Westin Diplomat
Hollywood, FL

2012
REIT Wise®

NAREIT's Law, Accounting & Finance Conference

SOURCEBOOK

All Session Material

This document is a sample of the 2012 REITWise Sourcebook. It contains the full table of contents plus partial samples of select resource materials contained in the full 2012 REITWise Sourcebook library.

Committee Meetings

Accounting Committee Meeting

- •Review of recent real estate transactions and valuation practices
- •Impact of pending legislation of financial reporting
- •Revenue Recognition Project
- •FFO reporting at 2010 year end
- •Financial Instruments Projects

Panel Presentations and Supporting Materials

- •Accounting Committee Meeting Agenda
- •Dataline 2011-35 - E&C supplement
- •Dataline 2011-35 - FASB & IASB revenue ED (revised 1-3-2012)
- •Defining Issues - FASB Consolidation Project
- •Defining Issues - FASB Financial Instruments Project
- •Heads Up - FASB Defers Portions of New OCI Standard
- •Heads Up - FASB Finalizes Amendments on Goodwill Impairment Testing
- •Heads Up - FASB Finalizes Guidance on Presentation of Comprehensive Income
- •Heads Up - FASB Proposes Amendments to Impairment Testing of Indefinite-Lived Intangible Assets

Government Relations Committee Meeting

- •IRS audit activity
- •Legislative update
- •FATCA regulations
- •Repair regulations
- •SEC issues

Panel Presentations and Supporting Materials

- •Government Relations Committee Agenda
- •FATCA Presentation
- •Annual Report - CapitalSource, Inc.
- •Efairness - Marketplace Equity Act of 2011 H.R. 3179
- •Efairness - Marketplace Fairness Act S 1832
- •FATCA Proposed Regulations
- •FIRPTA - Real Estate Investment and Jobs Act of 2011 S. 1616
- •FIRPTA - Real Estate Jobs and Investment Act of 2011 H.R. 2989

- Proposed Regulations Regarding Deduction and Capitalization of Expenditures Related to Tangible Property
- H.R. 3606
- Section by section summary of S 1832
- Update and Streamline REIT Act
- NAREIT Analysis of Final SEC Rule Impacting UPREIT Debt (Aug. 3, 2011)
- Tangible Property Regulations and Transitional Guidance

State and Local Tax Subcommittee Meeting

- Recent developments in state legislation, regulations and audits
- Choice of entity and unitary filing: selected jurisdictions
- State nexus through pass-through entities
- Unexpected local taxes

Panel Presentations and Supporting Materials

- State and Local Tax Subcommittee Meeting Agenda
- State and Local Tax Subcommittee Presentation
- DC Combined Reporting Regulations
- Final Model Captive REIT statute
- MD Alternative Minimum Assessment Proposal SB 248 - Fiscal and Policy Note
- MD Alternative Minimum Assessment Proposal SB 248 - Bill Text
- MD Controlling Interest Transfer Tax - Related Party Transfers SB 845 Bill Text
- MD Controlling Interest Transfer Tax - Related Party Transfers SB 845 Fiscal and Policy Note
- MD Proposed Combined Reporting SB 269 Bill text
- MD Proposed Combined Reporting SB 269. Fiscal and Policy Note
- SALT Report

Sessions

Anatomy of Ventas' Acquisitions of Atria and NHP

- Tax & structuring issues
- Change of control issues
- Securities law matters
- Accounting and reporting issues

Panel Presentation

- Anatomy of Ventas' Acquisitions of Atria and NHP Presentation

Convergence Update

- Investment Property Entities
- Investment Companies
- Leases

Panel Presentations and Supporting Materials

- PwC Dataline 2011-32
- PwC Dataline 2011-34
- PwC Dataline 2011-35 (Supplement)
- PwC Dataline 2011-35 (Supplement)
- In Brief 2011-04
- In Brief 2011-44
- In Brief 2011-45
- In Brief 2011-46
- NAREIT FirstBrief
- NAREIT Investment Companies Comment Letter
- NAREIT Investment Property Entities Comment Letter
- NAREIT SFO Alert
- NAREIT SFO Report
- REESA Comment Letter on Investment Entities
- REESA Comment Letter on Investment Property Entities
- REESA Comment Letter on Receivable & Residual Lessor Accounting Model
- PwC Joint Leasing Project & Investment Property Entity Project

Financial Reporting Hot Topics

- Condorsement
- SEC Comment letters
- XBRL
- Reporting FFO

Panel Presentations and Supporting Materials

- Financial Reporting Hot Topics Presentation
- Dataline 2011-36 - SEC staff papers

- Dataline 2011-37 - 2011 AICPA SEC Conference
- Point of View - Use of IFRS in US

Lessons Learned from Canada's Adoption of IFRS

- Key differences between US GAAP and IFRS
- How to prepare for convergence
- How did investors respond?

Panel Presentations and Supporting Materials

- KPMG AAS Slipsheet BC&RE
- KPMG Anti-Deferral Rules Real Estate Brochure
- KPMG Consolidated Financial Statements
- KPMG Joint Arrangements
- KPMG Revenue Reccomendation for Real Estate Investment and Development

Public Non-listed REITs

- FINRA Notice to Members
- SEC disclosure policy of per share valuations
- Market impact of NAV REITs
- Sales literature issues

Panel Presentations and Supporting Materials

- Notice to Members 11-44
- NAREIT Submission Re: FINRA Regulatory Notice 11-44
- FINRA Notice 12-1
- American Realty Capital Trust Joins Nasdaq
- American Realty Capital Trust Press Release
- Cole No Action Letter
- Inland Western Listing 2012 Press Release
- PLR 201109003
- PLR 201119025
- PLR 201135002
- PLR 201205004
- Quarterly Report Wells REIT II
- Schwab Alternative Investments
- SEC Division of Corporation Finance Disclosure Guidance Topic No. 3
- SEC 8-k Inland American Real Estate Trust

- Summary of SEC Remarks

REIT Tax Technical Panel

- Ownership waivers and related ownership tests
- TRS issues
- Newly-formed and lower-tier REITs
- UPREIT issues

Panel Presentations and Supporting Materials

- REIT Tax Technical Panel Presentation
- PLR 9552047
- PLR 9621032
- PLR 8921067
- PLR 9205030
- PLR 9430022
- PLR 9439005
- PLR 9440026
- PLR 9534022

SEC Legal Developments

- Structuring various methods for raising equity capital
- Recent developments on REIT 10-K and IPO disclosure issues
- Magic Page presentation issues
- Updates on "Say on Pay"

Panel Presentations and Supporting Materials

- Cybersecurity Risks (Scott Hodgkins)
- Institutional Share Voting (Scott Hodgkins)
- Recent Developments in Say-on-Pay in the US and UK (Scott Hodgkins)
- Say on Pay and Related Advisory Vote Proposals (Scott Hodgkins)
- SEC Legal Developments (Gil Menna)
- United States Say-on-Pay: The New World Order (Scott Hodgkins)

State and Local Taxes

- Sales and use tax issues
- UPREITs, tiered structures, and disregarded entities
- Transfer taxes
- State/local issues affecting mortgage REITs

Panel Presentations

- Sales & Use Taxes Presentation
- Real Property Transfer Tax Presentation
- UPREIT/Tiered Structure Issues & Opportunities

State of the Capital Markets

- Sources of capital
- M&A possibilities
- How to grow in the current environment
- Expanding the investor base
- IPO outlook

Panel Presentations and Supporting Materials

- Green Street Report 9-30-10 (Michael Knott)
- REIT Watch

State of the Commercial Real Estate Markets

Panel Presentation

- State of the Commercial Real Estate Markets Presentation

Tax and Business Issues Surrounding the Evolving REIT

- Infrastructure
- Media

- OpCo/PropCo
- New uses

Panel Presentation

- Tax and Business Issues Surrounding the Evolving REIT Presentation

Tax Planning for US REITs Investing Abroad

- Subpart F and PFIC issues
- Proper and efficient use of treaties/holding company structures
- Repatriation of trapped cash
- Tax accounting issues

Panel Presentation

- Tax Planning for US REITs Investing Abroad Presentation

The Treasury Speaks

- Review of recent significant rulings
- Best practices in obtaining a PLR
- Administration tax policies impacting real estate

Panel Presentations and Supporting Materials

- Best Practices in Obtaining a PLR
- Recent Private Letter Rulings
- PLR 201109003
- PLR 201118015
- PLR 201119025
- PLR 201122016
- PLR 201123005
- PLR 201129031
- PLR 201135002
- PLR 201144016
- PLR 201145008
- PLR 201147015

•PLR 201204006

•PLR 201205004

•PLR 201206001

•Rev. Proc. 2012-1 (procedures for obtaining a letter ruling, determination letter and closing agreement)

•Rev. Proc. 2012-3 (IRS no-rule issues)

•Excerpt from Chief Counsel Manual (Excerpts of the IRS Chief Counsel Directives Manual Concerning Letter Rulings, Information Letters and Closing Agreements)

•Priority Guidance Plan: Excerpts relating to REITs

•NAREIT May 26, 2011, Letter to IRS re: Priority Guidance Plan

•NAREIT Oct. 28, 2010, Letter to Treasury re: Repealing Preferential Dividends

•NAREIT April 7, 2011 Letter to Treasury re: Obama Administration's Better Buildings Initiative

•Treasury Department Green Book Explanation of FY 2013 Budget Provisions Relating to REITs

•Obama Administration Framework for Business Tax Reform

Roundtables

Cash Management/ Treasury Best Practices

Flexible Work Arrangements

•Sample Telecommuting Policy

•Managing Flexible Work Arrangements

General Counsel Issues

•ISS Report on Evaluating Pay for Performance Alignment

•Venable Maryland Law Memo - Living with the New GRId 2.0 & Maryland Law Issues

•White Paper - Social Media

•Status of Say-on-Pay Cases

Health Care REITs

•2011 Healthcare Real Estate Industry Report

•Healthcare REITs, Senior Housing & Skilled Nursing Operators Winter of 2012

•RIDEA Structure

Latest in Information Technology

Mortgage REITs

- SEC Request for Comments - Concept Release
- NAREIT Comment Submission

Office/Industrial REITs

- Office & Industrial REIT Roundtable Outline
- PLR 201014042
- PLR 201034010
- PLR 201037005

PCAOB Update

- About the PCAOB
- FIRCA Letter to PCAOB - February 23, 2012
- Inspected Firms Overview
- Mission Structure and History
- NAREIT Comment Letter on PCAOB Concept Release - December 9, 2011
- PCAOB Board
- PCAOB Concept Release on the Auditors Report Overview of Responses
- PCAOB Issues Concept Release on Auditor Independence and Audit Firm Rotation
- PCAOB Reproposes Auditing Standard on Communications with Audit Committees

Residential REITs

- 2012 Property Insurance Market Update
- U.S. Cap Trends - Monthly Volume & Pricing Trends
- CBRE Non-Bank Multi-Housing Loan Maturities
- CBRE Cap Rates & Spreads

Retail REITs

- RBC Report on Retail REITs

Timber REITs

- NAFO - Timber Industry Tax Discussion
- PLR 201123003
- PLR 201123005

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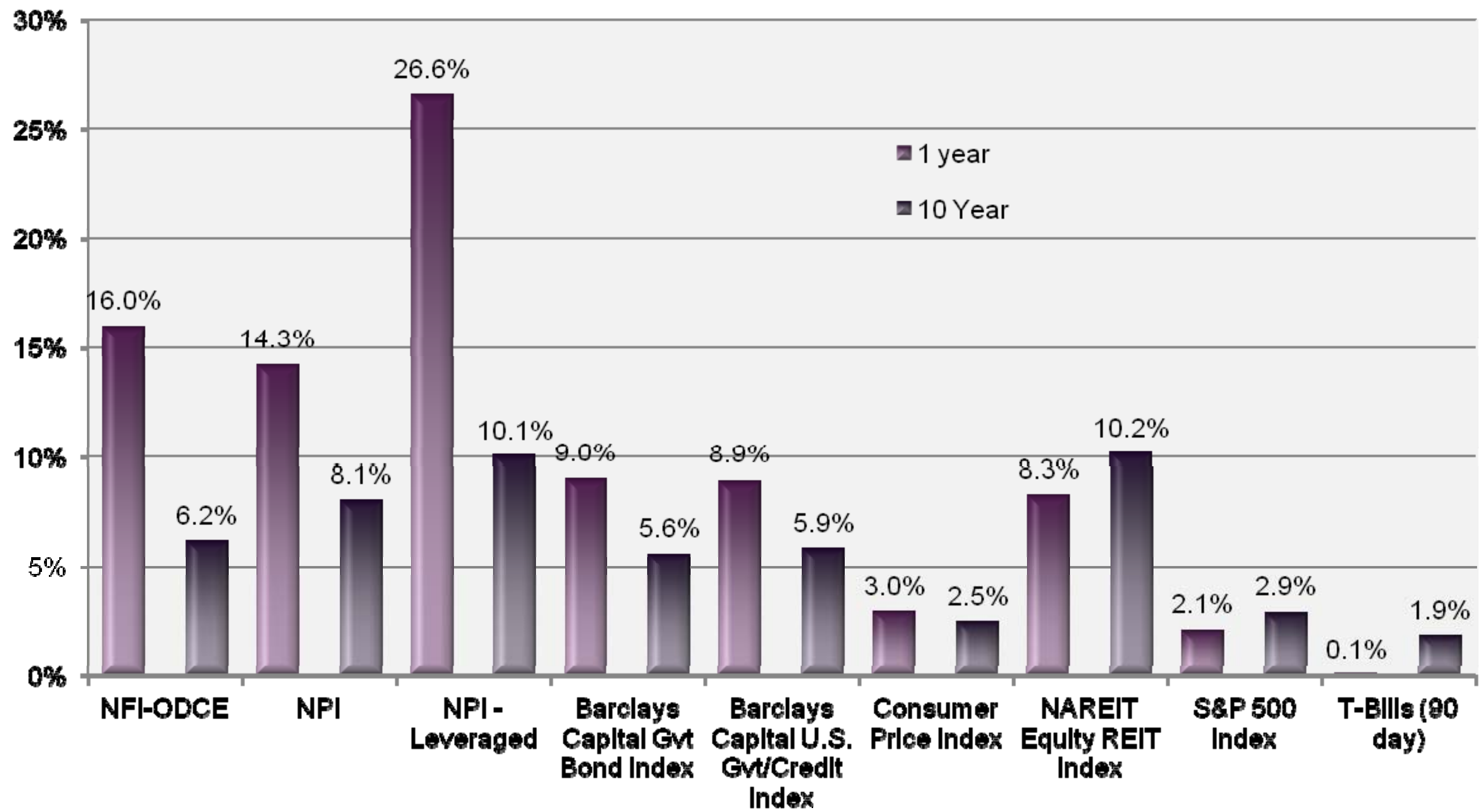
Space and Capital Market Trends March 21-23, 2012

NAREIT

Returns for Different Asset Classes: 1 and 10 year returns

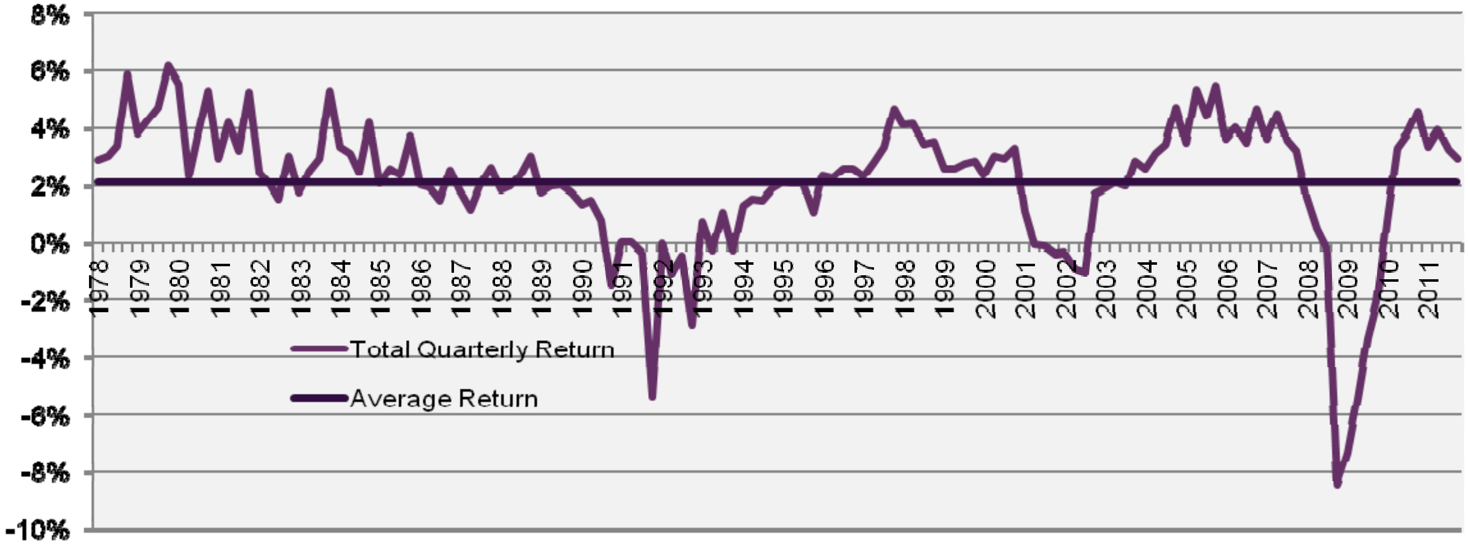
Total Return Index Comparison as of December 31, 2011



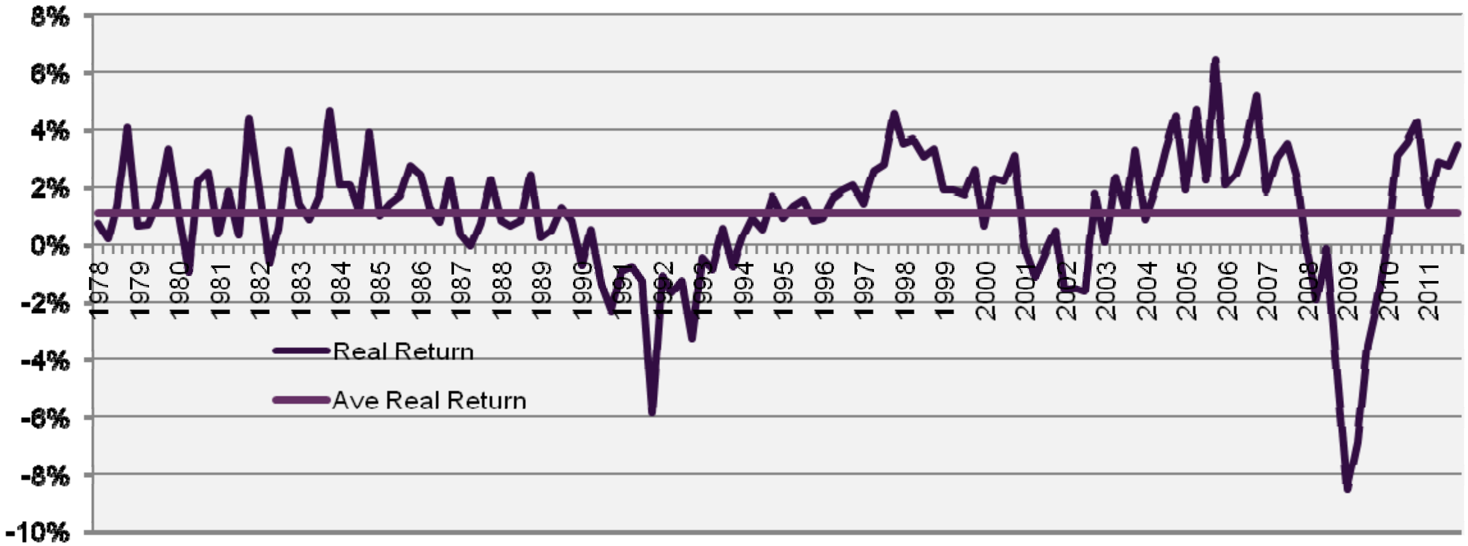
National Council of Real Estate Investment Fiduciaries

NPI Real Vs. Nominal

Quarterly Nominal Returns



Quarterly Real Returns



NCREIF
National Council of Real Estate Investment Fiduciaries

Accounting Committee Meeting

Wednesday, March 21st
1:15-2:45 p.m.
Westin Diplomat Resort & Spa
Hollywood, FL

Moderator:

Steven Broadwater, SVP & CAO - Simon Property Group, Inc.

Panelists:

Andrew Corsini, Partner - KPMG LLP
Louis DeFalco, Sr. Manager - PwC
Ross Prindle, Managing Director - Duff & Phelps
Patrick Scheibel, Sr. Manager - Deloitte LLP
Serena Wolfe, Partner - Ernst & Young LLP

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REITS: BUILDING DIVIDENDS AND DIVERSIFICATION®

Accounting Committee Meeting
(Open to all REITWise® Registrants)
Westin Diplomat – Hollywood, FL.
Regency Ballroom 2 & 3
Wednesday, March 21, 2012
1:15 pm – 2:45 pm

Co-Chairs:
Bruce Johnson, Regency Centers Corporation
Steve Broadwater, Simon Property Group
Heidi Roth, Kilroy Realty Corporation

NAREIT Staff Liaisons:
George Yungmann, Sr. VP, Financial Standards
Christopher Drula, Senior Director, Financial Standards

Topic	**Present**
• Introduction	Steve Broadwater
• Recent real estate transactions and latest investment property valuation practices	Ross Prindle *Duff & Phelps*
• Status of FASB/IASB Revenue from Contracts with Customers Exposure Draft	Lou DeFalco *PwC*
• FFO Reporting Practices	Serena Wolfe *E&Y*
• Status of FASB Consolidation: Principal vs. Agent Exposure Draft	Andy Corsini *KPMG*
• Status of FASB/IASB Accounting for Financial Instruments Projects	Andy Corsini
• FASB Presentation of Other Comprehensive Income Project	Patrick Scheibel *Deloitte*
• FASB Impairment of Goodwill and Other Indefinite-Live Intangible Assets Project	Patrick Scheibel
• Senate Bill 1933, ‘‘Reopening American Capital Markets to Emerging Growth Companies Act of 2011’’	Patrick Scheibel
• Questions from the audience	

Note: This meeting may qualify for 1.5 hours of continuing professional education credits, depending on the state. For CLE or CPE credit information, please contact Afia Nyarko at 202-739-9433 or anyarko@nareit.com.

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Dataline
A look at current financial reporting issues

No. 2011-35 (supplement)
November 22, 2011

What's inside:

Revenue from contracts with customers
The proposed revenue standard is re-exposed

Engineering and construction industry supplement

Overview

Entities in the engineering and construction (E&C) industry applying U.S. GAAP or IFRS have primarily been following industry guidance for construction contracts[1] to account for revenue. These standards were developed to address particular aspects of long-term construction accounting and provide guidance on a wide range of industry specific considerations including:

- Defining the contract, such as when to combine or segment contracts, and when and how to account for change orders and other modifications
- Defining the contract price, including variable consideration, customer furnished materials, and claims
- Recognition methods, such as the percentage-of-completion method (and in the case of U.S. GAAP, the completed contract method) and input/output methods to measure performance
- Accounting for contract costs, such as pre-contract costs and costs to fulfil a contract
- Accounting for loss making contracts

[1] This guidance is included in ASC Topic 605-35, *Construction-Type and Production-Type Contracts* (U.S. GAAP), and International Accounting Standards 11, *Construction Contracts* (IFRS).

Once the new revenue recognition standard becomes effective, the construction contract guidance and substantially all existing revenue recognition guidance under U.S. GAAP and IFRS will be replaced. This includes the percentage-of-completion method and the related construction cost accounting guidance as a standalone model.

This E&C industry supplement discusses the areas in which the proposed standard is expected to have the greatest impact. The examples and the related assessments contained herein are based on a current interpretation of the exposure draft, *Revenue from Contacts with Customers*, issued on November 14, 2011. Any conclusions set forth below are subject to further interpretation and assessment based on the final standard. We have also provided a high-level summary of key changes from the original exposure draft issued on June 24, 2010 (the "2010 Exposure Draft"). References to the “proposed model” or “proposed standard” throughout this document refer to the exposure draft issued in November 2011, unless otherwise indicated. For a more comprehensive description of the proposed standard, refer to PwC Dataline 2011-35 (www.cfodirect.pwc.com) or visit www.fasb.org or www.ifrs.org.

Defining the contract

Current guidance covers:

- When two or more contracts should be combined and accounted for together
- When one contract should be segmented and accounted for separately as two or more contracts
- When a contract modification should be recognized

These situations and, in particular, contract modifications such as change orders, are commonplace in the E&C industry.

The proposed standard applies only to contracts with customers when such contracts:

- Have commercial substance
- Have been approved by the parties to the contract and such parties are committed to satisfying their respective obligations
- Have enforceable rights that can be identified regarding the goods or services to be transferred
- Have terms and manners of payment that can be identified

Current practice is not expected to significantly change in the assessment of whether contracts should be combined. The proposed standard does not contain guidance on segmenting contracts; however, construction companies that currently segment contracts under current guidance might not be significantly affected because of the requirement in the proposed standard to account for separate performance obligations (refer to "Accounting for multiple performance obligations" below). Construction companies currently exercise significant judgment to determine when to include change orders and other contract modifications in contract revenue and therefore, there is diversity in practice. We expect that the use of judgment will continue to be needed and do not expect current practice (or existing diversity) in this area to be significantly affected by the proposed standard, including the accounting for unpriced change orders.

Proposed model	Current U.S. GAAP	Current IFRS
Combining contracts		
Two or more contracts (including contracts with parties related to the customer) are combined and accounted for as one contract if the contracts are entered into at or near the same time and one or more of the following conditions are met:	Combining and segmenting contracts is permitted provided certain criteria are met, but it is not required so long as the underlying economics of the transaction are fairly reflected.	Combining and segmenting contracts is required when certain criteria are met.

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cutting through complexity

Defining Issues®

November 2011, No. 11-61

Contents

FASB Progresses on Financial Instruments Project

The FASB continues to make significant tentative revisions to its exposure draft (ED) on accounting for financial instruments after considering feedback from constituents.[1] This edition of *Defining Issues* summarizes the FASB's tentative decisions through its November 9, 2011 meeting, which are subject to change until a final standard is issued.

The FASB is close to completing its redeliberations on classification and measurement. Although the FASB has not yet made a formal decision, we expect it will re-expose its classification and measurement conclusions. The FASB is also actively working on a new impairment model with the IASB. Once that model is fully developed, the Boards will determine whether re-exposure is necessary. We expect re-exposure will take place. We also expect final standards on classification and measurement and impairment to be issued in 2012. The FASB has not yet redeliberated its hedge accounting proposals and the timing of a final standard is unclear.

A chart in *Summary of Tentative Decisions Reached in Redeliberations* compares the FASB's tentative decisions reached to date in its redeliberations with the corresponding ED's original proposals. A subsequent chart in *Summary of the IASB's and FASB's Hedge Accounting Proposals* compares the main provisions of the IASB's hedge accounting proposals to the FASB's proposals.

Classification and Measurement

Overview. The proposals in the ED called for most financial instruments to be measured at fair value. However, most constituents disagree with fair value measurement for loans held for collection of cash flows. Constituents also disagree that financial liabilities should be measured at fair value unless an entity has the ability to trade them. Based on the FASB's tentative decisions, more financial instruments would be measured at amortized cost than under the ED.[2] The following represents the Board's tentative decisions reached on its classification and measurement model during redeliberations.

Initial Measurement. The initial measurement of a financial instrument would depend on how it would be measured subsequently. Financial instruments subsequently measured at fair value with all changes in fair value recognized in net income (FV-NI) would be initially measured at fair value. Financial instruments subsequently measured at amortized cost or fair value with fair value changes

[1] FASB Proposed Accounting Standards Update, Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities, available at www.fasb.org. See Defining Issues No. 10-22, Proposed Changes to Accounting for Financial Instruments and Hedging Activities, and Issues In-Depth No. 10-2, Proposed Changes to Accounting for Financial Instruments and Hedging Activities, available at www.kpmginstitutes.com/financial-reporting-network.

[2] See Defining Issues No. 11-2, FASB Tentatively Decides Not to Require Fair Value Measurement for Some Financial Assets, available at www.kpmginstitutes.com/financial-reporting-network.

Government Relations Committee Meeting

Wednesday, March 21st
3:00-4:30 p.m.
Westin Diplomat Resort & Spa
Hollywood, FL

Moderator:

Rohn Grazer, SVP & Director-Tax - Prologis, Inc.

Panelists

Jeffrey Clark, SVP-Tax - Host Hotels & Resorts, Inc.
Adam Handler, Principal - PwC
Emma Preston, Sr. Manager - KPMG LLP
Daniel Tucker, VP-Tax - Plum Creek Timber Company, Inc.
Thomas Yeates, Executive Director - Ernst & Young LLP

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REITS: BUILDING DIVIDENDS AND DIVERSIFICATION®

GOVERNMENT RELATIONS COMMITTEE
(Open to all REITWise® Registrants)
Westin Diplomat
Atlantic Ballroom
Hollywood, FL
Wednesday, March 21, 2012
3:00 p.m. - 4:30 p.m.

Co-Chairs:

Jeffrey S. Clark, Host Hotels & Resorts
Rohn T. Grazer, Prologis, Inc.
Daniel L. Tucker, Plum Creek Timber Company

NAREIT Staff Liaisons:

Tony M. Edwards, Executive Vice President & General Counsel
Dara F. Bernstein, Senior Tax Counsel

I. IRS Audits of REITs
Discussion led by Adam Handler, PwC

II. U.S. REIT Act
Discussion led by Dan Tucker

III. FIRPTA Reform
Discussion led by Jeff Clark

IV. Sales & Use Tax Collection/e-fairness
Discussion led by Dara Bernstein

V. FATCA
Discussion led by David C. Richardson, KPMG

VI. Proposed Repair Regs:
Discussion led by Thomas Yeates, E&Y

VII. SEC Issues: 1940 Act Concept Release; Risk Retention Proposed Rule; UPREIT Debt Final Rule; Derivatives; S. 1933
Discussion led by Tony Edwards

Note: This meeting may qualify for 1.5 hours of continuing professional education credits, depending on the state. For CLE or CPE credit information, please contact Afia Nyarko at 202-739-9433 or anyarko@nareit.com.

NAREIT's Analysis of Emerging National Issues

Policy Report

August 3, 2011

SEC Adopts New Short-Form Criteria to Replace Credit Ratings

As required by Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Securities and Exchange Commission (SEC) voted unanimously on July 26, 2011 to adopt new rules (New Rules) to remove credit ratings as eligibility criteria for companies seeking to use "short form" registration to register the offering of securities.[1] Rather than relying on certain credit ratings criteria, the New Rules now permit a majority-owned operating partnership of a real estate investment trust (REIT) that qualifies as a well-known seasoned issuer (WKSI) to use Form S-3 for offerings of non-convertible debt securities under the Securities Act of 1933 (the Securities Act), among other changes.

The National Association of Real Estate Investment Trusts (NAREIT) submitted a comment letter, dated March 28, 2011 (the NAREIT Letter), in response to the SEC's initial proposal. NAREIT representatives also met with the SEC staff to discuss, among other things, the REIT-specific eligibility criteria. The criteria suggested by NAREIT are reflected in the New Rules. The following table provides a comparison of NAREIT's proposal and the New Rules as adopted by the SEC regarding Form S-3 eligibility to register the offering of non-convertible debt securities:

NAREIT Proposals		SEC New Rules
Issuer is a majority-owned subsidiary, including majority-owned operating partnership, of a parent that is Form S-3 eligible for primary offerings, if the combined outstanding equity and debt of the parent and subsidiary meet certain thresholds		Issuer is a majority-owned operating partnership of a REIT that qualifies as a WKSI, as defined in Rule 405 under the Securities Act
Issuer has at least $250 million in aggregate principal amount of non-convertible debt securities outstanding ensuring that there is a wide following in the marketplace and information about the issuer is generally readily available		Issuer has outstanding (as of a date within 60 days prior to the filing of the registration statement) at least $750 million of non-convertible securities, other than common equity, issued in primary offerings for cash (not exchange), registered under the Securities Act

NAREIT Proposals		SEC New Rules
No comparable proposal		The issuer has issued (as of a date within 60 days prior to the filing of the registration statement) at least \$1 billion in non-convertible securities, other than common equity, in primary offerings for cash (not exchange) registered under the Securities Act, over the prior three years
No comparable proposal		Issuer is a wholly-owned subsidiary of a WKSI
Revise definition of WKSI in Rule 405 under the Securities Act to include the securities of a majority-owned subsidiary of a parent that is a WKSI, if the majority-owned subsidiary has at least \$500 million in aggregate principal amount of non-convertible debt securities outstanding		No comparable rule adopted

The REIT-specific eligibility criteria represents a significant broadening of the eligibility criteria contained in the SEC's initial proposal, which threatened to create substantial roadblocks to continued access by REITs to the public debt capital markets. In explaining why it singled out REIT operating partnerships for Form S-3 eligibility, the SEC specifically cited the NAREIT Letter in noting that investors and other market participants that follow Umbrella Partnership Real Estate Investment Trusts (UPREITs) analyze the operations of their operating partnerships in conjunction with following the UPREITs.

The New Rules will take effect 30 days after they are published, but will include a temporary grandfather provision that allows an issuer to use Form S-3 for a period of three years from the effective date of the New Rules if the issuer would have been eligible to register the securities offerings under the old criteria. However, since the final rule is favorable to UPREITs, the use of the grandfather provision will probably not be necessary.

[1]*See* SEC Release Nos. 33-9245; 34-64975 (July 27, 2011)

Contact

For further information, please contact Tony Edwards at tedwards@nareit.com.

Westin Diplomat Hollywood, FL

2012

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NAREIT's Law, Accounting & Finance Conference

Tangible Property Regulations and Transitional Guidance

Thomas C. Yeates, National Tax

NAREIT Law and Accounting, March 2012

NAREIT

Acquisition of Tangible Property Costs – Treas. Reg.§ 1.263(a)-2T

- Costs that facilitate the transaction must be capitalized
- Inherently facilitative costs (e.g. appraisals, title exam, etc)
- Special rules for non-facilitative costs:
  - Real property–whether and which test for investigatory costs
  - Employee compensation
- Whether or Which Test
  - Not applicable to tangible personal property

Improvements to Tangible Property – Buildings and Structural Component Units of Property

HVAC system – includes motors, compressors, boilers, chillers, pipes, ducts, etc.

Plumbing system – includes pipes, drains, sinks, bathtubs, toilets, water/sewer equipment, etc.

Electrical system – includes wiring, outlets, junction boxes, lighting fixtures, etc.

Gas distribution system – includes pipes and equipment used to distribute gas, etc.

Building structure – all other Section 1250 components, including roof, walls, foundation, finishes, windows, doors, etc.

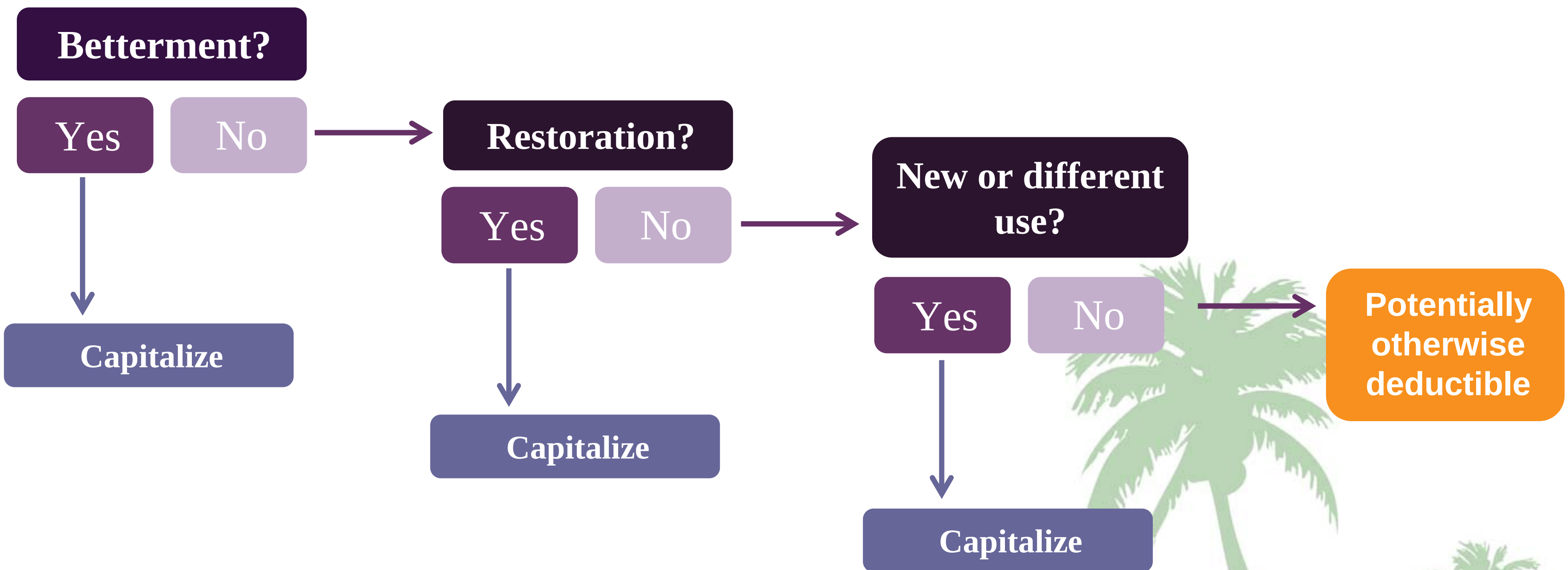
Fire protection and alarm system – includes sprinklers, computer controls, fire doors/escapes, etc.

Security system – includes window and door locks, security cameras, security lighting, alarm system, etc.

Elevator system – includes all elevators in the building

Escalator system – includes all escalators in the building

Improvements to Tangible Property – What is an improvement? – Treas. Reg.§ 1.263(a)-3T



State and Local Tax Subcommittee Meeting

Wednesday, March 21st
4:45-6:00 p.m.
Westin Diplomat Resort & Spa
Hollywood, FL

Moderator:
Sam Melehani, Partner - PwC

Panelists:
Pia Ackerman, SVP-Tax - Ashford Hospitality Trust, Inc.
Nabil Andrawis, EVP & Director-Taxation - Lexington Realty Trust
David S. Turzewski, Parter - KPMG LLP
Steven Wlodychak, Principal - Ernst & Young LLP

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REITS: BUILDING DIVIDENDS AND DIVERSIFICATION®

STATE AND LOCAL TAX SUBCOMMITTEE
(Open to all REITWise® Registrants)
Westin Diplomat
Regency Ballroom
Hollywood, FL
Wednesday, March 21, 2012
4:45 p.m. - 6:00 p.m.

Co-Chairs:

Nabil Andrawis, Lexington Realty Trust
Sam Melehani, Partner, PwC LLP

Panelists:

Pia C. Ackerman, SVP-Tax, Ashford Hospitality Trust, Inc.
David Turzewski, Partner, KPMG, LLC
Steven N.J. Wlodychak, Principal, Ernst & Young LLP

NAREIT Staff Liaison:

Dara F. Bernstein, Senior Tax Counsel

I. Choice of entity - selected jurisdictions

II. Recent state developments – Multistate Tax Commission, proposed MD legislation, and DC combined reporting

III. Unitary filing - tricks and traps

IV. State nexus through pass-through entities

V. Update on audit activity

VI. Unexpected local taxes

Note: This meeting may qualify for 1.25 hours of continuing professional education credits, depending on the state. For CLE or CPE credit information, please contact Afia Nyarko at 202-739-9433 or anyarko@nareit.com.

Westin Diplomat
Hollywood, FL

2012 REIT Wise®

NAREIT's Law, Accounting
& Finance Conference

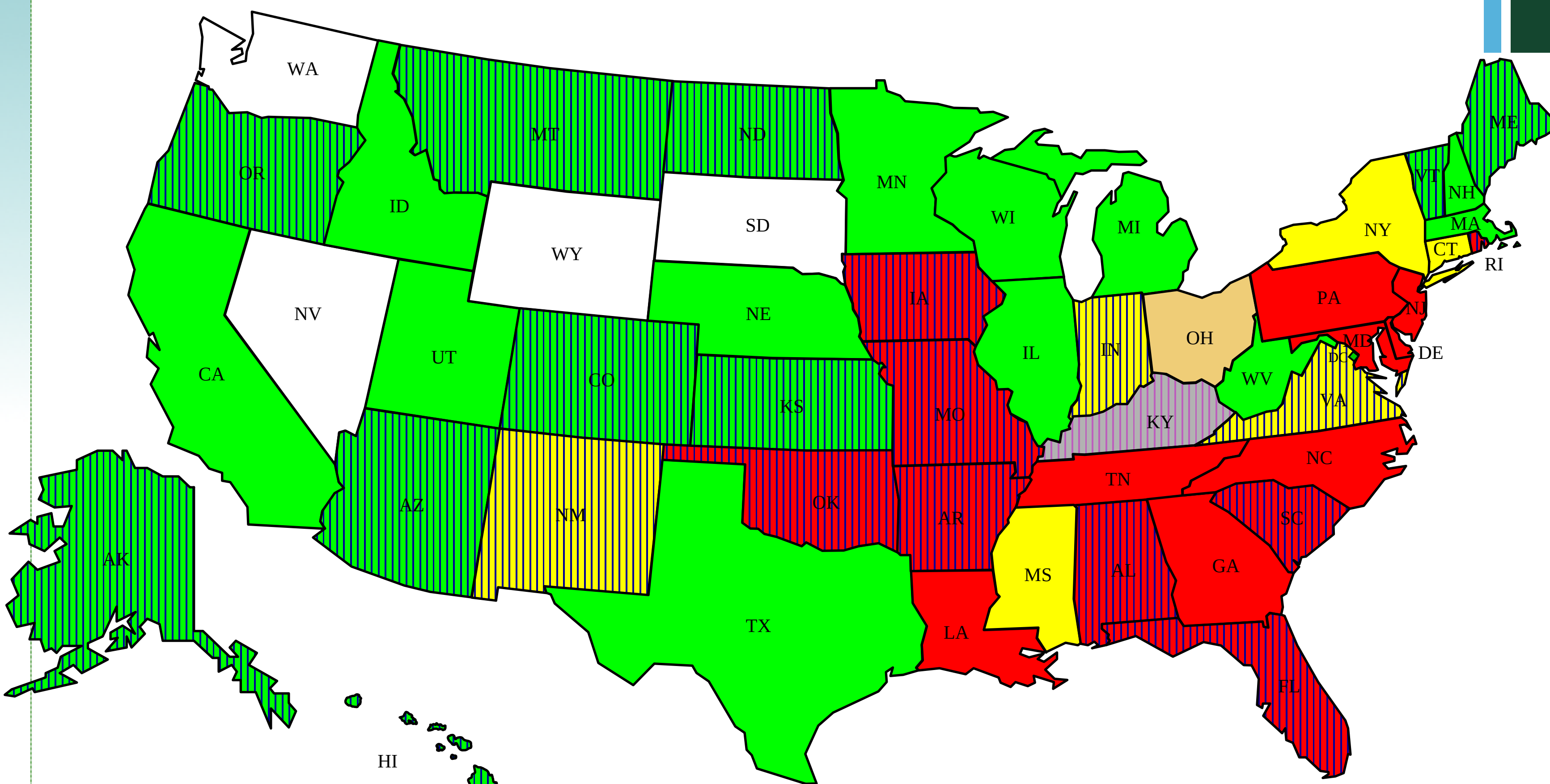
State and Local Taxes
March 22, 2012

NAREIT

Real Property Transfer Taxes – Introduction

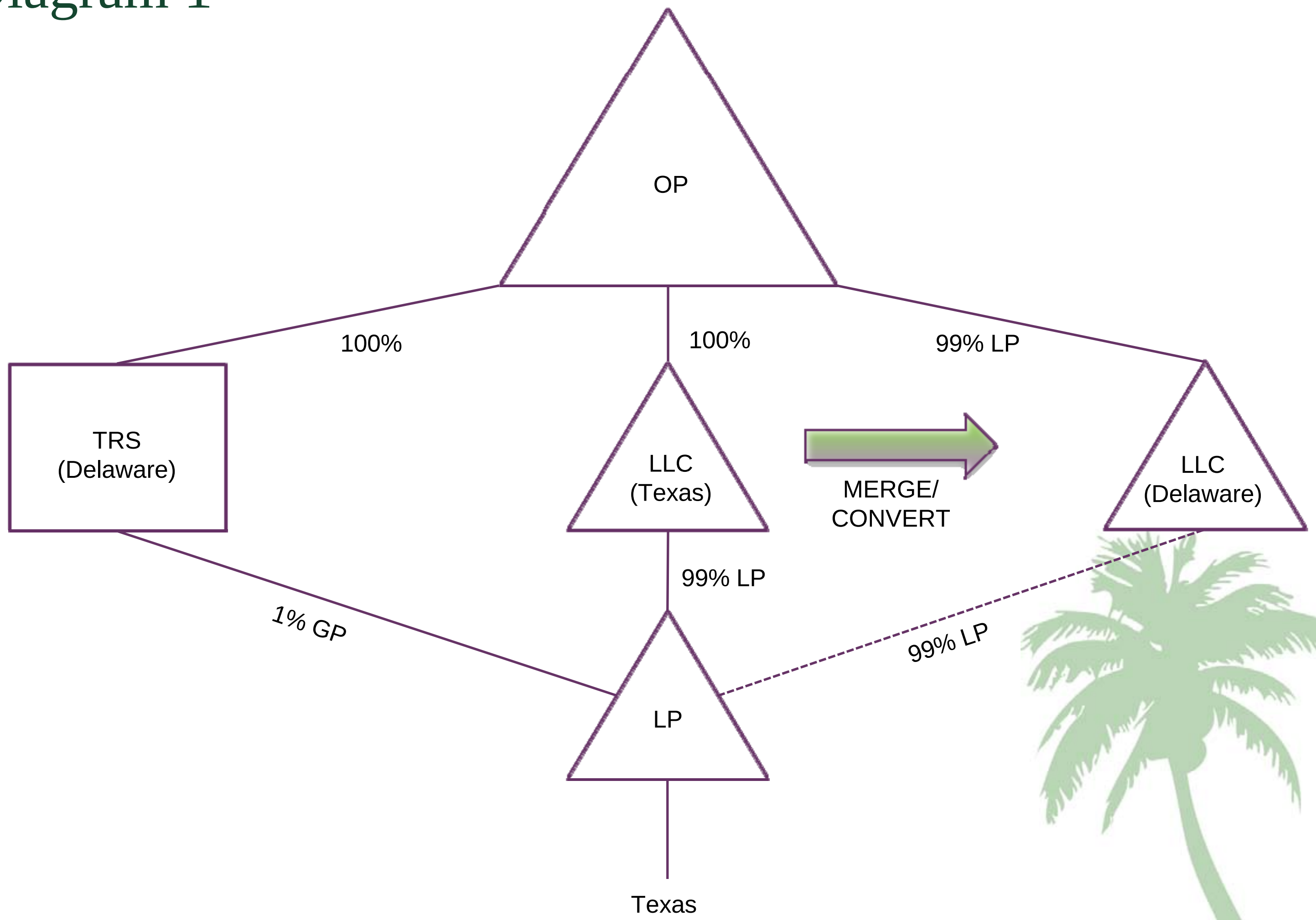
- Transfer tax is imposed in approximately 39 states at the state, county and local level
- 16 states impose tax on transfers of a controlling interest in an entity directly or indirectly owning real estate
- Tax can be imposed where property is directly held by entity **OR** where property is held indirectly via underlying subsidiary entities

Filing Options
(as of 3/13/2012)



Note that in many instances, state tax authorities may have power to mandate combined or consolidated reports. DC has changed to mandatory unitary combined reporting for tax periods beginning on or after Jan. 1, 2011.

Diagram 1



OP
100%
100%
99% LP
TRS
(Delaware)
LLC
(Texas)
MERGE/
CONVERT
LLC
(Delaware)
99% LP
1% GP
99% LP
LP
Texas

MULTISTATE TAX COMMISSION

Working together since 1967 to preserve federalism and tax fairness

Resolution Adopting Model Statute for Disallowance of Deductions for Payments to Captive Real Estate Investment Trusts as Recommendation to the States

Whereas, in 2008 the Commission adopted a Model Statute for the Taxation of Captive Real Estate Investment Trusts ("REITs") which prevents inappropriate income-shifting to captive REITs by denying a dividend paid deduction where the captive REIT is effectively subject to state taxation; and

Whereas, in 2009 the Uniformity Committee subsequently undertook a project to develop a Proposed Model Statute for the Disallowance of Deductions for Payments to Captive REITs that could be adopted in states as an alternative, or in addition, to the 2008 Model Statute as a superior method for addressing inappropriate income shifting for separate entity states and in situations where the captive REITs are not included in a combined report; and

Whereas, the Uniformity Committee on April 13, 2010 voted to recommend to the Executive Committee a proposed Model Statute for the Disallowance of Deductions for Payments to Captive REITs, and the Executive Committee on July 29, 2010 voted to conduct a public hearing on the proposed Model Statute; and

Whereas, a public hearing on the proposed Model Statute for Disallowance of Deductions for Payments to Captive REITs was held on September 14, 2010, and a hearing officer's report was provided to the Executive Committee on November 23, 2010; and

Whereas, the Executive Committee voted to recommend the Commission approve the proposed Model Statute for the Disallowance of Deductions for Payments to Captive REITs on January 9, 2011; and

Whereas, a Bylaw 7 Survey was sent to the affected compact member States on April 14, 2011, with a majority of States indicating they would consider adoption of the proposed Model Statute for Disallowance of Deduction for Payments to Captive REITs;

Now, therefore, be it:

RESOLVED, that the compact member States adopt the attached Model Statute for the Disallowance of Deductions for Payments to Captive Real Estate Investment Trusts as a uniformity recommendation to the States.

____
Steve Cordi, Chair

____
Joe Huddleston, Executive Director
Multistate Tax Commission

Dated: July 27, 2011

Anatomy of Ventas' Acquisitions of Atria and NHP

Thursday, March 22nd
11:15-12:30 p.m.

Moderator:
Wiliford Schlumberger, Executive Director - J.P. Morgan

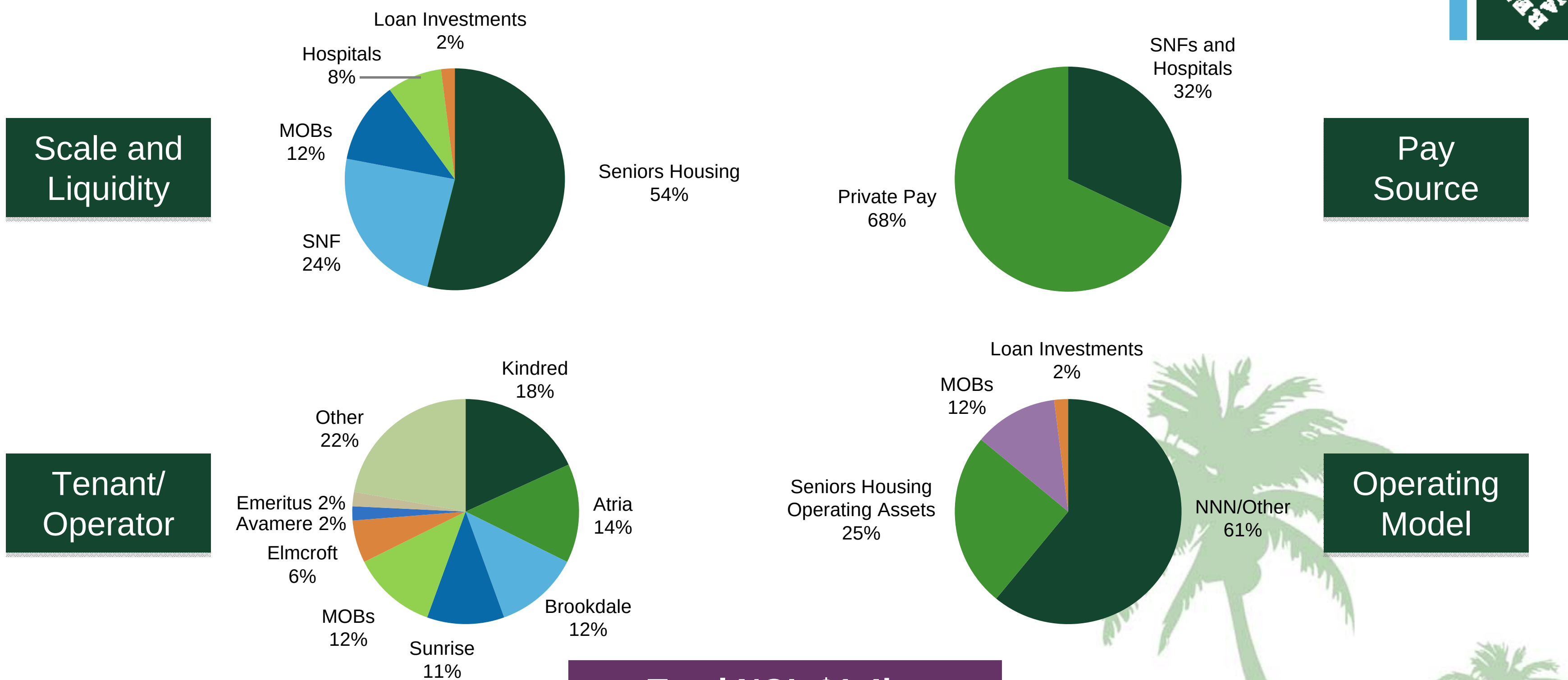
Panelists:
Kristen Benson, VP-Sr. Securities Counsel - Ventas, Inc.
Joseph Lambert, VP-Transactions Counsel - Ventas, Inc.
Brian Wood, SVP-Tax - Ventas, Inc.
Serena Wolfe, Partner - Ernst & Young LLP

Ventas 2011: A Transformative Year

	Ventas Pro forma for Acquisitions		
	Ventas	**Atria**	**NHP**
Transaction Size ($bn)		$3.1bn	$7.6bn
Date of transaction		May 2011	July 2011
Equity Capitalization ($bn)	$9bn	$10bn	$16bn
NOI ($)	$670mm	$860mm	$1.4bn
Tenant / operator relationship	22	23	100+
Largest tenant	36%	29%	18%
Private pay % of NOI	59%	67%	68%
NNN / Operations Mix	69% / 19%	56% / 36%	61% / 25%
Debt / EV	26%	33%	29%
Ratings	Baa3 / BBB- / BBB	Baa3 / BBB- / BBB	Baa2 / BBB / BBB+

Acquired $11bn+ of real estate, while improving credit stats and ratings

Diversified Enterprise with Scale & Growth Potential



Total NOI: $1.4bn

Ventas Business Model Provides Diversification and Balance Among Tenant/Operator, Operating Model and Asset Class

1. Annualized fourth quarter Ventas NOI assuming all events occurred at the beginning of the period. NOI reflect only Ventas' portion for joint venture assets. Totals may not add due to rounding

Two Very Different Transactions

	Atria	NHP
Structure	RIDEA Acquisition of a C-Corp	Public-to-Public Merger
Seller	Financial Sponsor	Public REIT
Consideration	Stock and Cash (Contingent consideration)	Stock (Fixed # of shares)
Tax Structure	Both Taxable & Tax Free	Tax Free
Third-Party Consent Issues	Many, Complex	Some, Straight-Forward
Target Shareholder Vote	No	Yes
Separation of Assets and Liabilities	Yes	No
Time to Close	7 months	4 months

Tax Transition Issues

TRS election	TRS election as of the date of the transaction for applicable OpCo
Short-period tax returns	The merged/acquired corporations (which became QRS or DREs on the merger date) must file short period tax returns ending on the merger/acquisition date
Terminations of partnerships	Partnerships owned by the seller in which there is an interest of greater than 50% creates a technical termination in which a short period tax return must be filed
Purchase accounting vs. historical tax basis	Analyzing book/tax differences relating to GAAP purchase accounting rules can be cumbersome
Transaction costs	New rules for deductibility of transaction costs
Short period	Transaction costs on or after the date of the transaction > What is accruable > End of the day rule versus specific identification, etc.
Government audits	IRS and state examinations in connection with these transactions
Set up of new entities	Most OpCos were new entities – New registrations for sales/property/license taxes

Convergence Update

Thursday, March 22nd
2:45-4:00 p.m.

Moderator:
Christopher Drula, Sr. Director-Financial Standards - NAREIT

Panelists:
Gareth Lewis, Director-Finance - European Public Real Estate Association
Jayne Stewart, CAO - Annaly Capital Management, Inc.
Thomas Wilkin, Partner - PwC

Dataline

A look at current financial reporting issues

No. 2011-32
November 8, 2011

What's inside:

Investing in a new investment company definition

FASB proposes to align investment company definition with IFRS proposal

Overview

At a glance

- On October 21, 2011, the FASB issued a proposal to (1) amend the criteria for determining whether an entity is an investment company and (2) address when an investment company should apply consolidation accounting.

- Investment companies would continue to measure their investments at fair value, including any investments in which they have a controlling financial interest. However, investment companies would be required to consolidate any other investment companies or investment property entities in which they have a controlling financial interest.

- Under the proposal, six criteria would have to be met in order for an entity to be an investment company. In addition to amending the current four criteria, two new criteria would be added. Entities that do not hold multiple investments or only have a single investor would not qualify. However, entities that are registered under the Investment Company Act of 1940 would qualify as investment companies regardless of whether they meet all of the six criteria in the revised definition.

- Concurrently, the FASB issued a proposal to define an investment property entity. The criteria to qualify as an investment property entity are similar to those for an investment company, but with some notable differences. Entities would need to determine if they are an investment property entity before determining whether they meet the criteria to be an investment company. Refer to our forthcoming Dataline on the investment property entity proposal for details.

- The new definition of an investment company was developed jointly with the IASB. The IASB issued its proposal in August 2011. While the criteria to qualify as an investment company are substantially similar, some key differences exist between the boards' respective proposals. Most notably, the IASB would not retain investment company accounting in consolidation by a non-investment company parent, and all investments would be measured at fair value even if they represent a controlling financial interest in another investment company. In addition, the IASB has not issued a corresponding proposal to define an investment property entity.

- The proposed amendments would apply to an entity's interim and annual reporting periods in fiscal years that begin after the effective date, which has not been determined. Comments on both the FASB and IASB's proposals are due January 5, 2012.

The main details

.1 The AICPA's Audit and Accounting Guide, *Investment Companies,* (the "Guide") originally defined an investment company. Under the Guide, investment companies were required to measure their financial assets at fair value and were precluded from consolidating non-investment company investees. These aspects of the Guide were subsequently codified in Topic 946, Financial Services—Investment Companies, of the Accounting Standards Codification.

.2 In 2007 the AICPA undertook a project to amend the definition of an investment company and determine when a parent or equity method investor should retain the specialized accounting in Topic 946 to account for their interest in an investment company. That project resulted in the issuance of SOP 07-1[1]. However, a number of implementation issues arose with the SOP and the FASB deferred it indefinitely[2] so that it could consider whether any changes were needed.

.3 Around the same time, the IASB was developing a new consolidation standard, which ultimately became IFRS 10. As part of that project the IASB began to explore establishing a definition of an investment company based on feedback it gathered from preparers and users. Specialized accounting for investment companies did not previously exist in IFRS. Consequently these types of entities were required to account for their investments, and apply consolidation and equity method guidance to their investee portfolios, consistent with all other entities.

.4 Since both boards were considering the investment company definition, they decided to add the project to their convergence agendas. Rather than starting with a new model, the boards agreed to utilize the criteria developed in SOP 07-1 as the starting point for identifying investment companies.

.5 While the boards are aligned on the six criteria to be used to define an investment company, their proposals reflect some differences. The most notable differences include: (1) an exception under the FASB's proposal that allows entities that are registered under the Investment Company Act of 1940 to qualify as investment companies even if they do not meet all of the other criteria, (2) the FASB's proposal requires investment companies to consolidate other investment companies and investment property entities in which they have a controlling financial interest whereas the IASB's proposal would require all investees to be measured at fair value, and (3) the FASB's proposal would retain investment company accounting in consolidation by a non-investment company parent, whereas the IASB's proposal would not allow that parent to retain the specialized investment company accounting.

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[1] AICPA Statement of Position 07-1

[2] FASB Staff Position SOP 07-1-1, *Effective Date of AICPA Statement of Position 07-1*

NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

February 15, 2012

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

Re: Financial Services – Investment Companies (Topic 946) Proposed Accounting Standards Update

Dear Ms. Cosper:

This letter is submitted by the National Association of Real Estate Investment Trusts® (NAREIT) in response to the request for comments from the Financial Accounting Standards Board (FASB or the Board) on the Financial Services – Investment Companies (Topic 946) Proposed Accounting Standards Update (the Proposed Update).

NAREIT is the worldwide representative voice for real estate investment trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other real estate businesses throughout the world that own, operate and finance commercial and residential real estate. NAREIT's members play an important role in providing diversification, dividends, liquidity and transparency to investors through their businesses that operate in all facets of the real estate economy.

REITs are generally deemed to operate as either Equity REITs or Mortgage REITs. Our members that operate as Equity REITs own lease and most often operate real estate. Our members that operate as Mortgage REITs finance housing and commercial real estate, by originating mortgages or by purchasing whole loans or mortgage backed securities in the secondary market.

A useful way to look at the REIT industry is to consider an index of stock exchange-listed companies like the FTSE NAREIT U.S. Real Estate Index, which covers both Equity REITs and Mortgage REITs. This Index contains 160 companies representing an equity market capitalization of $451 billion at year end. Of these companies, 130 consist of equity REITs representing 90.5% of total U.S. listed REIT equity market

♦ ♦ ♦
1875 I Street, NW, Suite 600, Washington, DC 20006-5413
Phone 202-739-9400 Fax 202-739-9401 REIT.com

capitalization (amounting to $407 billion).[1] The remainder, as of December 31, 2011, were 30 publicly traded mortgage REITs with a combined equity market capitalization of $43 billion.

NAREIT supports the Board's continuing efforts to achieve convergence of U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). However, NAREIT believes that adoption of the Proposed Update would entirely fail to accomplish this objective. Additionally, NAREIT believes the Proposed Update establishes specialized industry accounting which is contrary to a fundamental conclusion of the final report of the Advisory Committee on Improvements to Financial Reporting (CIFR) to the United States Securities and Exchange Commission dated August 1, 2008 that accounting standards should "focus on the nature of the business activity itself, since the same activities, such as lending, may be carried out by companies from different industries."

Also, NAREIT maintains that the Proposed Update is entirely at odds with two recent Board initiatives:

- Eliminating specialized industry accounting in the joint FASB and IASB revenue recognition project; and,

- Efforts to simplify accounting through qualitative approaches to the measurement of impairment for goodwill and other indefinite-lived intangibles.

Retain REIT Scope Exception

For purposes of financial standards, REITs have been historically treated as, and are in fact, operating businesses and thus should not be treated as investment companies in the Proposed Update. Therefore, NAREIT strongly objects to the FASB's decision to remove the explicit scope exception for REITs that exists in Topic 946 Financial Services – Investment Companies today. The REIT scope exception has been included in Investment Companies accounting literature for some time, dating back to when the mutual fund industry's financial reporting was governed by the American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide for Investment Companies. The scope exception recognizes the operating nature of the REIT business model and underlying activities of REITs as distinctly different from investment companies. This fact has been acknowledged by the FASB and the AICPA repeatedly over the years. For example, the AICPA Statement of Position 07-1 *Clarification of the Scope of the Audit and Accounting Guidance Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies,* paragraph A25 states the following:

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

[1] http://returns.reit.com/reitwatch/rw1201.pdf at page 20.

Additionally, the Emerging Issues Task Force recognized the fact that REITs are operating companies in their paper on EITF Issue No. 09-D, *Application of Topic 946, Financial Services – Investment Companies, by Real Estate Investment Companies.* Paragraph 27 states:

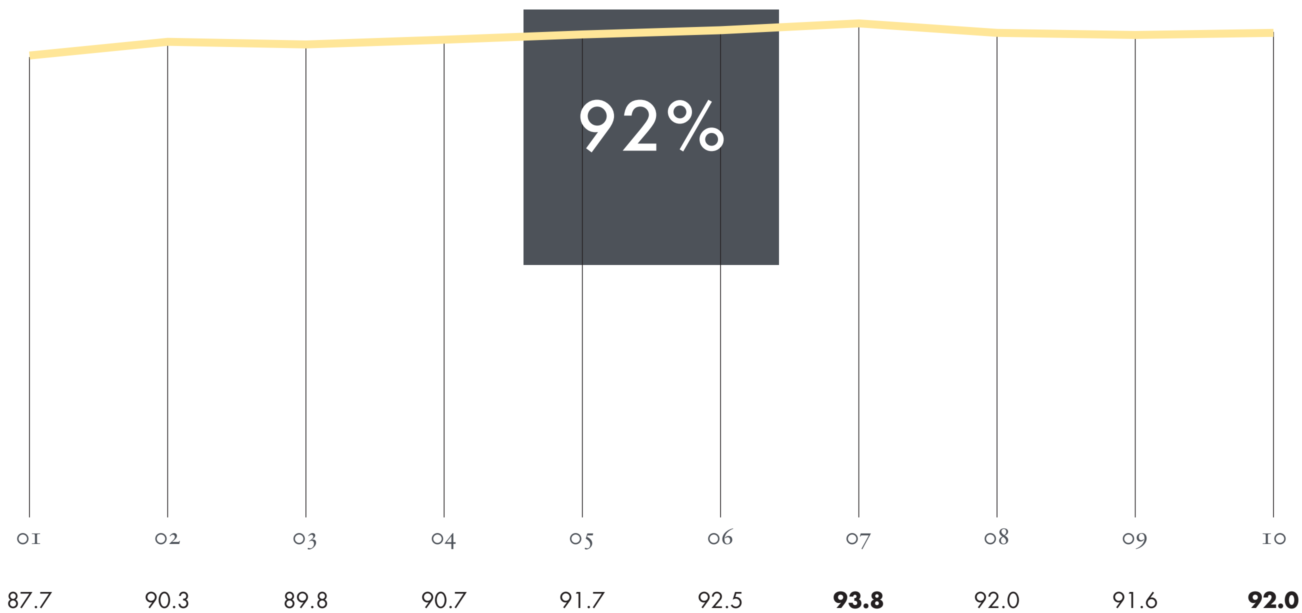
> Working Group members pointed out that some may interpret paragraph 946-10-15-3 to preclude any entity structured as a REIT for tax purposes from being an investment company. However, others interpret the paragraph to mean that those REITs that have other than insignificant non-investment operations (for example, property development or management activities) or otherwise meet the definition of an investment company are not precluded from applying Topic 946. *This view was based on the belief that the intent of the scope exclusion noted in paragraph 23 was that at the time that guidance was written, REITs generally were structured as operating entities and, accordingly, did not meet the criteria to be considered an investment company under the Investment Company Guide* [emphasis added].

There have been no changes in the operating nature of REITs' business operations since the time that the REIT scope exception was first introduced in U.S. GAAP. Therefore, NAREIT and its members do not understand why the FASB would abolish the REIT exception and potentially include REITs within the scope of specialized industry accounting. As a result, NAREIT strongly objects to the removal of the REIT scope exception.

Further, NAREIT questions the FASB's rationale in removing the REIT scope exception, while at the same time automatically scoping in companies that are currently regulated under the Investment Company Act of 1940 (1940 Act) into the Proposed Update regardless of whether those entities meet the definition of an investment company. On one hand, the FASB appears to elevate the importance of form over substance when developing the scope of the Proposed Update:

> BC9. The FASB ultimately decided that an investment company that is regulated under the Investment Company Act of 1940 should be within the scope of Topic 946 regardless of whether that entity meets the proposed investment company definition developed with the IASB. The FASB was concerned that some entities that are required to comply with the SEC's regulatory requirements for investment companies may not meet the proposed U.S. GAAP definition of an investment company. The FASB recognizes that defining an investment company on the basis of U.S. regulatory requirements is not convergent with the IASB's proposal, but this approach would avoid situations in which an entity would be required to present assets and liabilities under two measurement bases because it is considered an investment company for regulatory purposes but not for U.S. GAAP financial reporting purposes.

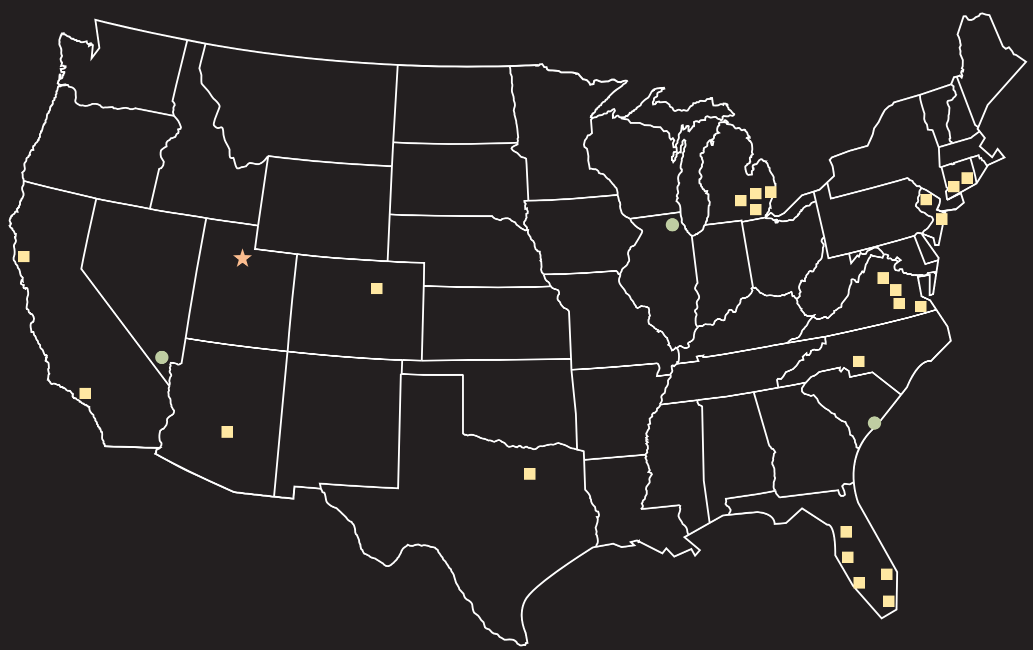
At the same time, the FASB decided to ignore a well-recognized and well-understood form of investment (*i.e.*, REITs) in order to try to divine substance in determining the scope of the Proposed ASU:



LEASED SPACE (%)

Since 2002, our leased space percentage has been consistently about 90 percent or greater, reaching its peak in 2007 at 93.8 percent. Even in the Great Recession of 2008 and 2009, our centers remained well-leased. Significantly, this important statistic began to grow again in 2010 indicating retailer interest in our high quality properties. It's not surprising that the world's greatest merchants want to do business in the most productive retail environments in the U.S.

2010 PORTFOLIO



ARIZONA MILLS
Tempe, AZ
arizonamills.com

BEVERLY CENTER
Los Angeles, CA
beverlycenter.com

SHOPS AT CHARLESTON PLACE
Charleston, SC
(leasing services)

CHERRY CREEK SHOPPING CENTER
Denver, CO
shopcherrycreek.com

CITY CREEK CENTER
Salt Lake City, UT
(Opening March 22, 2012)
shopcitycreekcenter.com

CRYSTALS AT CITYCENTER
Las Vegas, NV
(Leasing and development services)
crystalsatcitycenter.com

DOLPHIN MALL
Miami, FL
shopdolphinmall.com

FAIR OAKS
Fairfax, VA
shopfairoaksmall.com

FAIRLANE TOWN CENTER
Dearborn, MI
shopfairlane.com

GREAT LAKES CROSSING OUTLETS
Auburn Hills, MI
greatlakescrossingoutlets.com

IFC MALL
Yeouido, Seoul, South Korea
(Leasing, development
and management services)
ifcseoul.com

INTERNATIONAL PLAZA
Tampa, FL
shopinternationalplaza.com

MACARTHUR CENTER
Norfolk,VA
shopmacarthur.com

THE MALL AT MILLENIA
Orlando, FL
mallatmillenia.com

NORTHLAKE MALL
Charlotte, NC
shopnorthlake.com

THE MALL AT PARTRIDGE CREEK
Clinton Township, MI
shoppartridgecreek.com

THE PIER SHOPS AT CAESARS
Atlantic City, NJ
thepieratcaesars.com

REGENCY SQUARE
Richmond, VA
shopregencysqmall.com

THE MALL AT SHORT HILLS
Short Hills, NJ
shopshorthills.com

STAMFORD TOWN CENTER
Stamford, CT
shopstamfordtowncenter.com

STONY POINT FASHION PARK
Richmond, VA
shopstonypoint.com

SUNVALLEY
Concord, CA
shopsunvalley.com

TWELVE OAKS MALL
Novi, MI
shoptwelveoaks.com

WATERSIDE SHOPS
Naples, FL
watersideshops.com

THE MALL AT WELLINGTON GREEN
Palm Beach County, FL
shopwellingtongreen.com

WESTFARMS
West Hartford, CT
shopwestfarms.com

THE SHOPS AT WILLOW BEND
Plano, TX
shopwillowbend.com

WOODFIELD
Schaumburg, IL
(Leasing and management services)
shopwoodfield.com

MAP KEY
■ Owned centers
● Leasing, management
and/or development services
★ Project under development

Taubman Centers, Inc. (TCO)

October 21, 2011

DJIA: **11,809** | RMZ: **757** | 10-Year T-Note: **2.2%**

Price: **$56.14** | Recommendation: **BUY**

Green Street Advisors

The 1% Is Welcome Here

I. Overview

Taubman Centers (TCO) kicked off the mall sector's 3Q11 earnings season by again reporting strong tenant sales growth. While U.S. and global economic headwinds have picked up over the last three months, and uncertainty is high for future tax rates for upper-income earners, shoppers in Taubman malls appear unfazed. The spending habits of "the 1%" and other "rich" have boosted tenant confidence. This, in turn, has given Taubman more leverage when negotiating rental rates and has led to better-than-expected growth in NOI. Just as the rebound in tenant sales has been skewed towards the owners of higher-end portfolios, so too has the rebound in mall operating fundamentals. NOI growth for high-productivity owners should materially outpace the results for their lower-productivity peers in 3Q11 as well as the next several years.

II. What Taubman's Results Mean for the Rest of the Sector

- **The Positive Sales Trend Continues:** Taubman reported a 12% increase in tenant sales during the quarter, making 3Q11 the seventh consecutive quarter of double-digit sales growth. The company owns the highest-quality portfolio in the mall REIT sector and continues to benefit from the resurgence in spending by "the rich." Taubman's sales results should outpace the higher-productivity peer group (General Growth, Macerich, Simon, and Westfield) by a few hundred basis points and the medium-to lower-productivity group (CBL & Associates, Glimcher, and Penn REIT) by a much larger margin. While sales growth was solid across the board during the quarter, management indicated tourist markets, especially Florida, remain strong. This trend will likely have a positive impact on Simon's results.
- **Near-Term Mall M-RevPAF Still Strong:** The continued strength in tenant sales has shifted some negotiating power to the landlord side of the table. Market rents are likely growing in parallel to sales and high-end mall rents are on a steady upward trajectory. Market-RevPAF (i.e., the product of changes in market rents and occupancy) for the sector is expected to grow 5% during '11 and 3% in '12. Given continued strong sales growth, market rents may be growing faster than recently expected. By contrast, occupancy in the Taubman portfolio (93%) is up only modestly from one year ago when including temporary leases. This result is likely a reflection of 1) tepid demand from new concepts, and 2) Taubman's desire to maintain the "right" tenant mix, at the "right" rents in its centers. Occupancy gains by the peer group will likely outpace Taubman but should not be spectacular.
- **Better-than-Expected Internal Growth:** Strong re-leasing spreads and growth in average base rents drove a 6% (ex non-recurring CAM-related income) increase in same-property NOI during the quarter for Taubman. With Taubman's full-year NOI tracking higher than its previous forecast, management increased guidance for full-year '11. Our forecasted growth of 2.7% for '11 has now proven conservative and we will likely increase our estimate past management's new 3% guidance.

Valuation Measures*	
Green Street Nominal Cap Rate:	5.7%
Green Street Economic Cap Rate:	4.9%
Implied Nominal Cap Rate:	6.0%
2012E AFFO Yield:	4.0%

Warranted Pricing	
Warranted Premium to UAV:	-3.7%
Sector Average Premium to UAV:	-4.8%
NAV/sh Estimate:	$61.00
Warranted Share Price:	$57.41

*Nominal cap rate is before cap-ex. Economic cap rate is after cap-ex. Implied nominal cap rate is the cap rate at which NAV/sh equals the current share price.

- **Closer to Breaking Ground?** Taubman continues to pursue a number of opportunities on the U.S. development front. The material improvement in tenant sales means that ground-up mall development is closer to penciling. Taubman expects to build roughly a quarter of the new malls constructed in the U.S. over the next decade. There is now a growing possibility that developers will become active again in the near-term. While very low by historical standards, new mall supply will start growing in '14 and beyond and our current supply forecast could prove too conservative.
- **No Sale at These Malls**: Earlier this month, Taubman entered into an agreement to buy two high-productivity retail properties from a private owner ($560mm, 7% expansion of asset base). The disclosed nominal cap rate on the transaction was 4.5%. Given the low occupancy cost ratios and the expected growth in near-term NOI at the properties, pricing is better considered by looking at the projected total return (i.e., the IRR) rather than just the initial cap rate. The estimated low-to-mid 7% IRR is consistent to slightly lower than the returns currently expected for high-end malls. **The transaction appears to, at a minimum, support the cap rates used to value high-end malls in our NAV estimates. It may also suggest that the high-end mall cap rates should be decreased slightly.**

III. A Taubman Accounting Note

An accounting change associated with Taubman's transition to "fixed CAM" leases (i.e., charging tenants a fixed rate for common area maintenance expenses rather than passing expenses incurred) has impacted the optics of the reported same-property NOI growth in '11. While economically inconsequential, this accounting change has boosted YTD NOI growth but will be offset by a substantially negative (in the range of -3% to -4%) NOI result in 4Q11. Don't let the accountants fool you, Taubman's business remains sound.

NOI in the mall sector can be inflated due to the accounting treatment of capital expenditures. In certain circumstances, a portion of the costs associated with improvements (i.e., a new floor or fresh coat of paint) can be recouped from tenants. This reimbursement flows into the income statement of the REIT while the associated costs are capitalized and depreciated. In addition to overstating NOI, this treatment can also lead to volatility in a REIT's reported NOI when the level of investment varies from year to year.

IV. Recommendation

Taubman owns the highest-productivity portfolio in the mall REIT sector and has benefited from the continued strength in discretionary spending by "the rich". This trend has resulted, and should continue to result, in much better operating fundamentals at higher-productivity malls than lower-productivity ones. Taubman has also maintained a conservative balance sheet and is well positioned for either a ramp up in its external growth pipeline or buying back shares if the opportunity arises.

Taubman trades at a 5% **discount** to unleveraged asset value, which compares to an 8% **premium** for mall sector blue-chip Simon Properties, and a 5% **discount** for the sector average. As a result, Taubman's shares appear overly discounted. At the current price, we maintain our BUY recommendation on the shares of Taubman.

Cedrik Lachance
Andrew Johns, CFA
Daniel J. Busch
Julie Heckman

EPRA

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

Financial Reporting Hot Topics

Thursday, March 22nd
9:45-11:00 a.m.

Moderator:
Heidi Roth, SVP, CAO & Controller - Kilroy Realty Corporation

Panelists:
Steven Jacobs, Partner, Ernst & Young LLP
Janet Menko, Director-GAAP Center of Excellence - Forest City Enterprises, Inc.
Mark Skomal, SVP, CAO & Controller - DCT Industrial Trust Inc.

Agenda

Introduction	Heidi Roth
IFRS Implementation Update	Janet Menko
SEC Comment Letter Trends	Steven Jacobs
FFO Reporting Update	Mark Skomal
XBRL Update	Mark Skomal
Fair Value Measurement Update	Steven Jacobs
Derecognition of In-substance Real Estate – Scope Clarification	Janet Menko
Questions from the audience	

SEC Proposal to Adopt IFRS: Where do we stand?

In February 2010, the SEC unanimously agreed to publish a statement which:

- Continues its support for a single set of high-quality global accounting standards
- Acknowledges that IFRS is best positioned to be the global standard

In December 2010, SEC Chairman Mary Schapiro confirmed:

- SEC will be in position to make a decision on IFRS by the end of 2011
- If decision is to incorporate - SEC will allow at least a four year transition
- SEC Deputy Chief Accountant Paul Beswick coins the term "condorsement"

In May 2011, the SEC Staff released a paper describing one possible method to incorporate IFRS into the U.S. financial reporting system.

- Builds on December Staff speech and includes a gradual transition (over 5-7 years)
- No discussion of early adoption

In December 2011, the SEC staff indicated it needed additional time to complete a final report on its IFRS work plan and make a recommendation to the Commission on whether, when, and how to further incorporate IFRS into the US financial reporting system.

Dataline
A look at current financial reporting issues

No. 2011-36
December 6, 2011

What's inside:

SEC Staff continue progress on IFRS work plan

Comparison between IFRS and US GAAP frameworks and analysis of IFRS in practice

Overview

At a glance

- On November 16, 2011, the SEC's Office of the Chief Accountant (the SEC Staff) published two staff papers. The first summarizes differences between the US GAAP and IFRS frameworks, and the second analyzes how IFRS is applied in practice. The papers were published pursuant to the SEC Staff's work plan to analyze considerations relevant to the Commission's decision on whether, when, and how IFRS might be incorporated into the US financial reporting system.

- Key differences exist between US GAAP and IFRS. US GAAP is more rules-based and includes detailed industry guidance, whereas, IFRS is more principles-based and is intended to be applicable across all industries.

- Differences also exist in the application of IFRS between territories and industries. Legacy reporting requirements or options within IFRS may be the cause of some of this diversity.

- The SEC previously stated that it plans to make a determination on the future use of international standards by US public companies in 2011. The analysis within these papers will assist in making this decision, but the findings are not determinative.

The main details

.1 The *Comparison of US GAAP and IFRS* paper provides an inventory of areas in which IFRS, as issued by the IASB, differs from existing US GAAP.

.2 In the paper, the Staff compares current US GAAP accounting requirements included in Accounting Standard Codification (ASC) Topics as of June 30, 2010 to IFRSs, as promulgated by the IASB, as of January 1, 2010. The review omits an analysis of the standards that are the subject of the ongoing joint standard-setting projects between the FASB and IASB (the Boards), as well as the requirements of SEC interpretations and those of other jurisdictional authorities.

PwC observation:

The standards assessed in the review do not include ongoing joint standard-setting projects currently underway by the FASB and IASB. Progress on these projects is important regardless of the SEC's ultimate decision on IFRS. The Boards have reached substantially converged positions on many of the ongoing projects, such as the leases and revenue recognition projects, which are nearing completion. However, the joint projects may not result in convergence in all areas. Financial instruments has been a particularly challenging area with divergent answers arising on balance sheet offsetting. Additionally, the Boards are working hard to reach convergence on topics such as hedging, impairment, classification and measurement. For the latest update on all of the joint standard-setting projects, see our upcoming December edition of *Setting the standard*, expected in mid-December.

Many of the differences between IFRS and US GAAP outlined below are also addressed in our *IFRS and US GAAP: similarities and differences* guide. The guide is designed to help readers understand the broad differences between IFRS and US GAAP today.

.3 The Staff's paper on the *Analysis of IFRS in Practice* summarizes the Staff's findings on the application of IFRS in practice. The objective of this paper is to assist the SEC in determining whether US investors ultimately will benefit from the comparability of information from issuers on a worldwide basis if IFRS is incorporated into the US financial reporting system. The paper analyzes the financial statements of 183 companies that report under IFRS and are included in the 2009 Fortune Global 500, which ranks companies by revenue (including 47 current SEC registrants). The selection covers a wide range of industries with approximately 80% of the companies domiciled in the European Union. The paper also includes a summary of the primary areas of comment under the SEC’s Division of Corporation Finance's disclosure review program.

.4 The Staff’s findings indicate that the reviewed financial statements generally appear to comply with IFRS, with certain differences indicating a level of diversity in applying IFRS across various territories. Diversity may result from options contained within IFRS or the practice of utilizing previous home country or regulatory guidance to supplement IFRS. This may promote consistency within a country, while diminishing overall global comparability.

.5 The analysis also identifies the need for additional transparency and clarity within financial statement disclosures. This suggests that enhancing accounting disclosures around significant estimates, key assumptions, and fair value information may better support an investor's overall understanding of the financial statements.

PwC observation:

Overall, the findings noted were consistent with our understanding of the relevant guidance. The Staff's comprehensive assessment acknowledges some of the key aspects of diversity between US GAAP and IFRS.

Lessons Learned from Canada's Adoption of IFRS

Friday, March 23rd
11:00-12:15 p.m.

Moderator:
Glenn Cohen, EVP, CFO & Treasurer - Kimco Realty Corporation

Panelists:
Nancy Anderson, VP-Financial Reporting - Real Property Association of Canada
Raghunath Davloor, EVP, CFO & Corporate Secretary - RioCan
Heather Kirk, Director-Real Estate Equity Research Analyst - National Bank Financial
Tom Rothfischer, Partner-Audit & GTA Real Estate Industry Leader - KPMG LLP

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Impact of New Partnership Anti-Deferral Rules on Real Estate Sector

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New Partnership Anti-Deferral Rules Impact On Real Estate

The Legislative Framework

The 2011 federal budget proposed rules to limit the tax deferral opportunities for corporations with significant interests in partnerships that have a fiscal period different from the corporations' taxation years (the "2011 Partnership Anti-Deferral Rules"). These rules received Royal Assent on December 15, 2011 and apply to corporations' taxation years ending after March 22, 2011.

These new rules require a corporation to accrue deferred partnership income (the "**adjusted stub period accrual**") in addition to the income of the partnership for the fiscal period that ends in the corporation's taxation year. Therefore, there may be an inclusion of significant incremental partnership income for a corporation's first taxation year ending after March 22, 2011 (the "**transitional year**"). To mitigate the potential cash-flow impact of the initial adjusted stub period accrual, transitional relief may be available through a reserve which effectively results in the recognition of the incremental income over the five taxation years that follow the transitional year.

These rules apply to a corporation that owns a significant interest in a partnership. A corporation has a significant interest in a partnership if the corporation, together with affiliated or related parties, is entitled to more than 10% of the partnership's income (or assets in the case of a wind-up) at the end of the last fiscal period of the partnership that ended in the corporation's taxation year.

Adjusted stub period accrual is calculated by a formula that pro-rates the partnership's income for its fiscal period that ended in the corporation's taxation year over the remainder of the corporation's taxation year. However, the corporation may designate an amount to reduce this adjusted stub period accrual. The designation to reduce adjusted stub period accrual recognizes that the corporation may know or expect that the actual income of the partnership for the stub period will be lower than the adjusted stub period accrual computed under the formulaic approach. If the designation results in an underestimate of its share of the actual partnership income for the stub period, the corporation may be required to include in taxable income in its subsequent taxation year the income shortfall adjustment and a penalty amount computed as an interest charge on the under-accrued partnership income.

Certain corporate partners may wish to change the fiscal period of a partnership to avoid the accrual obligation and the resulting compliance burden. The corporate partners of a single-tier partnership may elect to change the fiscal period of the partnership in limited circumstances. Partnerships that are part of a multi-tiered partnership structure must adopt a calendar fiscal period, unless all of the partnerships in the structure elect otherwise. This multi-tier alignment election is available in certain circumstances only. Some or all of the partnership's income accelerated and allocated to the corporation under these alignment elections may be eligible for the transitional reserve.

A single-tier or a multi-tier alignment election is due by the earliest filing-due date for the transitional year of any of the affected corporate partners. However, on December 16, 2011, the Department of Finance (Canada) ("**Finance**") announced its intention to provide a short extension of time for corporate partners to late-file these alignment elections if filed on or before January 31, 2012.

Transitional relief is denied if the partnership no longer principally carries on the activities to which the reserve relates. This reserve denial rule may influence the decision to make a single-tier or multi-tier alignment election.

See KPMG's TaxNewsFlash-Canada 2011-26, *Corporate Partnerships Lose Tax Deferral* for a complete analysis of the 2011 Partnership Anti-Deferral Rules.

Real Estate Development Partnerships

A partnership that develops real estate may earn development income in a single fiscal period or perhaps over two fiscal periods. Under the 2011 Partnership Anti-Deferral Rules, a corporate partner of a real estate development partnership may still defer all or a portion of its share of the income of the partnership. The reason is twofold.

First, adjusted stub period accrual is calculated based on the income realized by the partnership for the fiscal period of the partnership ending in the taxation year of the corporation. Thus, where the partnership earns nominal income in the fiscal period of the partnership ending in the taxation year of the corporation, the adjusted stub period accrual should be nominal. This is so even if the partnership earns substantial development income in the stub period.

Second, the corporation may make a designation to reduce adjusted stub period accrual. It is possible that the year over year development income realized by the partnership is lumpy. If the partnership realizes development income in a fiscal period of the partnership that falls within the corporation's taxation year, but expects losses or substantially reduced income in the stub period, the corporation may use a designation to reduce its adjusted stub period accrual. For example, if the corporation expects the partnership to earn all of the development income in a single fiscal period of the partnership that falls within the corporation's taxation year, the corporation may designate and thereby reduce its adjusted stub period accrual in respect of the partnership in that year to nil without the risk of any significant interest charge on under-accrued partnership income in a subsequent taxation year.

Each corporate partner of the partnership should also consider its entitlement for transitional relief. In this regard, the corporation may wish to consider whether to make a single-tier or multi-tier alignment election. The election may accelerate the corporation's recognition of development income earned by the partnership which is eligible for transitional relief.

The reserve denial rule also must be considered. The reserve should be available if the partnership continues to develop real estate throughout the five-year transitional period. The partnership must principally carry on the activities to which the reserve relates, which may include fulfilling the obligations under warranty contracts or providing letters of credit or other guarantees for obligations of the partnership.

Finally, these new rules only apply to a corporate partner that has a significant interest in a partnership. Therefore, a corporate partner that is not related or affiliated with the other partners and that is entitled to 10% or less of the income or loss of the partnership or net assets of the partnership on liquidation may still benefit from income deferral planning opportunities with a careful selection of fiscal year ends.

Dispositions of Real Estate

The same analysis applies equally to partnerships that earn income and taxable capital gains from the disposition of real estate. The mechanisms that govern the accrual obligation for "lumpy" development income earned by a partnership likewise apply to the accrual obligation that accompanies one-time or non-recurring income realized by a partnership from a disposition of real estate.

However, if a corporation realizes income eligible for transitional relief, the application of the reserve denial rule should be considered. The corporation may lose the transitional reserve if the activities of the partnership have ceased on the disposition of the real estate. This result may arise where a single-purpose partnership disposes of all of its real estate, but not where a partnership holds a portfolio of real estate properties and disposes of only some of those properties.

These considerations may influence whether corporate partners should make a single-tier or a multi-tier alignment election.

Public Non-listed REITs

Thursday, March 22nd
9:45-11:00 a.m.

Moderator:
Nathan Headrick, Chief Compliance Officer & Corporate Counsel - CNL Lifestyle Properties, Inc.

Panelists:
Judith Fryer, Shareholder - Greenberg Traurig, LLP
Kimberly Smith, General Counsel-Capital Markets - Cole Real Estate Investments
Rosemarie Thurston, Partner - Alston & Bird LLP

Customer Account Statements

FINRA Requests Comment on Proposed Amendments to NASD Rule 2340 to Address Values of Unlisted Direct Participation Programs and Real Estate Investment Trusts in Customer Account Statements

Comment Period Expires: November 12, 2011

Executive Summary

FINRA is proposing amendments to NASD Rule 2340 (Customer Account Statements) to address how firms report the per share estimated values of unlisted Direct Participation Programs (DPPs) and unlisted Real Estate Investment Trusts (REITs) on customer account statements.[1] The amendments would limit the time period that the offering price may be used as the basis for a per share estimated value to the period provided under Rule 415(a)(5) of the Securities Act of 1933 (Initial Offering Period). The amendments also would require firms to deduct organization and offering expenses from per share estimated values during the Initial Offering Period. The amendments would prohibit a firm from using a per share estimated value, from any source, if it "knows or has reason to know the value is unreliable," based upon publicly available information or nonpublic information that has come to the firm's attention. Finally, the amendments would allow a firm to omit a per share estimated value on a customer account statement if the most recent annual report of the DPP or REIT does not contain a value that complies with the disclosure requirements of Rule 2340.[2]

Questions regarding this *Notice* may be directed to:

- Joseph E. Price, Senior Vice President, Corporate Financing/Advertising Regulation, at (240) 386-4623;
- Gary L. Goldsholle, Vice President and Associate General Counsel, Office of the General Counsel, at (202) 728-8104; or
- Paul Mathews, Director, Corporate Financing Department, at (240) 386-4639.

September 2011

Notice Type

- Request for Comment

Suggested Routing

- Compliance
- Legal
- Senior Management

Key Topics

- Customer Account Statements
- Unlisted Direct Participation Programs (DPPs)
- Unlisted Real Estate Investment Trusts (REITs)

Referenced Rules & Notices

- FINRA Rule 2231
- FINRA Rule 2310
- NASD Rule 2340
- NASD Rule 5110
- Regulatory Notice 09-09
- Rule 415 under the Securities Act of 1933

Financial Industry Regulatory Authority

NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS®

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REITS: BUILDING DIVIDENDS AND DIVERSIFICATION®

November 11, 2011

Ms. Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

Re: FINRA Regulatory Notice 11-44: FINRA Requests Comment on Proposed Amendments to NASD Rule 2340 to Address Values of Unlisted Direct Participation Programs and Real Estate Investment Trusts in Customer Account Statements

Dear Ms. Asquith,

This letter is in response to FINRA Regulatory Notice 11-44 (the Proposed Amendment) in which FINRA requests comment on proposed changes to NASD Rule 2340 (Customer Account Statements) with respect to how per share estimated values of unlisted Direct Participation Programs (DPPs) and unlisted Real Estate Investment Trusts (REITs) are reported on customer account statements.

NAREIT, the National Association of Real Estate Investment Trusts, is the worldwide representative voice for real estate investment trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other real estate businesses throughout the world that own, operate and finance commercial and residential real estate.

Our members identified as Equity REITs own, lease and often operate all types of real estate, while our members identified as Mortgage REITs finance housing and commercial real estate by originating mortgages or by purchasing whole loans or mortgage backed securities in the secondary market.

In addition, REITs in the U.S. may be public companies whose securities are registered with the SEC and listed on an established stock exchange (so-called, Listed REITs); public companies whose securities are registered with the SEC, but which are not listed on an established stock exchange (so-called, Public Non-Listed REITs (PNLRs)); or private companies.

As of June 30, 2011, 225 REITs were "public" through registration with the SEC, 159 of which are Listed REITs (predominantly listed on the NYSE) and 66 of which are PNLRs. Equity REITs own over 30,000 properties in all 50 states, with a value of approximately $700 billion, with about $80 billion of that

1875 I Street, NW, Suite 600, Washington, DC 20006-5413
Phone 202-739-9400 Fax 202-739-9401 REIT.com

amount attributable to PNLRs. These investments are estimated to comprise approximately 10-15% of investment-grade commercial real estate in the United States, and they include all property types, including retail, office, multifamily, health care, lodging, industrial, self storage and timber.

Given the nature of FINRA Regulatory Notice 11-44, this letter and its attachment are focused solely on PNLRs, which participate at NAREIT through its Public Non-Listed REIT Council, consisting of all 37 NAREIT PNLR corporate members (the PNLR Council). The mission of the PNLR Council is to advise NAREIT's Executive Board on matters of interest and importance to PNLRs.

The PNLR Council, led by its Executive Committee representing leading sponsors of PNLRs, has carefully reviewed the Proposed Amendment. As a result, it developed the attached comment letter for submission to and consideration by FINRA. In short, as reflected in the attached letter, the position of PNLR Council with respect to the Proposed Amendment is as follows:

Close of Initial Offering Period and Appraised Value

The PNLR Council supports limiting the period during which a per share estimated value based on the net offering price may be included on a Customer Account Statement to the Initial Offering Period, as proposed by FINRA.

Presenting Per Share Net Offering Price, Net of Certain Organization and Offering Expenses

The PNLR Council supports publication of the net offering price on the Customer Account Statement during the Initial Offering Period (when the program is acquiring assets and firms are selling shares at a stable value on a best-efforts basis); it supports the deduction of certain organization and offering expenses (O&O Expenses) characterized by FINRA as underwriting compensation (pursuant to FINRA Regulatory Notice 08-35) as proposed by FINRA; and it does not support the deduction of certain O&O Expenses characterized by FINRA as issuer expenses or due diligence expenses (pursuant to FINRA Regulatory Notice 08-35) which it contends are expenses intrinsically connected to the customer's investment in the REIT.

In addition, given the fact that the per share amount on the Customer Account Statement during the Initial Offering Period reflects a per share net offering price rather than a per share estimated value, the PNLR Council recommends to FINRA that the Customer Account Statement label the amount determined, after deduction of underwriting compensation, to be the per share net offering price. The PNLR Council supports disclosure of such expenses to the customer through the investor confirmation statement.

GOODWIN | PROCTER

Ettore A. Santucci
617.570.1531
esantucci@
goodwinprocter.com

Goodwin Procter LLP
Counselors at Law
Exchange Place
Boston, MA 02109
T: 617.570.1000
F: 617.523.1231

December 6, 2011

Ms. Michele M. Anderson, Chief
Ms. Mellissa Campbell Duru, Special Counsel
Office of Mergers and Acquisitions
Division of Corporation Finance
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: Cole Real Estate Income Strategy (Daily NAV), Inc.
(f/k/a Cole Real Estate Income Trust, Inc.)
Request for No-Action Relief Under Rule 13e-4

Dear Ms. Anderson and Ms. Duru:

Goodwin Procter LLP is counsel to Cole Real Estate Income Strategy (Daily NAV), Inc. (the "Company") in connection with its Registration Statement on Form S-11 under the Securities Act of 1933, as amended (the "Securities Act") (Registration Number 333-169535), filed with the Securities and Exchange Commission (the "Commission") on September 22, 2010 (the "Registration Statement"), as amended on December 6, 2010, May 16, 2011, August 26, 2011, November 3, 2011 and November [30], 2011, to register the offer and sale of up to $4,000,000,000 in shares of its common stock (or "shares"), in an initial public offering (the "Offering"), of which $3,500,000,000 in shares will be offered to the public in a primary offering and $500,000,000 in shares will be offered to stockholders of the Company pursuant to the Company's distribution reinvestment plan (the "DRIP"). The Company will not sell any shares until the date it has received and accepted purchase orders for at least $10,000,000 in shares and the Company's board of directors has authorized the release of these funds to the Company (the "Minimum Offering Date"). Prior to the Minimum Offering Date, subscriptions will be placed in an interest-bearing escrow account.

The Company was formed as a Maryland corporation on July 27, 2010 for the purpose of investing in single-tenant necessity commercial properties, which are leased to creditworthy tenants under long-term, net leases. The Company will be an externally advised investment vehicle that will operate and seek to qualify as a real estate investment trust ("REIT"). The

Company is not a mutual fund and does not intend to register as an investment company under the Investment Company Act of 1940, as amended (the "Investment Company Act").

Although the Company is offering a fixed amount of its shares pursuant to the Registration Statement, it intends to conduct a continuous offering of an unlimited amount of shares over an unlimited time period by filing a new registration statement prior to the end of each three-year period described in Rule 415 under the Securities Act. As a result, the Company considers itself to be an open-ended investment vehicle, as it has no finite date set for liquidation and no intention to list its shares for trading on an exchange or other trading market. After the Minimum Offering Date, the Company intends to offer for sale, on a daily basis, new shares at a price equal to the Company's net asset value ("NAV") divided by the number of its shares outstanding as of the end of business on such day (prior to giving effect to any share sales or redemptions to be effected on such day) ("NAV per share"). NAV per share will be based primarily on a valuation of the Company's real estate assets and liabilities, as determined by an independent valuation expert. Prior to the Minimum Offering Date, the price per share will be $15.00.

Because the Company does not have a defined life and does not intend to pursue a single liquidity event, the Company will make available to stockholders a share redemption plan (the "Redemption Plan") as the primary source of liquidity for their investment. Under the Redemption Plan, on a daily basis stockholders may request that the Company redeem all or any portion of their shares at a price equal to the Company's NAV per share next determined after receipt of their request. The Redemption Plan does not include limits on the sources of cash to fund redemptions. The Company expects that net redemption outflows will be funded first from cash on hand, by accessing its liquidity sleeve or drawings under available lines of credit, if any; and then by selling investment assets as needed. Net redemption inflows will be available for augmenting the liquidity sleeve and for investment in real estate. As discussed in greater detail later in this letter, redemptions may be limited in certain circumstances.

Division of Corporation Finance
Securities and Exchange Commission

CF Disclosure Guidance: Topic No. 3

Staff Observations in the Review of Promotional and Sales Material Submitted Pursuant to Securities Act Industry Guide 5

Date: December 19, 2011

Summary: This guidance summarizes the Division of Corporation Finance's observations in the review of promotional and sales material submitted by registrants under Securities Act Industry Guide 5.

Supplementary Information: The statements in this CF Disclosure Guidance represent the views of the Division of Corporation Finance. This guidance is not a rule, regulation or statement of the Securities and Exchange Commission. Further, the Commission has neither approved nor disapproved its content.

Introduction

The Commission approved Securities Act Industry Guide 5 for publication in 1976 to provide disclosure guidance for preparing registration statements relating to offers and sales of interests in real estate limited partnerships.[1] While Guide 5, by its terms, applies only to real estate limited partnerships, in 1991 the Commission stated that "the requirements contained in the Guide should be considered, as appropriate, in the preparation of registration statements for real estate investment trusts and for all other limited partnership offerings."[2] Continuous offerings conducted by real estate investment trusts (REITs) that do not have securities listed for trading on a national securities exchange, often referred to as "non-traded REITs," are the most common types of offerings that are subject to Guide 5.[3]

Registrants are permitted to use sales material in connection with their offerings if the sales material is accompanied or preceded by a final prospectus.[4] Item 19.B of Guide 5 defines sales material to include any memoranda, summary descriptions, graphics, supplemental exhibits, media advertising, charts and pictures relating to the offering of the security and proposed to be transmitted to prospective investors. Item 19.D provides that any sales material that is intended to be furnished to investors orally or in writing should be supplementally submitted to the staff prior to its use.[5] Item 19.D also provides for all marketing memoranda sent by the registrant or its affiliates to broker/dealers or other sales personnel, including material labeled "for broker/dealer use only,"[6] to be submitted to the staff prior to its use. The staff of the Division of Corporation Finance may review and, when appropriate, comment on all such sales material.

In an effort to assist registrants in preparing their sales material in a manner consistent with the federal securities laws, the Division has compiled this summary of comments frequently raised in its review of sales material submitted in response to Item 19 of Guide 5. Registrants may wish to consider the issues identified in this summary when preparing their sales material. These issues represent a substantial majority of our comments and repeatedly arise in our review of sales material. Because most of the sales material submitted to the staff in response to Item 19 of Guide 5 is prepared by non-traded REITs, many of the comments in this summary are specific to non-traded REITs. This summary does not address all issues that the staff may comment on in its reviews. Each registrant may wish to consider the rules and regulations under the Securities Act and its own facts and circumstances when preparing sales material.

Item 19.A – Balanced Discussion of Both Risk and Reward

Item 19.A of Guide 5 states that sales material "should present a balanced discussion of both risk and reward." We frequently ask registrants to enhance their risk disclosure when their sales material presents the potential benefits of purchasing the registrant's securities but does not present the material risks associated with the investment in a balanced way.

In our comments, we often ask registrants to ensure that the level of detail in the risk disclosure is proportional to the level of detail in the presentation of the potential rewards. For example, where the registrant submits a one or two page brochure highlighting the potential investment benefits of a security, we often suggest that the presentation of risks be similar in detail to the list of risks provided on the cover page of the prospectus. On the other hand, where the registrant submits a multi-page promotional slide deck that includes a detailed description of the potential investment benefits, we often suggest that the presentation of risks be similar in detail to the risk factor discussion that might be found in the prospectus summary.

We frequently ask registrants to present risk disclosure in their sales material with the same prominence as information about the benefits of the investment. In our comments, we ask registrants to consider the location of risk and reward disclosure within the sales material as well as the format, including font size and graphic features, when assessing the prominence of their risk disclosure. As appropriate, we have asked registrants to reformat their sales material to relocate risk disclosure from the last page of the materials to a more prominent location, to present the risk disclosure within the text rather than a footnote, or to increase the font size of risk disclosure so it is not smaller than the font used to describe the potential benefits of the investment.

Item 19.A – Consistent with the Representations in the Prospectus

Item 19.A of Guide 5 states that the contents of the sales material "should be consistent with the representations in the prospectus." In our comments, we frequently ask registrants to update sales material that appears outdated when compared to the current prospectus and to consider the need to update the prospectus to include material information about the registrant or the offering that is included in sales material. Although Guide 5 calls for sales material to be *consistent* with the representations in the prospectus, we have not asked registrants to include in the prospectus *all* information that appears in the sales material. For example, when sales material contains general background information about the industry that is

REIT Tax Technical Panel

Friday, March 23rd
11:00-12:15 p.m.

Moderator:
James Sowell, Principal - KPMG LLP

Panelists:
A. Cristina Arumi, Partner - Hogan Lovells US LLP
Marikay Klank, VP-Tax - Equity Office Properties
Charles Temkin, Director - Deloitte Tax LLP
Shari Thakady, Director-Tax - Ramco-Gershenson Properties Trust

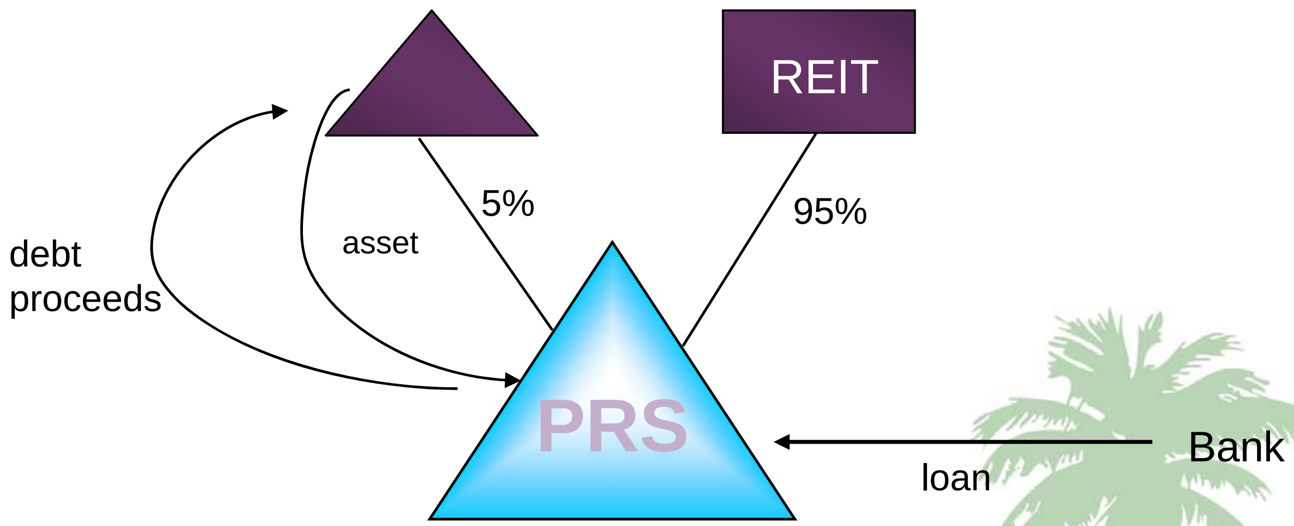
REIT Share Ownership Restrictions - Overview

- Basic Rules that the “Standard Ownership Restrictions” are intended to address:
- Section 856(a)(2) requires that shares of stock (or beneficial interest) of a REIT must be transferable.
- Section 856(a)(5) requires that a REIT have a minimum of 100 shareholders.
- Section 856(a)(6) requires that a REIT not be “closely held” within the meaning of Section 542(a)(2).

"Standard Ownership Restrictions"

- Fixed numerical limitation – e.g., 9.9% by number or value of each class of shares -- to comply with the closely held prohibition.
- Additional prohibition on ownership or transfers/acquisition that result in a closely held violation.
- A prohibition on transfers reducing the number of shareholders to under 100.
- Applies to all shareholders (but may include specific exemptions and allow for waivers).
- Some provisions are more restrictive than necessary. For instance, a company might not necessarily fail to be a REIT if it is a shareholder owned more than 9.9% of its shares.

UPREIT Issues – Debt-Financed Distributions



- Reg. §1.707-5(b) permits a tax-free property contribution and distribution of cash that is traceable to a financing incurred within 90 days of the distribution to the extent that the liability is allocated to the contributing partner
- Substance of economic risk of loss through guarantee or similar arrangement will be the focus of the modification to the regulations

SEC Legal Developments

Friday, March 23rd
9:30-10:45 a.m.

Moderator:
Gil Menna, Partner & Co-Chair-Real Estate & Real Estate Capital Markets Practice - Goodwin Procter LLP

Panelists:
Scott Hodgkins, Partner - Latham & Watkins LLP
Michael McTiernan, Assistant Director-Division of Corporation Finance - U.S. Securities and Exchange Commission
Thomas Morey, SVP & General Counsel - Washington Real Estate Investment Trust

LATHAM&WATKINS

Number 1247 October 24, 2011

Client Alert

Latham & Watkins Corporate Department

SEC Staff Issues Disclosure Guidance on Cybersecurity Risks and Cyber Incidents

"The guidance is helpful, however, in clarifying the full extent and nature of such obligations and the expectations of the Division of Corporation Finance vis-à-vis such disclosures."

On October 13, 2011, the Staff of the Division of Corporation Finance of the Securities and Exchange Commission (the SEC Staff) issued guidance on the disclosure of cybersecurity risks and cyber incidents.[1] Data security breaches and other cybersecurity incidents were repeatedly in the headlines in 2011, with several large public companies reporting breaches, attempted breaches or service and website shutdowns by "hacktivists" and other actors. Some companies that were in the headlines for cyber incidents were not attacked, but simply experienced systems failures that nonetheless exposed sensitive data or resulted in a degradation or complete loss of service.

It is important to note that the guidance is not itself a new rule, regulation or statement of the Securities and Exchange Commission itself. Rather, the guidance simply seeks to clarify the application of *existing* disclosure obligations in this area.[2] At the same time, the guidance reiterates that disclosure in compliance with the securities laws does not require registrants to reveal information that might negatively impact their cybersecurity efforts. This *Client Alert* reviews and summarizes the new guidance, specifically the scope of cybersecurity risks and cyber incidents and the types of disclosure obligations that may be implicated — risk factors, management's discussion and analysis, description of business, legal proceedings, financial statements, and disclosure controls and procedures. In the light of this new guidance, registrants should review their existing cybersecurity disclosures carefully and consider what, if any, improvements could be made.

The Scope of Cybersecurity Risks and Cyber Incidents

One of the first points the guidance makes is the breadth of what might be considered a cybersecurity risk or cyber incident. The guidance points out that "cyber incidents can result from deliberate attacks or unintentional events."[3] Cybersecurity attacks include not just technologically sophisticated hacking attempts or denial-of-service attacks, but also social engineering and other conventional efforts to gather information, such as security credentials, in order to pass (or bypass) cybersecurity systems. Additionally, while much of the guidance focuses on cyber attacks, it is worth bearing in mind that the principles outlined (and the underlying securities laws) apply to unintentional incidents as well. These would include, among other things, inadvertent cybersecurity lapses and other systems failures.

Regardless of the cause, cybersecurity risks and cyber incidents can have a material adverse impact on a registrant and remain subject to the same disclosure standards under the securities laws as other operational or financial risks or incidents.[4] A cybersecurity breach could result in the loss of valuable information or intellectual property, liability for stolen assets or information, remediation costs to repair damage caused by the breach (including business incentives to make amends with affected customers and business partners), additional security costs to mitigate against future incidents, litigation costs resulting from the incident, and lost revenues and reputational damage. To the extent that cybersecurity risks and cyber incidents could have a material adverse impact, the guidance discusses the extent and nature of disclosures that may be necessary in certain specific areas.

Risk Factors

Registrants are required to disclose "the most significant factors" that make an investment in their securities speculative or risky.[5] In determining if risks associated with cyber incidents should be disclosed, the guidance notes that registrants are expected to evaluate their cybersecurity risks and consider all relevant information, such as "prior cyber incidents and the severity and frequency of those incidents", "the probability of cyber incidents occurring and the quantitative and qualitative magnitude of those risks, including the potential costs and other consequences", and "the adequacy of preventative actions … in the context of the industry in which they operate and risks to that security, including threatened attacks of which they are aware."[6]

As with all risk factor disclosure, cybersecurity risk factors should be tailored to the facts and circumstances of the specific registrant. Depending on a registrant's particular facts and circumstances, examples of appropriately tailored disclosures might include:

- A discussion of aspects of the business or operations that give rise to material cybersecurity risks and the potential costs and consequences
- To the extent outsourced functions have material cybersecurity risks, a description of those functions and how the registrant addresses those risks[7]
- A description of cyber incidents experienced by the registrant that are, individually or in the aggregate, material, including the costs and other consequences of such incidents
- Risks related to cyber incidents that may remain undetected for an extended period
- A description of relevant insurance coverage

The guidance also reminds registrants that, as with other operational or financial risks, specific known or threatened cyber incidents may need to be discussed to put disclosed cybersecurity risks in context.[8] At the same time, the guidance provides reassurance that compliance with the securities laws does not require the provision of information that could compromise a registrant's cybersecurity measures, but only disclosure sufficient to "allow investors to appreciate the nature of the risks faced by the particular registrant in a manner that would not [compromise cybersecurity]."[9] Where investigation of a cybersecurity breach or other incident is ongoing, a registrant should consider, in light of the specific facts and circumstances, the nature and extent to which the breach or incident and the associated investigation are required to be disclosed under the securities laws.

LATHAM & WATKINS LLP

Corporate Governance Commentary

September 2011

Future of Institutional Share Voting Revisited: A Fourth Paradigm

Highlights

- The prevailing paradigm for voting institutional investor portfolio shares consists of delegating the function to corporate governance specialists (housed either internally or externally at proxy advisory firms), except, in the case of active investment managers, where votes with perceived economic significance are often decided with input by portfolio managers.
- To make this "outsourcing" paradigm economically viable in light of the thousands of votes required to be cast each proxy season, corporate governance specialists have automated their voting systems by adopting one-size-fits-all voting policies and metrics, which are applied to all companies without regard to their particular circumstances.
- The one-size-fits-all voting policy paradigm has been criticized on a number of bases, including the lack of convincing empirical evidence that the voting policies have any appreciable positive effect on corporate performance, the paradigm's rigidity and its empowerment of ISS and Glass Lewis as arbiters of corporate governance issues.
- The 2011 Say on Pay voting season illustrates the worst faults of the one-size-fits-all paradigm and has set the stage for ISS to become the veritable dictator of executive compensation policies and practices for all public US companies.
- We believe there is an alternative institutional voting paradigm that would avoid the problems inherent in the prevailing voting model. In 2008, the Department of Labor revisited the ERISA fiduciary requirements relating to voting portfolio shares and made clear there is no absolute duty to vote all portfolio shares on all matters; rather ERISA fiduciaries should first conduct a cost benefit analysis with regard to exercise of the shareholder franchise and vote only if the cost of doing so is outweighed by the value created by the vote.
- This elaboration of the fiduciary standard makes clear that institutional investors could well conclude that a voting policy of following management's voting recommendations in all cases (except where an investor affirmatively concluded a contrary vote would better serve shareholder value creation) would be a far better and lower cost solution, compared to the current corporate governance dominated paradigm.
    - The new paradigm would align institutional investor votes with portfolio investment policy. To put it most simply, if a stock is in an actively managed portfolio, presumptively the investment manager has confidence in the company's management. If the manager lacks that confidence, it should be exiting the position, not holding it in the hopes that some day corporate governance reform will make a positive difference.
    - It would take quantitative institutional investors out of an area in which they don't belong of making subjective voting decisions for portfolio companies selected on the basis of a quantitative model, not subjective investment judgment.

LATHAM&WATKINS LLP

Firm Publication

September 12, 2011

Say on Pay and Related Advisory Vote Proposals

By James D. C. Barrall and Alice M. Chung

Earlier this year, the Securities Exchange Commission (SEC) issued final rules (Final Rules) implementing Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act), which generally provides shareholders of US public companies with the right to cast three types of pay votes: (i) an advisory vote to approve the compensation of the named executive officers (say on pay vote); (ii) an advisory vote on the frequency with which shareholders should be entitled to cast votes on the company's executive compensation (frequency vote) and (iii) an advisory vote to approve certain payments made in connection with an acquisition, merger or other specified corporate transaction (golden parachute vote).

Public companies in the information technology sector may be affected by the Final Rules and the required advisory votes pursuant to such Final Rules because the rules apply to all US public companies, with specific temporary exemptions for smaller reporting companies (*i.e.*, generally, public companies with less than US$75 million in public equity float). Other than as specifically exempted by the Final Rules, all US public companies are required to hold a say on pay vote and frequency vote at their first shareholder meeting held on or after January 21, 2011 and a golden parachute vote for deal proxies filed on or after April 25, 2011. To view our previous *Corporate Governance Update* regarding the advisory vote requirements pursuant to the Final Rules, **click here** or visit **http://www.lw.com/upload/pubContent/_pdf/pub3940_1.pdf**.

The frequency vote, and the issue of whether board of directors should recommend annual, biennial or triennial say on pay advisory votes, which arguably garnered the most attention early in the proxy season, are generally settled now. Company recommendations have trended toward annual say on pay advisory votes and such recommendations have overtaken triennial recommendations, due to the voting results of the proxy season which, in approximately 82 percent of reported meeting results, have favored annual say on pay votes.[1] Public information technology companies that have not yet filed their proxies should still consider their compensation policies and plans and determine which frequency recommendation is in the best interest of the company. The Final Rules require disclosure of the final decision on how often it would hold a say on pay vote on a Form 8-K. Such filing may be made no later than the earlier of 150 calendar days after the date of the shareholder meeting or 60 calendar days prior to the deadline for the submission of shareholder proposals for the subsequent annual meeting.

The golden parachute advisory vote rules are also now in effect. The Final Rules require golden parachute compensation arrangement disclosures and a golden parachute advisory vote in connection with shareholder meetings to vote on certain change of control transactions. Such advisory vote is not required if the golden parachutes have been subject to a prior say on pay vote. However, if a company modified its golden parachute arrangements after the prior vote, the new arrangements and revised terms must be put up for a new golden parachute vote. To view our previous *Corporate Governance Alert* regarding the golden parachute requirements pursuant to the Final Rules, **click here** or visit **http://www.lw.com/upload/pubContent/_pdf/pub4164_1.pdf**.

Collective attention has now turned to the say on pay advisory vote results. The Final Rules require companies to discuss in the Compensation Discussion and Analysis (CD&A) of subsequent proxy statements whether they considered the results of the most recent vote and if so, how such consideration affected the companies' executive compensation decisions and policies. Therefore, the result of the say on pay advisory vote is of particular importance. As of July 21, 2011, of the 2,293 Russell 3000 companies that have reported meeting results, say on pay

Appendix B

March 24, 2009

Goodwin Procter LLP REIT Alert

In Search of Equity Capital: What Is the Best Manner of Sale in the Current Economic Environment?

In recent publications, we addressed ways in which U.S. REITs and other public real estate companies can preserve capital through the use of cash/stock dividends and raise equity capital through at the market offerings (see, Goodwin Procter REIT Alerts “Cash Preservation Strategies for REITs” and “At the Market Offerings: Raising Equity Capital in Volatile Markets,” and BNA International’s “Cash Conservation Strategies for REITs”). While these strategies can be successful in strengthening balance sheets on a small scale and conserving capital, the purpose of this alert is to discuss more meaningful ways to normalize a company’s debt-to-total-capitalization ratio and to position a company for upcoming debt maturities by raising significant amounts of common equity capital (as opposed to preferred stock issuances, asset sales or joint ventures). As discussed below, there is no optimal approach, and each company will need to address whether, and how, to raise significant equity capital in order to delever and address pending debt maturities. What is clear, however, is that in the midst of the current credit crisis, thoughtful action is needed to re-equitize REIT balance sheets and properly address the industry’s upcoming debt maturities. In the face of these maturities, many U.S. REITs will no longer be able to stand on the sidelines waiting for stock prices to climb before contemplating an equity issuance. Many REITs may be forced to take decisive action by issuing large blocks of common equity at discounts to their perceived underlying net asset values. Modestly dilutive issuances of common or preferred equity that only assist at the margin in addressing a REIT’s debt maturities will likely not be sufficient to address the liabilities side of the balance sheet. Arguably, for an issuance of common equity to be well received in light of the discounted prices that the market may demand to clear the offering in the current environment, the offering will almost certainly need to be large enough to solve (or at a minimum go a long way towards solving) the inflated debt to total capitalization ratios and related pending debt maturities that plague the balance sheets of many domestic REITs.

Background

The structural bear market has affected the REIT industry as much as any other industry. More than 45% of the NYSE-listed REITs currently trade at a per share value of $10.00 or less. Relatively recently, a REIT with a $1 billion equity market capitalization was considered a modest sized REIT. Today (as was the case earlier in the history of the REIT industry), that amount of equity capital would place the company in the top third of all publicly traded equity REITs as of the close of trading on March 20, 2009. Some REITs that only a year ago were some of the largest in the industry based on their equity market capitalization, including General Growth Properties (NYSE: GGP) and Maguire Properties (NYSE: MPG), are now teetering on the verge of bankruptcy with per share prices below $1.00 as they struggle with debt maturities and unfavorable debt to equity ratios.

How serious is the need for equity capital? Very serious, to put it mildly. According to current statistics, U.S. REITs need to refinance approximately $20 billion of debt in 2009 and between $33 billion and $40 billion in each of 2010, 2011 and 2012. To put this into perspective, based on rough estimates as of the end of February 2009, the total capitalization of all publicly traded U.S. REITs is approximately $369.8 billion, but the total equity capitalization of the same REITs is only approximately $128.5 billion

Appendix I

NAREIT's Accounting & Financial Standards Hot Topics

SFO Alert

February 13, 2012

SEC Areas of Focus in Reviewing 2011 10-K Filings

On Feb. 8, 2012, the Staff of the Division of Corporation Finance of the Securities and Exchange Commission (the Staff) shared with NAREIT areas of financial reporting on which they intend to focus in their reviews of 2011 REIT 10-K filings. The areas identified in this Alert do not impose new disclosure requirements and they are not intended to limit the areas of potential Staff comments. The Staff informed us that any Staff comments will depend on the facts and circumstances of a particular REIT. The areas of focus are separated for those that relate to equity REITs and those that relate to mortgage REITs and are further categorized as to whether they represent legal or accounting areas.

Areas of Focus Related to Equity REITs

Legal matters:

The Staff believes that if a REIT's management considers net operating income (NOI) a key performance measure, information regarding NOI may need to be included in the 10-K. If NOI is disclosed, accompanying disclosures should clarify those income and expense items that are included and those that are excluded in the measurement of NOI, especially any items that differ from the definition of NOI generally used by the REIT's peers. Also, disclosures of "same store NOI" should be accompanied by an explanation of how the same store pool is calculated and highlight changes in the pool from the prior reporting period.

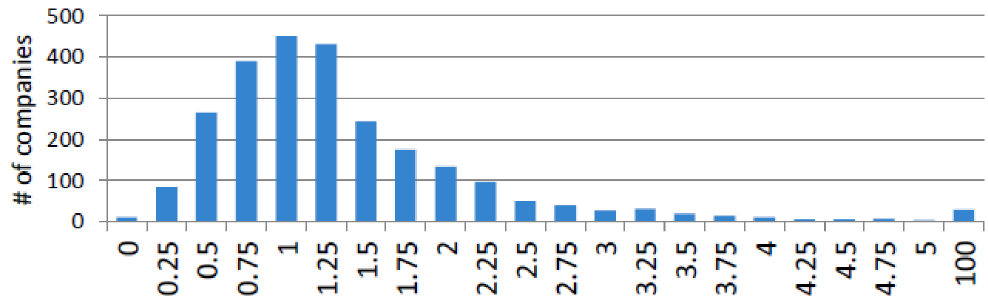
The Staff intends to focus its reviews on Management's Discussion and Analysis (MD&A) disclosure. For example, the Staff will examine whether the MD&A disclosure of period-to-period changes in rental revenue and expenses clarifies the relative impacts of same store and non-same store results and the relative impacts of changes in rental rates and occupancy. The Staff will also consider disclosure regarding lease rollover trends, including changes in rental rates on leases rolled in the reporting period and, for space expected to be re-leased over the next twelve months, the difference between existing rents and current market rents.

The Staff also intends to focus on disclosure regarding leasing activity during the reporting period, both for new leases and lease renewals, including:

- Square feet leased
- Average rents
- Per square foot cost associated with leasing, (e.g., leasing commissions, tenant allowance and tenant improvements)

measure are almost exactly 1.0 – meaning that the typical company in the back-test sample pays very close to the median pay of the ISS-selected comparison group. This finding provides evidence that in general, ISS' comparison group methodology selects appropriate companies.

Figure 2. Distribution of Multiple of Median Measures

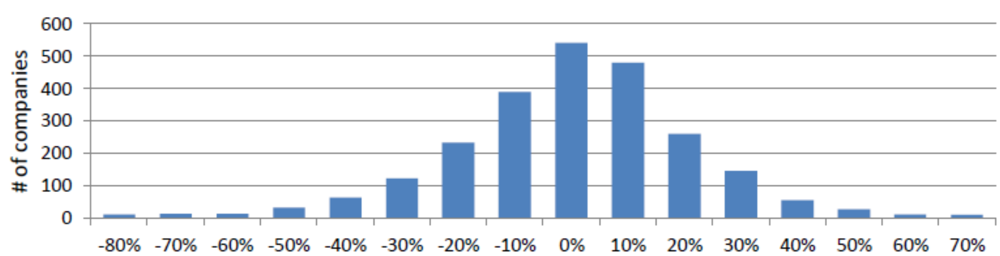


Values for the multiple of median measure range from 0 (for the handful of companies that pay close to zero) to 25 times. Approximately 25% of companies pay more than 1.5 times the comparison-group median; ten percent of companies pay more than 2.1 times median.

Pay-TSR Alignment

This measure, too, exhibits a normal distribution. The values range from -106% to 129%, with a median value of -3% - meaning that the median company saw pay changing at a trend rate approximately 3 percentage points higher than the performance trend.

Figure 3. Distribution of Pay-TSR Alignment Measures



Approximately 25% of companies had PTA measures less than -16.2%, and ten percent had values under -30.6%. Half of companies had PTA measures between -16.2% and 7.7%.

Relationship to Vote Results

Another assessment of the effectiveness of these measures to determine pay-for-performance alignment is the relationship they have with the outcomes of management say-on-pay (MSOP) votes at companies' annual meetings in 2011. Using a panel of 1,967 companies where vote results and all three measures were available, we regressed vote results against the three measures. The results indicate that all three measures are statistically significant ($p<.02$) predictors of vote results, with the strongest effect coming from the RDA measure.

covering named executive officers. Even in transactions that do not require a shareholder vote, companies were required to disclose golden parachute payments in filings, such as tender offers and going-private transactions.

Companies may avoid a separate golden parachute vote in their transactional proxy statements if the golden parachute arrangements were subjected to a prior say-on-pay vote; provided, however, that, if any golden parachute payments are adopted or enhanced after the prior say-on-pay vote, the new or enhanced golden parachute arrangements would need to be subjected to a vote in the transactional proxy statement.

It is not surprising that to date, because of the limited benefits of proactively subjecting executive golden parachute arrangements to an advanced say-on-pay vote, only a handful of companies have done so in advance of a transactional proxy statement.

To date, there has been no controversy with respect to the golden parachute vote. As of August 2, 2011, out of the approximately nine companies that have held shareholder meetings to approve transactions after the effective date of the golden parachute advisory vote rule, all nine companies have enjoyed passing votes from their shareholders for their executive golden parachute arrangements.

Say-on-Pay Vote

During the past few months, collective attention has shifted to the say-on-pay vote. For a while, executive compensation and governance experts were focused on the shareholder meeting voting statistics. From the beginning of the 2011 proxy season, the percentage of companies that did not receive a majority say-on-pay advisory vote from their shareholders remained at less than two percent, with more than 90 percent of companies receiving at least a 70 percent approval rate. But, behind the numbers were the real stories.

Proxy advisers, like ISS and Glass, Lewis & Co. (Glass Lewis) recommended against numerous companies' executive compensation policies. As of July 28, 2011, ISS had recommended against company say-on-pay advisory votes in approximately 13 percent of the Russell 3000 companies' proxies it reviewed. By some accounts, Glass Lewis' against recommendations numbered higher. Such negative recommendations have been triggered by a variety of pay policies and practices that the proxy advisers have labeled as "problematic" or "egregious." For example, ISS has recommended against company say-on-pay advisory votes for company executive compensation arrangements that included Internal Revenue Code Section 280G tax gross-up payments on golden parachute payments, single-trigger change-in-control payments or broad (so-called "liberal") change-in-control definitions, "excessive" severance pay and "excessive relocation payments," particularly including those with home-loss make-whole payments and related income tax gross-ups. However, the most prevalent and important basis for proxy adviser negative recommendations has been perceived "pay-for-performance" disconnects between the company's financial performance and its pay to its executive officers — most importantly, to its CEO.

Many companies addressed negative ISS and Glass Lewis recommendations head on, by filing additional proxy materials prior to shareholder meetings to dispute. While most companies disputed the negative recommendations by challenging their pay-for-performance judgments (noting factual errors, weaknesses in the stock option valuation method and disconnects in proxy adviser peer group determinations), some companies amended their existing employment and equity agreements to induce ISS to change its adverse recommendations. Still other companies made prospective pay-for-performance commitments to subject a certain percentage of shares underlying named executive officers' equity awards in future years to performance vesting.

Aside from the issues related to losing their say-on-pay advisory votes, companies that did not receive at least a majority say-on-pay vote, and even one company that received more than a majority say-on-pay vote, have also been subjected to shareholder derivative suits filed against their directors and executive officers, and in some cases, their independent compensation consultants firms. Although these shareholder derivative suits face substantial legal hurdles, these suits are distractions and may cause companies and their insurers to make settlement payments to the lawyers at relatively early stages in the proceedings to avoid the time and expense of trying them on the merits.

Conclusion

From its UK origins, say-on-pay is now a prominent fixture of the global corporate landscape. In the US, arguably the biggest say-on-pay scoop this proxy season has been the importance of proxy advisers' recommendations and how vocal companies have been in responding to adverse recommendations. Due to the importance of proxy advisers' say-on-pay recommendations and the difficulties companies had in engaging with shareholders on such matters between the short period of time from the proxy advisers' issuance of reports to the shareholder meetings, it is imperative that companies engage with their important shareholders much earlier in the proxy season. Given that most large public companies have adopted annual say-on-pay votes to follow their shareholders' advisory votes, companies will face these say-on-pay challenges annually, at least for the foreseeable future. Prior to the 2012 proxy season, public companies should review the outcome of their say-on-pay advisory votes and the reasons behind the outcome, evaluate whether executive pay at the company aligns with company performance, determine whether executive compensation policies should be revised in coming years and assess how to best explain the pay-for-performance alignment to shareholders in the upcoming proxy season. ■

State and Local Taxes

Thursday, March 22nd
11:15-12:30 p.m.

Moderator:

Joshua Cox, Director-Tax - Tanger Factory Outlet Centers, Inc.

Panelists:

Wendy Aberwald, VP-Tax - Wells Real Estate Investment Trust II, Inc.
James Helmus - Managing Partner, The Helmus Group
Michele Randall, Director - Deloitte Tax LLP
Stephen Ryan, Partner-State & Local Tax Services - Grant Thornton LLP

Sales & Use Taxes

Significant Considerations

- Heavy state audit activity (increasingly forensic in nature across the country)
- Unforeseen internal operating and capital budget variances
- Inadvertent liability assumption (tenant & guest charges, and property acquisitions)
- Transactional purchase price allocation deficiencies
- Insufficient PSA indemnities

Sales & Use Taxes

Transactional Tax Considerations

- Required "bulk sale" notifications- transferee liability implications and practical considerations
- Sales tax collection responsibilities
- Applicable occasional / isolated sale exemptions
- Purchase price agreement (PSA) allocation opportunities
- Inter-Company transaction issues (e.g., REIT & TRS)

UPREIT/Tiered Structure Issues and Opportunities

- Combined Reporting Challenges (cont.)
- REIT and TRS Combination
    - Intercompany Transactions
        - Property Sales/Transfers
        - IRC Sec. 163(j) Computation
        - TRS Dividends
    - Excess Dividend Paid Deduction
        - Earnings and Profits Calculations
        - REIT Sub Liquidation Issues
    - NOL Computations/Limitations
        - SRLY
        - Suspensions
- Tax Liability Allocation Issues
    - Tax Sharing Agreement?

UPREIT/Tiered Structure Issues and Opportunities

- Operating Partnership Issues
  - Taxable Entity Treatment/Issues
    - Tax Sharing Agreement
      - Liability Based on Partner Status?
  - Tiered Partnership Apportionment Computations
    - 'K-1' Pick-Ups?
    - 'Flow-Up' Underlying Apportionment Values
      - 'Corporate Partner' Treatment?
        - Technical Authority?
        - Partner Ownership % - Profit/Loss % v. Capital %
        - Unitary Treatment?
        - GP Interest – Presumed Unitary
        - LP Interest – Generally Presumed Nonunitary
        - Exception for Multiple Investments and/or Economic Relationships

UPREIT/Tiered Structure Issues and Opportunities

- Operating Partnership Issues (cont.)
  - Withholding Computations
  - REIT Partner Exclusion Issue
  - Increased Audit Activity
    - Aggressive Audit Techniques
    - Inherent Differences Between State Legal and Audit Departments
  - State Penalty Notices
    - Heightened Need For Complete Information
  - Pass-Through Taxes
    - Texas Margin Tax, etc.
      - "Recovery Fee"

Opening General Session: State of the Capital Markets

Thursday, March 22nd
8:00-9:30 a.m.

Welcome:
Steven Wechsler, President & CEO - NAREIT

Moderator:
Scott Schaevitz, Chairman-Americas Real Estate IBD - Barclays Capital

Panelists:
Kenneth Chang, Managing Director - Barclays Capital
Jon Cheigh, Portfolio Manager - Cohen & Steers Capital Management
Michael Knott, Managing Director-Office & Self-Storage - Green Street Advisors, Inc.
Ted Rollins, Co-Chairman & CEO - Campus Crest Communities
Brian Summers, CFO - DRA Advisors LLC

Heard on the Beach

September 30, 2010

Green Street Advisors

Executive Summary

In addition to the other competitive advantages (e.g., alignment of interests, low costs, etc.) REITs offer versus private-market alternatives, the vehicle's resilience has been on full display in the aftermath of the financial meltdown. The ability of REITs to recapitalize quickly has resulted in far fewer major casualties (and no fatalities) in the public market than what will appear in the final count among private operators. However, crash survival is a very different thing than crash avoidance, and REITland incurred plenty of badly dented balance sheets. A tally of the cost of the repairs – in the form of dilutive equity issuances – provides a compelling lesson that capital structures focused on crash avoidance are far superior to those designed primarily for crash survival.

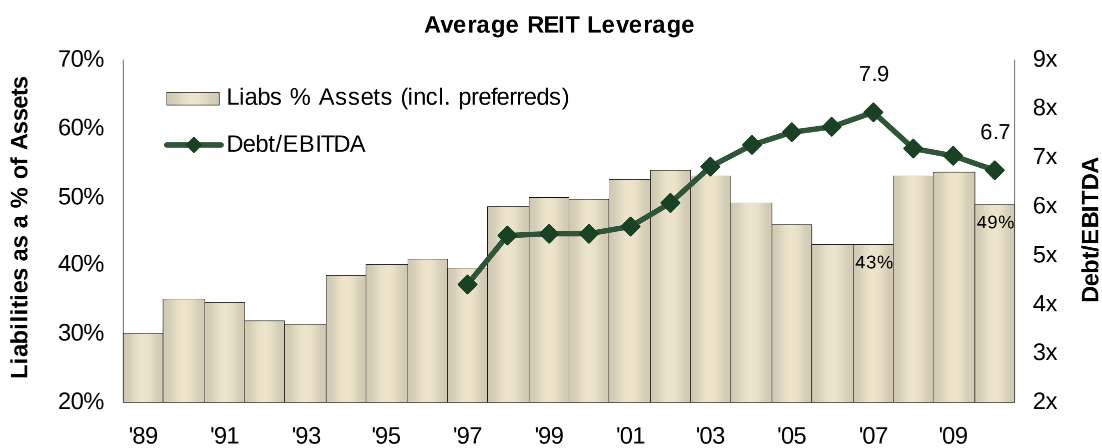
There is ample evidence that this lesson has sunk in with investors – levered REITs have delivered inferior returns and they trade at materially smaller premiums to asset value than their less levered peers – but epiphanies among REIT managers have been few and far between. Yes, leverage reduction goals are common, but the vast majority of them are so vague and undefined as to leave investors scratching their heads. Does leverage reduction mean repairing damage done by declining asset values, making rating agencies happy, or, hopefully, something more strategic? In the absence of much evidence that the latter is the case, investors are left to assume that this lesson will take a long time to sink in.

RMZ: **716** | DJIA: **10,788** | 10-Year T-Note: **2.51%** | Baa Yield: **5.6%**

Heard on the Beach
September 30, 2010

New Trick for an Old Dog. As the REIT industry celebrates its 50th birthday this year, particular honor should be paid to the progress that has been made since the industry turned 30. Improvements on a number of key fronts, including alignment of interests, governance structures, operational savvy and the overall quality of the companies, have allowed REITs to become the superior vehicle for accessing the real estate asset class. However, like most 50-year olds, the sector is not without its shortcomings, and none are more glaring than the balance sheet management acumen at many REITs. The progress on other fronts in recent decades provides reason to hope that an older, wiser REIT industry will, by the time of its 60th birthday, wonder why it took so long for so many REITs to realize that less leverage is better than more.

While REIT balance sheets have recently improved, they remain far more levered than has historically been the case. Debt levels relative to cash flow (Debt/EBITDA) remain 45% higher than they were from '97-'02.



At first glance, balance sheet management seems like an odd place to find fault with the public companies. After all, REITs entered the downturn with less leverage than their private-market counterparts and were much quicker to recapitalize after the crash. To boot, the recapitalization has occurred, more often than not, at pricing that made sense at the time (i.e., modest premiums to the underlying value of their real estate) and most REITs that have issued equity in the last couple of years have been rewarded with higher share prices. The REIT sector's ability to recapitalize when others couldn't highlights the fact that public markets provide numerous options that enhance the ability to survive a

NAREIT®

Febuary 2012

REITWatch®

A Monthly Statistical Report on the Real Estate Investment Trust Industry

National Association of Real Estate Investment Trusts®

REITs: Building Dividends & Diversification®

Exhibit 3
Selected Indicators of Equity Market Performance

January 31, 2012

Period	FTSE NAREIT All Equity REITs		S&P 500		Dow Jones Industrials[1]		Russell 2000		NASDAQ Composite[1]		US Treasury 10-Year Note[2]	
	Levels	Returns (%)	Levels	Returns (%)	Levels	Returns (%)	Levels	Returns (%)	Levels	Returns (%)	Yield	Returns (%)
Annual (including current year to date)												
2002	3,552.10	3.82	1,261.18	-22.10	8,341.63	-16.76	1,543.73	-20.48	1,335.51	-31.53	3.83	-1.24
2003	4,871.12	37.13	1,622.94	28.68	10,453.92	25.32	2,273.20	47.25	2,003.37	50.01	4.27	0.44
2004	6,409.30	31.58	1,799.55	10.88	10,783.01	3.15	2,689.86	18.33	2,175.44	8.59	4.24	-0.03
2005	7,188.85	12.16	1,887.94	4.91	10,717.50	-0.61	2,812.35	4.55	2,205.32	1.37	4.39	0.15
2006	9,709.31	35.06	2,186.13	15.79	12,463.15	16.29	3,328.90	18.37	2,415.29	9.52	4.71	0.32
2007	8,185.75	-15.69	2,306.23	5.49	13,264.82	6.43	3,276.77	-1.57	2,652.28	9.81	4.04	-0.67
2008	5,097.46	-37.73	1,452.98	-37.00	8,776.39	-33.84	2,169.65	-33.79	1,577.03	-40.54	2.25	-1.79
2009	6,524.25	27.99	1,837.50	26.46	10,428.05	18.82	2,759.17	27.17	2,269.15	43.89	3.85	1.60
2010	8,347.58	27.95	2,114.29	15.06	11,577.51	11.02	3,500.15	26.85	2,652.87	16.91	3.30	-0.55
2011	9,039.07	8.28	2,158.94	2.11	12,217.56	5.53	3,353.99	-4.18	2,605.15	-1.80	1.89	-1.41
2012	9,613.80	6.36	2,255.69	4.48	12,632.91	3.40	3,590.96	7.07	2,813.84	8.01	1.83	-0.06
Quarter (inlcuding current quarter to date)												
2010: Q2	6,886.77	-4.06	1,715.23	-11.43	9,774.02	-9.97	2,705.37	-9.92	2,109.24	-12.04	2.97	-0.87
Q3	7,770.14	12.83	1,908.95	11.29	10,788.05	10.37	3,010.78	11.29	2,368.62	12.30	2.53	-0.44
Q4	8,347.58	7.43	2,114.29	10.76	11,577.51	7.32	3,500.15	16.25	2,652.87	12.00	3.30	0.77
2011: Q1	8,973.82	7.50	2,239.44	5.92	12,319.73	6.41	3,778.03	7.94	2,781.07	4.83	3.47	0.17
Q2	9,234.38	2.90	2,241.66	0.10	12,414.34	0.77	3,717.36	-1.61	2,773.52	-0.27	3.18	-0.29
Q3	7,842.64	-15.07	1,930.79	-13.87	10,913.38	-12.09	2,904.55	-21.87	2,415.40	-12.91	1.92	-1.26
Q4	9,039.07	15.26	2,158.94	11.82	12,217.56	11.95	3,353.99	15.47	2,605.15	7.86	1.89	-0.03
2012: Q1	9,613.80	6.36	2,255.69	4.48	12,632.91	3.40	3,590.96	7.07	2,813.84	8.01	1.83	-0.06
Month												
2011: Jan	8,691.91	4.12	2,164.40	2.37	11,891.93	2.72	3,491.13	-0.26	2,700.08	1.78	3.42	0.12
February	9,090.25	4.58	2,238.55	3.43	12,226.34	2.81	3,682.59	5.48	2,782.27	3.04	3.42	0.00
March	8,973.82	-1.28	2,239.44	0.04	12,319.73	0.76	3,778.03	2.59	2,781.07	-0.04	3.47	0.05
April	9,432.70	5.11	2,305.76	2.96	12,810.54	3.98	3,877.79	2.64	2,873.54	3.32	3.32	-0.15
May	9,526.95	1.00	2,279.66	-1.13	12,569.79	-1.88	3,805.08	-1.87	2,835.30	-1.33	3.05	-0.27
June	9,234.38	-3.07	2,241.66	-1.67	12,414.34	-1.24	3,717.36	-2.31	2,773.52	-2.18	3.18	0.13
July	9,331.56	1.05	2,196.08	-2.03	12,143.24	-2.18	3,582.99	-3.61	2,756.38	-0.62	2.82	-0.36
August	8,809.33	-5.60	2,076.78	-5.43	11,613.53	-4.36	3,271.26	-8.70	2,579.46	-6.42	2.23	-0.59
September	7,842.64	-10.97	1,930.79	-7.03	10,913.38	-6.03	2,904.55	-11.21	2,415.40	-6.36	1.92	-0.31
October	8,962.35	14.28	2,141.81	10.93	11,955.01	9.54	3,344.17	15.14	2,684.41	11.14	2.17	0.25
November	8,625.48	-3.76	2,137.08	-0.22	12,045.68	0.76	3,331.98	-0.36	2,620.34	-2.39	2.08	-0.09
December	9,039.07	4.79	2,158.94	1.02	12,217.56	1.43	3,353.99	0.66	2,605.15	-0.58	1.89	-0.19
2012: Jan	9,613.80	6.36	2,255.69	4.48	12,632.91	3.40	3,590.96	7.07	2,813.84	8.01	1.83	-0.06
Historical (compound annual rates)												
1-Year		10.61		4.22		6.23		2.86		4.21		
3-Year		31.63		19.24		16.45		23.03		23.98		
5-Year		-1.80		0.33		0.02		1.19		2.69		
10-Year		10.86		3.52		2.45		6.45		3.82		
15-Year		9.28		5.33		4.20		6.59		4.87		
20-Year		10.99		8.15		7.07		8.47		7.85		
25-Year		10.04		8.92		7.32		8.50		8.20		
30-Year		12.20		11.19		9.32		10.19		9.43		
35-Year		12.99		10.86		7.66		NA		10.15		
40-Year		12.09		9.91		6.82		NA		8.23		

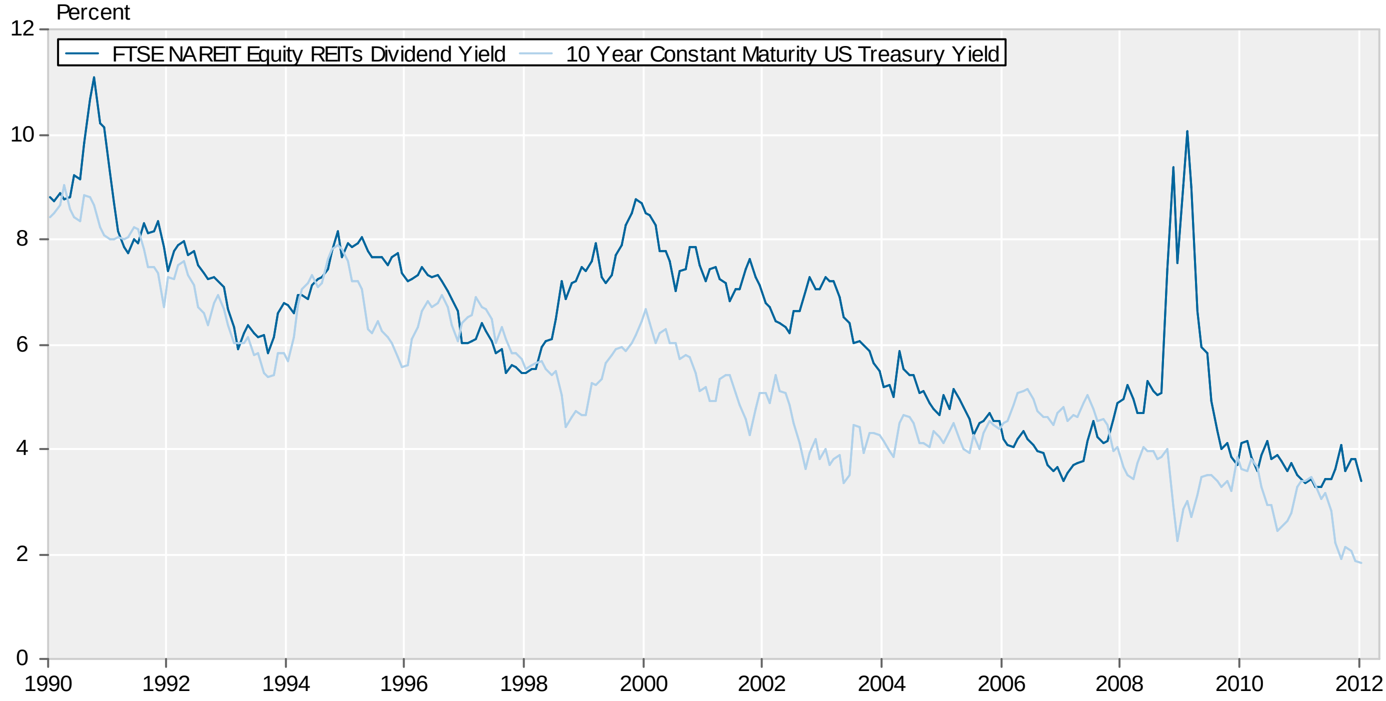
Source: NAREIT®, FactSet.

[1] Price-only returns

[2] Ten-year constant maturity Treasury note

Exhibit 5:
Equity REIT Dividend Yield vs. 10-Year Constant Maturity Treasury Yield

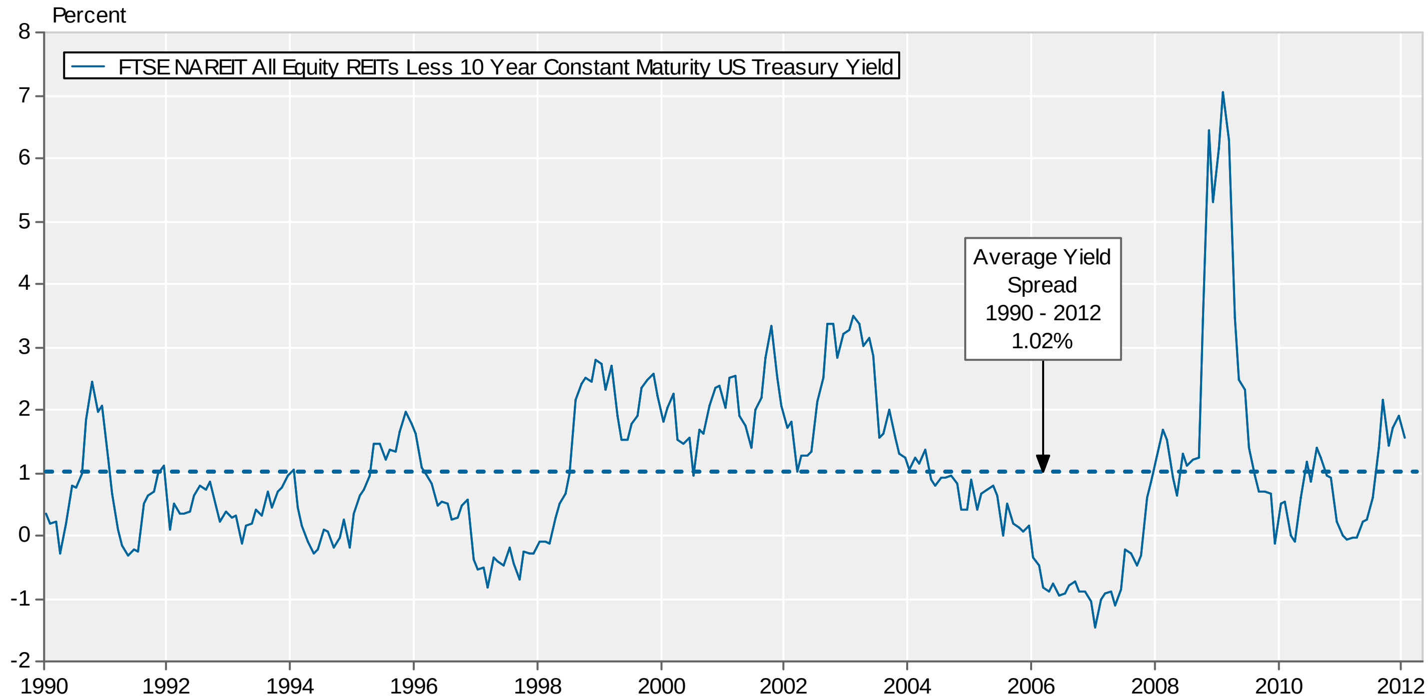
January 1990 - January 2012



Source: NAREIT®, FactSet.

Exhibit 6:
Monthly Equity REIT Dividend Yield Spread

January 1990 - January 2012



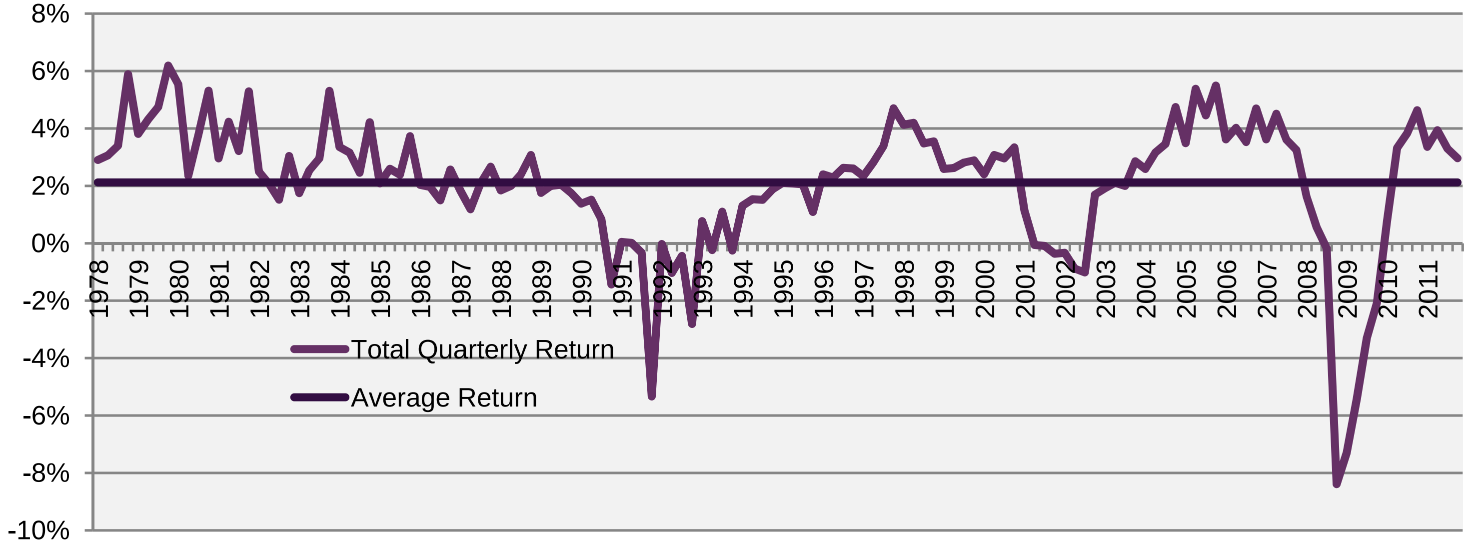
Source: NAREIT®, FactSet.

Primary Sources of Slides

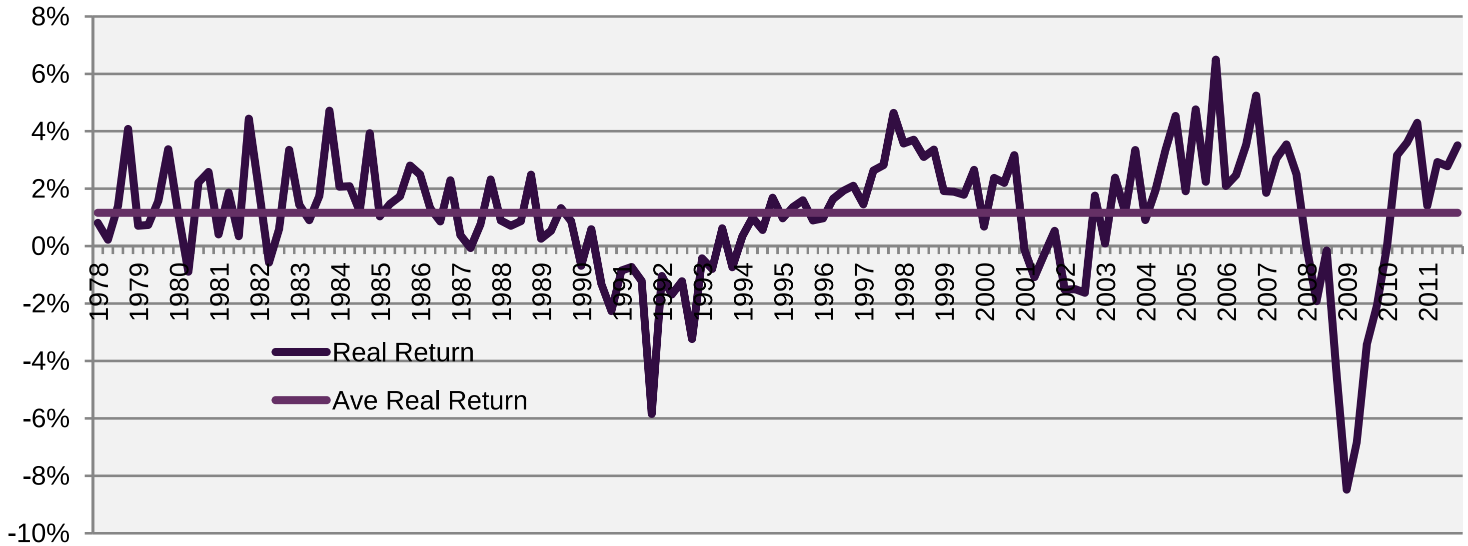
- National Council of Real Estate Investment Fiduciaries (NCREIF)
  - Tracks properties managed by institutional investors on behalf of pension funds
  - Valued quarterly (mark to market) usually relying on appraised values using programs like ARGUS Valuation DCF or ARGUS Enterprise
  - Currently over $270 billion in NCREIF Property Index (NPI)
- Real Capital Analytics (RCA)
  - Tracks all transactions over $2.5 million
  - Includes details about type of owner (buyer and seller), motivations for transaction (including whether distressed sale)
  - Basis for Moody's REAL CPPI Index (based on repeat sales)
- Grubb & Ellis
  - Sources include proprietary office and industrial databases and also third-party data sources deemed reliable.

NPI Real Vs. Nominal

Quarterly Nominal Returns



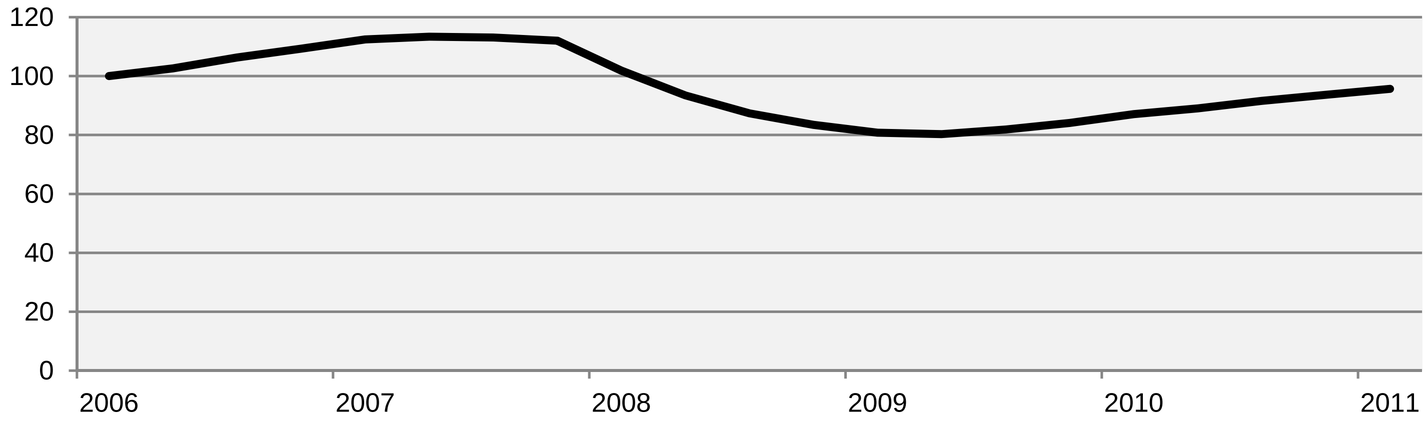
Quarterly Real Returns



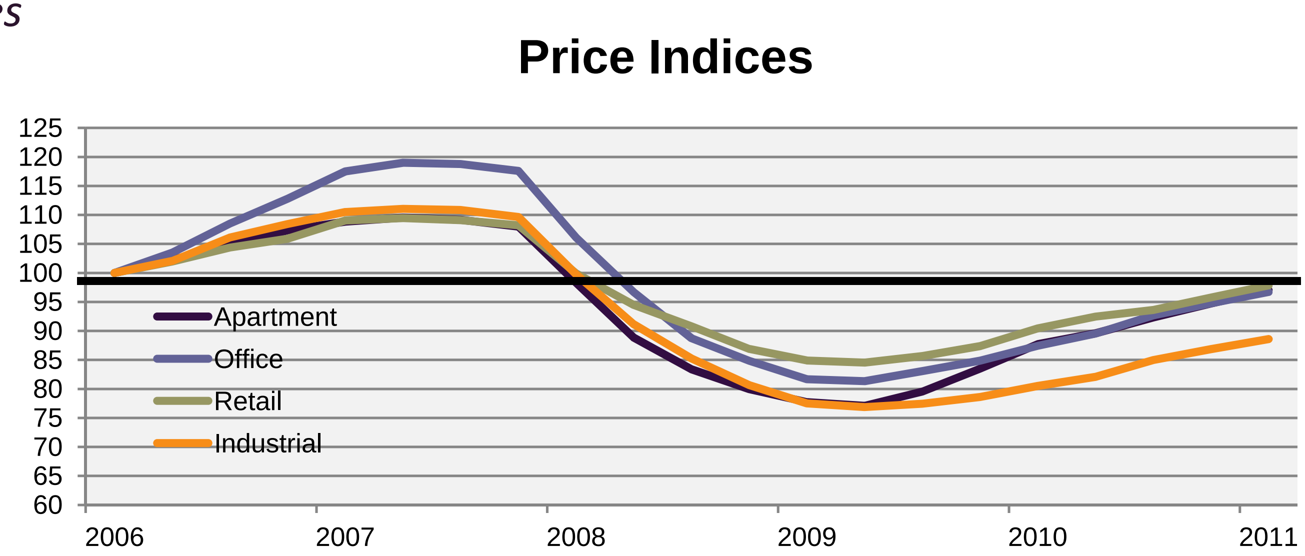
National Council of Real Estate Investment Fiduciaries

NPI Price Indices

NPI

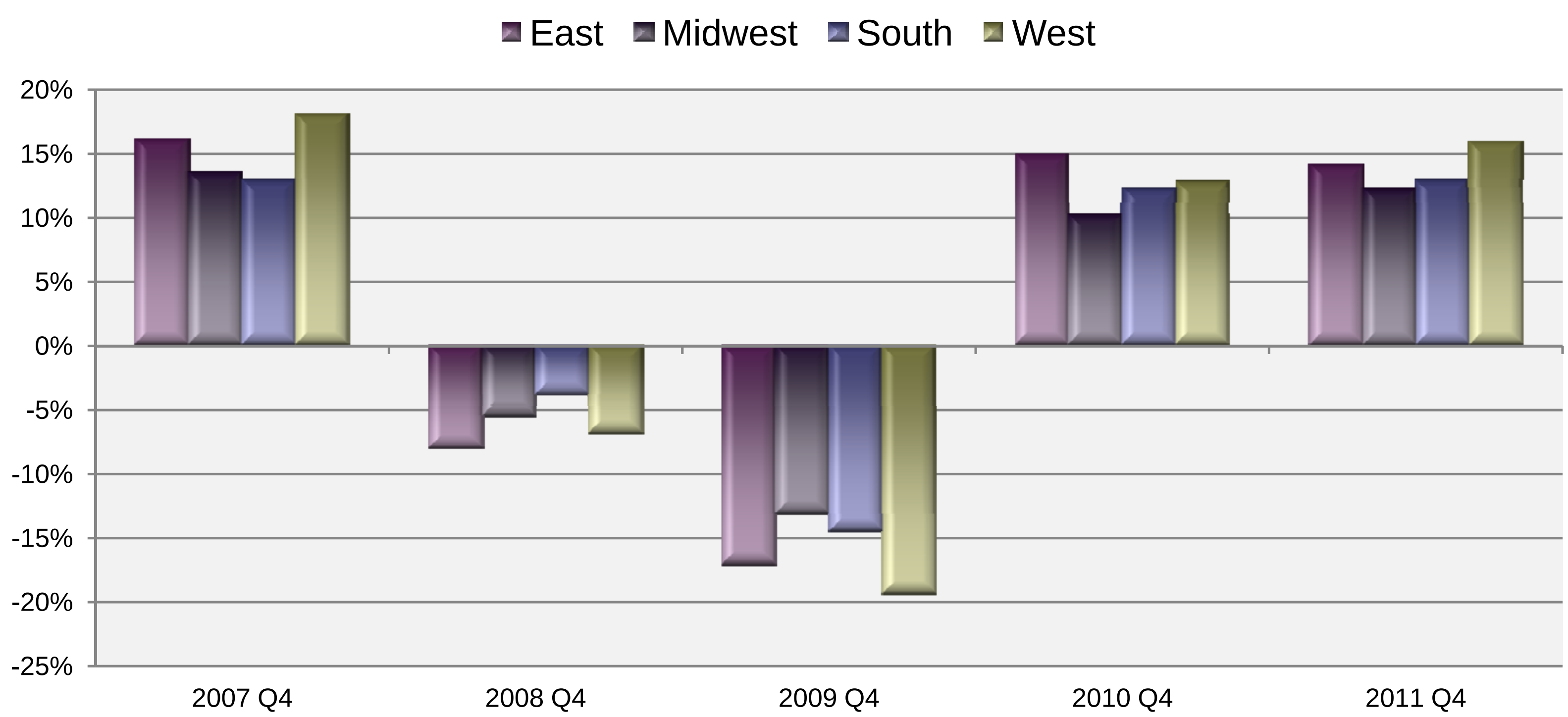


Property Types



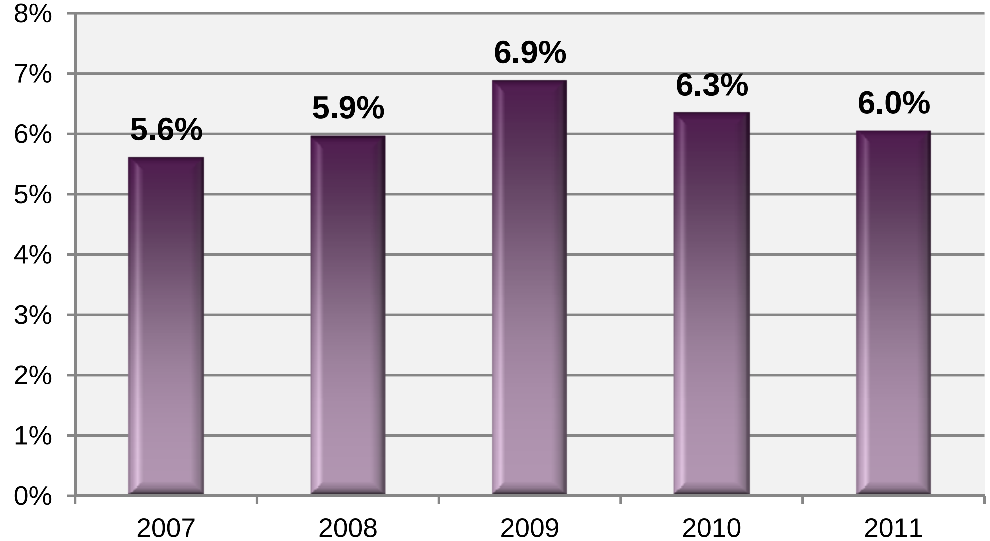
NCREIF Property Index (NPI)

Region Total Returns – Annual Returns Over Last Five Years

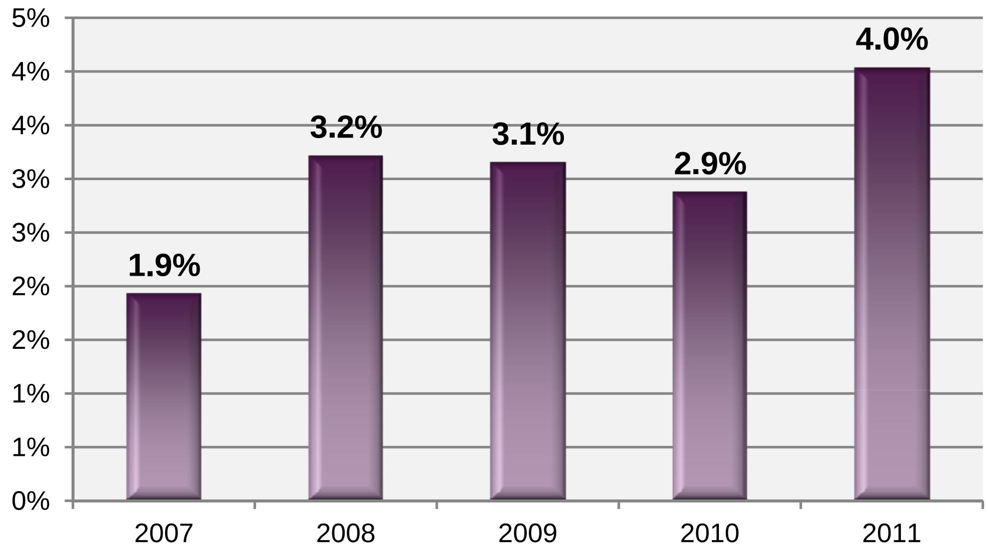


NCREIF Property Index (NPI)

Fourth Quarter Implied Appraisal Cap Rates



Rate Spread over 10 year Treasuries

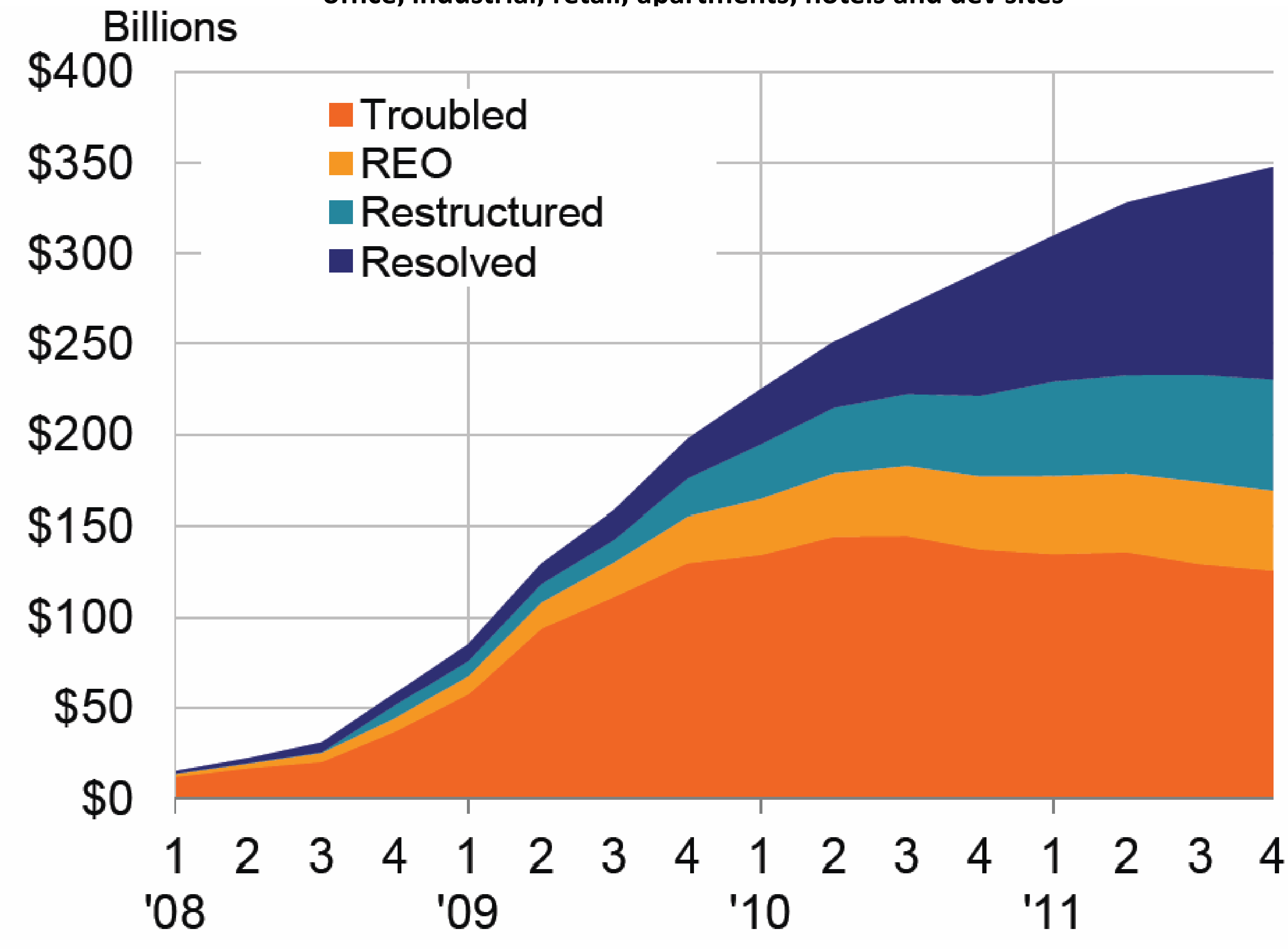


NCREIF
National Council of Real Estate Investment Fiduciaries

2011 Year in Review - Distress

Cumulative Distress for ALL Property Types

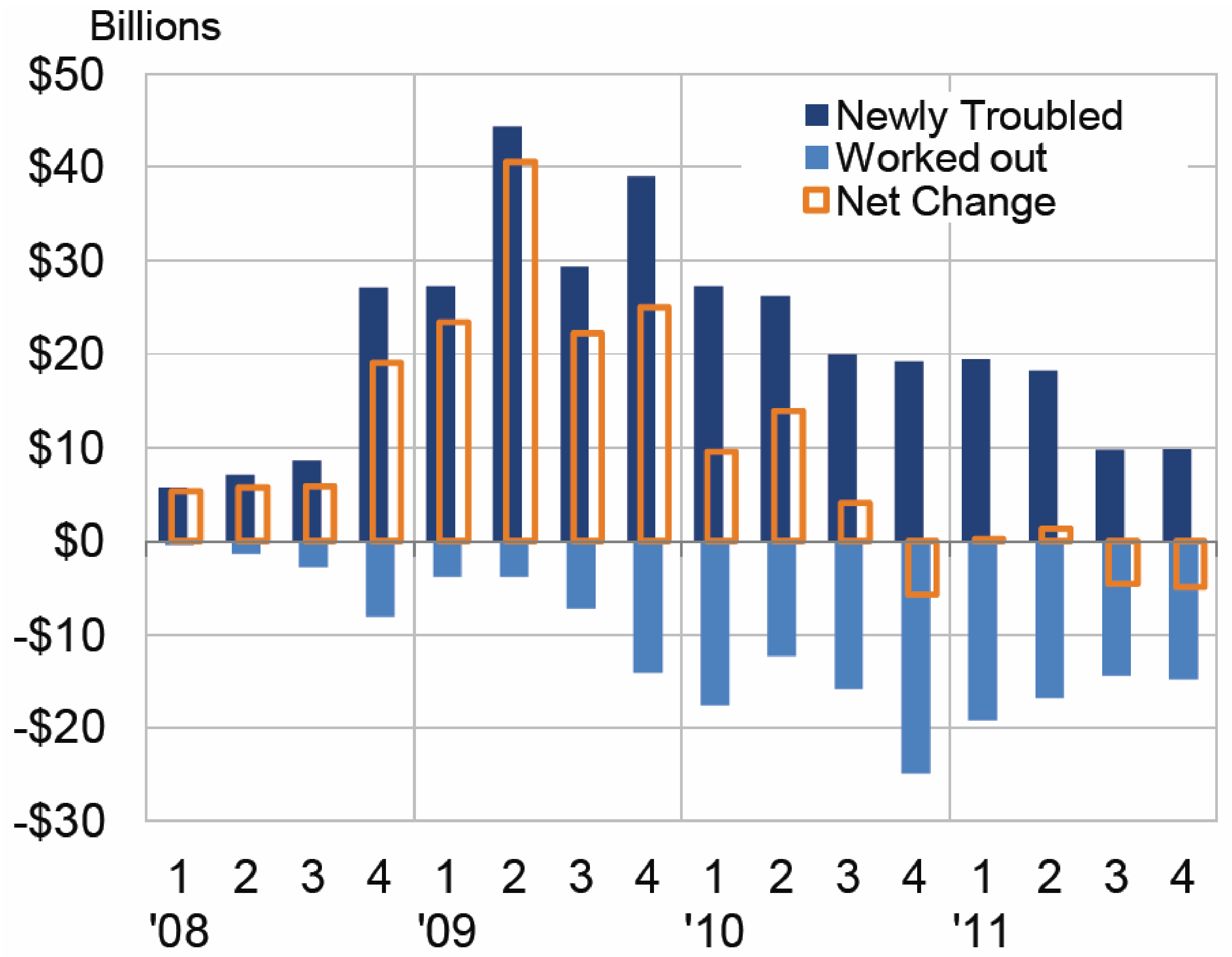
office, industrial, retail, apartments, hotels and dev sites



2011 Year in Review - Distress

Quarterly Additions and Reductions to Distress

office, industrial, retail, apartments, hotels and dev sites



2011 Year in Review - Distress

Outstanding Distress

office, industrial, retail, apartments, hotels and dev sites

By Property Type

	Outstanding Distress	% Chg vs 2010	Worked Out (%)	RR* (%)
Office	$ 40,862	5%	54%	68%
Apartment	34,926	-12%	54%	69%
Retail	28,680	6%	55%	64%
Industrial	11,911	3%	38%	73%
Hotel	22,133	-18%	57%	63%
Land	25,859	8%	36%	54%
Other	4,738	19%	38%	70%
All	169,111	-2%	51%	67%

* recovery rate before costs and fees

By Lender Type

	Outstanding Distress	% Chg vs 2010	Worked Out (%)	RR* (%)
CMBS	$ 79,219	7%	47%	63%
Int'l Bank	10,059	-28%	65%	66%
Domestic Bank	41,495	-8%	49%	69%
Insurance	2,827	-15%	62%	75%
Other	35,511	-13%	55%	70%
All	$ 169,111	-2%	51%	67%

* recovery rate before costs and fees

Tax and Business Issues Surrounding the Evolving REIT

Thursday, March 22nd
2:45-4:00 p.m.

Moderator:
Thomas Robinson, Sr. Advisor-Investment Banking - Stifel Nicolaus Weisel

Panelists:
Donald Hammett, Partner - Locke Lord LLP
Gregory Imhoff, VP & Tax Counsel - Electric Infrastructure Alliance of America, LLC
David Levy, Partner-Tax - Skadden, Arps, Slate, Meagher & Flom LLP

Introduction: A Historical Perspective

- From a relatively quiet start in the 1960's, the REIT form has evolved steadily
  - Early sale-leaseback concepts
  - Mortgage REITs
  - Emergence of "fully integrated real estate operating companies"
  - Spinouts of healthcare REITs
  - Specialty REITs
    - Restaurants, gas station/convenience stores, movie theaters, timber, data centers

Introduction: A Historical Perspective (cont'd)

- From a capital markets perspective, change has been similarly noteworthy
  - Early focus on dividends from an investor base dominated by individuals
  - REITs as "growth vehicles" in the real estate recovery of the 1990's
  - Total return focus
  - Ebbing and flowing foreign investor interest
  - Investor base dominated by institutions – dedicated and generalist – focused on
    - Growth strategies
    - Liquidity
    - Real estate NAV
    - Management focus and alignment of interest and other qualities

Introduction: Current Trends (cont'd)

- Why use a REIT?
  - Strong reliable dividend (payout requirements)
  - Tax efficient
  - Investor friendly
  - Can attract public and private capital from U.S. taxable, U.S. tax-exempt, and foreign portfolio investors
  - Acquisition/growth flexibility – operating partnership & taxable REIT subsidiaries
  - Liquidity
  - Long-term value
  - Not dependent upon public subsidies
  - Transparency

- Why not use a REIT?
  - The REIT tax requirements can make it difficult to place an entire non-traditional business into a REIT
  - The "normal" tax rules can make it difficult to separate the real estate and non-real estate components of an operating business
  - Business operational issues
  - Capital markets story issues
  - Limited ability to retain earnings

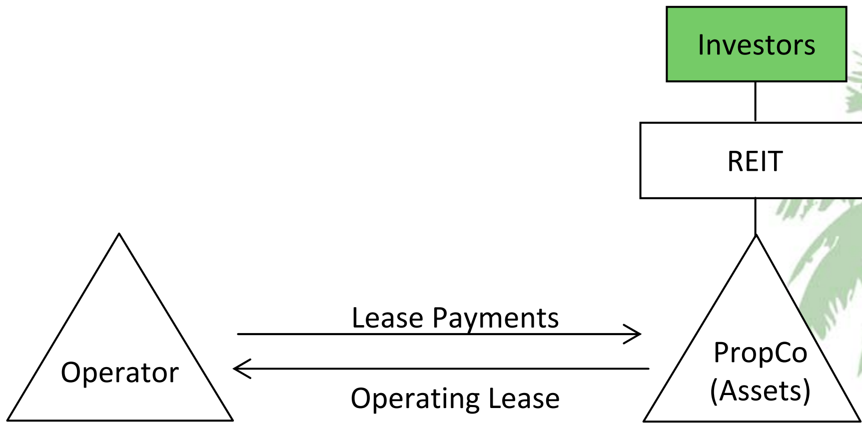
Key Benefits of REIT Status

- No U.S. corporate tax on income earned at the REIT level
- Potential tax-free exit for foreign investors
- Can reduce foreign investors' tax rates on REIT-level income from as much as 54% to as little as 15%, depending on the jurisdiction
- Can reduce tax-exempt investors' federal income tax rates on REIT-level income from 35% to 0%
- Simplified tax treatment and tax reporting for tax-sensitive investors (e.g., U.S. retail, U.S. tax exempts, and foreign investors):

	REIT	**Partnership**
Information Returns to Investors	1099 (simple)	K-1 (complex)
Flow Through of Losses and Corresponding Basis Adjustments (complex)	No	Yes
Shareholders Subject to State Taxes	No	Yes

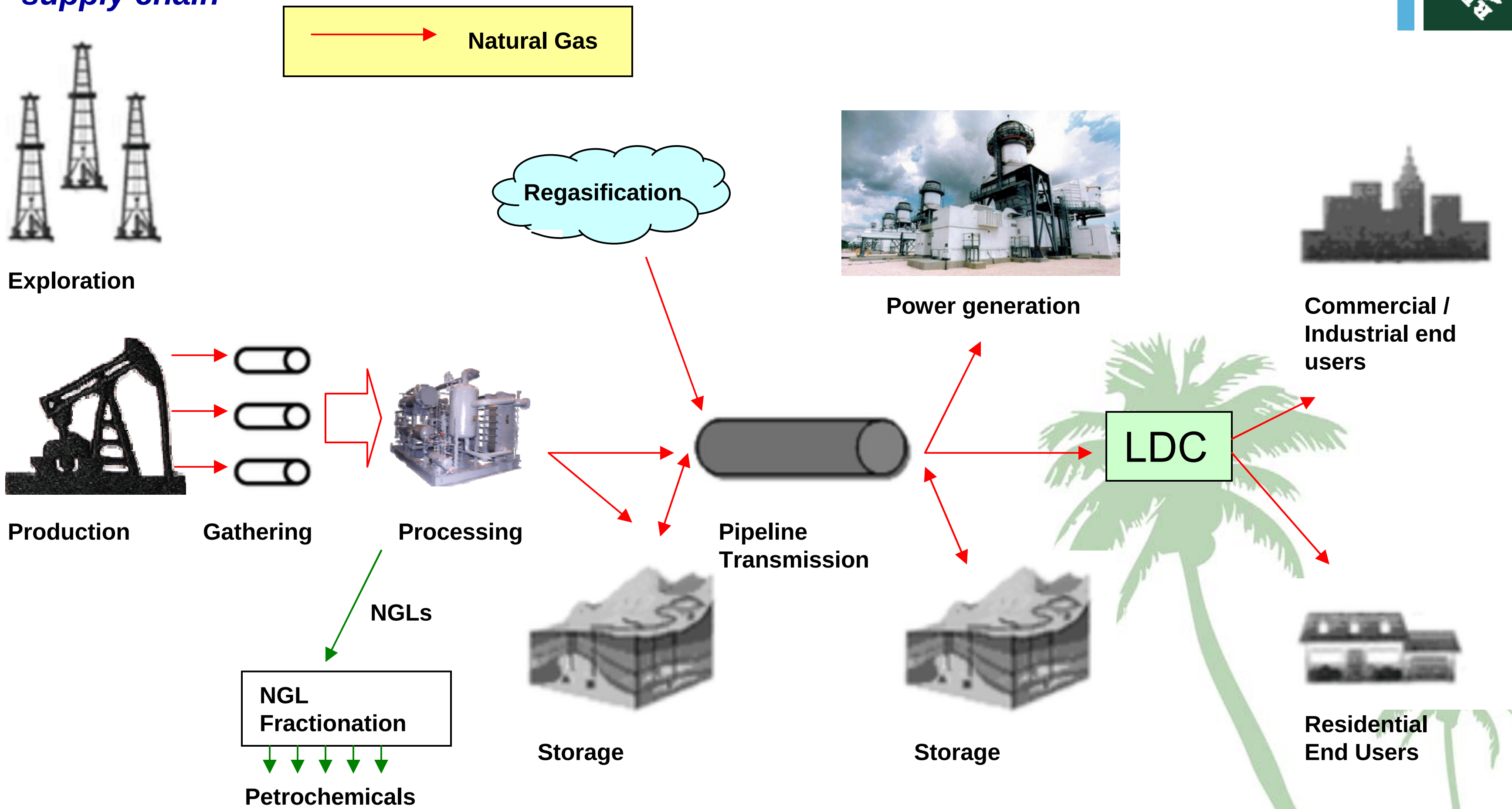
Structuring Considerations

- To create qualifying REIT income, certain infrastructure assets can be owned and operated under a lease arrangement, whereby the REIT owns the assets and leases them to a third party, who operates all aspects of the assets or system under a net lease



Natural Gas Infrastructure Overview

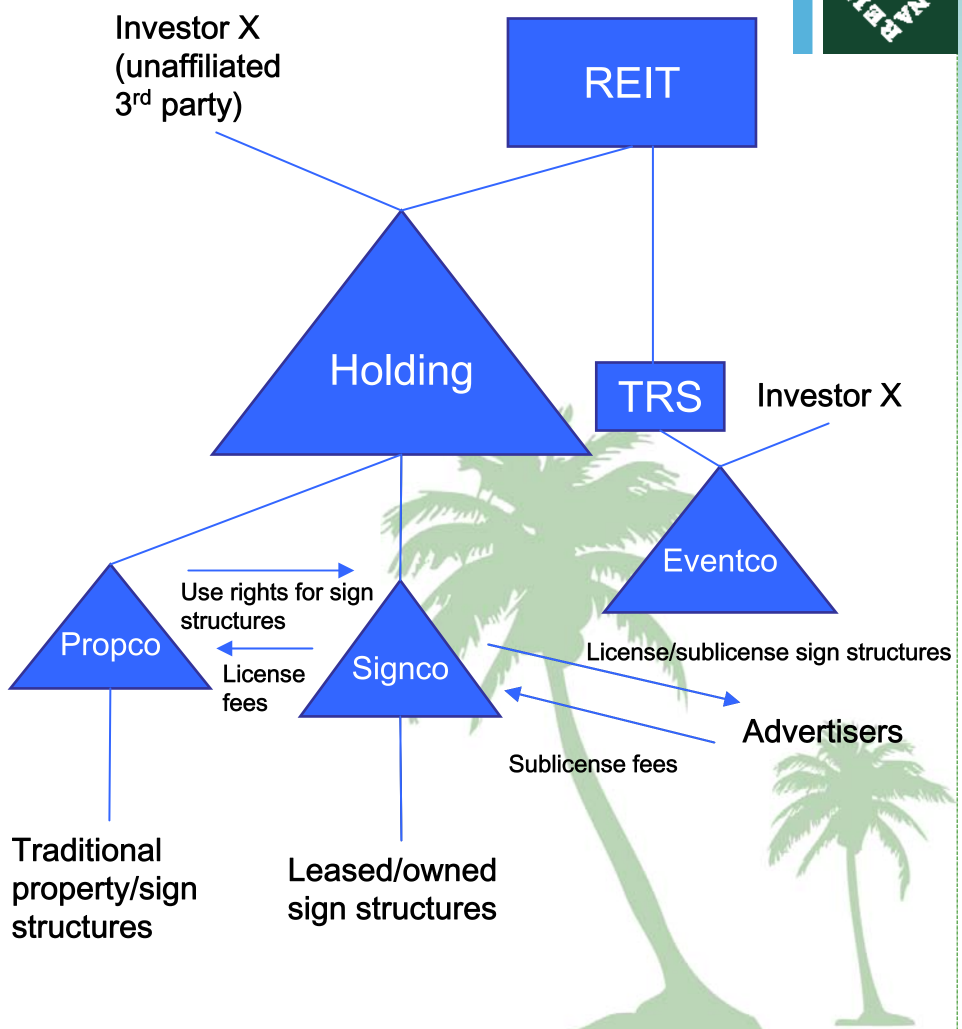
Delivering gas to consumers is capital intensive and involves a complex and fragmented supply chain



Media/Billboard REITs (cont'd)

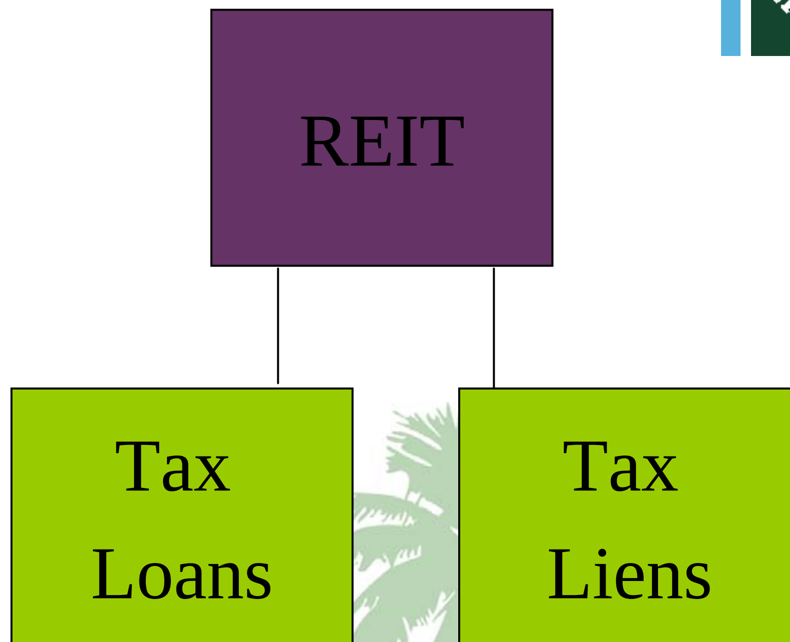
Sample Structure

- Propco licenses certain sign structures to Signco in exchange for license fees.
- Signco, in turn, sublicenses space on such sign structures to advertisers in exchange for sublicense fees.
- REIT holds its partnership interest in Eventco through TRS.
- Eventco sells sponsorship, media, merchandise and other similar rights to various companies in exchange for fees.



Proposed Structure

- REIT formed to make tax loans and acquire tax liens
- Tax liens must be <25% of the value of REIT's assets
- Income from tax liens must be <25% of gross income of REIT
- May need to locate tax liens in a TRS



Tax Planning for US REITs Investing Abroad

Thursday, March 22nd
9:45-11:00 a.m.

Moderator:
Jeffrey Clark, SVP-Tax - Host Hotels & Resorts, Inc.

Panelists:
Joseph Howe, Partner - Arnold & Porter, LLP
Jennifer Xiao, VP-Tax - Digital Realty
Bartjan Zoetmulder, Partner-Tax - Loyens & Loeff N.V.

Westin Diplomat
Hollywood, FL

2012
REIT Wise®

NAREIT's Law, Accounting & Finance Conference

TAX PLANNING FOR US REITs INVESTING ABROAD

Jeff Clark, Host Hotels & Resorts
Jennifer Xiao, Digital Realty Trust

Joseph Howe, Arnold & Porter
Bartjan Zoetmulder, Loyens Loeff

OVERVIEW

- Crafting Investment Structures
  - Host Country Considerations
  - US Tax Considerations
- Holding Company Regimes
- Representative Real Estate Investment Structures
  - United Kingdom
  - France
  - Germany

Host or Source Country Tax Considerations

- Mitigation of Source Taxation:

•Income Tax on Rental Income and Disposition Gains

- Real Estate Transfer Taxes
  - Direct Transfers
  - Indirect Transfers
- Tax Deferred Transfers
  - Reinvestment Regimes
  - Reorganizations
- VAT

•Withholding Taxes on repatriation of cash flow and disposition proceeds

- Branch Profits Taxes
- Local and Trade Taxes
- Foreign Currency Gains and Losses

Tax Planning Opportunities for Mitigating Host Country Income Taxation on Rental Income

- Limited Tax Treaty Relief
- Base Erosion/Earnings Stripping
  - Shareholder Leverage – Interest Deductions (tax treaty and domestic tax law relief from withholding)
  - Depreciation
  - License of Trademarks and Intellectual Property
  - Management Fees – Head Office Charges
  - Loss carry forwards
  - Inter-group leverage
  - Hybrid debt instruments
  - Fiscal unity (consolidation)

Tax Planning Opportunities for Mitigating Host Country Income Taxation

Other Considerations

– Special VAT Elections

–Special Structures to Avoid Local Trade Taxes by Structuring Service Activities in Separate Vehicles

Tax Planning Tools for Tax Efficient Exits

- The tax planning tools include the following:
  - Tax exemptions under the domestic tax legislation of the host country for capital gains derived by nonresident taxpayers;
  - Exemptions under older tax treaties which exempt capital gains derived from the disposition of real estate that does not constitute a permanent establishment in the host country;
  - Indirect transfers of real estate investments by share transfers of real estate holding companies in host countries without Foreign Investment Real Property Tax Act ("FIRPTA")-like legislation;
  - Indirect transfers by share transfers of real estate holding companies which benefit from tax treaty overrides of domestic tax law or FIRPTA-like legislation;

Tax Treaty Benefit

- Avoid double taxation
- Useful for holding companies due to reduced withholding tax on tax on certain categories of income:
  - Dividends
  - Interest
  - Royalty
  - Branch profits
  - Capital gains
  - Specified types of income
- Restrict host country taxation to business income attributable to a permanent establishment (that is, a higher threshold for taxation)

Limitation of Tax Treaty Benefits

- Modern tax treaties preclude “tax treaty-shopping” by a “Limitation of Benefits” article which may require certain levels of ownership by residents of the tax treaty country or publicly traded or certain level of business activity in the tax treaty country

- Tax authorities may attack “tax treaty-shopping” even without a “Limitation of Benefits” article based on lack of substance, tax avoidance or sham arguments or other specific legal provisions.

- Business purpose and substance required.

Luxembourg

- Mainly used as 'EU exit' jurisdiction
- Still most favoured on shore fund jurisdiction in Europe
- 0% wht: on dividends to all treaty countries (>10% ownership), interest and capital gains.
- US REIT treaty eligible? If not, CPECs, PPLs as exit.
- TP circular in January 2011 introducing substance rules similar to Netherlands

The Treasury Speaks

Friday, March 23rd
9:30-10:45 a.m.

Moderator:
Craig Stern, SVP-Tax & Compliance - Vornado Realty Trust

Panelists:
Michael Novey, Associate Tax Legislative Counsel - United States Department of the Treasury
David Silber, Branch Chief-FIP Branch 2 - Internal Revenue Service
Jonathan Silver, Assistant to the Branch Chief-FIP Branch 2 - Internal Revenue Service

REITWise 2012
March 23, 2012
"The Treasury Speaks": *Best Practices in Obtaining an IRS Private Letter Ruling*
Craig Stern
Vornado Realty Trust

1) Need for PLR vs. relying on an opinion of counsel

- When can you rely on existing PLRs?
- Review existing PLRs that have been issued.
- If there are many PLRs on point, in some cases you may decide that obtaining your own PLR may not be necessary.
    - Example: One might be comfortable with the reasoning of existing PLRs such as in cases of typical excess share provisions and many types of telecommunication services.
    - Example: One might need to request a PLR in cases of cutting edge real estate assets involving new technology (towers) and Section 856(c)(5)(j).
    - Please note that you cannot rely on anyone else's PLR as precedent
    - Please consider the possibility that the IRS may have change its position on that issue

2) When can you rely on opinion of counsel?

Where existing authorities (Code, regulations, published rulings issued) are such that tax counsel can render a well-reasoned opinion with a clear rationale.

- What level of opinion can you rely on?

It depends on the purpose of the opinion. If it is not a REIT qualification issue (*i.e.*, just wanting to keep your basket as clean as possible), a "more likely than not opinion" may be sufficient. If it is a REIT qualification issue, a will opinion (or possibly a "should" opinion) may be necessary. For offerings and financings, a "will opinion" is likely to be required; investment bankers won't accept less than that.

- <u>"Reasonable Cause" Safe Harbor</u>

The Code has a "reasonable cause" safe harbor[1] which lends itself to more appropriate reliance on opinions than before.

- Question of what will suffice for "reasonable cause?"
  - Treas. Reg. section 1.856-7(c) provides the following definition of "reasonable cause" for purposes of the section 856(c)(6) safe harbor for the REIT gross income tests.
    - The failure to meet the requirements of [the REIT gross income requirements] will be considered due to reasonable cause and not due to willful neglect if the REIT exercised ordinary business care and prudence in attempting to satisfy the requirements. Such care and prudence must be exercised at the time each transaction is entered into by the trust.[2]

---

1 Sections 856(c)(6), (c)(7).

2 Treas. Reg. section 1.856-7(c)(1).

- The reasonable reliance on a reasoned, written opinion as to the characterization for purposes of section 856 of gross income to be derived (or being derived) from a transaction generally constitutes "reasonable cause" if income from that transaction causes the trust to fail to meet the requirements of paragraph (2) or (3) of section 856(c) (or of both paragraphs). The absence of such a reasoned, written opinion with respect to a transaction does not, by itself, give rise to any inference that the failure to meet a percentage of income requirement was without reasonable cause. An opinion as to the character of income from a transaction includes an opinion pertaining to the use of a standard form of transaction or standard operating procedure in a case where such standard form or procedure is in fact used or followed.[3]
- If the opinion indicates that a portion of the income from a transaction will be nonqualified income, the trust must still exercise ordinary business care and prudence with respect to the nonqualified income and determine that the amount of that income, in the context of its overall portfolio,

[3] Treas. Reg. section 1.856-7(c)(2)(i).

reasonably cannot be expected to cause a source-of-income requirement to be failed.[4]

- Reliance on an opinion is not reasonable if the trust has reason to believe that the opinion is incorrect (for example, because the trust withholds facts from the person rendering the opinion).
- A written opinion means an opinion, in writing, rendered by a tax advisor (including house counsel) whose opinion would be relied on by a person exercising ordinary business care and prudence in the circumstances of the particular transaction. A written opinion is considered "reasoned" even if it reaches a conclusion which is subsequently determined to be incorrect, so long as the opinion is based on a full disclosure of the factual situation by the real estate investment trust and is addressed to the facts and law which the person rendering the opinion believes to be applicable. However, an opinion is not considered "reasoned" if it does nothing more than recite the facts and express a conclusion.[5]

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4 Treas. Reg. section 1.856-7(c)(2)(ii).

5 Treas. Reg. section 1.856-7(c)(2)(iii).

- This definition of "reasonable cause" may provide some parameters for the "reasonable cause" standard under the asset test safe harbor found in section 856(c)(7).

3) What are best practices for getting PLRs?

- If you want certainty, you need a private letter ruling.
  - Example of recent PLRs:
    - a) Health care PLRs
    - b) Section 856(c)(5)(j) PLRs
  - For these two types of issues, an opinion would be insufficient.
- <u>Once you have decided you need a PLR</u> (*e.g.*, where issue is novel or controversial, or where prior authorities are unclear, or where you cannot receive the level of opinion that is needed):
- Revenue Procedure 2012-1 provides the steps for obtaining a PLR.
- Given the $14,000 per ruling user fee and the legal fees to draft a PLR request, prior to drafting the PLR request, best practice is:
  - Make direct contact with the IRS (*i.e.*, call an IRS attorney in the Financial Institutions and Products branch)
  - Present the facts to the IRS attorney in an organized manner
  - Make reference to existing precedents
  - Obtain an initial reaction
    - If you get a favorable initial reaction, then submit the ruling request, and reference the contact with that IRS attorney in the

ruling request cover letter (Please note that there is no guarantee that you will get that attorney as the IRS needs to balance workloads).

- If the initial reaction you get is not favorable, or if you are uncertain, the IRS recommends requesting a pre-submission conference to agree on the facts and to get other tax groups involved if involves REIT and Non- REIT issues

<u>PLR process</u>

- If the Service raises issues or problems for obtaining the ruling during its review of the ruling request, request an in-person conference (but at that stage a conference would not be a matter of right if a pre-filing conference had been held).
- Please note that the IRS has a no ruling Revenue Procedure for certain issues (e.g., substance versus form, holding for sale related issues) .

NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

May 26, 2011

VIA E-MAIL [Notice.Comments@irscounsel.treas.gov]

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2011-39)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2011-39: 2011-2012 Guidance Priority List Recommendations

Dear Sir or Madam:

The National Association of Real Estate Investment Trusts® (NAREIT) appreciates the opportunity, pursuant to Notice 2011-39, 2011-20 I.R.B. 786, to offer our suggestions regarding regulatory guidance to be placed on the 2011-12 Guidance Priority List. NAREIT® is the worldwide representative voice for REITs and publicly traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other businesses throughout the world that own, operate, and finance income-producing real estate, as well as those firms and individuals who advise, study, and service those businesses.

We request that the Department of the Treasury and the Internal Revenue Service include in their 2011-12 Guidance Priority List the following five issues, listed in order of priority, with the first two items having the greatest priority:

1) reversing Notice 2007-55 regarding liquidating REIT distributions to non-U.S. investors;

2) clarifying certain regulatory provisions regarding the consequences to REITs to certain "distressed" debt, as discussed more fully in a letter dated February 3, 2011 from NAREIT to then-Secretary Mundaca and Commissioner Shulman;

3) clarifying that a REIT's investment in the shares of a money market fund constitutes an investment in a "cash item" for purposes of section 856(c)(4)(A), [1] consistent with an item in the 2009-10 Priority Guidance Plan and in accordance

[1] For purposes of this letter, "section" refers to the Internal Revenue Code of 1986, as amended, unless otherwise indicated.

1875 I Street, NW, Suite 600, Washington, DC 20006-5413
Phone 202-739-9400 Fax 202-739-9401 REIT.com

with the recommendations in an April 22, 2009 letter from the American Bar Association Section of Taxation (ABA Tax Section); and

4) revising the regulations under section 337(d) concerning "built in gains" so that these regulations do not apply to exchanges of property from a C corporation to a REIT under section 1031 nor to transfers of property to a REIT from a corporation exempt from tax under section 501(a), consistent with an item in the 2008-09 and 2009-10 Priority Guidance Plans, and in accordance with recommendations in a May 1, 2008 submission by the ABA Tax Section.

The reasons for the priority given to the above issues are as follows. First, because Notice 2007-55's application extends beyond Congressional intent, provides inconsistent results for foreign shareholders and domestic shareholders engaging in similar transactions, and discourages the investment of foreign equity in the U.S. at a time when such capital is needed to assist in the economic recovery, it should be reversed. Second, because of the difficult economic climate, guidance regarding the consequences of distressed debt would help ensure that REITs can work out existing mortgage loans and participate in the market for distressed mortgage loans without jeopardizing their qualification as REITs for federal income tax purposes. The other issues would permit REITs to carry on their business with more certainty and consistent with Congressional intent.

DISCUSSION

I. Priority Guidance Plan Recommendations

A. Reverse Notice 2007-55 to Treat REIT Liquidations and Redemptions as Sales/Exchanges of Stock

Although not clear, for many years tax practitioners concluded that payments from a REIT made as part of its liquidation or redemption should be considered a sale of its stock (to which FIRPTA does not apply under several circumstances) rather than a capital gain distribution (to which FIRPTA does apply in several circumstances). The IRS issued a private letter ruling in 1990 concluding that liquidating distributions should be treated as a sale of stock, but that ruling was revoked in 2004. In 2007, the IRS issued Notice 2007-55 in which it concluded that liquidating distributions and redemptions should be treated as capital gain liquidations that are subject to FIRPTA if paid to foreign shareholders. An item relating to Notice 2007-55 was contained on the 2008-09 Priority Guidance Plan, although the exact parameters of that item were unclear.

As more fully presented in another comment letter by the American Bar Association Section on Taxation (Tax Section) dated June 10, 2008, NAREIT believes that Notice 2007-55 should be reversed except when "the existing provisions create a clear loophole, namely, a foreign controlled REIT that undergoes a liquidation, with the REIT deducting liquidating distributions under section 562(b) and the REIT's foreign shareholders relying on the 'cleansing exception' of section 897(c)(1)(B) to avoid FIRPTA tax." As a result, if a third party stock sale would be exempt under current law (for example, as in the case of sales of shares of a "domestically controlled REIT", which are not United States Real Property Interests, or USRPIs), then the tax treatment of a non-dividend distribution that gives rise to a constructive sale or exchange ought to be taxed the same way. NAREIT agrees with this specific recommendation of the Tax Section as well as the other recommendations contained in its June 10, 2008 comment letter.

B. **Modify Revenue Procedure 2011-16 to Encourage Workouts of Distressed Debt**

NAREIT appreciates the issuance of Revenue Procedure 2011-16 (the Revenue Procedure) concerning modifications and acquisitions of distressed debt, and, in particular, the valuable guidance with respect to distressed mortgage loans that REITs modify to avoid foreclosure. With that said, and as discussed more fully in a February 3, 2011 NAREIT letter to the IRS and Treasury Department, NAREIT requests that the Revenue Procedure concerning modifications and acquisitions of distressed debt be clarified and revised as follows.

1) The Revenue Procedure should be clarified so that a REIT will not be penalized when the value of the real property that secures a distressed mortgage loan later increases. This clarification would prevent a disproportionate amount of a distressed mortgage loan from being treated as a nonqualifying asset when the value of the real property securing the loan increases;

2) Consistent with NAREIT's previous submissions on this issue, the Revenue Procedure should be revised to include a safe harbor providing that, when a REIT acquires a mortgage loan with market discount, the REIT may use as the "amount of the loan," for purposes applying the applicable apportionment regulations, the REIT's highest adjusted tax basis in the mortgage loan during the taxable year. If the Service believes that a regulatory change is needed to make this change, then NAREIT strongly urges that such a project be immediately initiated and then swiftly completed; and

3) The Revenue Procedure should be modified to include a safe harbor pursuant to which the value of, and the interest income from, a mortgage loan would not be bifurcated into qualifying and nonqualifying portions for purposes of the 75% gross income test or the 75% asset test if substantially all of the property securing the loan constitutes real property, determined as of the date the REIT committed to originate or acquire the loan. Such a safe harbor would mitigate many of the REIT qualification issues faced by REITs investing in distressed mortgage loans, as a REIT would not have to bifurcate a distressed mortgage loan when the value of the non-real property securing the loan is insubstantial.

If the Revenue Procedure is not clarified and revised as discussed herein, REITs will be significantly limited in their ability to invest in distressed mortgage loans and mortgage-backed securities. As a result, there will be less liquidity in the market for those assets, and retail investors will have limited ability to participate in that market. NAREIT believes that a failure by the Service to clarify and revise the Revenue Procedure would undermine the government's efforts to address the continuing effects of the credit crisis on the mortgage market.

NAREIT has requested this guidance in order to clarify the treatment of distressed loans and to eliminate uncertainties that are particularly problematic for publicly traded REITs. Given the country's current economic crisis, issuance of this guidance would be particularly timely.

C. Money Market Funds as "Cash Items" Under Section 856(c)(4)(A)

Section 856(c)(4)(A) requires that at the close of each calendar quarter of the taxable year at least 75% of the value of a REIT's "total assets" consist of real estate assets; government securities; and cash and cash items (the 75% asset test). On April 22, 2009, the ABA Tax Section submitted comments to the Internal Revenue Service requesting that the Treasury Department and the Service promptly issue guidance clarifying that a REIT's investment in the shares of a money market mutual fund (money market fund) constitutes an investment in a "cash item" for purposes of section 856(c)(4)(A).

As the ABA Tax Section noted:

> [Money market funds] play a pivotal role in the day-to-day operations of many companies, including [REITs], when cash must be readily available to meet the needs of their business. Money market funds are an attractive alternative to interest-bearing checking accounts due to the convenience they provide, their competitive returns, and their regulatory safeguards that are intended to provide liquidity and minimal risk to principal. In light of these features common to money market funds, industry practice for financial personnel and the accounting rules such personnel rely upon generally treat money market funds as "cash items."

NAREIT agrees with the ABA Tax Section's recommendation, especially since the Administration has taken extraordinary steps to assure the stability of money market funds. An item relating to this issue was included in the 2010-11 Priority Guidance Plan.

D. Revising Final Regulations Under § 337(d) Relating to Conversion Transactions Involving Tax-Exempt Entities

NAREIT reiterates its request for a revision to the regulations under § 337(d) relating to conversions of entities from, and transfers of assets by, C corporations to REITs or regulated investment companies (RICs), in accordance with the May 1, 2008 submission by the ABA Tax Section. An item concerning these issues was contained in the 2008-09; 2009-10; and 2010-11 Guidance Priority Lists.

The regulations under § 337(d) implement Congress' directive as part of the repeal of the *General Utilities* doctrine in the Tax Reform Act of 1986 (the 1986 Act) to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the amendments effected by the 1986 Act, including:

> …regulations to ensure that such purposes may not be circumvented through the use of … a regulated investment company, real estate investment trust, or tax exempt entity…

Section 337(d).

Prior to its repeal, the *General Utilities* doctrine allowed certain transfers of appreciated property to avoid corporate level tax. The 1986 Act eliminated those rules, effectively preventing the avoidance of corporate-level tax on the disposition of appreciated property.

We support the suggestions made in those comments, and respectfully request that the IRS and Treasury Department revise the regulations under § 337(d) relating to conversions of entities from, and transfers of assets by, C corporations to REITs or RICs, in accordance with those comments.

The ABA Tax Section comments address two specific issues:

First, the ABA Tax Section points out that the § 337(d) regulations technically apply to transfers from a C corporation to a REIT or RIC in an "exchanged basis" transaction and indicates that this treatment is inappropriate. "Exchanged basis" transactions include § 1031 like-kind exchange transactions. C corporations often transfer real property in like-kind exchange transactions when a REIT is the acquirer. These transactions are commonplace, non-abusive, and do not implicate any of the concerns that are properly addressed by the regulations.

Second, the ABA Tax Section states that the § 337(d) regulations improperly treat tax-exempt corporations as "C corporations" for purposes of the regulations. It follows from this treatment that a transfer of assets from a tax-exempt corporation to a REIT or RIC can result in the imposition of a C corporation level tax with respect to the property (under § 1374 principles if the property is sold by the REIT or RIC within ten years). As the ABA Tax Section points out, this treatment also applies in connection with a transfer of assets from a real estate partnership to a REIT when the partnership has partners that are tax-exempt corporations. Such transfers are undertaken all the time, and for the reasons given by the ABA Tax Section, NAREIT believes that the regulations should not be applied in these situations.

II. Additional Comment: Expand and Enact Obama Administration Budget Proposal to Repeal Preferential Dividend Rule

There are situations in which a REIT inadvertently, through a "foot fault" such as a rounding error or similar situation, arguably could be viewed as having distributed a non-deductible, preferential dividend. Because these errors truly have no substantive meaning, we were pleased to see the Obama Administration's Fiscal Year 2012 budget proposal would repeal this rule for publicly traded REITs and provide authority for the Treasury Department to issue guidance dealing with inadvertent errors in situations in which the preferential dividend rule still applied. This proposal is consistent with an item on the 2007-08 and 2008-09 Priority Guidance Plans addressing the "correction of minor errors by RICs and REITs."

Over the past few years, NAREIT and the trade association for mutual funds, the Investment Company Institute, have had a continuing dialogue with personnel from the Treasury Department, the IRS' Financial Institutions & Products group, and the IRS' Large and Mid-Size Businesses division regarding a mutually acceptable resolution to this difficult issue. Last year, Congress enacted the RIC Modernization Act, which repealed the rule for ñpublicly offeredò regulated investment companies.

Although we support the Obama Administrationôs FY 2012 budget proposal which would repeal the preferential dividend rule for publicly traded REITs, we believe that it should be extended to all publicly offered REITs (just as the RIC Modernization Act extended the repeal to publicly offered RICs) as well. We look forward to working with the Treasury Department and IRS to obtain a legislative solution to this problem.

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All of the suggested projects above would fulfill the goals and objectives set forth in Notice 2011-39. First, resolution of these issues would resolve significant issues relevant to the more than 1,000 entities that have elected REIT status and the tens of thousands of taxpayers who invest in REITs.

Second, these projects would promote sound tax administration. Specifically, in the context of how to manage distressed debt, the requested guidance could relieve uncertainties that are potentially paralyzing.

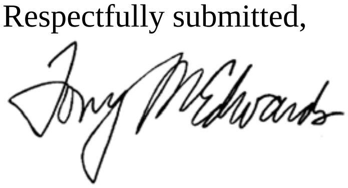
Third, these projects could clearly be drafted in a manner that would enable taxpayers to easily understand and apply the guidance. We have been working with, and would be pleased to continue to work with, with the IRS in discussing both how the distressed debt guidance and how preferential dividend guidance could be drafted so as to apply to the most common types of non-consequential ñfoot faultsò (in cases in which the repeal of the rule would not be applicable).

Fourth, we believe that guidance under these projects easily could be administered on a uniform basis.

Finally, guidance on the requested projects would reduce controversy and lessen the burden on taxpayers or the Service for the reasons stated above.

Feel free to contact me or Dara Bernstein, NAREITôs Senior Tax Counsel, if you would like to discuss this issues in greater detail.

Respectfully submitted,



Tony M. Edwards
Executive Vice President & General Counsel

cc: Mark J. Mazur, Esq.
Emily McMahon, Esq.
Douglas Shulman, Esq.

Flexible Work Arrangements

Thursday, March 22nd
2:45-4:00 p.m.

Discussion Leaders:
Beth Glassman, VP-HR, Brandywine Realty Trust
H. Lynn Stanfield, SVP-Tax, Apartment Investment & Management Company
Julie Yungmann, Director-Taxation, General Growth Properties, Inc.

Sample Telecommuting Policy

Source: Society for Human Resource Management

XYZ Corporation considers telecommuting to be a viable alternative work arrangement in cases where individual, job and supervisor characteristics are best suited to such an arrangement. Telecommuting allows an employee to work at home, on the road, or in a satellite location for all or part of their regular workweek. Telecommuting is a voluntary work alternative that may be appropriate for some employees and some jobs. It is not an entitlement; it is not a company-wide benefit; and it in no way changes the terms and conditions of employment with XYZ Corporation.

Procedure

1. Either an employee or a supervisor can suggest telecommuting as a possible work arrangement.
2. Telecommuting can be informal, such as working from home for a short-term project or on the road during business travel, or formal, as will be described below. Other informal, short-term arrangements may be made for employees on family or medical leave, to the extent practical for the employee and the organization, and with the consent of the employee's health care provider, if appropriate. All informal telecommuting arrangements are made on a case by case basis, focusing on the business needs of the organization first. Such informal arrangements are not the focus of this policy.
3. Individuals requesting formal telecommuting arrangements must have been employed with XYZ Corporation for a minimum of 12 months of continuous, regular employment and must have exhibited above average performance, in accordance with the company's performance appraisal process.
4. Any telecommuting arrangement made will be on a trial basis for the first 3 months, and may be discontinued, at will, at any time at the request of either the telecommuter or the organization.
5. XYZ Corporation will determine, with information supplied by the employee and the supervisor, the appropriate equipment needs (including hardware, software, modems, phone and data lines, facsimile equipment or software, photocopiers, etc.) for each telecommuting arrangement on a case-by-case basis. The human resource and information system departments will serve as resources in this matter. Equipment supplied by the organization will be maintained by the organization. Equipment supplied by the employee, if deemed appropriate by the organization, will be maintained by the employee. XYZ Corporation accepts no responsibility for damage or repairs to employee-owned equipment. XYZ Corporation reserves the right to make determinations as to appropriate equipment, subject to change at any time. Equipment supplied by the organization is to be used for business purposes only. The telecommuter should sign an inventory of all office property and agrees to take appropriate action to protect the items from damage or theft. Upon termination of employment all company property will be returned to the company, unless other arrangements have been made.
6. Consistent with the organization's expectations of information asset security for employees working at the office full-time, telecommuting employees will be expected to ensure the protection of proprietary company and customer information accessible from their home office. Steps include, but are not limited to, use of locked file cabinets, disk boxes and desks, regular password maintenance, and any other steps appropriate for the job and the environment.

7. The employee will establish an appropriate work environment within their home for work purposes. XYZ Corporation will not be responsible for costs associated with initial setup of the employee's home office such as remodeling, furniture or lighting, nor for repairs or modifications to the home office space. Employees will be offered appropriate assistance in setting up a work station designed for safe, comfortable work.
8. After equipment has been delivered, a designated representative of XYZ Corporation will visit the employee's home work site to inspect for possible work hazards and suggest modifications. Repeat inspections will occur on an as-needed basis. Injuries sustained by the employee while at their home work location and in conjunction with their regular work duties are normally covered by the company's workers' compensation policy. Telecommuting employees are responsible for notifying the employer of such injuries in accordance with company worker's compensation procedures. The employee is liable for any injuries sustained by visitors to their work site.
9. XYZ Corporation will supply the employee with appropriate office supplies (pens, paper, etc.) for successful completion of job responsibilities. The organization will also reimburse the employee for all other business-related expenses such as phone calls, shipping costs, etc. that are reasonably incurred in accordance with job responsibilities.
10. The employee and manager will agree on the number of days of telecommuting allowed each week, the work schedule the employee will customarily maintain, and the manner and frequency of communication. The employee agrees to be accessible by phone or modem within a reasonable time period during the agreed upon work schedule.
11. Telecommuting employees who are not exempt from the overtime requirements of the Fair Labor Standards Act will be required to record all hours worked in a manner designated by the organization. Telecommuting employees will be held to a higher standard of compliance than office-based employees due to the nature of the work arrangement. Hours worked in excess of those specified per day and per work week, in accordance with state and federal requirements will require the advance approval of the supervisor. Failure to comply with this requirement can result in the immediate cessation of the telecommuting agreement.
12. Before entering into any telecommuting agreement, the employee and manager, with the assistance of the human resource department, will evaluate the suitability of such an arrangement paying particular attention to the following areas:
    - Employee Suitability - the employee and manager will assess the needs and work habits of the employee, compared to traits customarily recognized as appropriate for successful telecommuters.
    - Job Responsibilities - the employee and manager will discuss the job responsibilities and determine if the job is appropriate for a telecommuting arrangement.
    - Equipment needs, work space design considerations and scheduling issues.
    - Tax and other legal implications for the business use of the employee's home based on IRS and state and local government restrictions. Responsibility for fulfilling all obligations in this area rests solely with the employee.
13. If the employee and manager agree, and the human resource department concurs, a draft telecommuting agreement will be prepared and signed by all parties and a 3 month trial period will commence.
14. Evaluation of telecommuter performance during the trial period will include daily interaction by phone and e-mail between the employee and the manager, and weekly face-to-face meetings to discuss work progress and problems. At the conclusion of the trial period the employee and manager will each complete an evaluation of the arrangement and make recommendations for continuance or modifications. Evaluation of telecommuter performance beyond the trial period will be consistent with that received by employees working at the office in both content and frequency but will focus on work output and completion of objectives rather than time-based performance.
15. An appropriate level of communication between the telecommuter and supervisor will be agreed to as part of the discussion process and will be more formal during the trial period.

Mastering flexibility

Part of an inclusive culture

Managing flexible work arrangements

What is an FWA?

Ernst & Young offers numerous formal FWA options, any of which can be customized to meet an individual's specific situation. Those options include:

- Reduced schedule
- Compressed workweek
- Telework
- Flextime

An FWA is not synonymous with a reduced work schedule, although about 60% of all FWAs at our firm are on reduced schedules.

Providing our people with the flexibility they need to succeed is one way Ernst & Young sets itself apart from other professional services firms. In our organization, flexible work arrangements (FWAs) are not part-time jobs — they are alternative paths to successful careers.

At Ernst & Young, we want to create an inclusive and flexible culture where everyone is respected for their skills and talents and treated as an individual. We want our people to achieve their potential by meeting both their personal and professional goals. Making that a reality means encouraging our people to think differently about their working lives, their attitudes and their actions, especially during our various busy seasons when the need for flexibility may be the greatest. With open communication and a two-way commitment to flexible work arrangements between leaders and their teams, it is possible to develop and flourish and still work flexibly.

How leaders make a difference

Leaders can play a large role in encouraging career development. If you are a leader of a team, here are some things you can do to manage FWAs successfully:

- Talk to everyone on your team — not just those on FWAs — about how they can use flexibility to meet their personal and professional objectives.
- Be respectful when setting team meetings, taking into consideration client demands and days that team members may be out of the office.
- Use team calendars to keep track of team needs.
- Share information about FWAs and learn about how others have used FWAs successfully.
- When appropriate, challenge client deadlines that create unreasonable hurdles for your team.
- Support promotions based on experience, readiness and results delivered, not on "face time" or time spent in a particular position.
- Help others realize what they are getting, not what they are giving up. Having 80% of a top performer's time is better than losing that person completely.
- Help everyone on your team — including those on FWAs — understand our business and our clients' expectations.
- Establish communication protocols for how to reach others on the team.
- Provide clear direction and set appropriate expectations for performance by everyone, including the person on an FWA.

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- Define when face-to face interaction adds value and how virtual supervision will be handled.
- Discuss protocols for scheduling meetings and fulfilling unexpected client demands.
- Be an active coach/mentor to those on FWAs. Meet periodically to discuss how the FWA is working and whether objectives are being met.
- Encourage those on FWAs to speak up and seek help if their FWA is not working.
- If issues arise from other team members that seem to be driven by the FWA, speak candidly with the team about how to reach positive resolutions.

Flexibility works both ways

Our teams need to be flexible to support one another. Like all of our professionals, those on FWAs need to be somewhat flexible on their days out of the office to handle unexpected client demands. Those on reduced-schedule FWAs should be reachable by cell phone and willing to check email and voicemail periodically. Those on FWAs may also have to periodically flex their days outside of the office to meet team and/or client needs. Here's how you can be helpful:

- Be strategic about client assignments and projects for those on FWAs. Consider the size and number of clients, meaningful work and chargeable and nonchargeable projects. Make sure that the individual and our staffing professionals are involved in the process.
- If the FWA is a reduced work schedule, then you must reduce all aspects of the role. For a client-serving professional, for example, it is not effective to eliminate the nonchargeable areas and leave a full client load. A person will get promoted only if they deliver on all aspects of their role.
- Periodically, evaluate how the FWA is working, including balancing work/project assignments and other nonchargeable requirements for career progression. Specifically focus on an appropriate workload to make sure that it is in accordance with the desired schedule reduction.
- Discuss available opportunities with those on an FWA. Don't assume there are limitations such as travel, overtime or specific days they are unavailable.
- Communicate regularly with the person about their aspirations for advancement in the firm and have a candid discussion about performance and readiness for promotion.
- Keep in mind that an FWA should not automatically affect the timing of a promotion. Speak regularly about the timeline.
- Assign project responsibility based on the level of experience. Support promotion based on experience and readiness of someone on an FWA, not on their time and grade.

Supporting flexibility

Flexibility is essential to creating an outstanding work environment. Overall, in the US, fewer than 10% of Ernst & Young people work on an FWA, but that number changes dramatically when you look at those on FWAs by level or gender.

- Of the Ernst & Young people on FWAs, 85% are female.
- Nearly 27% of our female senior managers and about 19% of our managers are on an FWA.
- More than 200 of our partners, principals, executive directors and directors are currently on an FWA.
- To date, more than 160 people have been promoted to partner, principal, executive director or director while on an FWA.
- Nearly 60% of all FWAs are reduced schedules, meaning that the individual works less than a full workload compared to his/her peers and takes a proportional reduction in compensation, vacation and holidays.
- More than 30% of those on reduced-schedule FWAs are teleworkers one or more days per week. A telework arrangement may be combined with another type of FWA.

As a leader in our business, you must be prepared to support all of our people, not only those with needs for day-to-day flexibility, but also those on formalized FWAs. Specifically, you can support those on FWAs in three ways: through sponsorship, open communication and a commitment to their career development.

Contacts and information

Karyn Twaronite
Americas Inclusiveness Officer
+1 212 773 1302

Maryella Gockel
Flexibility Strategy Leader
+1 201 872 4237

Or consult your People Leader, People Consultant or other Americas People Team professional in your Sub-Area or business unit.

Visit inclusiveness.iweb.ey.com and click on "Flexibility" to see other brochures in this series, learn more about FWA options and review the FWA Workbook, which includes the business case form.

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General Counsel Issues

Thursday, March 22nd
11:15-12:30 p.m.

Discussion Leaders:

Dawn Becker, COO & General Counsel - Federal Realty Investment Trust
J. Robert Fisher, VP-General Counsel & Secretary - Camden Property Trust
James J. Hanks, Jr., Partner - Venable LLP

Evaluating Pay for Performance Alignment

ISS' Quantitative and Qualitative Approach

Gary Hewitt
gary.hewitt@issgovernance.com

Carol Bowie
carol.bowie@issgovernance.com

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Executive Summary

Investor feedback on the issue of pay-for-performance has indicated a preference for putting the focus on long-term alignment, board decision-making, and pay relative both to market peers and to absolute shareholder returns. As a result, ISS is unveiling a new approach to evaluating pay-for-performance in 2012. It comprises an initial quantitative assessment and, as appropriate, an in-depth qualitative review to determine either the likely cause of a perceived long-term disconnect between pay and performance, or factors that mitigate the initial assessment.

The quantitative methodology utilizes two components:

- A relative evaluation -- primarily, rankings of CEO pay and performance relative to peers over three years, and
- An absolute evaluation -- CEO pay trends relative to shareholder return trends over five years.

Both are considered from an investor's perspective in evaluating the efficacy of top executive pay packages on a long-term basis. For the relative evaluation, peer groups are designed not for pay benchmarking or stock-picking but rather to compare pay and company performance within a group of companies that are reasonably similar in terms of industry profile, size, and market capitalization. The evaluation focuses on disclosed pay and equity grants, since they represent the pay and award opportunities the board determines should be provided to its top executive each year, and should be aligned with the company's performance trends – or if not, should be appropriately performance based, as ISS' qualitative analysis will address.

The quantitative methodology, described in detail in this paper, is designed to identify outlier companies that have demonstrated significant misalignment between CEO pay and company performance over time. Extensive back-testing has also validated that this approach generally aligns with shareholder opinions as expressed through say-on-pay votes in 2011. The follow-up qualitative assessment, applied to companies with apparent pay-performance disconnect, is designed to uncover mitigating factors (such as rigorous performance-based award opportunities that are designed to drive improvement) or potential causes of the misalignment, such as problematic pay benchmarking practices.

Introduction

Escalating CEO pay packages in the last few decades have stirred considerable debate, culminating in a Congressional mandate for advisory shareholder votes on executive compensation under the Dodd-Frank Act of 2010.[1] The advent of say-on-pay in the U.S. has also highlighted pay-for-performance as the most significant factor driving investors' voting decisions on the issue.[2]

Doubts about the strength of pay and performance alignment may stem from "agency problem" conflicts of interest, perceptions of weak board oversight and aggressive pay benchmarking; abuses such as options backdating; and most recently, concern that pay practices at some firms likely contributed to the financial meltdown that triggered the latest economic and market malaise. Further, while executive pay has increased at a fairly rapid pace since the 1980s, investor portfolios have experienced multiple market swings – booms and busts that often appear disconnected from individual executives' impact -- adding to skepticism about the pay process.

Still, in the absence of a universally accepted method to evaluate executive pay relative to performance, investor and issuer perceptions vary widely. Unlike many markets, the U.S. has no governance code establishing guidelines for pay practices, and performance may be measured on multiple dimensions. It is also clear that most institutional investors do not want to micromanage or interfere with a board's ability to devise programs that will

[1] The SEC delayed implementation of advisory votes at small issuers (less than $75 million in public float) until 2013.
[2] An overwhelming 94 percent of institutional respondents to ISS' 2009-2010 policy survey indicated that pay-for-performance would be a critical or important consideration for their "say on pay" vote determinations.

Published: December 20, 2011

help create and protect shareholder value, even while they recognize a responsibility to monitor the process.[3] From a voting policy perspective, ISS has regularly polled both clients and other market participants on the issue of executive pay, and has developed evolving methodologies to detect potential pay-performance disconnects of concern to shareholders. In the last few years, the approach has utilized a quantitative methodology to identify underperforming companies -- i.e., those with both 1- and 3-year total shareholder return (TSR) below the median of peers in their 4-digit Global Industry Classification Standard (GICS) group. Underperforming companies then received an in-depth qualitative review, focused primarily on factors such as the year-over-year change in the CEO's total pay, the 5-year trend in CEO pay versus company TSR, and the strength of performance-based pay elements.

This year, a substantial majority of institutional respondents to ISS' 2011-12 policy survey confirmed two factors as very relevant to evaluating pay-for-performance alignment: pay relative to peers and pay increases that are inconsistent with the company's performance trend. Most issuer respondents also indicated that pay versus peers is an appropriate factor and that pay increases in light of company performance should be a consideration. In addition, both institutions and issuers have contended in roundtables and other feedback that pay−performance alignment should be viewed in a long-term context. It is on this basis that ISS decided to refine our approach to pay-for-performance evaluations and develop a more sophisticated methodology to drive the quantitative component of the analysis. The remainder of this paper provides an overview and rationale for the elements considered, as well as detailed discussion of the new quantitative methodology and ongoing qualitative factors.

What We Measure -- Pay

A key question in any analysis is what to analyze. Per SEC disclosure requirements, each annual meeting proxy statement includes an array of pay data, with a three-year look-back, for the five highest-paid executives including the CEO and CFO. The centerpiece of these disclosures is the Summary Compensation Table, which enumerates the key elements found in typical top executive compensation packages, including cash, indirect pay, and equity grants:

- Salary
- Bonus and/or Nonequity Incentive Plan Compensation[4]
- Stock Awards (grant date value)
- Stock Option Awards (grant date value)
- Annual Change in Pension Value/Nonqualified Deferred Compensation Earnings (above market rate)
- All Other Compensation

Other tables provide, among other details, summaries of equity- and nonequity-based grants in the last fiscal year, unexercised/unvested equity-based awards, and the realized gains of vested and exercised grants. But the Summary Compensation Table presents the most comprehensive picture of each named executive officer's total planned and earned compensation for the year – specifically, the pay and pay opportunities that the compensation committee and board determined they ought to receive. It is those decisions that investors generally wish to monitor and evaluate, since their aim is to ensure that executives will be paid fairly, but not overpaid, for the performance they ultimately deliver and sustain. ISS focuses on the CEO's pay because that package sets the "compensation pace" at most companies; also the compensation committee and board are most directly involved in and accountable for the decisions that generate the CEO's pay.

Some observers suggest that shareholders evaluate "realized" rather than granted pay in determining whether pay and performance are aligned. This comprises compensation that results (or could result) from the exercise/vesting of an executive's previously granted equity awards at a given point in time. Since equity-based awards are by far the largest component of most top managers' pay, it is true that future shareholder returns will have substantial impact on those realized values – in other words, the pay realized from equity-based awards at underperforming

[3] Inferred from overwhelming support seen for annual say on pay votes; approximately 80% of companies that presented say-on-pay frequency votes in 2011 saw majority support for the annual frequency option, regardless of management's recommendation.

[4] Per disclosure rules, payouts of cash awards earned on the basis of pre-established goals are reported under the "Nonequity Incentive Awards" column; other cash incentive awards are reported under the "Bonus" column.

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companies is likely to be lower than that realized by executives at better performing companies, all else being equal. Nevertheless, those values are also significantly influenced by the award opportunities themselves, which reflect the compensation level the board has determined top executives deserve and that will appropriately incentivize future performance. Since all equity-based awards are sensitive, to some degree, to market trends beyond the control of individual executives, it is important that pay elements be considered if long-term company performance is misaligned with past pay and award opportunities. In that case, shareholders may expect the board to ensure that future incentive awards are clearly designed to promote performance improvements that will lead to shareholder value creation.

Finally, in the interest of protecting their assets, investors may have another reason to monitor granted pay: corporate pay benchmarking. Companies themselves measure their executives' compensation against competitors with respect to pay and pay opportunities, not "realized" pay. The awards delivered to executives become the basis for future realizable pay.[5]

Thus, in evaluating pay–performance alignment, ISS focuses on Total Compensation as reflected in the Summary Compensation Table, but utilizing a standard set of assumptions to value equity-based grants. All elements, including the Annual Change in Pension/Deferred Compensation Interest (not generally considered "direct" pay) are taken into account, since companies that do not provide components such as supplemental pensions and nonqualified deferral plans may compensate executives by making larger equity grants; thus, all elements are considered to help ensure equitable comparisons.

What We Measure -- Performance

There are, of course, myriad ways to measure corporate performance, and key metrics may vary considerably from industry to industry and from company to company depending on their particular business strategy at any given time. Investors expect that incentive plan metrics will stem from that strategy and be designed to motivate the behavior and executive decisions that will lead to its successful execution. But the key measure for investors in the context of a long-term pay-for-performance evaluation is total shareholder return (TSR).

Note that ISS does not advocate that companies use TSR as the metric underlying their incentive programs; on the contrary, shareholders may prefer that incentive awards be tied to the company's short- and long-term business goals. If the business strategy is sound and well executed, the expectation is that it will create value for shareowners over time, as reflected in long-term total shareholder returns. For this reason, TSR, which is objective and transparent, is the primary metric ISS utilizes in evaluating pay and performance alignment.

What We Measure -- Relative and Absolute Alignment Over Time

In 2011, a substantial majority of institutional respondents to ISS' policy survey confirmed two factors as important in determining pay-for-performance alignment: pay relative to peers (which 62% said is very relevant), and pay increases that are disproportionate to the company's performance trend (considered very relevant by 88% of institutional survey participants). Most issuer respondents also indicated these factors as at least somewhat relevant to a pay-for-performance evaluation.

In light of this and similar feedback in roundtables and other discussions, ISS has incorporated both perspectives into the quantitative component of its revised pay-for-performance analysis, as discussed in detail below. This ensures a balanced evaluation from both relative and absolute pay-for-performance perspectives. As noted, in cases where the quantitative assessment indicates significant pay-for-performance misalignment, an in-depth

[5] A number of academic studies have found weaknesses in corporate benchmarking practices that may have the effect of driving up CEO pay regardless of other factors. See "Compensation Benchmarking, Leapfrogs, and The Surge in Executive Pay," Thomas A. DiPrete & Greg Eirich, Columbia University and Matthew Pittinsky, Arizona State University, November 23, 2009. http://www.ssc.wisc.edu/soc/faculty/docs/diprete/frog11302009.pdf. Also "Inside the black box: the role and composition of compensation peer groups," M. Faulkender and J. Yang, *Journal of Financial Economics*, May 2010.

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qualitative analysis (also discussed in more detail below) is conducted to determine either the probable cause or any mitigating factors that should be considered.

ISS' Quantitative Evaluation of Pay-for-Performance Alignment

The first step in ISS' evaluation of pay for performance has historically been a quantitative assessment of how well a company's CEO pay has been aligned with its financial performance. This screen identifies companies that have underperformed over 1- and 3-year periods, relative to a broad industry category, combined with CEO pay increases. The screen is intended to flag companies where a potential misalignment of pay and performance may exist and therefore where additional qualitative assessment is warranted. Recommendations based on pay-for-performance evaluations are determined after that qualitative assessment.

ISS' new quantitative pay-for-performance model maintains this approach but, based on feedback from our institutional investor clients and the market, has new factors. Broadly speaking, ISS had three main goals in developing the new pay-for-performance methodology:

Measure alignment over multiple time horizons. Business cycles and compensation plans' performance cycles span multiple years. An assessment of alignment between shareholders and executives should accordingly see pay across timeframes that approach the length of performance and business cycles. However, it is important to note that the say-on-pay proxy resolution is typically directed at the prior year's compensation, and special attention should be paid to recent experience.

Use multiple measures to assess alignment. No single quantitative measure can conclusively indicate that pay and performance are aligned. ISS sought, therefore, to identify multiple measures, each of which assesses a company's pay for performance alignment from a distinct perspective. Where one or multiple measures fail to demonstrate pay for performance, a pay-for-performance concern may exist.

Provide more information about pay-for-performance concerns to investors and issuers. The current pay-for-performance screen is a binary pass/fail performance-oriented screen that is triggered for close to 30 percent of companies – less than one-third of which are ultimately determined to have a pay-for-performance disconnect of immediate concern to shareholders. The new screen is designed to provide more robust information about pay-for-performance alignment by evaluating and reporting the degree of alignment found.

Measures of Pay-for-Performance Alignment

At the core of the new quantitative methodology are three measures of alignment between executive pay and company performance: two *relative* measures where a company's pay-for-performance alignment is evaluated in reference to a group of comparable companies, and one *absolute* measure, where alignment is evaluated independently of other companies' performance.

The three measures, which are discussed in greater detail below, are:

- **Relative Degree of Alignment**. This relative measure compares the percentile ranks of a company's CEO pay and TSR performance, relative to an industry-and-size derived comparison group, over one- and three-year periods.
- **Multiple of Median**. This relative measure expresses the prior year's CEO pay as a multiple of the median pay of its comparison group for the same period.
- **Pay-TSR Alignment**. This absolute measure compares the trends of the CEO's annual pay and the value of an investment in the company over the prior five-year period.

Measures of Relative Alignment

Relative Degree of Alignment (RDA)

This measure addresses the question: Is the pay opportunity delivered to the CEO commensurate with the performance achieved by shareholders, relative to a comparable group of companies? The measure compares the percentile ranks of a company's CEO pay and TSR performance, relative to a comparison group of 14-24 companies

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selected by ISS on the basis of size, industry, and market capitalization, over one- and three-year periods. For more information on ISS' process for selecting peers, see Appendix I.

To determine this measure, the subject company's percentile ranks for pay and performance are calculated for one- and three-year periods. One- and three-year pay amounts (annual and average, respectively) for each comparison company are based on the most recently disclosed three years of pay data available in the ExecComp Analytics database for that company.

Because of the sensitivity of TSR to overall market performance, annualized TSR performance for all companies (subject company and comparison companies) will be measured for the same period: that is, the one- and three-year periods ending on the last day of the month closest to the fiscal-year end of the subject company. To illustrate: if a company's fiscal year ends on November 29, 2011, then all TSRs will be measured over the periods December 1, 2010-November 30, 2011 (for one-year) and December 1, 2008-November 30, 2011 (for three-year).

Combined percentile ranks for pay and for performance are calculated, based on a 40% weighting for the one-year and a 60% weighting for the three-year ranks. The Relative Degree of Alignment is equal to the difference between the ranks: the combined performance rank minus the combined pay rank. (Note that if three years of data are not available for the subject company, the combined measure will reflect only the one-year rankings.)

The table below illustrates how the factors combine to determine the final measure – in this case, the relative degree of alignment is -27.

	Performance	Pay	Difference
1-Year	42	52	-10
3-Year	26	64	-38
Combined (weighted)	**32**	**59**	**-27**

Values for the Relative Degree of Alignment measure range between -100 and +100, with -100 representing the high pay for low performance (i.e., 100th percentile pay combined with 0th percentile performance), zero representing a high degree of alignment (the pay rank is equal to the performance rank), and positive values representing high performance for low pay. More information is available in the Back-testing section, below.

Multiple of Median (MOM)

This measure addresses the question: Is the overall level of CEO pay significantly higher than amounts typical for its comparison group? Is the company significantly more than comparable companies, even for strong performance?

Calculating this measure is straightforward: the company's one-year CEO pay is divided by the median pay for the comparison group. (For more information on ISS' process for selecting peers, see Appendix I.)

Values can therefore range from zero (if the subject company paid its CEO nothing) to infinity. In ISS' back-testing analysis, the highest observed value was just over 25 times peer median.

Measure of Absolute Alignment

For the past two years, ISS has incorporated into its pay-for-performance analysis an appraisal of the last five years alignment of pay and performance, as embedded in a chart displaying the values of a company's pay and "indexed TSR" – the value of a $100 investment at the end of each fiscal year (assuming dividends are reinvested). This chart was intended to provide ISS analysts and clients with a means to assess the general alignment of pay and performance for a company over a 5-year period.

The new approach is designed to quantify and put analytical rigor around this long-term assessment. The concept itself is simple: compare pay and TSR trends to determine whether shareholders' and executives' experiences are directionally aligned.

There are, however, a number of theoretical and implementation challenges involved, for instance:

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- Pay and TSR are measured conceptually differently: pay as a number of dollars delivered in a year, and TSR as a percentage change over the course of a year
- Pay and TSR are measured on different scales and different timeframes
- Pay is "lumpy," with significant swings on a year-to-year basis that can obscure longer-term trends
- TSR measurements – even over a long term – are sensitive to the endpoints of the periods being measured

Pay-TSR Alignment (PTA)

ISS' new measure of long-term absolute alignment is intended to tackle these challenges and address the question: have shareholders' and executives' experiences followed the same long-term trend? It is important to note that PTA is not designed to measure the sensitivity of CEO pay to performance – whether pay and performance go up and down together on a year-over-year basis. It is a long-term measure of directional alignment.

At a high level, the measure is calculated as the difference between the slopes of weighted linear regressions for pay and for shareholder returns over a five-year period. This difference indicates the degree to which CEO pay has changed more or less rapidly than shareholder returns over that period. For technical information on how the regressions are calculated, see Appendix II.

By using regressions to estimate the long-term trends for pay and TSR, the method avoids the pitfalls of evaluating pay and performance over time:

- Performance over a fiscal year and pay granted over that period are measured in a consistent fashion, on the same scale, and are matched in time.
- Volatility of pay and lumpiness of performance are smoothed but not eliminated – addressing in a consistent fashion both the "lumpy pay" problem as well as the sensitivity of TSR to choice of endpoints.

The trend lines calculated by these regressions are analogous to a 5-year "trend rate" for pay and performance, weighted to reflect recent history. The final Pay-TSR Alignment measure is simply equal to the difference: performance slope minus the pay slope. Potential values for PTA are theoretically unbounded, but in practice they range from just over -100% to just over 100%, with a slightly negative median value (see Back-testing, below, for more details).

Back-testing the Measures

To back-test these measures, ISS analyzed pay and performance data for 2,500 companies from the years 2006-2010. Comparison groups were constructed for each company, and each of the three measures was calculated, according to the methodology described above.

Relative Degree of Alignment

RDA measures are normally distributed across the back-test sample, as indicated in the chart below. The median value is indistinguishable from zero, meaning that the percentile pay and performance ranks are nearly equal for the median company in the sample.

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Health Care REITs

Friday, March 23rd
11:00-12:15 p.m.

Discussion Leaders:

Pamela Kessler, EVP & CFO - LTC Properties, Inc.
Jeffrey Miller, EVP-Operations & General Counsel - Health Care REIT, Inc.

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Equity Research

Industry Analysis
Fall 2011

HEALTHCARE REAL ESTATE
$600B INDUSTRY WITH INCOME, GROWTH & VALUE INVESTMENT OPTIONS

Healthcare REITs, Senior Housing & Skilled Nursing Operators

JERRY L. DOCTROW
(443) 224-1309 • jldoctrow@stifel.com

DANIEL M. BERNSTEIN, CFA
(443) 224-1351 • bernsted@stifel.com

SETH P. COHN
(443) 224-1354 • cohns@stifel.com

INVESTMENT THESIS

Healthcare real estate (HC real estate) is a $1 trillion market that includes five types of healthcare properties – acute care hospitals, outpatient facilities/medical office buildings, skilled nursing facilities, private pay senior housing, and life science properties. We estimate approximately $613 billion (57%) of healthcare real estate is investment grade and potentially available for purchase by for-profit operators and healthcare Real Estate Investment Trusts (REITs). We estimate only 18.6% of all investment grade healthcare real estate is currently owned by publicly traded companies so substantial opportunities for further investment exist.

Distinguishing characteristics of healthcare real estate include

- Substantial growth opportunities driven by aging of the population and growing healthcare expenditures,
- Less downside in an economic downturn, less growth in an upturn than commercial real estate,
- Higher cap rates/returns than on commercial real estate, and
- Exposure to government reimbursement, particularly in skilled nursing facilities and hospitals.

There are four types of publicly traded equities through which to invest in healthcare real estate:

- Healthcare REITs (HCREITs),
- Private-Pay Senior Housing Operators (PPSH),
- Skilled Nursing/Post Acute Operators (SNFs), and
- Office REITs focused on life science investments (not included here, but covered by our office analyst John Guinee).

The amount of operating risk and leverage increases as you move from REITs to senior housing operators to skilled nursing operators, but we believe healthcare real estate dynamics are important for the performance of all of these stocks and have therefore chosen to group them together in this report. Government reimbursement accounts for over 75% of skilled nursing revenue, 1%-30% of most senior housing operators' revenue, and between 15% and 75% of the revenue at properties owned by HCREITs.

Publicly traded HCREITs have a better performance record than commercial real estate REITs over the past 10 years, suggesting that investments in healthcare real estate can improve long term performance compared to an investment in publicly traded real estate that excludes healthcare. Investments in private pay senior housing and skilled nursing operators' offerings have been volatile, requiring active trading to outperform.

With uncertain prospects for an economic and housing market recovery, we believe healthcare real estate is an attractive option for real estate, income, and Growth At a Reasonable Price (GARP) investors. We are underweight HCREITs, seeing attractive, stable growth and yield, but with largest caps fully valued to date of this report. We recommend some select PPSH operators that we believe are oversold on housing market and government reimbursement concerns, and are neutral on SNF operators over near-term reimbursement concerns.

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All relevant disclosures and certifications appear on pages 164 and 165 of this report.

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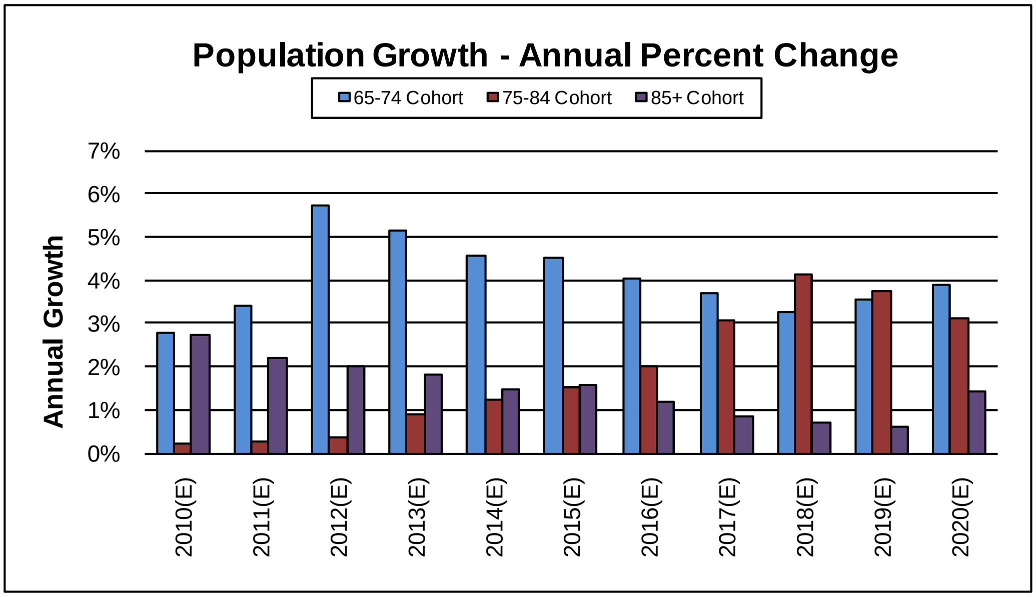
HEALTHCARE REAL ESTATE DEMAND DRIVERS

Demographics

Demographic factors, specifically the aging of the population, are typically the first pitch points for a potential investment in a healthcare operator or healthcare real estate stock. Based on our experience with both public companies and specific projects, we believe demographics help, but alone have never made a healthcare operator or healthcare real estate investment work.

Exhibit 1: Growth Rates of Senior Age Groups



Source: US Census Bureau

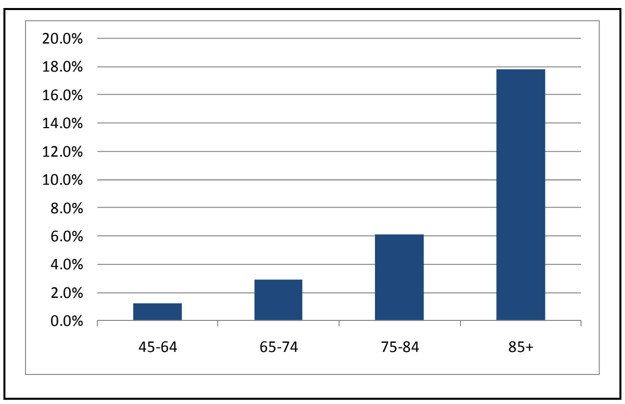
When we think about the role of demographics in healthcare real estate, we focus on three population groups or age cohorts.

- **Roaring Twenties Babies** (born between 1918 and 1929), the leading edge of which is now passing age 93 and the trailing edge of which is now passing age 82, have been driving growth in the PPSH and SNF population over the last decade. Eighty-five is the average entry age for most senior housing. As shown in **Exhibit 1**, while the 85-plus age cohort will continue to grow between 1% and 2% through 2013, the rate of growth then declines until 2020 (85 years after 1935 when birth rates began to increase as the Depression began to ease). The growth rate for the 85-plus age cohort will not return to the levels reached in the last decade until 2031 when the Baby Boomers begin passing age 85 and will be old enough to begin needing accommodations offering senior housing and care services. Skilled nursing demand is affected by growth in the 85-plus population, but also by growth in the 65-plus population if they need post acute care following a hospital visit.
- **Depression Era Babies** (born between 1930 and 1945), the leading edge of which is now passing age 81, are a smaller age cohort than either the Roaring Twenties Babies or the Baby Boomers. As we move into the period when Depression Era Babies start passing 85, we expect slower growth in demand for PPSH until 2020 (85 years after the worst of the Depression began easing and the rate of growth in the 85-plus age cohort begins to rebound). Growth in the 75-to-84-year-old age cohort is minimal over the next few years and does not get back to a 1% annual growth level until 2014. With slower growth for the 75-plus and 85-plus age cohorts, we believe the rate of growth in the supply of PPSH and the percentage of the population that chooses to live in PPSH (penetration rate) will be critical factors for the health of the PPSH industry.

- **Baby Boomers** (born between 1946 and 1964), the leading edge of which is now passing age 65, are the holy grail of the healthcare and senior housing industries. As shown in **Exhibit 1**, the 65-to-74-year-old age cohort is expected to grow between 3% and 6% annually over the next 10 years, driven by the aging of the Baby Boomers, compared to an annual growth rate of only about 1% for the U.S. population as a whole. As the Baby Boomers age, they will increase demand for inpatient, outpatient, physician, and post acute care services, but are nearly 20 years away from being customers for most types of PPSH. Aging of the Baby Boomers will place additional pressure on Medicare (the U.S. healthcare program for those over age 65) funding as the number of eligible recipients grows, which may force changes in health policy nationally to rein in healthcare cost inflation, promote preventative care, and encourage more rational use of services. We believe consumer preferences of the Baby Boomers, which have changed so many products over the last 60 years, will also have a growing influence on how healthcare and ultimately senior housing and post acute care is delivered; the industry is beginning to think about how today's products and services may need to change in order to appeal to future Baby Boomer demand.

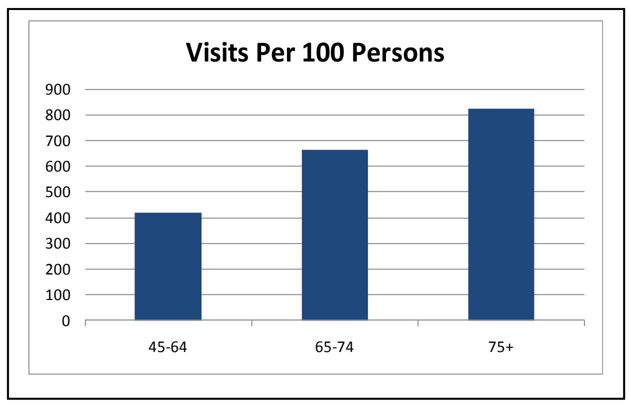
Exhibits 2 and 3 establish the links between aging and the demand for senior housing and care services with the demand for medical care. **Exhibit 2** shows the incidence of the need for assistance with the activities of daily living (ADL)[1] care and age. The need for ADL care more than doubles between the 65-74 age cohort and the 75-84 age cohort, and triples from the 75-84 age cohort to the 85-plus age cohort. The frequency of medical facilities use also increases with age, going up by about 50% between the 45-64 age cohort and the 65-74 age cohort, and by another 25% in the 75-plus age cohort.

Exhibit 2:
Percentage of Age Cohort Needing ADL Care



Source: CDC 2003-2007 National Health Interview Surveys

Exhibit 3:
Utilization of Medical Facilities By Age Cohort



Source: CDC National Center For Health Statistics

In our view, key impacts of the aging population on healthcare real estate include:

- Demand will be stronger over the remainder of the decade for inpatient and outpatient health facilities and for physician services than for PPSH because the Baby Boomers will drive faster growth in the 65-to-74-year-old age group than Depression Era Babies will drive in the 85-plus age cohort.
- Growth in the 65-74 age cohort that may increase efforts to control healthcare utilization and spending that may mute, in part, what we believe is a very positive, demographically-driven increase in demand for services.
- Two more years of healthy demand for PPSH as the trailing edge of the Roaring Twenties Babies continues passing age 85.

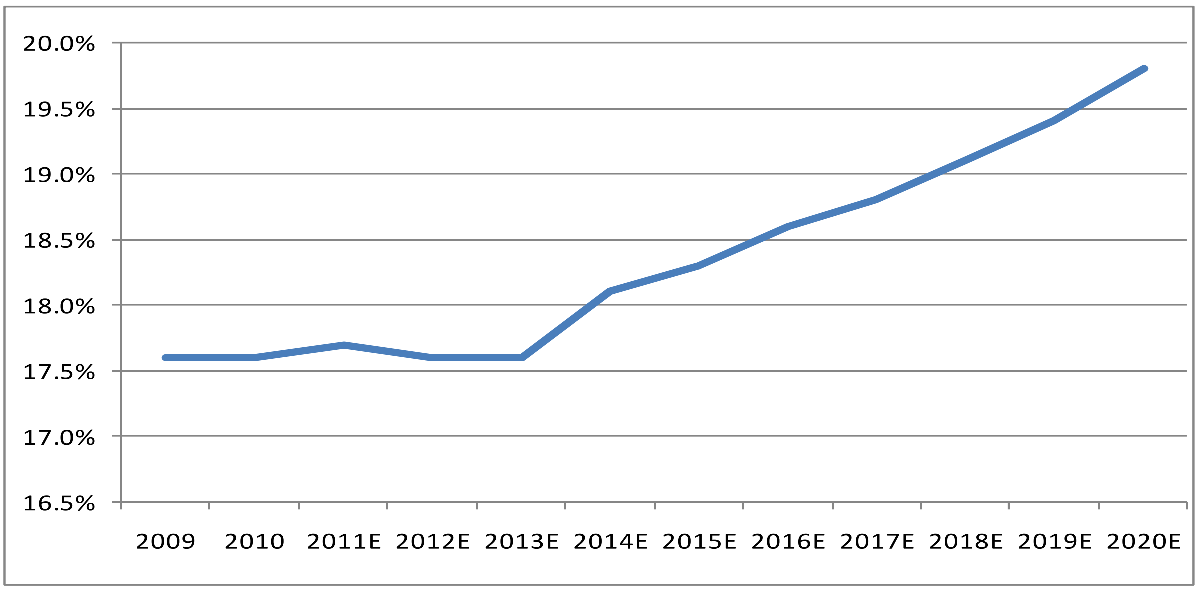
[1] ADLs are generally defined as things normally done in daily living including activities for self-care (such as feeding, bathing, dressing, grooming), work, homemaking, and leisure. Another related term is instrumental activities of daily living (IADL), which refers to activities such as shopping, balancing a checkbook, taking medications and both ADLs. The ability or inability to perform ADLs and IADLs are used as practical measures of ability/disability in many disorders.

- PPSH demand continuing to slowly grow due to increased longevity over the next 10 – 20 years. As we move from the Roaring Twenties Babies to the smaller Depression Era Babies passing age 85, it will be important for PPSH facilities to capture a growing share of senior households in order to continue growing at the rates seen in the past 10 years. But it is more likely that growth in demand for PPSH will moderate and the risk of overbuilding will increase.
- Reduced levels of new PPSH construction in 2011 and 2012 as a result of tighter credit markets appear to position the industry well for slower growth in the 85-plus age cohort; longer-term supply trends are uncertain.
- Positive impact on SNF demand by growth over the next two years in the 85-plus population, and over the next decade by growth in the 65-plus population that will increase demand for post-acute care.

Healthcare Spending

As shown in **Exhibit 4**, healthcare spending in the United States is estimated to be 17.7% of GDP in 2011 and projected to increase to 19.8% of GDP by 2020, even with the passage of the Patient Protection and Affordable Care Act of 2010.[2] In fact, the projections below may prove conservative because they assume that Congress reduces physician reimbursement 27.4% in 2012, which we believe is unlikely although it is current law.[3]

Exhibit 4: Projected National Health Expenditures as a % of GDP



Source: Centers for Medicare and Medicaid Services, Office of the Actuary

Uncertainty over public reimbursement of healthcare is the item we believe gives investors the greatest pause about investing in healthcare real estate. Concern about reimbursement for healthcare real estate investors is reinforced by the knowledge that following a 17% cut in Medicare reimbursement for SNF operators in 1999, five of the top seven U.S. SNF operators filed for bankruptcy from 1999–2002 with HCREITs significantly underperforming from 1999-2002 in what was generally a bad market for REITs. A number of HCREITs cut their dividends, and at least one HCREIT went private at a fire sale price during this period.

There are two types of government reimbursement for healthcare in the United States

[2] National Health Expenditure Projections 2010-2020, Centers for Medicare & Medicaid Services, Offices of the Actuary. http://www.cms.gov/NationalHealthExpendData/03_NationalHealthAccountsProjected.asp. Accessed on 10/5/2011.
[3] Subsequent to the date these projections were released, CMS released its proposed 2012 physician fee schedule indicating only a 27.4% 2012 decrease in physician fees but the general trend line would still be similar to that shown above.

- *Medicare* – The federally funded program for those over age 65 covers both hospital care and other acute care and physician services and drugs. In 2010, Medicare was estimated to spend $525.0 billion, about 20.3% of total health expenditures in the U.S., and the program is projected to grow to $922.0 billion, 19.9% of total spending, in 2020.[4] Spending growth is driven by growth in the 65-plus population and by continued inflation in medical costs despite health reform legislation enacted in 2010.
- *Medicaid* – The joint Federal/State funded program for the poor. Under the Patient Protection and Affordable Care of 2010, the income eligibility under Medicaid (together with the Children's Health Insurance Program – CHIP) will expand to cover all persons under age 65 in households with incomes up to 133% of the federal poverty level. This is expected to add 21.8 million additional insured persons in 2014. The Federal government will initially pay for 100% of this additional cost, dropping to 90% by 2020. In 2010, Medicaid and CHIP accounted for $400.7 billion of healthcare spending, 15.5% of total healthcare spending, and Medicaid/CHIP spending is projected to grow to $908.1 billion in 2020, 19.6% of total healthcare spending[5].

Healthcare reform legislation enacted in 2010 contains a variety of measures to control healthcare spending, particularly for Medicare, and both the Federal government and states have been working on a variety of efforts to reduce growth in Medicaid spending, as well. However, the Office of the Actuary for the Centers of Medicare and Medicaid Services continues to project overall healthcare spending in the U.S. rising at a compounded annual rate of 6.3% between 2010 and 2020.[6]

With a Republican majority in the House of Representatives actively working to repeal or derail implementation of President Obama's Patient Protection and Affordable Care of 2010, legal challenges, ballooning deficits, pressure to reduce entitlement programs, and a presidential and congressional election coming in 2012, there is considerable political uncertainty about the path that healthcare spending and healthcare reform will take. Our views may be summarized as follows:

- **2010 Healthcare Reform Legislation Was Major Fork In the Road For U.S. Healthcare**
  - 32 million more people insured beginning 2014
  - More government regulation/financing
  - Forcing systematic changes on free market healthcare delivery
- **Repeal Very Unlikely/Supreme Court Ruling Harder To Call**
- **Implementation A Slow-Moving Train Taking Years To Finally Arrive**
- **To Be Written Regulations Will Define Reform**
- **Positioning By Operators/Health Plans Already Underway**

Most investors see the greatest reimbursement risk in the areas of post acute care. Post acute care in this instance refers to SNFs, long-term acute care hospitals, inpatient rehabilitation facilities (rehabilitation hospitals) and other non-facility based services such as outpatient rehabilitation therapy and home healthcare that typically provide services following acute care provided in a hospital or outpatient facility. Unlike hospitals, post acute care providers receive no offsetting benefit under healthcare reform from more insured patients and some, like home healthcare, were singled out for significant reimbursement cuts in healthcare reform legislation. Conventional thinking is post acute and long-term care providers have less political clout than hospitals, insurance, or drug companies, and therefore face lower reimbursement prospects and greater risk from future efforts to rein in costs.

On July 29, 2011, the Centers for Medicare and Medicaid Services (CMS) implemented an 11.1% reduction in Medicare reimbursement for SNFs and other technical changes that private operators estimate may trim an additional 3%-9% from revenue before mitigation measures. In addition, to increase the debt ceiling in August 2011, legislation called for additional Medicare rate cuts for all providers of up to 2% if a Joint Select Committee of Congress could not agree upon and have enacted deficit reduction actions of at least $1.2 trillion, which the committee failed to do. Congress is also likely, in our view, to

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[4] National Health Expenditure Projections 2010-2020, Centers for Medicare & Medicaid Services, Offices of the Actuary. http://www.cms.gov/NationalHealthExpendData/03_NationalHealthAccountsProjected.asp. Accessed on 10/5/2011.
[5] Ibid
[6] Ibid

reduce or eliminate Medicare rate cuts scheduled to go into effect for physicians in January 2012, the so-called "Physician Fix," requiring them to find funds from other sources to offset the fiscal impact of this action.

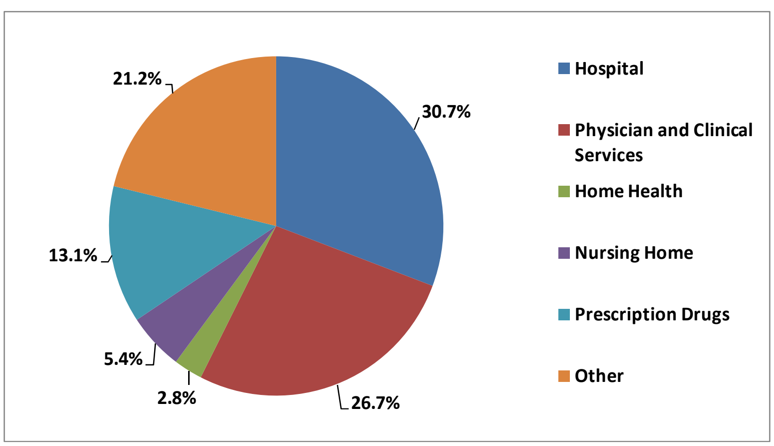
CMS believes the recently implemented 11.1% cut in the Medicare reimbursement for SNFs simply returns reimbursement levels to those of FY2010 before a windfall unintentionally realized from the RUGs IV reimbursement system implemented October 1, 2010. However, we see the combination of the 11.1% cut, technical changes coming into effect October 1, 2011, flat to down Medicaid reimbursement, pending cuts coming from deficit reduction triggers, and failure by the Joint Select Committee on the deficit or efforts to address the Physician Fix putting SNFs and post-acute care generally at real reimbursement risk. We expect this risk, particularly for SNF operators, to remain until at least 1Q12 when Congress addresses the FY13 budget, including the Physician Fix, and we are able to see how SNF operators can mitigate the impact of the 11.1% rate cut and the technical changes implemented October 1, 2011.

Longer term, we see SNF providers:

- **Offering a lower cost alternative to in-patient hospital care and potentially benefiting from a shift to more managed care and more preventative care,**
- **Nimble enough to manage reimbursement pressure, and**
- **Having significant consolidation opportunities,**
- **But continuing to face pressure from little or no growth in Medicaid rates and being less powerful than other healthcare interest groups such as hospitals, physicians and drug companies.**

Exhibit 5 shows U.S. healthcare spending in 2010 with the two largest categories being hospitals and physicians. The "Other" category consists of a number of spending items each under 6% of total spending. We believe any serious effort at reducing healthcare spending will have to focus on hospital and physician spending and drug spending to have any impact. Drug spending is only 13.1% of total healthcare spending, but is a potential source of rapid spending growth. SNF spending is only 5.4% of total and has been growing at a relatively slow rate except for FY2011 increases associated with RUGs IV that were rolled back October 1, 2011. We believe a focus on hospitals and physicians is already evident with rules to penalize hospitals for preventable readmissions and to promote the use of accountable care organizations, including physicians, hospitals and other providers to improve handoffs between levels of care and shift from a fee for service and quantity of care payment system to a quality of care payment system. Proposals are being circulated in Congress to change current law that includes a 27.4% cut in Medicare payments for physicians, which we believe will be reduced or eliminated, but we expect other more gradual reductions and changes in physician reimbursement ahead.

Exhibit 5: Aggregate Health Services and Supplies U.S. Health Spending 2010



Source: CMS Office of Chief Actuary 2010 Report

Exhibit 176: ESC Earnings Model

Emeritus Corporation	Jerry L. Doctrow					Daniel M. Bernstein, CFA				
Quarterly Earnings Models	Stifel Nicolaus & Company, Inc.					Stifel Nicolaus & Company, Inc.				
(in thousands, except per share data and average daily rate)	(443) 224-1309					(443) 224-1351				
Assumptions:	2010A	1Q11A	2Q11A	3Q11A	4Q11E	2011E	1Q12E	2Q12E	3Q12E	4Q12E	2012E
Revenue Assumptions											
Net Acquisitions, incl lease buyouts	442,500	15,750	42,800	34,800	20,400	113,750	20,400	20,400	20,400	20,400	81,600
Expansions and Development put in service	-	$ -	$ -	$ -	$ -	-	$ -	$ -	$ -	$ -	-
Unit capacity (leased & owned), excluding managed properties(1)	28,057	28,183	30,059	30,135	30,135	30,135	30,255	30,375	30,495	30,615	30,615
Units - acquired or leased properties	4,475	126	1,876	76	120	2,198	120	120	120	120	480
Units added - expansions and development	-	-	-	-	-	-	-	-	-	-	-
Ending Units For Period	28,057	28,183	30,059	30,135	30,255	30,255	30,375	30,495	30,615	30,735	30,735
Average Financial Capacity in Period	25,262	28,665	29,350	30,642	30,195	29,713	30,315	30,435	30,555	30,675	30,495
Average occupancy rate - existing stabilized properties	86.9%	86.0%	86.0%	86.5%	86.7%	86.3%	86.5%	86.7%	87.0%	87.2%	86.8%
Average Financial Occupancy In Period	**21,954**	**24,651**	**25,241**	**26,506**	**26,179**	**25,644**	**26,207**	**26,387**	**26,568**	**26,749**	**26,478**
Average Monthly Rate	**3,818**	**4,059**	**4,057**	**4,065**	**4,073**	**4,064**	**4,097**	**4,122**	**4,146**	**4,171**	**4,134**
Resident fees growth - quarter over quarter	4.1%	1.5%	0.0%	0.2%	0.2%	6.4%	0.6%	0.6%	0.6%	0.6%	1.7%
Expense Assumptions											
Facility Operating Margin (net of start-up losses)	33.5%	32.5%	31.9%	29.8%	33.0%	31.8%	32.8%	33.3%	32.8%	33.3%	33.0%
Facility Lease Expense % - quarterly increase	3.0%	0.8%	0.8%	0.8%	0.8%	3.2%	0.8%	0.8%	0.8%	0.8%	3.2%
G&A as % of net revenues	7.4%	7.7%	7.1%	6.7%	6.5%	7.0%	6.5%	6.5%	6.4%	6.3%	6.4%
Tax rate	-0.8%	1.3%	-1.3%	0.2%	1.9%	0.5%	1.9%	2.2%	2.2%	2.7%	2.3%
Recurring Capital expenditures per unit	554	$ 153	$ 143	$ 166	$ 165	628	$ 165	$ 165	$ 165	$ 165	660
Average interest rate on average cash balance	0.7%	0.4%	0.6%	0.6%	0.6%	0.6%	0.5%	0.5%	0.5%	0.5%	0.5%
Average interest rate on average debt outstanding	6.9%	7.2%	7.0%	7.3%	7.4%	7.2%	7.3%	7.3%	7.3%	7.3%	7.3%
Capital Allocation Assumptions											
Additional debt needed during period	450,085	5,155	218,600	23,093	35,383	282,231	18,948	17,899	15,384	73,643	125,874
Assumed Reduction in Cash to offset debt needs	-	-	-	-	-	-	(10,000)	(5,000)	-	-	(15,000)
Net Additional debt issued (retired), after cash offset	450,085	5,155	218,600	23,093	35,383	282,231	8,948	12,899	15,384	73,643	110,874
Additional equity issued during period	88,702	1,710	754	1,036	1,036	4,536	1,036	1,036	1,036	1,036	4,143
Additional common shares issued during period	4,919	76	32	59	61	228	55	49	45	41	190
CFFO Multiple (cur. quarter annualized)	**14.5x**	**19.3x**	**12.0x**	**9.2x**	**9.6x**	**10.6x**	**10.2x**	**10.x**	**11.2x**	**11.1x**	**12.1x**
Stock price at end of period	19.71	25.46	21.25	14.10	17.00	17.00	19.00	21.00	23.00	25.00	25.00
Quarterly Earnings Models											
(in thousands, except per share data)											
Revenue											
Resident Service Fees Existing Properties	995,179	294,720	301,722	318,237	319,883	1,234,562	322,137	326,276	330,458	334,681	1,313,551
Other Fees	-					-					-
Total Property Revenue	995,179	294,720	301,722	318,237	319,883	1,234,562	322,137	326,276	330,458	334,681	1,313,551
Management Fees -existing contracts	11,886	5461	5485	5000	5000	20,946	5150	5150	5150	5150	20,600
Net Management Fees After G&A Incr - Sunwest Venture	-				375	375	708	952	1,200	1,451	4,311
Net revenue	**1,007,065**	**300,181**	**307,207**	**323,237**	**325,258**	**1,255,883**	**327,995**	**332,378**	**336,807**	**341,282**	**1,338,463**
Expenses											
Facility operating expenses	662,140	199,031	205,358	223,423	214,322	842,134	216,637	217,789	222,233	223,400	880,059
General and administrative expenses	74,522	23,213	21,721	21,671	20,993	87,598	21,367	21,586	21,537	21,482	85,971
Acquisition and Development	1,800	6,749	1,844	492	-	9,085	-	-	-	-	-
Earnings (losses) in unconsolidated investments	(915)	(374)	(61)	(817)	0	(1,252)	167	337	566	801	1,870
Add: Other income	(1,320)	2,025	437	312	400	3,174	400	400	400	400	1,600
Net Loss Attributable To Non Controlling Interests	883	117	101	97	100	415	101	101	102	102	406
EBITDAR	**268,168**	**72,956**	**78,761**	**77,243**	**90,443**	**319,403**	**90,659**	**93,841**	**94,106**	**97,704**	**376,310**
Facility lease expense	122,290	30,996	31,202	31,014	31,250	124,462	31,500	31,752	32,006	32,262	127,520
EBITDA	**145,878**	**41,960**	**47,559**	**46,229**	**59,193**	**194,941**	**59,159**	**62,089**	**62,100**	**65,442**	**248,790**
Reconciliation of EBITDA to net income:											
Add: Interest income (cash, notes receivable & investments)	494	111	123	121	121	476	95	85	82	82	344
Less: Interest expense	(114,952)	(36,264)	(37,975)	(41,605)	(42,034)	(157,878)	(42,417)	(42,582)	(42,800)	(43,419)	(171,217)
Change in FMV Of Deriviatives	(182)	-	509	1,527	-	2,036.00	-	-	-	-	-
Less: Depreciation and amortization	(86,697)	(28,087)	(29,438)	(32,540)	(32,750)	(122,815)	(32,843)	(32,932)	(33,025)	(33,118)	(131,917)
Other non-recurring and unusual items	(1,345.00)	-	41,713	(17,258)	-	24,455.00	-	-	-	-	-
Pretax Income	(56,804)	(22,280)	22,491	(43,526)	(15,470)	(58,785)	(16,006)	(13,340)	(13,642)	(11,013)	(54,001)
Less: Income Taxes	762	(281)	(294)	(82)	(300)	(957)	(300)	(300)	(300)	(300)	(1,200)
Net Income (GAAP reported)	**(56,042)**	**(22,561)**	**22,197**	**(43,608)**	**(15,770)**	**(59,742)**	**(16,306)**	**(13,640)**	**(13,942)**	**(11,313)**	**(55,201)**
Discontinued Operations Adjustment	1,345	-	397	17,258	-	17,655	-	-	-	-	-
Less: One time items	6,820	4,687	(37,012)	9,097	-	(23,228)	-	-	-	-	-
Normalized Net Income (excluding non-recurring items)	**(47,877)**	**(17,874)**	**(14,418)**	**(17,253)**	**(15,770)**	**(65,315)**	**(16,306)**	**(13,640)**	**(13,942)**	**(11,313)**	**(55,201)**
Cash flow statement adjustments to Net Income	136,724	23,864	37,265	72,756	43,965	177,850	45,082	45,002	44,865	44,723	179,672
Normalized Cash Flow From Operations[1]	88,847	5,990	22,847	55,503	28,195	112,535	28,777	31,362	30,923	33,411	124,472
Corporate Capex	(3,005)	(1,093)	(1,041)	(496)	(1,000)	(3,630)	(1,000)	(1,000)	(1,000)	(1,000)	(4,000)
Maintenance Capex	(14,092)	(4,322)	(4,310)	(5,000)	(4,982)	(18,614)	(5,002)	(5,022)	(5,042)	(5,061)	(20,127)
Normalized Free Cash Flow, ex development costs	**70,833**	**575**	**17,496**	**50,007**	**22,213**	**90,291**	**22,775**	**25,340**	**24,881**	**27,349**	**100,345**
Development Capex	(6,496)	(1,805)	(1,819)	(3,228)	(1,500)	(8,352)	(2,000)	(2,000)	(2,000)	(2,000)	(8,000)
Normalized Free Cash Flow, incl development costs	**64,337**	**(1,230)**	**15,677**	**46,779**	**20,713**	**81,939**	**20,775**	**23,340**	**22,881**	**25,349**	**92,345**
Normalized CFFO Reconciliation											
Normalized Cash Flow From Operations	88,847	5,990	22,847	55,503	28,195	112,535	28,777	31,362	30,923	33,411	124,472
Changes in Operating Assets/Liabilities	(9,097)	15,768	4,025	(30,025)	-	(10,232)	-	-	-	-	-
Less: Capital lease amortization -fmv or no purchase option	(12,098)	(3,395)	(3,503)	(3,558)	(3,608)	(14,064)	(3,658)	(3,708)	(3,758)	(3,808)	(14,932)
Distributions from unconsolidated JV's	1,975	550	801	113	113	1,027	650	650	650	650	1,950
Less: Maintenance capital expenditures - property level	(14,092)	(4,322)	(4,310)	(5,000)	(4,982)	(18,614)	(5,002)	(5,022)	(5,042)	(5,061)	(20,127)
Normalized Cash Flow From Facility Operations[1]	**55,535**	**14,591**	**19,860**	**17,033**	**19,718**	**70,652**	**20,767**	**23,282**	**22,773**	**25,191**	**91,363**
Per Share Calculations											
Normalized Diluted EPS (excluding one-time items)	**$ (1.22)**	**(0.40)**	**(0.32)**	**(0.39)**	**(0.36)**	**$ (1.47)**	**(0.37)**	**(0.31)**	**(0.31)**	**(0.25)**	**$ (1.24)**
Diluted EPS (including one-time gains/losses)	$ (1.42)	(0.51)	0.49	(0.98)	(0.36)	$ (1.35)	(0.37)	(0.31)	(0.31)	(0.25)	$ (1.24)
CFFO - reported	$ 1.26	0.19	1.27	0.18	0.45	$ 2.08	0.47	0.53	0.52	0.57	$ 2.08
Normalized Cash Flow From Facility Operations	**$ 1.36**	**0.33**	**0.44**	**0.38**	**0.44**	**$ 1.60**	**0.47**	**0.52**	**0.51**	**0.56**	**$ 2.07**
Normalized FCF (incl. development costs)	**$ 1.61**	**(0.03)**	**0.35**	**1.06**	**0.47**	**$ 1.84**	**0.47**	**0.52**	**0.51**	**0.57**	**$ 2.07**
Weighted average common shares:											
Common shares outstanding	39,968	44,210	44,283	44,316	44,360	44,292	44,421	44,476	44,525	44,570	44,498
Additional common shares issued	0	-	-	-	30	8	27	25	23	21	24
Converted warrants, options, preferred stock, debentures, etc.	-	-	591	-	-	148	-	-	-	-	-
Weighted average shares - Diluted	39,968	44,210	44,874	44,316	44,391	44,448	44,449	44,501	44,548	44,591	44,522

Source: Company Reports and Stifel Nicolaus estimates

Emeritus Corporation	2010A	1Q11A	2Q11A	3Q11A	4Q11E	2011E	1Q12E	2Q12E	3Q12E	4Q12E	2012E
Balance Sheet Information:											
Average cash balance	127,163	112,452	77,229	80,774	80,774	80,774	75,774	68,274	65,774	65,774	65,774
Ending cash and restricted lease deposit balance	127,163	97,741	56,716	80,774	80,774	80,774	70,774	65,774	65,774	65,774	65,774
Average debt balance	1,652,520	2,025,591	2,173,901	2,269,861	2,287,553	2,189,226	2,309,718	2,320,642	2,334,783	2,379,296	2,336,110
Ending debt outstanding, incl capital leases and cvt debt	2,023,013	2,028,168	2,246,768	2,269,861	2,305,244	2,305,244	2,314,192	2,327,091	2,342,475	2,416,118	2,416,118
Ending common shares outstanding- diluted	44,194	44,270	44,302	44,360	44,421	44,421	44,476	44,525	44,570	44,612	44,612
Equity market capitalization (fully diluted)	871,060	1,127,101	941,413	625,482	755,163	755,163	845,041	935,028	1,025,114	1,115,291	1,115,291
Undepreciated Book Value of Capital	2,679,014	2,686,368	2,961,133	2,959,482	2,995,901	2,995,901	3,005,884	3,019,820	3,036,239	3,110,918	3,110,918
Operating Lease Expense Capitalized at 12x	1,222,900	1,487,808	1,497,696	1,488,672	1,500,000	1,244,620	1,512,000	1,524,096	1,536,289	1,548,579	1,275,201
Adjusted Undepreciated BV of Capital	3,901,914	4,174,176	4,458,829	4,448,154	4,495,901	4,240,521	4,517,884	4,543,916	4,572,528	4,659,497	4,386,119
Enterprise Value	2,766,910	3,057,528	3,131,465	2,814,569	2,979,633	2,979,633	3,088,459	3,196,346	3,301,815	3,465,635	3,465,635
Debt Metrics:											
Interest coverage, adjusted	1.47x	1.28x	1.37x	1.21x	1.51x	1.34x	1.49x	1.55x	1.54x	1.60x	1.55x
EBITDAR Fixed charges coverage, adjusted	1.36x	1.23x	1.27x	1.16x	1.37x	1.26x	1.35x	1.39x	1.38x	1.42x	1.39x
Net Adj. Debt+Pfd / Adj. Undepreciated BV Capital	79.9%	81.9%	82.7%	82.7%	82.8%	81.8%	83.1%	83.3%	83.4%	83.7%	82.7%
Net Adj. Debt + Pfd / EBITDAR	11.6x	11.7x	11.7x	11.9x	10.3x	10.9x	10.4x	10.1x	10.1x	10.0x	9.6x
Debt/Total market cap	69.9%	64.3%	70.5%	78.4%	75.3%	75.3%	73.3%	71.3%	69.6%	68.4%	68.4%
Valuation Metrics											
ENTERPRISE VALUE/EBITDA (Annualized)	19.0x	18.2x	16.5x	15.2x	12.6x	15.3x	13.1x	12.9x	13.3x	13.2x	13.9x
EVALUE/Adjusted EBITDA (Annualized), excl non-cash comp.	15.6x	15.5x	14.3x	13.1x	11.3x	13.3x	11.8x	11.7x	12.1x	12.1x	12.7x
Adjusted EV/Adjusted EBITDAR (Annualized)	**13.3x**	**13.4x**	**12.7x**	**12.0x**	**10.9x**	**12.1x**	**11.2x**	**11.1x**	**11.4x**	**11.5x**	**11.8x**
P/CFFO - period ending	**14.5x**	**19.3x**	**12.x**	**9.2x**	**9.6x**	**10.6x**	**10.2x**	**10.x**	**11.2x**	**11.1x**	**12.1x**
FCF Yield - period ending	8.2%	-0.4%	6.6%	29.9%	11.0%	10.8%	9.8%	10.0%	8.9%	9.1%	8.3%
Operating Metrics and Growth Rates											
Revenue Growth YoY	13.2%	28.2%	28.5%	29.3%	14.6%	24.7%	9.3%	8.2%	4.2%	4.9%	6.6%
EBITDAR margin	26.6%	24.3%	25.6%	23.9%	27.8%	25.4%	27.6%	28.2%	27.9%	28.6%	28.1%
Incremental EBITDAR margin QoQ	16.0%	-0.9%	82.6%	-9.5%	653.2%	20.6%	7.9%	72.6%	6.0%	80.4%	68.9%
Normalized Diluted CFFO Growth YoY	39.6%	-30.0%	313.5%	-41.4%	18.7%	74.4%	149.0%	-58.5%	188.0%	28.1%	-2.0%
Normalized Free Cash Flow Growth, ex development capex YoY	65.7%	-95.8%	-10.1%	159.8%	20.7%	27.5%	3860.8%	44.8%	-50.2%	23.1%	11.1%
Normalized Free Cash Flow Growth, incl development capex YoY	100.3%	-110.2%	-13.0%	159.0%	28.3%	27.4%	-1789.0%	48.9%	-51.1%	22.4%	12.7%

1) Normalized cash flow from operations and CFFO exclude one-times items

Source: Company reports and Stifel Nicolaus estimates

Non-GAAP Measures	2010A	1Q11A	2Q11A	3Q11A	4Q11E	2011E	1Q12E	2Q12E	3Q12E	4Q12E	2012E
Ajusted EBITDA - SN methodology											
EBITDA	145,878	41,960	47,559	46,229	59,193	194,941	59,159	62,089	62,100	65,442	248,790
add equity in earnings uncosolidated investments	915	374	61	817	0	1,252	(167)	(337)	(566)	(801)	(1,870)
add straight line lease expense	14,635	2,492	2,440	2,197	2,250	9,379	2,025	2,025	2,025	2,025	8,100
add: amortization of above/below mkt rents	8,635	1,967	1,966	1,845	1,950	7,728	1,950	1,950	1,950	1,950	7,800
less Amortization of deferred gain	(1,197)	(288)	(284)	(279)	(279)	(1,130)	(279)	(279)	(279)	(279)	(1,116)
add Non-cash compensation expense	5,934	2,343	2,366	2,173	2,200	9,082	2,266	2,266	2,266	2,266	9,064
add: convertible debenture conversion costs	-					-					-
add: amortization of loan fees	2,964	734	740	806	850	3,130	850	850	850	850	3,400
Total (check)	176,881	49,465	54,747	53,691	66,064	223,967	65,703	68,463	68,244	71,351	273,761
Per Share	4.53	1.27	1.40	1.37	1.69	5.73	1.68	1.75	1.75	1.82	7.01
YOY per share growth	**6.5%**	**20.3%**	**30.0%**	**23.5%**	**34.0%**	**26.6%**	**33.0%**	**25.1%**	**27.1%**	**8.0%**	**22.2%**
Adjusted EBITDA - reported	**150,647**	44,272	49,601	48,843	61,014	**203,730**	60,878	63,638	63,419	66,526	**254,461**
Cash From Facility Operations - reported											
Cash Flow From Operations - reported	82,027	(266)	59,859	46,406	28,195	135,763	28,777	31,362	30,923	33,411	124,472
Changes in Operating Assets/Liabilities	(9,097)	15,768	4,025	(30,025)	-	(10,232)	-	-	-	-	-
Lease Debt Amortization	(12,098)	(3,395)	(3,503)	(3,558)	(3,558)	(14,014)	(3,558)	(3,558)	(3,558)	(3,558)	(14,232)
Distributions From Unconsolidated JV's	1,975	550	801	113	113	1,577	650	650	650	650	2,600
Recurring Capex, net	(14,092)	(4,322)	(4,310)	(5,000)	(4,982)	(18,614)	(5,002)	(5,022)	(5,042)	(5,061)	(20,127)
Total (check)	48,715	8,335	56,872	7,936	19,768	94,480	20,867	23,432	22,973	25,441	92,713
Per Share	1.22	0.19	1.27	0.18	0.45	2.13	0.47	0.53	0.52	0.57	2.08
CFFO YOY per share growth	**39.6%**	**-30.0%**	**313.5%**	**-41.4%**	**18.7%**	**74.4%**	**149.0%**	**-58.5%**	**188.0%**	**28.1%**	**-2.0%**

Source: Company reports and Stifel Nicolaus estimates

Exhibit 177: ESC NAV Analysis

Emeritus Corporation (000s)

	12 Months Forward	Current Q Annualized	
Owned and Leased Properties			**Assumptions/Source**
Revenue	$1,298,753	$1,272,948	does not include loss on uncosolidated venture
Facility Operating Margin	32.9%	29.8%	Stifel Nicolaus Estimates
Gross Property Income	427,777	379,256	
Imputed 5% Management Fee	($64,938)	($63,647)	
Estimated Cash Flow	362,839	315,609	
Capitalization Rate	7.25%	7.25%	
NAV	**$112.54**	**$98.23**	
Management Business			
Management & Development Fee Revenue	$20,450	$20,000	
Estimated Operating Margin, incl. G&A	30.0%	30.0%	
Net Management Income	$6,135	$6,135	
Expected Add'l Net Fee Income From Sunwest	3,235	$0	
Assumed Multiple	12	12	
Management Business NAV	**$2.53**	**$1.66**	
Construction in Progress			
Assumed Value	$0	$0	Book
NAV	**$0.00**	**$0.00**	
Tangible Non Real Estate Assets			
Average Cash, incl restricted deposits	70,774	80,774	
Non-cash current assets	148,952	148,952	3Q11 Actual
Long-term investments	16,579	16,579	3Q11 Actual
Other tangible assets	39,791	39,791	3Q11 Actual
Subtotal Assets	**$276,096**	**$286,096**	
Liabilities			
Average Debt	2,313,174	2,269,861	SN Estimates
Capitalization of Operating Leases	$1,324,596	$1,294,656	12x operating lease expense
Current Liabilities, excluding debt	164,130	164,130	3Q11 Actual
Other liabilities	45,852	45,852	3Q11 Actual
Subtotal Liabilities	$3,847,752	$3,774,499	
NAV Balance Sheet	**($80.31)**	**($78.72)**	
Net NAV, excluding G&A and lease income	**$34.75**	**$21.18**	
Diluted Shares Outstanding	44,472	44,316	SN Estimates, fully diluted including vested stock options

Sources: Stifel Nicolaus estimates and Emeritus Corporation company information

Target Price Methodology/Risks

Our $25 target price is 12.8x our adjusted EV/2012 EBITDAR and 12.1x 2012 Price/CFFO.

Risks to Target:

Property Level Execution Risk – We see execution at the property level as the most significant risk to our estimates.

Market Risk – The housing market is adversely affecting absorption, occupancy, and rates at some private-pay senior housing properties providing assisted living (AL) and Alzheimer's (ALZ) care.

Selling Shareholders – CEO Dan Baty and affiliates own 13.6% of ESC shares and Apollo Real Estate Advisors and Saratoga partners own a combined 23.7% of ESC shares. We believe the Apollo and Saratoga Partners' holding in ESC will remain an overhang on ESC shares until sold. However, we don't believe that either Saratoga or Apollo will sell shares at current share price levels.

High Leverage – We calculate Emeritus' pro forma adjusted debt to under-appreciated book value at 83% adjusting for operating leases, although book value probably understates the current market value of the company's assets. We calculate fixed charge coverage at 1.3x for 2011.

Office/Industrial REITs

Friday, March 23rd
9:30-10:45 a.m.

Discussion Leader:
Jason Maxwell, Corporate Counsel, Hines Real Estate Investment Trust, Inc.

Internal Revenue Service

Number: **201034010**
Release Date: 8/27/2010

Index Number: 856.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:FIP:B03
PLR-108715-10
Date:
May 12, 2010

Legend:

Taxpayer =

Building(s) =

Year 1 =

Date 1 =

OP =

Current Holder =

Dear :

This is in reply to a letter dated February 19, 2010, requesting rulings on behalf of Taxpayer. You have requested a ruling that the Buildings described below, including their structural components, constitute real property for purposes of sections 856(c)(2)(C) and 856(c)(3)(C) of the Internal Revenue Code. You have also requested a ruling that the Buildings, including their structural components, constitute real estate assets for purposes of sections 856(c)(4)(A) and 856(c)(5)(B) of the Internal Revenue Code. Additionally, you have requested a ruling that the services furnished by Taxpayer through OP in connection with the leasing of the Buildings will not cause amounts received from tenants of the Buildings to be treated as other than “rents from real property” under section 856(d).

Facts:

Taxpayer is a newly-formed domestic corporation organized in Year 1 that has elected to be taxed as an S corporation commencing with its first taxable year. Shortly before an initial public offering of Taxpayer's stock, its S corporation status will be terminated and Taxpayer will elect to be treated as a real estate investment trust ("REIT") for its tax year ending Date 1. Taxpayer intends to be a fully integrated, self-managed REIT that conducts all of its business through OP, a newly formed limited partnership, in which it will be the general partner and a substantial limited partner. Taxpayer intends to conduct an initial public offering of its stock on the New York Stock exchange to be completed in Year 1. Taxpayer expects to contribute substantially all of the proceeds of the initial public offering to the capital of OP in exchange for its interest in OP. The initial Buildings (and in three instances, leasehold interests in floors in larger Buildings) are currently owned (indirectly) by Current Holder and will be acquired directly or indirectly by OP.

OP intends to acquire, purchase, develop, and build Buildings that will be leased to unrelated tenants. The space offered to tenants generally fall into two categories: (1) wholesale space and (2) retail co-location space. With respect to the wholesale space, tenants typically rent designated space pursuant to leases generally ranging from three to ten years. With respect to retail co-location space, a customer typically is entitled to the use of a specially identified co-location suite, cage or cabinet located in a common shared area pursuant to a license and service agreement. Such license and service agreements generally have terms ranging from one to three years. The tenants generally will use the space to accommodate their telecommunications, computing and electronic data storage equipment, including computer servers and personnel. The leases generally provide for a fixed base rent plus, in some case, the reimbursement of some or all operating expenses incurred by OP in operating the property or additional payments for the provision of power. Under certain leases, if OP does not provide an uninterruptible, stable source of power to the tenants' space or does not maintain an environment within the tenants' space at a specified temperature and humidity range, the tenants are entitled to an abatement of the amount that they are required to pay OP or landlord under the leases.

Within each Building, the tenant space is generally constructed on vinyl composite tile or raised flooring to accommodate the electric, ventilation, and air conditioning systems ("HVAC") required by tenants. The Buildings differ from other office buildings because of the magnitude and quality of the electrical power and air conditioning furnished to tenants and the redundancies built into the electrical and air conditioning systems.

The major structural components of the Buildings and floors are the (1) electrical distribution and redundancy system (the “electrical components”), (2) heating ventilation and air conditioning system (the “HVAC components”), (3) humidification system (the “humidification components”), (4) security system (the “security components”), (5) the fire protection system (the “fire protection components”), and (6) telecommunication infrastructure (the “telecommunication components”). Each of these components is designed and constructed specifically for the particular Building for which it is a part, and is intended to remain permanently in place. The electrical components are designed to provide an uninterrupted power supply to the property through redundancy. The HVAC components are designed to maintain a room temperature of typically between 70 and 72 degrees Fahrenheit. The humidification components are designed to maintain humidity levels in the tenant's space in the range of 45-55 percent. The security components typically include a single point of access to the Building that is monitored (sometimes remotely) at all times (24/7) by a security firm or by an employee of Taxpayer. The fire protection components consist of fire alarm and suppression systems. The telecommunications components provide access for tenants to third-party telecommunications providers. Taxpayer, through a taxable REIT subsidiary (a “TRS”), will provide connectivity services such as facilitating a tenant’s access to other tenants’ equipment within a Building or between Buildings. Taxpayer or the tenants will adequately compensate the TRS for such services.

Taxpayer represents that the Buildings are inherently permanent structures. Also, Taxpayer represents that each of the structural components described above are designed and constructed to remain permanently in place.

Taxpayer represents that services that will be provided to tenants of the Buildings consist of ordinary, necessary, usual, and customary services that relate to the operation or maintenance of the Buildings. They will not include personal services rendered to a particular tenant. Any service that would constitute a personal service to a tenant would be provided either through an independent contractor from whom Taxpayer does not derive or receive income, or through a TRS of Taxpayer that is owned by OP.

Services that will be provided by Taxpayer, through OP, are utilities, controlled humidity, security (as described above), fire protection (as described above), common area maintenance including cleaning and maintenance of public areas, landscaping, and pest control. Additionally, through OP, Taxpayer will provide management, operation, maintenance, and repair of the major Building systems and components of the Buildings, including structural components; parking for tenants and their visitors, including reserved and unreserved unattended parking; and telecommunications infrastructure to allow tenants to connect to third-party telecommunication providers.

Taxpayer represents that it has undertaken research regarding services by other similarly situated owners in connection with similar buildings located in the same geographic markets and it has determined that the services are customarily rendered in connection with the rental of comparable buildings in the geographic market in which Taxpayer's Buildings are located.

Law and Analysis:

A. Real Property Issue

Section 856(c)(5)(B) defines the term “real estate assets”, in part, to mean real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other REITs. Section 856(c)(5)(C) provides that the term “interests in real property” includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon, but does not include mineral, oil, or gas royalty interests.

Section 1.856-3(b)(1) provides that the term “real estate assets” means real property, interests in mortgages on real property (including interests in mortgages on leaseholds of land or other improvements thereon), and shares in other qualified REITs.

Section 1.856-3(c) provides that the term “interests in real property” includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon.

Section 1.856-3(d) provides that the term “real property” means land or improvements thereon, such as buildings or other inherently permanent structures thereon (including items that are structural components of those buildings or structures). In addition, real property includes interests in real property. Local law definitions do not control for purposes of determining the meaning of the term real property as used in section 856 and the regulations thereunder. The term includes, for example, the wiring of a building, plumbing systems, central heating or central air-conditioning machinery, pipes or ducts, elevators or escalators installed in the building, or other items that are structural components of a building or other permanent structure. The term does not include assets accessory to the operation of a business, such as machinery, printing press, transportation equipment that is not a structural component of the building, office equipment, refrigerators, individual air-conditioning units, grocery counters, furnishings of a motel, hotel, or office building, etc., even though those items may be termed fixtures under local law.

Rev. Rul. 75-424, 1975-2 C.B. 270, concerns whether various components of a microwave transmission system are real estate assets for purposes of section 856. The system consists of transmitting and receiving towers built upon pilings or foundations, transmitting and receiving antennae affixed to the towers, a building, equipment within the building, and waveguides. The waveguides are transmission lines from the receivers or transmitters to the antennae, and are metal pipes permanently bolted or welded to the tower and never removed or replaced unless blown off by weather. The transmitting, multiplex, and receiving equipment is housed in the building. Prewired modular racks are installed in the building to support the equipment that is installed upon them. The racks are completely wired in the factory and then bolted to the floor and ceiling. They are self-supporting and do not depend upon the exterior walls for support. The equipment provides for transmission of audio or video signals through the waveguides to the antennae. Also installed in the building is a permanent heating and air conditioning system. The transmission site is surrounded by chain link fencing. The revenue ruling holds that the building, the heating and air conditioning system, the transmitting and receiving towers, and the fence are real estate assets. The ruling holds further that the antennae, waveguides, transmitting, receiving, and multiplex equipment, and the prewired modular racks are assets accessory to the operation of a business and therefore not real estate assets.

Rev. Rul. 73-425, 1973-2 C.B. 222, considers whether a mortgage secured by a shopping center and its total energy system is an obligation secured by real property. A total energy system is a self-contained facility for the production of all the electricity, steam or hot water, and refrigeration needs of associated commercial or industrial buildings, building complexes, shopping centers, apartment complexes, and community developments. The system may be permanently installed in the building, attached to the building, or it may be a separate structure nearby. The principal components consist of electric generators powered by turbines or reciprocating engines, waste heat boilers, heat exchangers, gas-fired boilers, and cooling units. In addition, each facility includes fuel storage tanks, control and sensor equipment, electrical substations, and air handling equipment for heat, hot water, and ventilation. It also includes ducts, pipes, conduits, wiring, and other associated parts, machinery and equipment. The revenue ruling holds, in part, that a mortgage secured by the building and the system is a real estate asset, regardless of whether the system is housed in the building it serves or is housed in a separate structure apart from the building it serves. This is because the interest in a structural component is included with an interest held in a building or inherently permanent structure to which the structural component is functionally related.

Similar to the properties or structural components described in Rev. Rul. 75-424 and Rev. Rul. 73-425 that qualify as real property for purposes of section 856, the Buildings and the structural components described above are inherently permanent structures. Although the Buildings and structures help to facilitate the technology businesses of tenants that occupy such buildings, the buildings and structural components themselves are not assets accessory to the operation of a business like the examples set forth in section 1.856-3(d). Accordingly, based on the information submitted and representations made, we conclude that Taxpayer's Buildings, including the structural components, as described above, constitute real property for purposes of sections

856(c)(2)(C) and 856(c)(3)(A). In addition, because the Buildings and the structural components are real property, they constitute real estate assets for purposes of sections 856(c)(4)(A) and 856(c)(5)(B).

B. Tenant Services Issue

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from, among other sources, “rents from real property.”

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from, among other sources, “rents from real property.”

Section 856(d)(1) provides that “rents from real property” include (subject to exclusions provided in section 856(d)(2)): (A) rents from interests in real property; (B) charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated; and (C) rent attributable to personal property leased under, or in connection with, a lease of real property, but only if the rent attributable to the personal property for the taxable year does not exceed 15 percent of the total rent for the tax year attributable to both the real and personal property leased under, or in connection with, the lease.

Section 1.856-4(b)(1) provides that, for purposes of sections 856(c)(2) and (c)(3), the term “rents from real property” includes charges for services customarily furnished or rendered in connection with the rental of real property, whether or not the charges are separately stated. Services rendered to tenants of a particular building will be considered customary if, in the geographic market in which the building is located, tenants in buildings of a similar class are customarily provided with the service. In particular geographic areas where it is customary to furnish electricity or other utilities to tenants in buildings of a particular class, the submetering of those utilities to tenants in the buildings will be considered a customary service.

Section 1.856-4(b)(5)(ii) of the regulations provides that the trustees or directors of a REIT are not required to delegate or contract out their fiduciary duty to manage the trust itself, as distinguished from rendering or furnishing services to the tenants of its property or managing or operating the property. Thus, the trustees or directors may do all those things necessary, in their fiduciary capacities, to manage and conduct the affairs of the trust itself.

Section 856(d)(2)(C) provides that any impermissible tenant service income is excluded from the definition of “rents from real property.” Section 856(d)(7)(A) defines “impermissible tenant service income” to mean, with respect to any real or personal property, any amount received or accrued directly or indirectly by the REIT for services furnished or rendered by the REIT to tenants at the property, or for managing or operating the property.

Section 856(d)(7)(B) provides that if the amount of impermissible tenant service income exceeds one percent of all amounts received or accrued during the tax year directly or indirectly by the REIT with respect to the property, the impermissible tenant service income of the REIT will include all of the amounts received or accrued with respect to the property. Section 856(d)(7)(D) provides that the amounts treated as received by a REIT for any impermissible tenant service shall not be less than 150 percent of the direct cost of the REIT in furnishing or rendering the service.

Section 856(d)(7)(C) provides certain exclusions from impermissible tenant service income. Section 856(d)(7)(C) provides that for purposes of section 856(d)(7)(A), services furnished or rendered, or management or operation provided, through an independent contractor from whom the REIT does not derive or receive any income shall not be treated as furnished, rendered, or provided by the REIT, and there shall not be taken into account any amount which would be excluded from unrelated business taxable income under section 512(b)(3) if received by an organization described in section 511(a)(2).

Section 512(b)(3) provides, in part, that there shall be excluded from the computation of unrelated business taxable income all rents from real property and all rents from personal property leased with such real property, if the rents attributable to such personal property are an incidental amount of the total rents received or accrued under the lease, determined at the time the personal property is placed in service.

Section 1.512(b)-1(c)(5) provides that payments for the use or occupancy of rooms and other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, or apartment houses furnishing hotel services, or in tourist camps or tourist homes, motor courts or motels, or for the use or occupancy of space in parking lots, warehouses, or storage garages, do not constitute rent from real property. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The supplying of maid service, for example, constitutes such service; whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways and lobbies, and the collection of trash are not considered as services rendered to the occupant.

Many of the services described above are usual or customary services that are rendered in connection with the operation or maintenance of the properties and are not rendered primarily for the convenience of tenants. Other services that may constitute personal services to a tenant will be provided through independent contractors from whom Taxpayer will not receive or derive any income, or through a TRS owned by OP. Accordingly, the services furnished by Taxpayer through OP in connection with the leasing of the Buildings will not cause any amounts received from tenants of the Buildings to be treated as other than “rents from real property” under section 856(d).

No opinion is expressed or implied as to the federal tax consequences of this transaction under any provision not specifically addressed herein. Specifically, no opinion is expressed or implied whether the structural components of Taxpayer's Buildings constitute real property under any section of the Internal Revenue Code other than section 856. For example, no opinion is expressed or implied regarding whether the structural components at issue constitute section 1245 property or section 1250 property. Furthermore, no opinion is expressed concerning whether Taxpayer otherwise qualifies as a REIT under subchapter M, part II of Chapter 1 of the Internal Revenue Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

/S/

Alice M. Bennett
Branch Chief, Branch 3
Office of Associate Chief Counsel
(Financial Institutions & Products)

Enclosures:
Copy of this letter
Copy for section 6110 purposes

Internal Revenue Service

Number: **201014042**
Release Date: 4/9/2010

Index Number: 856.04-00

Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:FIP:02
PLR-132683-09
Date:
December 11, 2009

<u>LEGEND</u>:

Trust =

Operating Partnership =

Contractor =

State =

Building =

<u>x</u> =

<u>y</u> =

Dear :

This is in reply to your letter dated July 9, 2009, requesting a ruling that a third-party contractor be qualified as an independent contractor from whom Trust does not derive or receive any income for purposes of section 856(d)(7) of the Internal Revenue Code (Code).

FACTS

Trust is a State domestic corporation that has elected to be treated as a real estate investment trust (REIT). Trust is the managing general partner of Operating Partnership, owning approximately x percent of the outstanding common units of the Operating Partnership. The Operating Partnership, through business entities classified as taxable REIT subsidiaries, partnerships, and entities disregarded as separate from the Operating Partnership for Federal income tax purposes (Property-Owning Entities), owns and operates a diversified portfolio of numerous real properties throughout the United States (Properties). (Hereafter, Trust, the Operating Partnership, and the Property-Owning Entities will be referred to collectively as Taxpayer.)

Contractor is an independent construction services company that has provided various construction services (Services) to Taxpayer at certain of Taxpayer's Properties periodically. The Services generally involve the construction of various improvements to the Properties, including work in tenant space that would be considered non-customary services if performed by Taxpayer. All Services have been performed by Contractor for arm's-length amounts.

Taxpayer does not own any stock or any other interest in Contractor, either directly or indirectly, or through constructive ownership under section 318. To the best of Taxpayer's knowledge, Contractor does not own any stock or any other interest in Taxpayer, either directly or indirectly, or through constructive ownership under section 318. There is no overlapping ownership of Taxpayer and Contractor.

Taxpayer intends to continue to utilize Contractor to render Services at the Properties. Taxpayer intends to lease office space to Contractor at Building, an office building owned by Taxpayer, to serve as Contractor's office. The lease will be negotiated at arm's length, will be for a term of y years, and will contain a fixed rental amount. The lease terms will represent the fair market value of the office space. Other than rental income, Taxpayer will not derive or receive any income from Contractor or from the operation of Contractor's business.

Taxpayer believes that the lease of the office space at Building to Contractor will be conducive to Contractor's better provision of the Services to Taxpayer at both the Building and at other Properties owned by Taxpayer. Further, Taxpayer believes that such lease of office space at Building will allow Contractor to be more efficient in providing Services to Taxpayer.

LAW AND ANALYSIS

To qualify as a REIT, an entity must derive at least 95 percent of its gross income from sources listed in section 856(c)(2) and at least 75 percent of its gross income from sources listed in section 856(c)(3). Rents from real property are among the sources listed in sections 856(c)(2) and (3).

Section 856(d)(1) defines the term rents from real property as including (i) rents from interests in real property, (ii) charges for services customarily rendered in connection with the rental of real property, and (iii) rent attributable to certain leased personal property. Similarly, section 1.856-4(a) of the Income Tax Regulations provides that rents from real property generally means the gross amounts received for the use of, or the right to use, real property of the REIT.

Section 856(d)(2), in part, excludes from the term rents from real property any amount received or accrued directly or indirectly from (i) any corporation in which the REIT owns, directly or indirectly, 10 percent or more of the total combined voting power of all classes of stock entitled to vote, or 10 percent or more of the total value of shares of all classes of stock of the corporation; (ii) in the case of a person that is not a corporation, any interest in 10 percent or more in the assets or net profits of such person; and (iii) any impermissible tenant service income, as defined in section 856(d)(7). Section 856(d)(5) provides (with certain modifications as to percentage) that for purposes of section 856(d), the rules prescribed in section 318(a) apply for determining ownership of stock, assets, or net profits of any person.

Section 856(d)(7)(A) defines the term impermissible tenant service income as any amount received or accrued, directly or indirectly by the REIT for (i) services furnished or rendered by the trust to the tenants of such property, or (ii) managing or operating such property. Section 856(d)(7)(C) provides an exception to that definition for services furnished or rendered, or management or operation provided, through an independent contractor from whom the trust itself does not derive or receive any income.

Section 856(d)(3) defines an independent contractor as any person who does not own directly or indirectly, more than 35 percent of the shares or certificates of beneficial interest in the REIT, and if such a person is a corporation, not more than 35 percent of the total combined voting power of whose stock, or if such person is not a corporation, not more than 35 percent of the interest in whose assets or net profits is owned, directly or indirectly, by one or more persons owning 35 percent or more of the shares or certificates of beneficial interest in the trust.

Section 1.856-4(b)(5)(i) of the Income Tax Regulations provides, in effect, that for purposes of determining whether a trust qualifies as a REIT, amounts received by the trust either directly or indirectly, shall not qualify as rents from real property if the trust furnishes services to the tenants of the real property or manages or operates the real property, other than through an independent contractor from whom the trust does not receive or derive any income. The relationship between such independent contractor and the trust must be arm's-length, and the independent contractor must be adequately compensated for any services rendered to the trust. The prohibition against the trust deriving or receiving any income from the independent contractor applies regardless of the source from which the income was derived by the independent contractor.

In Rev. Rul. 66-188, 1966-2 C.B. 276, the Service addressed whether amounts received by an unincorporated trust from tenants of property managed or operated by an independent contractor were rents from real property as defined in section 856(d)(3) of the 1954 Code, if the trust received any income from the independent contractor with respect to the property serviced, managed or operated by the independent contractor. The ruling stated that pursuant to section 1.856-4(b)(3) of the then current Income Tax Regulations, the income received by the trust did not constitute rents from real property as defined in section 856(d) because the trust also received rental income from the independent contractor. The Service concluded, however, that the provisions in section 1.856-4(b)(3) were not intended to apply to a REIT renting office space to an independent contractor for the independent contractor's own occupancy where the independent contractor's presence in an office on the REIT's premises is conducive to better management of the trust's property.

CONCLUSION

In this case, Taxpayer represents that Contractor is an independent contractor within the meaning of section 856(d)(3). The facts indicate that Contractor's lease at Building will be negotiated at arm's-length, will be for a fixed term, and will be for a fixed rental amount that reflects the fair market rental value for the office space. Furthermore, Contractor will be adequately compensated for any Services provided to Taxpayer. On the basis of the information submitted and the representations of Taxpayer, the facts and circumstances indicate that the leasing of office space at Building will be conducive to Contractor's better provision of Services to Taxpayer. We conclude, therefore, that the leasing of space to Contractor at Building will not cause Contractor to fail to qualify as an independent contractor from whom Taxpayer does not derive or receive any income for purposes of sections 856(d)(3) and 856(d)(7)(C)(i).

Except as expressly provided herein, no opinion is expressed or implied concerning the Federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter under any other provision of the Code. Specifically, we do not rule whether Contractor qualifies as an independent contractor under section 856(d)(3) or whether Taxpayer qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Thomas M. Preston
Thomas M. Preston
Senior Counsel, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)

NAREIT LAW AND ACCOUNTING CONFERENCE

OFFICE & INDUSTRIAL ROUNDTABLE DISCUSSION

March 23, 2012
9:30 a.m. – 10:45 a.m.

Summary Outline of Discussion Items for Participants

Moderated by: Mike Comer (CAO, First Potomac Realty Trust) and Jason Maxwell (Corporate Counsel, Hines REIT and Hines Global REIT)

I. CURRENT TRENDS IN PURCHASE & SALE AGREEMENTS

Legal Considerations:

- "As-is, where-as" World – What does this mean?
- Current "Market" Standard for Survivability of Reps. and Warranties, including the Duration and Amount of the Deductible and Caps with respect to Seller's Indemnity
- Issues Particular to Acquisition of Entities (rather than asset sales)
- Acquisition of Single Asset REITs
- Hold/Sell Analysis

Accounting Considerations:

- Accounting Implications and Pitfalls - Continuing Involvement.
- Contingent Consideration.
- Valuation – issues associated with establishing fair value at acquisition.

II. JOINT VENTURE AGREEMENTS

Legal and/or Accounting Considerations:

- Design or Intent versus Economics – What is the Purpose of your JV?
- Control Determination – Major Decisions, Substantive Participation & Protective Rights
- Will they JV be Consolidated or Unconsolidated on your Financial Statements?
- Deal Points – Restrictions associated with transfer, assignment or sale
- Deadlock Concerns and Exit Mechanisms: Kick-Out Rights, Buy-Sell Rights, ROFRs, Forced Sale Rights and Put/Call Options
- Arbitration
- Earn-Out Scenarios
- Re-evaluation of JV after Closing

III. OTHER OFFICE/INDUSTRIAL REIT CURRENT ISSUES

- Are there any new "customary" services being offered by office REIT landlords that do not impair the status of the "good" rent from real property income at such property?
- Three 2010 Private Letter Rulings – Copies Provided (PLR 201037005, 201034010, 201014042)
- Impact of Dodd-Frank Regulations on Office REITs – 2 Main Risks:
  I. Your favored lenders may be forced to curtail investment and lending to you.

II. Financial industry tenants may downsize to avoid some of the “too big to fail” regulations – could result in decrease in office space demand and downward pressure on rents

Internal Revenue Service

Number: **201037005**
Release Date: 9/17/2010

Index Number: 856.04-00

Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:FIP:B02
PLR-105390-10

Date:
June 14, 2010

Legend:

Taxpayer =

Properties =

LLC 1 =

LLC 2 =

LLC 3 =

LLC4 =

TRS 1 =

TRS 2 =

Manager =

LLC5 =

a =

Equipment =

Dear :

This responds to a request for rulings dated January 28, 2010, submitted by your authorized representative. You have requested rulings that the Properties, including their structural components, constitute real estate assets for purposes of sections 856(c) of the Internal Revenue Code; and that the services furnished to tenants of the Properties by Taxpayer through LLC 1 and LLC 2 will not cause any amounts received from tenants of the Properties to be treated as other than “rents from real property” under section 856(d).

FACTS:

Taxpayer has elected to be taxed as a real estate investment trust (REIT) under section 856 of the Code. The Taxpayer wholly-owns two limited liability companies, LLC 1 and LLC 2 (the LLCs), that each own an a percent interest in the capital and profits of a lower-tier limited liability company that is taxed as a partnership for federal income tax purposes. LLC 1 owns an interest in LLC 3 and LLC 2 owns an interest in LLC 4. The LLCs’ principal business is to acquire, sell, finance, improve, lease, operate and manage real estate.

Taxpayer also directly or indirectly owns a percent of the common stock of each TRS 1 and TRS 2 (the TRSs). Taxpayer jointly elected with each of the TRSs under section 856(l) for it to be treated as a taxable REIT subsidiary (TRS) of Taxpayer. Taxpayer conducts the management activities for the Properties, provides certain services to tenants, and provides the tenants access to outside service providers through the TRSs. The TRSs contract with the LLC 5, which is represented to be an independent contractor, to provide certain other services to tenants of the Properties.

Tenants of the Properties generally use the Properties to house their Equipment and associated personnel. The Properties contain certain structural components regarding heating, ventilation, and air conditioning (“HVAC”) specifically suitable for the tenants’ technological requirements. The Properties’ components include electrical components designed with redundancy systems to provide uninterruptible power supply beyond that ordinarily found in office buildings. The Properties also possess a structural design with respect to humidification, fire protection and security systems at a level higher than the ordinary average for office buildings. The telecommunication system and infrastructure includes access to third-party providers. Tenant space is generally constructed on raised flooring designed to accommodate the systems necessary for the operation of tenants’ Equipment. Taxpayer represents that the Properties are inherently permanent structures and that the structural components of the Properties are designed and constructed specifically for the particular building for which they are a part and are intended to remain permanently in place.

Certain tenant services are currently provided to the tenants through the LLCs, Manager, independent contractors supervised by Manager, or LLC 5, supervised by the TRSs. Customary services performed by the Taxpayer on behalf of the tenants include the provision of utilities (such as HVAC, water, electricity, etc.); humidification services; fire protection; security by means of on-site staff and technology; receiving tenant deliveries during normal business hours in the absence of tenant personnel; unattended and unreserved parking; and maintenance of common areas, telecommunication infrastructure and major structural components and buildings systems. Certain of these customary services may be provided through an independent contractor from whom the Taxpayer neither derives nor receives any income.

Taxpayer represents that any noncustomary services rendered to any tenant are provided by a TRS or through an independent contractor from whom Taxpayer does not derive or receive any income. The TRSs may provide tenants technological services and support specific to the tenants' information technology and telecommunications equipment located at the Properties.

The Taxpayer represents that it has undertaken research regarding services furnished by other similarly situated owners in connection with similar buildings located in the same geographic markets, and it has determined that the services rendered by it to its tenants are customarily rendered in connection with the rental of comparable buildings in the geographic market in which the Properties are located.

LAW AND ANALYSIS

Sections 856(c)(2) and (c)(3) provide that for a corporation to be qualified to be taxable as a REIT for any taxable year at least 95 percent of its gross income must be derived from certain specified sources, including rents from real property, and at least 75 percent of its gross income must be derived from real property interests. Section 856(c)(4)(A) provides that at the close of each quarter of its tax year, at least 75 percent of the value of a REIT's total assets must be represented by real estate assets, cash and cash items (including receivables), and Government securities. Section 856(c)(4)(B)(ii) provides that not more than 25 percent of the value of a REIT's total assets is represented by securities of one or more taxable REIT subsidiaries.

Real Property Issue

Section 856(c)(5)(B) defines the term "real estate assets", in part, to mean real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other REITs. Section 856(c)(5)(C) provides that the term "interests in real property" includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon, but does not include mineral, oil, or gas royalty interests.

Section 1.856-3(b)(1) of the Income Tax Regulations provides that the term "real estate assets" means real property, interests in mortgages on real property (including interests in mortgages on leaseholds of land or other improvements thereon), and shares in other qualified REITs.

Section 1.856-3(c) provides that the term “interests in real property” includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon.

Section 1.856-3(d) provides that the term “real property” means land or improvements thereon, such as buildings or other inherently permanent structures thereon (including items that are structural components of those buildings or structures). In addition, real property includes interests in real property. Local law definitions do not control for purposes of determining the meaning of the term real property as used in section 856 and the regulations thereunder. The term includes, for example, the wiring of a building, plumbing systems, central heating or central air-conditioning machinery, pipes or ducts, elevators or escalators installed in the building, or other items that are structural components of a building or other permanent structure. The term does not include assets accessory to the operation of a business, such as machinery, printing press, transportation equipment that is not a structural component of the building, office equipment, refrigerators, individual air-conditioning units, grocery counters, furnishings of a motel, hotel, or office building, etc., even though those items may be termed fixtures under local law.

Rev. Rul. 75-424, 1975-2 C.B. 270, concerns whether various components of a microwave transmission system are real estate assets for purposes of section 856. The system consists of transmitting and receiving towers built upon pilings or foundations, transmitting and receiving antennae affixed to the towers, a building, equipment within the building, and waveguides. The waveguides are transmission lines from the receivers or transmitters to the antennae, and are metal pipes permanently bolted or welded to the tower and never removed or replaced unless blown off by weather. The transmitting, multiplex, and receiving equipment is housed in the building. Prewired modular racks are installed in the building to support the equipment that is installed upon them. The racks are completely wired in the factory and then bolted to the floor and ceiling. They are self-supporting and do not depend upon the exterior walls for support. The equipment provides for transmission of audio or video signals through the waveguides to the antennae. Also installed in the building is a permanent heating and air conditioning system. The transmission site is surrounded by chain link fencing. The revenue ruling holds that the building, the heating and air conditioning system, the transmitting and receiving towers, and the fence are real estate assets. The ruling holds further that the antennae, waveguides, transmitting, receiving, and multiplex equipment, and the prewired modular racks are assets accessory to the operation of a business and therefore not real estate assets.

Rev. Rul. 73-425, 1973-2 C.B. 222, considers whether a mortgage secured by a shopping center and its total energy system is an obligation secured by real property. A total energy system is a self-contained facility for the production of all the electricity, steam or hot water, and refrigeration needs of associated commercial or industrial buildings, building complexes, shopping centers, apartment complexes, and community developments. The system may be permanently installed in the building, attached to the building, or it may be a separate structure nearby. The principal components consist of electric generators powered by turbines or reciprocating engines, waste heat boilers, heat exchangers, gas-fired boilers, and cooling units. In addition, each facility includes fuel storage tanks, control and sensor equipment, electrical substations, and air handling equipment for heat, hot water, and ventilation. It also includes ducts, pipes, conduits, wiring, and other associated parts, machinery and equipment. The revenue ruling holds, in part, that a mortgage secured by the building and the system is a real estate asset, regardless of whether the system is housed in the building it serves or is housed in a separate structure apart from the building it serves. This is because the interest in a structural component is included with an interest held in a building or inherently permanent structure to which the structural component is functionally related.

Similar to the properties or structural components described in Rev. Rul. 75-424 and Rev. Rul. 73-425 that qualify as real property for purposes of section 856, the Properties and the structural components described above are inherently permanent structures. Although the Properties and structures help to facilitate the technology businesses of tenants that occupy such buildings, the buildings and structural components themselves are not assets accessory to the operation of a business like the examples set forth in section 1.856-3(d). Accordingly, based on the information submitted and representations made, we conclude that the Properties, including their structural components, as described above, constitute real property for purposes of sections 856(c)(2)(C) and 856(c)(3)(A). In addition, because the Properties and their structural components are real property, they constitute real estate assets for purposes of sections 856(c)(4)(A) and 856(c)(5)(B).

Tenant Services Issue

Section 856(d)(1) provides that, subject to section 856(d)(2), the term rents from real property includes, inter alia, rents from interests in real property and charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated.

Section 1.856-(4)(a) provides that the term “rents from real property” means, generally, the gross amounts received for the use of, or the right to use, real property of the REIT.

Section 1.856-4(b)(1) explains that services furnished to the tenants of a particular building will be considered to be customary if, in the geographic market in which the building is located, tenants in similar buildings are customarily provided with the service. The regulation goes on to provide that furnishing of water, heat, light, air conditioning, the cleaning of windows, public entrances, exits, and lobbies, the performance of general maintenance, janitorial, and cleaning services, the collection of trash and the furnishing of elevator services, telephone answering services, incidental storage space, laundry equipment, watchman or guard services, parking facilities, and swimming pool facilities are examples of services that are customarily furnished to tenants in many geographic marketing areas.

Section 856(d)(2)(C) excludes from the term rents from real property any impermissible tenant service income. Section 857(d)(7)(A) provides that impermissible tenant service income includes, with respect to any real or personal property, any amount received or accrued directly or indirectly by the REIT for (i) services furnished or rendered by the REIT to the tenants of such property, or (ii) managing or operating such property.

Section 856(d)(7)(C)(i) provides that services, management, or operations provided through an independent contractor from whom the REIT itself does not derive or receive any income or through a taxable REIT subsidiary of the REIT will not be treated as provided by the REIT. Section 856(d)(7)(C)(ii) provides that any amount which would be excluded from unrelated business taxable income under section 512(b)(3) if received by an organization described in section 511(a)(2) will not constitute impermissible tenant services income.

Section 856(d)(7)(B) provides that if the amount of impermissible tenant service income received or accrued directly or indirectly by a REIT with respect to a property for any taxable year exceeds one percent of all amounts received or accrued directly or indirectly by the REIT with respect to such property, the impermissible tenant service income of the REIT with respect to the property shall include all such amounts.

Section 856(d)(3) provides that an independent contractor is any person (A) who does not own, directly or indirectly, more than 35 percent of the shares or certificates of beneficial interest in the REIT; and (B) if the person is a corporation, not more than 35 percent of the voting power or total number of shares of whose stock; or if the person is not a corporation, not more than 35 percent of the interest in whose assets or net profits, is owned, directly or indirectly, by one or more persons owning 35 percent or more of the shares or certificates of beneficial interest in the REIT.

Section 1.856-4(b)(5) provides that no amount received or accrued, directly or indirectly, with respect to any real property qualifies as rents from real property if the REIT furnishes or renders services to the tenants of the property or manages or operates the property, other than through an independent contractor from whom the trust itself does not derive or receive any income. This section provides further that the requirement that the trust not receive any income from an independent contractor requires that the relationship between the two be an arm's-length relationship. To the extent that services (other than those customarily furnished or rendered in connection with the rental of real property) are rendered to the tenants of a property by an independent contractor, the cost of the services must be borne by the independent contractor, a separate charge must be made for the services, the amount of the separate charge must be received and retained by the independent contractor, and the independent contractor must be adequately compensated for the services.

Section 512(b)(3) provides, inter alia, that there shall be excluded from the computation of unrelated business taxable income all rents from real property and all rents from personal property leased with such real property, if the rents attributable to such personal property are an incidental amount of the total rents received or accrued under the lease, determined at the time the personal property is placed in service.

Section 1.512(b)-1(c)(5) explains, however, that payments for the occupancy of rooms and other space where services are also rendered to the occupant, such as payments for the use of a hotel room, are not rents from real property. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The supplying of maid services, for example, constitutes such service; whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways, and lobbies, and the collection of trash are not considered as services rendered to the occupant. Payments for the use or occupancy of entire private residences or living quarters in duplex or multiple housing units, or offices in any office building, are generally treated as rents from real property.

Many of the services described above are usual or customary services that are rendered in connection with the operation or maintenance of the Properties and are not rendered primarily for the convenience of tenants. Other services that may constitute personal services to a tenant will be provided through independent contractors from whom Taxpayer will not receive or derive any income, or through a TRS. Accordingly, the services furnished by Taxpayer in connection with the leasing of the Properties will not cause any amounts received from tenants of the Properties to be treated as other than “rents from real property” under section 856(d).

CONCLUSION

Based on the information submitted and representations made, we conclude that the Properties, including their structural components as represented, constitute real estate assets for purposes of sections 856(c)(4)(A) and 856(c)(5)(B). Accordingly, we conclude that income derived from leasing the Properties qualifies as rents from real property under section 856(c)(3).

Also, the customary activities that the Taxpayer undertakes directly with respect to the Taxpayer’s Properties will not cause the gross income received or accrued by the

Taxpayer with respect to those Properties to be treated as something other than rents from real property for purposes of section 856(c)(2) and (3). The activities undertaken by an independent contractor and/or the TRSs described above will not cause any amounts received by the Taxpayer to be treated as other than rents from real property under section 856(d). Further, the customary activities undertaken by the Taxpayer through the LLCs will not cause any amounts received by the Taxpayer to be treated as other than rents from real property under section 856(d).

No opinion is expressed or implied as to the federal tax consequences of this transaction under any provision not specifically addressed herein. Furthermore, no opinion is expressed concerning whether Taxpayer otherwise qualifies as a REIT under subchapter M, part II of Chapter 1 of the Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, copies of this letter are being sent to your authorized representatives.

Sincerely,

By: David B. Silber
David B. Silber
Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)

PCAOB Update

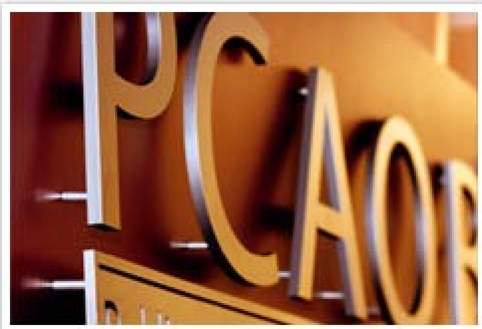
Friday, March 23rd
9:30-10:45 a.m.

Discussion Leaders:

Adam Reuille, Director-Corporate Financial Reporting - Simon Property Group, Inc.
Kevin Richards, Partner - Deloitte LLP

PCAOB
Public Company Accounting Oversight Board

About the PCAOB



The PCAOB is a nonprofit corporation established by Congress to oversee the audits of public companies in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports. The PCAOB also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection.

The Sarbanes-Oxley Act of 2002, which created the PCAOB, required that auditors of U.S. public companies be subject to external and independent oversight for the first time in history. Previously, the profession was self-regulated.

The five members of the PCAOB Board, including the Chairman, are appointed to staggered five-year terms by the Securities and Exchange Commission (SEC), after consultation with the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury.

The SEC has oversight authority over the PCAOB, including the approval of the Board's rules, standards, and budget.

The Act established funding for PCAOB activities, primarily through annual fees assessed on public companies in proportion to their market capitalization and on brokers and dealers based on their net capital.

THE BOARD

- Board Members and

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New York

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Detroit, Mich.
Minnetonka, Minn.

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Irving, Texas
Houston, Texas

Denver

Denver, Colo.

Orange County

Irvine, Calif.

San Francisco

San Mateo, Calif.

RELATED INFORMATION

- Bylaws

Statements

SENIOR STAFF

- Senior Staff Members

MISSION, STRUCTURE & HISTORY

- Former Board Members and Statements
- Mission and Vision
- PCAOB History
- Sarbanes-Oxley Act of 2002
- Recent Amendments to the Sarbanes-Oxley Act

OPERATIONS

- Accounting Support Fee
- Annual Reports
- Fiscal-Year Budgets
- Strategic Plans

PCAOB ADVISORY GROUPS

- Investor Advisory Group
- Standing Advisory Group
  - Pricing Sources Task Force

February 23, 2012

The Honorable James Doty
Chairman
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Dear Chairman Doty:

The Financial Instruments Reporting and Convergence Alliance ("FIRCA") is a coalition of ten trade organizations—American Council of Life Insurers, CRE Finance Council, Council of Federal Home Loan Banks, Group of North American Insurance Enterprises, Mortgage Bankers Association, National Association of Real Estate Investment Trusts, Property Casualty Insurance Association of America, The Financial Services Roundtable, The Real Estate Roundtable, and The U.S. Chamber of Commerce—representing all sectors of the economy and areas of the financial services arena in the United States and around the world. FIRCA recognizes that accurate and transparent financial reporting is a cornerstone of our capital markets in the United States and globally. Businesses are both preparers and users of financial reporting for investment, managerial, and competitive reasons.

FIRCA has supported efforts to improve standards and reduce complexity in financial reporting. We are concerned that there is an insufficient level of input from the business community on auditing proposals that have the potential to distort financial reporting, drive up compliance costs, skew financial activity and prevent companies from engaging in proved business practices all to the harm of investors. Accordingly, we respectfully recommend that the Public Company Accounting Oversight Board ("PCAOB") form a business advisory group and request that FIRCA have a representative participate in the upcoming roundtables on mandatory audit firm rotation.

FIRCA believes that standard setters should have a wide range of input to ensure the proper consideration of business operations and potential unintended consequences in the development and implementation of accounting and auditing standards. An insular approach may cause the PCAOB to expend resources that may be best allocated elsewhere, while developing standards that do not provide for adequate financial reporting structures to convey decision useful information to investors or businesses.

The recent experience of the proposed concept release on mandatory audit firm rotation is a case study in a failure to have sufficient broad based input before publicly moving forward on an issue.[1] The General Accounting Office ("GAO") has, pursuant to the Sarbanes-Oxley Act of 2002 ("SOX"), studied the issue and determined that mandatory audit firm rotation was extremely problematic and should not be pursued.[2] The GAO has recently reiterated that position, yet the PCAOB has moved forward in its consideration of mandatory audit firm rotation.

As of January 18, 2012, 612 comment letters had been filed on concept release, with 92% opposing mandatory audit firm rotation. More significantly 411 businesses or their audit committees wrote letters opposing the mandatory audit firm rotation (none wrote in favor), while only three investors wrote in favor of the concept release.

If the PCAOB had a business advisory group, it could have consulted with them and received input early in the process to understand the business and audit committee concerns with the issue. This may have lead to a differently tailored concept release or a decision not to pursue it at all. Consequently, the PCAOB may have saved time and resources for other issues. A business advisory group could also be an important resource for the PCAOB on many other issues as well, such as Audit Committee communications or the creation of an Auditor Discussion and Analysis document.

We recognize that the PCAOB has a Standing Advisory Group ("SAG"), however, in 2009, the PCAOB decided to create a separate Investors Advisory Group. Clearly, the failure of the PCAOB to consider the views of the entity at the core of a financial report illustrates the need for a business advisory group to provide the PCAOB with this important level of input that is currently lacking. While we believe that roundtables are an important means of developing input, they are also done on an ad-hoc basis. The formation of a business advisory group will allow for a more

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[1] Concept Release on Auditor Independence and Audit Firm Rotation and Notice of Roundtable (PCAOB Release No. 2011-006, August 16, 2011, PCAOB Rulemaking Docket Matter No. 37).

[2] GAO 04-217, *The Public Accounting Firms Required Study on the Potential Effects of Mandatory Audit Firm Rotation* (2003).

consistent means for the PCAOB to consult on issues as it develops priorities and moves forward on them.

We believe that an organization dedicated to promoting transparency should also be transparent in its own operations and deliberations. Therefore, we believe that a business advisory group should conduct its activities consistent with the Federal Advisory Committee Act ("FACA"). Subjecting such a group to FACA sunshine requirements will insure an openness providing a means of understanding of the PCAOB deliberations and thinking in the development of priorities and proposals.

Another improvement for audit standard setting is the use of cost benefit analysis. In 2008, the SEC's Advisory Committee on Improvements to Financial Reporting ("CIFiR") recommended that a cost benefit analysis should be used in developing financial reporting standards. As the PCAOB's audit standards have to go through the SEC's rulemaking process, we believe that the use of cost-benefit analysis, during the development of accounting and auditing standards will allow all market participants and the SEC to have a better understanding regarding implementation issues, as well as a keener awareness of potential adverse consequences that may be corrected. Obviously, if the costs outweigh the benefits, or if no benefits to a proposal exist, this must be known and open to public comment so that it may be considered and given proper weight in the finalization of a standard or rule.

Thank you for your consideration in this matter and we look forward to discussing it further with you to promote responsible financial reporting policies.

Sincerely,

American Council of Life Insurers
CRE Finance Council
Council of Federal Home Loan Banks
Group of North American Insurance Enterprises
Mortgage Bankers Association
National Association of Real Estate Investment Trusts
Property Casualty Insurance Association of America

The Financial Services Roundtable
The Real Estate Roundtable
The U.S. Chamber of Commerce

PCAOB
Public Company Accounting Oversight Board

Inspected Firms

As of January 18, 2011, 2,388 public accounting firms, including U.S. firms and non-U.S. firms, are registered with the PCAOB. The PCAOB conducts regular, periodic inspections of hundreds of those firms, but not all of those firms. It should not be assumed or expected that a firm registered with the PCAOB is, or necessarily will be, inspected by the PCAOB.

The Sarbanes-Oxley Act authorizes the PCAOB to inspect registered firms for the purpose of assessing compliance with certain laws, rules, and professional standards in connection with a firm's audit work for clients that are "issuers," as that term is defined in the Act,* and (following amendments to the Act in 2010) a firm's audit work for clients that are securities brokers or dealers. Many PCAOB-registered firms perform no such work, and the work they do perform is not within the scope of the PCAOB's statutory responsibility and authority to assess. The PCAOB does not inspect those firms.

There are a variety of reasons that firms that perform no audit work for issuers, brokers, or dealers might register with the PCAOB. Some regulators have adopted rules requiring persons subject to their jurisdiction to use PCAOB-registered firms for specified services unrelated to audits of issuers, brokers, or dealers. In addition, firms that currently do no audit work for issuers, brokers, or dealers might register with the PCAOB just to be in a better position to compete for future business for which registration is required.

The PCAOB regularly inspects those firms that issue audit reports opining on the financial statements of issuers. As of January 18, 2011, there are approximately 850 such registered firms, although the precise number fluctuates as some firms begin for the first time to issue audit reports for issuers and other firms cease to do so. In general, the PCAOB inspects each firm in this category either annually or triennially, depending upon whether the firm provides audit reports for more than 100 issuers (annual inspection) or 100 or fewer issuers (triennial inspection). At any time, the PCAOB might also inspect any other registered firm that plays a role in the audit of an issuer, and the PCAOB has a practice of inspecting, in each year, some firms in that category. The PCAOB began conducting inspections of registered firms' audits of brokers and dealers in 2011.

* The Act provides that the term "issuer" means an issuer (as defined in Section 3 of the Securities Exchange Act of 1934), the securities of which are registered under Section 12 of that Act, or that is required to file reports under section 15(d), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933, and that it has not withdrawn.

RELATED INFORMATION

- Registered Firms that have Issued Audit Reports for Issuers
- Issuer Clients of Firms in Jurisdictions that Deny Inspection Access
- Progress in the International Inspections Program

PCAOB
Public Company Accounting Oversight Board

Mission, Structure & History

OUR VALUES

Public Interest
Integrity
Excellence
Effectiveness and Efficiency
Fairness
Risk-Focused
Accountability
Teamwork
Inclusiveness and Diversity

OUR MISSION

The PCAOB mission is to oversee the audits of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports. The PCAOB also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection.

OUR VISION

The PCAOB seeks to be a model regulatory organization. Using innovative and cost-effective tools, the PCAOB aims to improve audit quality, reduce the risks of auditing failures in the U.S. public securities market and promote public trust in both the financial reporting process and auditing profession.

STRUCTURE & HISTORY

- Former Board Members and Statements
- PCAOB History
- Sarbanes-Oxley Act of 2002
- Recent Amendments to the Sarbanes-Oxley Act

RELATED INFORMATION

- Bylaws

NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

By Electronic Mail

December 9, 2011

Mr. J. Gordon Seymour
General Counsel and Secretary
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: Solicitation for Public Comment on *Concept Release on Auditor Independence and Audit Firm Rotation and Notice of Roundtable (PCAOB Release No. 2011-006, August 16, 2011, PCAOB Rulemaking Docket Matter No. 37)*

Dear Mr. Seymour:

This letter is submitted in response to the solicitation for public comment by the Public Company Accounting Oversight Board (PCAOB) with respect to its *Concept Release on Auditor Independence and Audit Firm Rotation and Notice of Roundtable (PCAOB Release No. 2011-006, August 16, 2011, PCAOB Rulemaking Docket Matter No. 37) (Concept Release).*

The National Association of Real Estate Investment Trusts® (NAREIT) is the worldwide representative voice for U.S. real estate investment trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets. Members are REITs and other businesses throughout the world that own, operate and finance income-producing real estate, as well as those firms and individuals who advise, study and service these businesses. NAREIT welcomes the opportunity to respond to the Concept Release and is submitting its comments below.

NAREIT appreciates the PCAOB's efforts toward improving audit quality since its inception in 2002. NAREIT believes that auditor independence, objectivity, and professional skepticism are critical elements to achieve high quality audits and commends the PCAOB for continuing to evaluate how these elements could be strengthened. However, NAREIT does *not* believe that mandatory audit firm rotation is a viable option to achieve the desired outcome.

♦ ♦ ♦
1875 I Street, NW, Suite 600, Washington, DC 20006-5413
Phone 202-739-9400 Fax 202-739-9401 REIT.com

Lack of Empirical Evidence

NAREIT believes that the Concept Release lacks empirical evidence that would suggest that the current audit structure of public companies requires pervasive reform. The Sarbanes-Oxley Act of 2002 (the Act or Sarbanes-Oxley) instituted a number of measures that were aimed at enhancing auditor independence, objectivity, and professional skepticism. For example, Sarbanes-Oxley requires the periodic rotation of audit partners. Additionally, the Act places limits on the types of non-audit services that audit firms can provide to their audit clients. Finally, the Act has taken the ability to select auditors away from management and placed it with the audit committee. Through all of these measures, NAREIT has observed that confidence in financial reporting has been restored through the decrease of financial scandals and restated financial statements. However, the Concept Release elaborates that despite all of these improvements,

> The Board's inspectors have reviewed portions of more than 2,800 engagements of such firms and discovered and analyzed several hundred cases involving what they determined to be audit failures. In this context, an **audit failure** is a failure to obtain reasonable assurance about whether the financial statements are free of material misstatement. **That does not mean that the financial statements are, in fact, materially misstated.** Rather, it means that the inspection staff has determined that, because of an identified error or omission, the firm failed to fulfill its fundamental responsibility in the audit – to obtain reasonable assurance about whether the financial statements are free of material misstatement. In other words, **investors were relying on an [audit] opinion on the financial statements that, when issued, was not supported by sufficient appropriate evidence.** [Emphasis added]

NAREIT notes that the use of the word "audit failure" has meant something far more severe in the past. Specifically, in the 2003 Government Accountability Office (GAO) Report,

> Audit failure refers to audits for which **audited financial statements** filed with the SEC **contained material misstatements** whether due to errors or fraud, and reasonable third parties with knowledge of the relevant facts and circumstances would have concluded that the **audit was not conducted in accordance with Generally Accepted Auditing Standards (GAAS)**, and, therefore, the **auditor failed to appropriately detect and/or deal with known material misstatements** by (1) ensuring that appropriate adjustments, related disclosures, and other changes were made to the financial statements to prevent them from being materially misstated, (2) modifying the auditor's opinion on financial statements if appropriate adjustments were not made, or (3) if warranted, the resigning as the public company's auditor of record and reporting the reason for the resignation to the SEC. [Emphasis added]

If the PCAOB's inspection findings were truly audit failures, would we not have seen more restatements during the period that the PCAOB conducted its inspections? Additionally, why has the PCAOB not made the portion of its Inspection Reports (*i.e.*, Part II of the Inspection Report) that deals with these "audit failures" public? It appears as though the PCAOB is recommending further regulation as a solution to a problem that simply *does not exist*.

Increased Risk of Audit Failures

The Concept Release was written on the presumption that changing auditors periodically would automatically result in more auditor independence, objectivity, and professional skepticism. However, studies of jurisdictions (*e.g.*, Italy) that require mandatory audit firm rotation have suggested that the requirement does not improve audit quality and could actually be to its detriment.

Others share this view. For example, the Concept Release includes the following quote from James Copeland, former CEO of Deloitte & Touche:

> There is strong evidence that requiring the rotation of entire firms is a prescription for audit failure. It would result in the destruction of vast stores of institutional knowledge and guarantee that auditors would be climbing a steep learning curve on a regular basis. It would expose the public to a greater and more frequent risk of audit failure. It would increase the likelihood of undetected fraud by management. It would make it easier for reckless management to mislead the auditor. And finally, it would allow companies to disguise opinion shopping by enabling them to portray a voluntary change in auditors as obligatory.

Additionally, the Concept Release includes following quote from Barry Melancon, President and CEO of the American Institute of Certified Public Accountants (AICPA): "[m]andatory rotation of audit firms has been proven to increase the potential for fraud".

Additionally, the PCAOB's own inspections process has failed to provide a "correlation between auditor tenure and the number of comments in PCAOB inspection reports."

Costs outweigh Benefits

NAREIT believes that requiring public companies to change audit firms periodically would increase costs with little to no benefit. In 2003, the GAO issued a study that evaluated the merits of mandatory audit firm rotation. The following is an excerpt from the Concept Release:

> The GAO's Report was issued in 2003 and was based, in part, on a survey "of public accounting firms and public company chief financial officers and their audit committee chairs of the issues associated with mandatory audit firm rotation." According to the GAO's survey, 79% of larger audit firms and Fortune 1000 companies that responded believed that changing audit firms **increases the risk of an audit failure in the early years of the audit**, and most believed that mandatory firm rotation "would not have much effect on the pressures faced by the audit engagement partner." Nearly all of the larger firms that responded estimated that **initial year audit costs would increase by more than 20 percent**. [Emphasis added]

NAREIT notes that the estimate for first year audit costs of 20 percent was *prior* to the effective date of Sarbanes-Oxley, which requires audit firms to perform integrated audits of public companies. In integrated audits, audit firms provide audit reports that cover both financial statements and internal control over financial reporting. Thus, the cost could be well in excess of the 20 percent originally estimated in the 2003 GAO study.

Lack of Competitors in the "Big 4" in Smaller Markets

Depending on where a company is located, the choice that audit committees have in selecting a "Big 4" public accounting firm can be limited. This limitation is further complicated when a company uses one of the "Big 4" to provide non-audit services. Thus, a requirement to change audit firms puts companies in smaller markets at a competitive disadvantage in selecting a qualified alternate audit firm. This is further complicated when taking into account industry specializations. Audit firms develop industry specializations depending on the types of clients that they audit. Companies headquartered in smaller markets may be required to reimburse audit firms for the travel expenses of entire engagement teams for the months that the companies are audited and reviewed. Mandatory audit firm rotation would place undue financial burdens on companies headquartered in smaller markets and could lead to a higher risk of audit failure due to lack of qualified alternate audit firms with the requisite level of industry expertise.

NAREIT's Recommendation

The costs that public companies bear to access the capital markets are already expensive without taking into consideration the costs associated with the Concept Release. Given the lack of empirical evidence, increased risk of audit failures, costs that outweigh benefits, and the lack of competitors among the "Big 4" in smaller markets, NAREIT urges the PCAOB to withdraw the requirement for mandatory audit firm rotation from its agenda.

In summary, NAREIT does not believe that mandatory audit firm rotation is a reasonable solution (given the cost and risk) to a problem that remains unsubstantiated.

NAREIT's recommends that the PCAOB should:

- Continue to study the *root cause* of inspection findings.

- Publish data on inspection findings to the filing community in order to provide for a more informed discussion based on empirical data which would focus on root causes behind these perceived audit failures. Also, this approach would allow for perspective as to the size and the scope of the findings which would drive the scope and appropriateness of any contemplated proposed solution.

- Mandate that audit firms discuss with audit committees their complete inspection reports as part of required auditor/client communications. This would provide audit firms with further incentive to address areas that the PCAOB cite as findings in inspection reports and lead to enhanced audit quality.

- Require additional education requirements for all CPAs in the areas of auditor independence, objectivity, and professional skepticism. Currently, educational requirements with respect to independence *vary* depending on the state that a Certified Public Accountant (CPA) is licensed. For example, the Commonwealth of Virginia has an annual ethics requirement; the state of New Jersey has a triennial ethics requirement, and the Commonwealth of Pennsylvania has not yet instituted an ethics requirement. NAREIT believes that there is an opportunity for the PCAOB to establish mandatory ethics and independence training for *all* CPAs *regardless of the state* where the CPAs hold their licenses. This stream-lined approach would ensure that CPAs in public practice have a sufficient understanding of independence, objectivity, and professional skepticism on an annual basis.

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NAREIT thanks the PCAOB for this opportunity to comment on the Concept Release. Please do not hesitate to contact George Yungmann, NAREIT’s Senior Vice President, Financial Standards, at (202) 739-9432, or Christopher Drula, NAREIT’s Senior Director, Financial Standards at (202) 739-9442 if you would like to discuss our comments on the Concept Release.

Respectfully submitted,

George Yungmann
Senior Vice President, Financial Standards

Christopher Drula
Senior Director, Financial Standards
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PCAOB
Public Company Accounting Oversight Board

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Chairman
since 2011

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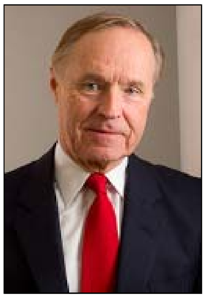

Lewis H. Ferguson
Board Member
since 2011

- Biography
- Public Statements

Daniel L. Goelzer
Board Member
since 2002

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Jay D. Hanson
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since 2011

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since 2008

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November 2, 2011
Volume 18, Issue 33

Heads Up

In This Issue:

PCAOB Concept Release on the Auditor's Report: Overview of Responses

by Brantley Blanchard, Deloitte & Touche LLP; Jennifer Burns, Deloitte LLP; and Robin Smith, Deloitte LLP

During the comment period for Concept Release No. 2011-003,[1] the PCAOB received more than 145 letters, the most the Board has received on a rulemaking project since it proposed Auditing Standard No. 5.[2] Almost half of the letters were from issuers or business groups (70 letters). Other commenters included accounting firms (20); state societies or groups representing the profession (16); audit committees or groups representing directors (9); academics (8); investor groups (11), including one such letter signed by 12 members of the PCAOB's Investor Advisory Group; and other regulators or government agencies (6).[3]

The PCAOB received over 145 comment letters, representing the largest amount of such letters the Board has received on a rulemaking project since it issued Auditing Standard No. 5.

Background

The PCAOB issued the concept release on June 21, 2011, to obtain public comment regarding a possible standard-setting project that could result in amendments to the content and form of the auditor's report. Comments on the concept release were due by September 30, 2011. For more information, see Deloitte's June 28, 2011, *Heads Up*.

Overview of Responses Received

With the objective of increasing the transparency and relevance of the auditor's report to financial statement users, the PCAOB, in its concept release, discussed supplementing the current auditor's report through the following potential approaches:

- Adding an Auditor's Discussion and Analysis section as a supplement to the auditor's report.
- Requiring and expanding the use of emphasis paragraphs.
- Reporting by the auditor on information outside the financial statements.
- Clarifying certain language in the current standard auditor's report.

Comments the PCAOB received on each alternative, as well as other responses, are outlined below.

[1] PCAOB Concept Release No. 2011-003, *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements.*

[2] PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements.*

[3] Information compiled by Deloitte as of October 28, 2011.

Inclusion of an Auditor's Discussion and Analysis

Investor groups were generally in favor of the Auditor's Discussion and Analysis (AD&A) approach and suggested that such an approach include disclosure of (1) the auditor's assessment of the estimates and judgments made by management in preparing the financial statements, including how the auditor arrived at that assessment; (2) areas of significant financial statement and audit risk and how the auditor addressed such risk areas; (3) unusual transactions, restatements, and other significant changes in the financial statements (including the notes); and (4) the auditor's assessment of the quality, not just the acceptability, of the issuer's accounting practices and policies. Investor groups generally supported this alternative, as indicated by the following views expressed in the letters submitted:

- The costs of an AD&A approach should not be burdensome because the type of information proposed to be included in an AD&A is already collected by auditors and communicated to the audit committee.
- Regardless of costs, the benefits of the additional information provided in an AD&A would outweigh the incremental costs.

Issuers, audit committees, and auditors were almost uniformly opposed to the AD&A approach, generally for the following reasons:

- An AD&A would represent a fundamental change to a central tenet of financial reporting and overturn the basic structure of the financial reporting system (i.e., that management is responsible for the financial statements and the auditor provides an attest service).
- An AD&A would undermine the governance role of the audit committee and inhibit open communication between the auditor, management, and the audit committee.
- An AD&A would be void of the interactive communication that occurs when similar information is shared by the auditor to the audit committee; therefore, it would be ineffective.
- Any benefits of such a change would be outweighed by the costs and the likely confusion that would result.

Issuers, audit committees, and auditors were almost uniformly opposed to the Auditor's Discussion and Analysis approach, while investors were in favor.

A few issuers and audit committees did indicate that the AD&A approach might be acceptable if it were very narrow in scope and contained limited information.

Most regulators and government agencies that responded did not support the AD&A approach.

Requiring and Expanding the Use of Emphasis Paragraphs

Investors did not provide significant commentary on the required and expanded use of emphasis paragraphs; however, several noted that they were more concerned about the substance of any disclosure rather than the form (e.g., AD&A vs. emphasis paragraphs).

Some issuers expressed general support for required and expanded use of emphasis paragraphs, but such statements of support were often qualified with concerns about cost, the information included, and the value of any perceived benefit. While some had concerns, others were silent on the issue, which suggests that they may have some tolerance for the required and expanded use of emphasis paragraphs approach. The concerns raised by issuers and audit committees about the approach were similar to those raised about the AD&A approach and included the following:

- Subjective use of emphasis paragraphs will likely result in inconsistent application of such paragraphs, reducing comparability of financial statements among companies and potentially leading to investor confusion.
- Highlighting significant matters in emphasis paragraphs, referencing their disclosure within the financial statements, and reporting audit procedures performed are unlikely to provide significant insight beyond that already included in management's disclosures.

Audit firms and state societies had mixed reactions to the required and expanded use of emphasis paragraphs. In general, large firms were in favor of some variation of the required and expanded use of emphasis paragraphs, but some smaller firms and state societies were opposed to such an approach.

Among regulators and government agencies that commented, reactions to the required and expanded use of emphasis paragraphs were mixed, with the Government Accountability Office (GAO) supporting it in certain, but not all, cases and noting that additional guidance would be needed.

Auditor Reporting on Information Outside the Financial Statements

As the following views suggest, investors either did not specifically address this alternative in their responses or generally were not in favor of auditor reporting on information outside of the financial statements:

- The PCAOB should focus on changing the existing auditor's reporting model rather than expanding the auditor's role to include assurance on information outside of the financial statements.
- Investors are generally more concerned with the content of the information outside of the financial statements rather than the assurance to be provided by the auditor on such information.

Among all groups of respondents, including audit committees, issuers, investors, auditors, and others, there was generally broad support for adding clarifying language to the current standard auditor's report.

Issuers were almost uniformly opposed to auditor reporting on information outside of the financial statements, while audit committees were mixed in their responses and offered limited indications of support for providing some level of assurance on information outside of the financial statements. Both issuers and audit committees raised concerns about:

- Whether such information is auditable and whether the auditor has the necessary expertise or depth of knowledge to audit such information given the variability of the information presented.
- The increase in the cost of an audit under such an expanded model and whether the benefit provided would outweigh such cost.
- The potential delay to regulatory filings, earnings releases, and other time-sensitive information.

Some of the larger audit firms and professional organizations expressed support for providing assurance on a portion of management's discussion and analysis related to critical accounting estimates. However, the above comments suggest that others, particularly issuers, were not in favor of this idea.

Most of the regulators or government agencies that responded did not support providing additional assurance on information outside of the financial statements.

Clarification of Certain Language in the Auditor's Report

Among all groups of respondents, including audit committees, issuers, investors, auditors, and others, there was generally broad support for adding clarifying language to the current standard auditor's report.

While the issuer group was in favor of clarifying language, a number of reservations were expressed about the extent to which changes were really needed and whether better education and outreach by the PCAOB and the profession was more appropriate.

Respondents supported the following types of clarifications to the report:

- Adding information about what an audit is, including an explanation of technical terms such as "reasonable assurance," "materiality," and "material misstatement."

- Clarifying the auditor's responsibility for (1) other information in documents containing auditing financial statements, (2) being independent under all relevant standards, (3) using professional judgment in making risk assessments and selecting audit procedures, and (4) planning and performing the audit to obtain reasonable assurance about whether the financial statements, taken as a whole, are free of material misstatements, whether due to error **or fraud**.

Other Information in Responses

Many commenters encouraged the PCAOB to work with other regulators and standard setters. For instance, several issuers noted that if investors are concerned that financial reports lack information, the FASB and SEC should address these concerns by requiring additional disclosures. Some of these same respondents questioned whether the PCAOB should be undertaking the project at all and suggested that the PCAOB redirect its efforts and resources.

The PCAOB has indicated that it intends to issue a proposed standard during the first quarter of calendar-year 2012.

In addition, while regulators that responded were generally in favor of a broad project to improve the audit report, many, including the GAO, recommended coordination with other standard setters, including the AICPA's Accounting Standards Board and the International Auditing and Assurance Standards Board.

The academic community was mixed in its responses. Generally, individual professors did not support changes to the auditor's report; however, the Auditing Standards Committee of the Auditing Section of the American Accounting Association was more positive in its support for such changes but noted that the implications of changing the reporting and corporate governance models would need to be considered.

Next Steps in Standard Setting

The PCAOB has indicated that it intends to issue a proposed standard during the first quarter of calendar-year 2012 and that it plans to seek public comment on such proposal when issued. Once the PCAOB approves it, the SEC is then required to consider and approve the proposed standard before it can become effective. The PCAOB anticipates that it might issue a final standard for SEC approval in the fourth quarter of 2012. It is not yet clear when any changes to the auditor's report would become effective.

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Heads Up

August 26, 2011
Volume 18, Issue 23

In This Issue:

The PCAOB announced that it will hold a public roundtable on the concept release in March 2012.

PCAOB Issues Concept Release on Auditor Independence and Audit Firm Rotation

by Consuelo Hitchcock, Deloitte LLP

On August 16, 2011, the Public Company Accounting Oversight Board (PCAOB or the "Board") issued a concept release[1] that seeks public comment on mandatory audit firm rotation and other ways in which auditor independence, objectivity, and professional skepticism could be improved. The PCAOB announced that it will hold a public roundtable on the concept release in March 2012. Comments on the concept release are due by December 14, 2011.

Background

In an August 16, 2011, statement, PCAOB Chairman James Doty emphasized that the concept release explores ways to mitigate the "fundamental conflict of the audit client paying the auditor." While the concept release largely focuses on mandatory audit firm rotation, it also seeks comment on whether measures other than firm rotation could meaningfully enhance auditor independence, objectivity, and professional skepticism.[2]

The concept release provides background on mandatory audit firm rotation and an overview of rulemaking by the Securities and Exchange Commission (SEC), PCAOB standard setting associated with auditor independence, and related reforms (e.g., audit committee oversight of auditor independence, audit partner rotation requirements, scope of service limitations) that were put in place as a result of the Sarbanes-Oxley Act of 2002. While the concept release notes that changes enacted as a result of the Sarbanes-Oxley Act have "made a significant, positive difference in the quality of public company auditing," it also says that the PCAOB inspection staff "continues to find instances in which it appears that auditors did not approach some aspect of the audit with required independence, objectivity and professional skepticism."

The concept release acknowledges that not all audit deficiencies detected by the PCAOB inspection staff necessarily result from a lack of objectivity or professional skepticism; rather, such deficiencies could "reflect a lack of technical competence or experience, which may be exacerbated by staffing pressures or some other problem." In addition, the concept release notes that because the PCAOB's inspection program is risk-based, "the Board may be looking at the most error-prone situations." During the open meeting, the Board and PCAOB staff discussed the staff's ongoing research to analyze whether audit deficiencies it had identified could be tied to a lack of professional skepticism, independence, and objectivity. This discussion revealed that though the PCAOB's research thus far was inconclusive, it was also incomplete. Nevertheless, it is clear that

[1] PCAOB Release No. 2011-06, *Concept Release on Auditor Independence and Audit Firm Rotation*.

[2] Footnote 2 of the concept release states, "While the terms 'independence,' 'objectivity,' and 'professional skepticism' have slightly different connotations, they all relate to the auditor's ability to perform the audit in a disinterested manner, free from influence by the client. An independent auditor is more likely to exercise appropriate professional skepticism and make objective auditing judgments."

the PCAOB's intent is to focus on the lack of independence, objectivity, and professional skepticism as potential root causes of audit deficiencies and to consider mandatory rotation as a means of addressing these potential root causes.

The concept release points out that the notion of mandatory audit firm rotation is not new and that it has, in fact, been discussed in various forums since the 1970s. In addition, the release presents summaries of various academic and other studies of the issue, including a 2003 study by the U.S. General Accounting Office (GAO),[3] which was required by the Sarbanes-Oxley Act.[4]

The study concluded that "mandatory audit firm rotation may not be the most efficient way to enhance auditor independence and audit quality considering the additional financial costs and the loss of institutional knowledge of a public company's previous auditor of record . . . . The potential benefits of mandatory audit firm rotation are harder to predict and quantify." The GAO report also stated that "it will take at least several years for the SEC and the PCAOB to gain sufficient experience with the effectiveness of the act in order to adequately evaluate whether further enhancements or revisions, including mandatory audit firm rotation, may be needed to further protect the public interest and to restore investor confidence." Chairman Doty and other Board members cited this latter point in stating their belief that now is an apt time to revisit this issue.

The concept release states that opponents of rotation have expressed concerns about the attendant costs (especially for large multinational companies) as well as the view that audit quality may suffer in the early years of an engagement.

Overview of Release and Request for Comment

The concept release notes that proponents of rotation believe that setting a term limit on the audit relationship could mitigate the effects of client pressures and "offer an opportunity for a fresh look at the company's financial reporting." However, it also states that opponents of rotation have expressed concerns about the attendant costs (especially for large multinational companies) as well as the view that audit quality may suffer in the early years of an engagement. At its August 16, 2011, meeting, the Board emphasized that it is looking for comments that expand on these traditional arguments as well as for empirical data supporting commenters' views.

The concept release includes 21 numbered questions as well as numerous questions embedded in or implied by the text of the release. On the basis of those questions, the PCAOB seems interested in constituents' views on the following general themes:

- Whether the current model in which the auditor is paid by its audit client in fact causes an inherent conflict that is not sufficiently mitigated by existing regulatory and other safeguards.
- Whether audit firm rotation would enhance auditor independence, objectivity, and professional skepticism or whether there are other alternatives that the Board should consider.
- The advantages and disadvantages of mandatory audit firm rotation.
- The effect that a rotation requirement would have on costs to auditors and companies (direct and indirect), whether steps could be taken to mitigate such costs, and how transitions between auditors are currently conducted.
- How the recently implemented engagement partner rotation and audit committee rules and regulations should factor into the consideration of audit firm rotation.
- Whether the Board should conduct a pilot program to further study mandatory rotation and, if so, how it could be structured.
- The significance of auditor independence, objectivity, and professional skepticism in relation to the Board's other possible areas of focus.

[3] Now known as the Government Accountability Office.

[4] More recently, the consideration of mandatory rotation and related issues has been a focus outside the United States, most notably by the European Commission, which raised the issue in its October 2010 consultation paper *Audit Policy: Lessons From the Crisis*. Currently, only a few countries have a form of mandatory audit firm rotation (which, in some cases, is limited by industry), while some countries that had introduced mandatory rotation in the past reversed their position after experiencing the implementation.

In addition, in the event that the PCAOB does consider rulemaking on mandatory rotation, the Board asks for views on the following four topics:

- Possible approaches to rulemaking, such as a rule under which an auditor would not be independent "if it has provided an opinion on the client's financial statements for a certain number of consecutive years."
- Potential maximum length of audit firm term, particularly the advantages and disadvantages of rotation terms of 10 years or more.
- Scope of the potential requirement, including whether a rotation requirement should apply to all audits conducted under PCAOB standards or only, for example, to audits of the largest companies or companies in certain industries.
- Transition and implementation considerations, including whether a rotation requirement would further limit a company's choice of auditor and whether there is a higher audit risk in the early years of an engagement.

Also, as noted, the PCAOB has emphasized that it is seeking input on whether there are alternatives to mandatory rotation that could enhance independence, objectivity and professional skepticism.

We encourage all financial statement stakeholders, including audit committees, company management, investor groups, and others to study the concept release and submit comments to the PCAOB.

Opportunity for Public Comment

We encourage all financial statement stakeholders, including audit committees, company management, investor groups, and others to study the concept release and submit comments to the PCAOB. Note that a concept release is a step before official rulemaking but is a crucial stage in the PCAOB's process. If, after considering feedback on this concept release and from the March 12 roundtable, the PCAOB decides to propose a regulatory requirement, it would also have to expose that proposal for public comment.

Interested parties can send comments to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C., 20006-2803. Comments also may be submitted via e-mail to comments@pcaobus.org or through the PCAOB's Web site at www.pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 37 in the subject or reference line and should be received by the Board no later than 5:00 p.m. EDT on December 14, 2011.

Additional Thoughts on Mandatory Firm Rotation

We agree with the PCAOB about the importance of auditor independence, objectivity, and professional skepticism. We also agree with Board member Lewis H. Ferguson, who emphasized, in his statement at the Board's August 16, 2011, meeting, that "[I]n this, as in all other instances where we consider regulatory change, we take seriously the Hippocratic maxim, that has application to anyone attempting to ameliorate anything, of 'first, do no harm'."

The concept release refers to some of the risks of mandatory audit firm rotation that have been suggested by commentators; these risks are likely to receive further consideration during the comment period. The many well-known potential detriments to a universal mandatory rotation include:

- Mandatory rotation destroys the knowledge base and understanding developed by the audit firm, which threatens audit quality and effectiveness.
- Efficiencies that were developed over time by the preceding auditor are lost upon rotation, thereby increasing the costs of maintaining the same level of audit services.
- Each time rotation occurs, management faces the disruption, expense, and time involved in changing its audit firm.
- Some may see mandatory rotation as an opportunity to leverage competition and pressure auditors to decrease their audit fees below reasonable levels.

- Mandatory rotation could be a disincentive for audit firms to accumulate sector/industry expertise and could jeopardize their ability to attract and maintain talent, especially in specialized industries.
- Similarly, it could be difficult for companies in specialized industries or remote locations to find successor audit firms that have the requisite expertise, staffing levels, and independence.
- Mandatory rotation may give rise to significant problems for global companies, if, for example, different national regulations require rotation after varying amounts of time.

While supporters of mandatory rotation have cited some potential benefits, these benefits are untested and we believe that they will not outweigh the potential risks in the final analysis.

Moreover, in response to the Sarbanes-Oxley Act, the SEC adopted a number of rules and regulations designed to address the PCAOB's concerns; however, the impact of these requirements has not been fully assessed. The provisions included audit committee engagement of and oversight of the independence of the auditor, five-year rotation of the lead audit partner and concurring partner, and seven-year rotation for certain other partners serving on the audit engagement team. These requirements became effective for fiscal years ending after May 31, 2003; thus, for many public companies, the end of the fiscal year 2010 audit marks the completion of the first cycle of partner rotation under these rules.

The PCAOB specifically has asked for comment on potential alternatives to mandatory rotation that could address its concerns in these areas. Because we agree with the PCAOB about the importance of auditor independence, objectivity, and professional skepticism, in the coming months we will be exploring alternatives that do not present the same level of risk as mandatory rotation and will share these alternatives with the PCAOB. We note that the PCAOB's concept release also raises fundamental questions about the role of the audit committee (and how its role was defined in the Sarbanes-Oxley Act), and we expect that members of audit committees and public companies themselves will actively participate in the comment process.

While supporters of mandatory rotation have cited some potential benefits, these benefits are untested and we believe that they will not outweigh the potential risks in the final analysis.

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February 10, 2012
Volume 19, Issue 5

Heads Up

In This Issue:

Overall, the PCAOB is seeking to improve audit committee communications by expanding upon existing required communications.

PCAOB Reproposes Auditing Standard on Communications With Audit Committees

by Jennifer Burns, Deloitte LLP, and Megan Zietsman, Deloitte & Touche LLP

On December 20, 2011, the PCAOB reproposed an auditing standard[1] on communications with audit committees that would supersede PCAOB AU Sections 310[2] and 380.[3] The PCAOB expects the reproposed standard to be effective, subject to SEC approval, for audits of fiscal years beginning on or after December 15, 2012.

The reproposed standard is the result of modifications made to the proposal originally issued by the PCAOB on March 29, 2010. The PCAOB revised the original proposal after reviewing feedback provided through comment letters and from a roundtable session held in September 2011 on the original proposal.

The PCAOB's primary objectives in reproposing the standard are to provide respondents with the opportunity to comment on the reproposal given (1) changes that would align it with requirements in the PCAOB's new risk assessment standards (which became effective after the original proposal), (2) the PCAOB's authority over broker-dealer audits (which also became effective after the original proposal) and the application of the standard to those audits, and (3) other additions and changes to the original proposal.

This *Heads Up* gives an overview of the reproposed standard and highlights significant changes from current standards and the original proposal.

Themes and Considerations Regarding the Reproposed Communication Requirements

Overall, the PCAOB is seeking to improve audit committee communications by expanding upon existing required communications, including those related to critical accounting policies, practices, and estimates as well as significant unusual transactions, significant risks, going-concern considerations, and the auditor's evaluation of the quality of the company's financial reporting. The proposal also addresses the importance of the auditor's obtaining information from the audit committee about its knowledge of complaints or concerns expressed about audit or accounting matters. Note that although auditors are already carrying out many of the new or expanded requirements today, they may not necessarily be doing so consistently throughout the profession.

The reproposed standard carries forward substantially all of the communication requirements of the current standards and, in certain circumstances, requires auditors to provide additional communications. The table in the appendix of this *Heads Up* lists the communications required by the reproposed standard as well as by other PCAOB standards and rules and identifies those that are new or expanded (relative to current requirements) as a result of the reproposed standard.

[1] PCAOB Proposed Auditing Standard *Communications With Audit Committees.*
[2] PCAOB AU Section 310, "Appointment of the Independent Auditor."
[3] PCAOB AU Section 380, "Communication With Audit Committees."

The most significant differences between the original proposal and the reproposed standard are that:

- The reproposal adds requirements "for the auditor to communicate to the audit committee [about] significant unusual transactions [and] the business rationale for such transactions."
- The reproposal deletes the originally proposed requirement that the auditor evaluate "the adequacy of the two-way communications between the auditor and the audit committee."

These changes are discussed in more detail below.

Opportunity for Public Comment

We encourage audit committees to study the reproposal and to submit comments to the PCAOB. Audit committees should carefully consider whether and, if so, how the requirements in the proposal will improve communication and, ultimately, audit committee performance. For instance, audit committees may wish to consider:

- Whether the reproposal will result in required communications that are useful to the audit committee as well as what should be added, deleted, or made optional in the reproposed standard.
- Whether there are aspects of the reproposed standard that will improve or will hinder communications.

The reproposed standard removes the objective and related communication requirements with respect to evaluating the adequacy of the two-way communications between the auditor and the audit committee.

Comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments also may be submitted via e-mail or the PCAOB's Web site. All comments should refer to PCAOB Rulemaking Docket Matter No. 30 in the subject or reference line and should be received by the PCAOB no later than 5:00 p.m. (EST) on February 29, 2012.

Overview of the Reproposed Standard

The reproposed standard states that the objectives of the auditor are to:

a. Communicate to the audit committee the responsibilities of the auditor in relation to the audit and establish an understanding of the terms of the audit engagement with the audit committee;

b. Obtain information from the audit committee relevant to the audit;

c. Communicate to the audit committee an overview of the overall audit strategy and timing of the audit; and

d. Provide the audit committee with timely observations arising from the audit that are significant to the financial reporting process.

The reproposed standard outlines requirements (discussed below) that are intended to fulfill the above objectives, many of which are present in the current standards and unchanged from the original proposal.

Editor's Note: As discussed previously, the reproposed standard removes the objective and related communication requirements with respect to evaluating the adequacy of the two-way communications between the auditor and the audit committee, both of which were included in the original proposal. Nevertheless, as the release accompanying the reproposal explains, the auditor remains responsible for assessing the audit committee's effectiveness under PCAOB Auditing Standards 5[4] and 12.[5]

[4] PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements.*

[5] PCAOB Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement.* Under Auditing Standard 12, the auditor obtains an understanding of the control environment, including whether the board or audit committee understands and exercises oversight responsibility over financial reporting and internal control. In addition, under Auditing Standard 5 and paragraph 5 of PCAOB AU Section 325, *Communications About Control Deficiencies in an Audit of Financial Statements*, if the auditor becomes aware or concludes that the audit committee's oversight of the external financial reporting and internal control over financial reporting is ineffective, the auditor is required to communicate that information to the audit committee.

Appointment and Retention

Significant Issues Discussed With Management

The reproposed standard reiterates the existing requirement of auditors to communicate to the audit committee any significant issues discussed with management in connection with the auditor's initial appointment or retention. The release that accompanies the reproposed standard adds that the scope of the discussion should relate to only the most important matters that might influence the appointment or retention of the auditor.

Editor's Note: This provision of the reproposed standard is substantively unchanged from the initial proposal.

Establish an Understanding of the Terms of the Audit

Under the reproposal, the auditor should establish annually an understanding of the terms of the engagement with the appropriate party or parties (as identified by the company). The auditor is required to achieve this by recording such understanding in a written engagement letter and providing such engagement letter to the appropriate party or parties (as identified by the company) each year. Among other things, the letter should describe the objective of an audit, the auditor's responsibilities, and the responsibilities of management. If the appropriate party is someone other than the audit committee or is its chair, the auditor should determine that the audit committee acknowledges and agrees to the terms of the engagement. This acknowledgement is not required to be in writing.

The reproposed standard reiterates the existing requirement of auditors to communicate to the audit committee any significant issues discussed with management in connection with the auditor's initial appointment or retention.

Editor's Note: This provision of the reproposed standard is substantively unchanged from the initial proposal; however, it now specifically requires the auditor to establish annually a mutual understanding with the appropriate party or parties and, if the appropriate party is not the audit committee, to determine that the audit committee acknowledges and agrees to the terms of the engagement. Current auditing standards were written before the Sarbanes-Oxley Act of 2002; therefore, they do not specifically require that understanding be reached with the audit committee, nor do they require documentation of the terms of the engagement in an annual engagement letter. However, it is common practice for auditors to use written engagement letters and to execute such letters with audit committees.

Obtaining Information and Communicating the Audit Strategy

Obtaining Information Related to the Audit

The reproposal requires the auditor to ask the audit committee whether it is aware of matters relevant to the audit, including but not limited to knowledge of violations or possible violations of laws or regulations and complaints or concerns raised regarding financial reporting matters (e.g., tips or complaints received through the audit committee's internal whistleblower program). This aspect of the reproposed standard complements other requirements in Auditing Standard 12 to inquire of the audit committee regarding risks of material misstatement, including fraud risk.

Editor's Note: The language in this provision of the reproposed standard regarding inquiring of the audit committee about "knowledge of violations or possible violations of laws or regulations" was not in the original proposal. The PCAOB, in its release, explains that this language was expanded because other matters the audit committee is aware of, including possible violations of laws, may be relevant to financial reporting and controls over financial reporting. Although these types of discussions typically take place currently, they are not specifically required under existing standards.

Overview of the Audit Strategy and Timing of the Audit

Under the reproposal, the auditor should give the audit committee an overview of the overall audit strategy, including a discussion of the significant risks and the timing of the audit. In addition, the reproposal requires the auditor to timely communicate significant audit strategy changes or changes to the significant risks. The communication of the audit strategy should include (1) the nature and extent of specialized skill or knowledge needed in the performance of the planned procedures and evaluation of the results; (2) the consideration and planned use by the auditor of the work of internal auditors and similar persons; (3) the names, roles, responsibilities, locations, and scope of work of the firms participating in the audit (those in and out of the network to which the principal auditor belongs); and (4) the basis for the auditor's determination that he or she can serve as the principal auditor if significant parts of the audit will be performed by other auditors.

Editor's Note: This provision of the reproposed standard is substantively unchanged from the initial proposal. Although these types of discussions typically take place currently, they are not specifically required under existing standards.

Results of the Audit

Accounting Policies, Practices, and Estimates

The reproposed standard substantively carries forward existing auditor communication requirements regarding:

- The "initial selection of, and changes in significant accounting policies, or the application of such policies."
- "The methods management used to account for significant unusual transactions."
- "The effect of significant accounting policies on financial statements or disclosures."

The PCAOB's reproposed standard differentiates between *significant* accounting policies and practices and *critical* accounting policies and practices.

Critical Accounting Policies, Practices, and Estimates

The PCAOB's reproposed standard differentiates between *significant* accounting policies and practices and *critical* accounting policies and practices. The term "critical accounting policies and practices" is defined by the PCAOB (and aligns with the SEC's definition) as "the company's accounting policies and practices that are both most important to the portrayal of the company's financial position and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain." Significant accounting policies and practices involve a broader range of matters over time, whereas critical accounting policies and practices, as discussed in the PCAOB's release, are tailored to specific events in the current year. Thus, critical accounting policies and practices would be a subset of significant accounting policies and practices.

Further, the reproposed standard aligns the definition of "critical accounting estimate" with that used by the SEC; namely, an "estimate where (a) the nature of the estimate is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and (b) the impact of the estimate on financial condition or operating performance is material."

With respect to critical accounting policies and practices, the reproposed standard includes requirements that are consistent with those in Regulation S-X, Rule 2-07,[6] stating that the auditor should report (1) all critical accounting policies directly to the audit committee, (2) all alternative treatments permissible under the applicable financial reporting framework for policies and practices related to material items discussed with management, and (3) other material written communications between the auditor and management.

[6] Regulation S-X, Rule 2-07, "Communication With Audit Committees."

The reproposed standard also carries forward the existing communication requirements regarding:

- "[T]he process used by management to develop critical accounting estimates."
- The "significant assumptions used in [such] estimates that have a high degree of subjectivity" and any changes in the process or assumptions.
- "The basis for the auditor's conclusions regarding the reasonableness of the critical accounting estimates."

The reproposal outlines new communication requirements with respect to the following:

- The "reasons certain policies and practices are considered critical, and . . . how current and anticipated future events might affect the determination of [what is] considered critical."
- Any "significant changes management made to the processes used to develop critical accounting estimates, . . . management's reasons for the changes, and the effects of the changes on the financial statements."

With respect to critical accounting estimates, the reproposed standard also clarifies that if management communicates to the audit committee about the required matters, the auditor does not need to communicate the same matters at the same level of detail as long as the auditor:

- "[P]articipated in management's discussion with the audit committee."
- "[A]ffirmatively confirmed to the audit committee that management has adequately communicated [the required] matters."
- "[I]dentified for the audit committee those accounting policies and practices that the auditor considers critical."

The reproposed standard removes communication requirements in the original proposal related to the following:

- "How management subsequently monitors . . . estimates."
- "[I]nformation that supports or challenges [significant] changes" in critical accounting estimates.
- "When critical accounting estimates involve a range of possible outcomes, how the recorded estimates relate to the range and how various selections within the range would affect the company's financial statements."

The reproposed standard specifically requires the auditor to communicate the results of the evaluation of the qualitative aspects of significant accounting policies and practices.

The Auditor's Evaluation of the Quality of Financial Reporting

The reproposed standard specifically requires the auditor to communicate the results of the evaluation of the qualitative aspects of significant accounting policies and practices, including situations in which the auditor identifies bias in management judgments about the amounts and disclosures in the financial statements. In addition, the auditor would be required under the reproposed standard to communicate his or her evaluation of the presentation of the financial statements, including specifically the form, arrangement, content, terminology, amount of detail given, and bases of amounts set forth.

As discussed previously, the reproposed standard carries forward communication requirements (contained in Regulation S-X, Rule 2-07) regarding:

- "Alternative accounting treatments . . . for policies and practices related to material items that have been discussed with management."
- "Material written communications . . . between the auditor and management."

In addition, the reproposed standard contains new communication requirements related to:

- "[D]ifficult or contentious matters for which the auditor consulted outside the engagement team [and] that the auditor reasonably determined are relevant to the audit committee's oversight." (Note that the original proposal contained an exception regarding consultations with the engagement quality reviewer; this exception has not been retained in the reproposed standard.)
- "Situations in which . . . the auditor identified a concern regarding management's anticipated application of [significant new] accounting pronouncements." (Note that this aspect of the reproposal has been narrowed from the original proposal, which would have required the auditor to communicate with the audit committee about the anticipated application by management of all new accounting and regulatory pronouncements.)
- The auditor's "assessment of management's disclosures related to critical accounting policies and practices, along with any significant modifications to the disclosures . . . proposed by the auditor that management did not make."
- "The basis for the auditor's conclusions regarding the reasonableness of the critical accounting [policies]."

Editor's Note: We believe that some of the above aspects of the reproposed standard are similar to and appear to replace current communication requirements to the audit committee regarding the auditor's judgments about the quality, and not just the acceptability, of the company's accounting principles.

The reproposal adds a requirement for the auditor to communicate to the audit committee significant unusual transactions that the auditor is aware of.

Significant Unusual Transactions

Current standards require the auditor to communicate with the audit committee about the methods used to account for significant unusual transactions. The reproposal adds a requirement for the auditor to communicate to the audit committee significant unusual transactions that the auditor is aware of, including the timing, size, nature, and business rationale for such transactions.

Editor's Note: This provision of the reproposed standard was not in the original proposal. As noted above, AU Section 380 contains a provision related to the auditor's determination that the audit committee is informed about the methods used to account for significant unusual transactions. Therefore, the new aspect of this provision relates to the requirement to communicate about additional elements of the significant unusual transactions (including the auditor's understanding of the business rationale for them), not just the methods to account for them.

Management Consultations With Other Accountants

The reproposal carries forward the current requirement to communicate management's consultations with other accountants about auditing or accounting matters, including the auditor's views about such matters; however, unlike the current standard, the reproposal states that such communications should only relate to those matters about which the auditor has identified a concern.

Editor's Note: The list of items that must be communicated is narrower under the reproposed standard than it was under the original proposal. Under the reproposal, such items are limited to consultations with outside accountants that relate to significant matters about which the auditor has identified a concern.

Going Concern

Although auditors typically communicate going-concern matters to the audit committee when applicable, they are not required to do so under current PCAOB standards. The reproposed standard requires that the auditor communicate (1) the conditions and events the auditor identified that indicate there could be substantial doubt about the company's ability to continue as a going concern for a reasonable period and (2) the information that mitigated the auditor's doubt (if such doubt was indeed mitigated). If the auditor concludes that substantial doubt was not mitigated, the auditor is required to communicate any effects on the financial statements, including the disclosures and on the auditor's report.

> **Editor's Note:** Unlike the original proposal, the reproposed standard does not require the auditor (if the auditor has concluded that there is substantial doubt about the ability to continue as a going concern for a foreseeable period) to communicate his or her assessment of management's plans to overcome the conditions and events that gave rise to the substantial doubt and management's ability to implement the plans.
>
> The FASB has on its agenda a related project on disclosures about risks and uncertainties and the liquidation basis of accounting (formerly going concern). See the FASB's project update page for information about this project.

Uncorrected and Corrected Misstatements

The reproposed standard reiterates the existing requirements to communicate corrected and uncorrected misstatements. It also emphasizes that auditors should include misstatements related to disclosures when communicating misstatements. In addition, it requires the auditor to:

Under the reproposal, the auditor should communicate matters that have arisen during the audit that are significant to the oversight of the financial reporting process.

- "[D]iscuss with the audit committee, or determine that management has adequately discussed with the audit committee, the basis for the determination that the uncorrected misstatements [are] immaterial, including the qualitative factors considered."
- "[C]ommunicate that uncorrected misstatements or matters underlying those uncorrected misstatements could cause future period financial statements to be materially misstated."

> **Editor's Note:** This provision of the reproposed standard and the discussion in the accompanying release clarify that such misstatements refer only to those identified in the audit process.

Other Matters

Under the reproposal, the auditor should communicate matters that have arisen during the audit that are significant to the oversight of the financial reporting process. Such matters include situations in which the auditor is aware of concerns having been raised about auditing or accounting and the results of the auditor's procedures regarding such concerns.

> **Editor's Note:** This provision of the reproposed standard is substantively unchanged from the initial proposal.

Other Communication Requirements

The reproposal includes communication requirements, largely taken from the existing standards, that address the auditor's responsibility in connection with information in documents containing audited financial statements, disagreements with management, and difficulties encountered in performing the audit.

The reproposal also requires the auditor to inform the audit committee if the auditor expects to modify an opinion or add an explanatory paragraph in the auditor's report and to explain the reasons why.

> **Editor's Note:** These provisions of the reproposed standard are substantively unchanged from the initial proposal.

Form and Documentation of the Communications

The reproposed standard allows the auditor to communicate to the audit committee either orally or in writing. In both cases, the auditor is specifically required to document such communications in the workpapers and to indicate whether they were oral or written. Under the existing standard, any written communication is restricted to the use of the audit committee, board of directors, or management. The reproposed standard does not contain this requirement, although, in accordance with the PCAOB's standards,[7] auditors may continue to restrict the use of written communications by specifying the intended users.

Editor's Note: This provision of the reproposed standard is substantively unchanged from the initial proposal.

Timing of Communications

The reproposed standard would apply to all audits of broker-dealers.

Currently, communications with audit committees are not specifically required to occur before the issuance of the auditor's report, although in practice they typically take place before it is issued and before the related filing of the annual financial statements. The PCAOB has explained its view that communications are considered an integral part of the audit and not incidental to the process. The reproposed standard (like the original proposal), therefore, specifically requires the communications to be completed with the full audit committee before issuance of the auditor's report, and, because the significance of specific matters may change from year to year, it requires annual communication of recurring matters.

Editor's Note: This provision of the reproposed standard is substantively unchanged from the initial proposal.

Application to Audits of Broker-Dealers

The reproposed standard would apply to all audits of broker-dealers. The Dodd-Frank Wall Street Reform and Consumer Protection Act gave the PCAOB authority to oversee the audits of broker-dealers registered with the SEC. The SEC has stated in interpretive guidance that for transitional purposes, audits of broker-dealers should continue to be conducted in accordance with the standards of the AICPA while it reconsiders its rules related to such audits.

Currently, although AICPA standards on audit committee communications apply to audits of broker-dealers, the PCAOB's interim standard on audit committee communications, AU Section 380, does not apply to audits of broker-dealers that do not have an audit committee.

As a result, if the SEC updates its rules such that PCAOB standards apply to audits of broker-dealers before the approval of the reproposed standard, there could be a timing gap in PCAOB requirements for audit committee communications in connection with audits of broker-dealers. Accordingly, the PCAOB has included a transitional amendment in the reproposed standard that would make the communication requirements in AU Section 380 applicable to audits of broker-dealers (once the SEC approves rules that make PCAOB standards applicable to audits of broker-dealers) until the reproposed standard is finalized and approved.

[3] See paragraphs .07 –.11 of PCAOB AU Section 532, *Restricting the Use of an Auditor's Report.*

Appendix

The table below (1) lists the communications to audit committees required by (a) the reproposed standard and (b) other PCAOB standards and rules and (2) indicates whether communications required by the reproposed standard are new or expand on current requirements.

Communications Required by the Reproposed Standard	New or Expanded Requirement
Significant issues discussed with management before the auditor's appointment or retention.	
Mutual understanding of the terms of the audit.	Expanded
Overview of the audit strategy and timing of the audit.	New
Accounting policies, practices, and estimates, including critical accounting policies, practices, and estimates.	Expanded
Auditor's evaluation of the quality of the company's financial reporting.	Expanded
Timing, size, nature, and business rationale for significant unusual transactions.	Expanded
Other information in documents containing audited financial statements.	
Management consultations with other accountants.	
Going concern.	New
Uncorrected and corrected misstatements.	
Departure from the standard auditor's report.	New
Disagreements with management.	
Difficulties encountered in performing the audit.	
Other matters.	New
Communications Required by Other PCAOB Standards or Rules	
Material weaknesses and significant deficiencies in internal control.	
Representations of management.	
Fraud and illegal acts.	
Communications in connection with interim reviews.	
Preapproval of services.	
Independence matters.	

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Residential REITs

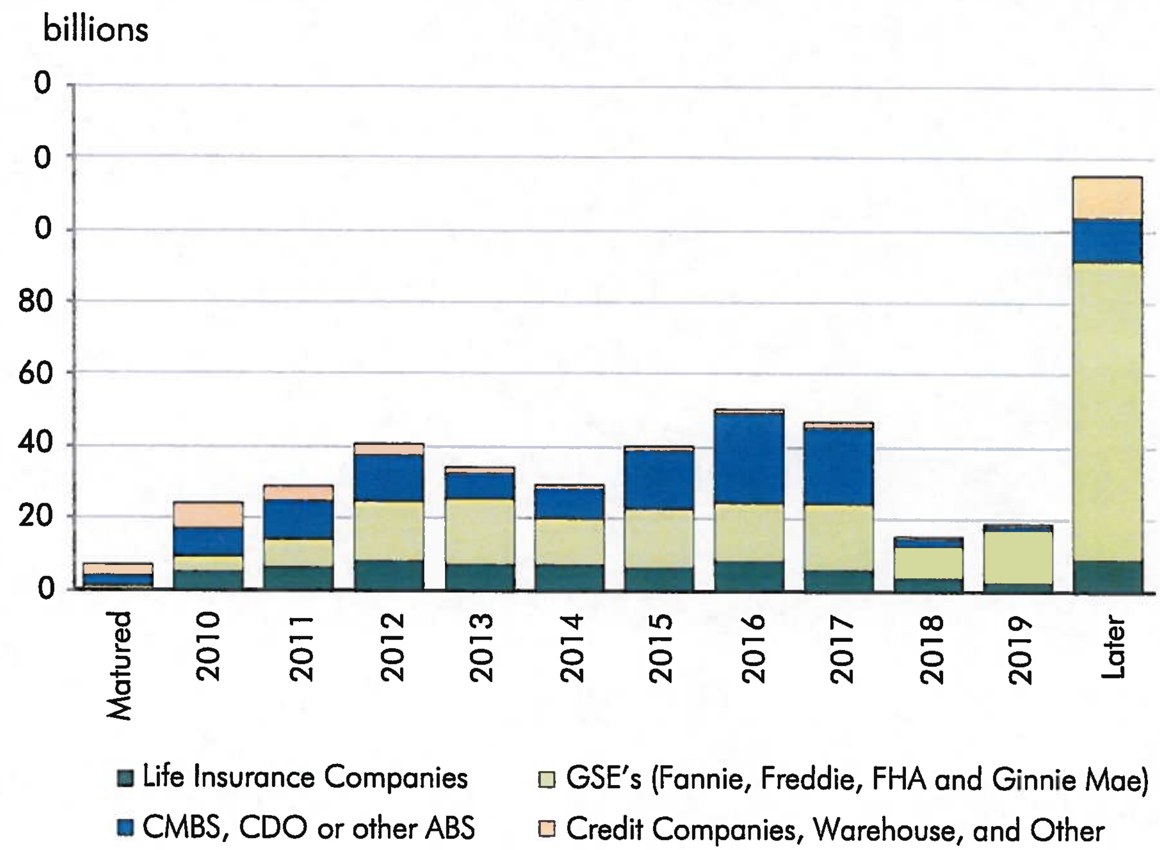
Thursday, March 22nd
9:45-11:00 a.m.

Discussion Leaders:

Howard Garfield, CFO, CAO & Treasurer - Behringer Harvard Multifamily REIT I

Andrew Higdon, VP-SEC Reporting & Accounting Standards - Apartment Investment & Management Company

Non-Bank Multi-Housing Loan Maturities
By Investor Type



Source: Mortgage Bankers Association

US CAPITAL TRENDS APARTMENT

MONTH IN REVIEW

- Sales of significant apartment properties totaled $3.8B in January representing a 53% increase from a year earlier, the strongest start to the year across the property types.
- Sales of mid/high-rise properties surged 87% with over half of the volume occurring in Manhattan. The number of smaller deals outside Manhattan continues to increase resulting in the slight upward movement in the cap rate average.
- Sales of garden communities totaled just $1.8B representing a 26% increase from a year ago. Prices and yields remained relatively unchanged.
- Sales of distressed apartments continue to fall, down 45% in January from a year ago and totaling less than 8% of volume.

Monthly Volume & Pricing Trends

PROPERTY PRACTICE
2012 PROPERTY INSURANCE MARKET UPDATE

January 2012 www.willis.com

OVERVIEW

2011 was a challenging year for the Property Insurance Market:

- RMS 11.0 model was released in February 2011 and caused much consternation
- Reinsurance costs continued to rise
- Global Property losses totaled $108 billion (Swiss Re, Dec. 2011- per Insurance Insider, December 15, 2011), which is only second to $123 billion in 2005 as the highest annual total on record.
- The global loss experience will translate into many insurers posting combined loss ratios in excess of 100%

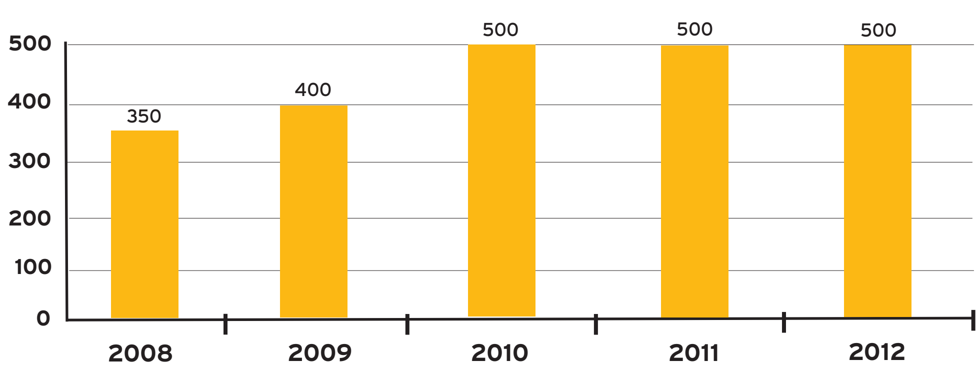
ACE	105%
Chartis/Lexington	115%
FM Global	121%
Munich Re	130%
Travelers	130%
XL	107%
Zurich	112%

(Note: Willis NA benchmarking results for Q4 2011 were mostly in the +5% to +10% for CAT exposed accounts, but we did notice more examples of increases in the +10% to +15% range as compared to Q3 2011).

As a result of all of these factors, we are forecasting the following for Q1 2012:

TYPE OF ACCOUNT	RATE		
	Q3 2011	Q4 2011	Q1 2012
Non-CAT	-5% to -10%	-5% to Flat	**-5% to Flat**
CAT	Flat to +10%	+5% to +10%	**+7.5% to +12.5%**

"CAT" PROPERTY CAPACITY ($Millions) ON LARGE "CAT" ACCOUNTS



2011 LOSS EXPERIENCE

Simply put, if it could happen, **then in 2011 it did!** For example:

- March 11 – As if a 9.0 magnitude earthquake in Japan in is not bad enough, let's add a tsunami that devastates the Fukushima and Miyagi prefectures of Japan. We're not done yet because you also need to add the dangerous complication of the damage to the Fukushima nuclear power plant and its threat to the surrounding area. The industry has never seen the complexity of this type of loss before – and we hope we never will again.

- April (Tuscaloosa, AL) and May (Joplin, MO) saw two F5 tornadoes (usually rare) that caused massive damage and were a large part of the spring tornado season, which caused total insured losses of $21.3 billion.

- August 23 – Maybe not a massive loss, but definitely an abnormal one: the Central Virginia Earthquake (5.8 magnitude) reminded us to be prepared for the unexpected. The tremors were felt in New York City, Canada and as far south as Savannah, GA.

- August-November – An unusually high level of rainfall from the monsoon season causes epic flooding in Thailand, affecting many manufacturing plants/assembly locations for the auto and computer industries. Imagine dirty flood water in buildings for 30 to 60 days. Initial insured losses estimated at $10 billion are expected to increase to $20 billion.

- Ongoing 2010-2011 – The original earthquake that hit Christchurch, New Zealand occurred in 2010, but that earthquake was followed by a 6.3 magnitude on February 22, 2011. Since then, numerous aftershocks continue to rock this region; insured losses are estimated between $13 billion to $15 billion.

Munich Re just released a report of the 2011 underwriting year. It is easy to see how losses can add up to $108 billion when you take a look at the top five losses.

DATE	REGION	EVENT	FATALITIES	OVERALL LOSSES U.S.$ M	INSURED LOSSES U.S.$ M
March 11, 2011	Japan	Earthquake, tsunami	15,840	210,000	35,000-40,000
February 22, 2011	New Zealand	Earthquake	181	16,000	13,000
August 1 to November 15, 2011	Thailand	Floods, landslides	813	40,000	10,000
April 22 to April 28, 2011	U.S.	Severe storms/ tornadoes	350	15,000	7,300
August 22 to September 2, 2011	U.S. Caribbean	Hurricane Irene	55	15,000	7,000

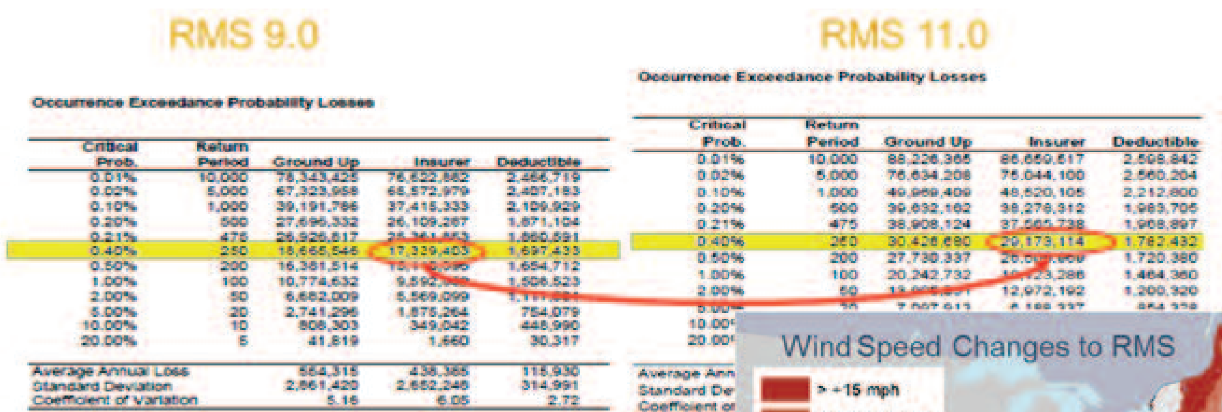
Source: Munich Re NatCat Service, Dec. 2011

RMS 11.0

The new model was released in February. Most of the property insurers began implementing it by the start of the third quarter. The new loss projections for windstorm and storm surge increased by 40% to 60% (and sometimes even higher) for exposure in many coastal areas, from New Jersey to Texas. As a result, underwriters were forced to either increase the price for their windstorm capacity or reduce the amount of capacity they were providing.

Renewals during the first half of 2012 will feel the effects of the model, since most of these accounts missed it in 2011.

We saw increased modeled results for the accounts we place, as evidenced in the following exhibits:



RMS 9.0

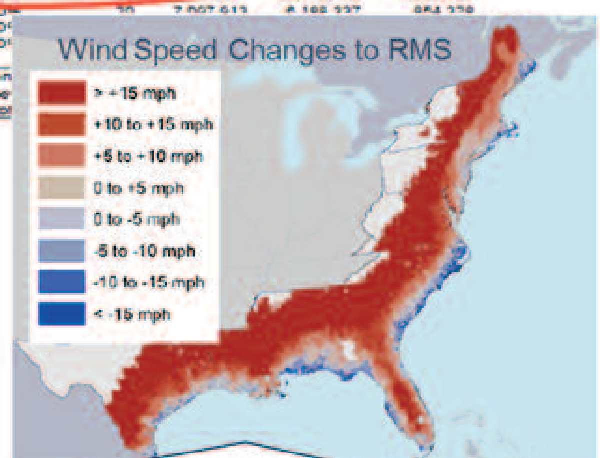
Occurrence Exceedance Probability Losses

Critical Prob.	Return Period	Ground Up	Insurer	Deductible
0.01%	10,000	78,343,425	76,622,662	2,466,719
0.02%	5,000	67,323,958	65,572,979	2,407,183
0.10%	1,000	39,191,786	37,415,333	2,109,929
0.20%	500	27,696,332	26,109,287	1,871,104
0.21%	475	26,926,817	[illegible]	1,860,591
0.40%	250	18,665,546	17,329,403	1,697,433
0.50%	200	16,381,514	[illegible]	1,654,712
1.00%	100	10,774,632	[illegible]	1,606,523
2.00%	50	6,682,009	5,569,099	[illegible]
5.00%	20	2,741,296	1,875,264	754,079
10.00%	10	808,303	349,042	448,990
20.00%	5	41,819	1,660	30,317
Average Annual Loss		554,315	438,365	115,930
Standard Deviation		2,861,420	2,652,246	314,991
Coefficient of Variation		5.16	6.05	2.72

RMS 11.0

Occurrence Exceedance Probability Losses

Critical Prob.	Return Period	Ground Up	Insurer	Deductible
0.01%	10,000	88,226,365	86,659,517	2,598,842
0.02%	5,000	76,634,208	75,044,100	2,560,204
0.10%	1,000	49,989,409	48,520,105	2,212,800
0.20%	500	39,632,162	38,278,312	1,983,705
0.21%	475	38,908,124	37,565,738	1,968,897
0.40%	250	30,426,680	29,173,114	1,782,432
0.50%	200	27,739,337	[illegible]	1,720,380
1.00%	100	20,242,732	[illegible]	1,464,360
2.00%	50	[illegible]	12,972,192	1,200,320
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
10.00%	[illegible]	[illegible]	[illegible]	[illegible]
20.00%	[illegible]	[illegible]	[illegible]	[illegible]
Average Ann[illegible]		[illegible]	[illegible]	[illegible]
Standard De[illegible]		[illegible]	[illegible]	[illegible]
Coefficient o[illegible]		[illegible]	[illegible]	[illegible]



- The drastic increases in predicted Average Annual Loss and Probable Maximum loss can be contributed to new data available to catastrophe modeling software.
- Contributing Factors include both observational data showing that hurricanes weaken less rapidly over land than previously thought, and updates to historical database which affect hurricane land fall frequency in concentrated areas.

RMS 9.0 VS RMS 11.0
ACTUAL RESULTS (% CHANGE - SAME DATA POINTS)

CLIENT	MODEL VERSION	100 YEAR WIND PML	% CHANGE	250 YEAR WIND PML	% CHANGE	500 YEAR WIND PML	% CHANGE
State	RMS 9.0 RMS 11.0	$77,842,969 $256,021,944	228%	$146,672,639 $499,981,762	327%	$210,780,730 $780,030,063	270%
Real Estate Management	RMS 9.0 RMS 11.0	$11,153,505 $23,363,687	109%	$21,308,356 $44,331,966	108%	$30,899,628 $64,910,657	110%
Academic Institute	RMS 9.0 RMS 11.0	$227,780,274 $485,651,081	113%	$390,468,355 $835,285,185	114%	$555,861,620 $1,160,294,560	109%
Hotel Gaming and Casino	RMS 9.0 RMS 11.0	$33,995,256 $45,177,317	32%	$62,605,792 $104,228,478	66%	$90,670,458 $159,337,139	76%

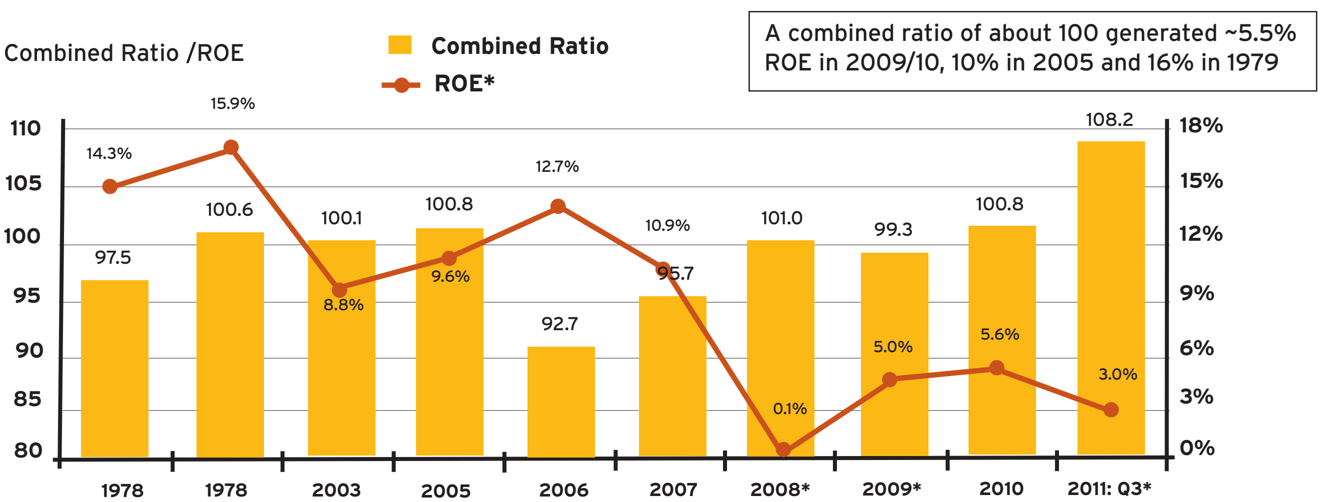
FINANCIAL RESULTS

If it were not for the abundant capacity in the property insurance market and the continuing weak economy, many believe property rates for CAT capacity would be firming even more.

Low interest rates limit insurers' ability to generate investment income and force insurers to make a profit on their pure underwriting results – **most of the property insurers failed to do so in 2011**. The broader Property/Casualty market was following the trend of the Property market through Q3 2011 with a 108% combined ratio. Net income was $7.9 billion for Q3 2011, compared to $34.6 billion Q3 2010. The estimated results for Q4 2011 are not expected to improve the picture because the Thailand Flood loss will be recorded in Q4 2011.

*(see financial exhibits provided by Insurance Information Institute (**www.iii.org**)*

A 100 COMBINED RATIO ISN'T WHAT IT ONCE WAS:
INVESTMENT IMPACT ON ROEs

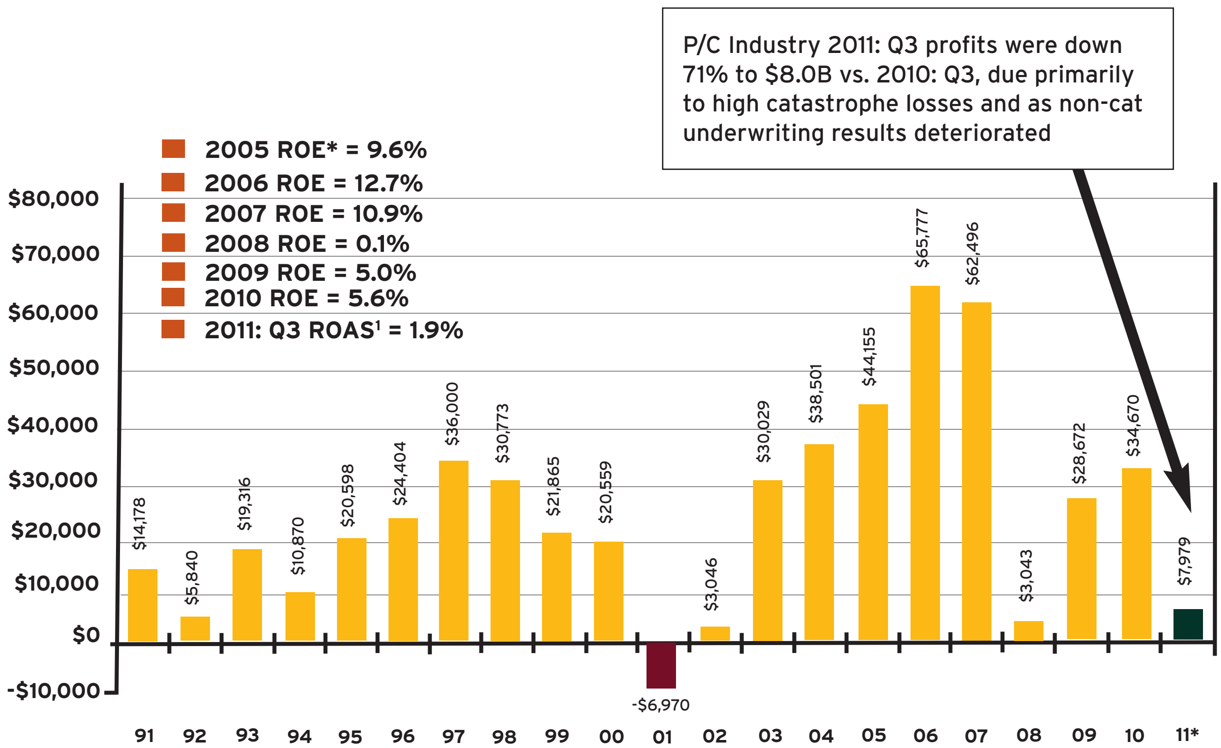


Combined Ratios Must Be Lower In Today's Depressed Investment Environment to Generate Risk Appropriate ROEs

*2011 figure is return on average statutory suplus. 2008-2011 figures exclude mortgage and financial guaranty insurers. 2011: Q3 combined ratio including M&FG insurers is 109.9, ROAS=1.9%

Source: Insurance Information Institute from A.M. Best and ISO data.

P/C NET INCOME AFTER TAXES
1991 – 2011: Q3 ($ Millions)



*ROE figures are GAAP; Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 3.0% ROAS for 2011: Q3, 7.5% for 2010 and 7.4% for 2009.

Source: A.M. Best, ISO, Insurance Information Institute

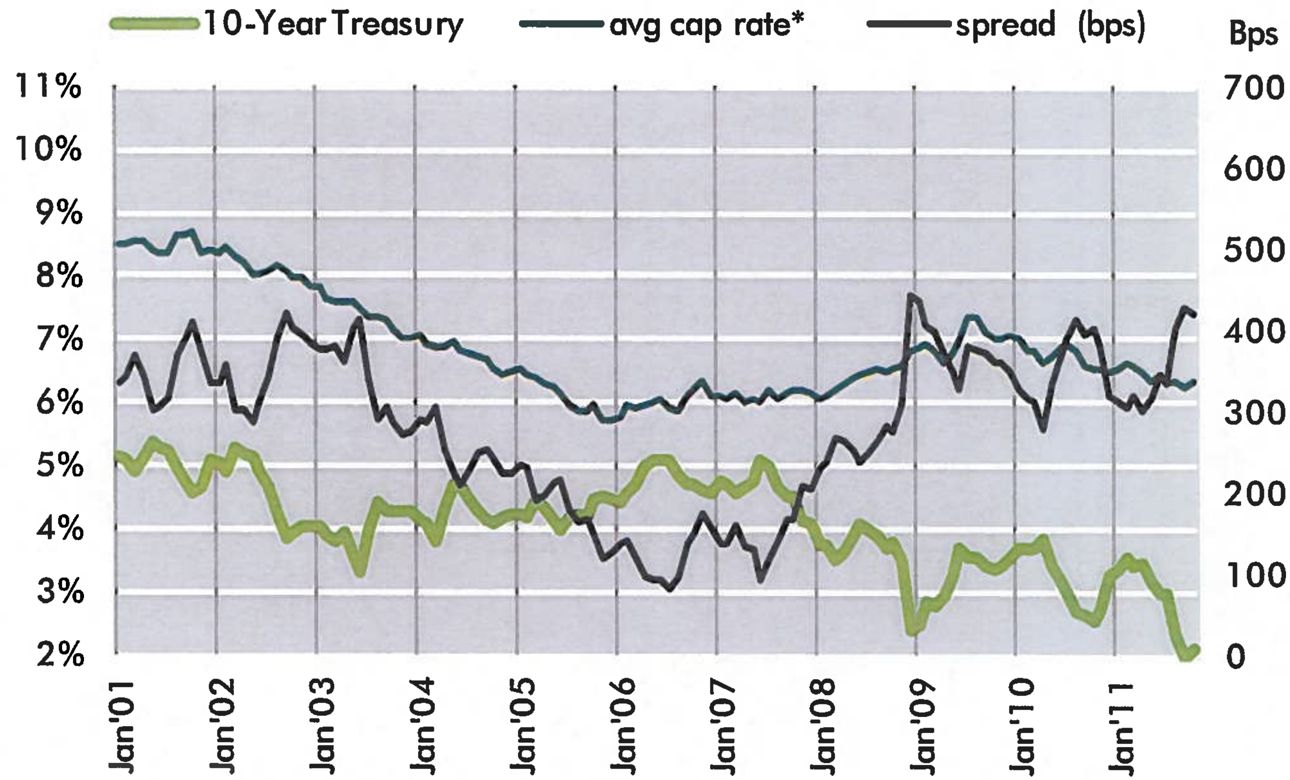
CONCLUSION

We will continue to monitor these factors affecting the market as we move into 2012. Hopefully, 2012 will be a much quieter year on the loss side and, if so, we can see the insurers return an underwriting profit on the property side. That would help put a halt to the continuing rise in rates.

CONTACT

Dave Finnis
National Property Practice Leader
+1 404 302 3848
david.finnis@willis.com

Cap Rates and Spreads



*3-month rolling average

Sources: Real Capital Analytics, Federal Reserve

Retail REITs

Friday, March 23rd
11:00-12:15 p.m.

Discussion Leaders:

Steven Adler, Director-Taxation - Acadia Realty Trust
Lisa Indest, SVP-Finance & Accounting - Glimcher Realty Trust

RBC Capital Markets, LLC.

Rich Moore, CFA (Analyst)
(440) 715-2646
rich.moore@rbccm.com

Wes Golladay, CFA (Associate)
(440) 715-2650
wes.golladay@rbccm.com

March 6, 2012

This report is priced as of market close March 2, 2012 EST.

All values in U.S. dollars unless otherwise noted.

For Required Conflicts Disclosures, please see page 19.

Retail REITS: 4Q11 Key Metrics Review

This Quarter Was Characterized By Broad Strength

If the metrics of the regional mall, shopping center, and triple net lease sectors are any indication, the U.S. economy is back on firm footing. During 4Q11, the retail REITs saw continued strength in operations, a steady improvement in acquisition volume, continued emphasis on non-core dispositions, and plenty of debt and equity availability. As such, the REITs in this sector are rapidly positioning themselves as a group for the next leg of cash flow growth from additional occupancy and rent growth as well as from acquisitions and redevelopments. Even on the development front, we have seen encouraging signs that select developments are moving from the drawing board to construction. Overall, it appears that the retail REITs will continue to drive the quality theme in their portfolios and to push leverage lower. The 4Q11 earnings results suggest that most of the retail REITs look good on these two fronts suggesting that the next major move will come from external growth. As such, those companies with the best growth platforms are the ones we find most intriguing. This report summarizes in 33 exhibits the key operating, balance sheet and valuation metrics of the 10 community center REITs, five regional mall REITs and three triple net REITs in our coverage list. Our general takeaways from the quarter include the following:

- **Operating metrics are getting better each quarter.** Occupancy in the quarter generally trended higher while same store NOI growth rates held steady along with average leasing spreads for most of the companies. Importantly, NOI yield on gross book value, or our measure of ROIC, trended higher for most of the companies in our coverage.

- **Balance sheet conversations are almost passé.** Debt availability appears to no longer be an issue. Traditional mortgage debt, unsecured term loans, lines of credit, and unsecured notes are all available at historically low all-in rates. LIBOR floors have disappeared and covenant terms have returned to traditional norms. Preferred equity is also making a comeback, and many more REITs are accessing the common equity markets through new offerings and ATMs.

- **Acquisitions are likely to accelerate.** With $60 billion of CMBS debt coming due this year and the CMBS market still looking for traction, more assets are likely to come to market. REIT management teams have indicated a pickup in the number of assets under review for acquisition. Cap rates across the quality spectrum are compressing driving retail REITs to accelerate the sale of weaker assets in their own portfolios.

Operating Metrics Were Strong In 4Q11

- Same store NOI grew for most companies vs. the year ago period (Ex 1-2).
- YOY occupancy rose for virtually every company (Ex 3-5).
- Leasing spreads were generally in line with 3Q11 results (Ex 6-7).
- Average base rent continued to increase reflective of an improved economy (Ex 8-9).
- Operating margins hit post recession highs in many cases… (Ex 10-12).
- …As did NOI yields – or our estimate of ROIC (Ex 13-15).
- Retailer sales at the malls show little sign of slowing (Ex 16).

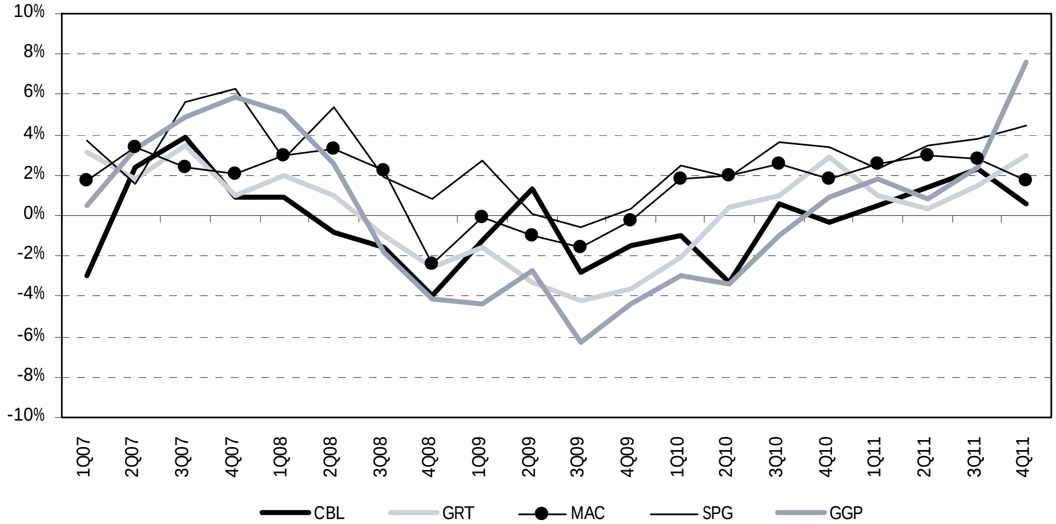
Balance Sheets Are No Longer An Issue In General

- Fixed charges coverage rose from 3Q11 for all but three companies (Ex 17-19).
- Debt/market caps fell for all but one company (Ex 20-22).
- Debt/NOI is too high (above 8x) for only two companies (Ex 23-25).

Valuation Metrics Are Increasingly Compelling

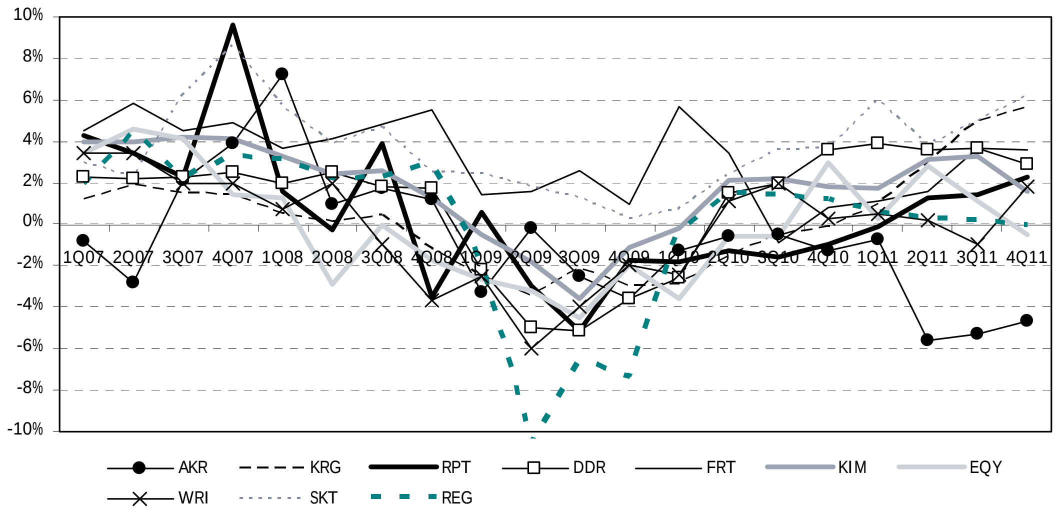
- Cash flow valuation metrics are once again pressing higher (Ex 26-30).
- While cap rates are compressing (Ex 31-33).

Exhibit 1: Same Store NOI Growth Was Mixed For Regional Malls In The Quarter



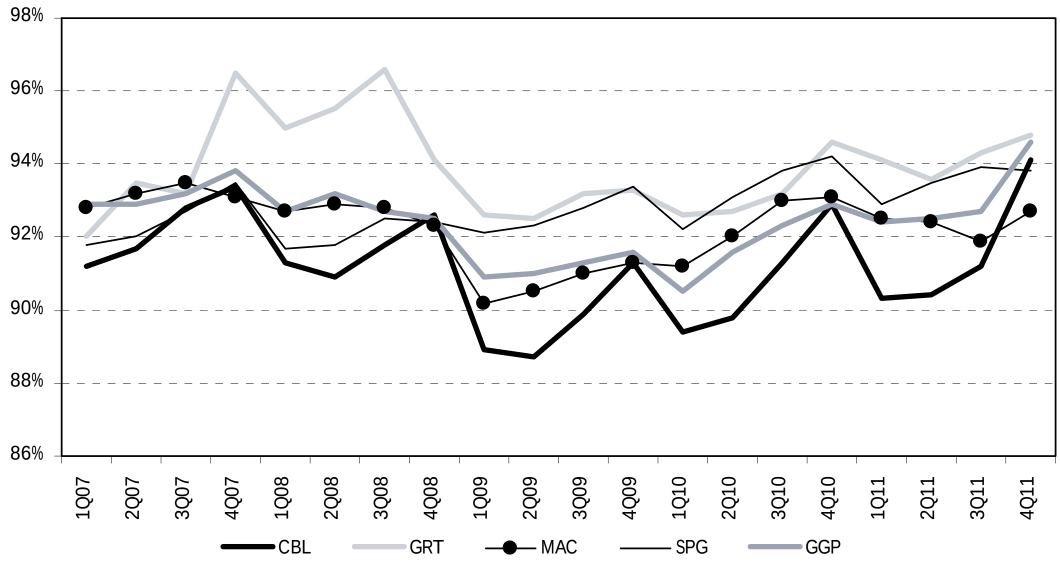
Source: SNL Financial, Company Documents and RBC Capital Markets

Exhibit 2: Same Store NOI Growth Accelerated For Many Community Center REITs



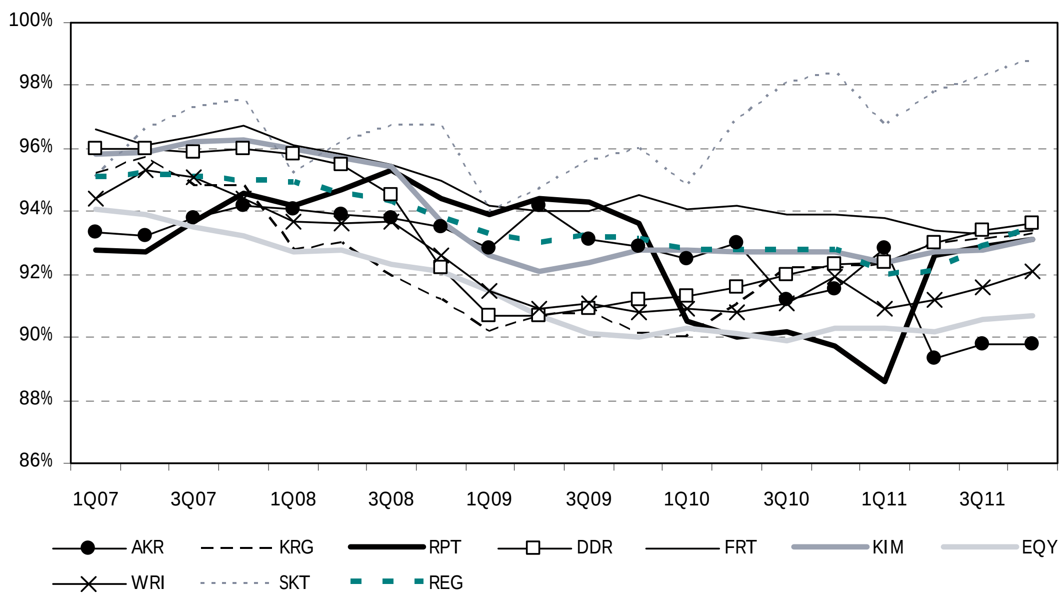
Source: SNL Financial, Company Documents and RBC Capital Markets

Exhibit 3: Regional Mall Occupancy Was Up Across The Board



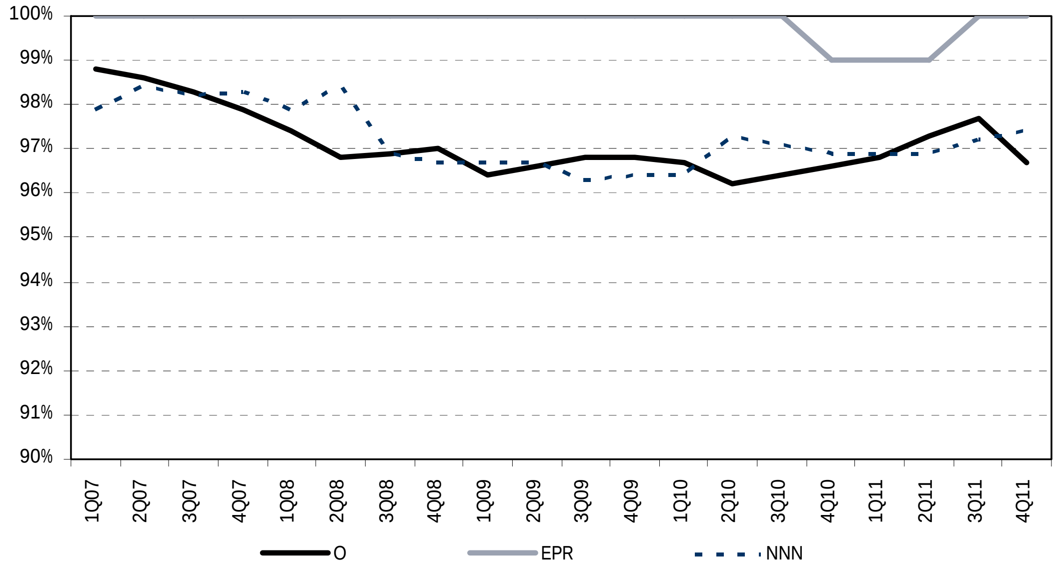
Source: SNL Financial, Company Documents and RBC Capital Markets

Exhibit 4: Community Center Occupancy Growth Was Likewise Strong



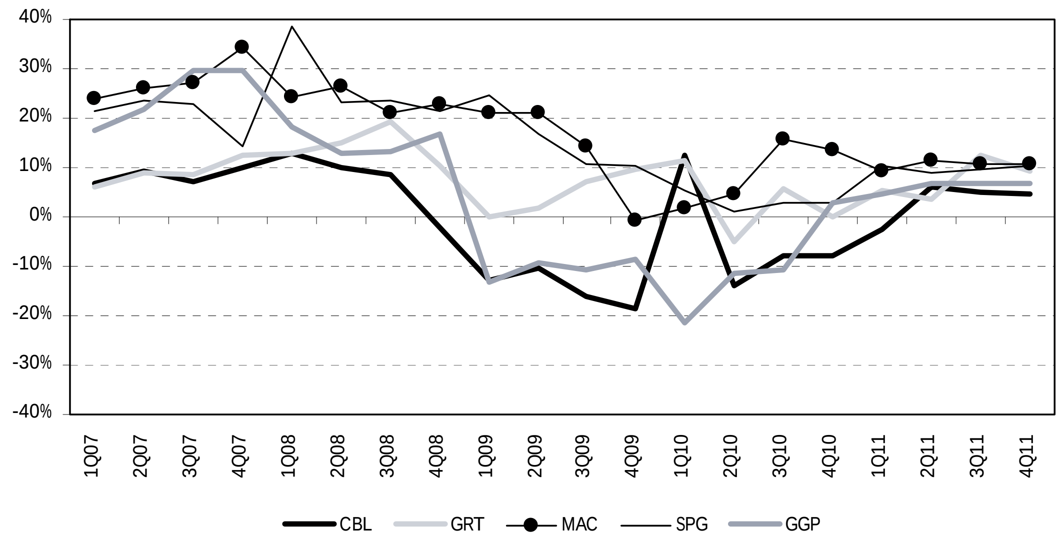
Source: SNL Financial, Company Documents and RBC Capital Markets

Exhibit 5: Triple Net Was Higher Except For Realty Income



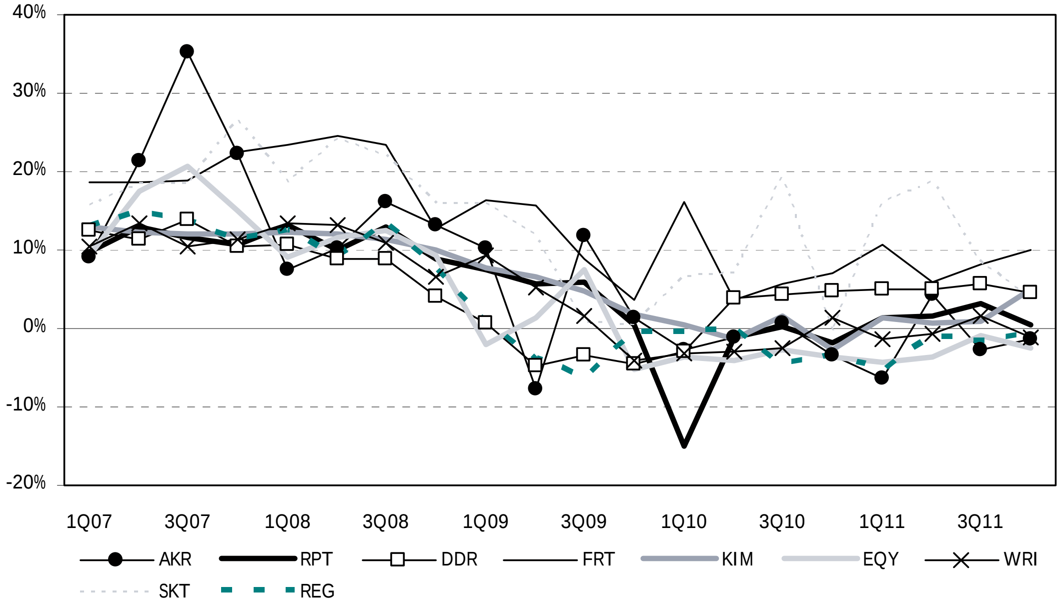
Source: SNL Financial, Company Documents and RBC Capital Markets

Exhibit 6: Regional Mall Leasing Spreads Have Remained Steady For A Number Of Quarters



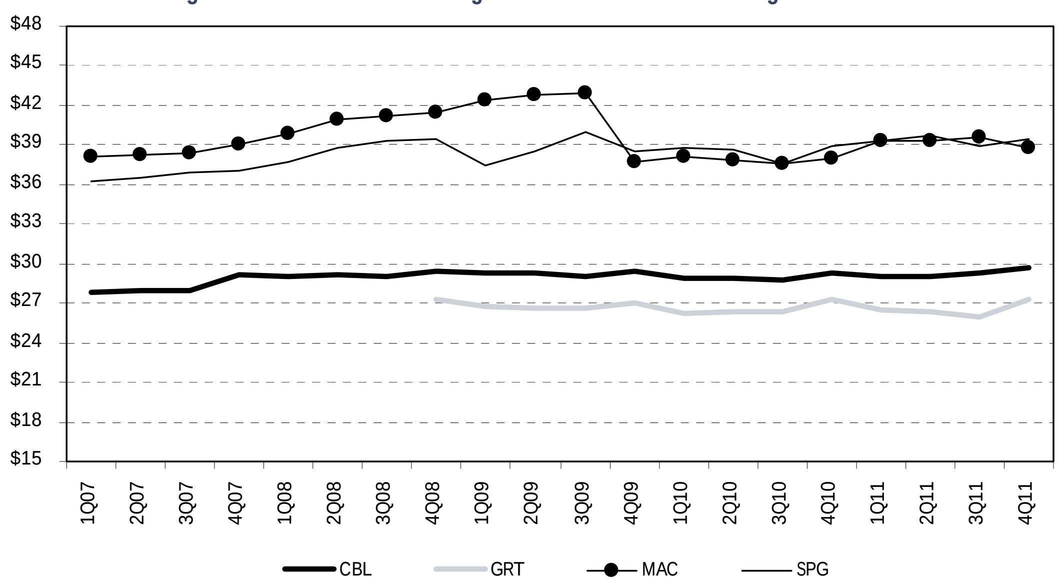
Source: SNL Financial, Company Documents and RBC Capital Markets

Exhibit 7: Community Center Leasing Spreads Strengthened In The Quarter



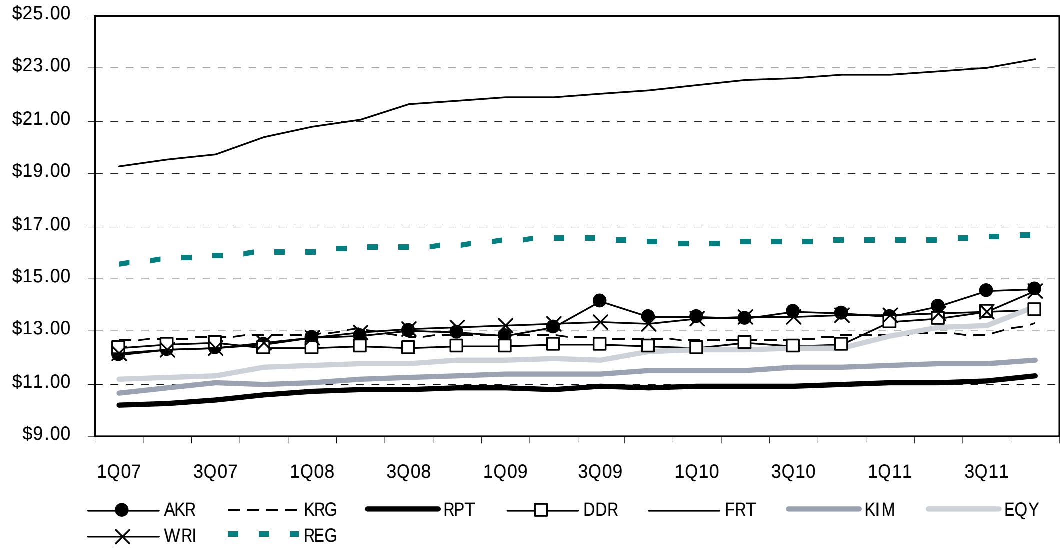
Source: SNL Financial, Company Documents and RBC Capital Markets

Exhibit 8: Average Base Rents For The Regional Mall REITs Moved Higher



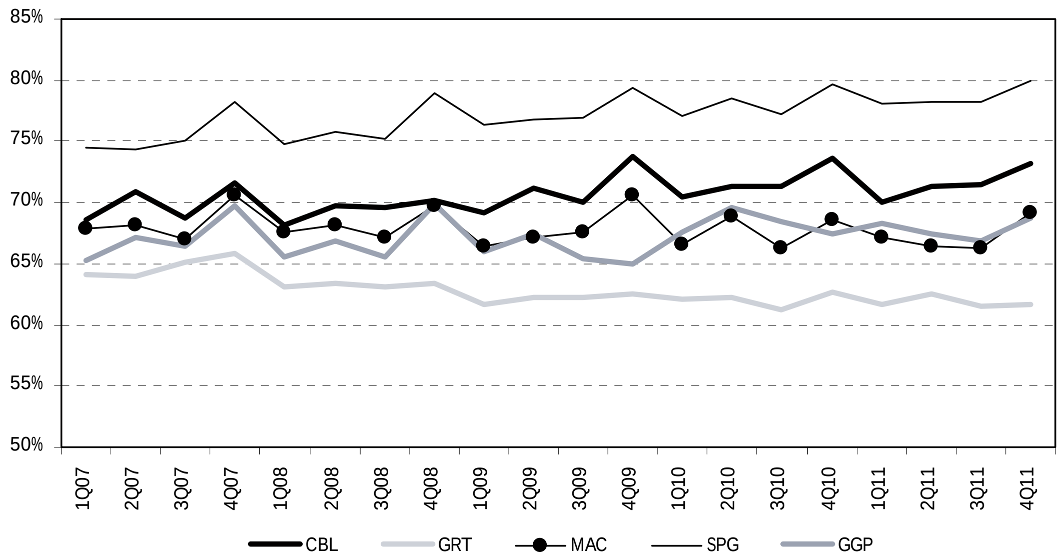
Source: SNL Financial, Company Documents and RBC Capital Markets

Exhibit 9: Average Base Rents For The Community Centers Were Up Across The Board



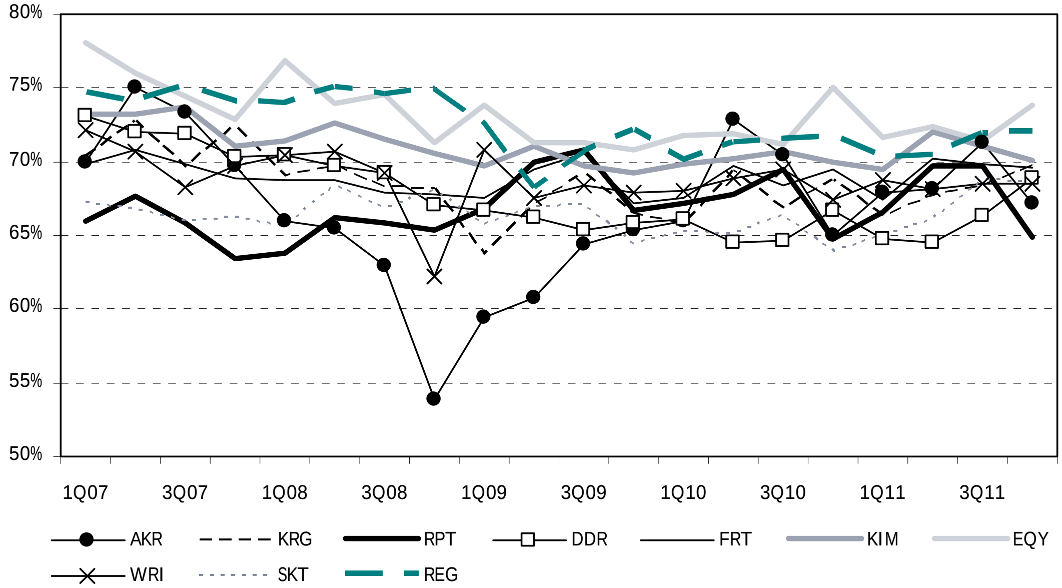
Source: SNL Financial, Company Documents and RBC Capital Markets

Exhibit 10: Mall Operating Margins Were Up Across The Board



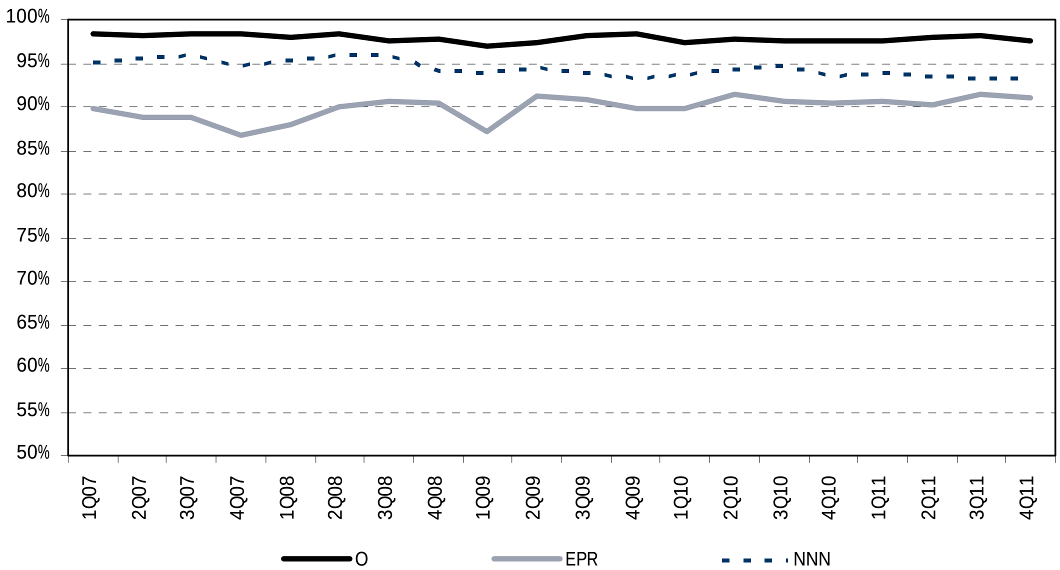
Source: SNL Financial, Company Documents and RBC Capital Markets

Exhibit 11: Community Center Operating Margins Were Mixed



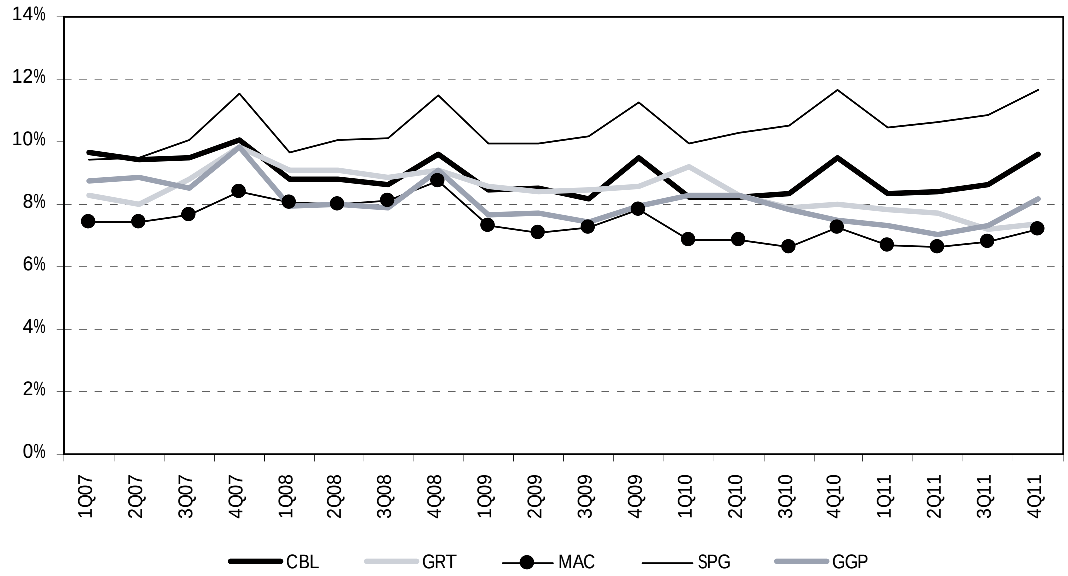
Source: SNL Financial, Company Documents and RBC Capital Markets

Exhibit 12: Triple Net Operating Margins Were Flat And Healthy



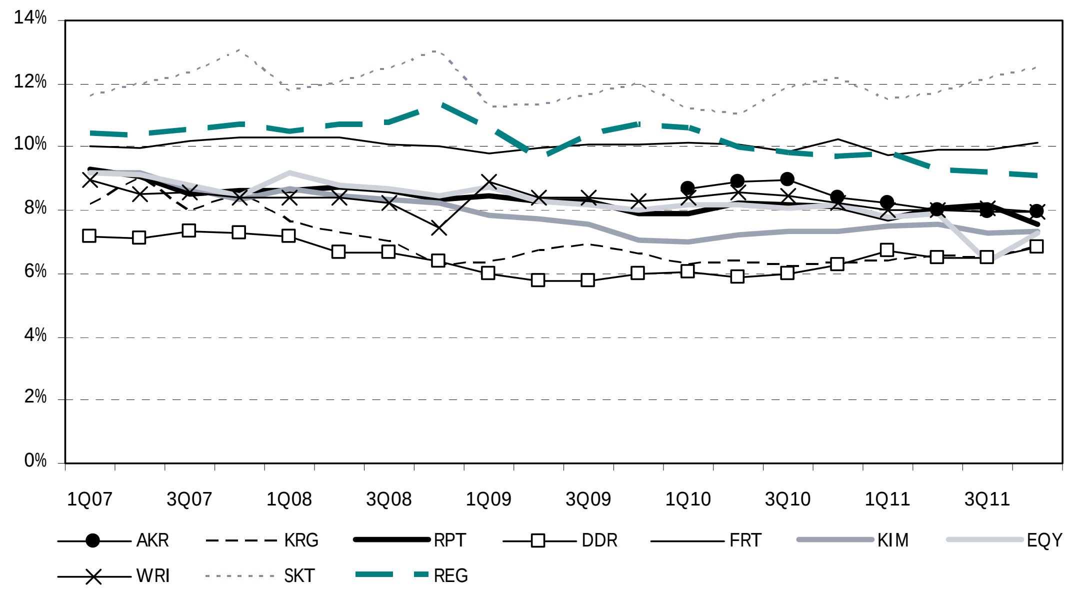
Source: SNL Financial, Company Documents and RBC Capital Markets

Exhibit 13: NOI Yield on Gross Book, or ROIC, Reached A Post Recession High Mall REITs



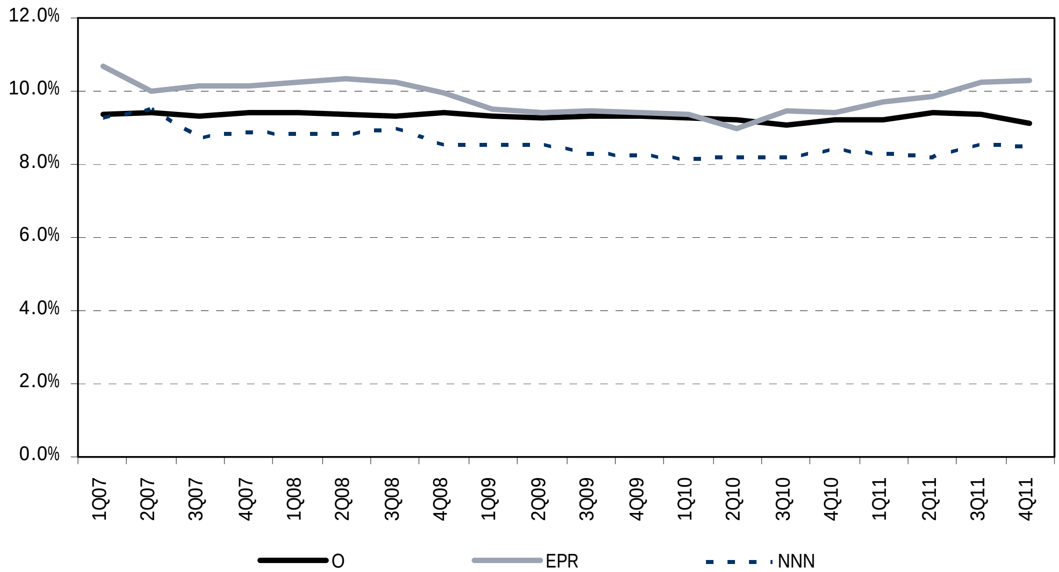
Source: SNL Financial, Company Documents and RBC Capital Markets

Exhibit 14: NOI Yields For Community Centers Were Largely Flat To Higher



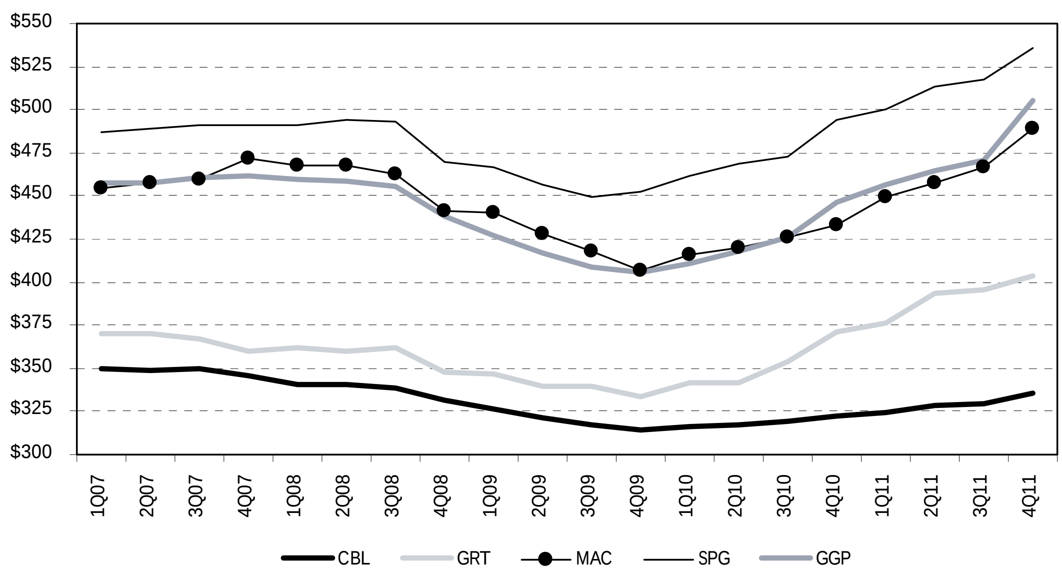
Source: SNL Financial, Company Documents and RBC Capital Markets

Exhibit 15: Triple Net NOI Yields Are All Very Healthy



Source: SNL Financial, Company Documents and RBC Capital Markets

Exhibit 16: Retailer Sales/SF At Regional Malls Are Rising At A Very Rapid Rate



Source: SNL Financial, Company Documents and RBC Capital Markets

Timber REITs

Thursday, March 22nd
9:45-11:00 a.m.

Discussion Leaders:

Thomas Smith, VP & Director-Taxes - Weyerhaeuser
Scott Winer, VP-Taxes - Rayonier Inc.

Long-Term Investment and Tax Policy for Working Forests

A. Background.

The planting, growing and harvesting of timber is a truly unique business. Over ten million private forest owners own approximately 420 million acres of forests, which is about 56% of all forest in the country. Small forest owners, averaging less than 100 acres per owner, own approximately 62% of the private forests in the United States. Large forest owners own about one third of the private forests.

Obviously, a tree does not grow overnight. Forests are managed to produce marketable timber after a period of years that varies depending on where the forest grows in the country, what species of tree grows in the forest, and what market is targeted. These periods range from 20 years in the south to as long as 80 years on the Pacific coast.

Growing timber ties up large amounts of capital in the land. In addition, substantial costs are incurred for replanting the trees, forest management (including fire prevention, road maintenance, and pest control), and improving tree growth and productivity. In addition, forest owners invest money in research, environmental protections and set-asides for wetlands, species habitat, and other sensitive areas. These activities provide significant public benefits by consuming carbon dioxide, curtailing erosion, creating wildlife habitat, sourcing drinking water, and maintaining natural open space for human recreation.

Ultimately, forest products are a significant contributor to the country's economy. The industry supports more than 2.9 million jobs in the United States, with 900,000 jobs in the actual growing and harvest of timberlands. Many of these jobs are in rural communities which depend heavily on the forest products industry for their economic viability.

Congress has recognized the unique nature of forest ownership and management by enacting specific provisions in the Internal Revenue Code (IRC) dealing with the treatment of timber production expenses, as explained in detail below: 194(b) (deduction and amortization of certain reforestation costs), 263 and 263A (deduction of post stand establishment costs), and 631(b) and 1231(b) (treatment of timber revenue as capital gains).

B. Capital Gains

For more than six decades, US tax policy has treated income from timber operations as capital gains. IRC sections 631(b) and 1231(b). A primary policy justification for the lower tax rate on capital assets is to mitigate the effects of inflation in the value of assets held for the long term. The seller of a long-term asset has not realized true economic income to the extent that gain is from inflation. This rationale applies to timber because a significant portion of the gain when timber is harvested is simply a return of the original investment using inflated dollars. Very few investments *require* the owner to expose an investment to 20 years or more of continuous inflation.

Policy. The same policy concerns for timber to be afforded capital gain treatment as set out by Congress in 1943 still exist today:

- Large upfront capital investments with extraordinarily long holding periods.
- High risk of loss due to natural disasters.
- Encouraging conservation and reproduction of timber as a critical natural resource in the United States.
- Incenting forest owners to keep lands in forestry.
- Incenting forest owners to invest in reforestation and intensive management of the timberland throughout the growing cycle.
- Providing the same capital gain treatment to those who harvest and replant as extended to those who sell land with mature timber on it.
- Supporting rural jobs in forest management and helping to ensure a cost-competitive supply of raw material for lumber and paper manufacturing in the U.S.
- Removing timber from capital gain treatment that has been in effect for the past 67 years would be bad tax policy after taxpayers have invested huge sums of money in reliance on receiving capital gain treatment.
- Taxing timber at ordinary rates in the year the asset is liquidated after a growing period of 20 to 80 years would be unfair if other long-term investments are taxed at capital gains rates.

Eliminating capital gain treatment for timber would significantly increase the cost of growing and harvesting timber which will, in turn reduce the competitiveness of U.S. manufacturers of wood and paper products at a time of historic market downturns and unprecedented international competition. This would, in turn, jeopardize U.S. jobs in rural communities throughout the supply chain.

Increased costs would also force forest owners to reduce investments in the land, resulting in less replanting, less management to improve forest productivity and produce multiple public benefits, and less research. It would also devalue forest lands as an asset and force the conversion of private forests to other more economically competitive land uses with potentially harmful environmental impacts.

C. Timber Production Expenditures

Timber production expenditures fall into the following general categories:

i. Stand establishment, or "reforestation," costs generally consist of site preparation, site regeneration, initial chemical application to reduce vegetation, nursery operating costs, seedlings and planting, and initial stand fertilization. These costs are also sometimes referred to as "reforestation" or "preparatory" costs. These costs must be capitalized and recovered through depletion allowances. IRC section 263.

ii. Post stand establishment, or "forest management," costs generally consist of pre-commercial thinning, chemical application to reduce competing vegetation, fertilization to promote growth rates of timber, pruning, fire and wildlife control. These costs are also sometimes referred to as "developmental" costs and are incurred for the management, maintenance, and protection of the timber stand value. These costs are considered ordinary and necessary business expenses and are deductible under IRC section 162. (In Rev. Rul. 2004-62, 2004-25 IRB 1072 (2004), the IRS concluded that the costs incurred for fertilization of an established timber stand are also ordinary and necessary business expenses deductible under § 162.) IRC section 263A(c)(5) provides that the uniform capitalization rules do not apply to the costs of growing timber.

iii. Carrying costs generally consist of interest, insurance, property taxes, together with salaries and other administrative overhead. These costs are considered ordinary and necessary business expenses and are deductible under IRC section 162.

Policy on Reforestation Costs. Congress adjusted the IRC section 263 capitalization requirement for stand establishment costs most recently in the American Jobs Creation Act of 2004. Reforestation is one of the largest expenditures incurred by the forest industry other than land acquisition itself. This amendment made two major changes to the statute. First, it removed the $10,000 annual limitation on reforestation expenditures that may be amortized over 84 months. Second, it allowed taxpayers to deduct immediately rather than amortize the first $10,000 of reforestation expenditures incurred during the taxable year with respect to each qualified timber property.

The American Jobs Creation Act of 2004 also repealed the reforestation credit allowed under IRC section 48. The reforestation credit was a credit allowed equal to 10% of the basis of qualified timber property amortizable under section 194. Congress identified the overlap of amortization of reforestation expenses and the credit for reforestation expenses as an area of complexity and determined that the overlapping provisions should be replaced with expensing of qualifying expenses.

The capitalization requirement of section 263 would tie up investment capital for many years and was thought to deter tree planting. As noted above, the forest growth period varies by region, species, and target market, but is rarely less than 20 years and can be as long as 80. When eliminating the cap on amortizable reforestation expenditures in 2004, the Senate Finance Committee report explained: "The Committee believes it is important to encourage taxpayers to make investments in reforestation. The Committee believes that by shortening the recovery period of such outlays taxpayers will find a greater investment return to investments in reforestation."[1] Allowing taxpayers to recover the costs of reforestation more quickly allows them to replenish forests more quickly preserving forest management jobs and other public benefits, such as removing greenhouse gasses from the atmosphere and providing species habitat.

Policy on Post Stand Establishment Costs. Congress has previously reviewed the treatment of post stand establishment costs. In the Tax Reform Act of 1986, Congress changed the capitalization process for expenses related to property, but explicitly left post stand establishment expenses under the ordinary and necessary business expense deduction provisions of section 162. Congress specifically rejected Treasury's proposal to subject timber production costs to the uniform capitalization rules by providing an exception for timber and timberlands in IRC Section 263A(c)(5). The conference report explaining the Act states that "the conferees intend that present law be retained with regard to which costs of growing timber are deductible in the year incurred and which costs must be capitalized."[2]

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[1] S. Rept. No. 192, 108th Cong., 2nd Sess. (2004)(accompanying S. 1637, Jumpstart Our Business Strength (JOBS) Act).
[2] H.R. Rep. No. 841, 99th Cong., 2nd Sess. (1986).

The impact of these expenditures is relatively short-lived, helping the forest to overcome the shock to the remaining timber stock caused by thinning of overly dense timber stands and eliminating competing vegetation to ensure robust re-growth. Requiring capitalization of such costs into the basis of the timber stand, to be recaptured only upon harvest, would discourage such management practices. Forest owners would likely reevaluate the economics of applying fertilizer at these stages in the growth cycle resulting in a reduction in the rate of growth and a corresponding reduction in stand productivity and timber quality. Each of these would significantly reduce the economic benefits of forest management and result in a corresponding reduction in forest management jobs and other public benefits, including removal of atmospheric greenhouse gases, recreation opportunities associated with well-managed stands and overall forest health. It would also ultimately lead to the conversion of forest lands to other more economically competitive land uses with potentially harmful environmental impacts.

D. Importance to Industry

As commentators have noted, "Investments in private forests are inherently long term, whereas costs are annual; liquidity is low; and risks from wildfire, insects, and disease can be high. Under such circumstances, a poor tax policy can discourage forest investments."[3] A study conducted in the late 1990's found that timberland investment returns, as measured by land expectation value, could be reduced significantly in the absence of favorable provisions in the tax code.[4] By reducing returns on growing timber, federal and related state income taxes affect the international competitiveness of U.S. timber growers. A slowing of the returns would also have an adverse impact on the communities which depend on the many primary and secondary jobs created by harvesting and processing these logs for their economic viability. At a time when foresters are seeing decreased demand for timber due to the housing market collapse and intense international competition with American pulp and paper manufacturing, American foresters cannot afford to have their capital tied up for so long a period without offsetting tax relief in the form of expensing of reforestation expenses.

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[3] Abigail R. Kimbell, Cliff Hickman, and Hutch Brown, "How Do Taxes Affect America's Private Forest Owners," JOURNAL OF FORESTRY (March 2010).

[4] P.D. Bailey, H.L. Haney Jr., D.S. Callihan, and J.L. Greene, "Income Tax Considerations for Forest Landowners in the South: A Case Study of Tax Planning," JOURNAL OF FORESTRY (April 1999).