Setting the global standard for investment professionals

March 12, 2012

Ms. Leslie Seidman
Chair
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856

Re: Comment Letter on Investment Property Entities

Dear Ms. Seidman,

CFA Institute,[1] in consultation with its Corporate Disclosure Policy Council ("CDPC"),[2] appreciates the opportunity to comment on the Financial Accounting Standards Board's ("FASB" or "Board") Proposed Accounting Standards Update ("Proposed Update" or "Exposure Draft) *Real Estate – Investment Property Entities (Topic 973)*.

CFA Institute is comprised of more than 100,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality.

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[1] With offices in Charlottesville, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 108,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 139countries, of whom nearly 99,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 135 member societies in 58 countries and territories.

[2] The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

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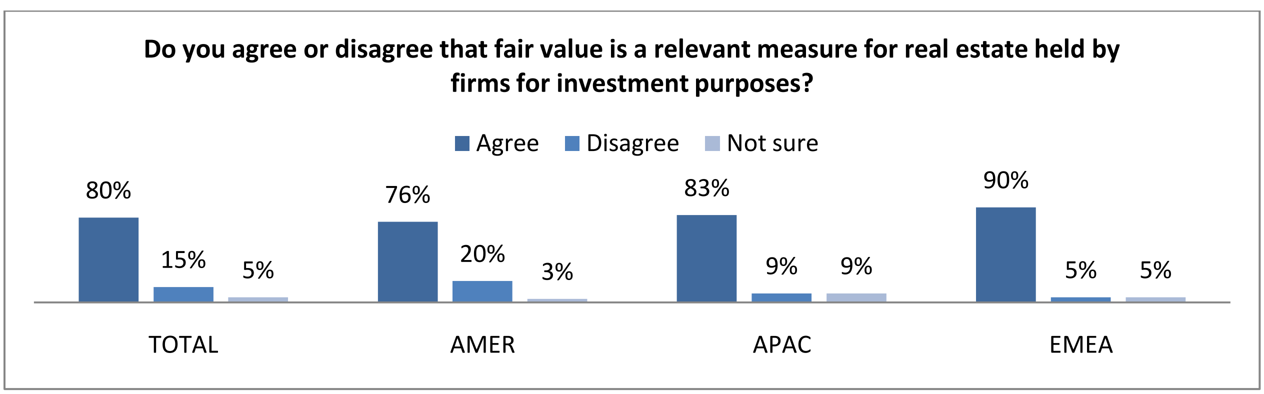
Summary of Our Position

1) We disagree with an entity-based & intent-based approach for measurement of investment properties specifically and real estate more broadly.
2) CFA Institute membership believes fair value is the most relevant measurement basis for investment properties.
3) The Proposed Update distracts stakeholders from the relevance of fair value for real estate across a broad spectrum of enterprises. Fair value is not only relevant for investment properties housed within investment property entities ("IPEs") as defined in the Proposed Update.
4) Recent examples – as analyzed in **Appendix I** – provide empirical evidence regarding the relevance of real estate fair values in the investment decision-making process across a broad spectrum of enterprises. The examples demonstrate that management intent and the nature of the entity owning the real estate do no alter the relevance of fair value information to investors. They also demonstrate that the lack of fair value information disadvantages shareholders.
5) Convergence objective has not been achieved. In fact, the Proposed Update will increase complexity and lack of comparability for investors. A high-quality solution as proposed below should be prioritized over convergence.
6) An asset-based approach focused on fair value measurement for all real estate would provide the most decision-relevant information for investors. A reasonable intermediate step would be to require fair value measurement for investment properties, rather than allow its optional application. Using an asset-based approach, with a broader definition of investment properties (i.e. total return rather than rental income) is more appropriate than the entity-based approach in the Proposed Update. The FASB needs to go further, however, and at a minimum require the parenthetical disclosure on the face of the financial statements of audited fair values of real estate properties. An annual disclosure with interim updates when significant economic events occur would be a major improvement over the current state of reporting and disclosure. We believe that requiring investment properties to be measured at fair value and requiring the disclosure of fair value of other real estate should be addressed simultaneously.
7) Should the FASB continue down the path of an entity-based approach we have provided our views in the **CFA Institute Response to IPE Proposed Update Questions ("Question Response")** posted on our website and summarized below. Broadly speaking, we believe the IPE criteria are subjective accounting rules which do not focus on economic distinctions and which will be subject to interpretive pressures and include implicit optionality. Further, we believe that the measurement basis of all assets and liabilities within an IPE should be fair value, as we believe that such an approach would be most applicable given the importance of the reported net asset value ("NAV"). We also believe there is substantial work required on the presentation and disclosure elements of the Proposed Update.

Disagree With Entity-Based & Intent-Based Approach
Perspectives on Entity-Based Approach – The primary purpose of financial statements is to provide investors with relevant, transparent, comparable, and consistent information in order for them to appropriately value assets and enterprises and make capital allocation decisions within and among entities. The economic value of assets, including investment property assets, does not differ depending upon what enterprise owns them. Accordingly, the notion that investment property should be valued at fair value only if "housed" within an investment property entity is not grounded in economic logic. As such, we fundamentally disagree with the entity-based approach to investment properties taken by the FASB. The general principle of allowing entity-specific guidance is detrimental to investor interests, as it does not allow for comparable financial reporting and economic decision-making across entities.

Perspectives on Intent-Based Approach – Still further, management intent does not alter the value of an asset. An asset's "value" is not different because management expresses an intent to hold the asset or sell the asset. The value of such an asset still increases or decreases in value based upon market conditions – not management's expressed intent. Moreover, intent can change over time or with a change in management and this should not alter the valuation of the asset. The intent-based guidance expressed in this Proposed Update will lead to different entities measuring identical or similar real estate differently, depending upon the reason that management states for holding the real estate, and will cause comparability issues across entities. Investors will not be able to make comparable analyses and investment decisions based upon information on investment properties owned by different entities with different expressed intents.

CFA Institute Member Views on Relevance of Investment Real Estate Fair Values
CFA Institute conducted an abbreviated survey of a portion of its membership which has expressed interest in financial reporting matters. We sent a one question survey to approximately 500 members in the last week of January 2012 asking for their views on whether or not fair value is a relevant measurement basis for real estate held for investment purposes. As illustrated below, 80% of the just over 100 respondents (a response rate of 20%) stated that fair value was indeed relevant. 90% of European respondents – where IAS 40, Investment Property, which allows the optional use of fair value, would be applied under International Financial Reporting Standards ("IFRS") – indicated its relevance.



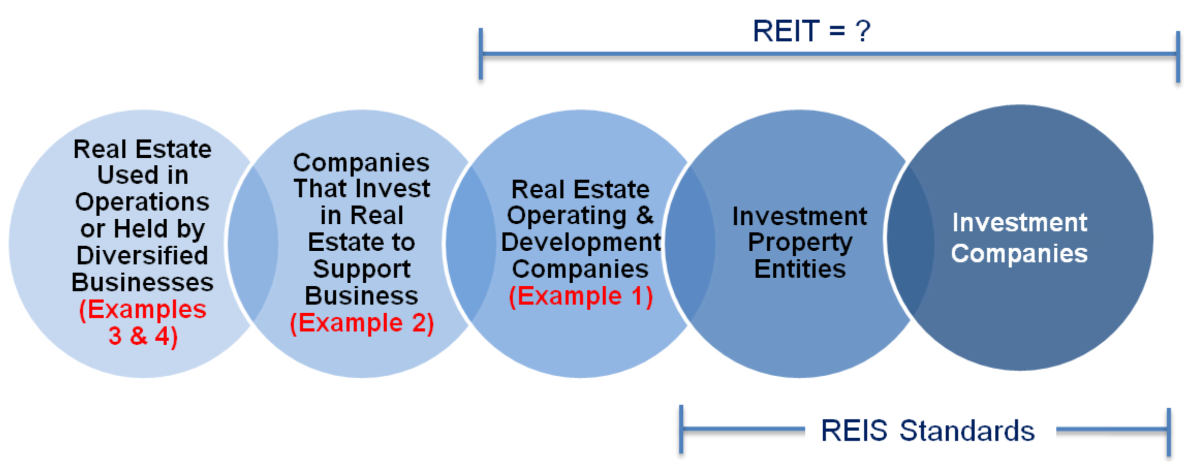
AMER = Americas   APAC = Asia Pacific   EMEA = Europe, Middle East and Africa

The findings of this abbreviated survey are consistent with our prior more comprehensive surveys on the relevance of fair value broadly and with respect to real-estate more specifically.

Proposed Update's Focus on "Investment Property Entities" Distracts Stakeholders from Relevance of Fair Value for Real Estate Across Broad Spectrum of Enterprises

As we considered and developed our views on this Proposed Update, we participated in various discussion groups and task forces. We found that some argue the fair value of real estate is not relevant and/or the cost of arriving at such fair value estimates is cost prohibitive in the context of their relevance. We also observed that the FASB's entity-based approach may improperly focus stakeholders attention on the need to measure investment properties at fair value only for those entities that are akin to investment companies (e.g. those that strike a net asset value). This is evident through certain stakeholder comments that the proposed investment properties guidance should be included within or subsumed into the investment companies guidance. Our view is that, while important to the debate, this thinking misses the broader issue. That issue being: What is the most relevant measurement basis for investment properties specifically, as well as real estate, more broadly – irrespective of the form of entity which owns them?

We would argue that real estate fair values are relevant for a much broader spectrum of entities and not only when such properties are held for investment purposes – as it is difficult to distinguish real estate held for investment purposes. As we note above, we believe the most relevant measurement for real estate is fair value and the form of entity and management intent do not affect the relevance of that valuation. Real estate is deployed in numerous ways across a variety of enterprises as illustrated below:



Much of the debate regarding the appropriate use of fair value to measure real estate has been focused on the right-hand side of the spectrum in the preceding illustration. As outlined in their letter to the FASB, the Real Estate Investment Standards ("REIS") Board expressed their belief that fair value with a high-quality net asset value is an essential objective to improving the standards related to accounting for real estate investment entities. In their comment letter, the

REIS Board outlines the history of developing the REIS standards which are meant to be interpretative guidance to the existing U.S. GAAP standards because U.S. GAAP accounting for investment companies does not address all issues pertinent to their industry. They also highlight that the entity-based IPE standard is not beneficial to clarifying what entities are able to utilize fair value or in ensuring that a high-quality net asset value is derived. We support their view that full fair value is the relevant measure for such entities. The Global Investment Performance Standards ("GIPS") promulgated by CFA Institute, to which they also refer in their letter, utilize fair value and add to their, and our illustration, of the importance of fair value for real estate. While we support their views with respect to fair value for real estate investment entities, we believe the need for measurement of real estate at fair value is broader than that contemplated by the FASB's current Proposed Update.

We also found that real estate investment trusts ("REIT"s) struggle to identify their home in the existing or proposed guidance. Our understanding is that despite believing fair value is the better measurement basis for their real estate assets, REITs have operations which do not constitute those of investment companies or investment property entities and the investment company disclosures are not consistent with what they believe their investors need for investment decision-making. Further, they appear to have similar concerns with the subjectivity and optionality of the definitional criteria. Essentially, the FASB proposal will preclude REITs from applying fair value measurement to their real estate investments as many are not likely to qualify as IPEs. The FASB's proposed Investment Company ("IC") guidance would, however, eliminate the REITs exemption thereby potentially subjecting some to qualify as investment companies. Further, some are concerned that REITs being considered an investment company under U.S. GAAP guidance may subject them to different regulatory requirements in the U.S. We would argue that REITs are simply a vivid illustration of why an entity-based model is not appropriate. REITs have difficulty applying these artificial accounting rules to the underlying economics of their business.

Our view is that there is compelling evidence that real estate fair values are relevant for a variety of investment vehicles which own real estate. However, we also believe that fair value for real estate is relevant in a much broader context. As such, we have undertaken to identify situations where real estate fair value has demonstrated its relevance not only for investment properties but also in the context of other real estate and other enterprises.

Examples Where Relevance of the Fair Value of Real Estate Is Demonstrated Irrespective of Nature of Entity or Management Intent

U.S. GAAP does not currently require the accounting for real estate properties at fair value or even require disclosure of such fair values. **Appendix I** includes four examples, across the spectrum of entities set forth in the illustration above, which we believe demonstrate that fair value information is relevant to investors. We believe the examples also illustrate that the lack of access to such fair value information can disadvantage even the most sophisticated investors.

It is important to remember that these are just a handful of very recent examples of the relevance of real estate fair values reported in the press. Their accessibility demonstrates the prevalence of the information asymmetry. The examples illustrate that value-based investors have tried to use the lack of real estate fair value information and their ability as sophisticated investors to estimate fair values to the disadvantage of smaller or less sophisticated investors. Our view is that this U.S. GAAP "disclosure gap" should be addressed by the Board.

Example 1 (Real Estate Development and/or Operating Companies – The St. Joe Company) – Companies who develop or operate real estate would not, based upon our understanding, be within the scope of the IPE standard. As outlined in more detail in **Appendix I,** a recent (January 27, 2012) Wall Street Journal ("WSJ") article, *St. Joe Pares Back Its Florida Vision,* provides a vivid illustration as to why management intent and legal entity have no bearing on whether real estate fair values are relevant. The St. Joe Company ("St. Joe") also provides a poignant example where the lack of disclosure regarding real-estate fair values resulted in two well-known fund managers (Bruce Berkowitz and David Einhorn) taking opposite views on the company based upon different estimates of fair value.

The WSJ article analyzes the SEC filing in which the company disclosed – in advance of filing their Form 10-K – that the company finally took an impairment charge (expected by some investors) due to the adoption of a "new real estate investment strategy." This new strategy resulted in a write-down of $374.8 million, nearly 80% of the related real estate of $466.2 million to a carrying value of $91.4 million. This write-off represented nearly 40% of the company's total assets and equity prior to the write-off. One has to question whether the 80% write-down was due to a change in strategy or the long-awaited realization that the prior strategy was not viable and that the carrying value of these assets could no longer be justified because it was far below fair value. One also has to question whether this impairment charge should have been taken in an earlier period.

This example illustrates that, while Berkowitz and Einhorn may have very different views regarding the value of the real estate, the fair value of the real-estate is highly relevant to the valuation of real-estate development companies. It does not matter which party was right, what matters is that both parties took very different positions due to the lack of reliable fair value information.

With respect to this Proposed Update, this example demonstrates that the fair value of real estate is relevant for a real estate operating company like St. Joe (i.e. regardless of the nature of the entity) and irrespective of management's stated intent, which changed over time based upon market conditions The original intent to develop became unrealistic and the underlying market conditions which drove the fair value of the property prevailed.

It also demonstrates that while sophisticated shareholders such as Berkowitz and Einhorn, who have the resources to obtain estimated property values from tax records, may have an informational advantage over other shareholders, even they may not be able to make reliable estimates given the lack of sufficient disclosure. Only management had the complete information upon which to obtain and present reliable fair value estimates of the real estate.

We believe this example illustrates why it is important that real estate investment properties be measured at fair value – even in real estate development companies. We also believe real estate fair value should be disclosed for those entities not reflecting real estate at fair value within the financial statements based upon the examples which follow.

Example 2 (Entities Which Invest in Real Estate To Support Operating Activities – MetLife) –
Companies who invest in real estate to support their operations would not, based upon our understanding, be within the scope of the IPE standard. Insurance companies are significant investors in real estate. They make such investments through both entities which would be covered by the IPE Proposed Update and those which they own directly which would not be covered by the Proposed Update. In this example, we demonstrate that real estate fair values are relevant to the analysis and valuation of enterprises outside the scope of the Proposed Update by considering the sale of three iconic New York City properties [MetLife's Home Office at One Madison Avenue, The MetLife (Pan Am) Building at 200 Park Avenue, and Peter Cooper Village/Stuyvesant Town] owned by MetLife Inc. ("MetLife") but sold during 2005 and 2006. What the analysis will show is that there were many years of appreciation which preceded the sale of these properties by MetLife, yet the market, and shareholders, were not able to see the extent of the appreciation because of a lack of disclosure or recognition of the unrealized appreciation under U.S. GAAP.

Appendix I includes a complete analysis of the gains and their impact on retained earnings and market capitalization. Such properties accounted for less than 1% of total assets at December 31, 2004 and 2005 prior to their sale. However, when sold, the gains represented 25.7% of net income in 2005 (sale of One Madison and 200 Park) and 48.7% of net income in 2006 (sale of Peter Cooper Village/Stuyvesant Town). The gains accounted for 28.0% and 52.5% of the change in retained earnings in 2005 and 2006, respectively, and 42.1% of the cumulative change in retained earnings from 2004 through 2006. They represented 25.3% of retained earnings and 12.4% of total equity, respectively, at December 31, 2006. The gains accounted for 16.0% and 41.3% of the change in market capitalization in 2005 and 2006, respectively, and 28.5% of the cumulative change in market capitalization from 2004 through 2006. They represented 9.4% of market capitalization at December 31, 2006. While a small percentage of assets, these gains resulted in significant impact on net income, retained earnings and market capitalization.

From the data and analysis in **Appendix I**, we see that the market appeared to price such information only when it was provided upon the sale or disposal of the real estate investment properties despite the fact that such appreciation occurred prior to the period of disposal. As a result, the appreciation was reported when management made the decision to dispose of the properties. Unfortunately, shareholders prior to disposal date were not apprised of such unrealized appreciation because it was not required to be disclosed or recognized. Failing to recognize this real estate/investment property at fair value allowed these gains to be reflected in the period of management's choosing rather than when the gains occurred, making reported earnings a less representationally faithful measure of the company's performance both during the periods when the appreciation occurred and in the periods the gains were reported.

Overall, we believe the notion that the relevance of fair value information to investors depends upon the nature or characteristics of the entity holding the real estate investment property or management's expressed intent as it relates to the property is disproved by this example. As it relates to the Proposed Update, this example illustrates several key points and results in several conclusions:

1) *Intent-Based Accounting Isn't Useful to Investors* – Management intent does not matter in assessing the relevance of real estate fair values to investors. This example highlights several reasons why:
   a. *Intent Can Change Over Time* – As each of these three sales illustrate, management's intent can, and does, change over time with market conditions.
   b. *Investment Property Can Be Held for Investment Income and Total Return* – Investment property needs to be defined more broadly in the Proposed Update. Peter Cooper/Stuyvesant Town is a perfect example of a property held for investment income for many years and then sold for capital appreciation/total return when market conditions became so lucrative that an investment income strategy was less optimal than a total return strategy. In particular, we believe that the argument that investment properties may be held for rental income only (not total return) lacks any basis in reality.
   c. *Fair Value Is Relevant to Real Estate Used In Operations* – Simply because real estate was used in operations (e.g. One Madison and 200 Park Ave have both been considered MetLife's Home Office) does not mean that market conditions will not change management's intent. MetLife's Home Office moved several times over the period 2003 to 2008 switching from owned to leased property. As these examples illustrate, former home offices can be disposed of when the market appreciation warrants. The notion that fair values for real estate used in the business are not relevant is disproved by these examples. When the

price is right, the properties will be disposed of and operations relocated even when such properties are icons which bear the entity's name.

2) *Entity-Based Accounting Precludes Obtaining the Most Useful Information* – From this example, it is also apparent that real estate fair values are relevant to shareholders irrespective of the nature of the entity owning the real estate. The entity-based approach proposed in the IPE Proposed Update excludes the use of fair value where it is clearly relevant to investment decision-making.
3) *Being a Small Percentage of Assets Doesn't Mitigate the Relevance of Real Estate Fair Values* – As we note in more detail in the next example, some opponents to the measurement of real estate at fair value suggest it is not relevant because such real estate represents a small percentage of assets. This example illustrates that despite being a small percentage of assets, the lack of fair value information disadvantages shareholders who were not aware of its substantial appreciation.
4) *Relevance More Important Than Volatility* – Those who oppose recognizing real estate at fair value many times cite that the financial results will be more volatile and less meaningful with the inclusion of this fair value information in the financial statements. This example illustrates that not having the information results in less meaningful results than does including measurements which may result in more volatile financial results but reflect the underlying economics of a company's assets. Further, not recognizing fair value information in the financial statements and allowing the accumulation of gains, as in this example, illustrates the gaming which may occur and the lack of economic relevance of recognizing 50+ years of gains in two accounting periods in which they did not originate.

Our view is that an asset's value will increase or decrease in value based upon market conditions – not management expressed intent or the nature of the legal entity holding the investment – and that investors should have access to such highly relevant information.

Example 3 (Diversified Businesses – General Electric) – As described in more detail in **Appendix I**, General Electric ("GE") discloses in its Management Discussion & Analysis ("MD&A") an unaudited non-GAAP "estimated value" related to its real estate investments. We understand this disclosure is made based upon the request of investors. This example, analyzed in more detail in **Appendix I**, demonstrates that despite the argument against the broader use of fair value measurements for investment properties being made by entities such as GE, they disclose the value of real estate investments because of their relevance to investors.

Proponents of the entity-based guidance suggested by the Proposed Update such as GE argue that investors in diversified companies that hold investment properties, and other real estate, do not evaluate the entity based upon the fair value of its investment properties because these assets constitute a small fraction of the entity's operations, the assets are not managed for capital appreciation and recognizing the changes in fair value in earnings does not provide decision-useful information to investors and creates unnecessary volatility. They also believe that non-fair value measurements are consistent with how investors in such reporting entities make investment decisions and realize investment returns. In **Appendix I** we undertook an analysis of the "immaterial" nature of such real estate valuation differences at GE. Key data points from the analysis include:

1) *Percentage of Total Assets* – On average the real estate investments were approximately 4 to 5% of total assets during the period 2007 to 2011.
2) *Unrealized Losses* – The unrealized losses ranged from $3.0 billion to $(7.0) billion in the period 2007 to 2011which represented (12.9%) to (70.7%) of income before tax and (12.9%) to (42.5%) of net income during the same period.
3) *Change in Unrealized Losses* – The change unrealized losses ranged from $2.5 billion to $(7.0) billion in the period 2007 to 2011 which represented 12.4% to (35.4%) of income before tax and 12.4% to (26.3%) of net income during the same period.
4) *Most Significant Change in Unrealized Losses* – The largest fluctuations in unrealized was $(7.0) billion from 2007 (unrealized gain of $3.0 billion in 2007 to an unrealized loss of ($4.0) billion to 2008) which accounted for (20.2)% of income before tax and (15.0)% of net income in 2008.
5) *Percentage of Equity* – During the period 2007 to 2011 unrealized losses accounted for between 1.7% to (3.9)% of equity.
6) *Effect on Reported Earnings* – As in the MetLife example, GE has been able to report the (i.e. time the recognition of) gains and losses in the period of its choosing rather than when the gains and losses economically originate. Further, the standards on impairment provide management with a substantial degree of discretion with respect to the timing of their recognition. As a result, reported earnings reflects management's choice of which period gains and losses should be reported rather than reflecting the events in the period they originate.

Conglomerates such as GE would not qualify as IPEs and because of this would not have to measure their investment property at fair value under the Proposed Update. Under existing U.S. GAAP, and the Proposed Update, such a diversified business would not be required to disclose the fair value of its investment properties. We believe the analytical data and trend analysis summarized above demonstrates that this information is decision-useful to investors irrespective of the nature of entity or management's stated intent. GE's disclosure of this non-GAAP "estimated value" demonstrates the relevance.

GE has publicly stated that investors prefer the current accounting model with supplemental disclosure of fair values. We don't believe investors prefer the current accounting model as evidenced by our survey results and the examples included herein. Rather, it is our view that this statement – along with their disclosures of non-GAAP "estimated value" – is an acknowledgment that fair values for real estate are relevant for diversified businesses. This example and the disclosure of the fair value information illustrates that the nature of the entity does not change the underlying relevance of real estate fair value information.

Further, we believe intent-based accounting allows management to time the recognition of gains and losses and impairments in the period of their choosing rather than reflecting the events in the period they originate.

We believe that the FASB in re-deliberations should, at a minimum, require fair value disclosures for all real estate because of its relevance – even in diversified businesses – to investment decision-making.

Example 4 (Businesses Which Utilize Real Estate in Operations – Sears Holdings) – In **Appendix I**, we also consider Sears Holdings Corporation ("Sears"). As noted from a 2010 interview, Bruce Berkowitz's Fairholme Fund invested in Sears because it believed that the retailer's liquidation value – including its real estate holdings – were in excess of the then current share price. The investment thesis was that if the organization couldn't make it as a retailer, it could be liquidated and sold for more than then current market values of its assets net of its liabilities. As noted in the interview, Berkowitz's fund undertook an exercise in 2008 to go to tax collectors offices around the U.S. to get the tax values of Sears' and Kmart's properties. Based upon this leg work and his view with respect to the liquidation of other assets and liabilities, Berkowitz acquired an approximately 16% interest in Sears. Others argue that the value of Sears properties are not undervalued on the books because they were written-up in connection with the 2005 purchase accounting exercise as Kmart, not Sears, was the accounting acquirer.

Sears stock price has been highly volatile during the intervening period, with some questioning whether Berkowitz will prevail on his thesis. Berkowitz continues to assert the accuracy of the thesis as recently as February 8, 2012. Recent actions – including the sale of stores and properties – by management (February 23, 2012) were followed by a significant increase in share price which has some in the media reporting that management actions signal the break-up (i.e. liquidation) of Sears. This may, or may not, be true.

A complete summary of the real estate holdings and an analysis can be found at **Appendix I** and should be reviewed to understand the importance of the real estate values to the debate.

What does all this mean relative to the importance of real estate property, fair values and this Proposed Update on IPEs? What is germane to this discussion is that, no matter the outcome, the investment thesis has as one of its cornerstones that there is an information arbitrage regarding the true value of Sears' underlying real estate (land and buildings). Whether or not Mr. Berkowitz's thesis on the value of Sears is correct, the value of its real estate is relevant to the analysis and valuation of an entity's value – irrespective of management's intent or the nature of the legal entity – and the financial statements provide no disclosure of such values.

This example also demonstrates that the fair value of real estate is relevant even if housed within a business which does not "invest" in real estate but utilizes such real estate in operating its business. Because the fair value information of the real estate properties is not even disclosed, Berkowitz is attempting to capitalize on the asymmetry of information and the time and knowledge sophisticated investors have to seek such information and perform such analysis. This asymmetry of information will benefit some and disadvantage others depending upon the positions they take. Accordingly, we think it is important for the Board to include real estate fair values – at a minimum – as a disclosure in the financial statements.

Proposal Does Not Achieve Stated Convergence Objective & Creates Unnecessary Complexity For Investors

IASB (Asset-Based & Optional Use of Fair Value) vs. FASB (Entity-Based & Required Use of Fair Value) Guidance – The Proposed Update does not meet its stated objective of aligning U.S. GAAP with IFRS. In fact, the FASB's "entity-based" guidance does not converge with IAS 40 in the most fundamental manner. The International Accounting Standards Board's ("IASB") "asset-based" guidance applies to investment properties irrespective of the entity owning the properties, but includes an option to measure investment properties at either fair value or cost. The FASB proposed guidance is an "entity-based" approach that requires entities meeting the definition of an "investment property entity" to measure their investment properties at fair value. As stated above, our view has been that neither the nature of the entity nor management's intent changes the value of an investment property or how it should be valued in the financial statements. Accordingly, such lack of convergence only creates unnecessary complexity and reduces comparability for investors and other users of the financial statements.

IASB vs. FASB Definition of Investment Properties – In addition to the differences associated with the FASB vs. IASB model being "entity vs. asset-based" approaches and the FASB guidance requiring the use of fair value while the IASB guidance allows fair value to be an optional election, the IASB and FASB have different definitions of investment properties. The FASB focuses solely on total return while the IASB allows investment property to be held for receipt of income as well as total return. Our view is that maintaining different definitions of investment property under U.S. GAAP and IFRS is not consistent with economic reality. We do not believe that investment property is purchased without considering the ultimate value as well as the periodic income. Thus, the FASB view would result in accounting, rather than economic, distinctions which produce less decision-useful and comparable information for investors.

FASB Provides Further Entity Specific Accounting for IPE Investees Which Differs from U.S. GAAP Accounting for These Entities – The FASB's proposed guidance includes rules regarding how to account for an investment property entity's ownership interests in investees. We have included a chart which illustrates the IPEs accounting requirements by level and type of ownership at the **Question Response** on our website. Some of these "rules" are just that, rules, which are not consistent with investment company guidance in certain circumstances (e.g. the use of relevant U.S. GAAP rather than fair value for all investees/financial interests where there is no control or significant influence and the consolidation of investment companies and investment property entities irrespective of the fund-of-funds structure where there is control) and consistent with investment company guidance in other circumstances (e.g. the use of fair value for other investees where there is control or significant influence and the use of equity or consolidation for service providers where there is significant influence or control).[3]

Because the IASB does not have a standard that proposes specific guidance to define an IPE, an entity that may qualify as an IPE under U.S. GAAP would apply the proposed investment entities requirements under IFRS and would account for its investment properties in accordance

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[3] We have also illustrated these differences in our comment letter to the FASB and IASB on Investment Companies and Investment Entities dated March 12, 2012.

with IAS 40. Consequently, the reporting by such an entity would be different under U.S. GAAP and IFRS.

The overall result is a mixture of investment company accounting and traditional U.S. GAAP which, when layered on to the complexity of the definition of an IPE, will only make the decision-usefulness and comparability of this information more challenging for investors and other users.

IASB & FASB Should Converge on an Asset-Based Approach Which Requires Fair Value – For the aforementioned reasons, we believe the complexities of the FASB's proposal on investment property entities combined with the lack of convergence will only limit the decision-usefulness of information provided.

The complexities created by the IASB and FASB approaches along with their lack of convergence are not beneficial to investors as they create accounting rather than economic distinctions and reduce comparability. We believe an asset-based model with a fair value requirement would be preferable to the FASB's entity-based approach.

Asset-Based Approach Requiring Fair Value for All Real Estate Irrespective of Entity or Intent Is Optimal Solution: Measured Progress Toward This Objective Should Be FASB's Goal

Asset-Based Rather Than Entity-Based Approach Is Most Appropriate – We support the FASB proposal to measure investment properties at fair value. However, we believe an asset-based approach is most appropriate. Utilization of arbitrary accounting rules, which are not grounded in economic distinctions, to define an investment property entity – rules which are subject to significant interpretative issues and create implicit optionality – result in complexities, a lack of convergence and decreased comparability which does not benefit investors in the investment decision-making process. Further, the underlying measurement differences from U.S. GAAP for other entities and investments which reside within these IPEs only adds greater complexity, lack of convergence and reduced comparability for investors.

Examples Demonstrate Relevance of Fair Value for All Types of Real Estate Across Broad Spectrum of Enterprises – The examples summarized above and considered in detail in **Appendix I**, clearly demonstrate that, irrespective of the nature of the entity owning the real estate or management's expressed intent (i.e. held-for-use or held-for-investment), investors consider the fair value of real estate relevant to the investment decision-making process across a broad spectrum of enterprises. The examples demonstrate that shareholders not privy to such information and not having the resources to estimate fair values may have been disadvantaged and even sophisticated investors have difficulty estimating fair values. While CFA charterholders who know how to obtain and utilize such information may have a competitive advantage over other investors, our mission supports advocating for transparency of information for all investors and for that reason we promote greater reporting or disclosure of fair value measurements.

Fair Value for All Real Estate Is Relevant to Investors: This May Be Too Progressive For Accountants – While we believe all real estate should be measured at fair value in the financial statements, we realize that the utilization of amortized cost measurements – and the ease of verifying and auditing this meaningless information – is entrenched in the psyche of U.S. accountants. Adoption of fair value measurement for all real estate would be too progressive for the accounting community. Progress, however, toward this goal is possible.

Evolutionary Rather Than Revolutionary Change Necessary Now – We have argued in the past that fair value should be adopted on a step-by-step basis by asset class. Disclosures build confidence in the data preparation and auditing process, making it easier to mandate measurement at fair value at a later date. After financial instruments, we believe that real estate is the next logical asset class for this approach, given that real estate markets are broad and active. Therefore, we urge the FASB to expand the scope of the proposal to include all entities that own investment properties and that all such investment properties should be required to be measured at fair value. Fair value measurement should not be an option as under the IASB model as optionality creates a lack of comparability. Further, we believe the definition of investment property should not incorporate the specious distinction between properties held for total return or receipt of income as we believe that real estate investments are always made based on estimates of total return. Market conditions can cause management's intent to change and management intent has nothing to do with the underlying valuation of the real estate. Said differently, we believe in a broad definition of investment properties.

Opposition Based Upon Inconsistency With Financial Instruments Projects Is Incorrect – We would also observe that some oppose required measurement of investment properties at fair value utilizing an asset-based approach because they believe it is inconsistent with the FASB's Financial Instruments Project where, they argue that, less liquid instruments are not carried at fair value. We believe they are incorrect. Based upon the FASB's current definition of investment property – property which is being held for total return (i.e. total return can only be achieved by selling the properties) – that the classification and measurement of such investment properties at fair value is entirely consistent with the FASB's Financial Instruments Project. Management's stated intent with respect to investment property is to hold it for total return – which includes selling it to realize capital appreciation. That is consistent with the business strategy classification of the Financial Instruments' Project. As such, opponents' arguments against this required, asset-based fair value approach to investment properties based upon comparison to the Financial Instruments Project are incorrect.

FASB Should Require Fair Value Disclosure of Real Estate Not Considered Investment Property Because of Its Demonstrated Relevance to Investment Decision-Making – As it relates to real estate that would not meet the aforementioned definition of investment properties, the FASB should require disclosure of the fair value of real estate in the audited financial statements. As noted from the General Electric example, and their own acknowledgement, real estate fair values are relevant to investors and to their decision-making process (i.e. even if such fair values are unaudited non-GAAP "estimated values" provided outside the financial statements).

In the MetLife, St. Joe and Sears examples, the omission of fair value information disadvantaged shareholders who did not have access to such information. We think a prudent first step for the FASB would be to require such fair value measurement disclosures for all entities on an annual basis – unless underlying economic events suggest more timely updating is necessary. Presentation of this information parenthetically on the face of the financial statements would ensure that it was audited and delivered in a timely fashion. This presentation would also be consistent with the FASB's proposed re-deliberations on financial instruments.

We would note that IAS 40 requires the disclosure of fair values for investment properties where the fair value option is not elected. Said differently, the fair value of investment properties is always provided under IFRS. We believe the examples demonstrate that extending the disclosure requirement to all real estate provides decision-useful information to investors.

Cost Ineffectiveness As Argument Against Providing Disclosures – Some who dislike the use of fair values for real estate argue that providing such information is cost prohibitive. We disagree. Many real estate investment funds routinely obtain fair value measurements to compute net asset values. The notion that diversified businesses cannot provide such information in a cost effective manner is inconsistent with the ability of such real estate entities to utilize professional appraisers to obtain such information. Further, we find it disingenuous for major corporations – who have real estate and investment departments and who buy and sell real estate based upon their monitoring of such valuations – to say they do not have this information or it is cost prohibitive to obtain.

<u>*Quality & Relevance Should Trump Convergence*</u> – We do not believe convergence should be pursued at the expense of high-quality information. Our proposed approach does not result in a converged solution, but provides for greater comparability with those entities which elect the most appropriate measurement (i.e. fair value) under IAS 40. Further, it provides greater disclosure of the most relevant measurement basis for a broader group of enterprises. As such, we believe it is a preferred approach to IAS 40.

<u>*Timing & Prioritization*</u> – We believe that the Proposed Update on IPEs has raised the awareness and relevance of fair value for investment properties. We believe the FASB should move from an entity to an asset based approach requiring fair value at this time. We do not believe it is a substantial undertaking to require the disclosure of fair value for all real estate. Accordingly, we believe the FASB can undertake this additional disclosure requirement simultaneously.

<u>*Change Should Be Based Upon Conceptual Justification to Improve Transparency, Comparability & Decision-Useful Information: This IPE Proposed Updated Does Not Meet Those Objectives*</u> – Our view is that financial reporting reform should be designed and based on a sound conceptual justification to improve the transparency, comparability and decision-usefulness of information for investors and other users of the financial statements. We do not support the accounting rather than economic distinctions which are being created by this standard. Further, we are concerned by the false sense of comparability between U.S. GAAP and IFRS which some believe this Proposed Update creates.

CFA Institute Views Should FASB Continue To Consider an Entity-Based Approach
Though we disagree with an entity-based approach to investment property guidance, we have provided comments on the proposed approach for the FASB's consideration at **Question Response**.

Definitional Issues: Criteria to Be an Investment Property Entity Are Subject to Interpretative Issues, Create Implicit Optionality & Establish Accounting Rather Than Economic Distinctions – As we more fully explain in the **Question Response**, the proposed guidance includes various requirements used to define an investment property entity which are subject to significant interpretative issues, create implicit optionality and establish accounting rather than economic distinctions. Our view is that the complexities created by these "rules," and the lack of convergence, does not benefit investors in the investment decision-making process.

Measurements Issues: Importance Of A High-Quality Net Asset Value (NAV) – As we note above, we are concerned by the notion of investment properties being "housed" within an accounting contrived convention such as an IPE as we do not believe this is the only situation where fair value is relevant. Additionally, we are concerned by a belief expressed by some that the most expedient solution is simply to merge the proposed investment property entities guidance into the investment companies guidance because we believe that such a solution would not address the entity-based issues. In the circumstances where such a solution might be perceived as appropriate, the quality of net asset values derived may be very important to investors. To appropriately meet the needs of investors in real estate investment entities, we believe it is critical for such entities which invest in real estate to provide a high-quality NAV measure, which we define as simply the amount investors would receive if all investments of the real estate investment vehicle were sold at their respective fair values. We believe the importance of a high quality NAV measure cannot be underestimated because of the manner in which the NAV measure influences capital flows in the capital markets (i.e. investors want to know the price at which they should buy and sell their interests). As such, we believe it is important to consider the Proposed Update's guidance on other elements of measurement of assets and liabilities within such an entity as follows:

1. *Interests in Other Entities Should Be At Fair Value* – CFA Institute believes that the financial statements of an IPE should reflect all interests in other entities at fair value in order to achieve the aforementioned high-quality NAV. Instead, the Proposed Update recommends that different investees be accounted for using different measurement bases. These different measurement bases lack consistency, will cause confusion amongst investors and will not result in a high-quality NAV.
2. *Financial Liabilities Should Be At Fair Value* – We also recommend that an IPE be required to measure its financial liabilities at fair value. Unlike other investment vehicles, IPEs must have substantially all of their assets invested in real estate. Therefore, all of the debt is effectively secured directly or indirectly by the real estate investment assets that would be measured at fair value. Measuring financial liabilities associated with such real estate investments at amortized cost would not provide investors and other users of the financial statements with decision-useful information.

If these principles are not followed, then reported NAV may be misstated, resulting in investor decisions that are suboptimal. Our views on all the related measurement issues are presented in the **Question Response**. We recommend that an entity investing in real estate be required to measure all of its assets and liabilities at fair value because it would improve the quality of the NAV measure reported to investors. Requiring certain investments and liabilities to be measured using the cost method will reduce the quality of the NAV measure and will negatively impact the proper functioning and efficiency of capital markets.

Financial Statement Presentation & Disclosure Matters – The Board also needs to consider a number of issues with respect to financial statement presentation that remain unaddressed in the Proposed Update. We have articulated these issues in the **Question Response**. Furthermore, CFA Institute believes that the disclosure requirements in the Proposed Update are insufficient especially given the increased complexity created by the standard and its entity and management intent bias. We, therefore, propose that the disclosure requirements be expanded. The **Question Response** includes suggestions as to specific disclosure requirements.

Conclusion

We support the FASB's efforts to report investment properties at fair value; however, we believe the scope of the Proposed Update should be extended. An asset-based approach focused on the fair value for all real estate is the most investor-relevant solution. Reasonable intermediate steps which require, rather than allow, fair value measurement for investment properties using an asset-based approach with a broader definition of investment properties is more appropriate than the entity-based approach in the Proposed Update. The FASB needs to go further, however, and at a minimum require the parenthetical disclosure on the face of the financial statements of audited fair values of real estate properties. An annual disclosure with update upon significant interim economic events would be an improvement over the current state of reporting and disclosure for real estate..

CFA Institute believes that the most important aspect of accounting reform is the development of high-quality standards. Our members have repeatedly stressed the importance of this point. The aforementioned issues raised in this comment letter cause us significant concerns with respect to the quality of the proposal and whether it provides the most relevant and decision-useful information, results in less complexity and seeks a converged solution which will enhance comparability for investors. As the FASB re-deliberates the Proposed Update, we urge the FASB to consider these factors and our proposed alternative.

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Thank you again for the opportunity to comment on the Proposed Update. If you or your staff have questions or seek further elaboration of our views, please contact either Mohini Singh, ACA, by phone at +1.434.951.4882, or by e-mail at mohini.singh@cfainstitute.org or Sandra J. Peters, CPA, CFA by phone at +1.212.754.8350 or by email at sandra.peters@cfainstitute.org.

Sincerely,

/s/ Sandra J. Peters
Sandra J. Peters, CPA, CFA
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Gerald I. White, CFA
Chair
Corporate Disclosure Policy Council

cc: Corporate Disclosure Policy Council

Appendix I

Examples Where Fair Value of Real Estate Was Relevant Irrespective of Nature of Entity or Management Intent

Example 1 – St. Joe Company: Bruce Berkowitz (Long) vs. David Einhorn (Short)
Background & Why A Pertinent Example – Companies who develop or operate real estate would not, based upon our understanding, be within the scope of the IPE standard. A recent (January 27, 2012) Wall Street Journal article, *St. Joe Pares Back Its Florida Vision*, provides a vivid illustration as to why management intent and legal entity have no bearing on whether real estate fair values are relevant. The St. Joe Company also provides a poignant example of where the lack of disclosure regarding real estate fair values resulted in two well-known fund managers taking opposite views on the company based upon different estimates of fair value.

An Impairment of 80% Resulting From A "New Real Estate Investment Strategy?" – The WSJ article was written in response to an SEC filing (Form 8-K, January 27, 2012) in which the company disclosed – in advance of filing their 2011 Form 10-K – that the company finally took a impairment charge (expected by some investors) due to the adoption of a "new real estate investment strategy." As a real estate developer St. Joe holds its real estate at cost.

This new strategy resulted in a $374.8 million write-down of real estate with a carrying value of $466.2 million to a new carrying value of $91.4 million – a write-down of nearly 80% of the real estate's value. This write-down represented nearly 40% of the company's total assets and equity prior to the write-down. It seems reasonable to ask whether an 80% write-down in value of the real estate was due to a change in strategy or the long-awaited realization that the prior strategy was not viable and that the carrying value of the assets could no longer be justified because it was far below fair value.

Was the Accounting Correct? – As a side note, investors should be asking whether this impairment charge should have been taken in an earlier period. Many critics of the company (investors amongst others) have argued over the past several years that the company was overvalued and have questioned the company's accounting practices. It seems reasonable to ask: Were the undiscounted cash flows (i.e. the trigger for impairment) really above carrying value with such a large one-time write-down? If so, investors should challenge the artificial "accounting rule" which triggers impairment based upon undiscounted cash flows – something CFA Institute has long questioned. As noted in the excerpt from the article below, the SEC is questioning St. Joe's accounting practices.

What Makes This Newsworthy? – What makes the article particularly newsworthy for the WSJ is not the impairment per se, but the events and actions of several well-known fund managers which preceded the write-down. They are touched-upon in the article. Two fund managers Bruce Berkowitz of Fairholme Fund (who holds a long position in St. Joe) and David Einhorn of Greenlight Capital Inc. (who had during this period a short position in St. Joe) have taken positions and publicly expressed their views on the company based upon their respective – but different – view of the fair value of the real estate holdings. A value that is not disclosed in the financial statements and not required to be disclosed under U.S. GAAP – despite its obvious relevance.

The WSJ article outlines the succession of events involving Mr. Berkowitz's position in the St. Joe stating:

> Friday's news was the latest in litany of convulsive changes at St. Joe, which has struggled since the housing bust and has had just one profitable quarter since 2008. **Last spring, the company's largest shareholder, Miami-based mutual-fund manager Bruce Berkowitz, successfully ousted St. Joe's board in a proxy battle and installed himself as chairman.** In March, he named Park Brady, the former chief executive of vacation-rental company ResortQuest, with a mandate to cut costs and return St. Joe to profitability. In July, the WaterSound, Fla., company disclosed that the SEC was investigating the company's accounting practices for possible fraud. Mr. Berkowitz declined to comment through a representative.

The WSJ article also presents Mr. Einhorn's views on St. Joe:

> The strategy shift also seems to validate some of the assertions made by St. Joe's critics, who have argued that the company is overvalued. In October 2010, David Einhorn, president of the hedge-fund firm Greenlight Capital Inc., publicly questioned the company's accounting practices at a popular investment conference, saying St. Joe had valued some of its land too high on its balance sheet. Mr. Einhorn, who at the time had placed bets that St. Joe's stock would fall, suggested that the company should have written down the value of its assets by about two-thirds. On Friday, Mr. Einhorn said in an emailed statement, **"Today's news confirms our view that St. Joe's land is worth less than they thought and that it can't be developed profitably." Mr. Einhorn retains a short, or bearish, position in St. Joe**.

A Bit More History & What Others Point Out Regarding The Need for Better Information on Real Estate Values – Below is a copy of the October 13, 2010 post, *The St. Joe Company: Einhorn vs. Berkowitz*, from The Rational Walk which provides history on the, at least, two year debate over the value of the real estate at St. Joe:

> According to an article on Barron.com, David Einhorn presented a very bearish case against The St. Joe Company this morning at the Value Investing Congress. Mr. Einhorn is President of Greenlight Capital and one of the most prominent "super investors" in the value investing community. He is most well-known for his early warnings forecasting the demise of Lehman Brothers. In the case of St. Joe, Mr. Einhorn is taking a position directly opposite to many other prominent value investors, most notably Bruce Berkowitz who controls 29 percent of St. Joe shares through The Fairholme Fund.
>
> *Beautiful Land or Dreary Acreage?*
> St. Joe is the largest private landowner in Florida and owns 577,000 acres of land in Northwest Florida according to the company's latest 10-K report. According to Mr. Berkowitz, St. Joe's land is very attractive but has been left undeveloped for years due to a lack of good transportation options for those who may want to own second homes in the region. The recent opening of a new international airport built on land donated by St. Joe is supposed to serve as a catalyst for tourism and vacation housing. While the land holdings are within close proximity of the Gulf Coast, it appears that the company escaped major direct impact from the Deepwater Horizon oil spill, although St. Joe has filed lawsuits alleging related economic damages including a claim against Transocean filed on October 12.
>
> Mr. Einhorn cast doubt on the quality of St. Joe's land and displayed several slides showing "dreary" looking acreage around the airport. He also went into some detail regarding individual developments that have not been built out according to previous plans and even claimed that one development is "next-door to a sewage facility". The bearish thesis seems to rest on the assumption that St. Joe has overstated the value of its remaining land holdings. With the best acreage sold during the real estate boom, Mr. Einhorn claims that only $7 to $10 per share of value remains. St. Joe shares are currently down nearly 10 percent for the day at $22.16 due to reaction to Mr. Einhorn's presentation.

Einhorn vs. Berkowitz
Mr. Einhorn was asked about Mr. Berkowitz's ownership of St. Joe and said that he reached out to debate the stock with him but is still waiting for a response. The video below from May 2009 features Mr. Berkowitz presenting the bullish case for St. Joe. According to more recent comments (as well as his continued ownership), it appears that his views remain basically unchanged: For RSS Feed Subscribers, please click on this link for the video.

Lesson for Investors: Do Your Own Work… Many investors closely monitor the holdings of well-regarded managers when searching for investment candidates. This practice makes a great deal of sense as part of an idea sourcing strategy, but it is never a good idea to simply follow a well-regarded investor into a stock. As we can see from the case of St. Joe, well regarded value investors will excellent track records can look at the same set of facts and come to completely opposite conclusions. ***We don't know who is correct about St. Joe, but it is clear that both Mr. Berkowitz and Mr. Einhorn cannot be correct regarding the company's prospects***.

We have no position regarding whether the bullish or bearish thesis for St. Joe makes more sense based on reading the company's financial data. ***One of the reasons is that St. Joe may be one situation where the company cannot be evaluated properly without actually looking at the land in question directly. Investors purchasing St. Joe shares are actually buying acreage, and clearly the beauty (or lack thereof) of this land is in the eye of the beholder. The current controversy makes it even more interesting to consider inspecting the land directly***.

It should be noted that after Einhorn's speech, referred to in the blog post above, the shares of St. Joe dropped from $24.74 on October 12, 2010 to $22.16 on October 13, 2010 and to $19.74 on October 14, 2010. A decline of nearly 20% in two trading days.

What the post highlights, which is relevant for the FASB, is that there is a lack of information regarding the fair value of the underlying real estate and that very sophisticated investors have different views of the Company's value and prospects because of this lack of information. The blog promotes investors doing their own work and inspecting the land directly. While a good idea, is this really practicable for all but the most sophisticated investors? We would think not. What would be helpful is a disclosure regarding the fair value of the real estate so that investors can make an informed assessment regarding the value of the company and whether management has taken impairment charges in a timely manner.

What Happened to Share Price Post Release on Impairment: The Share Price Went Up 2-3% – The WSJ article highlights the board takeover and management changes made by Berkowitz in early 2011 subsequent to the date of Einhorn's speech in October 2010. What's interesting is that the share price recovered to the $25 to $29 range subsequent to those actions in early 2011 but proceeded downward thereafter and into 2012.

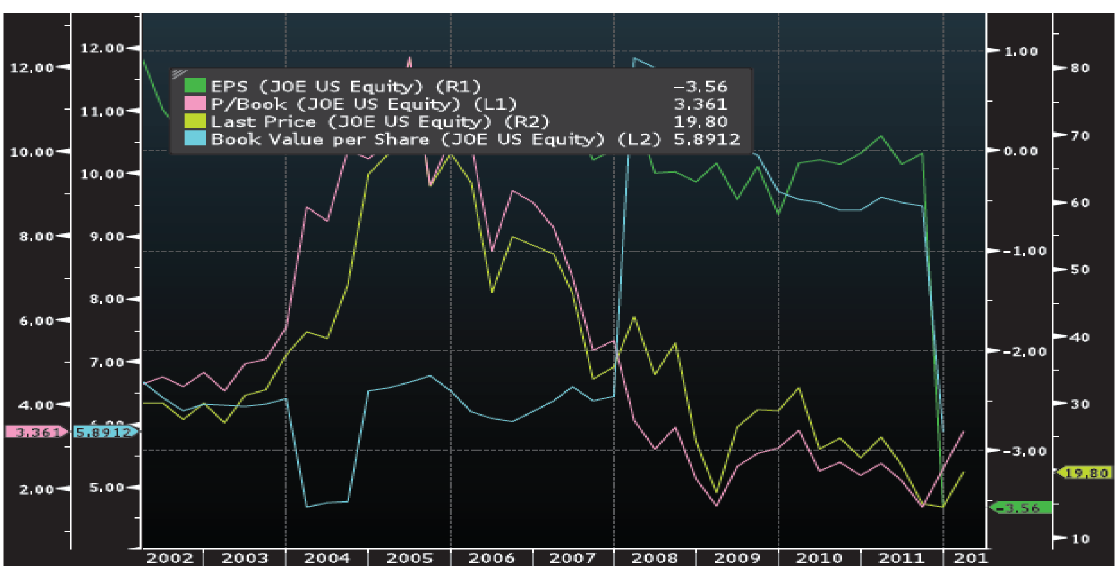
Also interesting is that the Form 8-K release made on the morning of January 27, 2012 was met with little market reaction. The share price closed at $16.83 on January 26, 2012 and closed at $17.27 on January 26, 2012 – an increase of 2.6% despite a loss in book value of nearly 40%. The point: The market had already incorporated the information.

Consideration of Historical Prices and Price-to-Book Ratios – We extracted from Bloomberg the historical prices for St. Joe (ticker symbol JOE) from Bloomberg.

A couple of observations regarding the data:

1) You see share price rise and decline with a fluctuation in real estate prices.
2) The book value per share is substantially below the stock price during the period where real estate prices were on the rise. Book value per share was substantially above the stock price when the market perceived the fair value of the land was overvalued on the books of St. Joe. After the impairment charges you see the price and book begin to converge.

The overall message is that the underlying value of the real estate – which is not disclosed – is a key driver of share price.



What's the Bottom Line? – While Mr. Einhorn and Mr. Berkowitz may have very different views regarding the value of St. Joe's real estate, the debate over its value existed because of the lack of reliable fair value information. It does not matter which party was right, what matters is that both parties took very different positions based upon the lack of available information. With respect to this Proposed Update this example demonstrates that the fair value of real estate is relevant even for a real estate operating company like St. Joe (i.e. regardless of the nature of the entity) and irrespective of management's stated intent which changed over time based upon market conditions. The original intent to develop became unrealistic and the underlying market conditions which drove the fair value of the property prevailed.

It also demonstrates that while sophisticated shareholders such as Berkowitz and Einhorn, who have the resources to obtain estimated property values from tax records, may have an informational advantage over other shareholders, even they may not be able to make reliable estimates given the lack of sufficient disclosure. Only management had the complete information upon which to obtain and present reliable fair value estimates of the real estate.

We believe this example illustrates why it is important that real estate investment properties be measured at fair value – even in real estate development companies. We also believe real estate fair value should be disclosed for those entities not reflecting real estate at fair value within the financial statements based upon the examples which follow.

Example 2 – MetLife's Sale of Key Properties in New York City

Background – During 2006 and 2005 MetLife, Inc. sold its investments in three key properties in New York City realizing net of tax gains of $1.2 billion and $3.0 billion, respectively. The carrying value of such properties was $.8 billion and $.8 billion, respectively, while the properties were sold for $5.4 billion and $2.6 billion, respectively. This reflects unrealized appreciation of such properties of $4.6 billion and $1.8 billion, respectively. Such information is summarized in the table which follows. All information presented below has been extracted from publicly available information in MetLife Inc.'s Form 10-K and Form 10-Q filings during the respective periods as well as from other publicly available market sources (e.g. market capitalization).

Analysis of Gains on Disposition of Key Real Estate Properties	2006	2005		
	(in millions)			
	Peter Cooper Village/ Stuyvesant Town	One Madison Avenue (MetLife Home Office)	200 Park Avenue (Pan Am Building)	Total
Proceeds	$ 5,400	$ 918	$ 1,720	$ 2,638
Carrying Value Implied	785	255	548	803
Gain	4,615	663	1,172	1,835
Income Tax @ 35%	1,615	232	410	642
Gain, Net of Income Tax*	$ 3,000	$ 431	$ 762	$ 1,193

* - Included Within Discontinued Operations.

Prior to the sale of such properties in the second quarter of 2005 and fourth quarter of 2006, respectively, the fair value of such properties and their aggregate unrealized appreciation of $6.4 billion, $4.2 billion after tax, were not disclosed as the real estate investments were carried at amortized cost until such time as management expressed its intent to dispose of the properties (i.e. approximately one quarter prior to their disposal).

As a percentage of assets, the carrying value of the real estate noted above was a small percentage of total assets at the year-end prior to the sale. These properties represented approximately .4451% of total assets at December 31, 2004 (i.e. Peter Cooper/Stuyvesant Town, One Madison and 200 Park) and .1630% of total assets at December 31, 2005 (i.e. Peter Cooper/Stuyvesant Town).

The unrealized appreciation of such properties occurred over many years yet the appreciation of such properties was not reflected in the primary financial statements or disclosed in the notes to the financial statements prior to their disposal of the investments. As such, investors – prior to management's change in stated intent – were not apprised of the appreciation of such properties values. Accordingly, investors who were shareholders prior to the date of the sale would have likely undervalued their investment in the organization due to the lack of disclosure of, or accounting for, such relevant appreciation information.

Gains on Key Property Sales Contribution To Net Income – The following table shows the significant contribution the aforementioned real estate sales made to net income during the respective periods.

Analysis of Key Real Estate Sales Gains Contribution to Net Income	2006	2005
	(in millions)	
Gain, Net of Income Tax	$ 3,000	$ 1,193
Net Income Available to Common Shareholders	$ 6,159	$ 4,651
Percentage of Net Income Available to Common Shareholders	48.7%	25.7%

While less than 1% of total assets, as noted previously, these sales contributed enormously to the net income of MetLife during 2005 and 2006.

Gains on Key Property Sales Contribution To Retained Earnings – The following table shows the contribution of the aforementioned key real estate sales gains to the change in retained earnings and the cumulative retained earnings of the organization during the respective periods.

Analysis of Key Real Estate Sales Gains Relative to Retained Earnings	2006	2005	2004
		(in millions)	
Preferred Stock	$ 1	$ 1	$ -
Common Stock	8	8	8
Additional Paid-In Capital	17,454	17,274	15,037
Retained Earnings	16,574	10,865	6,608
Treasury Stock	(1,357)	(959)	(1,785)
Accumulated Other Comprehensive Income	1,118	1,912	2,956
Total Equity	$ 33,798	$ 29,101	$ 22,824
Gain, Net of Income Tax	$ 3,000	$ 1,193	
Change in Retained Earnings	$ 5,709	$ 4,257	
Percentage of Change in Retained Earnings	52.5%	28.0%	
Cumulative Gain, Net of Income Tax	$ 4,193		
Cumulative Change in Retained Earnings	$ 9,966		
Percentage of Change in Retained Earnings	42.1%		
Cumulative Gain, Net of Income Tax	$ 4,193	$ 1,193	
Retained Earnings	$ 16,574	$ 10,865	
Cumulative Gain As A Percentage of Retained Earnings	25.3%	11.0%	
Cumulative Gain, Net of Income Tax	$ 4,193	$ 1,193	
Total Equity	$ 33,798	$ 29,101	
Cumulative Gain As A Percentage of Total Equity	12.4%	4.1%	

The contribution of such realized investment gains to the respective periods was significant as noted by the following:

1) As of December 31, 2005, the after tax gain on the sales of these properties in 2005 accounted for 28.0% of the change in retained earnings from December 31, 2004 to December 31, 2005.
2) The after tax gain on the sale of the properties in 2006 account for 52.5% of the change in retained earnings from December 31, 2005 to December 31, 2006.
3) The cumulative after tax gain on the sales of these properties in 2005 and 2006 accounted for 42.1% of the change in retained earnings from December 31, 2004 to December 31, 2006.
4) As of December 31, 2005, the after tax gain on the sales of these properties in 2005 accounted for 11.0% of retained earnings.
5) The cumulative after tax gain on the sales of these properties in 2005 and 2006 accounted for 25.3% of retained earnings as of December 31, 2006.

6) As of December 31, 2005, the after tax gain on the sales of these properties in 2005 accounted for 4.1% of total equity and the cumulative after tax gain on the sales of these properties in 2005 and 2006 accounted for 12.4% of total equity as of December 31, 2006.
7) Overall, these properties which comprised less than 1% of total assets have contributed 25.3% of MetLife's retained earnings and 12.4% of their total equity.

Analysis of Change in Market Capitalization During Period of Key Property Sales –
The information above illustrates the importance of unrealized appreciation of real estate properties to the book value of the enterprise. The following table illustrates the importance of such information to the change in market capitalization and total market capitalization of the enterprise during this same period.

Analysis of Key Real Estate Sales Gains Relative to Market Capitalization	**2006**	**2005**	**2004**
		(in millions)	
Market Capitalization	$ 44,375	$ 37,119	$ 29,673
Change in Market Capitalization	$ 7,256	$ 7,446	
Cumulative Change in Market Capitalization	$ 14,702		
Gain, Net of Income Tax	$ 3,000	$ 1,193	
Cumulative Gain, Net of Income Tax	$ 4,193		
Gain, Net of Income Tax as a Percentage of Change in Market Capitalization	41.3%	16.0%	
Cumulative Gain, Net of Income Tax as a Percentage of Cumulative Change in Market Capitalization	28.5%		
Cumulative Gain, Net of Income Tax as a Percentage of Market Capitalization	9.4%	3.2%	

The relationship between these after tax gains and market capitalization was significant as follows:

1) As of December 31, 2005, the after tax gain on the sales of these properties in 2005 accounted for 16.0% of the change in market capitalization from December 31, 2004 to December 31, 2005.
2) The after tax gain on the sale of the properties in 2006 account for 41.3% of the change in market capitalization from December 31, 2005 to December 31, 2006.
3) The cumulative after tax gain on the sales of these properties in 2005 and 2006 accounted for 28.5% of the change in market capitalization from December 31, 2004 to December 31, 2006.
4) As of December 31, 2005 the after tax gain on the sales of these properties in 2005 accounted for 3.2% of market capitalization.
5) The cumulative after tax gain on the sales of these properties in 2005 and 2006 accounted for 9.4% of market capitalization as of December 31, 2006.
6) Despite being less than 1% of total assets these properties have contributed 12.4% and 9.4% to the company's retained earnings and market capitalization, respectively.
7) Comparing the % change in retained earnings relative to the % change in market capitalization, these gains appear to explain 60-80% of the change in retained earnings relative to the change in market capitalization. The gains as percentage of total equity and as a percentage of total market capitalization appear to represent 75% of the total equity to total market capitalization.

Conclusion – As can be seen from the detail provided above, the after tax gains on the sale of the key real estate properties tracks relatively consistently as a percentage of the change in retained earnings, cumulative retained earnings, total equity, change in market capitalization and market capitalization. This would suggest that these gains are highly instructive in explaining the movement in market capitalization during the period despite being less than 1% of MetLife's total assets.

The results would suggest that the market did not incorporate, or price, such information until such time as management's intent changed and the properties were sold. Unlike in the St. Joe example (i.e. where real estate represented a substantial percentage of the total assets and investors actively sought separate real estate valuation) in this example, the properties were a small percentage of assets but a more than substantial percentage of income when the gains were triggered by management's change in intent. Failing to recognize this real estate/investment property at fair value allowed these gains to be reflected in the period of management's choosing rather than when the gains occurred, making reported earnings a less representationally faithful measure of the company's performance both during the periods when the appreciation occurred and in the periods the gains were reported.

It is important to note, that these properties did not experience the significant appreciation represented by these reported gains solely in 2005 and 2006. Rather, the appreciation occurred in the decades these investment properties/real estate were owned prior to the decision to dispose of the property. Shareholders, however, did not have insight into the valuations and as such could not appropriately price the shares to reflect such valuations. To appropriately price securities investors need access to this highly relevant fair value of real estate information.

As it relates to the Proposed Update, this example illustrates several key points and results in several conclusions:

1) Intent-Based Accounting Isn't Useful to Investors – Management intent does not matter in assessing the relevance of real estate fair values to investors. This example highlights several reasons why:
    a. *Intent Can Change Over Time* – As each of these three sales illustrate, management's intent can, and does, change over time with market conditions.
    b. *Investment Property Can Be Held for Investment Income and Total Return –* Investment property needs to be defined more broadly in the Proposed Update. Peter Cooper/Stuyvesant Town is a perfect example of a property held for investment income for many years and then sold for capital appreciation/total return when market conditions became so lucrative that an investment income strategy was less optimal than a total return strategy. In particular, we believe that the argument that investment properties may be held for rental income only (not total return) lacks any basis in reality.
    c. *Fair Value Is Relevant to Real Estate Used In Operations* – Simply because real estate was used in operations (e.g. One Madison and 200 Park Ave have both been considered MetLife's Home Office) does not mean that market conditions will not change management's intent. MetLife's Home Office moved several times over the period 2003 to 2008 switching from owned to leased property. As these examples illustrate, former home offices can be disposed of when the market appreciation warrants. The notion that fair values for real estate used in the business are not relevant is disproved by these

examples. When the price is right, the properties will be disposed of and operations relocated even when such properties are icons which bear the entity's name.

2) *Entity-Based Accounting Precludes Obtaining the Most Useful Information* – From this example, it is also apparent that real estate fair values are relevant to shareholders irrespective of the nature of the entity owning the real estate. The entity-based approach proposed in the IPE Proposed Update excludes the use of fair value where it is clearly relevant to investment decision-making.
3) *Being a Small Percentage of Assets Doesn't Mitigate the Relevance of Real Estate Fair Values* – As we note in more detail in the next example, some opponents to the measurement of real estate at fair value suggest it is not relevant because such real estate represents a small percentage of assets. This example illustrates that despite being a small percentage of assets, the lack of fair value information disadvantages shareholders who were not aware of its substantial appreciation.
4) *Relevance More Important Than Volatility* – Those who oppose recognizing real estate at fair value many times cite that the financial results will be more volatile and less meaningful with the inclusion of this fair value information in the financial statements. This example illustrates that not having the information results in less meaningful results than does including measurements which may result in more volatile financial results but reflect the underlying economics of a company's assets. Further, not recognizing fair value information in the financial statements and allowing the accumulation of gains, as in this example, illustrates the gaming which may occur and the lack of economic relevance of recognizing 50+ years of gains in two accounting periods in which they did not originate.

Overall, this example illustrates that investors require fair value information to make appropriate investing decisions irrespective of entity or intent.

Example 3 – General Electric's Disclosure of Real Estate Fair Values

Some Argue Real Estate Fair Values Are Not Relevant in Diversified Businesses – Proponents of the entity-based guidance suggested by the Proposed Update argue that investors in diversified companies that hold investment properties, and other real estate, do not evaluate the entity based upon the fair value of its investment properties because these assets constitute a small fraction of the entity's operations, the assets are not managed for capital appreciation and recognizing the changes in fair value in earnings does not provide decision-useful information to investors and creates unnecessary volatility. They also believe that non-fair value measurements are consistent with how investors in such reporting entities make investment decisions and realize investment returns.

We disagree with these views for the reasons noted in the body of this letter and the examples provided herein. We would also note that investors do not make investment decisions or realize investment returns based upon amortized cost information in the reporting entity. Investors must transact in the market for the diversified companies shares not based upon the amortized cost information provided in the financial statements but based upon the market's expectation regarding the value of these assets and liabilities and the company's future business prospects.

An Illustration of the Significance & Relevance of Such Measurements – That said, those arguing for an entity-based approach acknowledge the relevance of fair value information[4] by providing an unaudited non-GAAP "estimated value"[5] related to their real estate investment properties in the Management Discussion and Analysis ("MD&A") of their Annual Report. We understand that this is made upon the request of investors. Below is an extract from the 2011 Annual Report of General Electric where such information is disclosed:

> ***Included in other assets are Real Estate equity investments of $23.9 billion and $27.2 billion at December 31, 2011 and December 31, 2010, respectively***. Our portfolio is diversified, both geographically and by asset type. We review the estimated values of our commercial real estate investments at least annually, or more frequently as conditions warrant***. Based on the most recent valuation estimates available, the carrying value of our Real Estate investments exceeded their estimated value by about $2.6 billion.*** Commercial real estate valuations in 2011 showed signs of improved stability and liquidity in certain markets, primarily in the U.S.; however, the pace of improvement varies significantly by asset class and market. Accordingly, there continues to be risk and uncertainty surrounding commercial real estate values. Declines in estimated value of real estate below carrying amount result in impairment losses when the aggregate undiscounted cash flow estimates used in the estimated value measurement are below the carrying amount. As such, estimated losses in the portfolio will not necessarily result in recognized impairment losses. ***During 2011, Real Estate recognized pre-tax impairments of $1.2 billion in its real estate held for investment***, which were driven by declining cash flow projections for properties in certain markets, most notably Japan and Spain, as well as properties we have identified for short-term disposition based upon our updated outlook of local market conditions. ***Real Estate investments with undiscounted cash flows in excess of carrying value of 0% to 5% at December 31, 2011 had a carrying value of $1.6 billion and an associated estimated unrealized loss of approximately $0.2 billion***. Continued deterioration in economic conditions or prolonged market illiquidity may result in further impairments being recognized.

For those supportive of an entity-based approach to real estate based upon: a) their belief that such real estate valuations are small percentages of assets and net income, and b) their view that such real estate values are not relevant to the trading value of the diversified company nor

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[4] See discussion regarding GE's stated view on relevance of fair value disclosures in conclusion to this example.

[5] The term "estimated value" is not a defined term under U.S. GAAP. Specifically, it is not a "fair value" as defined in Topic 820, *Fair Value Measurements*. Additionally, such "estimated value" being presented in MD&A would not be subject to audit. The use of this non-GAAP measurement and the fact that it is not audited make it substantially less reliable than needed by investors.

decision-useful to investors; we have summarized the carrying value and estimated values reported in the 2007 – 2011 Annual Reports of General Electric and considered the valuations and changes in valuations relative to income and equity measurements. Further, we have considered the holdings as a percentage of total assets. Such information is summarized in the table below:

Analysis of the Carrying Value vs. Estimated Value of GE Real Estate Investments	**2011**	**2010**	**2009**	**2008**	**2007**
			(in billions)		
Real Estate Equity Investments *	$ 23.9	$ 27.2	$ 32.2	$ 32.8	
Real Estate Held For Investment (derived) *	4.4	4.4	4.8	3.9	
Carrying Value of Real Estate Investments	$ 28.3	$ 31.6	$ 37.0	$ 36.7	$ 40.5
Estimated Value of Real Estate Investments (derived) *	$ 25.7	$ 26.5	$ 30.0	$ 32.7	$ 43.5
Unrealized (Loss) Gain on Real Estate Investments (Estimated Value below Carrying Value)	$ (2.6)	$ (5.1)	$ (7.0)	$ (4.0)	$ 3.0
Change in Unrealized (Loss) Gain on Real Estate Investments	$ 2.5	$ 1.9	$ (3.0)	$ (7.0)	
Impairment of Real Estate Held for Investment *	$ (1.2)	$ (2.3)	$ (0.8)	$ (0.3)	
Unrealized (Loss) Gain on Real Estate Investments as Percentage of Carrying Value	(9.2%)	(16.1%)	(18.9%)	(10.9%)	7.4%
Change in Unrealized (Loss) Gain on Real Estate Investments as Percentage of Carrying Value	7.9%	5.1%	(8.2%)	(19.1%)	
Earnings From Continuing Operations Before Income Tax	$ 20.1	$ 14.2	$ 9.9	$ 19.8	$ 26.6
Net Earnings Attributable to GE Common Shareholders	$ 13.1	$ 11.3	$ 10.7	$ 17.3	$ 22.2
Unrealized (Loss) Gain on Real Estate Investments/Earnings From Continuing Operations Before Income Tax	(12.9%)	(35.9%)	(70.7%)	(20.2%)	11.3%
Unrealized (Loss) Gain on Real Estate Investments Net of Tax**/Net Earnings Attributable to GE Common Shareholders	(12.9%)	(29.3%)	(42.5%)	(15.0%)	8.8%
Change in Unrealized (Loss) Gain on Real Estate Investments/Earnings From Continuing Operations Before Income Tax	12.4%	13.4%	(30.3%)	(35.4%)	
Change in Unrealized (Loss) Gain on Real Estate Investments Net of Tax**/Net Earnings Attributable to GE Common Shareholde	12.4%	10.9%	(18.2%)	(26.3%)	
Total GE Shareowners Equity	$ 116.4	$ 118.9	$ 117.3	$ 104.7	$ 115.6
Unrealized (Loss) Gain on Real Estate Investments Net of Income Tax**/Total GE Shareowners Equity	(1.5%)	(2.8%)	(3.9%)	(2.5%)	1.7%
Change in Unrealized (Loss) Gain on Real Estate Investments Net of Income Tax**/Total GE Shareowners Equity	1.4%	1.0%	(1.7%)	(4.3%)	
Total Assets	$ 717.2	$ 747.8	$ 781.9	$ 797.9	$ 795.8
Carrying Value of Real Estate Investments/Total Assets	3.95%	4.23%	4.73%	4.60%	5.09%

* - See Note below table.
** - Assumed a tax rate of 35% though actual rate could be lower.

Note: The information provided in the MD&A is not presented in a comprehensive manner where the carrying values and estimated values of real estate equity interests and real estate held for investment are presented separately. As noted from the highlighted excerpt from the 2011 MD&A above, the disclosure provides information on total real estate investments, real estate equity interests and real estate held for investment but does not provide all the respective elements of the carrying value, estimated value and impairment losses associated with each. Where amounts in the table above are noted as having been derived, they have been computed by determining the differences in the elements of the disclosure provided. Impairments on real estate held for investment are presented separately in the MD&A. Only very general qualitative disclosures have been provided regarding the decline by 30% since 2007 in the carrying value of real estate equity interests. Whether this decrease was attributable to decline in values of equity investees, foreign currency, sales (including related gains and losses), or other reasons was not disclosed.

As noted above, proponents of the entity-based guidance argue that investors in a diversified reporting entity that hold investment properties, and other real estate, do not evaluate the entity based upon the fair value of its investment properties because these assets constitute a small fraction of the entity's assets and operations and recognizing the changes in fair value in earnings creates unnecessary, and immaterial, volatility which is not decision-useful. From the table above we would make the following observations:

1) *Percentage of Assets= 4-5%* – GE's real estate investments declined by 30% from 2007 to 2011 were 5.1% of total assets in 2007 and 4.0% of total assets in 2011 (a period over which there was a 10% decline in total assets).
2) *Unrealized Loss Impact on Earnings Substantially More Material* – The unrealized losses or change in unrealized losses, if recognized, would have been material:
    a. *Unrealized Losses* –
        i. As a percentage of earnings from continuing operations before income tax, unrealized losses ranged from (12.9%) to (70.7%) over the period of 2008 to 2011.
        ii. Assuming a tax rate of 35%, unrealized losses as a percentage of net earnings ranged from (12.9%) to (42.5%) over the period of 2008 to 2011.
    b. *Change in Unrealized Losses* –
        i. As a percentage of earnings from continuing operations before income tax, the change in unrealized losses ranged from 12.4% to (35.4%) over the period of 2008 to 2011.
        ii. Assuming a tax rate of 35%, the change in unrealized losses as a percentage of net earnings ranged from 12.4% to (26.3%) over the period of 2008 to 2011.
3) *Unrealized Loss Impact on Book Value (Not Immaterial)* – The unrealized losses and change in unrealized losses were not immaterial to book value. They swung from a gain of 1.7% of GE shareowners equity at December 31, 2007 to a loss of (2.5%) of GE shareowners equity at December 31, 2008 – a net decrease in book value of 4.3%. Further, at December 31, 2009, such unrealized losses accounted for (3.9%) of GE shareowners equity.

While we agree with the assertion that these investments do not constitute a significant percentage of this diversified business assets we do not agree that the unrealized losses are immaterial to earnings measures. We believe the amounts and trends presented in the table above, demonstrate the relevance of such measures to investors.

Timing of Recognition of Gains and Losses – As a result reported earnings reflect management's choice of which prior period gains and losses to report rather than solely the effects of current period events. As noted in the preceding example, the failure to disclose or recognize real estate at fair value allows management to time the recognition of such gains and losses and manage the market's assimilation of such information. Further, in certain diversified businesses these gains and losses may not be segregated by management – and, accordingly, some analysts – as non-operating earnings. The ability to time the disposal – and the recognition of related gains and losses – of these properties may be used to manage shortfalls in underlying operating results. Still further, the use of undiscounted cash flows as the impairment trigger has the effect of delaying impairments. With fair values below carrying value some real estate properties are not considered impaired allowing management to manage the timing of the sale or write-down of these properties. Overall, the failure to recognize, or disclose, fair values in the financial statement allows management to control the assimilation of this highly relevant information into the valuation of an enterprise.

Conclusion: Fair Values Are Relevant, Even For Diversified Businesses – Conglomerates such as GE would not qualify as IPEs and because of this would not have to measure their investment property at fair value under the Proposed Update. Under existing U.S. GAAP, and the Proposed Update, such a diversified business would not be required to disclose the fair value of its investment properties. We believe the analytical data and trend analysis above demonstrate that this information is decision-useful to investors irrespective of the nature of entity or management's stated intent. GE's disclosure of this non-GAAP "estimated value" demonstrates the relevance.

GE has publicly stated that investors prefer the current accounting model with supplemental disclosure of fair values. We don't believe investors prefer the current accounting model as evidenced by our survey results and the examples included herein. Rather, it is our view that this statement – along with their disclosures of non-GAAP "estimated value" – is an acknowledgment that fair values for real estate are relevant for diversified businesses. This example and the disclosure of the fair value information illustrates that the nature of the entity does not change the underlying relevance of real estate fair value information.

Further, we believe intent-based accounting allows management to time the recognition of gains and losses and impairments. As in the MetLife example, companies such as GE are able to report the (i.e. time the recognition of) gains and losses on disposals in the period of its choosing rather than when they economically originate. Further, the impairment standards provide management with a substantial degree of discretion with respect to the timing of their recognition. As a result, reported earnings reflects management's choice of which period gains and losses should be reported rather than reflecting the events in the period they originate.

We believe that the FASB in re-deliberations should, at a minimum, require fair value disclosures for all real estate because of its relevance – even in diversified businesses – to investment decision-making.

Example 4 – Bruce Berkowitz's (Fairholme Fund's) Investment in Sears Holdings

Why Is Berkowitz Interested in Sears Holdings? – Below is an excerpt from an article from The Rational Walk entitled: *Looking For Hidden Real Estate Value at Investors Title Company*, dated March 15, 2011; which captures the importance of real estate values in the assessment of company valuations. While the article centers around the valuation of real estate at Investors Title Company, it opens with a discussion of the distortion of historical cost information in publicly available financial statements and the fact that Bruce Berkowitz has made a significant investment in Sears Holdings Corporations based upon the liquidation value of its assets and liabilities – including its real estate holdings.

> Experienced investors know that in order to achieve long term success, it is necessary to read voraciously and to insist on personally reviewing primary sources such as SEC filings when considering investments. Outsourcing investment analysis, whether to a talking head on television or to a highly paid investment advisor, is almost never a satisfactory substitute for personal research for enterprising investors taking an active role in managing their own funds. Only a careful examination of primary sources can provide the insight required to make decisions and the confidence to stay the course when Mr. Market's psychological warfare threatens to result in capitulation at the worst possible time.
>
> While examining SEC filings is a necessary condition for long term investment success, it is not sufficient in most cases. ***Accounting rules, even when faithfully followed by honest and capable management, often introduce distortions that can result in trouble when an analyst fails to look beneath the numbers. While there are numerous pitfalls that an analyst must be aware of, in this article we will focus on a specific type of distortion that can occur when the value of real estate on the balance sheet may be understated due to the passage of long periods of time and the effects of inflation***.
>
> *Bruce Berkowitz and Sears Holdings*
> In the March 17, 2009 issue of Outstanding Investor Digest, Bruce Berkowitz made the following statement: "I think almost our entire portfolio is selling at a back-up-the-truck price." With the benefit of hindsight, we know that Mr. Berkowitz was being interviewed almost exactly at the bear market lows but he didn't know this at the time. However, he had confidence in his convictions and this was due to the depth of research underlying his fund's positions.
>
> Sears Holdings was one of Fairholme's largest positions in early 2009 and remains a large position today (click here for dataroma.com data on Fairholme's history with Sears). What was Mr. Berkowitz's investment thesis for Sears based on? ***In the Outstanding Investor Digest interview, he made it clear that the investment was based primarily on property values***:
>
>> ***Last summer, we spent a tremendous amount of time going to all the tax collectors' offices around the U.S. trying to get the tax value of Sears and Kmart properties — and we came up with numbers that ranged from between $80 and $90 per share***.
>>
>> So, how much has it changed from last summer? And where is the stock today? And how much is the largest appliance servicer worth, or a large automotive center worth, or three or four brands, or Sears Canada and over $11 billion of inventories? It just doesn't take a lot these days to get to the current market price ….
>>
>> So there are many ways to get to heaven. I think there are many ways that we will make money in Sears. Has our estimate of liquidation value declined in this environment? Yes, it has. But it's still dramatically above where Sears is trading today.
>
> [Editor's Note: Sears Holdings closed at $39.50 on March 17, 2009 and closed at $82.71 on March 15, 2011.]
>
> ***Mr. Berkowitz did not rely on private appraisals or non public information to determine that Sears had property worth far in excess of the value reported on the balance sheet. He simply went through the process of locating tax assessment information throughout the country — an arduous task, no doubt, but ultimately a task that anyone could accomplish given enough time and motivation***.

The original comments of Mr. Berkowitz were reported in the March 17, 2009 issue of Outstanding Investor Digest where he notes that his investment thesis on Sears was based on the value of its assets and liabilities and an estimation of their liquidation value. He made the following statements – in addition to those noted above – regarding his investment and thesis with respect to Sears:

> **Berkowitz:** It's mostly based on assets and liabilities…To make money right now, all you have to do is liquidate the company. That's it. It's no more difficult than that given its assets and liabilities.
>
> * * *
>
> **Berkowitz:** We have always purchased Sears based on liquidation values, and always thought we were buying below liquidation values.
>
> * * *
>
> **Shareholder:** How will you know when Eddie Lampert reaches the point where he has to sell the underlying real estate at distressed prices in order to prop up the retail side? Wouldn't it be wise to meet with Lampert to get a sense of whether he actually has a turnaround or asset sale plan?
>
> **Berkowitz:** I guess we'll know when he sells. But even when he starts to sell real estate, I think investors have to be careful to not assume that any one piece of real estate is representative of the entire portfolio. I mean, if our opinion is correct, the real estate probably very much matches up with some type of 80/20 rule, where you have 20% of the real estate that's very, very valuable, even today — and 80% that may not be nearly as valuable.

Overall his investment was based upon the thesis of liquidation value should attempts to revive the retailer by management prove unsuccessful.

What Value Are Sears' Land and Buildings Reflected At In the Financial Statements? – Given the focus on Sears Holdings' land and buildings we excerpted the information for 2009 to 2011 as follows:

Sears Property & Equipment Holdings	2011	2010	2010	2009	2009
		(in billions, except shares)			
As Disclosed					
Land			$ 2.1		$ 2.1
Buildings and Improvements			6.3		6.2
Furniture, Fixtures and Equipment			3.0		2.8
Capital Leases			0.4		0.4
Gross Property & Equipment			11.8		11.5
Depreciation			(4.4)		(3.7)
Total Property & Equipment, Net	$ 6.6		$ 7.4		$ 7.8
With An Approximation of Depreciation Allocation					
Land			$ 2.1		$ 2.1
Buildings and Improvements, Gross		$ 6.3		$ 6.2	
Depreciation*		(3.0)		(2.4)	
Buildings and Improvements, Net			3.3		3.8
Furniture, Fixtures and Equipment , Gross		3.0		2.8	
Depreciation*		(1.4)		(1.3)	
Furniture, Fixtures and Equipment , Net			1.6		1.5
Capital leases			0.4		0.4
Total Property & Equipment, Net	$ 6.6		$ 7.4		$ 7.8
Land, Buildings and Improvements, Net			$ 5.4		$ 5.9
* - These are approximations.					
Other Information					
Total Assets	$ 21.4		$ 24.3		$ 24.8
Total Liabilities	17.1		15.7		15.4
Total Equity	$ 4.3		$ 8.6		$ 9.4
Shares Outstanding (in millions)	106		109		115
Book Value Per Share	$ 40.57		$ 78.90		$ 81.74
Goodwill	$ 0.8		$ 1.4		$ 1.4
Trade Names and Other Intangible Assets	$ 2.9		$ 3.1		$ 3.2
Total Equity Excluding Goodwill	$ 3.5		$ 7.2		$ 8.0
Book Value Per Share Based Upon Total Equity Excluding Goodwill	$ 33.02		$ 66.06		$ 69.57
Total Equity Excluding Goodwill, Trade Names and Intangibles	$ 0.6		$ 4.1		$ 4.8
Book Value Per Share Based Upon Total Equity Excluding Goodwill, Trade Names and Intangibles	$ 5.66		$ 37.61		$ 41.74
Land, Buildings and Improvements, Net Per Share			$ 68.44		$ 72.18

Note: 2011 Form 10-K has not yet been filed so only summarized information is available.

Note 1: As the depreciation is not presented in the financial statements by the respective asset class, it is difficult to ascertain the depreciated value of the $6.3 billion and $6.2 billion, respectively, in buildings. Amounts of depreciation were estimated based upon capital expenditures in recent years and disclosed useful lives.

With land of $2.1 billion at each year-end, this results in approximately $5.4 billion and $5.9 billion, respectively, as of January 29, 2011 and January 30, 2010, respectively, of land and buildings – or approximately 25% of Sears Holdings' assets of $24 billion. As disclosed in the Form 10-K, this real estate is unencumbered contributing significantly to Sears Holdings' $79 of book value per share at January 29, 2011. The Form 10-K for January 28, 2012, has not yet been filed, but as can be seen from the press release information above, property and equipment in its entirety dropped from $7.4 billion at January 29, 2011 to $6.6 billion and January 28, 2012. As of January 28, 2012, the book value per share of Sears Holdings was $41 per share. What is clear is that real estate is now an even larger percentage of assets and net book value.

Some Say The Real Estate is Not Undervalued – In a recent (March 3, 2012) post on Seeking Alpha, *The Sears 'Real Estate is Undervalued' Myth*, one blogger presents an interesting analysis regarding the fact that Sears real estate holdings are not undervalued because they were written up in 2005 in connection with the Kmart merger. Relevant excerpts from the post are included below:

> Clearly, one of the theses helping Sears (SHLD) put on a massive short squeeze, is the idea that it has a lot of real estate on its books, and that this real estate is hugely undervalued, because it's carried at cost from 50 years ago and things like that. There is just one problem with this theory - and that problem is that it is a myth. I will show in this article that there is NO undervaluation to Sears-owned real estate.
>
> In fact this is rather easy to do. The reason is simple: Sears Holding wrote up the value of the real estate when it completed its merger with Kmart back in 2005. It wrote up the real estate value to fair market prices, and indeed, wrote up the value of a host of other things as well, to a point where instead of undervaluation, quite possibly there's massive overvaluation in the asset side of Sears' balance sheet.
>
> **So is the real estate undervalued?**
> As we've seen above, the Sears real estate was written up to its fair value as of March 24, 2005. However, as we all know, from the end of 2007 to mid-2009, the U.S. economy was mired under the Great Recession and prior to that, there had been a residential and commercial real estate bubble. What this means, is that the Sears real estate was written up during that bubble, so what passed as "fair value" then, is not necessarily what is "fair value" today.
>
> So this means that on average, "fair value" in March 2005 would mean a value 18.8% lower today. Yet, Sears has never written down its real estate (though it does depreciate buildings on a 50-year schedule, so might have depreciated them 14%, removing most of the overvaluation).
>
> In short, not only there is no reason to believe the real estate in the books is undervalued, but there is some reason to believe it might be somewhat overvalued. Obviously, these are national averages, so there can always be variations in individual properties - but on the whole, this conclusion is solid.
>
> **The balance sheet**
> The whole point of saying that there's hidden value in the balance sheet of an entity that's generating deep operating losses, is to say that if the company were to liquidate, it would somehow be worth more dead than alive. Yet, we've just seen that the value of the real estate on the books is at, or over, fair value. So there's no particular reason to believe that Sears' book value is much higher than what is stated in its balance sheet. And how much is that?
>
> Well, if we take into account tangible book value - since Sears is still considering a lot of intangibles - then this comes to $4.341 billion minus ($0.841 billion + $2.937 billion), or $563 million … over 106.3 million shares, that's $5.30 a share.
>
> And if you believe the intangible value really exists, which is a stretch at times, given that no one would pay for the Sears brand, for instance, then you come to $4.341 billion over 106.3 million shares, that's $40.84 a share.
>
> Also, again, it should be noted that in a liquidation scenario the asset side of the balance sheet overstates values - inventory being liquidated is worth less, leasehold improvements are mostly worthless, etc. At the same time, the liability side of the balance sheet is inflated, by severance payments, by payments for leases that are over market. What this means, is that both values calculated above are potentially over the real value.
>
> And obviously, outside of a liquidation scenario, there's no reason to think that the operational performance will turn meaningfully - and it certainly won't, if Sears keeps on selling the profitable stores. And the present operational performance implies losing at least $5 a share per year of those stated above.

Conclusion

> There is more than enough reason to believe Sears real estate is carried on the books broadly at, or even above, market values. The real estate was written up during the 2005 acquisition to values which were higher then, than they are now. There is some hidden value in long-term leases but these too have been written up, so it isn't much. And at the same time, there's hidden negative value in long-term leases that are presently over market rates, in unattractive stores - precisely the kind that Sears needs to close if it wants to turn operations around.
>
> Given all this, there's no reason to believe that the book value on Sears balance sheet deviates much from reality, and such book value is just around $5.30 per share taking into account tangible book value, or $40.84 taking into account stated book value. Both of these values overstate what could be gotten in a liquidation scenario since some assets would lose value in that scenario, and some liabilities would be created. And in a going concern scenario, Sears will most likely continue bleeding money, especially since it's selling its profitable stores.
>
> So, once the present short squeeze ends, the stock will once again fall heavily as there's no value to be had here. In the meantime, though, the short rebate rates are so high (at 83%) that it's near impossible for shorts to profit from this situation. However, there still remains the obvious conclusion that the longs who don't sell into the squeeze will eventually see their share value greatly diminished.

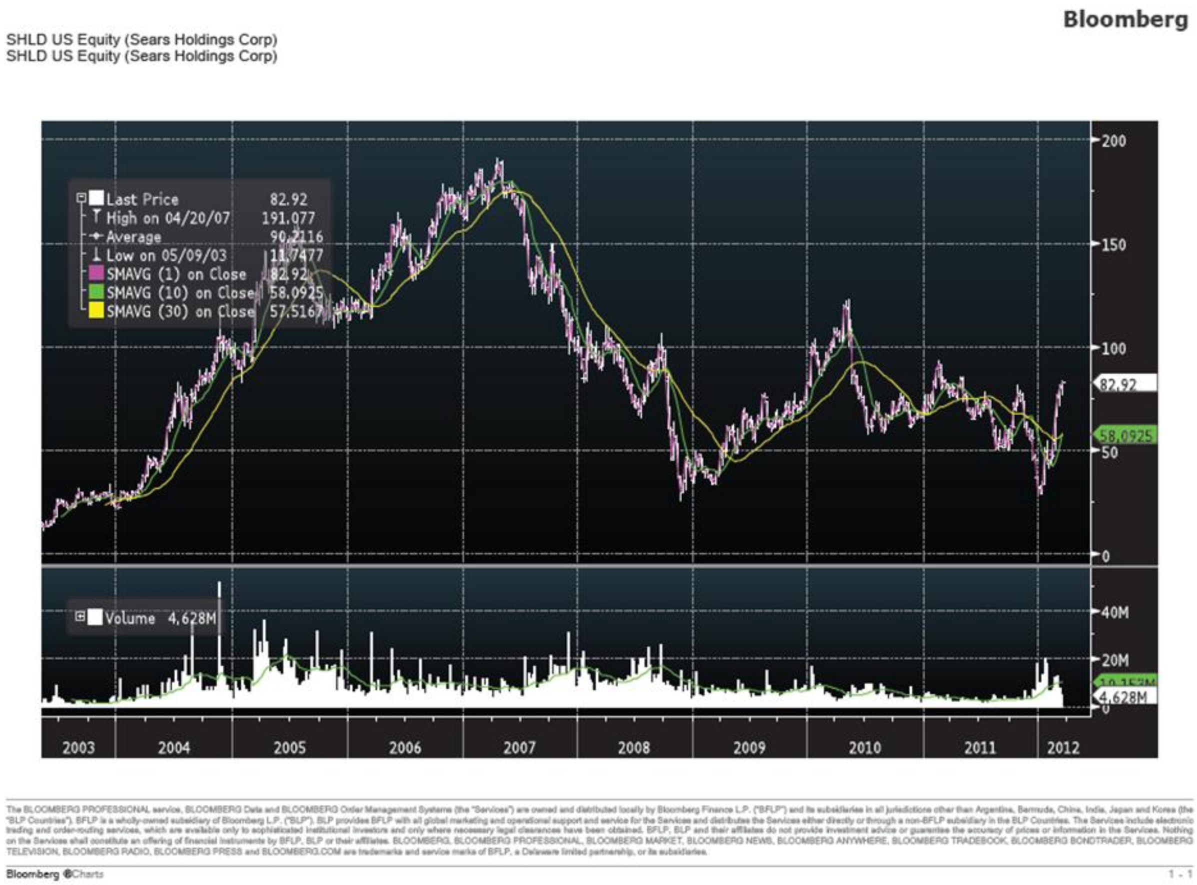
Our review of the Sears Holdings 2005 Annual Report notes the following disclosure:

> In accordance with SFAS No. 141, "Business Combinations", the Merger has been treated as a purchase business combination for accounting purposes, with Kmart designated as the acquirer. In identifying Kmart as the acquiring entity, the companies took into account the relative share ownership of the Company after the Merger, the composition of the governing body of the combined entity and the designation of certain senior management positions. Accordingly, the historical financial statements of Kmart became the historical financial statements of Holdings. The purchase price for the acquisition of Sears, including transaction costs, has been allocated to the assets acquired and liabilities assumed based on estimated fair values at the date of the Merger, March 24, 2005. The allocation of purchase price is substantially complete. Pending receipt of additional information regarding the fair values of certain properties and of certain pre-acquisition contingencies, the Company will finalize the purchase price allocation during the first quarter of fiscal 2006.

As such, the observations of the blogger have some merit, but the central issue of importance here is that the current fair value is not disclosed and is relevant to the investor’s decision-making process.

Berkowitz's Holdings & Sears Share Price – Sears Holdings was one of Fairholme's largest positions in early 2009 and remains a large position today. Mr. Berkowitz has 16 million shares, which he bought at an average price of $64.50 per share – based upon disclosure by various public sources.

Sears Holdings closed at: $39.50 on March 17, 2009; $82.71 on March 15, 2011; $31.78 on December 31, 2011; $52.08 on February 22, 2012 (pre-announcement); $61.80 on February 23, 2012 (post-announcement); $68.31on February 24, 2012; and $80.48 on March 9, 2012. Below is a chart from Bloomberg showing the history of Sears Holdings share prices over the last ten years:



Recent News – Interview with Berkowitz (February 8, 2012) – Sears Holdings stock price has fluctuated significantly because of the questions regarding whether its future will be as a retailer or whether it will be liquidated. In a February 8, 2012 interview Mr. Berkowitz talked about the "intrinsic value" of Sears. On February 8, 2012 the share price was $48.80 per share. Berkowitz would not comment on an exact intrinsic value number, but said that when you consider the real estate, brands and online stores you come up with a pretty big number at "multiples" of current levels. His comments from the interview are excerpted below:

> **Bruce:** Great, if you've got questions, hopefully, we'll have answers.
> **Fred:** Okay. The most asked question was about Sears. People want to know what is the intrinsic value of Sears?
> **Bruce:** That seems to be the $64 question, and it's hard for most to get a hold of it because of the different components. Everyone knows there's real estate, that they're a brand, and there's an online component. A lot of people don't realize that there's a service business with 12 million visits to homes every year, a warranty business on the products. Of course there's Sears Canada – mostly owned by Sears now. But the real interesting issue which people have to get their hands around is the long leases that Sears and Kmart have. You have to ask yourself the question, when does the long lease equal in value what ownership is. So when you take into account the very long leases and just the nature of what it is to be an anchor in a mall, how you become an anchor and the terms and conditions of becoming an anchor in a mall, there's tremendous value. Quite a lot of work to get there, but when you add up all the values, including the long leases and the importance of anchors in malls, plus the brands, whether it's Lands' End online or the Sears websites that are doing reasonably well, you come up with a pretty big number. The number is multiples of what we think the current stock price is, but we'll let everybody on the outside figure out what the exact range is.

A complete copy of the interview released by Fairholme Funds may be found at ValueWalk-Berkowitz. In this excerpt of the interview Berkowitz cites not only the real estate, but the leases which are driving fair values.

Recent News – Earnings Announcement (February 23, 2012) – On February 23, 2012 Sears reported a colossal fourth-quarter loss of $2.4 billion as a result of asset, principally goodwill, write-downs and tax-related expenses – principally the establishment of deferred tax asset valuation allowances (i.e. non-cash charges). The year-to-date loss was $3.1 billion. However, Sears's shares jumped after news that the retailer will sell 11 mall-based Sears' stores to a real estate investment trust and will spin-off its Sears Hometown chain, its outlet stores and certain hardware stores. Post announcement shares closed at $61.80 – nearly 20% higher than the stock's prior day market closing price of $52.08. In the press release Mr. Ambrosio, CEO of Sears, stated:

> It's .. important to distinguish between our earnings issue and the strength of our balance sheet, where we have significant assets and liquidity. We are further strengthening our balance sheet by approximately $1 billion through the actions we are announcing today.

Price vs. Book Value Per Share – Below is chart from Bloomberg which summarizes Sears EPS, Price-to-Book, Price, and Book Value Per Share over the ten year period 2002 to 2012. Several observations can be made with respect to the information content of this chart:

1) For the period from 2002 through 2005, the measurements move in lock-step albeit with a lag on price and book value per share to price-to-book.
2) From 2005 through 2007 and increasingly from 2007 onward to 2012, the book value per share and the price per share diverge significantly with book value per share substantially above price per share. In early 2012, with the write-downs of deferred tax assets, goodwill and other items, you see the book value per share and the price per share begin to converge and change positions.

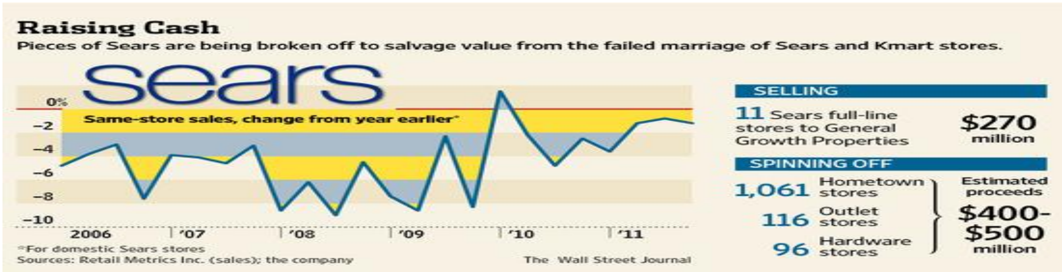
What this chart suggests is that the market priced these impairments and write-downs before they were taken by the company.

Will Sears Survive as A Retailer or Be Liquidated? – Post release many in the market place debate the extent to which real estate sales and spin-offs signal the break-up (liquidation) of Sears and whether this will result in an increase in market value. As reported in Forbes (February 29, 2012), *Analyst on Sears: Like a Sinking Ship*, this excerpt notes significant doubt regarding Sears viability as a retailer.

> When an equity analyst issues a report like this one from Credit Suisse's Gary Balter, it's time to take notice. Balter thinks management is stripping Sears Holdings of its assets. As *Crain's Chicago* notes:
>
> …when one likens a company to both a sinking ship and a foreclosed house, it's pretty much the equity analysis equivalent of a Charlie Sheen outburst (without the drugs).
>
> Last week Sears announced it was closing more stores and separating the Hardware, Hometown and Outlet businesses. Management expects this to generate $400 to $500 million, "unlocking the value of those businesses." It's also selling 11 stores for $270 million, generating cash from real estate. Along with inventory reductions, Sears Holdings says it will further strengthen its balance sheet by $1 billion.
>
> But that's just getting money out of an otherwise failing venture, since Sears has yet to demonstrate any retail prowess, as in selling goods and services.
>
> In a letter to employees last week Sears Holdings President and CEO Lou D'Ambrosio said:
>
>> We're taking immediate actions to restore the strength of Sears Holdings. These actions are targeted to improve operations, unlock the value of our assets and portfolio, and accelerate our strategy around Integrated Retail.
>>
>> We are an asset-rich company with multiple resources at our disposal and ample financial flexibility. As you talk to friends, neighbors and our customers, it is important to distinguish between our operating performance – as reflected in our earnings – and our balance sheet and liquidity, which are strong.
>
> But Sears Holdings isn't generating cash from retail operations and hasn't in a long time and when analysts like Balter say things like "I now see that returning to positive operating cash flow levels is likely impossible, so let me keep the ship afloat while I dispose of the dinnerware and other valuable items before abandoning" — it rings a little too true.
>
> Is Sears trying to appear like a stable company working on its retail problems while management strips it of all value? Or are they just trying to buy time before making some kind of effort to right the retail stores?

As reported in the Wall Street Journal (February 24, 2012), *In Retreat, Sears Set to Unload Stores*, many believe the recent actions signal the liquidation of Sears' assets. Relevant excerpts from the article are presented below:

> After seven years of trying to rebuild the iconic retailer Sears, hedge-fund manager Edward S. Lampert reversed course on Thursday, announcing that Sears Holdings Corp. will unload more than 1,200 stores in an effort to raise up to $770 million of much-needed cash.
>
> Many on Wall Street interpreted the move as the beginning of the breakup of the company. Sears on Thursday reported a loss of more than $3 billion for 2011, and same-store sales have fallen for six straight years. The company's shares, which fell below $30 last month, rose almost 19% on Thursday to $61.80 on news of the asset sales.
>
> But that plan hasn't worked. Now, in the face of mounting concerns about its liquidity—its cash shrank to $754 million at year-end, from $1.4 billion a year earlier—Sears is selling 11 stores to General Growth Properties Inc., the company that owns the malls they anchor, for $270 million. Sears also intends to raise $400 million to $500 million through a rights offering, spinning off a company that will control roughly 1,250 small but profitable franchised stores that sell Sears products.



The moves didn't answer questions about the long-term viability of the 126-year-old retail brand, and its executives offered few new specifics about their plans for Sears over the next couple of years, reiterating their intention to use technology to revive the fortunes of the more than 2,000 remaining Sears and Kmart stores.

Mr. Lampert, a onetime Goldman Sachs arbitrager, controls roughly 61% of Sears through his hedge fund, ESL Investments Inc., and he serves as Sears's chairman. In a letter to Sears' shareholders Thursday, he said: "We will make the difficult decisions required to position Sears Holdings for the future." He didn't rule out selling or spinning off other assets, such as the company's successful Lands' End clothing business, which it acquired before he bought Sears.

Unlike many retailers, which lease space in malls, Sears owns many of its stores. It has an array of venerable in-house brands, including Craftsman tools, and it remains the largest seller of appliances in the U.S.

<u>What Does All This Mean In Assessing The Proposed Update?</u> – What does all this mean relative to the importance of real estate property, fair values and this Proposed Update on IPEs? The point is this: Whether or not Mr. Berkowitz's thesis on the value of Sears is correct, he is correct in that the value of its real estate is relevant to the analysis and valuation of an entity's value – irrespective of management's intent or the nature of the legal entity – and the financial statements provide no disclosure of such values.

This example demonstrates that the fair value of real estate is relevant to investors even if housed within a business which does not "invest" in real estate but utilizes such real estate in operating its business. Because the fair value information of the real estate properties is not even disclosed, Berkowitz is attempting to capitalize on the asymmetry of information and – as noted in the opening quote – the time and knowledge sophisticated investors have to seek such information and perform such analysis. This asymmetry of information will benefit some and disadvantage others depending upon the positions they take. Accordingly, we think it is important for the Board to include real estate fair values – at a minimum – as a disclosure in the financial statements.