777 S California Avenue Palo Alto, CA 94304 Tel 650 494 1400 Fax 650 424 9136 www.mmcrealestate.com

February 15, 2012

Ms. Susan M. Cosper Technical Director Financial Accounting Standards Board 401 Merritt 7 Norwalk, CT 06856-5116

Via Email to director@fasb.org

RE: <u>Proposed Statement of Financial Accounting Standards – Real Estate – Investment</u> Property Entities (Topic 973) - File Reference No. 2011-210

Dear Ms. Cosper,

Marcus & Millichap Company (the 'Company' or 'MMC') appreciates the opportunity to comment on the October 21, 2011 Proposed Accounting Standards Update (ASU), Real Estate – Investment Property Entities (Topic 973). MMC is a privately-held diverse family of real estate companies serving the commercial, mixed-use, multi-family apartments and single-family markets. While the Company is diverse in its operations (including developing real estate for sale in the normal course of business), a significant part of MMC's business activities is represented by investments in multi-family apartments for total return, including capital appreciation. In addition to securing standard mortgage loans to finance the acquisition of these apartments, the Company may also enter into joint ventures with third party investors (mainly pooled real estate funds) to act as a capital source to mitigate risk and diversify the portfolio. These third party investors typically have controlling financial interests in the real estate properties and MMC therefore accounts for the investments in the joint ventures in accordance with Topic 323, Investments – Equity Method and Joint Ventures. Whether joint ventures are entered into

or the properties are wholly-owned, the Company, including lenders, considers these investments to be investment properties and manages the portfolio as such.

The Company is encouraged by the FASB's initiative via Topic 973 (and the proposed amendments to scope, measurement and disclosure requirements under Topic 946, Financial Services - Investment Companies) to provide an avenue for a larger proportion of entities investing in real estate to report at fair value. We agree that the concept of Investment Property Entity ('IPE'), following an analysis of the potential pitfalls of the optional accounting incorporated within the IAS 40 standard, is long overdue. Currently, unless an entity qualifies as an Investment Company under current US GAAP1 or has elected the fair value option in accordance with Topic 825, Financial Instruments, the current accounting for real estate properties for investment purposes precludes the recording of investment properties at fair value, and instead requires such assets to be recorded at lower of carrying amount or fair value less cost to sell ('Cost'), in accordance with Topic 360, Property, Plant, and Equipment. Such analysis requires performing impairment and recoverability tests by assessing fair value of the real estate in certain circumstances. In reality, companies are already performing fair value analysis of their portfolio of investment properties for management reporting purposes. Therefore, the ability to report at fair value would be a significant benefit to users of the financial statements. We also concur with the FASB's intention to measure the change in the fair value of investment properties through current earnings. This is an appropriate method to record such changes (as it reflects the nature of a real estate investment company's business), and it also promote convergence with the international accounting standards.

We appreciate the FASB's intent to provide specific criteria to be met for an entity to qualify as an IPE so as to promote comparability between entities with similar economic circumstances. We noted in the proposed standard that lessors of investment properties would not be required to apply the proposed lessor accounting requirements. We agree with the FASB's tentative decision that a lessor's lease of investment property would not

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¹ Neither MMC nor its subsidiaries qualify as an Investment Company.

be within the scope of the receivable and residual approach as significant changes in measurement of assets and lessor leases will result in distortion of financial statements that are difficult to understand and a cost burden to many companies. Moreover, we also agree with maintaining the overall premise in Topic 810, *Consolidations*, whereby specialized industry accounting (like Topic 973) is maintained in the financial statements of entities consolidating IPEs, irrespective of whether that parent entity is/is not an IPE. If not maintained, we believe that it would result in inappropriate accounting which is onerous to preparers and users of financial statements.

We agree that there needs to be a required fair value accounting of investment properties for IPE and that specific criterias should be met to qualify for fair value measurements of investment properties. In addition, the requirement to meet all of the criteria is an appropriate approach to promote comparability in the marketplace. Finally, while basing the criterion developed for Investment Companies per Topic 946 is appropriate as the two topics are related in many ways, we believe that the IPE criteria need to reflect the different nature of real estate investment companies in relation to Investment Companies. This is critical given the structure that real estate investment properties are held (wholly-owned or joint venture) and the extent of financial reporting to third parties i.e. lenders. We respectfully believe that certain of the criteria in Topic 973 that are required to be met for an entity to be considered an IPE are misguided and/or need further guidance, specifically related to the (a) Nature of the business activities and (b) **Pooling of funds** criteria. We concur with the other three criteria i.e. express business purpose, unit ownership and reporting entity, under the proposed standards for an entity to be an IPE. As the FASB is well aware, there are a large number of companies reporting under US GAAP (predominantly privately and closely held, like MMC) where a significant portion of their assets is invested in underlying real estate for investment purposes (whether wholly-owned or in joint ventures). MMC believes that the requirements to meet all of the five above-noted criteria under the proposed standard would prove counterproductive because it would result in the following:

 inconsistencies in relation to the measurement of wholly owned and joint venture real estate investments by closely held entities and joint venture partners that qualify under Topic 973 or Topic 946

We believe that most of our joint venture partners (mainly pooled real estate funds) would meet the criterion set out under Topic 973 to qualify as an IPE or under Topic 946 to qualify as an investment company. In particular, our joint venture partners typically have controlling financial interests in (and therefore consolidate) those joint venture real estate investments, and, as a result, our joint venture partners would more than likely meet the "Nature of the business activities" criteria in Topic 973. Moreover, based on their capital structure, our joint venture partners would also meet the "Pooling of funds" criteria. Consequently, the joint venture entities will be required to prepare fair value financial information related to the real estate investments for consolidation purposes.

However, a significant number of entities (like MMC) that enter into joint ventures with pooled real estate funds are closely-held and therefore would not meet this criterion (in spite of investing in *the exact same assets*). As noted above, entities (like MMC) see the decision to invest in real estate on a wholly-owned basis or a joint venture basis as a financing / risk mitigation decision; the investment will still be made in the underlying real estate to realize a total return, including capital appreciation. Therefore, such real estate entities (like MMC) that choose to enter into joint ventures instead of acquiring the real estate investments as wholly-owned will not qualify to be an IPE under Topic 973. This would result in an inconsistent accounting for investments in *the exact same asset*. As a result of the "Nature of the investment" criteria as currently proposed, an IPE (the joint venture partner) would consolidate the joint venture at fair value while a non-IPE (like MMC) would account for such joint venture investments in accordance with Topic 323 at Cost (assuming significant influence is exercised over the joint venture entity). This is illogical.

Separately, assuming the real estate investment is wholly-owned, entities like MMC involved in diverse real estate investments and business activities would not meet the criteria under "Nature of business activities' as currently defined under paragraph 973-10-55-2, which requires 'substantially all of the entity's business activities' to be investing in real estate property or properties. As such, the fair value measurement per Topic 973 as currently proposed would not apply to our wholly owned real estate investment properties despite having the same objectives in total return, including capital appreciation.

In addition, entities like MMC that do not pool funds would not qualify as an IPE. Investments in real estate are very different from other types of investments (stocks, bonds, mutual funds) in that they are often owned by individuals (or groups of individuals) through one closely-held company/fund and would not qualify as an Investment Company in accordance with Topic 946. Such investments are more prevalent in the marketplace and typically require reporting, particularly to third party lenders. The IPE criteria requiring "Pooling of funds" effectively causes the form that the real estate is held to become a criteria instead of focusing on the nature of the real estate investment itself (i.e., investing for total return, including capital appreciation).

The inconsistencies in the measurement of our portfolio of investment properties that would result under the proposed standards will make our financial information less useful and logical than if real estate entities are required to fair value their investment properties. While we understand that FASB is looking to prevent (or at least minimize) such inconsistencies, the criteria in Topic 973 as they currently stand are not appropriate and contradictory to what we understand is the FASB's purpose with the introduction of the IPE concept. Should the FASB retain the criterion under Topic 973, we have concerns regarding the inconsistencies that would result in real estate entities.

ii. operational concerns where the fair value option was not elected for equity method investments

Further to our comments in (i), in reality, most entities, including MMC, have not elected the fair value method of accounting for investments in which they exercise significant influence. Therefore, under Topic 973 as currently proposed, significant (and unnecessary) efforts and cost will be needed to measure the real estate investments (i) at fair value for the purpose of preparing financial statements of the joint ventures (typically with third parties who are in scope under Topic 973 and Topic 946 and thus would qualify as IPE's) and (ii) at Cost for MMC since MMC will not be an IPE or Investment Company under Topic 973 or Topic 946. It should be noted that this is in addition to existing management reporting of fair value of the real estate investments, which could be integrated with the fair value reporting for MMC and its apartment investing subsidiary. This would be an undue burden and cost in setting up processes in order to conform to US GAAP, particularly as different accounting treatments would be required for the same asset or type of asset (investment property that would otherwise qualify for fair value reporting) simply because of the form of the entity owning the asset. From MMC's perspective, the increased workload would result in no significant changes to the Company's financial statements when all the fair value information is available and would be a much better alternative to current GAAP.

To address the above-noted issues that would be caused by the adoption of Topic 973 in its current form, we recommend the FASB remove completely the "Pooling of funds" criteria. We also recommend the FASB modify and provide greater guidance on the "Nature of the investment activities" criteria to include an investment in underlying real estate (irrespective of wholly-owned or through a joint venture) and remove the word 'substantially' from its implementation guidance. Instead, the FASB should consider a real estate entity to be an IPE if 'a **significant portion** of its business activities are invested in real estate property/properties'. We also suggest that FASB provide quantitative

guidance on what should be deemed 'significant' (i.e., a % threshold of investment in real estate at fair value to total balance sheet assets).

Ultimately, we believe that the criteria should be broad enough to apply to all types of entities investing in real estate investments (other than real estate for self-use or for sale in the ordinary course of business) as opposed to excluding certain real estate entities based on arbitrary criteria that cause inconsistencies and confusion in the marketplace. The concept of an Investment Property Entity is an appropriate medium to achieve the above, providing the scope is not unduly restricted. Entities such as MMC that has a significant portion of its assets invested in multi-family apartment investment properties should be considered an IPE, and should not be excluded because of an arbitrary (and artificial) focus on form over substance. The above-noted modifications will focus on the substance of the transactions (and the true nature of the entity), which is more beneficial to users of the financial statements.

We would be pleased to discuss our comments with you. If you have any questions, please contact Scott Posternack, VP Accounting, at (650) 842-2254 or sposternack@mmcrealestate.com.

Sincerely,

Scott Posternack