



Real Estate Information Standards (REIS)

October 12, 2009

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

File Reference: 1710-100

Re: Proposed Accounting Standards Update — *Improving Disclosures about Fair Value Measurements*

Dear Mr. Golden:

We are pleased to comment on the FASB's proposed Accounting Standards Update on Fair Value Measurements and Disclosures (Topic 820), *Improving Disclosures about Fair Value Measurements* (the "proposed ASU").

Responding Organization

The Real Estate Information Standards ("REIS") were first published in 1995 in collaboration with the National Council of Real Estate Investment Fiduciaries, the Pension Real Estate Association, and the National Association of Real Estate Investment Managers in order to provide standards for calculating, presenting and reporting investment results to the institutional real estate investment industry. The REIS Board is an established body which serves as the official governing body of REIS and provides leadership and expertise in establishing REIS as authoritative and verifiable for the institutional investment industry. The REIS Council is responsible for establishing transparency and open involvement in the REIS process and for communicating its activities to the industry. Our industry investors consist primarily of tax-exempt pension funds that own equity interests in an estimated \$750 billion of commercial real estate and real estate related investments vehicles of which we estimate approximately one half of such property is financed with commercial mortgage financing.

The REIS standards represent an effort to codify a single set of desired industry practices and to improve standardization of valuation procedures, fair value financial accounting and reporting, and reporting of investment performance return information. The REIS

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standards play an important part in the overall efficiency of the real estate investment industry as consistency, comparability and transparency are critical for institutional investors to make prudent investment decisions regarding their investments, investment managers, and the asset class. The REIS standards depend upon, and are intended to supplement and in some cases, clarify, but not replace other established standards from authorized bodies including, but not limited to, valuation standards established through Uniform Standards of Professional Appraisal Practice (USPAP), accounting standards established by Generally Accepted Accounting Principles (GAAP) and the performance measurement and reporting standards known as the Global Investment Performance Standards (GIPS).

Response to Proposed ASU

Our detailed response is attached as Appendix A.

Our organization represents both the preparers and users of financial statements. We support the Board's efforts to enhance disclosure about assets and liabilities measured at fair value and to converge with the disclosure requirements with International Financial Reporting Standard No. 7 Financial Instruments: *Disclosures* (IFRS 7), issued by the International Accounting Standards Board (IASB). In principle, we support sensitivity analyses and disclosure about the assumptions used therein, as a well done analysis provides investors with important insights. As described below and in the attached appendix, we think there are potential problems with creating informative sensitivity analyses which should not be understated and the costs to provide such analyses within the audited financial statements are not commensurate with the benefits derived.

Delivery of prudent, transparent and consistent disclosure of information to users of financial statement information should take precedence over the costs and challenges associated with a particular task. The benefits of such costs however, need to be commensurate and the information must be more helpful than confusing to the reader. If such sensitivity analyses are poorly designed, they will have the unintended consequence of obscuring – rather than illuminating – important assumptions which investors ought to consider. As described in more detail in Appendix A, the inherent nature of sensitivity analyses does not lend itself to assessing the potentially important effects of correlation among variables/inputs. More broadly, another unfortunate byproduct of this process may be that preparers of financial statements disclose the sensitivities of too many assumptions – thereby rendering the analysis unwieldy for a good number of investors. ,

We recognize that providing sensitivity analyses may be more standardized with certain publicly traded assets. For example, a Treasury bond's "duration" and a common stock's "beta" may capture much (though not all) of the valuation risk. However, the nature of illiquid, indivisible assets – such a private real estate – has yet to lead to such all-encompassing sensitivity measures. In our industry, the number of inputs which would render themselves important to sensitivity analyses includes, but are not limited to: cap

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rates; holding periods; rental rates; leasing assumptions and property level debt assumptions. (Please refer to Appendix A for additional considerations.)

We think that the credibility and sustainability of real estate investment relies upon transparent and consistent information reporting. Investment strategies utilized within our industry range from single investor investment accounts which contain one or more property investments to several hundred property investments in open-end commingled funds. The valuation of these investments is primarily dependent upon unobservable inputs (Level 3 within ASC Topic 820). Accordingly, while providing insightful sensitivity analyses may not prove challenging for reporting entities with few real property investments, providing such analyses for entities with up to several hundred investments is likely to prove significantly challenging. Some of these challenges might seem to be mitigated by materiality, however, the assessment of materiality results from the underlying processes which would likely require deliberate analysis of the underlying unobservable inputs.

More detailed comments about some aspects of the proposed disclosures and our responses to the specific matters on which comment was requested by the FASB are noted in the Appendix A.

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We appreciate the opportunity to comment on the proposed ASU. If you have any questions concerning our comments, please contact Doug Poutasse, REIS Board Chair at dpoutasse@ncreif.org or Marybeth Kronenwetter, REIS Administrator at marybeth@ncreif.org.

Yours truly,

Douglas M. Poutasse
REIS Board Chair

APPENDIX A

Real Estate Information Standards Industry Response Responses to Proposed ASU's Questions

Issue 1: With respect to the disclosure of the effect of changes in reasonably possible, significant, alternative inputs for Level 3 fair value measurements for each class of assets and liabilities (sometimes also referred to as sensitivity disclosures), the Board is seeking input from:

- 1. Financial statement preparers about their operationality and costs*
- 2. IFRS financial statement preparers about the approach they plan to use to comply with a similar disclosure requirement in IFRS 7*
- 3. Financial statements users about their usefulness-more specifically, a discussion of how they would benefit from, and use, such disclosures.*

From a preparer's perspective, we believe this could result in an extremely onerous task for Funds with significant portfolios (i.e., significant number of properties). Disclosing the sensitivity to reasonably possible outputs for the fair value of real estate is extremely complex and will be time consuming for the preparer. Under existing principles, fair value measurements and disclosures should not result in undue cost and effort. We do not believe the costs of providing such analyses within the financial statements are commensurate with the benefits received, and in many cases would outweigh the benefits. For portfolios with a significant number of real property investments, such analysis may result in potentially misleading information. Such an analysis would commence on a property by property basis and then be aggregated at a portfolio level. In many cases this would not provide meaningful information for users of the financial statements. Depending on the size of the underlying portfolio, a Fund may require system upgrades to track this information on a property by property basis.

With respect to the complexity of valuing real estate, values are derived by taking the various methods of valuation (cost, income, market) and using the judgment of the appraiser to conclude on the value of a particular property. *Each* valuation method requires multiple inputs and assumptions, many of which could have a material impact on the ultimate value of each property. For example, the discounted cash flow approach alone utilizes inputs such as tenant turnover, current and projected vacancy rates, market rent, operating costs, tenant reimbursements, tenant improvements and leasing commissions, leverage assumptions, holding period and exit cap rates. The property type, geographic location and sub-market also have varying levels of impact on the value of a property. Certain inputs that are more significant to a particular property can be insignificant to others. When evaluating a portfolio of real estate that consists of multiple properties, the number of inputs becomes significant, but the significance of one or a few inputs will be extremely subjective. A disclosure that would try to contemplate all of these complexities and

consider the correlation among them would not only be extremely difficult to demonstrate, but could be confusing to the users of the financial statements.

We noted that the proposed ASU, if finalized as currently drafted, would create a difference with IFRS 7 that does not require entities to consider the correlation among changes in significant inputs, in determining reasonably possible alternative inputs. Based on the valuation techniques described above, we believe this requirement adds too significant a complexity to the disclosure, be costly to produce, and ultimately would not provide meaningful or useful information to the users. We also request that the Board clarify what is meant by the “effect of more than one reasonably possible change” and whether the entity is required to consider the expected effects of correlation among changes in all significant inputs (i.e., Levels 1, 2 and 3) or only in unobservable significant inputs (Level 3).

Issue 2: With respect to the reconciliation (sometimes referred to as a roll forward) of fair values using significant unobservable inputs (Level 3); the amendments in the proposed Update would require separate disclosure of purchases, sales, issuances, and settlements during the reporting period. Is this proposed requirement operational? If not, why?

We believe this proposed requirement is operational for our industry.

Issue 3: Is the proposed effective date operational? In particular:

- 1. Will entities be able to provide information about the effect of reasonably possible alternative inputs for Level 3 fair value measurements for interim reporting periods ending after March 15, 2010?*
- 2. Are there any reasons why the Board should provide a different effective date for nonpublic entities?*

We believe that the implementation of the proposed disclosure requirements for the sensitivity analysis will prove extremely challenging for certain reporting entities, including nonpublic entities (e.g., they may be required to update their systems). Given the expected issuance date of this update, it does not provide sufficient time for preparers to evaluate the requirements and potentially change processes and systems.