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NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

August 4, 2015

Ms. Susan Cosper
Technical Director
File Reference No. 2015-280
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116
director@fasb.org

Delivered Electronically

Re: Proposed Accounting Standards Update *Investments – Equity Method and Joint Ventures (Topic 323) Simplifying the Equity Method of Accounting*

Dear Ms. Cosper:

This letter is submitted by the National Association of Real Estate Investment Trusts® (NAREIT) to provide input on the Proposed Accounting Standards Update *Investments – Equity Method and Joint Ventures (Topic 323) Simplifying the Equity Method of Accounting* (the Proposal). Similar to other income-producing real estate owners, our members structure joint ownership arrangements as joint ventures regularly. As further discussed below, NAREIT believes that the proposed accounting generally would diminish the usefulness of reporting the investor's economics in these arrangements. In NAREIT's view, the best way forward would be for the Board to further research the usefulness of the equity method of accounting to ensure that any proposed accounting would not diminish the profession's response to investor needs.

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 real estate businesses throughout the world that own, operate and finance commercial and residential real estate. NAREIT's members play an important role in providing diversification, dividends, liquidity and transparency to investors through their businesses that operate in all facets of the real estate economy.



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REITs are generally deemed to operate as either Equity REITs or Mortgage REITs. Our members that operate as Equity REITs acquire, develop, lease and operate income-producing real estate. Our members that operate as Mortgage REITs finance housing and commercial real estate, by originating mortgages or by purchasing whole loans or mortgage backed securities in the secondary market.

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A useful way to look at the REIT industry is to consider an index of stock exchange-listed companies like the FTSE NAREIT All REITs Index which covers both Equity REITs and Mortgage REITs. This Index contained 224 companies representing an equity market capitalization of \$890 billion at June 30, 2015. Of these companies, 183 were Equity REITs representing 93.5% of total U.S. stock exchange-listed REIT equity market capitalization (amounting to \$832 billion)¹. The remainder, as of June 30, 2015, is represented by 41 stock exchange-listed Mortgage REITs with a combined equity market capitalization of \$58 billion.

NAREIT Comments

NAREIT appreciates the Financial Accounting Standards Board's (FASB or Board) efforts to reduce complexity in financial reporting and concurs with the proposed simplification to eliminate the retrospective application of the equity method of accounting for all previous periods presented when the investor increases its percentage ownership and thus obtains significant influence over the investee.

At the same time, NAREIT believes that eliminating the accounting for basis differences between the investor's investment and its share of the book value of the assets and liabilities of the investee would distort financial reporting by failing to faithfully present the investor's economics in these transactions. The following example illustrates this issue when applying the Proposal:

An investor invests \$200 for a 40% interest in an investee that owns five office buildings. The depreciated cost basis book value of these assets is \$50. Assuming the investee has no debt, the investor's basis in its investment is \$200 while its basis in the net assets of the investee is \$20 – resulting in a basis differential of \$180.

Issue 1 – earnings recognition

In year one, the investee has net income of \$30. The investor records \$12 as its share of the investee's net income (40% of \$30). The investor's \$200 investment is not amortized and, therefore, the investor includes the full \$12 in its net income. Does this \$12 really represent the

¹ <https://www.reit.com/sites/default/files/reitwatch/RW1507.pdf> at page 21.

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investor's economic earnings with respect to the joint venture transaction? Or is the investor's economic return \$12 less amortization of the \$180 basis difference -- in essence representing a depreciating asset?

NAREIT believes that, in real estate transactions, it is relatively easy to assign the basis difference to the real estate, in this example the five office buildings held and operated by the investee, and that the basis difference should be amortized.

Issue 2 – increased concern with respect to impairment of the investment

Given the same assumptions as above, a sale of any of the real estate could result in a significant impairment issue under the proposal. If three of the office buildings were sold for \$270 at the end of the first year that the investor owned 40% of the investee, the investor would have recorded \$12 of operating income for the year plus its 40% of the \$240 gain (\$96) on the sale of the three buildings (ignores depreciation in year 1). Therefore the investor's net income includes \$108 from its investment in investee. At this point, the investor's basis in the investment is \$308. The investee's assets now include \$270 in cash and net book value of property of \$20 for total net assets of \$290. Since the investor's share of net assets of the investee is only \$116 (40% of the \$290) compared with an investment balance of \$308, a) is the investment balance impaired; and, b) did the investor's share of investee net income, including the gain on sale, represent the investor's economics in these transactions? This evaluation of possible impairment of the investor's investment balance adds significant complexity to accounting for equity investments.

NAREIT believes that the proposed accounting ignores the investor's underlying economics in this example and therefore diminishes the usefulness of the proposed accounting.

To respond to Question 1 in the Proposal, NAREIT believes that accounting for basis differences in the context of equity method accounting more faithfully represents the investor's economics than does the proposed accounting. To achieve simplification to a significant degree, NAREIT proposes that the investor's aggregate basis difference be amortized over a reasonable estimate of the economic life of the primary assets held by the investee.

NAREIT recommends that the Proposal be further evaluated in the context of what is the purpose of the equity method of accounting and not simply part of the FASB's Simplification Initiative. Is the equity method of accounting meant to be a variation of business acquisition accounting, simply a proxy for pro rata/proportionate consolidation or something else that is not a surrogate for one-line consolidation?

NAREIT acknowledges the challenges and difficulties that are associated with making a significant equity investment in a diverse business conglomerate that makes consumer products and provides services. However, when a real estate company performs the analysis of whether it should make an equity investment, management has a solid understanding of the predominant underlying assets and liabilities associated with the entity that holds the investment property. NAREIT questions whether the elimination of today's requirement to identify, account for and disclose basis differences would provide users of financial statements with decision-useful information. In our view, ignoring basis differences would distort the investor's financial



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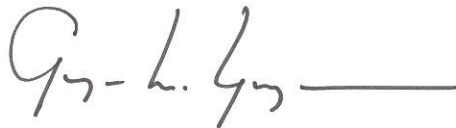
reporting by failing to faithfully present the investor's economics under the joint venture arrangement.

Should the Board go forward with NAREIT's recommendation to perform further analysis of the equity method of accounting, NAREIT recommends that the Board consider the International Accounting Standards Board's (IASB) project on the equity method of accounting². Further, the FASB might consider the deliberations on the FASB Accounting for Goodwill Project³ specific to amortization as well as its work on identifiable intangibles. In our view, there could be parallels between how goodwill (and other intangible assets) might be amortized and how basis differences in the equity method of accounting are treated.

While we believe the Proposal requires capitalization of interest on the investment account, some of our members are confused by the possible implications of eliminating the last sentence of paragraph 835-20-35-2. Capitalization of interest costs by the investor on its equity method investments, when the conditions are met, is common in the real estate industry. NAREIT strongly agrees that interest should continue to be capitalized under the appropriate circumstances. It would be helpful for the FASB to clarify the accounting for interest under the Proposal.

We thank the FASB for the opportunity to comment on the Proposal. If you would like to discuss our views in greater detail, please contact George Yungmann, NAREIT's Senior Vice President, Financial Standards, at gyungmann@nareit.com or 202-739-9432, or Christopher Drula, NAREIT's Vice President, Financial Standards, at cdrula@nareit.com or 202-739-9442.

Respectfully submitted,



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Christopher T. Drula
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² <http://www.ifrs.org/Current-Projects/IASB-Projects/equity-method-accounting/Pages/equity-method-accounting.aspx>

³ http://www.fasb.org/jsp/FASB/FASBContent_C/ProjectUpdatePage&cid=1176163679475