NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

February 17, 2010

Ms. Danielle Zeyher
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Subject: IASB Agenda Reference 9D; FASB Memo Reference 63
Project – Leases; Topic – Lessor Accounting – Investment Property

Dear Danielle:

We thought this brief letter and illustration might be helpful to the Board as they consider the agenda proposal to examine the reporting for investment property.

NAREIT staff and other members of the Real Estate Equity Securitization Alliance (REESA) observed the Boards' discussion of the subject agenda paper on January 20, 2010. At this meeting, there seemed to be some question as to the integration of lease revenue in the valuation of investment property. This letter attempts to clarify this question.

As illustrated in the exhibit attached, the projected revenue from both in-place leases and leases projected to be put in place through lease renewals and re-leasing are integral to the valuation of investment property. There are two commonly used methods of valuing an investment property.

Most valuations today discount: i) the *net operating income* (NOI) of the property projected over the subsequent five or ten years from the measurement date; and, ii) the residual value at the end of the projection period. The residual value is measured by applying a capitalization rate to the final year's NOI.

The second valuation method capitalizes a single year's NOI.

All rates employed represent current investor yield requirements used in the property markets at the date of measurement.

The projected NOI is based on i) revenue from current leases; ii) revenue from expected lease renewals and replacement leases; and, iii) expected operating expenses over the projection period. Rental rates for new leases are based on terms specified in lease renewal options or on market studies.

We believe that separately reporting the "value" of in-place leases from the value of the property would be inconsistent with users' views. At a meeting of representatives of the Boards and real estate industry financial statement users, John Lutzius of Green Street Advisors stated that "a change in accounting presentation to show real estate broken out between the net present value of leases in place and residual value would, in my view, be very disruptive to the user community in both the U.S. and Europe." John is a preeminent industry financial analyst in North America, the U.K. and Europe. If the Boards' conclusion in the final Lease Standard requires the disclosure of the portion of the property's value yielded by in-place leases, we would suggest that the disclosure be measured by discounting the revenue from in-place leases at the same discount rate used to measure the property.

In the attached illustration, the value of the investment property is $582,214 using the discounting approach and a 12% discount rate and $566,250 using the capitalization approach and an 8% capitalization rate. The revenue from in-place leases discounted at 12% is $215,461.

<u>An Important Link between Operating Results and Net Asset Value</u>

In comment letters on the Leases Project preliminary views document, both REESA and NAREIT pointed out the important link between NOI (a major portion of operating results) and the net asset value (NAV) of investment property. The aggregate of individual property values represents a large portion of the net asset value of an entity that owns and operates portfolios of investment property. This portfolio NAV is an important element in determining the current investment value of these companies. This link between the operating results of investment property, the fair value of the property and the investment value of companies that own and operate portfolios of investment property is extensively discussed in exhibits to the REESA comment letter.

<u>Further Comment on the Boards' Discussion</u>

REESA and NAREIT strongly support the International Accounting Standards Board's tentative decision with respect to the Leases Project that would continue to permit the current accounting for leases of investment property by lessors when the fair value approach under International Accounting Standard 40 *Investment Property* is chosen. We also support the Financial Accounting Standards Board's agenda request that would consider providing at least an option to report investment property at fair value and hope that this agenda item would allow the FASB to consider some improvements to IAS 40 as NAREIT discussed with the Board in January 2008. REESA and NAREIT are available to assist the Boards by providing information from preparers and financial statement users in the global real estate industry.

As a reminder to the Boards, REESA has developed and shared with the Boards a *global industry view* of the issues, as well as solutions to the issues, that would be faced by real estate investors and analysts under the proposed lessor accounting model. Further, we have provided the Boards with personal investors' and analysts' views with respect to this matter. On August 25, 2009, the following real estate industry investors and analysts shared their views of the negative impact of the proposed lessor accounting guidance on the usefulness of the industry's financial reporting:

- John Lutzius, Green Street Advisors
- Stuart Martin, First State Investors
- Harm Meijer, JP Morgan
- Rogier Quirijns, Cohen & Steers
- David Smetana, Morgan Stanley
- Rafael Torres Villalba, APG

Please contact us if you would like to discuss this matter further.

Sincerely,

George L. Yungmann
Sr. V.P., Financial Standards

Sally R. Glenn
Director, Financial Standards

CC: Ms. Rachel Knubley, International Accounting Standards Board

Investment Property Company
Consolidated Statements of Operations*
(Amounts in thousands)

	For the Years ended December 31				
	20X1	20X2	20X3	20X4	20X5
Lease/Rental Revenue					
From In-place Leases:					
Minimum Rents	$ 42,000	$ 40,000	$ 36,000	$ 32,000	$ 29,000
Contingent Rents	1,600	1,400	1,100	1,000	800
Expense Recoveries	25,000	23,000	22,000	20,000	18,000
Total	68,600	64,400	59,100	53,000	47,800
From Renewals and Re-Leasing:					
Minimum Rents	3,000	7,000	15,000	24,300	37,000
Contingent Rents	1,000	4,400	7,200	10,300	13,000
Expense Recoveries	2,000	5,000	10,100	12,400	15,200
Total	6,000	16,400	32,300	47,000	65,200
Direct Operating Costs					
Maintenance and Utilities	20,000	22,000	24,000	25,500	27,000
Property Taxes	4,100	4,250	4,400	4,500	4,800
Security	1,700	2,650	2,800	3,850	875
Other Property Level Costs	3,500	4,500	5,000	6,000	12,000
Total	29,300	33,400	36,200	39,850	44,675
Net Property Income (NPI) or NOI	45,300	47,400	55,200	60,150	68,325
G&A	3,000	3,500	3,800	4,000	4,500
Interest Expense	14,000	17,000	18,000	20,000	23,000
Income From Operations (IFO)	28,300	26,900	33,400	36,150	40,825
Depreciation	18,000	19,000	20,000	18,000	17,000
Net Income	$ 10,300	$ 7,900	$ 13,400	$ 18,150	$ 23,825
Residual Value at the End of 20X5, Note A	$ 683,250				
Property Fair Value:					
Discounting Approach, Note B	$ 582,214				
Capitalization of 20X1 NOI, Note C	$ 566,250				

*****This financial statement illustration applies metrics, such as NPI and IFO, from the global real estate financial statement model approved by the Real Estate Equity Securitization Alliance (REESA). NPI is equivalent to Net Operating Income (NOI) and IFO is equivalent to Funds From Operations (FFO) used in North America and EPRA Earnings used in Europe.

Note A -- The residual value of the investment property at the end of 20X5 represents 20X5 NPI capitalized at 10%.
Note B -- The discounting approach represents the present value of 1) NPI (NOI) in years 20X1 through 20X5 and 2) the residual value at December 31, 20X5 at 12%.
Note C -- The capitalization approach represents 20X1 NPI capitalized at 8%.