

October 17, 2013

Ms. Susan M. Cosper Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, Connecticut 06856-5116 director@fasb.org

File Reference No. EITF – 12Gr, Measuring the Financial Liabilities of a Consolidated Financing Entity

Dear Ms. Cosper:

The Commercial Real Estate Finance Council ("CRE Finance Council") appreciates this opportunity to comment on *Measuring the Financial Liabilities of a Consolidated Financing Entity* (Proposed Update).

The CRE Finance Council is the collective voice of the entire \$3.1 trillion commercial real estate finance market. Our principal missions include setting market standards, facilitating market information, and providing education at all levels. Because our membership consists of all constituencies across the entire CRE finance markets, the CRE Finance Council has been able to develop comprehensive responses to policy questions that promote increased market efficiency and investor confidence.

The CRE Finance Council supports the concept that a reporting entity should not recognize a gain or loss on the consolidation or deconsolidation of a variable interest entity (VIE) for which it has elected to measure the financial assets and financial liabilities at fair value. We agree that a primary beneficiary should recognize gains and losses for a consolidated VIE equal to the change in the fair value of its retained interests in the VIE.

However, the CRE Financial Council believes that the prescribed calculation is flawed. In many cases, it will require that liabilities be measured using less reliable inputs for the assets than are available to measure the liabilities directly.

For most collateralized securitizations, the assets are whole loans, which are not separately traded, while the liabilities, which represent the interests of security holders, are often traded in liquid markets. Commercial mortgage-backed security (CMBS) pools are well-known to be highly idiosyncratic. CRE loans are not standardized, as are residential mortgage loans, suggesting that Level 2 pricing information would rarely be available for CMBS collateral. CRE Finance Council believes that the Proposed Update should be based on the principle that the

choice to value the assets or the liabilities of the VIE should be based upon the one that has the fair value measure that is the highest in the fair value hierarchy.

We understand that the Board was concerned that an approach that used the more observable data for the liabilities would result in the non-financial assets (primarily real estate owned) being measured at fair value. This need not be the case.

Consider the following example. A Commercial Mortgage-Backed Security (CMBS) VIE has liabilities with a total fair value of \$1,000, including \$100 of interests owned by the primary beneficiary and \$900 owned by unaffiliated investors. The CMBS VIE has REO with a carrying value of \$50. Based on current GAAP, the carrying value of the REO would be the lower of cost or market (LOCOM). While the effect is that a company would be carrying the non-financial asset at fair value, it is only because that is lower than the cost basis. If the fair value were higher than the cost basis, the borrower would not have let the property be foreclosed upon. Based on this information, the fair value of the financial assets (not otherwise available with reliable market data) would be \$950. In this way, the calculation relies on the more reliable market observations available for the liabilities, rather than the less reliable inputs for the assets. We note further that this issue affects only the balance sheet gross-up resulting from consolidation and does not affect earnings.

CRE Finance Council would also like to point out that the assets of concern are assets that were acquired through foreclosure and are awaiting sale; they are not assets that are intended to be long term investments. Additionally, the percentage of these assets is small compared to the overall CMBS universe. Currently, REO assets as a percentage of outstanding CMBS total less than 5%. It would seem that allowing valuation to be based on either assets or liabilities of the VIE depending on which measurement is highest in the fair value hierarchy, would produce the most accurate financial information.

The CRE Finance Council and our members appreciate your consideration of our views on the issues of concern to us, as described above.

Please do not hesitate to contact us at your convenience if you have questions or if any additional information would be helpful.

Sincerely,

Steven M. Renna President and CEO