NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

July 2, 2002

Financial Accounting Standards Board
MP&T Director
File Reference No. 1100-163
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Proposed Statement of Financial Accounting Standards – Amendment of Statement 133 on Derivative Instruments and Hedging Activities

Dear MP&T Director:

The National Association of Real Estate Investment Trusts (NAREIT) is pleased to have the opportunity to respond to the Financial Accounting Standards Board's (the Board) Exposure Draft of the above referenced proposal. NAREIT is the national trade association for real estate investment trusts (REITs) and other publicly traded real estate companies. Members include REITs and other businesses that develop, own, operate, and finance income-producing real estate, as well as those firms and individuals who advise, study, and service these businesses.

The business of developing, owning and operating income-producing property regularly involves the use of debt capital in the form of bonds, lines of credit, and mortgages, and may involve the use of foreign exchange transactions. In this context, the accounting standards for derivative instruments and hedging activities are important to producing useful and relevant financial reports for real estate companies. NAREIT supports the efforts to clarify and bring consistency to the application of accounting for these activities. NAREIT's comments on the Exposure Draft are presented below.

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Modification of a Derivative

In paragraphs 6(b) and 12 of Statement 133, the Board describes certain rules for those non-option-based products with an initial net investment of more than five percent of the fully prepaid amount. Our questions and requests for clearer guidance about the application of these paragraphs to swaps and foreign exchange (FX) forwards are set forth below. We also would request clarification about the appropriate accounting under Statement 133 for the bifurcation of the loan portion that results from the application of this rule.

Our request for clarification is triggered by certain real estate companies that enter into arrangements to modify and/or restructure key provisions of an existing derivative instrument, such as a swap or an FX forward. Instigated by the current low interest rate environment, major money-center banks that serve as derivatives counterparties on interest rate swaps held by REITs and real estate companies offer swap holders (involved in cash flow hedging relationships) an opportunity to reduce the fixed rate of the swap in exchange for an extension of the maturity date of the swap. This revised derivative is hereafter referred to as an "extend-and-blend swap."

The arrangement under the modified swap, now an extend-and-blend swap, will be *off market;* the swap would have a negative fair value as of the date of modification. In the extend-and-blend hedge modification, the swap holder benefits from avoiding a charge to cash on execution of the extend-and-blend swap, and simultaneously reducing the ongoing cash outflows associated with subsequent periodic settlements as a result of the reduction in the fixed leg of the swap.

NAREIT requests that the Derivatives Implementation Group (DIG) consider clarifying the implications of this scenario, or other transactions that could be analogized involving modifications of derivative instruments. Specifically, (1) whether an extend-and-blend swap should be considered a new derivative subject to the initial net investment test or whether it is an existing relationship, and (2) if it is an existing relationship, what is the appropriate methodology to account for the inherent "financing element" of these types of arrangements?

Should the DIG ultimately determine that an extend-and-blend swap be bifurcated into a debt host (with the value of the financing equal to the fair value of the modified terms) and a derivative comprised of an at-the-money swap, it would be helpful if the accounting at the time of initial application and going forward were described and illustrated with an example. NAREIT requests that the guidance and illustration include the methodology for amortizing the *financing* element of an extend-and-blend swap into earnings. The economics of the transaction suggest that the financing element would be *amortized* into earnings through the periodic swap settlements using a comparison of the actual cash outlay of the extend-and-blend swap to the amount that would have otherwise been paid had the swap been executed *at market*.

NAREIT appreciates the opportunity to continue to participate in FASB's standard setting process. This comment letter has been reviewed and approved by NAREIT's Best Financial Practices Council. If you have any questions regarding this response, please contact me at (202) 739-9432 or David Taube at (202) 739-9442.

Respectfully submitted,

George L. Yungmann
Vice President, Financial Standards