
The Goldman Sachs Group, Inc. | 200 West Street | New York, NY 10282
Tel: 212-357-8437 | Fax: 212- 256-4489 | email: matthew.schroeder@gs.com

Matthew L. Schroeder
Managing Director
Global Head of Accounting Policy



February 15, 2012

Ms. Leslie Seidman
FASB Chairman
401 Merritt 7
PO Box 5116
Norwalk, CT 06856

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

Dear Ms. Seidman:

Goldman Sachs appreciates the opportunity to provide comments on the Financial Accounting Standards Board’s (“FASB” or the “Board”) exposure draft on investment property entities (the “ED”). We serve as the general partner and asset manager for the real estate opportunity funds (“REO Funds”) sponsored by the merchant banking division of the firm. We are one of the largest real estate fund managers globally with approximately \$29 billion of capital raised since inception in 1991. Our REO Funds are considered investment companies and account for their investments at fair value. Through our ownership interests in our REO Funds, we also invest indirectly in real estate and carry those investments at their respective net asset values; direct investments are accounted for similar to property, plant, and equipment.

Consequently, we have followed this project, along with three other related projects (Consolidation: Principal versus Agent Analysis, Financial Services -- Investment Companies¹ and Leases) with much interest. For the reasons discussed below and in the Appendix – primarily undue complexity, minimal benefit to users, and a significant cost to implement and maintain – we do not support the project and believe it should be abandoned. In particular, the project would require fundamental changes in financial reporting by REO Funds for little if any benefit. We are not aware of investor dissatisfaction with the current reporting model for REO Funds and therefore see no need to change it.

We have heard informally that the REIT industry initially supported the creation of IPEs, as REITs sought fair value accounting for investment property in response to the Board’s earlier

¹ See separate letters to the Board with reference to Consolidations: *Principal versus Agent Analysis and Financial Services – Investment Companies*).

thinking on leases. In the project on leases, the Board initially provided a beneficial scope exception from the onerous gross-up provisions contained in the proposed leasing model, provided the investment property was carried by the lessor at fair value. However, after the issuance of the ED, the Board decided to expand this exception to broadly exclude all lessors of investment property, regardless of whether lessors account for investment property at fair value. Consequently, the IPE model is no longer necessary to address these concerns.

The IPE model would require REITs and REO Funds to follow the same accounting and financial reporting framework. As discussed below and with the FASB Staff, REITs have different investment objectives than REO Funds. REITs generally hold their investments for very long periods of time and their primary focus is providing their investors with current yield from available funds from operations. REIT investors are therefore concerned primarily about the gross amount of assets, liabilities, rental revenues, property expenses and funds from operations. In contrast, REO Funds generally have a much shorter time horizon and the primary focus of investors is the fair value of the portfolio and not funds from operations.

Many REO Funds will qualify as both IPEs and investment companies. In that case, the ED's tie-breaker provision will require REO Funds to follow the IPE rules, including the ED's gross presentation financial reporting model. In our view, requiring REO Funds to switch to a gross presentation model will provide little benefit to REO Fund investors.

Furthermore, it will be costly for REO Funds to switch to and maintain a gross presentation model. REO Fund portfolios can be highly complex; ranging from single assets to large real estate portfolios across a broad range of asset types and global locations. Accounting records for these investments are often maintained by a large array of operating partners using different accounting systems and reporting under a diverse range of GAAP regimes. Gathering the required data and conforming the presentation in a timely manner would be very challenging. A significant number of incremental accounting personnel would need to be employed; costly systems re-engineering projects would be required and audit processes will be significantly more complex and time consuming.

In short, the IPE model does not pass the cost-benefit test and should be abandoned.

However, if the Board decides to continue with a project on the accounting for investment property, we favour a much simpler and principles-based model that utilizes the definition of investment property in the ED, does not amend Topic 946 (Investment Companies), and does not require the creation of IPEs.

Under our model, prevailing consolidation guidance would still apply. Direct and indirect investments held by non-investment companies (including REITs) would be carried at fair value, except when the information necessary to perform the fair value measurement is not available without undue cost and effort. Rental income, interest and associated property expenses from direct investments would continue to be reported, except for depreciation and amortization, which are not relevant in a fair value model. Constituents would apply judgment based up on the business objectives and strategy of the entity with regard to the investment in determining whether they have a direct or indirect investment in investment property.

Our detailed comments on the questions in the ED are included in the Appendix to this letter. If you have any questions or would like to discuss any of these comments further, please contact Israel Snow at 212-357-5730 or me.

Sincerely,

A handwritten signature in black ink that reads "Matthew L. Schroeder". The signature is written in a cursive style with a large, stylized 'M' and 'S'.

Matthew L. Schroeder

Appendix – Responses to selected questions

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.*

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 to questions 1 & 2: As noted in the body of the letter, we believe the IPE project should be abandoned. We believe that investment property held by an entity that meets the criteria of an investment company should continue be recorded at fair value in accordance with the Topic 946. For investments held by other entities, we believe an entity should be required to measure investment property at fair value based on its facts and circumstances, with robust disclosure. Management of the entity would apply judgment based upon the business objectives and strategy of the entity in determining whether the investment constitutes investment property.

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 business strategies of REITs and REO Funds differ; consequently, the investor community and its reporting needs are dissimilar. Management of REITs focuses on “funds from operations” (“FFO”) and acquiring stable, cash flow-producing assets that will be held for a long-term investment horizon (10+ years). REIT investors are typically retail investors, hedge funds and mutual funds that are looking for stable return profiles. On the other hand, REO Fund management focuses on internal rates of return (“IRR”) and profit multiples. They target opportunistic investments that typically are currently yielding limited, if no, current cash flows. REO Funds target assets that have value-add characteristics that can be realized over a relatively short time horizon (3-7 years.) This is similar to a conventional private equity investing model. In fact, investors in REO Funds are generally private equity investors that have an objective to diversify some of their holdings into the real estate private equity class. REO Fund investors are typically institutional investors (including sovereign wealth funds, pension funds, insurance companies and university

endowments) and high net-worth individuals and family offices. See Exhibit I for detailed REIT / Real Estate Opportunity Funds Comparison.

These differences in business strategy and investor base necessitate different financial reporting. Since REITs focus on cash flows and real estate operations, there is a clear necessity to provide detailed information regarding rental revenues and operating expenses in the statement of operations. This is also consistent with reporting properties and the related debt on a “gross” basis. This contrasts with REO Funds. Private equity investors are focused on net asset value and capital appreciation and therefore, REO Fund reporting should continue to be conformed to Topic 946. We believe that it is not appropriate to eliminate the differences in reporting that exist within the current US GAAP framework for REITs and RE Funds.²

If the Board decides to adopt the guidance proposed in the ED, we believe that management of entities that meet the guidance in both Topic 973 and Topic 946 should have the option to choose which guidance more accurately reflects the entity’s underlying business strategy and the reporting needs of the investor base.

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: We believe that the distinction between real estate property or properties and investing in real estate assets in general is not significant to investors in REO Funds. The ED creates two categories of real estate exposures: (1) *real estate properties* and (2) exposures to real estate that are not *real estate properties* such as, real estate-related securities, mortgage receivables, noncontrolling ownership interests in other real estate entities, certain hotel investments and development properties. We do not think this distinction is significant to investors in such funds. Their focus is on total return and capital appreciation provided by their real estate investment. Funds may choose to diversify in different types of exposures; albeit all under the general real estate category. Requiring different reporting for these categories only confuses matters.

Additionally, paragraph BC15 of the Basis for Conclusions states that “An entity performing significant business activities other than investing in real estate property or properties would call into question whether the entity is an investment property entity. For example, an entity that operates a hotel that is located on its investment property may be investing in real estate property, but the activities related to operating the hotel are not considered investing in real estate properties.” This guidance is confusing. We believe that hotel investments are real estate at their core. While a hotel may have many ancillary operations (for instance restaurants, spas, etc...) the primary focus is to bring occupants into the hotel space. If the Board decides to retain this guidance, we believe that they should provide indicators to provide preparers with a better framework to make this evaluation.

² We note that a working group of the FASB Emerging Issues Task Force reached a similar conclusion (see Issue No: 09-D, “Application of Topic 946, Financial Services – Investment Companies, by Real Estate Investment Companies” working group report No. 1 dated January 11, 2010.

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 non-controlling financial interests (for example, investments in which the entity can exercise significant influence)? Why or why not?*

Response: Similar to the response to question 6 above, we believe that this distinction is not relevant to investors in REO Funds. The investor has an underlying exposure to the real estate sector whether that investment is in the form of a controlling or noncontrolling financial interest.

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: As noted in response to questions 1 and 2 above, we believe that the decision as to whether investment properties should be measured at fair value should be determined by management based upon the business objectives and strategy of the entity with regard to the investment. We do not believe that the nature of the investors is a relevant criterion aside from situations where the entity meets the specialized investment company criteria. We note the Board's concern as discussed in paragraph BC26 that, "...without such a requirement, an investment property entity could be inserted into a larger corporate structure to achieve a particular accounting outcome while the parent could own almost all of that investment property entity with a nominal amount held by an unrelated investor." However, we believe inappropriate conclusions can be avoided if management faithfully applies the "Express Business Purpose" criteria.

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: If the Board proceeds with the IPE entity (and does not accept our recommendation to abandon the project), we believe that the scope of the exception from the pooling of funds requirement is too limited since there are other entities whose primary attribute for reporting purposes is fair value. We believe that such companies should also be entitled to the exception. Consequently, we propose modifying section 973-10-15-3 as follows:

"Notwithstanding ... may still be in the scope of this Topic provided the subsidiary entity has a parent entity that is required to account for its investments at fair value in accordance with this Topic or another Topic, or has a parent entity that is a **not-for-**

profit entity under Topic 958 that is permitted to account for its investments at fair value, or otherwise accounts for substantially all of its investments at fair value.”

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 do not support the premise of the question, that is, we believe that the requirements for reporting and measurement of debt for IPEs should be identical to those for Investment Companies (i.e. “net” presentation at fair value). In the context of a gross presentation model, we believe non-recourse debt secured by investment property should be measured at fair value so that changes in the entity’s net exposure are appropriately measured in earnings. All other debt should be measured at amortized cost.

We note, however, that based on the tentative decisions the Board has reached in its project on the classification and measurement of financial instruments, the fair value option would not be available to non-recourse debt secured by investment property. If the ED is approved as proposed, it would result in a required change in measurement if there is no longer the option to elect fair value accounting for such debt. In our opinion, this would not be a desirable outcome.

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 note that a fair value framework facilitates the financial statement recognition of all transaction economics which makes separate recognition of rental revenues unnecessary. However, as a practical expedient, we would not object to recognizing rental income in accordance with the contractual terms of the lease, similar to how interest coupons on a bond are recognized as interest income, for example.

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

Response: Consistent with our comments above, we believe that the extensive time that will be necessary to gather and disclose this incremental information will not be cost-beneficial.

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

Response: As discussed in the body of the letter, it will be costly for REO Funds to implement the switch to a gross presentation model. A significant number of incremental accounting personnel would need to be employed; costly systems re-engineering projects would be required and audit processes will be significantly more complex and time

consuming. Therefore, we believe that if the Board implements this proposal, a minimum of 18 months would be necessary to allow sufficient time to implement this proposal.

Please note that a timeline for implementing the proposed amendments assumes implementation of only the proposed amendments to Topic 973, Topic 946 and Topic 810 at a specified effective date. Decisions made by the Board relating to the timing of implementation for other projects currently under deliberation could affect our estimate.

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

We support allowing management of IPEs to elect early adoption if that is feasible and desirable for their entity.

**Goldman
Sachs**

Exhibit I: REIT / Real Estate Opportunity Funds Comparison

February 15, 2012



REIT / Real Estate Opportunity Funds Comparison

Overview

	REIT	Real Estate Opportunity Fund
General Description	<ul style="list-style-type: none"> ■ A real estate investment trust (REIT) is a public or private company that owns or engages in financing income producing real estate and elects to be treated as a REIT for federal income tax purposes ■ An Equity REIT owns and often operates property, while a Mortgage REIT finances property (Hybrid REITS do both) ■ The shares of most public REITs are traded on major stock exchanges ■ REITs qualify for special tax treatment, but must meet certain strict guidelines (see fund structure) 	<ul style="list-style-type: none"> ■ Real estate opportunity (REO) funds (which are structured as private equity funds) target higher risk/higher reward investments ■ REO funds invest equity in or finance real estate assets using privately raised investment capital ■ Capital for REO funds is raised primarily from institutional investors, public and private pension plans, endowments, sovereign wealth funds and high net worth individuals ■ REO funds make investments directly into real estate assets, invest in private real estate companies, conduct buyouts of public real estate companies and/or lend on the same
Fund Structure	<ul style="list-style-type: none"> ■ To qualify as a REIT a company must: <ul style="list-style-type: none"> — Have at least 75% of its assets and income tied to real estate investments — Must distribute at least 90 percent of its taxable income to shareholders annually in the form of dividends ■ A company that qualifies as a REIT is permitted to deduct dividends paid to its shareholders from its corporate taxable income <ul style="list-style-type: none"> — Most REITs historically remit at least 100 percent of their taxable income to their shareholders and pay no corporate tax — Taxes are paid by shareholders on the dividends received and any capital gains from the sale of shares ■ REITs generally are required to register their securities with the SEC 	<ul style="list-style-type: none"> ■ Non-listed investment conduit that provides limited liability, tax efficiency, and restricted liquidity ■ Most REO funds are structured as limited partnerships and have a general partner which raises capital and manages the fund's investments ■ Unlike REITs, REO funds are exempt from many of the registration requirements of the SEC ■ They are offered and sold pursuant to an exemption available under Regulation D and are considered "covered securities" under the National Securities Markets Improvement Act of 1996
Types of Assets	<ul style="list-style-type: none"> ■ Focus on stable, cashflow-producing assets ■ Specific focus on product type ■ Target assets that are "accretive" from a yield/FFO (funds from operations) perspective ■ Long investment horizon (10+ years) 	<ul style="list-style-type: none"> ■ Focus on investing opportunistically ■ Target assets that have value-add characteristics and provide opportunities for upside ■ Generally short investment horizon (3-5 years)



REIT / Real Estate Opportunity Funds Comparison

Overview

	REIT	Real Estate PE
Investment Objectives	<ul style="list-style-type: none"> ■ REITs focus on return on capital - generating attractive dividend yields (since the investor controls the timing of their return by decision to sell shares) ■ Lower leverage/risk targets ■ Focus on providing consistent, attractive dividend yields ■ Look for stable, income producing investments ■ Access to capital via public and/or private markets ■ Longer hold periods (“own forever”) ■ Make investments that do not rely on cap rate compression/back ended returns ■ Open-ended (i.e. no defined fund life) 	<ul style="list-style-type: none"> ■ Focus on return of (and return on) invested capital with management and incentive fees paid to the fund manager ■ Higher leverage/risk to maximize returns ■ Focus on IRR and profit multiples ■ Opportunistic ■ Shorter hold periods (typically 3-7 years) (“flipping” of assets) ■ Closed-ended (i.e. defined fund life)
Targeted Returns	<ul style="list-style-type: none"> ■ Single-digit dividend yields 	<ul style="list-style-type: none"> ■ 18-20% IRR's
Investors	<ul style="list-style-type: none"> ■ Retail investors ■ Hedge funds ■ Mutual Funds 	<ul style="list-style-type: none"> ■ Institutional investors <ul style="list-style-type: none"> — Sovereign wealth funds — Pension funds — Insurance companies — University endowments ■ High net-worth individuals and family offices