. Consequently, we believe there is no longer a significant reason to retain an exit strategy requirement for IPEs.



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If the Board does not accept our recommendation to revise the proposed ASU to make exit strategies an indicator rather than a requirement, we believe disposal of real estate investments only upon liquidation of the entity or to facilitate investor redemptions should qualify as valid exit strategies. It is common for a real estate investment entity to own the majority of its 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. Often this type of indirect ownership structure is used for legal and risk management reasons. The single member LLC typically is liquidated upon the disposition of the property and repayment of the related debt (i.e., single member LLCs are usually not “re-used” for ownership of real estate properties other than those they were originally created to hold).

In order for the parent of a 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 this requirement if it is designed to be liquidated contemporaneously with the disposition of the real estate property or properties that it holds and, therefore, its parent would not qualify as an IPE. This would mean that an entity would need to hold its investment property investments directly in order to be an IPE, which would significantly limit the population of entities that qualify as IPEs. We believe that sales upon liquidation should be considered valid exit strategies. (We do not believe the IPE criteria would be operational if the Board were to include guidance stating that liquidation upon sale is different than sale upon liquidation.)

Real Estate Investments Used for Operating or Administrative Purposes

We recommend modifying 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 purpose, or (b) development for sale in the ordinary course of business upon completion would not meet the express business purpose criterion. Alternatively, the Board may want to conform this guidance to paragraph 10 of IAS 40 by indicating 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 may meet the express business purpose criterion. We believe that insignificant use by the entity for operating purposes should not automatically result in a violation of the express business purpose criterion.

Reporting Entity

Proposed ASC paragraph 973-10-15-2(a) would require an IPE to provide financial results about its investing activities to its investors. We recommend that the final ASU not require an entity that is a wholly owned subsidiary of an IPE 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 the financial results of the entity’s investing activities from its underlying accounting records.



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Financial Reporting Framework for IPEs

We believe the Board should develop, and include in the final ASU, an overall financial reporting framework for IPEs. Specifically, we recommend that the Board develop guidance that would:

- Not require consolidation of IPE or investment company investees in which an IPE holds a controlling financial interest in certain circumstances,
- Require an IPE to measure its financial liabilities at fair value,
- Address how an IPE should present changes in fair value of non-controlling equity interests in investees over which it has significant influence in its income statement and how distributions received from all investments measured at fair value should be accounted for and presented in an IPE's income statement and statement of cash flows,
- Require an IPE to measure non-controlling equity interests in investees over which it cannot exercise significant influence and other investment assets (e.g., investments in debt) at fair value,
- Address measurement and presentation issues applicable to real estate that is measured at fair value that do not arise for other types of investments, and
- Provide illustrative presentation and disclosure examples in the final ASU.

These matters are discussed in further detail below.

Consolidation of IPE Investees

We agree with the principle that an IPE should consolidate other IPEs and investment companies in which it holds a controlling financial interest, especially in situations where the investee is formed as an extension of the reporting entity (e.g., so-called "blocker" entities). However, consistent with our recommendations on the proposed ASU on Topic 946, we believe the Board should permit an IPE not to consolidate IPE or investment company investees in which the IPE holds a controlling financial interest when the IPE either (1) provides the investee's financial statements (or information about how to obtain those financial statements) along with its financial statements, or (2) provides sufficient alternative disclosures in its financial statements.

In order for the alternative disclosures to be meaningful, we believe the schedule of investments and financial highlights should be presented in a manner that is consistent with how they would be presented if the IPE consolidated other IPE or investment company investees in which it holds a controlling financial interest. We believe additional consideration should be given to the disclosures for such investees with leverage. For example, if there is leverage, we believe the amount of the investee debt could be shown either on the face of the financial statements or in the schedule of investments. We also believe that pro forma financial highlights should be provided with the debt if there are significant differences from the financial highlights that are calculated without the debt.



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We believe that our recommended alternative presentation and disclosures would help provide investors with the most relevant information in the circumstances. Gross financial statement presentation by IPEs where assets, liabilities, income and expenses of IPE investees in which the IPE holds a controlling financial interest are separately reported on a consolidated basis may be most meaningful to investors where current income represents a significant portion of the IPE's total return. However, net presentation in some situations may allow investors to analyze and compare the entity's performance with that of other investment vehicles in which they currently invest or may consider investing.

There are some real estate entities' whose primary objective is to generate a large capital return upon disposition of their investments over the period of time it takes to maximize and realize the enhanced value. Consolidation of IPE investees in which the IPE holds a controlling financial interest in these situations may yield little additional information of benefit to investors that would not be derived from a fair value measurement of the net investment in the underlying investee.

Measurement of Financial Liabilities

As discussed previously, we believe that a fair value NAV is the most relevant measure for investors in a real estate investment entity. If an IPE that has debt with above- or below-market interest rates measures its assets at fair value and its liabilities at amortized cost, investors that subscribe and redeem interests at its NAV would pay or receive an amount that differs from their share of the entity's underlying value. Under the current proposal, an IPE would measure investment properties at fair value and measure any associated debt at amortized cost unless the IPE elects to measure the debt at fair value under the fair value option. Consequently, the NAV of an IPE that does not elect the fair value option for its debt may not approximate a fair value NAV.

Consistent with our recommendations on the proposed ASU on Topic 946, we believe that the final ASU should require an IPE to measure its financial liabilities at fair value. We also believe fair value is the appropriate measure for debt of an IPE because fair value more appropriately reflects the value of debt in the context of current market conditions. Fair value measurement of financial liabilities by investment entities provides more 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 than amortized cost measurement.

Non-controlling Equity Interests

We agree that IPEs should measure non-controlling equity interests in investees over which they have significant influence at fair value. However, we believe that IPEs should be permitted to report their share of these 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.



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This is solely a matter of presentation that would have no effect on net income. If the investee income were not separately reported it would flow through unrealized gain or loss. We believe separately reporting an IPE's share of its investees' operating income may better meet the needs of investors who are interested in understanding the sources of changes in the value of the investments. This presentation alternative would enable investors to see an IPE's operating income from consolidated IPEs, as well as the IPE's share of operating income from non-controlling interests in joint ventures and other investees in which the IPE has significant influence.

The Board also should provide guidance on how distributions received from all non-controlling investment interests measured at fair value should be accounted for and presented in an IPE's income statement and statement of cash flows.

Other Investment Assets

We recommend that the final ASU require an IPE to measure its other investment assets (e.g., investments in debt) at fair value.

Real Estate Fair Value Measurement and Presentation Guidance

We believe the Board should provide guidance on a number of measurement and presentation issues applicable to real estate that is measured at fair value that do not arise for other types of investments, including the matters identified below. Many of the issues that follow are described more specifically in "Summary of Real Estate Fund Inquiries" prepared by the AICPA Real Estate Funds Task Force. We recommend the Board revisit this guidance and consider it for the final ASU.

Realized Gains

The final ASU should specify how an IPE should measure realized gains and losses on real estate investments. We believe realized gains and losses should be measured as the sales price, net of sales costs, reduced by the accumulated cost basis in the investment. The accumulated cost basis would be the original cost, including transaction costs, and any subsequent capital improvements or capitalized costs associated with the property. The Board should address whether other U.S. GAAP on cost capitalization, such as interest capitalization (Topic 835) and capitalization of other costs (Topic 970) would apply to real estate investments measured at fair value and whether the accumulated cost basis of such investments would be adjusted for depreciation or other U.S. GAAP that affects the measurement of real estate that is not measured at fair value.

Investment Losses

The Board should provide guidance that addresses how an IPE should account for payments to fund losses of investees in which the IPE does not hold a controlling financial interest. We believe such funding should represent an increase in the IPE's accumulated cost basis of the investment.



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Advisor Fees

An IPE may incur advisor fees that are in part based on the gain on sale of real estate investments. We believe the Board should address an IPE's accounting and financial reporting for such fees, including when the fees should be recognized in the IPE's income statement.

Impairment

Consistent with the guidance in IAS 16 and IAS 36, we believe the Board 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. We believe any excess of an investment property asset's accumulated cost basis over its fair value should be reported as an unrealized loss rather than an impairment loss.

Effect of Future Sales Costs on Fair Value Measurement

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

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 ASC paragraph 973-360-50-1 and suggest that the Board clarify the reason for this distinction. The proposed ASU would require contractual obligations related to an investment property to be disclosed. There are many operational obligations, such as maintenance, cleaning and other contracts that are entered into in the normal course of managing and operating investment property. We recommend that the



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Board differentiate contractual obligations related to operating expenditures that arise in the ordinary course of managing the property from other contractual 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.

Our responses to the questions asked in the proposal are set out in the Appendix of this letter.

If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact Mark Bielstein or Kimber Bascom with KPMG LLP in New York at (212) 909-5419 or (212) 909-5664, respectively.

Sincerely,

KPMG LLP



Appendix – Responses to FASB’s Questions

As discussed in the body of this letter, we believe that the Board should include the guidance on accounting and financial reporting by real estate investment entities within ASC Topic 946 rather than creating a separate ASC topic on IPEs. We have provided the responses in this Appendix for the Board’s consideration should the Board choose to move forward with a separate IPE Topic. If the Board agrees with our proposal to include the guidance on accounting and financial reporting by real estate investment entities within ASC Topic 946, certain recommendations related to IPEs within this letter should be addressed in Topic 946.

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.

As discussed in our cover letter, we support the Board’s proposal to require real estate investment entities to measure investment properties at fair value. We do not believe that all entities should be required to measure their investment properties at fair value for the reasons noted by the Board in the proposed ASU.

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.

As discussed above, we believe that fair value measurement should be required for entities that meet appropriate criteria of IPEs and investment companies as this provides their investors with the most relevant, comparable and decision-useful information with respect to the entity’s investment properties. Inconsistency in financial reporting for entities with similar investment property assets may arise if optionality is permitted.

As indicated in the body of this letter, we have provided other comments related to the IPE model.

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 the scope criteria and have provided detailed recommendations on improving the criteria in the body of this letter. As currently proposed, investments in assets such as hotels, assisted living centers, mortgage loans, and non-controlling equity



interests may cause an entity not to meet the definition of an IPE. As discussed in our response, we believe that the “substantially all” test in the nature of business activities criterion should consider all real estate investments and not just investments in real estate property or properties.

In addition to our comments in the body of this letter on the scope criteria, we believe the Board should revise the guidance in proposed ASC paragraph 973-10-15-3 to indicate that a subsidiary entity that does not meet the unit ownership and pooling of funds criteria in proposed ASC paragraph 973-10-15-2 may still be an IPE if the subsidiary has a parent entity that measures its investments at fair value in accordance with the IPE Topic or another Topic. Otherwise, a subsidiary entity whose parent is a for-profit entity that measures its investments at fair value under the fair value option in ASC Topic 825, *Financial Instruments*, would be precluded from being an IPE.

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. Currently, the proposal does not address whether reassessment is required if there is a change in the investment mix or if assets acquired differ from the original intent. For example, if an entity has an initial strategy to acquire distressed debt but later forecloses, the proposal is not clear on whether the entity’s status changes from being an investment company to an IPE, and then back to an investment company if the entity then sells the foreclosed property. 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 do not believe the legal form of the entity should be a determinative factor. Depending on the assets held, nature of management and business activities, real estate funds and REITs may be very similar to alternative investment vehicles such as private equity funds from an investor’s perspective. Application of consistent financial reporting models in those situations would facilitate investors’ ability to analyze and compare the real estate investment entity’s performance with that of other investment vehicles they currently invest in or may consider investing in. As discussed in the body of this letter, we believe that the Board should not establish a separate accounting model for IPEs. If the Board establishes a separate IPE model, the Board should provide additional guidance on the distinction between 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 in the nature of business activities criterion should consider all real estate investments and not just investments in real estate property or properties. Real estate investments take a number of different forms including full ownership, controlling financial interests, non-controlling interests, and debt interests (including beneficial interests in securitizations backed by real estate 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 that are desirable to its investors. We do not believe holding a particular subset of these investments should preclude a real estate investment entity from being considered an IPE.

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 our response to Question 6, we believe that all real estate investments should count toward the substantially all test in the nature of business activities criterion. Many real estate investment entities invest in real estate through non-controlling interests in joint ventures with financial partners. Without considering these investments, many entities that hold real estate investments 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 proposal. However, we recommend a revision in the wording of the second sentence to “real estate held predominantly for...” This would allow for instances where an entity may occupy a small portion of the property for administrative purposes. Alternatively, we recommend 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 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.

Although exit strategies may be an indicator of an IPE, we believe an IPE should not necessarily be required to have an exit strategy for its investments. In addition, as currently written, the proposal is unclear about whether entities that have an opportunistic approach to investing (e.g., sell when and if they receive the right offer) would meet the exit strategy requirement. Excluding such entities from the definition of an IPE may lead to diversity in practice. In addition, the exit strategy requirement may result in optionality in the definition of an IPE.

If the Board decides to retain this requirement, we believe disposal upon liquidation and to satisfy investor redemptions should be considered valid exit strategies.

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?

As currently written, we believe this criterion is unclear and may imply that more than two unrelated investors must hold a significant ownership interest in the entity. We recommend revising this requirement consistent with paragraph BC 26 of the proposed ASU to state “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.”

It is unclear whether certain parties would be considered related parties of the entity’s parent (e.g., if feeder funds have the same general partner as the fund, but with independent unrelated investors, whether this is considered related to the parent). In addition, there are situations where an entity is formed and the investors are related parties. For example, it is common for investment managers to create co-investment vehicles that permit their employees to invest alongside the manager. These vehicles are managed



parallel to vehicles that would currently qualify as an IPE under the proposed ASU and are formed to provide employees with the ability to participate in the investment strategy without paying fees. As proposed, these co-investment vehicles may not meet the pooling of funds criterion because the employees would be considered related parties. Accordingly, the entity would not have a significant ownership interest held by unrelated parties. We have concerns that virtually identical investment vehicles with the same investment strategy would be accounted for differently in this situation as the consequence would be that employee-investors would receive less meaningful financial information than investors in the parallel funds. We recommend the Board provide additional guidance about these situations in the final standard.

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 the Board's proposal to provide 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. As discussed in the body of this letter, we also believe the Board should provide a similar exemption from the reporting entity criterion when the entity is a wholly-owned subsidiary of an IPE.

Although the proposal is intended to encompass pension funds, we believe the Board should clarify whether the guidance is applicable to entities whose controlling interest holder is a pension plan following Governmental Accounting Standards No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*.

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 agree with the proposal to require an IPE to measure real estate properties other than investment properties in accordance with other U.S. GAAP. We note that this proposal is consistent with the current U.S. GAAP requirements that apply to investment companies. As discussed in the body of this letter, we believe that real estate investments held by an IPE, other than those used predominantly for (a) the entity's own use in the production or supply of goods or services or for administrative purpose, or (b) development for sale in the ordinary course of business upon completion should be considered investment properties and measured at fair value. In addition, we believe all of an IPE's other investment assets and financial liabilities should also be measured 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?

We support the Board's proposal to require a right-of-use asset held by an IPE or investment company 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. However, as discussed in the body of this letter, it is unclear whether such right-of-use assets would be included in evaluating the *substantially all* test 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 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 or investment companies, and should measure all investees other than IPEs or investment companies in which it holds a controlling financial interest at fair value. We have provided separate recommendations about situations in which an IPE that holds a controlling financial interest in another IPE or investment company should be permitted not to consolidate the investee 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 should be permitted to report their share of investee's 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. The Board also should provide guidance on how distributions received from all non-controlling investment interests measured at fair value should be accounted for and presented in an IPE's income statement and statement of cash flows.



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 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?

We disagree with the Board's proposal and recommend that an IPE be required to measure all of its investments at fair value consistent with the requirements that apply to investment companies. As discussed in the body of this letter, we believe it is critical for an IPE to provide a net asset value (NAV) to its investors that reflects the fair value of all its investments and financial liabilities. Requiring or permitting certain investments and financial liabilities to be measured at other than fair value will reduce the relevance and comparability of the IPE's NAV.

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 discussed in our response to the previous question and in the body of this letter, we recommend that an IPE be required to measure its financial liabilities at fair value. We believe that a fair value NAV is the most relevant measure for investors in an IPE. Measuring financial liabilities associated with an IPE's real estate investments at amortized cost would not provide its investors and other financial statement users with the most 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 generally 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, recognizing rental income on investment properties when lease payments are received would represent a cash basis of income recognition and would not be appropriate. In addition, the Board should clarify that lease payments should be recognized as revenue when they become receivable in accordance with the contractual terms of the lease only to the extent they are non-refundable. For example, in a lease that requires the rent to be fully prepaid, we do not believe rental



income should be recognized for the portion of the payment (if any) that is refundable to the lessee in the event that the lease is terminated. We recommend that the FASB provide application guidance that clarifies that “receivable in accordance with the contractual terms of the related lease” means the rent is not refundable to the lessee.

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 the guidance in the proposed ASU, we believe there may be investments that would no longer qualify for the practical expedient (e.g., investments in IPEs that do not allow redemptions at NAV). If the Board accepts our recommendation to require fair value measurement of all of an IPE’s investments and financial liabilities, we believe investors should be permitted to apply the practical expedient to an investment in an IPE that does not qualify for a Level 1 fair value measurement even if the IPE does not transact at NAV (e.g., because it is a closed-end fund).

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 differentiating between properties that generated rental revenue during the period and those that did not (proposed ASC paragraph 973-360-50-1) and suggest that the Board explain why this distinction is necessary. The proposed ASU also would require disclosure of contractual obligations related to an investment property. There are many operational obligations, such as maintenance, cleaning and other contracts that are entered into in the normal course of managing and operating investment property. We recommend that the Board differentiate contractual obligations related to operating expenditures that arise in the ordinary course of managing the property from other contractual 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.

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 proposed transition guidance provided in the exposure draft.



Question 22

How much time would be necessary to implement the proposed amendments?

We suggest an effective date of no less than one full calendar year after the issuance date. The actual effective date would need to be determined based on the nature of the final requirements, including the extent of the work entities that would be newly-required to measure their real estate investments at fair value would be required to perform.

Question 23

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

We do not believe that early adoption should be permitted.

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 believe the proposed amendments should apply to both public and non-public entities.