



REIS

REAL ESTATE INFORMATION STANDARDS

2011-210
Comment Letter No. 12A

February 15, 2012

Financial Accounting Standards Board
Technical Director - File Reference No. 1850-100
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 (“Topic 973”)

Dear Board Members:

This letter represents the Real Estate Information Standards (“REIS”) Board’s comments on behalf of the members of the National Council of Real Estate Investment Fiduciaries (“NCREIF”) and Pension Real Estate Association (“PREA”) to the Financial Accounting Standards Board (“FASB”) regarding the exposure draft, *Real Estate – Investment Property Entities (Topic 973)*. Our comments also reference the release of the FASB’s exposure drafts on the proposed amendments to *Financial Services – Investment Companies (Topic 946)* and the International Accounting Standards Board’s (“IASB”) exposure draft, *Investment Entities* and our comment letters associated with them. In our opinion, it is imperative that the FASB and IASB Boards align their thinking on a consistent basis globally in regards to what constitutes Investment Property Entities and Investment Companies/Entities and how these entities should report their investment holdings. We urge the development of principles which result in comparable and consistent net asset value calculated on a fair-value basis. As explained further herein, since this fundamental objective cannot be achieved within proposed Topic 973, we respectfully reject it. We appreciate the opportunity provided by the FASB to comment on the exposure draft.

We acknowledge the efforts by the FASB to issue fair-value accounting guidance for the real estate industry and have greatly appreciated the FASB’s willingness to engage in ongoing dialogue with us throughout the process, including the opportunity to discuss the proposed standard with the Staff at the November 2011 NCREIF meeting. Our comments throughout the process have been directed toward achieving comparable net asset values calculated on a fair-value basis that are presented in a meaningful manner. Anything short of that goal for our industry results in financial statements and resulting performance measurements that are neither meaningful nor useful to the investors and other end users of the financial statements.

The Responding Organization

The REIS initiative is sponsored by NCREIF and PREA to develop, refine and integrate each of the standards within the Foundational Standards¹ and provides interpretive guidance concerning their application within the private institutional real estate investment industry. NCREIF is an association of institutional real estate professionals which includes investment managers, plan sponsors (i.e. pension funds and endowments), academicians, consultants, public accountants and other service providers who share a common interest in the industry of private institutional real estate investment. NCREIF serves the institutional real estate community as an unbiased collector and disseminator of real estate performance information. NCREIF produces several quarterly indices that show real estate performance returns using data submitted by its members, most notably the NCREIF property index (NPI) and the NCREIF open end diversified core equity index (ODCE). PREA is a nonprofit organization whose members are engaged in the investment of tax-exempt pension and endowment funds into real estate assets. PREA’s mission is to serve its members engaged in institutional real estate investments through the sponsorship of objective forums for education, research initiatives, membership interaction, and information exchange. Collectively the organizations represent the institutional real estate community consisting of over 9,000 investment properties with a fair value of approximately \$350 billion.

¹ Within REIS, Foundational Standards include U.S. Generally Accepted Accounting Principles, the Global Investment Performance Standards and the Uniform Standards of Professional Appraisal Practice.

Two Prudential Plaza
180 N. Stetson Ave., Suite 2515
Chicago, IL 60601
312.819.5890
www.reisus.org

Sponsored By:



Although two fair-value reporting models (generally a gross operating model for pension plans and a net basis under investment company) are utilized in our industry, the REIS Board and Council diligently and continuously work within an established GAAP framework to ensure that the resulting funds' net asset values are calculated on a consistent fair-value basis and the resulting returns generated from the underlying financial information under either model, are comparable.

Background on Fair-Value Reporting in Our Industry

Private institutional real estate investments are structured in a variety of ways including, but not limited to: fee simple interests, joint ventures, partnerships, pooled investment vehicles, single purpose entities, participating mortgages, mortgage receivables, CMBS, RMBS, and mezzanine loans. Ownership is primarily held in open-end and closed-end commingled funds and single client accounts.

Regardless of various strategies or various legal structures created to hold these assets, fund and investment performance measured holistically on a fair-value basis and calculated consistently across all investment vehicles, is critically important to investors and other users of the financial statements. Audited results that support the performance measurement calculations provide the much needed assurance to investors that those performance measures are accurate. Fair-Value Net Asset Value ("FVNAV") financial statements calculated on a consistent and comparable basis and audited are critical to investors, consultants, investment managers and other financial statement users primarily for the following reasons:

- Fair value is critical to industry-related performance measurement including industry benchmarks (i.e. NCREIF Indices) and the Global Investment Performance Standards ("GIPS")
- Although private real estate does not trade shares on an exchange, its investors (many of whom are identical to those invested in publically traded funds) do trade shares in funds (particularly open-end funds) based on FVNAV. Therefore, FVNAV results are used to make subscription and redemption (buy/sell) decisions.
- Investment decisions are primarily driven by a total return (comprised of income and appreciation) that can only be derived from the underlying FVNAV.
- Institutional investors who are also pension plans, are required by ERISA to measure plan assets at fair value in order to determine settlement value of the plan
- Investments are managed and evaluated on a fair-value basis
- The fair value of investments is used to determine portfolio diversification/allocation (e.g. stocks, bonds, real estate) made by plan sponsors
- A fair-value accounting model improves transparency to financial statement users by providing financial results indicative of current market conditions made readily accessible to investors and other users
- Comparability of audited fair-value results across real estate investment property type, structure, and strategy (i.e. core, value-add, opportunistic, or mixed) is essential to investors
- Consistent fair-value accounting application creates comparability of real estate with other investable asset classes, that are typically reported to investors at an exchange traded value
- Enables the investor to evaluate and compare the performance of potential investment managers

In 1983, in response to the needs of the investor community, the NCREIF Accounting Committee developed guidelines for fair-value accounting to be used by the institutional real estate investment industry. These guidelines, known as the REIS Fair-Value Accounting Policy, are continuously reviewed and updated by the REIS Council to align with changes to U.S. GAAP. The fundamental premise for fair value is based on existing GAAP identified in Accounting Standards Codification ("ASC") Topic 960, *Plan Accounting – Define Benefit Pension Plans* (i.e. former FASB Statement of Financial Accounting Standards No. 35) and Governmental Accounting Standards Board ("GASB 25"), Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, which require that certain investments held by tax-exempt investors, including defined benefit pension plans and endowments be reported at fair value. For example, Topic 960 which applies to corporate plans, requires that all plan investments be reported at fair value because it provides the most relevant information about the resources of a plan and its present and future ability to pay benefits when due. In addition, GASB 25 requires government-sponsored pension plans to present investments at fair value in their financial statements. Defined benefit and government-sponsored pension plans often invest in various real estate investments and/or real estate companies. Accordingly, the more traditional historical cost basis of accounting used by other real estate companies, owners, and operators is not appropriate; as it does not provide tax-exempt investors with the financial information they require to comply with authoritative accounting standards and is not viewed as a faithful representation of their investment activity.

Additionally, over the years, investments made by fund managers have become increasingly complex and it has become apparent that many of these funds have attributes similar to those of an “investment company,” as set forth in Topic 946, *Financial Services – Investment Companies*, (former AICPA Audit and Accounting Guide: *Investment Companies*). This authoritative guidance supports the use of a fair-value accounting model for those real estate funds that have the attributes of an investment company.

REIS Board’s Opinion on the Proposed Investment Property Entities Standard

REIS recognizes and appreciates the overall objectives of the FASB which include addressing the diversity in practice related to entities that invest in real estate and aligning the scope of entities that would apply the proposed lessor accounting model under US GAAP and IFRS. However, under the proposed exposure draft the comparable and consistent fund net asset value calculated on a fair-value basis, which is of paramount importance to our industry and the users of its financial statements, is not achieved. Therefore REIS rejects the proposed in the exposure draft.

Our fundamental objective is to provide investors audited financial statements accounted for on a full fair-value basis (including the resulting FVNAV asset value) which are comparable across all investment styles, structures and strategies.

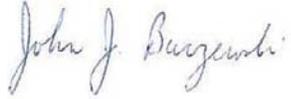
Under the proposed exposure draft, some investments may be prohibited from being reported at fair value. We think all investments must be reported at fair value and the related accounting principles should be indifferent to investment style, structure or strategy. The real estate industry does not limit the scope of its real estate investments solely to direct or indirect ownership of real estate properties nor to the traditional property types of office, retail, industrial, and residential, nor to traditional core investment strategies. Many institutional sponsored real estate investment vehicles hold diversified investments based on market conditions for various investment types and sometimes for investor liquidity purposes. Various forms of pools, exchanges, and ownership share structures exist to deal with issues around the transaction liquidity and the needs of the investors. An investor may determine that each of the various equity real estate investment vehicles or property types presents a unique risk/return solution for different portions of their portfolio. Varying investment structures provide investors the proper mechanisms to access property investments in an off-market situation when the trading of the underlying asset is not particularly liquid. It is widely customary for a fund to hold a partial investment in an investment property by acquiring: i) a noncontrolling financial interest in a special purpose vehicle such as a joint venture, limited partnership or limited liability company that owns the property; or ii) a mortgage receivable, participating mortgage, CMBS, or RMBS, or investment in a non-traditional property type such as a hotel or senior living property. Similar to a direct ownership interest in a traditional property type, each of these investments are dependent on underlying real estate for the generation of investment returns to the investors, and they are each managed/evaluated, and reported on a fair-value basis. The nature of business activities criterion for investment property entities (“IPE”) states: “substantially all of the entity’s business activities are investing in a real estate property or properties”. Accordingly, this requirement could prohibit a reporting entity (e.g. fund) from potentially qualifying as an IPE because of its diverse interest in real estate investments that include investments other than direct or indirect ownership of investment properties. If the reporting entity in fact satisfies the criteria of an IPE, but holds other real estate investments the following concerns persist:

- An IPE is not permitted to report these other real estate investments at fair value unless permissible under other GAAP and
- Currently, mortgage debt is required to be measured in accordance with other US GAAP, which is amortized cost, unless the fair-value option in Topic 825 is elected. This lack of a “required” critical accounting treatment will create diversity in practice and result in diversity in results. Different funds’ net asset values will not be comparable due to the diversity in financial reporting and the current as well as proposed disclosures will not cover the missing pieces (e.g. debt within a joint venture is not treated identically as that of wholly-owned investments).

Based on the combined proposed standards and their revisions, it appears that the comparable and consistent FVNAV required by our industry is best achieved under a more globally encompassing Investment Company accounting framework as the nature of the investment activities, business purpose, and fair-value management of the funds in our industry align more closely with those concepts required of an Investment Company. We refer you to our comment letter, also dated February 15, 2012, on the Proposed Accounting Standards Update, *Financial Services – Investment Companies* (Topic 946) and our comment letter to the IASB, dated January 5, 2012, on its expose draft, *Investment Entities*.

We would be pleased to discuss our comments with you at your convenience. Should you wish to discuss the contents of this letter with us, please feel free to contact us at the above address or at 978-887-3750.

Very truly yours,

A handwritten signature in cursive script that reads "John J. Baczewski".

John Baczewski
Chairman of the Board
Real Estate Information Standards