NCREIF PREA
Reporting Standards

Via Email:standards@cfainstitute.org
CFA Institute Global Investment Performance Standards (GIPS®)
RE: Response to the GIPS 20/20 Consultation Memo
915 East High Street Charlottesville, VA 22902
July 25, 2017

Dear GIPS Executive Committee:

This letter represents the NCREIF PREA Reporting Standards Board's (RS Board) and Council's (RS Council) comments to the CFA Institute regarding the GIPS 20/20 Consultation Memo. We commend the Global Investment Performance Standards Executive Committee for attempting to update, revise, and reimagine the GIPS standards to provide investors and managers with guidance that is more streamlined and structural than the current GIPS standards.

We appreciate the opportunity provided by the GIPS Technical Committee to comment on the Consultation Memo. We understand that comments received on this initial outreach will be considered as you work towards an exposure draft and the reissuance of GIPS in 20/20. We welcome the opportunity to continue and further our collaboration with the GIPS Real Estate Working Group (REWG) (whose members actively participate in our efforts in the US and globally) as you consider changes for private, non-listed real estate investments.

The focus in this response letter is to respond to the Consultation Memo on behalf of the private non-listed real estate investment industry. We understand the proposed GIPS 20/20 standards are to provide performance standards that are dependent on structural characteristics instead of investment types. This will provide prospective investors with comparable representative presentations when making investment decisions and will eliminate some nuances and confusion when applying the GIPS standards to mixed-investment structures and alternatives. While the GIPS standards focus on the marketing of discretionary investment products to prospective investors, from our experience many organizations (such as NCREIF and PREA for the creation and maintenance of the Reporting Standards) look to the provisions of the GIPS standards as the foundation for our discretionary and non-discretionary fund reporting requirements to existing investors With that we encourage the Executive Committee to collaborate with industry organizations who represent investment managers, investors, and consultants (such as NCREIF, PREA, INREV, and ANREV within real estate) to ensure that the requirements across alternative investments and portfolios are harmonized to prevent the need for investment managers to report performance in different manners leading to confusion rather than increasing transparency within the industry. We contend that GIPS reporting, NCREIF PREA Reporting Standards Fund Reporting and investor specific reporting all provide different yet complementary objectives. The different reporting should not contradict, but (as indicated in our response) may provide additional information to address fund reporting nuances and investor specific requests.

Respondent

We collaborate with the CFA Institute on numerous projects. A detailed description of the NCREIF PREA Reporting Standards, its sponsorship, team and initiatives, can be found on our website, www.reportingstandards.info.

Please note that NCREIF, PREA, INREV and ANREV have provided feedback that is reflected in this response for the purpose of collaboration on the development of global reporting standards for our industry.

Responses

Our responses to the specific questions posed in the exposure draft are included in Appendix 1 to this letter.

We would be pleased to collaborate with the Executive and Technical Committees regarding our responses in Appendix 1. Please feel free to contact Marybeth Kronenwetter, NCREIF Director, Reporting Standards at 630-469-4088.

Nathan Zinn, Reporting Standards Board Chair

Aon Center, 200 E. Randolph St., Suite 5135
Chicago, IL 60601 +312.819.5890
www.reportingstandards.info

1. Structure

The GIPS standards as they are now focus primarily on the use of composites, which are the aggregation of individual portfolios managed to the same strategy. Although this is useful in situations where firms are presenting strategies to prospective clients who are interested in having the firm manage a separate account, when firms are selling participation in an individual pooled fund, composite reporting may not be relevant or appropriate. There needs to be clear guidance on situations where the firm is not selling a composite strategy but instead is selling participation in a pooled fund. There is another fundamental difference between how composite performance is presented by investment managers and asset owners. Investment managers have prospective clients and asset owners do not, and asset owners primarily report performance to their oversight boards.

Therefore, we are planning to structure the 20/20 edition of the GIPS standards differently. We believe that the relationship between the party presenting performance (i.e., the investment manager or asset owner) and the receiver of the information (i.e., prospective client, prospective pooled fund investor, or oversight board) is the defining criterion regarding how performance should be presented. Our thinking is to organize the GIPS standards into three "pillars," based on the following:

- *One to one*—composite performance is appropriate. This pillar is where the investment manager has an individual, one-to-one relationship with the client. For example, a typical institutional separate account would fall under this category. This type of relationship is usually characterized by the client's ability to have input into the management of their portfolio (e.g., specific risk constraints, liquidity level), resulting in a customized, client-specific portfolio. This pillar will have many of the same requirements and recommendations currently seen in the GIPS standards.
- *One to many*—fund performance is appropriate. This pillar is where the investment manager is selling participation in a specific pooled fund. This pillar will expand on the concepts currently in the Guidance Statement on Broadly Distributed Pooled Funds and include guidance for all pooled funds, including limited distribution pooled funds, as well as closed-end, fixed life, fixed commitment portfolios where investment managers control the cash flows.
- *One to none*—for asset owners that have no prospective clients. This pillar will have many of the same requirements and recommendations in the Guidance Statement on the Application of the GIPS Standards to Asset Owners.

Question 1: Do you agree with the pillars concept? If so, should there be any other pillars?

Overall, we appreciate the perspective to start with a top down approach by first identifying the end user of the compliant presentation. The performance information should be catered to their investment intentions in order to facilitate their investment decisions.

Using the definitions you have provided for the three-pillar approach, we have identified the private equity real estate products for each of the three pillars. For the "one to one" pillar, we agree that composite performance should be the primary presentation. In private equity real estate, we have individual client products identified as discretionary separate accounts mandates, which may share many characteristics (strategy, risk profile, sector/geography diversification) which would benefit from a composite presentation. For the "one to many" pillar, we think providing fund performance through a product performance report is consistent with how real estate advisers market commingled funds and what real estate investors generally request. For the "one to none" pillar, we have real estate investment asset owners who would benefit from this approach.

Please note that within the real estate industry, there are joint ventures and club deals where the investment(s) are identified and the marketing dissemination is targeted. Using the pillars approach, such structure may be considered "one to many" as there are various parties investing in one product. As an industry, we market and report these structures similar to a "one to one" relationship. Such nuances should be considered while defining relationships related to disseminating performance. Also, please note that a pure product approach within the one to many pillar may limit the ability to aggregate the performance of similar strategies which are included in another pillar. For example, a discretionary separate account (in one to one pillar) may have a similar mandate as a core diversified product (in the one to many pillar).

The proposed framework may be too simple to adhere to given the complexity of these types of structures. We encourage the GIPS Executive Committee to continue to work with real estate working groups as they provide more guidance around these pillars.

2. Pooled Funds

One of our goals with the 20/20 edition is to better accommodate the presentation of pooled fund performance versus composite performance. We have begun to apply this concept with the recently issued Guidance Statement on Broadly Distributed Pooled Funds. GIPS 20/20 will expand on the concepts in this Guidance Statement.

Currently firms are required to make every reasonable effort to provide a compliant presentation to all prospective clients. Firms will still be required to do so when they are marketing a composite strategy. In GIPS 20/20, we are proposing that firms managing any type of pooled fund would be required to present to prospective investors in those funds a pooled fund report that would include only the pooled fund's information. The information required to be included in a pooled fund report will depend on whether the pooled fund is typically broadly distributed or not and whether it is a closed-end, fixed life, fixed commitment fund where the investment manager controls the cash flows. The fund report information may differ from the information included in a composite compliant presentation. We believe that the performance of a single fund that is presented to prospective investors should be required to be presented net of all fees and expenses because this reflects the pooled fund client experience. In addition to presenting returns that are net of all fees and expenses, firms may choose to present gross-of-fees returns as permitted by regulatory requirements.

Pooled funds would still be required to be included in the appropriate composite according to the investment mandate, objective, or strategy if they meet the composite definition. However, firms would not be required to create single-fund composites simply to meet the requirement that "all fee-paying discretionary portfolios must be included in at least one composite." Firms would be required to create a list of all composite and pooled fund descriptions.

Question 2: Do you agree with the proposed treatment of pooled funds?

Yes. We agree with the proposed treatment of pooled funds as described above. Please note that we understand that the Guidance Statement on Broadly Distributed Pooled Funds specifically excludes real estate and private equity. We contend that this exclusion should be lifted so that the proposed treatment of pooled funds encompasses real estate.

3. Asset-Class-Specific Guidance

Currently the GIPS standards have specific provisions and guidance on private equity, real estate, alternative investment strategies and structures, and wrap fee/separately managed account (SMA) portfolios. We propose reducing the number of asset-class-specific guidance wherever possible. For example, many of the requirements for private equity and closed-end real estate funds are very similar. These requirements were created as a result of the investment structure (e.g., closed-end limited partnership) rather than the specific asset class. The current private equity and real estate closed-end fund provisions could be consolidated and could include other strategies that use a similar investment structure.

Question 3: Do you agree that asset-class-specific guidance should be consolidated where possible?

Yes, where practical and possible, the asset class specific guidance should be consolidated. The prospective pillars and structure approach adheres to a top-down, investor based decision tree. As such, defining guidance characteristics at vehicle structure seems to be logical and appropriate as applicable. For example, within the Reporting Standards, we have grouped standards by structure, distinguishing open-end commingled funds from closed-end commingled funds. Although there are common standards across all commingled funds, open-end funds and closed-end funds have a number of different performance and valuation provisions. For example, in the Reporting Standards, IRR is the primary performance measure for closed-end funds while time-weighted return (TWRR) is the primary performance measure for open-end funds. Further, closed-end real estate and private equity investment structures and partnerships share many similarities. The GIPS Executive Committee should consider how to effectively balance the consolidation of guidance with asset specific guidance. Consolidating guidance may lead to a more streamlined process, however, it risks losing some of the asset specific details that may be more readily flushed out through standards that are allowed to address asset-class specific concerns. We would be pleased to collaborate further with you on this topic.

4. Time-Weighted Rates of Return vs. Internal Rates of Return

We would like to eliminate the current approach in which the return required to be used is based on the underlying investments in the portfolio, and instead, base the calculation methodology decision on the portfolio structure. For open-end funds and composites with separate accounts, time-weighted rates of return (TWRR) would be required. For closed-end, fixed life, fixed commitment funds, for which the investment manager controls the cash flows, firms would be allowed to present internal rates of return (IRR) or TWRR. Once a firm determines which methodology is more appropriate, it would create a policy and apply it consistently to the pooled fund or composite. This change would allow the GIPS standards to be more readily adopted by firms that offer fixed life, fixed commitment products where the investment manager controls the cash flows.

Question 4a: Do you agree with the proposal that firms should be allowed to choose whether to present IRRs or TWRRs for any closed-end, fixed life, fixed commitments fund where the firm controls the timing of the cash flows?

No. For GIPS reporting (which is for prospective investors), we do not agree that firms should be allowed to choose whether to present IRRs or TWRRs for any closed-end, fixed life, fixed commitment fund where the firm controls the timing of the cash flows. Rather, from our perspective and for GIPS standards reporting to prospective investors, it is important that the GIPS standards define a primary return metric. For closed-end, fixed life funds (including real estate and private equity) the advisor controls the timing of the cash flows and therefore the appropriate performance measure is IRR. For open-end funds, the primary return metric must be TWRR.

Please note that the topic of requiring closed-end funds to report TWRRs to existing investors for fund reporting purposes is hotly debated within the NCREIF PREA Reporting Standards. We intend to communicate and involve members of the GIPS REWG as our deliberations continue and are resolved. While we appreciate that GIPS is for prospective clients, we recognize and appreciate that existing investors may request TWRR information to aggregate their positions in all their portfolio investments. These investor specific requests are readily accommodated within the NCREIF PREA Reporting Standards.

Question 4b: What criteria should be required for a firm to be allowed to present an IRR versus TWRR?

Overall, it should start with cash control. If the adviser lacks the ability to control cash for a respective portfolio, the return metric should default to a TWRR. This is the case with open-end real estate funds. If the adviser can control the inflows/outflows of cash, the requirement for reporting to prospective investors should be IRR as the adviser should be judged on market timing as well.

The GIPS Executive Committee should provide additional clarification regarding the nuances and decision tree regarding these criteria. Similar to previous questions, we hope the Executive Committee continues to work with us to define the appropriate use of certain return metrics.

5. Valuation Frequency

For time-weighted rates of return, the more frequent the valuation and performance calculation, the more accurate the return. The requirement at this time is that firms calculating TWRRs must value portfolios monthly and at the time of all large cash flows. We have heard from some firms that valuing at the time of large cash flows means that they must have the ability to value daily anyway and that they moved to daily valuation years ago. That said, we remember the concerns that some firms had in 2010 about being able to value daily. These concerns brought us to the current requirement to value monthly and at the time of large cash flows.

When calculating IRRs, we are proposing that portfolios would be required to be valued annually. We are also proposing that firms would be required to value portfolios whenever performance is calculated and reported to prospective clients or prospective fund investors. For example, if a firm is calculating IRRs through 30 June, the firm must value the portfolio as of 30 June.

Question 5a: For calculating TWRR, do you believe that valuing monthly and at the time of all large cash flow suffices?

No. We recommend that we maintain the quarterly valuation frequency as currently stated in GIPS 6.A.2. “For periods beginning on or after 1 January 2008, Real Estate Investments must be valued at least quarterly.”

Question 5b: For calculating IRR, do you agree with the proposed valuation frequency for all portfolios regardless of the underlying investment or asset class?

No. For real estate open and closed-end funds, we contend that valuations should be performed on a quarterly basis. This is consistent with the NCREIF PREA Reporting Standards requirement for quarterly fair value reporting. In addition and as stated above, valuations can be internal or external and annual external appraisals must be required for open-end funds. Within the NCREIF PREA Reporting Standards, we are working to provide guidance on minimum standards which must be considered for any internal valuation. In addition, the requirement for annual external appraisals for closed-end real estate funds is also hotly debated. Consistent with our answer to question 4a above, we intend to communicate and involve members of the GIPS REWG as our deliberations continue and are resolved.

6. Distribution of Composite Compliant Presentations and Pooled Fund Reports to Existing Clients

The GIPS standards have always been focused primarily on the prospective client relationship and the information that must be provided to prospective clients. Currently, investment management firms are required to make every reasonable effort to provide a compliant presentation to all prospective clients. No GIPS-compliant information is required to be provided to existing clients.

In the situation where investment managers of closed-end, fixed life, fixed commitment funds are raising capital for a new fund, there is typically no fund track record available to present because the fund has not yet begun investing. Therefore, the GIPS-compliant fund report with a performance track record would never be seen by the investors in that fund if the requirement is limited to prospective clients.

Also, once a prospective client becomes an existing client under the current requirements, they would never again be required to receive a GIPS-compliant presentation of the composite's performance track record. Although an existing client has initially made the decision to invest with an investment management firm, it is constantly evaluating that decision and determining whether to add, withdraw, or continue investing at the same level. An existing client is effectively always a prospective client. The same is true for existing pooled fund investors.

We believe that GIPS-compliant information should be provided to existing clients/pooled fund investors as well as prospective clients/pooled fund investors. We, therefore, are proposing that investment management firms should be required to make every reasonable effort to provide the composite compliant presentation or pooled fund report to existing clients/investors in the composite/pooled fund on an annual basis. Alternatively, we are considering proposing that investment management firms make an offer to provide a composite compliant presentation or pooled fund report to existing clients/pooled fund investors on an annual basis.

Question 6a: Do you agree that firms should be required to provide a pooled fund report to investors in the pooled fund on an annual basis?

No, investment management firms should offer to provide a pooled fund report to investors. If this becomes a requirement, the GIPS compliant pooled fund report should be added to the back of the annual report, similar to the financial statements.

Question 6b: Do you agree that firms should be required to provide a compliant presentation to existing clients in the composite on an annual basis?

No, investment management firms should offer to provide a compliant presentation to investors. In situations that an investor only wants to receive their reports within their intended format, requiring dissemination seems to be unnecessary.

Question 6c: Do you agree that firms should be required to make an offer to provide a composite compliant presentation or pooled fund report to existing clients or pooled fund investors on an annual basis?

Yes, in order to meet the spirit of the GIPS standards we agree that it is important for firms to offer to provide a compliant presentation (or fund report) to current investors who wish to see such a document. Existing clients generally are making an active decision to maintain their investment with the investment manager, in effect rendering those existing clients and prospective clients at the same time. By affording GIPS compliant reports only to prospective investors that are not existing clients the investment manager may inadvertently be providing more transparent information to these prospective investors. Given the continuous re-evaluation and decision making process in which most investors engage, affording them the opportunity to review GIPS compliant information on an annual basis would increase transparency and consistency of information that investment managers provide to the marketplace. Further, it may increase consistency and reduce redundancy within the investment manager arena as a single GIPS compliant report could be used for prospective investors and existing clients.

7. Total Firm Assets

We recognize that advisory assets are becoming a larger part of the investment management industry. These assets include unified managed accounts (UMAs), model portfolios, and advisory-only portfolios. Currently these assets are not included in GIPS total firm assets. The underlying portfolios in overlay strategies that are not managed by the firm are also excluded from total firm assets. We are considering whether these assets should be included in compliant presentations differently by creating a new category of assets that includes assets managed, advised, and overlaid. We are also considering whether this information should be required or recommended to be included in compliant presentations.

Question 7a: Do you agree with creating a new category of assets as described above?

Yes, we agree there should be an additional category of assets that includes assets managed, advised, and overlaid. By creating the referenced new categories of assets, the enhanced definition of total firm assets may provide prospective clients and existing investors with a deeper understanding of the firm's business, strategy, areas of focus and potential risks.

Question 7b: Which assets should be included in this new category of assets (e.g., UMAs, models, overlay, and advisory-only portfolios)?

From a real estate private equity perspective, the only additional category that would be included is asset management-only portfolios and serviced assets for lenders.

Question 7c: Should firms be recommended or required to report this new category of assets as well as total firm assets in compliant presentations?

We contend that the new category should be recommended. Requiring firms to present the proposed new categories of assets may create an onerous and heavy reporting burden, particularly for model portfolios or advisory-only portfolios. Conversely, recommending that firms include such categories of assets in compliant presentations, perhaps requiring the firm to disclose whether or not they have chosen to report such categories, would allow firms the opportunity for increased clarity in the firm's total assets without requiring additional reporting when overly burdensome or costly.

8. Non-Fee-Paying Portfolios

Currently only actual, fee paying, discretionary portfolios must be included in a composite. Firms may choose to include or exclude non-fee-paying portfolios from composites. We are considering removing the "fee-paying" criterion, so that all actual discretionary portfolios must be included in a composite. Doing so would ensure that composites include all portfolios managed according to a specific strategy.

Question 8a: Do you agree with no longer allowing firms to exclude non-fee-paying portfolios from composites based solely on fee-paying status?

No, given recent stances taken by regulatory bodies, requiring firms to include non- fee paying accounts (or even assets) may cause firms to report numbers that are not fully in compliance with the GIPS standards or disclosures, due to laws or regulations that conflict with the standards. It may be worth requiring firms to disclose composite AUM and as a separate data point the AUM of non-fee paying assets managed to the composite to facilitate fair representation and full disclosure. Combining fee paying and non-fee paying portfolios within a composite will distort the net of fee return results.

Question 8b: How should non-fee-paying portfolios be treated for net-of-fees calculations?

Non-fee paying portfolios should not be required to be included in a composite. In the instance of portfolios that pay only an asset management fee it is easy enough to calculate the returns net of a model fee. However, when looking at alternative investments which are more likely to be subject to a performance fee, modeling out these fees on a non-fee paying account and the necessary review of these calculations can add an undue burden on asset managers that offers little to no valuable insight to investors.

9. References to the Firm's Claim of Compliance

Currently firms can state that they claim compliance with the GIPS standards in only three ways: in a compliant presentation, in an advertisement that is prepared in accordance with the GIPS Advertising Guidelines, and in a GIPS Pooled Fund Claim of Compliance that is included in the official pooled fund document or fund-specific marketing material for a broadly distributed pooled fund. We are considering expanding how firms can demonstrate that they are in compliance beyond the three ways allowed now. It is important that firms be able to state that they are GIPS-compliant in more than just these three ways. Including a statement that the firm claims compliance with the GIPS standards in more marketing materials would help to increase awareness of the GIPS standards.

Question 9: Do you agree that firms should have more flexibility to state that the firm complies with the GIPS standards?

Yes we agree that firms should have more flexibility with stating the firm complies with the GIPS standards.

10. Timeliness and Frequency of Compliant Presentations

As previously discussed, firms must make every reasonable effort to provide a compliant presentation to all prospective clients. Currently, there is no guidance on the timeliness of the compliant presentation. Some firms are distributing compliant presentations that are not current (e.g., in September 2016, providing prospective clients with compliant presentations that include annual returns through December 2014). We understand that some firms are reluctant to update compliant presentations until the firm's verification is complete. We are considering requiring firms to provide compliant presentations to prospective clients on a timely basis that include more current performance.

Question 10a: Do you agree with requiring firms to update compliant presentations on a timely basis?

Yes. We agree that firms should update compliant presentations on a timely basis. Requiring firms to provide more timely compliant presentations (e.g., one year, not more frequently) would help ensure more relevant information is distributed to prospective clients.

Question 10b: How current should the information be required to be in a compliant presentation?

GIPS compliant presentation should not be older than 1 year.

11. Estimated Trading Expenses

Currently, all returns must be calculated after the deduction of actual trading expenses incurred during the period and estimated trading expenses are not allowed. When the GIPS standards were originally created, trading expenses were generally higher than they are now and were more standardized. Today, trading expenses can be charged in a variety of ways and may not be under the control of the firm. Indeed, in some instances, firms may not have the ability to determine how or where trading expenses are charged. We, therefore, are considering allowing firms to use estimated trading expenses, if returns are equal to or lower than those that would have been calculated if actual trading expenses had been used. We would expect firms to determine the estimated trading expense rate based on other portfolios managed by the firm that do pay them.

Allowing estimated trading expenses may eliminate the need for specific wrap fee/SMA requirements and recommendations.

Question 11: Do you agree with allowing firms to use estimated trading expenses?

Trading expenses are transparent within our industry so estimating trading expenses would not be applicable.

12. Compliant Presentation Numerical Information and Disclosures

Firms are required to include certain numerical information and disclosures in compliant presentations. We hope to eliminate any items that are not particularly helpful or informative.

We would also like to consider whether there are other items that should be required to be included in compliant presentations (e.g., attribution information or asset allocation).

In addition, we are considering whether there are disclosures that are only relevant for a certain length of time (e.g., five years) and should be allowed to be removed from compliant presentations because they are no longer relevant.

Question 12a: Which existing numerical information and disclosure requirements, if any, should be removed?

There are not current numerical information or disclosure requirements for real estate private equity that should be removed.

Question 12b: Is there any information not currently required that should be required in compliant presentations?

Currently, there is not a lot of guidance within the GIPS standards for transparency with fees and expenses. This has been a focus of SEC examinations of real estate and private equity investment managers. There are efforts within the real estate and private equity industries to disseminate consistent and transparent disclosures with how advisers charge clients. As part of our global collaboration with INREV and ANREV, we are nearing conclusion on a global measure of fund fee load and related disclosures which we would be happy to share and discuss with you.

Question 12c: Are there any disclosures that can be discontinued after a certain period-of-time?

Disclosures that cover a period that is no longer included in the compliant presentation should be considered for removal. For example, if a firm only shows ten years of performance information in their compliant presentation, it likely does not offer any value for them to continue disclosing that the composite was redefined in 2002.

13. General

Question 13: Are there other issues that are important for us to address as part of the GIPS 20/20 project (e.g., private wealth, outsourced CIO, model/hypothetical performance, carve-outs and "building blocks")?

As the updates are contemplated, we encourage the Executive Committee and any other relevant committees or working groups to consider how the changes will impact the marketing of alternative funds as they relate to the marketing of funds with onshore and offshore feeders and other situations that may be encountered in a fund environment. In the case of a fund with onshore and offshore feeders the fees and expenses borne by the feeders can be materially different, especially at the inception of the feeder. This can be even more distortive to total fund performance if the feeders do not begin at the same time. While we understand it is impossible to provide guidance for every possible situation, it may be worth clarifying if funds as covered in the one to many pillar is intended to address the total fund or feeders.

Concerning external valuations, the Executive Committee may consider weighing in on the value of an external appraisal (either annual or a three-year period) in the case of closed-end funds given that investors cannot enter or exit the fund at will. Additional consideration should be given to what qualifies as an external appraisal as third party reviews are gaining in popularity. Please note that annual external appraisals for open-end funds should remain a requirement.

Regarding the use projected IRRs within marketing material and client presentations. We fully understand that such practices are not included in GIPS compliant presentations. However, in the guidance related to the use of Supplemental Information, the guidance stated calculating hypothetical performance with actual performance is restricted within and outside of GIPS compliant presentations. We disagree with this overriding requirement and presented this within our response letter to the Supplemental Information exposure draft.