NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

April 21, 2016

Ms. Susan M. Cosper
Technical Director
File Reference No. EITF-15F
Financial Accounting Standards Board
401 Merritt 7
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Delivered electronically

RE: *Proposed Accounting Standards Update, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, a consensus of the FASB Emerging Issues Task Force*

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, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, a consensus of the FASB Emerging Issues Task Force* (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 221 companies representing an equity market capitalization of $901.1 billion at February 29, 2016. Of these companies, 179 were Equity REITs representing 94.3% of total U.S. stock exchange-listed REIT equity market capitalization (amounting to $849.8 billion)[1]. The remainder, as of February 29, 2016, is represented by 42 stock exchange-listed Mortgage REITs with a combined equity market capitalization of $51.3 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 a Comprehensive Evaluation of the Statement of Cash Flows in connection with the Financial Performance Reporting Project

NAREIT supports the Board's objective in addressing diversity in practice in how certain cash receipts and cash payments are presented and classified in the cash flow statement. However, NAREIT recommends that the Board pursue a comprehensive evaluation of the Statement of Cash Flows in connection with its Financial Performance Reporting Research Project. In NAREIT's view, a comprehensive look at these financial statements in tandem would provide a more effective method of solving the problem of diversity in practice rather than seeking incremental changes over time.

In the event that the Board decides to move forward with the Proposal, NAREIT recommends that the Board permit a "look through" approach to the classification of distributions received from equity method investees as discussed later in this letter.

NAREIT's Objects to the Proposed Guidance for the Classification of Cash Flows from Distributions Received from Equity Method Investees

The Proposal addresses eight cash flow statement issues evaluated by the Emerging Issue Task Force (EITF). In evaluating the eight issues, NAREIT identified one issue that is of particular interest to the real estate industry. Equity method investments are common transactions in the real estate space, and the Proposal recommends guidance that, in our view, would diminish the usefulness of the cash flow information to investors and other financial statement users.

The Proposal includes the following proposed solution to the classification and presentation of distributions received from equity method investees:

> Distributions received from an equity method investee would be presumed to be returns on investment and classified as cash inflows from operating activities, unless the investor's cumulative distributions received in prior periods that were determined to be returns of investment exceed cumulative equity in earnings recognized by the investor. When such an excess occurs, the current-period distribution up to this excess would be considered a return of investment and

[1] https://www.reit.com/sites/default/files/reitwatch/RW1603.pdf on page 21.

> would be classified as cash flows from investing activities. This proposed solution does not address equity method investments measured using the fair value option.[2]

The new guidance in the Proposal would represent a fundamental change in the way that investors classify distributions received from equity method investees. Depending on the number and size of equity method investments, a considerable portion of distributions a real estate company receives from equity method investees would be classified as a return of investment as the income that the company recognizes from unconsolidated ventures would be reduced by significant non-cash depreciation and amortization charges. Therefore, we do not believe that the Proposal would provide users of financial statements with information that reflects the economics of distributions from unconsolidated ventures and, in turn, of the operating cash flow reported by the real estate company/investor.

Our concern is exacerbated by the fact that one of the criteria to maintain REIT status under the Internal Revenue Code is a requirement to distribute 90% of its taxable income. Given this requirement, cash flow from operations reported by the REIT is an important indicator of its ability to meet dividend requirements.

In our view, the proposed accounting treatment does not reflect the economics of distributions received from an equity method investment.

NAREIT Recommendation: Provide a "Look Through" Approach for the Classification of Distributions received from Equity Method Investees

NAREIT recommends that the Board pursue an alternative approach by providing investors with the ability to look through the distributions that the investor receives from an equity method investment when classifying distributions received in its cash flow statement. Under this approach, the classification of a distribution from an equity method investee would reflect the nature of the business activity that generates a distribution payment. We believe that there should be a distinction between distributions that result from ongoing operations (*i.e.,* a return on investment classified as an operating cash inflow) and those that result from sales of assets (*i.e.,* a return of investment classified as an investing cash inflow). The Proposal as written would require some investors, including real estate companies, to characterize most of the distributions received as returns of investment, when in reality, a significant amount of these distributions result from ongoing operating activities of the investee. In our view, the Proposal as written would generally understate the cash flow from operations of the investor.

NAREIT continues to support the FASB's efforts to improve financial reporting. 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.

[2] http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176167829544&acceptedDisclaimer=true on page 2.

Respectfully submitted,

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