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NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS®

September 30, 2010

Mr. Russell Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Subject: File Reference No. 1810-100, Exposure Draft; *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* ("the Exposure Draft")

Dear Mr. Golden:

The National Association of Real Estate Investment Trusts® (NAREIT) welcomes this opportunity to respond to the request for comments from the Financial Accounting Standards Board (FASB or Board) on the above referenced Exposure Draft.

NAREIT is the worldwide representative voice for Real Estate Investment Trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other businesses throughout the world that own, operate and finance income-producing real estate, as well as those firms and individuals who advise, study and service those businesses.

NAREIT is strongly committed toward improving the relevance and usefulness of financial reporting and routinely provides input on proposals issued by the FASB, International Accounting Standards Board (IASB) and Securities and Exchange Commission (SEC).

We commend and support the FASB's efforts to continue to develop high-quality accounting standards and particularly support the Board's efforts to achieve convergence of U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS).

1875 I Street, NW, Suite 600, Washington, DC 20006-5413
Phone 202-739-9400 Fax 202-739-9401 REIT.com

Executive Summary

Financial instruments accounting is a pivotal element of convergence. Given the recent inter-connected worldwide financial market challenges and increased complexity of financial transactions, we believe the joint FASB and IASB financial instruments project has the potential to provide a significant impact toward the successful completion of U.S. GAAP and IFRS convergence.

NAREIT urges the Board to continue to develop a fully converged standard for financial instruments in concert with the IASB. The different models currently developed by each Board would result in dramatically different accounting. If the SEC decides to adopt IFRS for U.S. issuers, this divergence would exacerbate the complexity involved in implementing IFRS.

Unless the FASB and IASB issue a converged financial instruments standard, U.S. companies and financial statement users would be forced to become familiar with and adopt a new U.S. GAAP standard and then potentially become familiar with and adopt the IFRS standard within a relatively short period of time. NAREIT urges the FASB and the IASB (the Boards) to develop a converged financial instruments standard with respect to the following key areas:

- Classification and measurement;
- Impairment;
- Hedging activities; and,
- Disclosure

Classification and Measurement

A Mixed Attribute Model

While NAREIT commends the FASB's efforts in developing a new model for financial instruments accounting, NAREIT supports a mixed attribute model with respect to the classification and measurement of financial instruments, generally similar to the principles included in IFRS 9 *Financial Instruments* and the IASB exposure draft on financial liabilities.

A mixed attribute model would be consistent with the business models of companies that own and operate real estate, as well as companies that finance transactions involving real estate. These companies typically hold or issue financial assets and liabilities for collection or payment of contractual cash flows for principal and interest. We believe that the amortized cost method more accurately reflects this business strategy, rather than measuring these financial instruments at fair value implying that the intention is to trade financial instruments or hold them for sale. For financial instruments held for sale or trading, we agree with the Board that fair value is a more relevant measure than amortized cost.

Accordingly, NAREIT recommends that the fair value of financial assets and liabilities held or issued with the intent to collect or pay contractual cash flows should be provided in disclosures only. The determination of fair value may involve a significant amount of resources and time,

particularly for nontraded instruments, that may interfere with the time-sensitive reporting of companies' earnings. Therefore, in addition to amortized cost being a more relevant measure for these financial instruments, the disclosure of fair value in the notes to the financial statements would allow fair value reporting to be more operational.

While NAREIT supports the IASB's mixed attribute model, we recommend the following changes:

- NAREIT suggests bifurcating embedded derivatives in assets, as well as in liabilities, rather than having to measure the entire instrument at fair value with changes in fair value recorded in net income. The bifurcation of embedded derivatives would also help to address concerns with respect to minor embedded derivatives driving the accounting for the instrument in its entirety.

- We strongly encourage the recycling of realized gains and losses previously recognized as unrealized in other comprehensive income (OCI), such as realized gains and losses on investments in common stock and extinguishment of debt.

Specific Classification and Measurement Concerns with the Exposure Draft

NAREIT has the following specific concerns or questions with respect to the Exposure Draft:

Equity method. NAREIT recommends that the FASB retain the existing guidance for equity method accounting. The Exposure Draft would introduce a new criterion requiring companies to evaluate whether an investee's operations are "related" to the investor's operations. We believe this "related" notion would present application issues that may reduce the comparability of financial statements.

NAREIT members have already expressed concerns around the determination of "related" operations. For example, questions have been raised as to whether operations would be considered related if a REIT holding and operating office buildings invests in a joint venture owning and operating healthcare properties. While both of these types of investment property involve earning rental revenue from leasing real estate, we believe that preparers could conclude differently as to the question of whether they represent related operations.

Further, we analogize the equity method to a one-line consolidation. Since consolidation is not based on whether a subsidiary is "related," NAREIT believes that similarly the basis for equity method accounting should also ignore this "related" concept.

Convertible debt. NAREIT recognizes that the Board intends on addressing the classification of convertible debt and whether or not it should be bifurcated into debt and equity components in conjunction with a separate convergence project on financial instruments with characteristics of equity.

Consistent with our support for a mixed attribute model and for bifurcation of embedded derivatives, we believe that issuers of convertible debt should generally account for it at amortized cost. For the typical use of convertible debt in our industry, NAREIT believes that amortized cost is a more relevant measure as compared to fair value of the debt component or the whole instrument. To accomplish this result, until the FASB and IASB complete the financial instruments with characteristics of equity project, we recommend the following:

- If convertible debt is bifurcated under current U.S. GAAP, the debt component should be measured at amortized cost (assuming that the issuer does not intend to trade the instrument). We would not limit this accounting to "Instrument C" only, since in all cases the principal is extinguished. The equity component should be classified consistent with current accounting and not subject to subsequent mark-to-market accounting.

- For more traditional convertible debt, we would continue the exemption from bifurcation as required in current accounting for derivatives and measure the total instrument at amortized cost.

Based on concerns from our members, we believe that there would be significant implementation issues in this area and clarification would be helpful in addressing the various types of convertible instruments.

Loan fees/costs. NAREIT agrees with the Board's decision to retain the accounting guidance in Statement of Financial Accounting Standard (SFAS) 91 *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* or Accounting Standards Codification (ASC) Topic 310. We believe that accounting for these costs as an adjustment of the basis of the loan more closely reflects the effective cost and yield, rather than being recognized directly in OCI. Retaining this accounting would simplify the process of changing current systems yet produce a similar result as proposed in the Exposure Draft.

Debt transaction costs. We believe that debt transaction costs should be deferred and amortized over the term of the debt instrument regardless of whether the financial liability is measured at fair value through OCI or amortized cost. Similar to the accounting for loan fees, this accounting more accurately portrays the costs of funds.

Loan commitments. NAREIT recommends that all loan commitments and letters of credit should be excluded from the scope of the Exposure Draft. We are not aware of problems existing in current practice related to this specific area. We believe that disclosure of loan commitments by the creditor would provide financial statement users with the appropriate information necessary. We also believe that our recommendation is convergent with IFRS.

Measuring credit risk. NAREIT requests further guidance on how to reflect the effect of a company's own credit risk when the borrowing is recourse only to the pledged assets (*i.e.*, real estate) and not to the general credit of the borrower.

Impairment

NAREIT strongly recommends that the FASB and IASB continue to work together to develop a fully converged impairment model for financial assets. With respect to the FASB Exposure Draft, we have two significant issues concerning credit impairment analysis: 1) the timing of recognition in the context of forecasting future losses; and, 2) assumptions about future events.

First, we believe that forecasting future losses involved in the proposed impairment model would result in uneconomic outcomes. Because the Exposure Draft would require companies to evaluate impairment based on expected future losses, the proposed model would lead to immediate loss recognition at the origination of the loan and result in the loan being measured at an amount less than fair value. This accounting does not faithfully represent the economics of a loan that is entered into based on current market conditions.

Second, we disagree with the Exposure Draft proposal of forecasting future losses using a model that would place restrictions on the assumptions about future events. NAREIT believes that the inability to consider potential future events beyond the reporting date would not result in best estimates and would inaccurately represent the economic reality of expected losses on financial assets.

For example, when calculating the credit impairment of a financial instrument under the proposal, a company would only consider economic conditions present at the measurement date and assume that these factors would remain unchanged over the remaining life of the financial asset. This proposal would be especially problematic when evaluating impairment for loans secured by commercial real estate. If a fixed rate 30-year term loan is secured by a commercial building that is currently 100% leased to one tenant for 20 years, would the lender be required to assume that the expiring lease would not be replaced given that the renewal lease did not exist currently? The assumption that the expiring lease would not be replaced would lead to the assumption of insufficient income to cover debt service and ultimately result in impairment recognition.

The exclusion of assumptions about future events for credit impairment evaluations would be inconsistent with the assumptions involved in fair value measurement. NAREIT believes that similar to companies applying their best estimates in determining fair value, they should also use their best assumptions in making impairment assessments.

Other Specific Impairment Concerns with the Exposure Draft

Interest Income. NAREIT strongly recommends that the Board decouple interest income recognition from impairment issues, since financial statement users are primarily focused on contractual flows of interest. The reduction of interest income by the effect of credit loss allowances under the proposal would fail to provide this information. Our recommendation would also simplify companies' systems requirements.

Nonaccrual Loans. NAREIT requests that the Board should maintain the current guidance for determining the status of nonaccrual loans. Additionally, NAREIT recommends that the existing disclosures continue to be required, since financial statement users find the current information to be beneficial.

Hedging Activities

NAREIT appreciates the FASB's response to the comments received on the 2008 hedging proposal. We especially support the continued ability to bifurcate a benchmark interest rate, which is consistent with our August 15, 2008 comment letter to the Board. The bifurcation-by-risk model is also consistent with the manner that companies manage risk and we favor extending the application of this model to prime rate and other indices.

As stated in NAREIT's 2008 letter, we support the reasonably effective threshold for hedge accounting qualification. This threshold is more consistent with the business approach for many companies. We believe that the reasonably effective threshold could be subject to a wide range of interpretation; therefore, incremental guidance for determining when hedging relationships are reasonably effective would be useful.

We also agree with the provisions of the Exposure Draft concerning the hypothetical derivative method to address hedging frequent transactions and credit risk needed on a hypothetical derivative. We found the guidance included in the Exposure Draft to be helpful.

While we agree with several of the Exposure Draft's improvements to hedge accounting discussed above, NAREIT has certain concerns with the proposal. We recognize the reasons behind eliminating the short-cut method for certain hedging activities, however, NAREIT supports retaining a pragmatic approach for simple interest rate swaps. In our industry, simple interest rate swaps are very common and, therefore, we believe that there is a need for a practical accounting solution. If the FASB ultimately decides to prohibit the short-cut method, we suggest that the Board should provide transition guidance for existing hedging relationships so that they would continue to qualify for hedge accounting.

Additionally, we oppose the Board's proposal to prohibit the discontinuation of hedge accounting based on the removal of a hedge designation. Business risks are dynamic and companies need to revise or "dedesignate" hedge accounting without having to incur the cost of terminating the hedge agreement.

If the Board concludes to prohibit dedesignation, we request that the FASB provide clarity with regard to the following questions:

- Are net investments hedges for foreign currency risk under SFAS 52 *Foreign Currency Translation* or ASC Topic 830 included in the scope of the Exposure Draft? If the Exposure Draft does include these investments, the prohibition of dedesignation would be very problematic, since it is common practice to adjust these hedges periodically (for both derivatives and nonderivatives).

- Does the notion of an effective closeout mean entering into a now off-market swap to exactly match the original swap?

NAREIT also opposes the Board's proposal concerning "under hedges." The Board specifically addressed this issue in developing current accounting for derivatives and we are unaware of any reason that the outcome should change.

Disclosure

NAREIT supports the Board's efforts toward enhancing financial statement disclosures in connection with the FASB disclosure framework project. At the same time, we urge the Board to require disclosures that present meaningful substantive information to financial statement users. It is important that disclosure requirements insist upon clear and concise information to avoid the obfuscation of critical financial information.

Again, we strongly believe that the Board should work collectively with the IASB to develop a fully converged solution for financial instruments accounting. If the Board or its staff would like to discuss NAREIT's views as expressed in this comment letter, please do not hesitate to contact George Yungmann at gyungmann@nareit.com or (202) 739-9432.

Respectfully submitted,

George L. Yungmann
Senior Vice President, Financial Standards

Sally R. Glenn
Director, Financial Standards