



February 15, 2012

Financial Accounting Standards Board  
Technical Director - File Reference No. 2011-210  
Financial Accounting Standards Board  
401 Merritt 7 - PO Box 5116  
Norwalk, CT 06856-5116

**Re: Proposed Accounting Standards Update, Topic 973: Real Estate – Investment Property Entities; issued October 21, 2011**

Dear Board Members and Staff:

We thank the Financial Accounting Standards Board (“the Board”) for providing us with the opportunity to respond to the Exposure Draft of a Proposed Accounting Standards Update for Real Estate-Investment Property Entities (“IPE”), Topic 973. We appreciate the Board’s consideration in addressing fair value accounting guidance specific to the real estate industry and for its efforts in attempting to converge this guidance with International Accounting Standards 40-Investment Property (“IAS 40”) and proposed standards recently issued by the International Accounting Standards Board (“IASB”), Exposure Draft-Investment Entities.

### ***Clarion Partners***

Clarion Partners was founded in 1982 and is an SEC registered investment advisor. Today, the firm manages \$24 billion in investment real estate throughout the US, Mexico and Brazil on behalf of institutional investors. Headquartered in NY, Clarion currently has 10 offices located throughout the US and Latin America. The firm executes strategies in the core, value-added and opportunistic space on behalf of both separate account and fund investors. Clarion’s fund program includes both open-end and closed-end funds.

### ***General Opinion on Proposed Accounting Standards Update, Topic 973***

Through Topic 973, we believe the Board endeavored to develop fair value guidance specific to the real estate industry. However, because the IPE Exposure Draft does not provide for all real estate investments to be presented at fair value which may result in certain real estate investments such as real estate related securities, mortgage receivables and investments in unconsolidated ventures being recorded at historical cost, we believe that the resulting hybrid fair value presentation could be confusing to our institutional investors who rely on comparable Fair Value-Net Asset Value (“FV NAV”) presentation of their investments.

Additionally, we believe the criteria proposed for determining IPE should be more principles based and serve as strong indicators that an entity should present real estate investments at fair value as opposed to an entity being required to meet all requirements.

We also support the Board’s efforts to converge with global accounting standards. However, we believe that IPE’s divergence with global accounting standards, by way of examples; varying presentations of joint venture equity interests and entity level scope approach verses property level

Barbara Flusk  
Senior Vice President  
230 PARK AVENUE  
NEW YORK, NY 10169  
T 212-883-2676 M 646-552-7257  
Barbara.flusk@CLARIONPARTNERS.COM  
WWW.CLARIONPARTNERS.COM



scope approach, could cause a diminution of comparability of global real estate investment results presented to investors.

We appreciate the Board's time and consideration of these views and we are happy to discuss them in further detail at any time.

Sincerely,

A handwritten signature in cursive script, appearing to read 'Barbara Flusk'.

Barbara Flusk  
Senior Vice President, Financial Operations  
Clarion Partners

## RESPONSES TO TOPIC 973 EXPOSURE DRAFT QUESTIONS

### Scope

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**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.*

**Answer 1:** We believe that all entities that hold real estate investments, including investment properties, for investment purposes (i.e. capital appreciation, investment income or both) should measure all real estate investments at fair value. We believe that fair value measurement under Topic 973 should not be isolated to investment properties but rather should apply to all real estate investments including but not limited to; non-controlling equity investments in a joint ventures, mezzanine debt, and real estate securities.

Although we generally support the IPE Exposure Draft Topic 973 and the proposed criteria for determining IPE (*Nature of Business Activities, Express Business Purpose, Unit Ownership, Pooling of Funds, and Reporting Entity*), we believe that the language in the Exposure Draft in its present form such as; “*substantially all of the entity’s business activities are investing in real estate property or properties*” and “*to invest in real estate property or properties for total return...*”, is too restrictive. Accordingly, we believe that such criteria would better serve as strong indicators that an entity should be in scope of Topic 973 as opposed to all criteria being a requirement of scope.

We believe that fair value measurement of real estate investments, is operational. By way of example,



the private equity real estate industry has been reporting real estate investments to investors on a fair value basis for approximately 30 years.

***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.***

**Answer 2:** As indicated in our response to *Question 1*, we believe that real estate investments, including investment properties, held for investment purposes, be measured at fair value. We believe the option to fair value would create financial results and FV-NAV that is not comparable. However, we also believe that convergence between GAAP and IFRS is equally important in assuring comparable results and FV-NAV. Further clarification of fair value option criteria or indicators would be beneficial in preserving comparability for investors.

***Question 3: Do the criteria in the proposed amendments appropriately identify those entities that should be required to measure their investment property or properties at fair value, and, therefore, should be excluded from the scope of the lessor accounting model in the proposed update on leases? If not, what changes or additional criteria would you suggest, and why are those criteria more appropriate?***

**Answer 3:** As noted in our response to *Question 1*, we believe that entities that hold real estate investments, including investment properties, for investment purposes (i.e. capital appreciation, investment income or both) should measure all real estate investments at fair value. As such, we do not believe that the proposed amendments appropriately identify those entities that should be required to measure their real estate investments, including investment property or properties, at fair value. However, we believe that those entities that do measure their real estate investments, including investment properties, at fair value based on investment purpose criteria outlined in our response to *Question 1*, be excluded from the scope of the lessor accounting model in the proposed update on leases.

***Question 4: The proposed amendments would require an entity to reassess whether it is an investment property entity if there is a change in the purpose and design of the entity. Is this proposed requirement appropriate and operational? If not, why?***

**Answer 4:** We believe that an entity should reassess whether it should continue to measure its real estate investments at fair value based on a change in the purpose and design of the entity and whether the “strong indicators” are still applicable to the entity. We believe the proposed requirement is operational as changes in reporting are prospective.

***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.***

**Answer 5:** In general, we believe that an entity that would meet the criteria to be both an IPE under Topic 973 and an Investment Company under Topic 946 be subject to the amendments in this proposed Update. However, as stated in our response to *Question 1*, we feel that the criteria presented under Topic 973, in its present form, is too restrictive.

We believe that the strong indicators, and not the form of the entity, should determine whether an entity should follow Topic 973-Investment Property Entity or Topic 946-Investment Company.

### **Nature of the Business Activities**

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***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.***

**Answer 6:** No, an entity's business activities should not 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, mortgage receivables and non-controlling equity investments in a joint ventures) to be an IPE. As referenced in our response to *Question 1*, we believe that the criteria presented under Topic 973 (e.g. "substantially all of the entity's business activities are investing in real estate property or properties" and "to invest in real estate property or properties for total return..."), is too restrictive. Accordingly, we believe that such criteria would better serve as strong indicators that an entity should be in scope of Topic 973 as opposed to all criteria being a requirement of scope. Also, fair value measurement should not be isolated to investment properties but rather should apply to all real estate investments including but not limited to; non-controlling equity investments in a joint venture, mezzanine debt, and real estate securities.

***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?***

**Answer 7:** Yes, evaluation of an entity's business activities should consider properties and other real estate investments held through non-controlling financial interests (for example, investments in which the entity can exercise significant influence) as we referenced in our response to *Question 1*.



We believe that fair value measurement should be applied to all real estate investments including but not limited to; non-controlling equity investments in a joint venture, mezzanine debt, and real estate securities, in order to provide a true FV-NAV to our investors that is comparable.

### **Express Business Purpose**

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***Question 8: To be an investment property entity, the proposed amendments would require that the express business purpose of an entity is to invest in a real estate property or properties for total return with an objective to realize capital appreciation, for example, through disposal of its real estate property or properties. Real estate properties held by an entity for either of the following purposes would not meet this criterion:***

- a. The entity's own use in the production or supply of goods or services or for administrative purposes***
- b. Development for sale in the ordinary course of business upon completion (such as land developers and home builders).***

***Should an entity whose express business purpose is to hold real estate properties for the reasons listed above be excluded from the amendments in this proposed Update? If not, why? Is the express-business-purpose criterion operational? Please describe any operational concerns.***

**Answer 8:** As referenced in our response to Question 1, we believe that entities that hold real estate investments, including investment properties, for investment purposes (i.e. capital appreciation, investment income or both) should measure all real estate investments at fair value. If either a. or b. does not meet these criteria, we believe that they should not be subject to Topic 973.

In its present form, we do not believe that express-business purpose is operational as it would exclude real estate investments that are not investment properties and therefore would produce a hybrid FV-NAV which may be confusing to investors.

***Question 9: To meet the express-business-purpose criterion, the implementation guidance in this proposed Update would require that an investment property entity have an exit strategy to dispose of its real estate property or properties to realize capital appreciation to maximize total return. An entity that invests in a real estate property or properties to collect rental income long term and does not have an exit strategy for its real estate property or properties would not be an investment property entity under the proposed amendments. Should those entities be excluded from the amendments in this proposed Update? If not, why? Is the exit strategy requirement operational? Please describe any operational concerns.***

**Answer 9:** As referenced in our response to Question 1, we believe that entities that hold real estate investments, including investment properties, for investment purposes (i.e. capital appreciation, investment income or both) should measure all real estate investments at fair value. We believe that the current criteria, as outlined under Topic 973 is too narrow and may potentially exclude those entities that hold real estate investments for investment purposes (i.e. investment income purposes).

## **Unit Ownership and Pooling of Funds**

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**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?*

**Answer 10:** We believe this criterion is appropriate as long as the single-investor exemption as described in Topic 973 remains in the standard and the related party restriction is waived during the temporary "ramp up" period of an entity.

**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?*

**Answer 11:** We are in agreement with the exemption as referenced in Topic 973.

## **Measurement**

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**Question 12:** *The proposed amendments would require real estate properties other than investment properties that are held by an investment property entity to be measured in accordance with other U.S. GAAP. Should an investment property entity be required to measure those properties at fair value with all changes in fair value recognized in net income instead of applying other U.S. GAAP? Why or why not?*

**Answer 12:** We believe that entities that hold real estate investments, including investment properties, for investment purposes (i.e. capital appreciation, investment income or both) should measure all real estate investments at fair value. This includes real estate properties held through non-controlling equity interests and single investments.

**Question 13:** *The proposed amendments would require a right-of-use asset in which the underlying asset meets the definition of an investment property to be measured at fair value with all changes in fair value recognized in net income. Should those right-of-use assets be measured at fair value with all changes in fair value recognized in net income? If not, why and which measurement attribute would you recommend for those right-of-use assets?*



**Answer 13:** We do not believe that right-of-use assets as proposed under the new lease accounting exposure draft are appropriate under a fair value accounting model and therefore, they should be measured at fair value through net income.

### Interests in Other Entities

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**Question 14:** The proposed amendments would require an investment property entity to evaluate whether an interest in (a) another investment property entity, (b) an investment company as defined in Topic 946, or (c) an operating entity that provides services to the investment property entity should be consolidated under Topic 810. Should an investment property entity consolidate controlling financial interests in those entities? If not, why? Should an investment property entity consolidate controlling financial interests in other entities? If yes, why?

**Answer 14:** We do not believe that the criteria referenced in *Question 14* should be used as the basis for consolidating controlling financial interests. We believe consolidation criteria should be based on the converged guidance proposed by the Board and the IASB in order to preserve comparability of financial presentation globally.

**Question 15:** The proposed amendments would prohibit an investment property entity from applying the equity method of accounting in Topic 323 unless the investee is an operating entity that provides services to the investment property entity. Is that exception to the equity method of accounting requirements in Topic 323 appropriate for investment property entities? If not, why?

**Answer 15:** We agree with the Board in that application of Topic 323 – *Investments – Equity Method and Joint Ventures* is not appropriate for fair value reporting as that topic was written for the historical cost accounting model. However, reporting fair value through profit and loss that incorporates fair value measurement (i.e. unrealized gains and losses) is included in the IASB's Investment Entity Exposure Draft guidance and would ensure comparability of results globally if applied under GAAP in a similar manner.

However, we do agree with the Board's decision to allow the equity method in the case where the entity is an operating entity providing services to a parent IPE, since those entities are not included in the investing activities of the fund.

**Question 16:** The proposed amendments would require an investment property entity to measure investments in which it does not have a controlling financial interest or cannot exercise significant influence in accordance with U.S. GAAP. For example, that would currently require held-to-maturity debt securities to be measured at amortized cost and would permit certain equity securities to be measured using the cost method, unless the fair value option in Topic 825, *Financial Instruments*, is elected. Should an investment property entity be required to measure those investments at fair value with all changes in fair value recognized in net income instead of applying other U.S. GAAP? Why or why not?

**Answer 16:** As referenced in our response to *Question 1*, we believe that fair value measurement should not be isolated to investment properties but rather should apply to all real estate investments

including but not limited to; non-controlling equity investments in a joint venture, mezzanine debt, and real estate securities.

### **Financial Liabilities**

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**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?*

**Answer 17:** We believe that the fair value debt option in Topic 825 should be maintained until deliberations are completed by the Board and the IASB in their joint convergence effort and after public comment to the *Financial Instruments Exposure Draft* is received.

### **Rental Revenue Recognition**

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**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?*

**Answer 18:** We are in agreement with the proposed amendment as stated.

### **Practical Expedient for Measurement of an Interest in an Investment Property Entity**

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**Question 19:** *The proposed amendments would permit, as a practical expedient, an entity to estimate the fair value of its investment in an investment property entity using the net asset value per share (or its equivalent) of the investment if the entity would transact at the net asset value per share. Are there investments that currently qualify for the practical expedient that would no longer qualify for the practical expedient because of the proposed amendments? If so, please identify those types of investments.*

**Answer 19:** We agree that the practical expedient is appropriate and therefore, should be permitted where a stated share value is the transaction price. We are not aware of any situations where application of this methodology would no longer apply.

### **Disclosure**

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

**Answer 20:** In general we agree with the proposed disclosures, but would request further clarification on “contractual obligations”.

### **Effective Date and Transition**

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**Question 21:** *Should an entity recognize the effect of adopting the requirements in this proposed Update as an adjustment to the beginning balance of retained earnings in the period of adoption? If not, what transition requirements would you recommend and why?*

**Answer 21:** We agree that an entity should recognize the effect of adopting the requirements in this proposed Update as an adjustment to the beginning balance of retained earnings in the period of adoption.

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

**Answer 22:** We would require at least 1 ½ years to implement the guidance in its present proposed form due to the hybrid fair value reporting requirements.

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

**Answer 23:** We believe early adoption should be prohibited.

### **Nonpublic Entities**

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**Question 24:** *The proposed amendments would apply to both public and nonpublic entities. Should the proposed amendments apply to nonpublic entities (such as private companies and not-for-profit organizations)? If not, how should the proposed requirements differ for nonpublic entities and why?*

**Answer 24:** The proposed amendments should apply to both public and non-public entities as this would provide comparability of results for both reporting entities.