EUROPEAN PUBLIC REAL ESTATE ASSOCIATION

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

Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

5th January 2012

Re: Investment Entities Exposure Draft

Dear Sir/Madam:

We are pleased to submit this comment letter in response to the International Accounting Standards Board's (IASB) Exposure Draft: *Investment Entities*. We are submitting these comments on behalf of the members of the Real Estate Equity Securitization Alliance (REESA). These members include the following real estate organizations:

Asia Pacific 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)

The purpose and activities of REESA are discussed in Appendix II. Members of the organizations identified above would be pleased to meet with the Boards or staff to discuss any questions regarding our comments.

We thank the IASB and the FASB (collectively, the Boards) for the opportunity to comment on the proposal with respect to this important project. If you would like to discuss our comments, please contact Gareth Lewis, EPRA's Director of Finance, at gareth.lewis@epra.com (+32 2739 1014), or Mohamed Abdel Rahim, EPRA Financial Reporting Manager, at mohamed.abdelrahim@epra.com (+32 2739 1010).

Respectfully submitted,

Gareth Lewis

Comment Letter Submitted by the

European Public Real Estate Association (EPRA)

On behalf of the following members of the
Real Estate Equity Securitization Alliance (REESA):

Asia Pacific 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)

In response to the

Exposure Draft

Investment Entities

Issued by the International Accounting Standards Board

August 2011

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

Technical Director
File Reference No. 2011-200
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

5th January 2012

Re: Investment Entities Exposure Draft (ED)

Dear Sir/Madam:

REESA is the global representative voice for publicly traded real estate companies. Members of REESA organisations are corporate property groups, including REITs and other businesses throughout the world that primarily develop, own, operate and finance investment property, as well as the institutions that invest in these businesses and the firms and individuals that advise, study and service the sector.

REESA strongly supports the harmonisation of global accounting and financial reporting and understands the importance of achieving a high quality universal set of accounting standards. We have been fully engaged in the IASB and FASB's (the Boards) discussions on major convergence projects and have actively participated in meetings with the Boards and their staff with respect to these projects. REESA greatly appreciates the opportunities to express our global views through these meetings and comment letters.

Executive Summary

- We understand that the objective of the *Investment Entities* ED is to define a relatively unique form of investment vehicle where a departure from normal accounting rules relating to consolidation is considered appropriate in order to provide users of financial statements with more relevant information.
- Corporate property groups including REITs that own, develop, actively manage and operate the underlying 'bricks and mortar' property asset do not naturally fall within the *Investment Entities* ED. It is also our understanding that it is not the IASB's intention to scope in such businesses.
- Consistent with the above comments, our view is that most corporate property groups do not meet the criteria as defined in the ED, primarily because they operate just like any other normal corporate business and do not have an explicit commitment to invest for capital appreciation, investment income (e.g. dividends, interest) or an explicit exit strategy in the way that a typical investment entity would have.

- Unlike the type of investment business anticipated in the ED, investors in corporate property groups require information on their underlying business activities and the performance of the company, employees, and management in operating the business. Users of these financial statements are interested in the separate reporting of rental revenue and rental expenses related to the real estate properties as key performance metrics, among others. A requirement to report investments at fair value through profit or loss and not consolidate the results, as proposed, would undermine the transparency of financial reporting that investors and users require.

- Real estate is a unique asset class and the real estate sector consists of a range of different businesses - some of which have fund characteristics which might commonly be viewed as 'investment entities', and other businesses that are not funds and operate just like any other 'normal' business in the broader corporate sector. For this reason, we have some concerns that the relatively ambiguous terms used in the ED might cause confusion and result in the incorrect conclusion when applying the ED to the broader property sector.

- For example, NAV and capital appreciation are relatively important performance measures for corporate property groups compared to many other sectors. This reflects the capital intensive nature of the business of owning and managing property rather than necessarily indicating a business which is an Investment Entity. More broadly, the term 'investment' is commonly used within the property industry without meaning that the business is not an operating business.

- We believe that the ED would therefore be enhanced considerably with a clear description of the types of business arrangements that are being targeted as 'investment entities' and those that are not.

- Whilst it may not be possible to provide absolute clarity in the criteria for defining what is an Investment Entity, businesses themselves and investors in those businesses will generally have a very clear idea whether they are Investment Entities. We would suggest that businesses technically falling within the scope of the ED but which would nevertheless prefer to consolidate their results should be allowed to do so.

Detailed comments

Overview of the real estate industry and corporate property groups

The commercial real estate industry is typically understood to cover businesses whose primary activity revolves around physical real estate (re)development and rental income generation and growth over the medium to long term. It incorporates a broad range of real estate assets from commercial offices, retail, industrial, residential property as well as hospitality, leisure, education, healthcare and infrastructure.

The activities real estate businesses engage in can include: acquiring bare land, developing it and selling or holding the property; assembling land to carry out major urban regeneration (including infrastructure); acquiring properties producing a stable income and requiring minimal management; acquiring property and refurbishing and selling or holding the property; ownership of pubs or restaurants and leasing out to individuals, and; ownership of property assets used by a particular operating business or other organization e.g. a supermarket; manufacturer; or government department.

Corporate property groups and REITs

Corporate property groups, like all operating businesses, generally have discretion to carry on any real estate activity of the types described above. Some corporate property groups opt to become 'REITs', a tax designation which allows companies that primarily invest in real estate for the long term to benefit from a specific beneficial tax treatment in return for agreeing to distribute the vast majority of profits (typically 90%) as well as leverage and other requirements. For all intents and purposes most REITs are normal operating businesses that actively manage and operate their real estate.

The operating nature of REITs has been recognized by the FASB in the past. For example, the FASB *Investment Companies* standard specifically excludes REITs because they are operating businesses. This position is consistent with the American Institute of Certified Public Accountants (AICPA's) guidance on the existing standard (SOP 07-01) which stated that:

> "*REITs typically would not meet the definition of an investment company because REITs typically are involved in the day-to-day management of the investee in ways that are inconsistent with the activities of an investment company. For example, REITs typically develop and operate real estate*."

REESA are in full agreement with this policy statement which is still valid for US REITs and indeed, more broadly for operating real estate businesses worldwide. Our recommendation would therefore be that the IASB include a similar statement in its basis for conclusions on the new *Investment Entities* standard.

Ambiguity around terminology

It is our understanding that corporate property groups are not a category of business that is generally intended to be within the scope of this standard. There are clearly many real estate investment vehicles that essentially allocate and manage the pooled capital of investors, where the type of reporting envisaged by the new standard is both appropriate and desirable. Although it should be generally clear to these particular businesses (and their investors), whether they are the type of business intended to be within the scope of the *Investment Entities* standard, it is very difficult to clearly define the precise criteria for identifying them for the purposes of the ED.

The criteria in the ED are relatively ambiguous and could be subject to wide interpretation. We have identified three particular concerns below:

1. Business purpose (investing to 'earn investment income')

The ED states that in order to meet all of the criteria there is a requirement that the '*entity makes an explicit commitment to a group of investors that the entity's purpose is investing to earn capital appreciation, investment income (such as dividends or interest), or both'*.

Corporate property groups, like any other corporate business, do not typically make an explicit commitment to invest for either capital appreciation or investment income. Therefore, REESA believes that our members would <u>not</u> meet this criterion.

Nevertheless, the identification of an explicit commitment is likely to be a grey area and there is further ambiguity around what constitutes investing for investment income - since all companies can be said to be investing and thereby could be seen to derive 'investment' income.

A sensible approach might be for companies that meet the broad criteria of the ED, but nevertheless wish to consolidate the results, to be able to permanently 'opt-out' of the *Investment Entity* standard and apply normal consolidation accounting if this would result in more useful information to investors and users of financial statements.

2. Nature of the Investment Activity (investing to 'earn investment income')

The ED requires that '*the entity's only substantive activities are investing in multiple investments for capital appreciation, investment income (such as dividends or interest), or both'*.

Within corporate property groups, real estate could typically be held within a number of different types of special purpose vehicles (SPV) including corporate JV's, partnerships and other arrangements. In the case of a corporate SPV, for example, we have concerns that since the parent company is only entitled to receive dividends or interest, they could be seen to invest for this purpose.

For the avoidance of any doubt we believe that it would be useful to make clear that when assessing whether an entity invests for capital appreciation and/or investment income, one needs to consider not just the legal form of the investment (e.g. the shares in the subsidiary from which the parent receives dividends or interest) but the economic substance. In other words, the assessment of the nature of the investment should <u>not</u> be based purely on the legal form.

We note that that the ED does include a similar ‘substance over form’ clarification (in Example 4 in the ED) to highlight that in determining whether a company has multiple investors one should not look at the legal form of the ownership (i.e. the joint ownership by the feeder funds in the example) but the true substance (the multiple investors in the feeder funds).

3. Fair value Management (investments managed and evaluated on a ‘fair value basis’)

The ED requires that *‘Substantially all of the investments of the entity are managed, and their performance is evaluated, on a fair value basis’*

Whilst the fair value/NAV is clearly important for assessing the performance of a capital intensive asset class such as real estate, it is only one of many key performance measures used in assessing the performance of a corporate property group. For example, the rental income, net and recurring operating income, and rental yield are important KPIs used by both management (in assessing performance and deciding whether to retain, sell, (re)develop, etc) as well as investors (in assessing the performance of the management). This is clearly evidenced by the fact that the real estate industry has developed a host of KPIs such as the EPRA Best Practices Recommendations[1] and NAREIT financial measures, designed to evaluate the overall performance. If REESA’s members were considered to meet the scope of the *Investment Entities* ED, these KPIs would be lost as companies would not be able to consolidate the results (e.g. rental income, expenses, etc) of their subsidiaries.

Whereas the fair value information is useful in assessing potential gains/losses from selling property and the financial strength of a company’s balance sheet, it would be simplistic to conclude that because of this fact, all property is managed on a fair value basis. The primary aim of corporate property groups is to own, actively manage and operate property to obtain rental income for the long term (and not just to realize capital appreciation) in line with the definition of investment property[2] under International Accounting Standard 40 *Investment Property*. This may involve (re)developing, refurbishing, changing the tenant mix, improving the infrastructure, developing neighboring sites, and other activities.

We therefore welcome the views in the ED that the evaluation of whether an entity meets the fair value criteria *‘is based on how the investment entity manages and evaluates performance, rather than on the nature of its investment’* and that ‘*the entity’s activities must demonstrate that the fair value is the primary measurement attribute used to make a decision about the financial performance of those assets*.

[1] EPRA financial reporting Best Practices Recommendations consist of KPIs such as EPRA Earnings per Share, EPRA Net Asset Value, EPRA Net initial Yield, etc developed by European listed and used by 80% of the largest listed property companies in Europe. Similar industry KPIs have been developed by NAREIT e.g. NAREIT FFO (“Funds from Operations”), and other real estate groups around the globe.
[2] Definition of Investment Property (IAS 40): “Property (land or a building or part of a building or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both”.

Conclusion

REESA believes that corporate property groups should not be subject to the *Investment Entities* ED based on the current criteria. Nevertheless, the ambiguity around the terms 'investment entity', 'investment income' and the criteria which are vague could lead to some companies being unintentionally scoped in. This unintended consequence would lead to a lack of transparent financial reporting of the KPIs that are used to evaluate the real estate industry. To avoid this, we would recommend that the Boards:

- Provide a clear description of the types of entities that the standard is intended to cover, and
- Provide an option to companies that may be considered to meet the criteria to apply normal consolidation accounting and a gross presentation of rental revenue and rental expense on the income statement.

We appreciate the opportunity to share our views with the IASB and FASB and welcome the Boards' questions on our comments.

Respectfully submitted,

Asia Pacific Real Estate Association

Singapore

British Property Federation

United Kingdom

European Public Real Estate Association

Belgium

National Association of

Real Estate Investment Trusts

United States

Property Council of Australia

Australia

Real Property Association of Canada

Canada

Appendix I

Responses to Selected Questions

Question 5 - *Do you agree that investment entities that hold investment properties should be required to apply the fair value model in IAS 40, and do you agree that the measurement guidance otherwise proposed in the exposure draft need apply only to financial assets, as defined in IFRS 9 and IAS 39 Financial Instruments: Recognition and Measurement? Why or why not?*

It would seem logical that if the standard requires all controlled investments to be reported at fair value, that investment property held by the investment entity should also be reported at fair value.However, it should be recognized within the standard that investment properties are owned and managed by operating businesses as well as Investment Entities. In other words, engaging in the business of property investment and reporting properties under IAS 40 does in no way indicate that a company is an investment entity.

Appendix II

REESA – The Real Estate Equity Securitization Alliance

REESA is made up of seven real estate organizations around the world grounded in one or more facets of securitized real estate equity. REESA's broad mission is to improve the opportunities for investment in securitized real estate equity around the globe. The REESA member organizations are:

- Asia Pacific Real Estate Association, APREA
- Association for Real Estate Securitization in Japan, ARES
- 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

REESA has responded positively to the challenges presented by the developments in the global economy and, in particular, the global real estate markets. 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 harmonisation 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.

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

- FASB/IASB Accounting for Leases
- FASB/IASB Financial Statement Presentation
- FASB/IASB Reporting Discontinued Operations
- FASB/IASB Revenue from Contracts with Customers
- FASB/IASB Effective Dates and Transition Methods
- IASB Fair Value Measurement
- IASB Income Tax
- IASB Real Estate Sales – IFRIC D21
- IASB Capitalization of Borrowing Costs – IAS 23
- IASB Accounting for Joint Arrangements – ED 9
- IASB Consolidated Financial Statements – ED 10
- IASB 2007/2008/2009 Annual Improvements to IFRS
- OECD developments on cross border real estate flows and international tax treaties