Real Estate Information Standards (REIS)

CFA Institute
Global Investment Performance Standards
P.O. Box 3668
Charlottesville, VA 22903

Re: Guidance Statement on Alternative Investment Strategies and Structures

Dear GIPS Executive Committee:

This letter represents the Real Estate Information Standards Board's (REIS Board) and Council's comments to the CFA Institute regarding the exposure draft of the Guidance Statement on Alternative Investment Strategies and Structures. The REIS organization thinks that establishing specific guidance for alternative investments is a very important undertaking given the lack of guidance currently available.

We appreciate the opportunity provided by the GIPS Executive Committee to comment on the exposure draft. Our main focus in this response letter will be the applicability of these proposed revisions to the real estate industry.

We think that the hierarchy of applicability of these guidelines to private Real Estate (which has a dedicated chapter and guidance statement in the GIPS Standards) should be expressly stated. As noted in the responses to the questions, there are instances where the alternatives guidance statement contradicts the GIPS Standards Real Estate requirements and recommendations. Therefore, we recommend a statement which clearly states that these guidelines should be followed if guidance is not available within the real estate standards chapter or related guidance statements for real estate. We would expect the expressly stated applicability hierarchy would prove beneficial to private equity as well.

Responding Organization
We have been privileged to collaborate with the CFA Institute on numerous initiatives. A detailed description of REIS, its sponsorship, team and initiatives, including the Real Estate Information Standards can be found on the REIS web site (www.reisus.org).

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

We would be pleased to discuss our comments above or the answers to the specific questions at Appendix 1 with you at your convenience. , Please feel free to contact the undersigned at 978-887-3750 should you wish to discuss the contents of this letter.

Very truly yours,

John J. Baczewski

John J. Baczewski
Chair, Real Estate Information Standards Board

Appendix 1Responses to Individual Questions:

1. *Do you agree with the proposed requirements related to the frequency of portfolio valuations? Why or why not?*

   As mentioned in the introduction to our response, for our industry, we think the real estate standards and guidance provisions should take priority to the guidance established herein. Private real estate investments are generally valued quarterly and this practice is allowed in GIPS. Therefore, we think that the language in Section 2.2.2 should be amended to clarify that all real estate investments, including fund-of-fund and side-pocket investments that primarily invest in real estate, should continue to follow the valuation policies laid out in Section 6 in GIPS. Alternatively, as mentioned in the introduction to this letter, an overriding statement concerning applicability of this guidance to real estate would satisfy our recommendation for a specific call out within Section 2.2.2.

2. *Do you agree with the proposed treatment of estimated versus final values?*

   No, we think firms should be allowed to use estimated values without the requirement to restate history when the final values have been determined. Valuations in the real estate industry are appraisal based. In the U.S., all valuations- whether internal or external- follow USPAP and are based on appraisal models that approximate the sales price of the property based on market conditions, current and projected leasing and other metrics at that point in time. The accuracy of a firm's internal or external valuation can only be determined if the asset is sold in close proximity to the date of the valuation. This method of appraisal modeling to determine a price doesn't require the investment manager to restate history to reflect the actual price. Accordingly, we think alternative investments should be treated consistently with the practice currently utilized in real estate.

3. *Do you support different guidance for pooled funds and managed portfolios?*

   Based on the answer to question #2 above where we do not support the notion of publishing compliant presentations until the final valuations have been received, we do not support different guidance for pooled funds and managed accounts.

4. *Do you agree with requiring the disclosure of the use of estimated values? Why or why not?*

   Yes, we believe that requiring disclosures describing value estimations are appropriate as full disclosure is one of the guiding principles of GIPS.

5. *Do you agree with the proposed treatment of gross-of-fee returns and net-of-fee returns for master-feeder structures? Why or why not?*

   Due to the complicated structure of these arrangements where fees may be charged at all levels, we think the proposed treatment of gross-of-fee returns and net-of-fee returns should be consistent with the treatments described elsewhere in the GIPS where model fees or actual fees are allowed.

6. *Do you agree with the proposed treatment of side pockets? Why or why not?*

   In our industry, the use of side pockets often goes beyond what is described in the opening paragraph of Section 2.4.3 as they are commonly used to allocate larger ownership percentages in certain investments to some investors in existing commingled funds, outside what the other investors are willing to invest. For example, a core fund may allow 5% of its investment in non-core deals. If a large non-core deal is found that would push the fund above the 5% threshold, the fund may look to create JV in which the fund invests in 50% of the deal (keeping it under the 5% threshold) and a side pocket of existing fund investors who may have a larger risk appetite is created to own the additional 50%.

   We strongly believe that the inclusion of the side pocket within the performance of the pooled fund should be considered on a case-by-case basis. If the side pocket is still a fee paying, discretionary account that is managed by the firm, we believe that it should be included in one of the firm's composites. We believe that the manager should be able to determine which composite it belongs in based on the unique facts and circumstances of each case and it should not merely be tied to the associated pooled fund. For example, in the scenario provided in the preceding paragraph, it may be more appropriate to include the side pocket that was created to invest in the non-core asset with the firm's non-core composite, rather than automatically including it with the core composites simply because it is associated with the firms' core fund.

7. *Should a firm be required to disclose the creation of a side pocket in all instances? Or only when a side pocket is created to hold non-discretionary assets that are no longer reflected in composite performance? What should be required to be disclosed?*

   We believe that the firm should not be required to disclose the creation of side pockets in all instances. If however, the side pocket remains within the composite of the fund from which the side pocket was created, appropriate disclosures would include a general description of the investment as well as management reasoning for creating the side pocket may be appropriate.

8. *Do you agree with the proposed treatment of illiquid investments? Why or why not?*

   Yes, we agree with the proposed treatment of illiquid investments. In our industry, the illiquid nature of the investments is generally well understood by potential investors. Nevertheless, adding a disclosure requirement noting such is appropriate and consistent with the GIPS guiding principle of full disclosure.

9. *Should portfolios managed with discretionary leverage be allowed to be deleveraged for inclusion in composite performance? Why or why not?*

   No, firms should not be allowed to deleverage any leverage for composite purposes. We do realize that investors, consultants, and potential investors do sometimes find value in the deleveraged performance, so we agree that firms may be allowed to present those returns as supplemental information. However, a “de-levered” return is hypothetical and it is never appropriate to include such a return in a composite regardless of whether the leverage is discretionary or non-discretionary.

10. *Should portfolios managed with nondiscretionary leverage be allowed to be deleveraged for inclusion in composite performance? Why or why not?*

No, see our response to question 9 above.

11. *Should firms be allowed to adjust portfolio and composite performance for the double counting of assets?*

Yes, we think firms should be allowed to adjust portfolio and composite performance for the double counting of assets. We fundamentally believe that double counting should not be allowed. However, we recognize that the composite structure coupled with the complexity of the underlying funds and limitations of existing performance measurement software may make adjustment to eliminate double counting of assets impractical especially in the case of a fund of funds.

12. *Alternatively, do you agree that firms should be prohibited from recalculating portfolio and composite performance to eliminate double-counted assets? Why or why not?*

While we believe double counting should not be allowed, complexities within investments may make the removal of double counted investments impractical. Therefore, firms should be given the option to eliminate the double counting of assets if they chose. The firm's GIPS policies and procedures should address how double counting is handled and disclosures should be developed and consistently applied across all composites.

13. *When presenting net-of-fee returns, firms are allowed to reduce gross-of-fee returns by the actual investment management fee incurred by each portfolio or a model fee. The model fee must be the highest investment management fee incurred by portfolios in the composite. Should firms also be allowed to present net-of-fee returns that are reduced by a model fee which is the maximum investment management fee applicable to the prospective client, even if it is not the highest investment management fee that is incurred by portfolios in the composite? Why or why not?*

See response to question 5.