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NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

July 17, 2006

Mr. Lawrence W. Smith
Director-Technical Application and Implementation Activities and EITF Chair
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856-5116

Re: SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144 or the Standard)

Dear Larry:

The National Association of Real Estate Investment Trusts® ("NAREIT®") provided its views to the Financial Accounting Standards Board (FASB or Board) as the Board developed SFAS 144. Further, in a follow-up letter dated December 27, 2001 (the Letter), NAREIT raised concerns regarding the standard and guidance as it was thought to apply to Real Estate Investment Trusts (REITs) and other entities that manage portfolios of investment property. A copy of the Letter is attached as Exhibit A.

NAREIT is the representative voice for U.S. REITs and publicly traded real estate companies worldwide. Members are 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 those businesses.

More specifically, the Letter discussed the industry's concern over many accountants suggesting that, since the final standard did not explicitly provide for a notion of significance, most dispositions of investment property (even individual properties) would be required to be reported as discontinued operations. The Letter further indicated that this application of the standard would create considerable confusion among financial statement users. NAREIT requested that the Board clarify, in the Standard, its intention "to allow for judgment in determining whether, based on facts and circumstances unique to a particular entity, a disposal transaction should be reported in discontinued operations." At that time, the Board concluded that no further guidance was necessary.

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The primary concern expressed in the Letter was that the notion of "**significant** components" [emphasis added] was not carried forward from the exposure draft and that absent this notion, the regular/continuous reclassification of operating results from continuing to discontinued operations would create considerable complexity and confusion among users of our industry's financial statements. As more fully discussed below, our concerns have been realized to an even greater extent than we had initially thought.

Discussion

Investment Property Dispositions

The reporting issue addressed in this letter results from three converging factors:

- Most preparers of real estate company financial statements, influenced to a great extent by outside accountants who audit these financial statements, have applied paragraph 42 of the standard literally and have reported dispositions of investment properties as discontinued operations even in cases where the reporting entity views the disposition as insignificant.

- REITs regularly dispose of individual or insignificant groups of properties – see further discussion below.

- In paragraph B103 of SFAS 144, the Board indicates that it chose not to define the term *significant* to allow for judgment in determining whether, based on facts and circumstances unique to a particular entity, a disposal transaction should be reported in discontinued operations. But, while the ED included the notion of significance in the proposed standard, the notion of judgment is not included in the Standard. Therefore, common interpretations of the Standard conclude that paragraph B105 "trumps" the application of judgment when it concludes that, if an operating element of a company meets the definition of "a component of an entity" as defined in paragraph 41 of the standard, its disposition should be reported as a discontinued operation -- period. The wording of this standard and the way in which it is being "enforced" by audit firms represents a clear example of a rule based standard that results in inappropriate financial reporting when considered in the context of the facts and circumstances of many real estate companies.

Negative Impacts of this Reporting

Complexity for Financial Statement Users

First and foremost, reporting the regular disposition of investment property as discontinued operations has caused confusion among investors and analysts who follow real estate companies. Analysts regularly complain about the complexity that constant reclassification/restatement

causes in their ability to forecast future profitability. Exhibits B and C are letters from two prominent industry analysts discussing their views of this problem.

Further, the analytical methodology used by at least one major credit rating agency eliminates the "discontinued operations distinction" between properties sold and properties owned. Following is an excerpt from page 18 of Moody's *Rating Methodology for REITs and Other Property Firms*:

> SFAS No. 144 requires that the historical and current revenues and expenses, including gains or losses on sale, of a "component" of an entity (a component is considered to comprise operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the larger entity) held for sale or that has been disposed of, be classified as discontinued operations. For REITs, this requirement normally results in properties held for sale or sold being classified as discontinued operations. As selling properties is a regular part of many REITs' normal business operations, this results in a significant amount of each period's earnings being classified as discontinued operations, with annual restatements to prior years for comparability. Moody's believes the "discontinued" classification of these activities makes it difficult to determine a REIT's real estate property business performance and therefore we combine discontinued operations related to these core activities with the operating income from real estate properties that continue to be owned but are not classified as held for sale.

A copy of the complete Moody's document is attached as Exhibit D.

The Moody's methodology is particularly important for REITs that have implemented "capital recycling programs." Current reporting obscures the economics of these programs under which mature properties are sold and the proceeds are used to acquire properties with greater potential for earnings growth. Most industry participants believe that earnings from properties sold and earnings from acquired properties should be reported as results from continuing operations so as to not overstate growth in earnings from continuing operations – the result of excluding earnings generated by properties sold.

Similar to Moody's methodology, in order to communicate appropriate trends in operating results, both in aggregate and in terms of financial statement elements, many companies are forced to provide supplemental reports to management, Boards of Directors and financial analysts that do not segregate operating results of properties that are sold.

The frequency of reporting discontinued operations is enormous

In order to provide an understanding of the magnitude of restatements, NAREIT surveyed fifty significant REITs as to their reporting discontinued operations. Twenty-three companies (12% of publicly traded REITs) responded to the survey and provided information with respect to their disposition of properties and discontinued operations reporting over ten quarters -- 1Q03 through 2Q05. Property dispositions were reported as discontinued operations and previously reported net income or income from continuing operations was restated in 177 or 77% of these 230 accounting quarters. Management of these companies considered the great majority of these dispositions to be insignificant to the core operations and consolidated financial results of the company.

Inconsistency with Application to Other Industries

To understand whether other industries face issues of reporting discontinued operations similar to those faced by our industry, we looked at earnings reports of the 25 largest Fortune 500 companies for the same ten quarters – 1Q03 through 2Q05. Discontinued operations were reported in 25 or 10% of a possible 250 quarters for these companies. More importantly, the reasons for this discontinued operations reporting indicate that the companies disposed of lines of business, brands or major interests in affiliated businesses. Exhibit E summarizes the results of our study.

Inconsistency with IFRS 5

In addition to eliminating the complexity discussed above, we believe that an FASB interpretation that would clarify that the judgment discussed in paragraph B103 of the Basis for Conclusions of the Standard should be applied in determining whether the disposition of an asset should be reported as discontinued operations as prescribed in paragraph 42 of the Standard would significantly reduce or eliminate the wide inconsistency between U.S. GAAP and International Financial Reporting Standard (IFRS) No. 5, *Non-Current Assets Held for Sale and Discontinued Operations.* The International Accounting Standards Board (IASB) focused squarely on the issue of "significance" in its exposure draft and concluded that a discontinued operation is generally a component of an entity that represents "a separate major line of business or geographical area of operations" or "is part of a co-coordinated plan to dispose of a separate major line of business or geographical area of operations." NAREIT member companies are rapidly expanding outside of the United States. Requiring very different reporting of property dispositions as compared to real estate companies outside the U.S. results in financial performance reporting that is not comparable among real estate companies around the world. In addition, forcing U.S. companies to deal with the financial communications complexities caused by the prevailing interpretation of SFAS 144 when international competitors are not saddled with this issue puts U.S. companies at a bit of a disadvantage in the international capital markets.

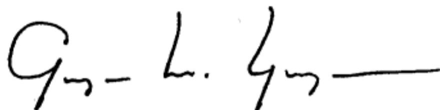
Increased Administrative Burden and Cost

In our survey of NAREIT member companies discussed above, we asked for information regarding other specific issues that result from having to report virtually every property sale in discontinued operations. The response was loud and clear. The constant restatement and re-audit of previously filed financial statements creates additional administrative burden and cost. A specific example of this burden was identified by a number of companies -- that companies are forced to restate previously filed Form10-Ks and Form 10-Qs in order to incorporate them into filing requirements in connection with selling securities or issuing debt under shelf registrations. REITs that operate as an UP-REIT must also amend previously filed periodic reports of the UP-REIT Operating Partnership. All of these restatements and amendments must, of course, be audited.

<u>Our Request</u>

Based on the industry's experience in applying SFAS 144 over the ten fiscal quarters surveyed, including the negative impacts of this reporting on the ability of investors and analysts to predict future earnings and the communications complexities faced by our member companies in the international business arena, we respectfully request that the FASB consider issuing some form of guidance that would explicitly provide for the judgment discussed in paragraph B103 of the Standard in determining whether the disposition of assets should be reported in discontinued operations.

Respectfully submitted,



George L. Yungmann
Senior Vice President, Financial Standards

cc: Scott Taub, Securities and Exchange Commission
Donald Young, Financial Accounting Standards Board