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Ms. Susan M. Cosper Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5166 Norwalk, CT 06856-5116 15 February 2012

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

Dear Ms. Cosper:

We are pleased to respond to the Financial Accounting Standards Board's (FASB or Board) Proposed Accounting Standards Update, Real Estate – Investment Property Entities (Topic 973) (the proposed Update).

We do not believe that the Board should issue a final standard to create specialized accounting for investment property entities.

We understand that the Board added the investment property entity project to its agenda to address certain real estate lessor issues, to align the accounting for investment properties with IFRS and to address diversity in accounting by real estate investors. Given the Board's tentative decision in its joint project on leases to establish a separate accounting model for lessors of investment properties, we question whether the proposed Update is necessary to address lessor issues. In addition, we note that the proposed Update would not align with IFRS because an investment property entity concept does not exist under IFRS. Lastly, we believe that existing diversity in practice among real estate entities would be better addressed through the Board's efforts to refine the definition of and accounting by an investment company.

We understand the FASB and the International Accounting Standards Board intended to address concerns about applying the proposed lessor accounting guidance to leases of investment property with their recent decision to allow lessors of investment property to use an accounting model similar to current operating lease accounting. We encourage the Boards to first complete the leases project and only then consider whether specialized accounting that would exclude certain real estate entities from the lessor accounting guidance applied by other entities is either necessary or desired.

In addition to addressing concerns related to lessor accounting for investment properties, we note that the Board sought to address diversity that exists in reporting by entities that primarily invest in real estate. Much of the diversity that exists today relates to a lack of clarity about whether certain entities are within the scope of investment company accounting under Topic 946, *Financial Services – Investment Companies*, and how to apply the accounting requirements of Topic 946 to entities that invest primarily in real estate. Many different types of entities primarily invest in real estate (e.g., REITs,



real estate investment funds), and they often are designed as a way for investors to indirectly invest in real estate. The business purpose, structure and composition of these investment vehicles vary. Before the Board makes further decisions to address today's diverse accounting, we believe more outreach is needed with real estate companies and their investors to determine a financial reporting model that responds to user needs.

The proposed Accounting Standards Update Financial Services – Investment Companies (Topic 946) (the investment companies proposal), with certain changes, may be sufficient to address user needs for real estate entities. We encourage the Board to develop a definition of an investment company that would be broad enough to encompass investment entities that primarily invest in real estate property as well as entities that invest in a mixture of investments, including real estate property. Through additional outreach with financial statement users, the Board should determine the appropriate criteria to qualify for fair value reporting. We believe that a single set of criteria for investment entities that measure their investments at fair value with all changes in fair value recognized in net income would be preferable.

If the Board decides to establish separate criteria for investment property entities, we believe that the accounting and reporting requirements for investment property entities should be consistent with those for investment companies. We do not see a conceptual basis for creating unique measurement, presentation or consolidation requirements for companies that invest in real estate, including those for which investing in real estate constitutes substantially all of their investing activities. Such entities are often compared with investment companies (e.g., certain private equity vehicles), and inconsistent accounting or presentation requirements would make such comparisons difficult.

While we believe that fair value reporting is preferred for investment companies, we are not convinced that the most useful unit of account for fair value measurement of investments in real estate is at the real estate property level. Under current application of the guidance in Topic 946, investment companies measure and report fair value at the investment level. That is, an investment company measures a controlling financial interest in an operating company (e.g., a manufacturer) at fair value with changes in the fair value of the investment in the entity recognized in net income. An investment company does not present the assets and liabilities or the operating results of the investee in its financial statements. We fail to see why an investment company (or an investment property entity) should measure and report a controlling financial interest in an entity that holds real estate property on a different basis, as proposed. Given that financial statement users are most interested in the fair value of the investment (and not the financial position and results of operations of the investee) for an operating entity that does something other than invest in real estate, we do not understand why users would have a different view with regard to a controlling financial interest in an entity that primarily invests in real estate.

The Appendix to this letter provides our detailed responses to the questions included in the proposed Update, presuming that the Board decides to pursue a separate financial reporting model for investment property entities.

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We would be pleased to discuss our comments with the Commission or its staff at your convenience. Very truly yours,

Ernst + Young LLP

## Appendix – Responses to specific questions raised in the Proposed Accounting Standards Update, Real Estate – Investment Property Entities (Topic 973)

#### 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.

## Response:

We observe that the fair value measurement issues that have occurred with illiquid financial instruments are likely more prevalent when measuring the fair value of real estate. Determining fair value for real estate properties presents challenges due to the unique attributes of each real estate property. In addition, we are concerned that users may ascribe a degree of precision to fair value estimates of real estate that fail to recognize the subjectivity involved. In deliberations to date, the Board has focused more on the definition of an investment property entity as opposed to the definition of investment property. Given the concerns described above, we believe additional analysis and refinement of the definition of investment property is necessary before assessing whether all entities should be permitted or required to measure investment properties at fair value.

As discussed in our cover letter, we do not believe separate investment property entity guidance is necessary. Instead, user needs for real estate entities should be addressed as part of the investment companies project.

If the Board decides to develop separate investment property entity criteria, we do not believe entities should be provided with an unrestricted choice of whether to measure their investment properties at fair value or cost. Entities that clearly meet the investment property entity criteria should be required to measure their investment properties on a basis consistent with other investment property entities and investment companies. However, we are concerned that the criteria to be an investment property entity included in the proposed Update contain "bright line" requirements that would cause certain entities to have different accounting when users would expect them to be the same. We are concerned that certain entities may have the characteristics of an investment property entity but may not meet all of the proposed criteria. Given the diversity in real estate investments and different user needs, we believe it would be difficult to use "bright line" scoping criteria that are both operational and effectively capture all entities for which fair value reporting provides the most decision-useful information.

In lieu of developing "bright line" criteria, we believe the Board should allow for the application of reasonable judgment and we have provided some of our thoughts in that area in our comment letter on the investment company proposal. We believe reaching the most appropriate conclusion includes considering the most useful financial information for users which, in our view, may or may not be fair value. Additionally, entities would consider a variety of user expectations including the reporting of peer companies and the nature of financial statement users. The use of judgment would result in

entities that are "near the edge" appropriately reaching different answers. We believe that the Board should explicitly acknowledge that different conclusions could be reached to prevent others from second guessing conclusions. We see this diversity as a better alternative to rigid criteria.

#### 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.

## Response:

See our response to Question 1.

#### 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?

## Response:

As previously discussed, we do not believe that separate investment property entity guidance is necessary.

In addition, we do not believe that the exclusion from the scope of the lessor accounting model is relevant to establishing the most appropriate criteria for entities that should be considered investment property entities. We believe that establishing criteria for an investment property entity based on the exclusion from the lessor accounting model is a flawed approach that would not appropriately identify the entities that should report on a fair value basis. Instead, the criteria should identify the types of entities for which financial statement users would most benefit from fair value measurement. See our response to Question 1 for additional discussion about the criteria.

We also believe that if the Board decides to establish separate criteria for investment property entities, the basic criteria should be broadly consistent with the criteria established for investment companies. For example, we do not understand the rationale for including the fair value management criterion in the investment companies proposal but not in the proposed Update. We would expect that the criteria for investment property entities would be aligned with the criteria for investment companies with only specific differences related to the nature of the investments of an investment property entity being primarily related to real estate.

In addition, please consider specific feedback on the proposed criteria provided in our responses to Questions 6-11.

## 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?

## Response:

We agree that an entity should be required to reassess whether it is an investment property entity if there has been a change in the purpose and design of the entity. However, to make the reassessment operational, we encourage the Board to consider adding guidance on what constitutes a change in purpose and design similar to the guidance provided in Topic 810.

#### 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.

## Response:

The investment companies proposal, with certain changes, may be sufficient to address user needs for real estate entities. We encourage the Board to develop a definition of an investment company that would be broad enough to encompass investment entities that primarily invest in real estate property as well as entities that invest in a mixture of investments, including real estate property.

As noted previously, if the Board decides to pursue separate criteria for investment property entities and investment companies, we believe that the specialized accounting (e.g., measurement of investments, consolidation requirements, presentation and disclosure requirements) for investment property entities and investment companies should be the same. If the accounting, presentation and disclosure requirements were consistent for investment property entities and investment companies, we do not believe that either the proposed Update or the investment company proposal would need to include guidance for entities that meet the criteria to be both an investment property entity and an investment company.

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We do not believe that the form or tax status of an entity should dictate whether an entity would be an investment property entity, an investment company or excluded from the scope of the specialized accounting for investment-type entities. We do note, however, that the proposed Update would provide for a different accounting and reporting model based on the structure of an entity. An entity that invests in different investments, including real estate, could not be an investment property entity. However, if the investors in that entity form a separate entity to invest only in those same real estate properties, that separate entity could be an investment property entity.

#### 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.

## Response:

If the Board decides to establish separate criteria for investment property entities, we agree that one of the criteria to assess whether an entity is an investment property entity should be the nature of the business or investing activities of the entity; however, we have concerns about the interaction between the scope of the investment property entity criteria and the investment companies project criteria. We believe certain entities may not be within the scope of either the proposed Update or the investment companies proposal, even though all of the entities' business activities are investing in real estate-related assets for a total return including capital appreciation. For example, an entity that has 50% of its investments in directly owned real estate properties and 50% of its investments in real estate-related debt securities may not meet either the proposed Update criteria (i.e., substantially all of its business activities would not be investing in real estate property) or the investment companies proposal criteria (e.g., if controlled real estate properties are not managed on a fair value basis). However, an entity that has 100% of its investments in directly owned real estate property may qualify as an investment property entity even if it does not manage its properties on a fair value basis, and an entity that has 100% of its investments in real estate-related debt securities could qualify as an investment company. We struggle to understand these outcomes and believe that they demonstrate why a single set of criteria for investment entities that report investments at fair value with all changes in fair value recognized in net income is preferable.

The proposed Update is clear that entities that develop real estate for sale in the ordinary course of business upon completion or that do not invest for capital appreciation are outside the scope of the specialized accounting requirements for investment property entities. However, real estate companies perform a wide range of business activities, and we believe the Board should provide additional clarity with regard to activities that would be considered "investing in real estate property or properties" and related services. While the information provided in paragraph BC15 is helpful, it does not provide insight on how to make the assessment of whether business activities are related to investing in real estate properties. It is not clear what factors should be considered when determining whether activities that enhance the value of real estate properties would qualify as relating to investing in real estate

property. For example, many entities that invest in real estate properties for capital appreciation are involved in some level of development or redevelopment. The proposed Update is unclear as to whether those activities are consistent with the activities of an investment property entity.

The difference between property management services (as described in paragraph 973-10-55-3) and operating activities is also unclear. For example, it is unclear whether security and maintenance services provided to tenants would be considered investing activities or operating activities.

## 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?

## Response:

If the Board decides to establish separate criteria for investment property entities, we believe that investing in real estate assets other than controlling financial interests in real estate property would be consistent with the nature of business activities of an investment property entity. For instance, we do not believe that buying, selling and managing indirect investments in real estate through noncontrolling financial interests in other entities that would be considered in-substance real estate for purposes of revenue recognition or derecognition under US GAAP would be inconsistent with the business activities of an investment property entity. An entity that holds both controlling financial interests in real estate properties and noncontrolling financial interests in other real estate properties should not be excluded from the scope of the guidance for investment property entities simply because a significant amount of its activities relate to investing in real estate through noncontrolling interests. Similarly, we believe that investing in acquisition, development and construction loans that are considered to be investments in real estate under applicable US GAAP is also consistent with the nature of business activities of an investment property entity.

We have concerns about the interaction between the scope of the investment property entity criteria and investment companies project criteria. Similar to our response to Question 6, we believe certain entities may not be within the scope of either the proposed Update or the investment companies proposal, even though all of the entities' business activities are investing in real estate. For example, an entity that has 50% of its investments in real estate properties held through controlling interests and 50% of its investments in real estate properties held through noncontrolling interests may not meet either the proposed Update criteria (i.e., substantially all of its business activities would not be investing in real estate property through controlling interests) or the investment companies proposal criteria (e.g., if controlled real estate properties are not managed on a fair value basis). However, an entity that has 100% of its investments in real estate properties through controlling interests may qualify as an investment property entity even if it does not manage its properties on a fair value basis, and an entity that has 100% of its investments in real estate through noncontrolling interests could

qualify as an investment company. We struggle to understand these outcomes and believe that they further demonstrate why a single set of criteria for investment entities that report investments at fair value with all changes in fair value recognized in net income is preferable.

## 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.

## Response:

We believe that real estate properties held for an entity's own use or held for development for sale in the ordinary course of business should be excluded from qualifying as investment property. If an entity has an express business purpose to hold all of its real estate properties for such purposes, we agree that the entity would not be an investment property entity.

We believe the express-business-purpose criterion is not operational as proposed. We agree that how an entity presents itself to investors is a helpful factor to support that the entity is investing to maximize total return, including an objective to realize capital appreciation. However, one could read the criterion to mean that an explicit statement of business purpose (via offering memorandums or other means) is required. We observe that some companies' communications to investors do not have such an explicit statement; however, the companies otherwise meet the investment property entity criteria. Including a strict requirement could also allow companies to avoid the accounting requirements for investment property entities by excluding such a statement. We question whether this approach would properly capture entities that users believe should be subject to fair value reporting.

See our response to Question 9 for additional views on the express-business-purpose criterion.

## 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.

## Response:

We agree that the existence of an exit strategy would support an assertion that an entity's investing goal is to realize capital appreciation. However, we struggle with the operation of this criterion requiring an entity to have an exit strategy. Given that there is no required timetable and that most companies make strategic decisions to sell properties based on market factors, it would appear that many companies would meet this criterion, including entities for which users may question whether fair value reporting provides the most decision-useful information. In some ways, the express-business-purpose criterion appears to be a matter of the entity's intention, and we question whether the exit strategy requirement is necessary to support the criterion. We are also concerned with the potential expectation gap between preparers, auditors and users with respect to intent-based accounting.

Many real estate entities use funds from operations, a measure that explicitly excludes gains on disposal of property, as their key performance indicator. It is unclear whether using such a metric would be inconsistent with the proposed express-business-purpose criterion.

We believe additional clarity on the proposed requirement to have an exit strategy and what would qualify as an exit strategy would be beneficial. It is not clear what an entity would have to do in order to have an exit strategy. For most real estate properties, disposition through sale would be a strategy available to owners of the property. Would simply having the ability to sell the property (i.e., the absence of a restriction) constitute an exit strategy? We note that many entities that intend to hold real estate properties long term for rental purposes would have available to them strategies to dispose of their properties; however, the proposed Update contemplates that such entities may not have exit strategies. It is not clear how entities would differentiate between having an ability to dispose of a property and developing an exit strategy.

We understand that a wide variety of views exist about what would constitute an exit strategy for purposes of meeting this criterion. For example, refinancing a real estate property could be a means to benefit from the capital appreciation in the property without disposing of the property. We have presumed that a strategy to refinance or borrow against appreciated property values would not meet this criterion.

In addition, illustrations of what constitutes an exit strategy to dispose of properties would also help make this criterion operational.

#### 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?

## Response:

Given the Board's desire to pursue an entity-based accounting standard, we understand the Board's concerns about structuring opportunities described in paragraph BC26 of the proposed Update and agree that an entity should not be able to attain a particular accounting outcome by inserting an investment property entity into a larger corporate structure.

#### 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?

## Response:

We agree with the Board's proposal.

## **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 Board's proposal to require real estate properties other than investment properties (i.e., real estate held by the investment property entity for its own use or development for sale in the ordinary course of business) to be measured in accordance with other US GAAP. Requiring fair value measurement for real estate properties other than investment properties appears to be outside the scope of this project. In addition, based on the proposed criteria, the amount of real estate properties other than investment properties held by an investment property entity would not be significant.

However, we would expect that the measurement of real estate properties other than investment properties for an investment property entity and an investment company to be consistent. We note that the investment companies proposal would require that all investments in real estate properties held by an investment company be measured at fair value with changes in fair value recognized in net income. If the Board's intent is for investment companies to measure real estate properties held for an investment company's own use or for development for sale in the ordinary course of business at fair value, we question why an investment company would measure these real estate properties at fair value but an investment property entity would apply other US GAAP.

#### 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?

## Response:

The right-of-use model developed as part of the joint leases project is a historical cost accounting model. Because the proposed Update would require an investment property entity to measure investment property at fair value, we do not support the requirement that investment property entities recognize both a right-of-use asset and related liability for leased properties. Instead, we believe that an investment property entity should recognize and measure leasehold interests in investment properties at fair value using the lease contract as the unit of account. We note that although the fair value of the lease contract at inception would typically be zero, measuring the lease contract at fair value would result in recognizing an asset or liability as market rates and other factors change.

Requiring an investment property entity to separately recognize a right-of-use asset for leasehold interests in investment property necessitates the recognition of a lease liability. We believe the proposed Update is unclear on how to subsequently measure the liability. Should the liability be subsequently measured at amortized cost, at fair value or simply at the same amount as the right-of-use asset? Separately accounting for the right-of-use asset and the lease liability could be complex and may not lead to decision-useful information.

An example would help clarify the accounting treatment described when a premium is paid or discount is received for a right-of-use asset that is recognized as investment property (paragraph 973-360-30-3).

We believe the proposed Update is unclear with respect to how to consider leasehold interests in investment property when assessing the proposed Update's scoping criteria at paragraph 973-10-15-2. For example, it is unclear how to consider a significant leasehold interest that cannot be sold or transferred when assessing the nature-of-business-activities and express-business-purpose criteria.

We note that the investment companies proposal does not include any consequential amendments for leasehold interests accounted for as investment properties. If the Board decides to require investment companies to measure real estate properties at fair value, we believe an investment company should also measure leasehold interests in real estate properties at fair value and consistent guidance should also be included in the investment company amendments.

#### 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?

## Response:

We believe that the consolidation requirements for an investment property entity should be consistent with the consolidation requirements for an investment company. Please see our comment letter on the investment company proposal for our views on the consolidation requirements for investment companies.

## 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?

## Response:

We support prohibiting an investment property entity from applying the equity method of accounting as proposed. We believe requiring fair value measurement is consistent with the premise that fair value measurement is more useful for investment-type entities, regardless of the level of ownership or control over the investee. We also note that prohibiting investment property entities from applying the equity method of accounting is consistent with requirements for investment companies.

## 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?

## Response:

We believe that if the Board establishes specialized accounting for investment property entities, those entities should measure their investments at fair value. We believe that investments in which the investment property entity does not have a controlling financial interest or cannot exercise significant influence should not be measured differently from other investments. Therefore, we believe that such investments should be measured at fair value with all changes in fair value recognized in net income rather than in accordance with other US GAAP. We note that investment companies measure these types of investments at fair value with all changes in fair value recognized in net income and believe investment property entities should have consistent accounting requirements.

## 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?

#### Response:

We believe that fair value measurement of certain financial liabilities (e.g., debt) could provide more decision-useful information; however, we agree with the Board that requiring fair value measurement for financial liabilities is outside the scope of this project. The linkage of debt with an asset is not unique to investment property entities. Current US GAAP provides for the fair value option election. In addition, we understand the current decision in the Board's ongoing financial instruments project would permit measurement of financial liabilities at fair value in certain circumstances. The appropriate measurement for financial liabilities should be addressed in conjunction with the financial instruments project. As previously noted, we believe that the accounting for an investment property entity should be consistent with the accounting for an investment company. There is no requirement for an investment company to measure its financial liabilities at fair value with all changes in fair value recognized in net income. However, we also note that inconsistent units of account between the proposed Update and the investment companies proposal (as noted in our cover letter) would make this issue more prevalent for investment property entities.

#### 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?

## Response:

We question whether rental income is a relevant metric when investment properties are measured at fair value (including the respective leases) with all changes in fair value recognized in net income. The change in fair value of investment properties (i.e., unrealized gain or loss) is difficult to separate from an inflow or enhancement of assets that has occurred as a result of the entity's major or ongoing operations. Since investment companies do not report the operating results of investees (e.g., controlling financial interest in a manufacturing company) that are measured at fair value, we question why investment property entities would present the revenues and expenses of controlled investees that lease real estate properties.

#### 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.

## Response:

We believe that the practical expedient for 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) should be consistent with the practical expedient for an entity to estimate the fair value of its investment in an investment company. That is, there should not be an additional restriction that the entity would transact at the net asset value per share. Many investment-type entities that primarily invest in real estate properties, such as closed-end funds or real estate property funds, do not stand ready to transact with their investors. We note the challenges in estimating fair value considering all of the fair value requirements in Topic 820 that led the Board to issue guidance providing for the use of net asset value per share as a practical expedient for investments in investment companies and believe similar challenges would exist in estimating fair value for investments in investment property entities.

## 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?

## Response:

We believe that the disclosure requirements for an investment property entity should be consistent with the disclosure requirements for an investment company. Please see our comment letter on the investment company proposal for further comments on those disclosure requirements.

## 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?

## Response:

We agree with the proposed transition method.

## Question 22:

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

## Response:

The level of effort and extent of time needed to implement the proposed amendments would depend on the final scope and other decisions but would likely be a significant endeavor for many companies. In addition to the effort required to assess the new accounting treatment, the proposed changes would significantly affect accounting processes, information system needs and internal controls. The amendments could also affect the key financial metrics and operations of real estate companies, which would require preparers to inform and educate financial statement users.

## Question 23:

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

## Response:

We agree that early adoption of the proposal should be prohibited because the level of effort and amount of time needed to implement the amendments would likely be significant for many companies. We agree with the Board's concerns about comparability of financial statements of similar entities, particularly if the period between the issuance of a final standard and an effective date is several years.

## 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?

## Response:

We do not believe that there should be any difference in recognition and measurement criteria for nonpublic entities. We do believe it would be reasonable to reduce disclosure for nonpublic entities if supported by outreach with nonpublic entities and their financial statement users.

## Other comments

Investment properties may have associated obligations, such as asset retirement obligations or environmental liabilities. We believe the proposal is unclear about the accounting for these obligations. The fair value of these obligations is typically included in the fair value of the property. However, the amendments do not include an exception to Topic 410, Asset Retirement and Environmental Obligations.