

Please note that the comments expressed herein are solely my personal views

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24 November 2011

- **File Reference No. 2011-210**
- **Real Estate – Investment Property Entities (Topic 973)**

Dear Sir,

Thank you for giving us the opportunity to comment on your Exposure Draft: Real Estate – Investment Property Entities (Topic 973). I will first make some general comments, and then discuss some more detailed points.

I agree with the proposals, which are clear and understandable, more internally consistent and principles-based, and would align US Gaap more closely with IFRS. This will improve comparability across all entities that would be investment property entities, and therefore have similar business operations, and will also improve comparability in international financial reporting.

The proposals would require an investment property entity, as defined, to initially measure acquired investment properties at transaction price, after including transaction costs, and subsequently at fair value with all changes in fair value recognized in net income. Real estate properties other than investment properties would be measured in accordance with other relevant US Gaap. An investment property entity would be required to present additional items of information that would help users of financial statements (users) to understand the nature, risks and benefits of the entity's investment activities. The proposals also require the investment property entity to provide additional disclosures such that users could evaluate and understand the potential cash flows from the properties and the timing of those cash flows. This is reasonable and appropriate, and it should align internal performance measurement with external financial reporting.

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I strongly agree with the proposed criteria for determining whether an entity is an investment property entity, particularly the basic criteria that:

- "a. Nature of the business activities. Substantially all of the entity's business activities are investing in a real estate property or properties.
- b. Express business purpose. The express business purpose of the entity is to invest in a real estate property or properties for total return including an objective to realize capital appreciation, for example, through disposal of its real estate property or properties";<sup>1</sup>

and the criteria concerning unit ownership, pooling of funds, ownership requirements and reporting entity.

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<sup>1</sup> Proposed Paragraph 973-10-15-2.

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## **Answers to other specific questions raised by the FASB**

### **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.

*I would recommend, as a minimum, that an investment property entity should be required to measure its investment properties at fair value. Fair value is the most relevant measurement attribute for their investment properties. I would prefer that all entities should be required to measure their investment properties at fair value. This will increase comparability across entities and would provide more complete and meaningful information to users.*

*Fair value measurement of investment properties is clearly operational, as it is already being done now.*

**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.

*I would support the requirement that an investment property entity should measure its investment properties at fair value. This would align internal performance measurement with external financial reporting, and is also consistent with the business rationale for investment property entities. It will also reduce options and increase the comparability across all investment property entities.*

**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?

*Yes, the criteria in the proposed amendments appropriately identify those entities that should be required to measure their investment property or properties at fair value.*

**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?

*Yes, the proposed requirement is clear, appropriate and operational.*

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**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.

*I would support that an entity that would meet the criteria to be both an investment property entity and an investment company under Topic 946 should be subject to the amendments in the proposed Update. Applying the look-through principle to the actual underlying investments, the key criteria are the nature of the business activities and the express business purpose. If these are property-related (see my comments above and proposed Paragraph 973-10-15-2), then the entity should be subject to these proposed amendments.*

#### **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.

*Yes, the entity's business activities should be limited to investing in a real estate property or properties. These are the basic underlying investments. Other securities may be related to property, but have a price which varies with other factors than just the property itself, such as supply and demand or regulation. These are not properties in themselves.*

**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?

*I agree that the evaluation of an entity's business activities should not consider properties held through noncontrolling financial interests, because the entity could not reasonably be able to comply with some of the key criteria, for example the requirement to have an exit strategy.*

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## **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:

- The entity's own use in the production or supply of goods or services or for administrative purposes
- 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.

*Yes, such an entity should be excluded from the proposed amendments. This is entirely appropriate. Such an entity cannot be considered an investment property entity that invests in a real estate property or properties for total return including an objective to realize capital appreciation.*

**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.

*Yes, 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 should not be considered an investment property entity. An exit strategy is essential under the definition of express business purpose, and is internally consistent with fair value accounting.*

## **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?

*Yes, this is appropriate. Pooling provides external investors with easier access to professional investment management. External investors should also hold a significant*

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*ownership interest in the entity. I agree that this is necessary in order to stop entities structuring operations and results accordingly.*

**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?

*Yes, the exemption is reasonable in these cases and is consistent with the entities' business purposes. The exemption is clear and understandable.*

### **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?

*The proposed amendments are not unreasonable and are at least internally consistent in this regard.*

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

*Yes, this is internally consistent and will provide more meaningful and decision useful information to users.*

### **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?

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*I would suggest that it would be more meaningful to require an investment property entity to measure its financial liabilities at fair value with all changes in fair value recognized in net income. This would be more internally consistent.*

### **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?

*Yes, this basis of recognizing rental revenue is more appropriate for investment properties measured at fair value. It is more internally consistent.*

### **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.

*I believe that the practical expedient is particularly pertinent for investment property entities.*

### **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?

*I would prefer more principles-based disclosure. An investment property entity should provide information to enable users to evaluate the nature and financial effect of its investment activities. The information should be provided in aggregate and per-unit.*

### **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?

*Yes, this is appropriate.*

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*Prospective application will provide more meaningful information to users. An entity should not be applying hindsight if it must derive a fair value that needs significant unobservable inputs.*

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

*I believe that most entities that would be affected by the proposals are already measuring and reporting fair value information, either internally or externally.*

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

*In general I would recommend that you should permit early adoption.*

Yours faithfully

Chris Barnard