Financial Standards Update

May 2008

NAREIT Financial Standards Update

National Association of Real Estate Investment Trusts®
REITs: Building Dividends and Diversification®

Highlights

Mandatory U.S. Adoption of IFRS No Later than 2013 Under Discussion

The Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) (the Boards) discussed an agenda paper (the Paper) at the Boards' joint meeting on April 21 and 22, 2008 in London. The Paper addresses the February 2006 Memorandum of Understanding (MOU) between the FASB and IASB, *A Roadmap for Convergence between IFRS and U.S. GAAP – 2006-2008*. It further provides a progress report and sets forth a recommended plan to complete the MOU. The Paper is available by clicking here. The plan was approved as a strategic guide to be used as the basis of a technical plan to be developed by the staff and presented to the Boards in June 2008.

International Accounting Standards Board®

The most important recommendation contained in the report is that all capital markets, including the U.S., are meant to adopt International Financial Reporting Standards (IFRS) no later than 2013.

In this context, the Boards' short-term priority is to complete projects addressing significant IFRS weaknesses by mid-2011. These projects are focused in part on fair value measurement, financial statement presentation, lease accounting, consolidation (including special purpose entities) and derecognition. The Paper also indicates that substantial progress should be made on the revenue recognition project by 2011, although it likely will not be completed by that date.

Because both Boards acknowledge that many companies in the U.S. and elsewhere will be engaged in the adoption of IFRS in 2013, they anticipate a "quiet period" during which the issuance of significant revisions to IFRS will be suspended. Therefore, projects completed by 2011 are expected to remain unchanged for three or more years after completion. It is then expected that changes to standards during the three years subsequent to 2011 will be minimal.

Notably, the Paper recommends that lessor accounting should be excluded from the lease accounting project and should be considered later as part of the revenue recognition project. Because revenue recognition accounting represents a major accounting issue, the Paper recommends that this project move forward expeditiously, although it is not expected to be

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completed by 2011. Also, the Paper suggests that the financial statement presentation project should continue "on track" but that certain contentious issues could be eliminated from the project. A preliminary views document covering this project is expected to be issued by the Boards during the summer of 2008. Finally, the Paper also recommends that work on "other short-term convergence projects," such as the fair value option – phase 2 project, should be suspended.

NAREIT and its global partners are actively engaged in evaluating IASB and FASB proposals and providing input to the Boards on those proposals that may impact accounting and financial reporting by real estate companies. This coalition is a part of the Real Estate Equity Securitization Alliance (REESA), which includes the following organizations: Association for Real Estate Securitization (Japan), ARES; Asian Public Real Estate Association, APREA; British Property Federation, BPF; European Public Real Estate Association, EPRA; National Association of Real Estate Investment Trusts, NAREIT; Property Council of Australia, PCA and Real Property Association of Canada, REALPac.

NAREIT Meets with FASB

On Jan. 25, 2008, NAREIT representatives met with members of the FASB and its staff in a public meeting to discuss NAREIT's views on three current projects underway by FASB in conjunction with the IASB:

- Fair Value Option – Phase 2 (Investment Property)
- Financial Statement Presentation
- Accounting for Leases

NAREIT's representatives were:

- Steven Wechsler, President & CEO, NAREIT
- James Fleming, EVP & CFO, Cousins Properties Incorporated
- John Lutzius, CEO, Green Street Advisors, Inc.
- Michael Pappagallo, EVP & CFO, Kimco Realty Corporation
- George Yungmann, Sr. VP, Financial Standards, NAREIT

Through his introductory remarks, Steve Wechsler noted that NAREIT was pleased to have been invited to present its views to FASB in a setting conducive to constructive dialogue. He said that NAREIT had become increasingly active and engaged in recent years with respect to a host of GAAP (generally accepted accounting principles) and IAS (international accounting standards) issues; and that NAREIT views the specific projects at hand as well as the general FASB/IASB "convergence" process underway as a meaningful opportunity to improve accounting for investment property in a manner equally beneficial to users, investors and managers. He noted that the specific projects under discussion had the potential to provide users of the industry's financial statements with information that would be more relevant to the investment property business and to better reflect how managements at investment property companies see their operations and assess their financial position.

NAREIT's other representatives then provided NAREIT's specific views on each of the three projects. With respect to phase 2 of FASB's fair value option project (and the potential convergence of GAAP with IAS 40 which provides an option for the use of fair value for investment property), NAREIT indicated that it accepts the global move toward a fair value approach for investment property with the following reservations: 1) changes in the fair value of investment property should be reflected outside key industry metrics (NOI and FFO), e.g., in the balance sheet only, in comprehensive income only or in net income only after presentation of NOI and FFO; 2) the fair value approach for investment property should be mandatory rather than optional; 3) the marketplace should dictate the nature of appropriate fair valuation processes, methods and procedures without the requirement of third party appraisals; and, 4) lodging and health care facilities should be included in the definition of investment property.

In connection with the joint FASB/IASB Financial Statement Presentation Project, NAREIT's representatives stated that a coalition of representative real estate organizations around the world, including NAREIT, EPRA, APREA, BPF, PCA and REALpac, had developed an agreed-upon financial statement presentation model for consideration by FASB and IASB. They said that the model provides for the presentation of two critical investment property operating metrics, net property income (i.e., net operating income) and income from operations (i.e., funds from operations); that it assumes investment property is reported at fair value; and that it addresses changes in value outside of net property income and income from operations.

Finally, NAREIT representatives provided FASB with the views of NAREIT and its partner organizations around the world on lease accounting issues under review by FASB and IASB. The FASB/IASB review of lease accounting practices may be influenced by a "preliminary views" document completed for FASB and IASB in 2000. This study recommended that leases associated with lessors of investment property should be reported on balance sheets in two parts – the "fair value of lease receivables" and the "fair value of interests in property residual value." It also recommended that the lessor's rental revenue should also be split in two elements – "interest income" and "principal" payments on the lease receivables.

NAREIT representatives indicated to FASB that NAREIT and its partners around the world would vigorously oppose changes to lease accounting which would re-characterize what has long been understood and accepted to be a rental transaction for real property into a financing activity. NAREIT made clear that the real estate community is unified on this issue around the world and that it rejects any approach to lease accounting which fails to faithfully portray the substance of the investment property business and which diminishes the understandability and utility of the industry's financial statements.

Throughout, FASB members asked probing questions and appeared quite interested in NAREIT's views.

NAREIT Works with EITF on Accounting for Maintenance Recovery Revenue

EITF 08-2, *Lessor Revenue Recognition for Maintenance Services,* raises the issue of how lessors should properly account for revenue representing reimbursements received from lessees for services performed under a lease contract to maintain the leased asset. To date, NAREIT has actively participated in discussions with the EITF staff to share the industry's current treatment of maintenance recovery revenue. NAREIT surveyed a small group of members to obtain a sample of the current practice for these types of maintenance reimbursements and concluded that a majority of leases generally provide for the tenant to reimburse the lessor for both routine and capital maintenance – all of which are generally referred to as common area maintenance costs (CAM). Although both types of maintenance costs are subject to reimbursement, the tenant's obligation to reimburse for these maintenance costs is not dependent on the accounting treatment for such costs. Generally, leases simply identify the types of these costs subject to reimbursement.

As a result of this work with EITF staff, NAREIT is considering submitting a letter urging the EITF to eliminate it's consideration of accounting for this revenue by real estate companies since this accounting will ultimately be covered in the FASB/IASB joint revenue recognition project. Additionally, the issue addressed in EITF 08-2 primarily relates to other industries, such as the airline industry.

FASB Concludes Proposed Guidance on Accounting for Certain Convertible Debt

On Mar. 26, 2008, the Board reaffirmed the underlying guidance provided in FASB Staff Position (FSP) APB 14-a, which addresses the accounting for convertible debt instruments that may be settled in cash upon conversion (including partial settlement). FSP APB 14-a primarily requires the bifurcation of the debt and equity components of convertible debt instruments and for those individual components to be accounted for separately. The debt component will be measured based on the fair value of similar debt without an equity conversion feature, and the carrying amount of the equity component will be determined as the residual of the fair value of the debt deducted from the initial proceeds received from the convertible debt issuance. As a result, a discount on the debt component will be recorded and subsequently amortized as interest expense, which will represent additional interest expense to the stated interest on the convertible debt instrument. Because FSP APB 14-a will increase interest expense for convertible debt instruments, it consequently will decrease net income and FFO.

After gaining a one-year deferral on the issuance of the proposed guidance (in part as a result of comment letters submitted by NAREIT, NAREIT members and others), the guidance will become effective for financial statements issued for fiscal years beginning after Dec. 15, 2008 and will be applied retrospectively to all periods presented. It is expected that the final FSP will be issued in May 2008. For more information on FSP APB 14-a, click here.

NAREIT Comments to the SEC on XBRL

On April 4, 2008, NAREIT submitted a comment letter to the SEC on the Extensible Business Reporting Language (XBRL) taxonomy for the real estate industry. In the near future, XBRL will shape the financial statements filed with the SEC and other regulators around the world, probably on a mandatory basis. A primary goal of XBRL is to provide financial statement users comparable information across a particular industry in the U.S. and globally. In addition, XBRL proponents believe that XBRL will provide efficiencies in preparing and filing financial statements with regulators. To learn more about XBRL, visit the SEC website by clicking here.

Since NAREIT is committed to improving the relevance and usefulness of financial reporting, NAREIT sponsored a webcast on Feb. 28, 2008 and held a session at NAREIT's recent Law & Accounting Conference to inform industry participants about XBRL. Additionally, NAREIT asked participants to comment on the XBRL taxonomy by the April 4, 2008 deadline. In addition to NAREIT staff, financial reporting representatives of DCT Industrial Trust Inc., Developers Diversified Realty Corporation, General Growth Properties, Inc., Home Properties, Inc., ProLogis and Taubman Centers, Inc. submitted comments on the taxonomy directly to the SEC.

Based on input received from these and other NAREIT members, NAREIT recommended several changes with respect to how net operating income and several operating metrics are "tagged" in the taxonomy and requested that the SEC issue a second draft of the taxonomy that includes comments received by the SEC as of April 4,

2008. To read NAREIT's letter submitted to the SEC, click here.

Penn State Professors Issue Industry Paper

Last year, NAREIT commissioned a paper for the purpose of further educating the FASB, SEC and others about the commercial real estate industry and, in particular, the investment property business. The paper, developed by two Penn State professors, is based on the fundamental view that "real estate is an asset class with unique characteristics that differentiate it from other asset classes and that distinguish the real estate industry from other economic activities such as manufacturing and the financial sector." The paper discusses a wide range of subjects, including:

- The economic fundamentals of the industry
- Macro level performance issues
- Leases and lease strategy
- Micro level analysis of property development
- Real estate investment analysis

To access the paper, click here.

Upcoming 2008 NAREIT Financial Standard Events:

Internal Audit Forum

The 2008 Internal Audit Forum will be held on Aug. 5 and 6 in Philadelphia, Pennsylvania. The event will be hosted by: Brandywine Realty Trust, Liberty Property Trust and Pennsylvania Real Estate Investment Trust. The Internal Audit Forum is designed exclusively for internal audit directors or other senior level financial professionals responsible for internal audit and has proven to be a success in providing useful information in improving the internal audit function. Program and registration information will be available in the coming weeks. For more information on this event, please contact Sally Glenn at sglenn@nareit.com or (202) 739-9442.

Retail Sector Operations Accounting Forum

Taubman Centers, Inc. will sponsor the third annual Retail Sector Operations Accounting Forum, which will be held on Aug. 13 and 14 in Detroit, Michigan. The program offers best practice guidelines for the retail sector and provides a forum for participants to share industry practices. More information on this program and registration will soon be provided. For additional information regarding this event, please contact Sally Glenn at sglenn@nareit.com or (202) 739-9442.

Senior Financial Officers/Investor Relations Officers Workshop

NAREIT's 2008 Senior Financial Officers/Investor Relations Officers Workshop will be held on Sept. 22 and 23 in New York City. The program is specifically developed for senior officers in the fields of accounting, financial reporting, capital markets, insurance and investor relations. It provides attendees with opportunities to understand and discuss the latest developments and trends impacting the areas of finance, financial reporting, investor relations and insurance in the real estate industry. Program and registration information will soon be available. If you would like to submit recommendations on specific workshop topics, please contact Sally Glenn at sglenn@nareit.com or (202) 739-9442.

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