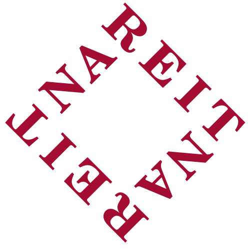

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January 21, 2016

Ms. Susan M. Cosper
Technical Director
File Reference No. 2015-330
Financial Accounting Standards Board
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director@fasb.org

Delivered electronically

RE: Proposed Accounting Standards Update – *Business Combinations (Topic 805) – Clarifying the Definition of a Business*

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 – *Business Combinations (Topic 805) – Clarifying the Definition of a Business* (the Proposal).

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.

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.

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 225 companies representing an equity market capitalization of $935 billion at November 30, 2015. Of these companies, 184 were Equity REITs representing

94.1% of total U.S. stock exchange-listed REIT equity market capitalization (amounting to $880 billion)[1]. The remainder, as of November 30, 2015, is represented by 41 stock exchange-listed Mortgage REITs with a combined equity market capitalization of $55 billion.

This letter has been developed by a task force of NAREIT members, including members of NAREIT's Best Financial Practices Council (the Council). Members of the task force include financial executives of both Equity and Mortgage REITs, representatives of major accounting firms, institutional investors and industry analysts.

NAREIT supports the Board's objective

NAREIT supports the Board's objective in addressing constituent concerns that the definition of a business in current U.S. GAAP is applied too broadly, resulting in many transactions qualifying as businesses while purchasers view them as asset acquisitions. This phenomenon has been pervasive in the real estate industry since the implementation of FAS 141(R) where the acquisition of even a single property by a REIT is generally required to be accounted for as a business combination. Further, preparers and auditors have struggled to understand why the acquisition of an investment property is accounted for as a business combination, but treated as an asset disposition upon sale of the investment property (a sale of real estate).

What adds further complexity to the asset versus business determination is the difference in application by companies that report pursuant to U.S. GAAP and International Financial Reporting Standards (IFRS). Despite the fact that the words in GAAP and IFRS are identical, real estate companies across the globe that report under IFRS generally account for acquisitions of investment properties as asset acquisitions, while companies that report under U.S. GAAP account for the same types of transactions as business combinations. NAREIT appreciates the Board's efforts to address this divergence in application.

NAREIT Recommendation – Align the accounting guidance for business combinations with existing asset acquisition guidance

While NAREIT appreciates the Board's efforts in pursuing clarified guidance to address what constitutes an asset versus a business, NAREIT believes that the Board could achieve its objective in a much simpler manner. Rather than redefining what would qualify as a business, NAREIT strongly believes that the board should align the accounting guidance for business combinations with existing asset acquisition guidance. A major difference between business combinations guidance and asset acquisition guidance under today's GAAP is whether acquisition transaction costs are capitalized or expensed. NAREIT believes that eliminating this difference by requiring the capitalization of acquisition costs whether a transaction is considered an asset acquisition or a business combination would provide the following benefits to both the preparer and user community alike:

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[1] https://www.reit.com/sites/default/files/reitwatch/RW1512.pdf at page 21.

- Simplify accounting by eliminating a need for an evaluation of what constitutes an asset acquisition or a business combination;

- Help converge the accounting results for acquisitions of investment property as between IFRS and U.S. GAAP;

- Mirror the accounting for real estate acquisitions with economics of the transaction; and,

- Eliminate the need by financial statement users in the real estate industry to reverse the expensing of acquisition costs when evaluating the economic earnings prospects of real estate companies.

Other Comments

In the event that the Board decides to pursue the issuance of the Proposal, NAREIT recommends the following clarifications to the Proposal:

- Clarify the wording in paragraph 805-10-55-78 to include the italicized terms below:
    - Although the leases are at market *rates*, REIT concludes that the fair value of the in-place lease *intangible asset is* significant and that the fair value of the gross assets acquired is not concentrated in either the leases or the tangible assets.
        - Without these changes, the wording leads the reader to believe that the analysis would compare the fair value of in-place leases with the fair value of the operating property. This is a circular analysis, given that the fair value of the building is measured by the present value of cash flows to be received under in-place leases.

- Amend the criteria for the evaluation of similar asset types to include a comparison of the types of assets acquired with the acquirer's existing portfolio of assets.
    - For example, if a real estate company that owns and manages a portfolio of office buildings and, therefore has an operating platform focused on office buildings, acquires office properties to add to its portfolio, the acquisition should be accounted for as an asset purchase.
    - Further, some REITs do not own and operate a single asset type. NAREIT groups these REITs into the diversified sector (*e.g.,* a REIT that owns shopping malls, parking lots, and apartment buildings). Many times, these different types of properties are acquired together in single transactions. We believe that the acquisition of different types of assets should be accounted for as an asset acquisition to the extent that the transaction is consistent with the acquirer's business model. If the Board does not provide this clarification, the preparer may be left to debate with his or her auditor whether this acquisition represents similar

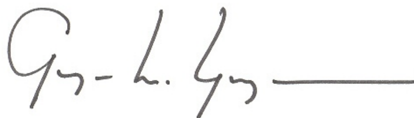
assets or multiple assets which could provide an uneconomic result that the transaction should be accounted for as a business combination (particularly noting that if acquired separately, they would be asset acquisitions).

- Add guidance that clarifies that the acquisition of multiple properties that are in various stages of development would still be considered similar assets.

    - Along the same lines as the preceding bullet, REITs can acquire a group of assets that are in various stages of development (*e.g.*, buildings under construction, vacant buildings, and operating properties). NAREIT recommends that the Board clarify that a transaction that includes properties at different stages of development would be considered similar in nature. The business purpose of acquiring the group of assets serves the same purpose – to add investment property to the company's current portfolio of investment properties. In our view, the economics of the transaction is more akin to an asset acquisition than a business combination.

NAREIT continues to support the FASB's *Clarifying the Definition of a Business* Project. If there are questions regarding this comment letter, please contact either George Yungmann at 202-739-9432 or gyungmann@nareit.com or Christopher Drula at 202-739-9442 or cdrula@nareit.com.

Respectfully submitted,



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