REALpac
Real Property Association of Canada
Association des biens immobiliers du Canada

September 24, 2009

International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
United Kingdom

Re: Exposure Draft *Fair Value Measurement*

Dear Sir/Madam:

We are pleased to submit this comment letter on the International Accounting Standards Board's (the Board) Exposure Draft of *Fair Value Measurement.* We are submitting these comments on behalf of the Real Estate Equity Securitization Alliance (REESA), which includes the following real estate organizations:

Asian Public Real Estate Association (APREA)
British Property Federation (BPF)
European Public Real Estate Association (EPRA)
National Association of Real Estate Investment Trusts (NAREIT)® (U.S.)
Property Council of Australia (PCA)
Real Property Association of Canada (REALpac)

Members of the organizations identified above would be pleased to meet with the Board or its staff to discuss any questions regarding our comments.

We thank the IASB for this opportunity to comment on the Exposure Draft. Please contact Teresa Neto, REALpac's VP, Financial Reporting at tneto@realpac.ca or 1-416-642-2700 ext. 226 if you would like to discuss our comments.

Respectfully submitted,

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Comment Letter Submitted by the

Real Property Association of Canada

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which includes the following organizations:**

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In response to the

Exposure Draft

Fair Value Measurement

Issued by the International Accounting Standards Board

May 2009

September 24, 2009

International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
United Kingdom

Re: Exposure Draft *Fair Value Measurement*

Dear Sir/Madam:

The undersigned real estate organizations welcome this opportunity to respond to the request from the International Accounting Standards Board ("IASB" or "Board") for comments on the Exposure Draft *Fair Value Measurement* (the Exposure Draft). The undersigned organizations represent publicly traded real estate companies and Real Estate Investment Trusts (REITs) around the world. Our members are real estate companies and other businesses that develop, own, operate and finance investment property, as well as those firms and individuals who advise, study and service those businesses.

The purpose and activities of REESA are discussed in Appendix I.

Our response to this Exposure Draft is fairly focused with our key concerns summarized below. Following the summary, we have provided specific responses to the questions included in the Exposure Draft.

Summary

We have identified several areas within the proposed standard which are of particular concern for the real estate industry, namely:

- Loss of fair value guidance currently part of IAS 40 that has proven to be a useful and relevant framework for company management, the valuation community and auditors in measuring fair value of investment property;
- Concerns regarding disclosure requirements for investment property pertaining to sensitivity analysis of fair value and the impact of changes in valuation techniques;
- The requirement to disaggregate the fair value of investment property into land and building components;
- Inconsistency in accounting for transaction costs and the recognition of day one gains or losses; and
- Lack of complete convergence with SFAS 157.

1. Loss of IAS 40 fair value guidance

We support the Board's effort in trying to establish a framework for measuring and disclosing fair value on a consistent basis to all assets, liabilities and equity instruments. The Exposure Draft establishes a single definition for fair value as well as a single source of generic guidance for fair value measurement which we believe should form the basis for fair value guidance throughout IFRS. However, REESA has several concerns with moving to a single source of generic guidance as being proposed by the Exposure Draft, namely:

- The fair value measurement framework should not eliminate fair value guidance currently within IAS 40 that may continue to be relevant and useful while remaining consistent with the principles of the framework; and
- It is difficult to assess the full impact to IAS 40 including changes, if any, to the Basis for Conclusions on IAS 40.

<u>Deletion of useful IAS 40 guidance</u>

Accounting standard setters have long recognized the unique business and economic characteristics of property investment; the IASB in IAS 40 and the FASB in its Statement of Financial Accounting Standards No. 41 Financial Reporting and Changing Prices: Specialized Assets – Income Producing Real Estate (now superseded).

Management of investment property companies, industry investors and analysts are strongly supportive of IAS 40, because it provides an opportunity for reporting investment property at fair value which enables investors to understand property performance based on the value enhancement/diminution caused by management actions and changing market values for rents and valuation yields.

We fully support the conclusion reached by the IASB in 2000 that there is a need for a separate accounting standard on investment property and that the "information about the fair value of investment property, and about changes in its fair value, is highly relevant to users of financial statements"[1].

In the decade since IAS 40 has been in place, preparers, valuers, auditors and users have found that the guidance in IAS 40, combined with International Valuation Standards guidance (followed by the vast majority of valuation professionals), has worked well. Removing this in favour of the more generic guidance contained in the Exposure Draft could create further uncertainty.

The Exposure Draft proposes to eliminate certain paragraphs of IAS 40 which will result in those entities that report fair value of investment property under IAS 40 to solely rely on the generic proposals of the Exposure Draft. IAS 40 contains paragraphs that provide specific guidance to the real estate industry on determining fair value of investment property. In particular, paragraphs 40, and 45 to 49 of IAS 40 provide useful and relevant guidance that is normally used

[1] IAS 40 Basis for Conclusions on IAS 40 (2000) *Investment Property* par. B6

today by entities, or the external appraisers engaged by those entities, to establish the fair value of investment property.

We believe these paragraphs are consistent with the guidance in the Exposure Draft with respect to valuation techniques and with the overall proposed fair value framework, but, provide an additional level of guidance with respect to determining the assumptions and methodologies to consider in establishing a fair value specifically for investment property (for example, paragraph 46 provides useful guidance on measuring fair value in inactive markets). We are concerned that the loss of this additional guidance may lead to more uncertainty or variability in determining the fair value of investment property. While the generic guidance of the Exposure Draft may work well for financial instruments, it may not be sufficient in itself for certain non-financial assets such as investment property where there is already a well established accounting standard and framework of guidance as described above. This is particularly the case in Europe and Australia. For example, in Europe over 95% of listed property companies adopt the fair value option under IAS 40[2].

We further observe that proposed paragraph 39 of the Exposure Draft could be interpreted to be in conflict with IAS 40 paragraph 47. Paragraph 39 of the Exposure Draft could be interpreted to suggest that an entity will need to determine a weighting of fair values when multiple valuation techniques are used to measure fair value. We believe that IAS 40 paragraph 47 is more appropriately worded, and reflective of how fair value is determined in practice, recommending that entities use the most reliable estimate of fair value within a range of reasonable fair value estimates.

Of the proposed paragraphs to be deleted from IAS 40, REESA does support the deletion of paragraph 51 of IAS 40. We believe this paragraph is in conflict with how fair value is determined for properties under construction and in how fair value is determined on a highest and best use basis for any property.

REESA recommends that the Board retain paragraphs 40, and 45 to 49 of IAS 40 when the final fair value measurement standard is issued. We acknowledge that these IAS 40 paragraphs may need to be amended to be consistent to the final standard with respect to the terminology used.

<u>Clarification of the full impact to IAS 40</u>

In order to clarify our views on the Exposure Draft, it would be helpful to understand the proposed changes to the Basis for Conclusions on IAS 40 as a result of this Exposure Draft, particularly the paragraphs dealing with: guidance on fair value (paragraphs B52 to B54); independent valuation (paragraphs B55 to B56); and the inability to measure fair value reliably (paragraphs B57 to B62). In addition, the Basis for Conclusions currently indicates that the Board considered guidance provided by the International Valuation Standards. We wish to understand if this continues to be the case in light of the Exposure Draft and our comments above, and if not, it would be helpful to understand why.

[2] FSTE EPRA NAREIT Developed Europe Index 2008

2. Concerns regarding disclosure requirements for investment property

The Exposure Draft establishes a fair value hierarchy that prioritizes the inputs to valuation techniques into three levels. The proposal also requires that the fair value measurement is categorized in its entirety in the same level as the lowest level input that is significant to the entire measurement. For investment properties, fair value measurements may fall into the Level 2 category when the property markets are active. However, in some cases, fair value of investment property will require not only market observations but adjustments to those market observations as well as input of management's estimates. In these cases, the valuations of investment property may fall to a Level 3 category requiring, significantly more disclosures.

Our major concerns regarding Level 3 disclosure requirements of the Exposure Draft pertaining to investment property include:

- the requirement to disclose sensitivity analysis demonstrating the impact a change in one or more inputs will have on fair value is appropriate only if applied at the property portfolio level; and
- the requirement to disclose a change in valuation technique and to disclose reasons for making the change and its effect on the fair value measurement is appropriate only for changes that result in significant variations to fair value.

Sensitivity analysis

External valuations today do not normally provide sensitivity analysis. However, most entities do assess, as a matter of good business practice, the sensitivity of fair value measurements to changes in major assumptions supporting those valuations. REESA supports the disclosure of the possible impacts to fair value that may be significant, when one or more inputs are changed as proposed by the Exposure Draft. We believe that this disclosure is appropriate generally at the property portfolio level, where changes in key assumptions such as yield rates, vacancy rates, market rental rates, etc. may have a material impact to the fair values of all investment properties held by an entity.

Changes in valuation techniques

Valuations of investment property typically provide one fair value amount for the entire property. The income approach is most commonly used for investment property but it is possible other valuation techniques may be applied depending on the circumstances. In addition, for each valuation technique, a different method may be utilized. For example, under an income approach, the appraiser may use a discounted cash flow model, or may choose to use a capitalization model where recurring property net operating income is capitalized based on current market yields, or, any other income approach method. The appraiser uses judgment in assessing which method is used depending on the specific facts pertaining to the property.

Valuations also consider a wide variety of inputs and factors including, but not limited to:

- physical inspection of the property
- recent sales in the property's market
- recent sales of similar property in other markets

- market yield demands
- economic outlook
- market sentiment
- management estimates
- cash flow projections

The valuation of investment property involves the judgment, skill and experience from the appraiser who weighs all factors and chooses the appropriate valuation technique to arrive at a market selling price for the property at one point in time. It is not uncommon for appraisers to switch between valuation techniques or the type of method within a valuation technique, using the method that makes the most sense for the specific property at any given point in time. REESA believes it is appropriate to disclose the impact a change in valuation technique has on the measurement of fair value, but we believe such disclosure should be limited to only those changes that result in significant variations to fair value.

3. Disaggregating the fair value of investment property into land and building components

Paragraph 6 of the Exposure Draft indicates that the IFRSs applicable to the asset or liability or group of assets or liabilities should determine the unit of account being measured at fair value. For investment property, entities will refer to IAS 40 for guidance on the appropriate unit of account. Although the illustrative examples of the Exposure Draft do not form part of the proposed standard, they do provide some valuable insight on how the principles of the standard may be applied. Given this understanding, based on Examples 2, 12 and 13 it would appear that in order to appropriately apply the valuation and disclosure principles of the Exposure Draft, the fair value of investment property would need to be split between land and building components.

Valuations of investment property are not typically split between land and building but are valued as a single asset. This is consistent with how the majority of transactions are conducted for investment property where the transaction will consider the property site as a whole rather than its land and building components. Only under rare circumstances is the land split from the building in a purchase and sale transaction.

REESA believes the fair value of investment property should be accounted for as a single unit of account consistent with the measurement requirements of IAS 40. We do not believe that the fair value of an investment property should be disaggregated into separate land and building components as it does not reflect how business is conducted in the real estate industry, how valuations are prepared for investment property and we fail to see the added benefit it would provide to users of the financial statements of a real estate entity. The illustrative examples accompanying the final standard should be amended to present investment property as one fair value measurement.

4. Day one recognition of gains or losses

REESA believes that in the vast majority of transactions, the price paid for the transfer of an investment property is the best evidence of fair value at that point in time and that no gain or loss will be recognized on initial recognition.

However, the concept of recognizing day one gains or losses proposed by the Exposure Draft highlights an inconsistency with respect to how transaction costs are accounted for under IAS 40 and IAS 16. Currently, under both standards, assuming an acquisition is not a business combination, transaction costs are capitalized to the acquired asset upon initial recognition. Only upon subsequent remeasurement, at the end of the reporting period, under either the fair value model or revaluation model, will transaction costs be eliminated. If the concept of day one losses suggests that transaction costs need to be recognized to profit and loss when incurred, it is unclear why paragraph 20 of IAS 40 and paragraph 16 of IAS 16 have not been amended.

5. Lack of complete convergence with SFAS 157

One of the major goals of REESA is to enhance the comparability of financial information between real estate companies worldwide. We have therefore been strong supporters of the joint convergence projects between the Board and the Financial Accounting Standards Board (FASB) on key accounting standards in recent years. Fair value measurement is an important standard that permeates many other IFRS and U.S. standards and therefore it is critical that both accounting regimes adopt the same standard of fair value measurement to ensure global convergence is achieved. Further, this standard will be critical to regularly reporting investment property at fair value pursuant to IAS 40.

The Exposure Draft highlights eight areas in which the Exposure Draft differs from SFAS 157. Some of the differences are quite fundamental to establishing fair value measurements and could result in significantly different results being determined under IFRS or U.S. GAAP. Specifically, the differences in scope, reference market and recognition of day one gains and losses may have a major impact on how fair value is measured.

REESA strongly encourages the Board and FASB to reconcile/resolve these outstanding differences between the Exposure Draft and SFAS 157 prior to issuing a final IFRS. This will ensure consistent and comparable reporting of fair value for all global reporters including the global real estate industry.

<u>Specific questions of the Exposure Draft</u>

The remainder of this comment letter addresses the specific questions of the Exposure Draft.

Definition of fair value and related guidance

Question 1

The exposure draft proposes defining fair value as 'the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date' (an exit price) (see paragraph 1 of the draft IFRS and paragraphs BC15–BC18 of the Basis for Conclusions). This definition is relevant only when fair value is used in IFRSs.

Is this definition appropriate? Why or why not? If not, what would be a better definition and why?

REESA believes the definition of fair value is appropriate and is consistent with how valuations of investment property are performed today.

Scope
Question 2
In three contexts, IFRSs use the term 'fair value' in a way that does not reflect the Board's intended measurement objective in those contexts: (a) In two of those contexts, the exposure draft proposes to replace the term 'fair value' (the measurement of share based payment transactions in IFRS 2 Share-based Payment and reacquired rights in IFRS 3 Business Combinations) (see paragraph BC29 of the Basis for Conclusions). (b) The third context is the requirement in paragraph 49 of IAS 39 Financial Instruments: Recognition and Measurement that the fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid (see paragraph 2 of the draft IFRS and paragraph BC29 of the Basis for Conclusions). The exposure draft proposes not to replace that use of the term 'fair value', but instead proposes to exclude that requirement from the scope of the IFRS.

Is the proposed approach to these three issues appropriate? Why or why not? Should the Board consider similar approaches in any other contexts? If so, in which context and why?

REESA has no specific comments regarding these proposals.

The transaction
Question 3
The exposure draft proposes that a fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place in the most advantageous market to which the entity has access (see paragraphs 8–12 of the draft IFRS and paragraphs BC37–BC41 of the Basis for Conclusions).

Is this approach appropriate? Why or why not?

REESA generally agrees with this proposal with the understanding that investment properties are valued assuming the most advantageous market, which in most cases, also represents the principal market. We support the inclusion of paragraph 10 which states entities need not undertake an exhaustive search for all possible markets to identify the most advantageous market. The real estate industry has become an integrated global industry where market participants can be found in any geographical domain and from many different business structures (i.e. REITs, private companies, public and private funds, pension plans, etc.). Therefore valuing investment property based on the principal market in many cases will be the most practical approach for establishing the fair value of investment property.

Question 4
The exposure draft proposes that an entity should determine fair value using the assumptions that market participants would use in pricing the asset or liability (see paragraphs 13 and 14 of the draft IFRS and paragraphs BC42–BC45 of the Basis for Conclusions). Is the description of market participants adequately described in the context of the definition? Why or why not?

REESA believes the description of a market participant is adequately described.

Application to assets: highest and best use and valuation premise
Question 5
The exposure draft proposes that: (a) the fair value of an asset should consider a market participant's ability to generate economic benefit by using the asset or by selling it to another market participant who will use the asset in its highest and best use (see paragraphs 17–19 of the draft IFRS and paragraph BC60 of the Basis for Conclusions); (b) the highest and best use of an asset establishes the valuation premise, which may be either 'in use' or 'in exchange' (see paragraphs 22 and 23 of the draft IFRS and paragraphs BC56 and BC57 of the Basis for Conclusions); (c) the notions of highest and best use and valuation premise are not used for financial assets and are not relevant for liabilities (see paragraph 24 of the draft IFRS and paragraphs BC51 and BC52 of the Basis for Conclusions).

Are these proposals appropriate? Why or why not?

REESA generally agrees with these proposals. In most cases, the fair value of investment property is based on an "in exchange" valuation premise.

The "in use" valuation premise may be more appropriate for the valuation of property, plant and equipment. The requirement of the Exposure Draft to consider both the "in use" and "in exchange" value of an asset may be inappropriate and adds scope to the work of an external appraiser where that work would not have been considered before.

Knowledgeable and willing parties should always determine a fair value that represents the highest and best use. The fair value will reflect the expectation of any future changes but not the full value of that change. Our interpretation of the Exposure Draft is that the highest and best use does not represent the value for an alternative use that might be realized if there are yet conditions that need to be met in order to make that alternative physically possible, legally permissible and financially feasible. We believe this interpretation to be consistent with the proposals of the Exposure Draft, however, we believe this should be made clearer in the Exposure Draft.

REESA believes that further clarity is necessary with respect to the consideration that the use of an asset must be "legally permissible" in determining an asset's highest and best use. Many market participants may be prepared to pay a certain price for a property based on a use that is not currently zoned for the property, and hence not legally permissible at that point in time. The developer (market participant) factors into the price, any uncertainties associated with negotiating with planning officials to change the zoning permit. We believe that some entities may interpret paragraph 17(b) of the Exposure Draft to mean that in determining the highest and best use of an investment property, one must only consider the use in which the property is currently zoned for. Although we believe that this was not the intent of the guidance in paragraph 17, we believe additional clarity around what is meant by "legally permissible" would be helpful.

Question 6

When an entity uses an asset together with other assets in a way that differs from the highest and best use of the asset, the exposure draft proposes that the entity should separate the fair value of the asset group into two components: (a) the value of the assets assuming their current use and (b) the amount by which that value differs from the fair value of the assets (ie their incremental value). The entity should recognise the incremental value together with the asset to which it relates (see paragraphs 20 and 21 of the draft IFRS and paragraphs BC54 and BC55 of the Basis for Conclusions).

Is the proposed guidance sufficient and appropriate? If not, why?

REESA believes that in most cases, an investment property's highest and best use is it current use. The requirement to separate the incremental value associated with an asset's highest and best use should be made only on exceptional cases where development plans or permits are in place to realize such incremental value. In practice today, where an operating investment property has a material incremental value associated with a highest and best use, most entities will disclose this fact, explaining the significant assumptions associated with the incremental value. An example may be an operating office building which has a license to increase the number of floors in the future. An appraiser will assess a value for the incremental floors that can be built in the future and associated economic benefit that will flow from it. We believe the requirements of the Exposure Draft to recognize the incremental value of an asset associated with an asset's highest and best use is consistent to how entities report today.

Application to liabilities: general principles
Question 7

The exposure draft proposes that: (a) a fair value measurement assumes that the liability is transferred to a market participant at the measurement date (see paragraph 25 of the draft IFRS and paragraphs BC67 and BC68 of the Basis for Conclusions); (b) if there is an active market for transactions between parties who hold a financial instrument as an asset, the observed price in that market represents the fair value of the issuer's liability. An entity adjusts the observed price for the asset for features that are present in the asset but not present in the liability or vice versa (see paragraph 27 of the draft IFRS and paragraph BC72 of the Basis for Conclusions); (c) if there is no corresponding asset for a liability (eg for a decommissioning liability assumed in a business combination), an entity estimates the price that market participants would demand to assume the liability using present value techniques or other valuation techniques. One of the main inputs to those techniques is an estimate of the cash flows that the entity would incur in fulfilling the obligation, adjusted for any differences between those cash flows and the cash flows that other market participants would incur (see paragraph 28 of the draft IFRS).

Are these proposals appropriate? Why or why not? Are you aware of any circumstances in which the fair value of a liability held by one party is not represented by the fair value of the financial instrument held as an asset by another party?

REESA has no specific comments regarding these proposals.

Application to liabilities: non-performance risk and restrictions
Question 8
The exposure draft proposes that: (a) the fair value of a liability reflects non-performance risk, ie the risk that an entity will not fulfill the obligation (see paragraphs 29 and 30 of the draft IFRS and paragraphs BC73 and BC74 of the Basis for Conclusions); (b) the fair value of a liability is not affected by a restriction on an entity's ability to transfer the liability (see paragraph 31 of the draft IFRS and paragraph BC75 of the Basis for Conclusions).

Are these proposals appropriate? Why or why not?

REESA has no specific comments regarding these proposals.

Fair value at initial recognition
Question 9
The exposure draft lists four cases in which the fair value of an asset or liability at initial recognition might differ from the transaction price. An entity would recognise any resulting gain or loss unless the relevant IFRS for the asset or liability requires otherwise. For example, as already required by IAS 39, on initial recognition of a financial instrument, an entity would recognise the difference between the transaction price and the fair value as a gain or loss only if that fair value is evidenced by observable market prices or, when using a valuation technique, solely by observable market data (see paragraphs 36 and 37 of the draft IFRS, paragraphs D27 and D32 of Appendix D and paragraphs BC76 BC79 of the Basis for Conclusions).

Is this proposal appropriate? In which situation(s) would it not be appropriate and why?

REESA believes that in the vast majority of transactions, the price paid for the transfer of an investment property is the best evidence of fair value at that point in time and that no gain or loss will be recognized on initial recognition.

However, the concept of recognizing day one gains or losses proposed by the Exposure Draft highlights an inconsistency with respect to how transaction costs are accounted for under IAS 40 and IAS 16. Currently, under both standards, assuming an acquisition is not a business combination, transaction costs are capitalized to the acquired asset upon initial recognition. Only upon subsequent remeasurement, at the end of the reporting period, under either the fair value model or revaluation model, will transaction costs be eliminated. If the concept of day one losses suggests that transaction costs need to be recognized to profit and loss when incurred, it is unclear why paragraph 20 of IAS 40 and paragraph 16 of IAS 16 have not been amended.

Valuation techniques
Question 10
The exposure draft proposes guidance on valuation techniques, including specific guidance on markets that are no longer active (see paragraphs 38–55 of the draft IFRS, paragraphs B5–B18 of Appendix B, paragraphs BC80–BC97 of the Basis for Conclusions and paragraphs IE10–IE21 and IE28–IE38 of the draft illustrative examples).

Is this proposed guidance appropriate and sufficient? Why or why not?

The guidance provided in the Exposure Draft is appropriate generic guidance meant to be applicable to most assets, liabilities or equity transactions. However, REESA does believe that this generic guidance should not necessarily eliminate fair value guidance currently within IFRS that may continue to be relevant and useful while remaining consistent with the principles of the fair value framework.

Accounting standard setters have long recognized the unique business and economic characteristics of property investment; the IASB in IAS 40 and the FASB in its Statement of Financial Accounting Standards No. 41 Financial Reporting and Changing Prices: Specialized Assets – Income Producing Real Estate (now superseded).

Both management of investment property companies, industry investors and analysts are strongly supportive of IAS 40, because it provides an opportunity for reporting investment property at fair value which enables investors to understand property performance based on the value enhancement/diminution caused by management actions and changing market values for rents and valuation yields.

We fully support the conclusion reached by the IASB in 2000 that there is a need for a separate accounting standard on investment property and that the "information about the fair value of investment property, and about changes in its fair value, is highly relevant to users of financial statements"[3].

The Exposure Draft proposes to eliminate certain paragraphs of IAS 40 which will result in those entities that report fair value of investment property under IAS 40 to solely rely on the generic proposals of the Exposure Draft. IAS 40 contains paragraphs that provide specific guidance to the real estate industry on determining fair value of investment property. In particular, paragraphs 40, and 45 to 49 of IAS 40 provide useful and relevant guidance that is normally used today by entities, or the external valuators engaged by those entities, to establish the fair value of investment property.

We believe these paragraphs are consistent with the guidance in the Exposure Draft with respect to valuation techniques and with the overall proposed fair value framework but, provide an additional level of guidance with respect to determining the assumptions and methodologies to consider in establishing a fair value specifically for investment property. The loss of this additional guidance may only lead to more uncertainty or variability in determining the fair value of investment property. While the generic guidance of the Exposure Draft may work well for financial instruments, it may not be sufficient in itself for certain non-financial assets such as investment property.

We further observe that proposed paragraph 39 of the Exposure Draft could be interpreted to be in conflict with IAS 40 paragraph 47. Paragraph 39 of the Exposure Draft could be interpreted to suggest that an entity will need to determine a weighting of fair values when multiple valuation techniques are used to measure fair value. We believe that IAS 40 paragraph 47 is more appropriately worded, and reflective of how fair value is determined in practice, recommending

[3] IAS 40 Basis for Conclusions on IAS 40 (2000) *Investment Property* par. B6

that entities use the most reliable estimate of fair value within a range of reasonable fair value estimates.

Of the proposed paragraphs to be deleted from IAS 40, REESA does support the deletion of paragraph 51 of IAS 40. We believe this paragraph is in conflict with how fair value is determined for properties under construction and in how fair value is determined on a highest and best use basis for any property.

Lastly, we note that paragraphs 53 and 54 of IAS 40 deal with situations where there is an inability to determine fair value. This may be particularly relevant to property under construction. The Exposure Draft does not propose to eliminate these paragraphs, however, although we fully support this decision it seems inconsistent with the approach taken on the other IAS 40 paragraphs discussed above.

REESA recommends that the Board retain paragraphs 40, and 45 to 49 of IAS 40 when the final fair value measurement standard is issued. We acknowledge that these IAS 40 paragraphs may need to be amended to be consistent to the final standard with respect to the terminology used.

Disclosures
Question 11
The exposure draft proposes disclosure requirements to enable users of financial statements to assess the methods and inputs used to develop fair value measurements and, for fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period (see paragraphs 56–61 of the draft IFRS and paragraphs BC98–BC106 of the Basis for Conclusions).

Are these proposals appropriate? Why or why not?

REESA supports many of the proposed disclosure requirements and believes that these proposals will lead to more consistent reporting of fair value in the financial statements. However, we do have concerns with some Level 3 disclosure requirements as it pertains to investment properties.

The Exposure Draft establishes a fair value hierarchy that prioritizes the inputs to valuation techniques into three levels. The proposal also requires that the fair value measurement is categorized in its entirety in the same level as the lowest level input that is significant to the entire measurement. For investment properties, fair value measurements may fall into the Level 2 category when the property markets are active. However, in some cases, fair value of investment property will require not only market observations but adjustments to those market observations as well as input of management’s estimates. In these cases, valuations of investment property may fall to a Level 3 category requiring significantly more disclosures.

Our major concerns regarding Level 3 disclosure requirements of the Exposure Draft pertaining to investment property include:

- the requirement to disclose sensitivity analysis demonstrating the impact a change in one or more inputs will have on fair value is appropriate only if applied at the property portfolio level; and

- the requirement to disclose a change in valuation technique and to disclose reasons for making the change and its effect on the fair value measurement is appropriate only for changes that result in significant variations to fair value.

Sensitivity analysis

External valuations today do not normally provide sensitivity analysis. However, most entities do assess, as a matter of good business practice, the sensitivity of fair value measurements to changes in major assumptions supporting those valuations. REESA supports the disclosure of the possible impacts to fair value that may be significant, when one or more inputs are changed as proposed by the Exposure Draft. We believe that this disclosure is appropriate generally at the property portfolio level, where changes in key assumptions such as yield rates, vacancy rates, market rental rates, etc. may have a material impact to the fair values of all investment properties held by an entity.

Changes in valuation techniques

Valuations of investment property typically provide one fair value amount for the entire property. The income approach is most commonly used for investment property but it is possible other valuation techniques may be applied depending on the circumstances. In addition, for each valuation technique, a different method may be utilized. For example, under an income approach, the appraiser may use a discounted cash flow model, or may choose to use a capitalization model where recurring property net operating income is capitalized based on current market yields, or, any other income approach method. The appraiser uses judgment in assessing which method is used depending on the specific facts pertaining to the property.

Valuations also consider a wide variety of inputs and factors including, but not limited to:

- physical inspection of the property
- recent sales in the property's market
- recent sales of similar property in other markets
- market yield demands
- economic outlook
- market sentiment
- management estimates
- cash flow projections

The valuation of investment property involves the judgment, skill and experience from the appraiser who weighs all factors and chooses the appropriate valuation technique to arrive at a market selling price for the property at one point in time. It is not uncommon for appraisers to switch between valuation techniques or the type of method within a valuation technique, using the method that makes the most sense for the specific property at any given point in time. REESA believes it is appropriate to disclose the impact a change in valuation technique has on the measurement of fair value, but we believe such disclosure should be limited to only those changes that result in significant variations to fair value.

Convergence with US GAAP
Question 12
The exposure draft differs from Statement of Financial Accounting Standards No. 157 Fair Value Measurements (SFAS 157) in some respects (see paragraph BC110 of the Basis for Conclusions). The Board believes that these differences result in improvements over SFAS 157. Do you agree that the approach that the exposure draft proposes for those issues is more appropriate than the approach in SFAS 157? Why or why not? Are there other differences that have not been identified and could result in significant differences in practice?

REESA strongly encourages the Board and FASB to work together, in the near term, to resolve the outstanding differences between the Exposure Draft and SFAS 157 prior to issuing a final IFRS. Fair value measurement is an important standard that permeates many other standard of IFRS and U.S. standards and therefore it is critical that both accounting regimes adopt the same standard of fair value measurement to ensure global convergence is achieved. Further, this standard will be critical to regularly reporting investment property at fair value pursuant to IAS 40. One of the major goals of REESA is to enhance the comparability of financial information between real estate companies worldwide. We have therefore been strong supporters of the joint convergence projects between the Board and the Financial Accounting Standards Board (FASB) on key accounting standards in recent years.

The Exposure Draft highlights eight areas in which the Exposure Draft differs from SFAS 157. Some of the differences are quite fundamental to establishing fair value measurements and could result in significantly different results being determined under IFRS or U.S. GAAP. Specifically, the differences in scope, reference market and recognition of day 1 gains and losses may have a major impact on how fair value is measured.

Other comments
Question 13
Do you have any other comments on the proposals in the exposure draft?

<u>Clarification of the full impact to IAS 40</u>

REESA believes it would be helpful to understand the proposed changes to the Basis for Conclusions on IAS 40 as a result of this Exposure Draft, particularly the paragraphs dealing with: guidance on fair value (paragraphs B52 to B54); independent valuation (paragraphs B55 to B56); and the inability to measure fair value reliably (paragraphs B57 to B62). In addition, the Basis for Conclusions currently indicates that the Board considered guidance provided by the International Valuation Standards. We wish to understand if this continues to be the case in light of the Exposure Draft our comments in this letter, and if not, it would be helpful to understand why.

International Valuation Standards are followed by the vast majority of valuation professionals that provide independent valuation to entities preparing statements under IAS 40. Since IAS 40 has been issued, entities, valuers, auditors and users have found that the guidance in IAS 40, combined with guidance from International Valuation Standards has worked well. We believe it would be beneficial to retain the important discussions regarding fair value guidance within the Basis for Conclusions on IAS 40.

Disaggregating the fair value of investment property into land and building components

Paragraph 6 of the Exposure Draft indicates that the IFRSs applicable to the asset or liability or group of assets or liabilities should determine the unit of account being measured at fair value. For investment property, entities will refer to IAS 40 for guidance on the appropriate unit of account. Although the illustrative examples of the Exposure Draft do not form part of the proposed standard, they do provide some valuable insight on how the principles of the standard may be applied. Given this understanding, based on Examples 2, 12 and 13 it would appear that in order to appropriately apply the valuation and disclosure principles of the Exposure Draft, the fair value of investment property would need to be split between land and building components.

Valuations of investment property are not typically split between land and building but are valued as a single asset. This is consistent with how the majority of transactions are conducted for investment property where the transaction will consider the property site as a whole rather than its land and building components. Only under rare circumstances is the land split from the building in a purchase and sale transaction.

REESA believes the fair value of investment property should be accounted for as a single unit of account consistent with the measurement requirements of IAS 40. We do not believe that the fair value of an investment property should be disaggregated into separate land and building components as it does not reflect how business is conducted in the real estate industry, how valuations are prepared for investment property and we fail to see the added benefit it would provide to users of the financial statements of a real estate entity. The illustrative examples accompanying the final standard should be amended to present investment property as one fair value measurement.

REESA – The Real Estate Equity Securitization Alliance

The real estate industry has responded positively to the challenges presented by the developments in the global economy and, in particular, the global real estate markets. Collectively the organizations in REESA are responsible for representing a large proportion of the global real estate market. The benefits of collaboration on a global scale are increasingly valuable on major industry issues such as the sustainability of the built environment, tax treaties, corporate governance and research.

The formation of REESA was, in part, a direct response to the challenge and opportunity presented by the harmonization of accounting and financial reporting standards around the world. Given the size and importance of the real estate industry, our view is that there are considerable benefits to be gained by both accounting standard setters and the industry in developing consensus views on accounting and financial reporting matters, as well as on the application of accounting standards. Associations represented thus far in the alliance include:

- 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
- Real Property Association of Canada, REALpac
- Association for Real Estate Securitization (Japan), ARES

Since its formation REESA members have exchanged views on a number of tax and accounting related projects and shared these views with regulators and standards setters. These projects include:

- Financial Statement Presentation
- Reporting Discontinued Operations
- Real Estate Sales – IFRIC D21
- Capitalization of Borrowing Costs - IAS 23
- Accounting for Joint Arrangements – ED 9
- Consolidated Financial Statements – ED 10
- IASB 2007/2008 Annual Improvements to IFRS
- FASB/IASB Leasing project
- FASB/IASB Revenue Recognition Project
- Income Tax
- OECD developments on cross border real estate flows and international tax treaties

Asian Public Real Estate Association
Singapore

British Property Federation
United Kingdom

European Public Real Estate Association
Netherlands

National Association of
Real Estate Investment Trusts
United States

Property Council of Australia
Australia

Real Property Association of Canada
Canada