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Technical Director
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Dear Technical Director:

We appreciate the opportunity to comment on the Financial Accounting Standards Board's ("FASB") Real Estate - Investment Property Entities Proposed Accounting Standards Update ("Proposed Update"). Equity Residential ("EQR"), a Maryland real estate investment trust ("REIT"), is an S&P 500 company focused on the acquisition, development and management of high quality apartment properties in top United States growth markets. Equity Residential owns or has investments in 427 properties located in 15 states and the District of Columbia consisting of 121,974 apartment units. While we support the continued efforts of the FASB to develop high quality accounting standards and converge U.S. Generally Accepted Accounting Principles ("GAAP") and International Financial Reporting Standards ("IFRS"), we do not believe the Proposed Update accomplishes those goals. We generally agree with the proposal to measure real estate properties acquired for investment purposes at fair value because we believe this is the most appropriate measurement for real estate. However, we do not agree with the approach (i.e. meeting the criteria of an investment property entity ("IPE")) to implementing it and believe that there are a number of questions the Proposed Update does not address. Below are our comments on matters outlined in the Proposed Update.

We believe that all entities that invest in real estate and are generating a return or are held to realize capital appreciation should measure their investments at fair value with changes in fair value recognized in net income. The measurement of these investments at fair value is a more systematic and rational method of valuing assets that have the potential to appreciate (depreciate) in line with positive (negative) changes in market conditions and will accurately reflect the appreciation (depreciation) in a company's statement of operations. The current model that requires a company to depreciate an asset over its estimated useful life does not consider appreciation in the value of an asset, resulting in an asset with a zero net book value at the end of its useful life. This is generally inconsistent with the use of the asset, which can provide value to the investor for several

years after the estimated useful life. The fair value model will be more useful to investors as it will provide a better representation of a company's financial position. It will also enhance comparability of operating performance among all entities that invest in real estate, including IFRS users, by eliminating differences due to historical cost accounting and useful life estimates, which can vary among owners of identical assets in similar condition, and incorporating changes in market factors.

We agree with the requirement 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 lease rather than on a straight-line or other basis. This concept will facilitate the matching of revenue and expense recognition. As a result, profits will be more comparable between periods as increases in operating expenses will be aligned with increases in rental income. In addition, recognition of rental income on a contractual basis more closely aligns with how revenues are shown in the discounted cash flow model which is one of the primary methodologies for calculating fair value of investment properties. We also do not object to the concept of recording financial liabilities, such as debt, at historical cost as it represents the value of the liability that a company would pay in order to extinguish its obligation.

We do not agree with the IPE concept approach to valuing real estate for the following reasons:

- There are significant differences that exist between International Accounting Standards 40, *Investment Property* ("IAS 40"), and the Proposed Update;
- The IPE criteria in the Proposed Update are vague and do not appropriately distinguish between a real estate operating company (such as a REIT) and an investment company; and
- The elimination of the equity method of accounting for noncontrolling interests in real estate affiliates would no longer allow companies to pick up their share of the profits earned by these investments.

The most significant difference that exists between IFRS and the Proposed Update is the asset based approach under IAS 40 that provides accounting guidance for investment properties across all industries as compared to the entity based approach under the Proposed Update that provides accounting guidance for specific types of entities that hold investment properties. This lack of convergence with IFRS is not consistent with the FASB's intent to address the diversity in practice related to entities that invest in real estate and seems to suggest very complex, specialized accounting treatment for REITs or the potential exclusion of REITs (see further discussion below). This industry-specific guidance will not enhance comparability and is not in concert with the FASB's stated goal to move away from promulgating industry-specific guidance. The guidance on accounting for investment properties should focus on the nature of business activities conducted by these investment properties regardless of their industry as similar activities can be carried out by companies in different industries.

The second difference that exists between IFRS and the amendments in the Proposed Update is the option to value investment properties at fair value or historical cost under IAS 40 as compared to the requirement for an entity that meets the criteria of an IPE to measure its investment property at fair value under the Proposed Update. Although we realize that the proposed amendments do not converge with IRFS, we do not object to the requirement to measure investment properties at fair value as this should lead to greater comparability among U.S. registrants.

A significant issue with the IPE criteria in the Proposed Update is a result of the FASB's decision to use the definition of an investment company in the Proposed Update on investment companies as a starting point for developing the criteria of an IPE. The criteria are virtually the same; however, real estate operating companies are very different from investment companies. The IPE concept is flawed for the following reasons:

- its definition of "substantially all" when describing the nature of business activities criterion; and
- its description of the express business purpose criterion.

Under the nature of business activities criterion, companies are not permitted to include real estate properties held indirectly through investments in which the parent entity does not have a controlling financial interest when evaluating whether substantially all of the parent entity's business activities are investing in real estate properties. It is not reasonable to assume that a company's intentions would be different with respect to consolidated investments versus unconsolidated investments especially when the unconsolidated investments relate to entities with substantially all of their activities invested in real estate properties. This may lead to a number of REITs being scoped out of the IPE guidance as it is not uncommon for REITs to hold significant unconsolidated investments. It may also lead a company to move in and out of IPE status based upon the nature of its transactions.

As an example, EQR has recently pursued acquisition of a 26.5% noncontrolling ownership interest in the Archstone entities. If the acquisition were to close and it were to be accounted for under the equity method of accounting (unconsolidated), EQR would potentially not meet the criteria of an IPE based upon the significance of the investment to its balance sheet. With an investment of \$1.325 billion on \$16.7 billion of total assets, this results in 7.9% that cannot be evaluated under the "nature of business activities" criterion. This raises questions surrounding the definition of "substantially all". A lack of clarity here may result in similar types of entities arriving at different conclusions as to whether they meet the scope of an IPE. In addition, if EQR were to acquire an additional interest in the Archstone entities such that it may no longer be considered a noncontrolling ownership interest, EQR would potentially meet the criteria of an IPE. This variability of a company moving in and out of IPE status presents a significant problem for consistent accounting and reporting as well as developing processes and controls.

Under the express business purpose criterion, the Proposed Update requires that an IPE have an exit strategy to dispose of its real estate properties, thereby realizing capital appreciation and ultimately maximizing total return. This idea of a defined exit strategy is both troubling and vague. The troubling aspect relates specifically to REITs as this express-business-purpose concept regarding a defined exit strategy may be in direct disagreement with REIT tax rules which do not allow for specific exit strategies on assets unless those assets are held by taxable REIT subsidiaries ("TRS"). The Internal Revenue Code provides that REITs may own greater than ten percent of the voting power and value of the securities of a TRS, provided that the aggregate value of all of the TRS securities held by the REIT does **not** exceed 25% of the REIT's total asset value. The vague aspect relates to what the FASB's idea of a defined exit strategy actually means. Possible suggestions have included proof through sale, explicit statements in offering documents and/or financing and/or refinancing activities associated with real estate properties. Or is a defined exit strategy inherent within the concept of investing in real estate properties? This may also lead to a number of REITs being scoped out of the IPE guidance as it is not common for companies to expressly state their exit strategies.

While we disagree with the description of the express business purpose criterion outlined in the Proposed Update, we do agree that an entity whose express business purpose is to hold real estate properties for its own use in the production or supply of goods or services or for administrative purposes or for development for sale in the ordinary course of business upon completion should be excluded from the amendments in this Proposed Update. Because these real estate properties are not held to earn income or realize capital appreciation, the requirement to measure them at fair value in line with positive (negative) changes in market conditions does not seem reasonable. These types of properties are held by companies to conduct their day-to-day operations in the normal course of business and rather than for investment purposes.

If certain REITs are excluded from the IPE guidance based upon the issues with the nature of business activities and express business purpose criteria mentioned above, they must then evaluate the criteria within the investment company guidance. It may also be difficult for REITs to meet the criteria of an investment company since they are virtually the same (with the exception of one criterion requiring fair value measurement) as the criteria in the Proposed Update. This would then scope REITs back into the lessor accounting model. As a result, it appears that REITs may arrive at different conclusions, and thus, be scoped into different accounting. This does not make sense as we believe it is in the best interest of all parties involved to ensure all REITs are operating under a consistent accounting model given the similarities of their businesses.

By eliminating the equity method of accounting and thereby no longer allowing companies to pick up their share of the profits earned by these investments, information on how these investments are performing will not be available. This information can be significant and is oftentimes used by investors and analysts when evaluating a company. Measuring an equity method investment at fair value could lead to volatility in the financial statements depending on the adjustments resulting from changes in market conditions. It is not consistent with the treatment of consolidated investments in real

estate properties as the underlying assets and liabilities are valued rather than the investment. In addition, companies with investments in which they do not have a controlling financial interest or cannot exercise significant influence may not have access to the information necessary to appropriately value these investments. We believe that a company should continue to pick up its share of the profits earned by an equity method investee, which would include fair value adjustments to the underlying real estate properties in line with the fair value requirements discussed above, and record it on its own line in the statement of operations. We do not object to companies recording a fair value adjustment for basis differences between the company's fair value of the investment and the investee's valuation of its real estate properties; however, we believe this adjustment should be recorded on a separate line in the statement of operations. This may have an effect on key metrics (i.e. FFO), depending on whether the company would adjust for these line items.

We do not agree with the FASB's plans within the Proposed Update to modify the consolidation standards related to controlling financial interests. Instead, consolidation guidance is best handled within the FASB's separate consolidation project.

We believe that with the appropriate team and advance preparation, fair value measurement of investment properties is operational. However, there are several issues summarized below that must be addressed prior to the implementation of fair value:

- Would companies be permitted to use an internal team to value its investment properties or would they be required to engage an external valuation firm?
- If companies performed the valuations internally, would they be required to engage an external valuation firm periodically to support the reasonableness of their assumptions and the accuracy of their valuations?
- If companies are required to engage an external valuation firm, how often would these valuations be necessary (e.g. annually, every other year, every three years) and would they be required on an interim basis?

Some of the potential requirements mentioned above will greatly increase the costs companies may incur in order to be in compliance. We believe that our internal investments team is best equipped to value our investment properties as this would represent an extension of what our team currently does when they underwrite acquisitions of investment properties. Our team is extensive, very sophisticated and has experience valuing both a large number and wide variety of multifamily investment properties.

In addition to the financial considerations mentioned above, companies will need to consider the Sarbanes Oxley Act ramifications, including changes to processes and controls. This may require extensive training for all parties involved in the process. With the valuation of the most significant line items on a real estate company's balance sheet and income statement significantly influenced by non-accountants (i.e. the investments team), there will be a need for tight coordination with the accounting team to review the calculations or in some cases perform the calculations (i.e. after receiving assumptions/inputs from the investments team). Finally, companies will need to consider

the IT impacts of integrating both the calculations and the data into their financial reporting systems, which would require a significant amount of advance preparation. The costs to implement and maintain these considerations will undoubtedly be significant to even large, well-established companies. As a result, companies will need a long lead time to not only implement and develop processes and controls but also budget for the ongoing financial impacts.

Given all of the considerations mentioned above, we believe that companies will need at least one full year to develop a process, implement controls and obtain appraisals (whether internal or external). If companies are required to implement this Proposed Update retrospectively, they will need at least one year prior to the earliest period reported. For example, if the effective date were to be January 1, 2016, companies would be required to retrospectively restate 2014 and 2015 as well as apply the guidance to 2016. As a result, the guidance would need to be finalized by January 1, 2013.

We believe that the amount of disclosure necessary to present an accurate representation of a company's financial position and results of operations will be greatly increased; however, we do not feel that there is adequate guidance surrounding these additional disclosures. For example, these types of fair value measurements generally fall within Level 3 of the hierarchy and, as a result, would require increased disclosure within the footnotes to the financial statements. The following questions would need to be addressed:

- Would this disclosure be aggregated or disaggregated?
- What level of detail related to inputs/assumptions/calculations would need to be provided for each market (if aggregated) or each property (if disaggregated)?
- What would Schedule III look like?

If the Proposed Update were to be adopted, we believe that early adoption will result in non-comparability among similar entities and possibly complicate the analysis by investors, but we would not object to allowing companies to early adopt the proposed amendments. The processes, controls and techniques may serve as a gauge for how our company will implement the guidance as well as provide us with a network of peers with whom we can speak to ensure we are implementing the guidance consistently as it is in the best interest of all parties involved to ensure all REITs are operating under the same accounting model and applying it consistently. We believe the effect of adopting the requirements should be recorded as an adjustment to the beginning balance of retained earnings in the period of adoption as it would be unreasonably difficult to retrospectively assess fair value and restate prior year information in the period of adoption.

We would be pleased to discuss our comments with the FASB at your convenience.

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