NCREIF PREA

Reporting Standards

EXPOSURE

DRAFT

Proposed changes to time-weighted return and related disclosures requirements for closed-end funds

EFFECTIVE DATE: FOR FISCAL YEARS ENDING AFTER DECEMBER 15, 2018 WITH EARLY ADOPTION ENCOURAGED

INVITATION TO COMMENT: NOVEMBER 20, 2017 TO JANUARY 22,2018

Executive Summary

The mission of the NCREIF PREA Reporting Standards ("Reporting Standards") is to establish, manage and promote transparent and consistent reporting standards for the real estate industry to facilitate informed investment decision making. In 2015, the Reporting Standards Council ("Council") performed an outreach to a group of closed-end, value-added funds in an effort to broaden the applicability of the Reporting Standards to the same group. Two requirements were identified as being an issue for investment managers: (1) the disclosure of time-weighted returns ("TWR") and (2) annual external appraisals[1]. The Council commissioned a task force in December 2015 to research, analyze and, if appropriate, recommend changes to the Reporting Standards.

This Exposure draft outlines a proposal to amend the current requirements for closed-end funds to report time-weighted returns.[2] The Council is seeking comments from the public through a 60 day period, which concludes on January 22, 2018. Changes to the Reporting Standards will be made upon successful conclusion of the public comment process and final approvals by the Reporting Standards Board. The effective date for any changes to Handbook Volume 1 is expected to be for fiscal years beginning after December 15, 2018, with early adoption encouraged.

Recommendations

Based on the research and analysis outlined in this Draft, the Council recommends the following actions.

Changes to the Reporting Standards for Closed-End Funds

- Change the requirement to report TWR and replace with a requirement to make an offer to provide (i.e., option) to investors.
- Add an additional required disclosure to the existing required disclosures for TWR relating to start and end dates
- Keep the requirement to report IRR, and add another disclosure to the existing required disclosures for IRR relating to start and end dates.

Topics requiring further research and discussion

- This exposure draft addresses fund level reporting. However, in order to ascertain the relevance and applicability of TWR for closed-end funds, investor and investment manager survey respondents were asked about the relative importance of TWR at the investor level. This topic will be explored further.
- Given the complexities and independent discussions required for both issues identified in the initial outreach, a separate task force will be formed to explore the annual external appraisal requirement.

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[1] Per the Reporting Standards, unless client agrees to another frequency but in no event less frequently than once every three years.

[2] March 31, 2014 version of the NCREIF PREA Reporting Standards Handbook, Volume 1 (Handbook Volume 1)

Proposed Changes

Figure 1: Current version of Handbook Volume 1

Element	Frequency	Required or recommended element	Handbook Volume I Reference
Total Time-Weighted Return (TWR) - Gross and Net of Fees	Quarterly	Required	PR.01
Disclosures accompanying TWR	Quarterly	Required	PR.01.1-01.6
Since Inception Internal Rate of Return (IRR) – Gross and Net of Fees	Quarterly	Required	PR.06
Disclosures accompanying IRR	Quarterly	Required	PR.06.1-06.3

Figure 2: Proposed Changes to Handbook Volume 1

Element	Frequency	Required or recommended element	Handbook Volume I Reference
Agree to report or make an offer to provide Total Time-Weighted Return (TWR) - Gross and Net of Fees	At fund inception	Required	TBD
When reported, total Time-Weighted Return (TWR) –Gross and Net of Fees	Quarterly	Required	TBD
Disclosures accompanying TWR when reported	Quarterly	Required	TBD
Disclosures accompanying TWR start dates and end dates when reported (new)	Quarterly	Required	
Since Inception Internal Rate of Return (IRR) – Gross and Net of Fees	Quarterly	Required	PR.06
Disclosures accompanying IRR	Quarterly	Required	PR.06.1-06.3
Disclosures accompanying IRR start dates and end dates (new)	Quarterly	Required	TBD

The proposal to amend the aforementioned Reporting Standards requirements for closed-end funds provides the following benefits:

✓ Maintains the overall integrity of the Reporting Standards and its mission to establish standards which are useful, transparent and comparable thereby facilitating informed investment decision making and which can be complied with without incurring significantly increased time and cost burden.

- ✓ Maintains Reporting Standards which are structure based, promoting consistency of performance measures most meaningful to closed-end real estate funds and private equity investments.
- ✓ Maintains a consistent set of Reporting Standards which may be used for index and data product contribution and reporting.
- ✓ Reconciles diverging views of managers and investors with respect to the relevance of time-weighted returns for fund reporting while maintaining the standards established within the Reporting Standards for calculation and disclosures.
- ✓ Time-weighted returns are offered to all investors yet provided only to those investors that find such information useful and relevant.
- ✓ Amendment to the requirement does not conflict with the considerations being made within the Global Investment Performance Standards-GIPS® [3] when it is reissued in 2020.

Invitation to comment

The NCREIF PREA Reporting Standards Board ("Board") and Council seeks comment on the proposal set forth here regarding changes to the Standards for closed-end funds with respect to the requirement to report time-weighted returns and certain related disclosures.

Five questions are included in this document to obtain feedback on specific issues. In addition to responding to these questions, please provide feedback on the entire document, including items you support. All comment letters will be considered and are greatly appreciated.

Comments must be submitted and received no later than January 22, 2018. Responses will be accepted by e-mail or hard copy only. Unless requested otherwise by the responding organization, all comments and replies will be made public on the Reporting Standards website (www.reportingstandards.info). Comments may be submitted as follows:

Email: administrator@reportingstandards.info

Post: NCREIF
Attn: Director, Reporting Standards
200 East Randolph Drive
Suite 5135
Chicago, IL 60601

[3] Site as Foundational Standard –with definition and specifically GIPS 20/20 Consultation paper.

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Introduction

Background

The Reporting Standards currently require time-weighted returns in order to maintain compliance. Specifically, the current requirements are stated as follows:

- *Quarterly, Total and Component Time-weighted returns (TWR) gross and net of fees:* The information used to calculate the Account TWR includes the activity from the aggregation of all the investments made by the Account and Account level income and expenses. All period returns (total and component) must be calculated separately using a geometrically linked TWR. Annualized returns must be computed for measurement periods presented that contain more than four full quarters. For periods longer than one year, the sum of component returns may not be the same as the total return. Generally, an Account Report may also include the annualized rolling average one, three and five year return.

- *Quarterly, Disclosures accompanying TWR:* When presenting performance returns within the quarterly or annual Account Reports or, in situations where Reporting Standards-compliant performance elements of TWR are presented in another report, disclosures surrounding fees, periodicity, calculation methodology, valuation and accounting policy and fees and treatment of activity before initial contribution must accompany the presented element.

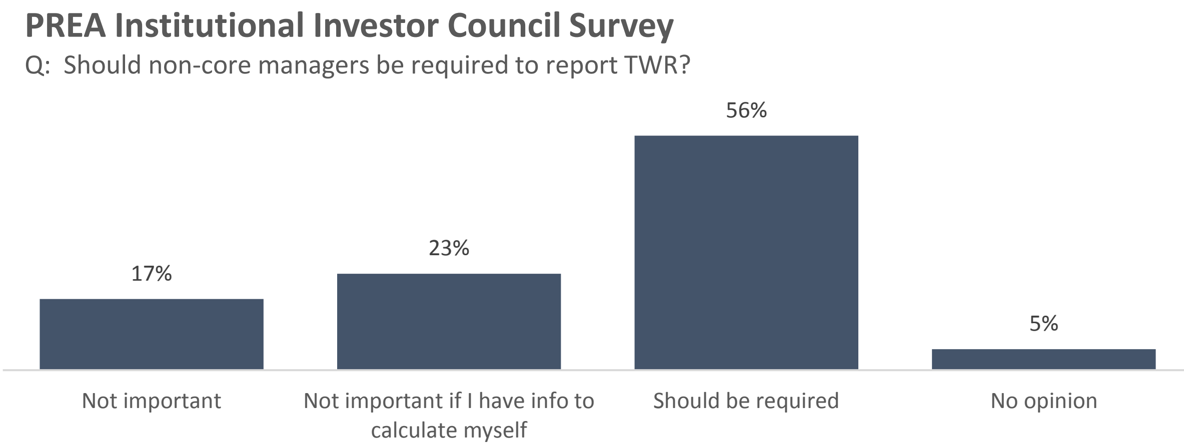
The foundation of the Reporting Standards is derived from U.S. Generally Accepted Accounting Principles (GAAP), Global Investment Performance Standards (GIPS®), and Uniform Standards of Professional Appraisal Practice (USPAP). These standards are referred to as the Foundational Standards within the Reporting Standards. The Reporting Standards strive to remain consistent with these foundational standards and supplement their guidance by providing interpretations and additional standards.

The Reporting Standards are grouped by fund structure, that is open-end funds, closed-end funds and single client (separate accounts) and are intended to provide guidance across all strategies within each structure (e.g., core, value-add, opportunistic). Over the years, the Council vigorously debated whether strategy based standards should be incorporated into the Reporting Standards but concluded that definitions of strategies can be blurry while structures are definitive.

Many of the Reporting Standards are the same across the fund structures however, there are particular elements which are solely meaningful or useful to one structure or another. One of the ancillary purposes of this project is to specifically address the possibility of differences in TWR requirements across structures (open-end funds, closed-end funds and separate accounts).

Initial Investor Feedback

The relevance and applicability of the Reporting Standards requirement for time-weighted returns (TWR) for closed-end funds is a hot topic. A poll of members of the PREA Institutional Investor Council taken during the fall 2014 PREA conference and the results are indicated in Figure 3 below:



The majority of investors wanted TWR to remain a requirement within the Reporting Standards. The task force's mission included researching and analyzing these differing views with a goal to support a position as to the appropriateness of the requirement within the Reporting Standards which balances best reporting practices and reporting requirements.

Industry Feedback

The task force held discussions to address the issues faced by closed-end funds and created two surveys to assess current industry practices and the industry views on the applicability of TWRs to closed-end funds. One survey was prepared for investment managers and the other survey was prepared for investors.

The TWR portion of the investment manager survey was comprised of 4 questions; 1 question on the overall composition of the managers' portfolios, and 3 questions on the topic of return metrics. The questions in the investor manager survey were designed to assess what investment managers report to their investors as well as the investment managers' opinions on the applicability of returns to their closed-end fund business. The questions were also designed to assess how these topics are viewed differently at the fund level compared to the investor level and among the risk strategies (core/core-plus, value-add and opportunistic).

The TWR portion of the investor survey was comprised of 6 questions; 1 question on the overall composition of the investor's real estate investments, and 5 questions on the topic of return metrics. The questions in the investor survey were designed to assess what investors receive from their investment managers as well as the investors' opinions on the applicability of returns to their closed-end real estate fund investments. The questions were also designed to assess how these topics are viewed differently at the fund level compared to the investor level and among the risk strategies (core/core-plus, value-add and opportunistic).

The surveys were solicited among 43 investment managers and 43 investors and responses were received from 29 (67%) and 14 (33%) of investment managers and investors, respectively.

In addition to the surveys, and for the purpose of gathering anecdotal evidence to support the conclusions reached, a number of conversations were held with senior members of organizations managing closed-end funds. For these conversations, the discussions focused on their detailed explanations of their positions as to the relevance and applicability of the TWR requirements. The profile of the participants in these one on one conversations are as follows:

- ✓ 9 total conversations with managers
- ✓ 7 offering closed-end products only either as value-add or opportunistic or both
- ✓ 2 offering both open-end and closed-end products
- ✓ 4 listed in PERE's Top 50[4]

Information from the surveys and conversations was compiled and the recommendations are presented in this exposure draft.

Upon successful completion of the exposure draft process (which includes consideration of all comments received), necessary changes to the Reporting Standards for closed-end funds will be incorporated and the Reporting Standards will be reissued. The anticipated effective date of the new Reporting Standards for closed-end funds is for fiscal years ending after December 15, 2018, with early adoption encouraged.

[4] PERE's Annual Ranking of the Largest Private Real Estate Firms in the World, May 2017.

Time-weighted Return compared to IRR

General

Time-weighted returns (TWRs) and Internal rates of return (IRRs) are the most relied upon metrics for performance reporting within the private institutional real estate investment industry (hereinafter referred to as "Industry"). Handbook Volume 1 currently requires reporting of TWRs for both open and closed-end funds. IRRs are required for closed-end funds and recommended for open-end funds. Much has and continues to be debated regarding the use of the TWR for closed-end funds. Open-end funds, which due to their undefined life, recycling of capital, and longer term nature of holding assets find the TWR to be an effective measure of performance and basis for comparison. Unlike open-end funds, closed-end funds have a defined life, less predictability in cycling of capital and shorter holding period durations. As a result, the TWR while in some instances is calculable for closed-end funds, may be considered a less effective measure of performance. Furthermore, the variability of closed- end fund offerings in timing and investing pace further complicate any reasonable basis for comparison to one another.

Most institutional investors allocate capital to both open-end and closed-end funds and therefore, it is understandable that they seek a measurement tool that will allow for comparison of these strategies within their portfolios. Generally, closed-end fund investment managers have access to the input data for the TWR calculation and the technical tools to undertake the calculation and can readily provide it to investors. The question is not as to whether the information can be provided but rather why TWRs are important and relevant within the Reporting Standards.

TWR

Definition and calculation

As noted in the Reporting Standards Handbook Volume II, Performance and Risk Manual ("Performance and Risk Manual"), a TWR is the geometric average of the holding period yields to an investment portfolio. They are used in the Industry to measure performance of a vehicle (e.g., funds, investments and properties). The formula isolates the performance of the vehicle by removing the timing effect of cash contributions and distributions for the ending fair value of the vehicle. TWRs measure performance over a specific period regardless of the size of the investment or the timing of external cash flows. For the formula, the numerator generally represents some measure of absolute performance of the vehicle over the holding period and the denominator represents a measure of the vehicle's average size (e.g. weighted average NAV) over the same holding period. A return for each discrete holding period is geometrically linked and averaged resulting in the TWR. This is generally considered an effective measure of performance of the manager when the manager has no control of cash flows.

Sentiment of industry stakeholders relating to Fund level TWR

Overview

In order to ascertain the relevance and applicability of TWR for closed-end funds, investor and investment manager survey respondents were asked to rate on a scale from 1-5 the importance of TWR, IRR and equity multiples at the fund level (with 1 being most important and 5 least important). The results are summarized in Figure 4 below:

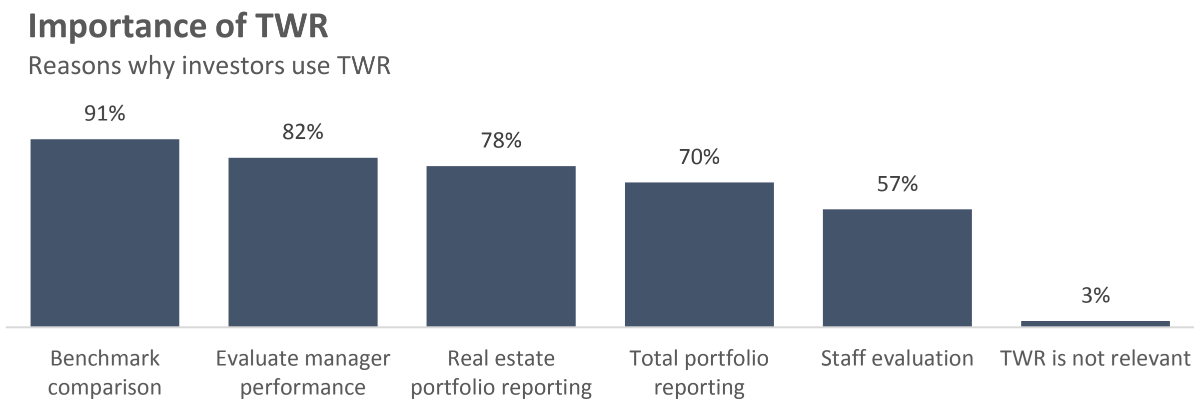
Importance of Return Metrics	Fund Level			
Investment Managers	**Core/Core-Plus**	**Value-Add**	**Opportunistic**	**Weighted Avg.**
Time Weighted Return (TWR) Total, gross of fees	2.17	2.50	3.40	2.75
TWR Total, net of fees	2.00	2.41	3.33	2.65
TWR Total and Components, gross of fees	2.50	2.68	3.40	2.90
TWR Total and Components, net of fees	3.17	2.77	3.33	3.03
Target TWR (over anticipated holding period)	5.00	4.27	4.20	4.37
Since Inception Internal Rate of Return (IRR) (through current quarter)	1.00	1.09	1.47	1.20
Projected IRR (at anticipated liquidation date)	3.17	1.91	1.60	2.02
Equity Multiple	2.67	1.82	1.33	1.80
Projected Equity Multiple	3.83	2.18	1.73	2.31
Investors				
Time Weighted Return (TWR) Total, gross of fees	2.10	2.00	2.15	2.08
TWR Total, net of fees	1.60	1.67	1.92	1.74
TWR Total and Components, gross of fees	2.30	2.33	2.31	2.31
TWR Total and Components, net of fees	2.00	2.08	2.08	2.06
Target TWR (over anticipated holding period)	2.60	2.50	2.77	2.63
Since Inception Internal Rate of Return (IRR) (through current quarter)	1.20	1.50	1.77	1.51
Projected IRR (at anticipated liquidation date)	2.10	2.17	2.23	2.17
Equity Multiple	1.40	1.42	1.85	1.57
Projected Equity Multiple	2.10	2.08	2.31	2.17

Difference in Response b/t Investment Managers and Investors				
Time Weighted Return (TWR) Total, gross of fees	-0.07	-0.50	-1.25	-0.67
TWR Total, net of fees	-0.40	-0.74	-1.41	-0.91
TWR Total and Components, gross of fees	-0.20	-0.35	-1.09	-0.58
TWR Total and Components, net of fees	-1.17	-0.69	-1.26	-0.97
Target TWR (over anticipated holding period)	-2.40	-1.77	-1.43	-1.75
Since Inception Internal Rate of Return (IRR) (through current quarter)	0.20	0.41	0.30	0.31
Projected IRR (at anticipated liquidation date)	-1.07	0.26	0.63	0.15
Equity Multiple	-1.27	-0.40	0.51	-0.23
Projected Equity Multiple	-1.73	-0.10	0.57	-0.14

It is interesting to note that investment managers report that the fund style is impactful to their sentiment about the importance of TWR. Investors, however do not seem to share that sentiment. It is also interesting to note that investment managers consistently underweight the importance of TWR relative to their investors and, with the exception of projected IRR's core/core plus strategies, overweight the importance of IRR.

Reasons why investors want TWR

As noted in Figure 4, investors place more emphasis on TWR than investment managers. An additional question was posed to investors asking why TWRs were relevant to their organizations. Investors were asked to check all the named categories which were applicable. Figure 5 below shows the results.



Benchmark Comparisons

As shown in Figure 5 above, investors think one of the main benefits of TWR is the ability to roll all product performance returns up and compare the periodic TWR annualized performance to other TWR benchmarks across all investment product types. Perhaps an obvious reason for this is that the other investible asset classes (exclusive of alternatives) measure performance using TWRs and associated benchmarks. In order for investors to report aggregated performance across portfolios, TWRs would need to be provided.

Existing fund-level real estate open-end fund indices such as NCREIF's NFI-ODCE and PREA/IPD US Property Fund Index publish quarterly and annualized TWRs (by income, appreciation and total return components) and are regularly used to benchmark fund performance. Although these are open-end fund indexes, it is known that managers frequently benchmark to these indices using them as a starting benchmark and adding basis points for the increased risk of the closed end funds.

Another related benefit of the TWR based benchmarks used for the real estate industry is that income and appreciation can be evaluated separately on a periodic and annualized basis. This allows the investor to better understand the volatility of cash flows and the overall performance/risk. The IRR's do not separate the components of cash flows between income and sales nor do they recognize interim valuation changes. Therefore IRRs do not provide the same level of transparency that TWRs provide. Another disadvantage of using IRR as a benchmark is because IRR's are typically shown on a since-inception basis, and therefore are generally only comparable to an IRR benchmark when the benchmark is calculated and reported on the same vintage year basis as the closed-end fund.

The NCREIF Closed End Value Add Fund Index (NFI-CEVA) is the only known index of its kind and is building and expanding to become more widely accepted as a benchmark for closed-end value add funds. As of this writing, NCREIF has formed a task force to enhance the NFI-CEVA to make it more relevant to the closed-end value add space. Although TWR information is expected to remain available, the emphasis for benchmark reporting will likely change to IRR on a vintage year basis.

As shown in the Figures below, there are significantly divergent views between investors and investment managers on the appropriateness of TWRs for benchmark purposes. Once again, the investment managers' views become stronger as to the inappropriateness of a benchmark when the style of the closed-end fund becomes riskier.

Figure 6:

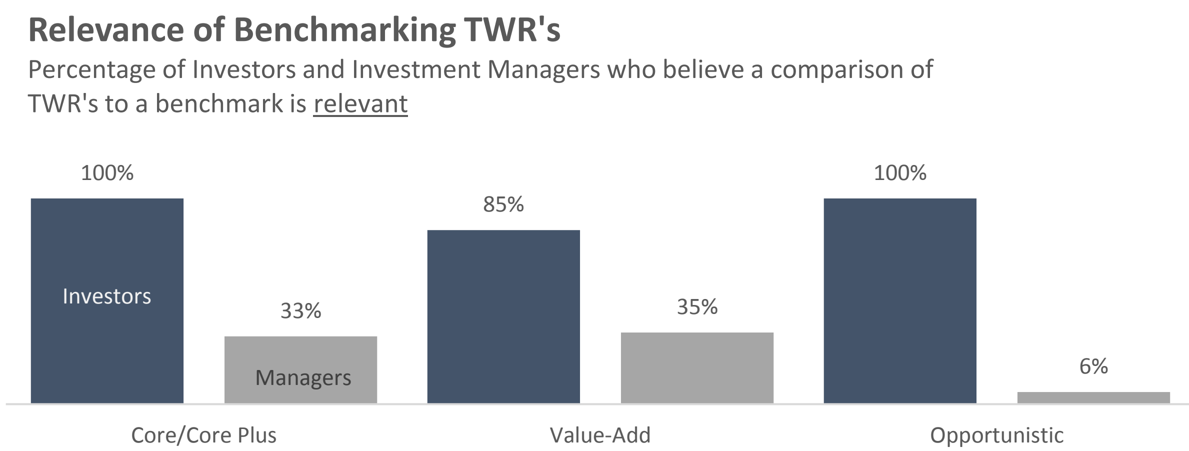
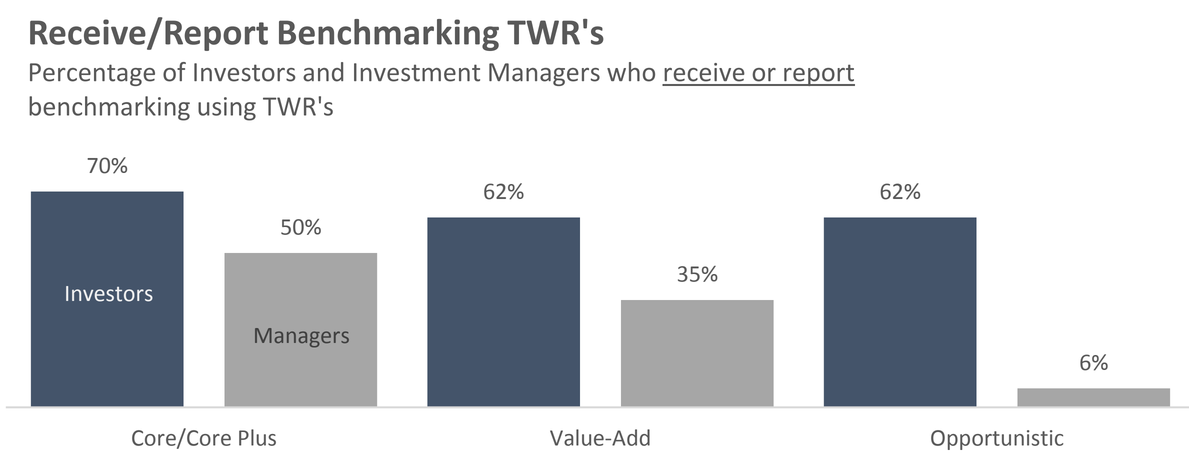


Figure 7:



IRR

Definition and calculation

As noted in the Performance and Risk Manual, an IRR is the annualized implied discount rate (effective compounded nominal rate) that equates the present value of all the appropriate cash inflows associated with an investment with the sum of the present value of all the appropriate cash outflows accruing from it and the present value of the unrealized residual portfolio. The IRR is also known as a "money-weighted" return because unlike TWR, the vehicle's cash flows do impact the IRR formula. The IRR is generally considered an effective measure of performance of the investment.

Relevance to industry stakeholders

Overview

As noted in Figure 4 above, both investors and investment managers reported that IRRs are more important than TWRs for closed-end funds regardless of the strategy of the closed-end fund. The current Reporting Standards requirement for closed end funds to report IRR remains supported through the survey as well as through the conversations with selected closed-end managers and will remain in place. The adequacy of the disclosures surrounding IRR are discussed in the Disclosures section of this exposure draft.

When TWRs do not represent performance

Although the Reporting Standards for IRR will remain in place, in order to reach a conclusion with respect to the relevance and applicability of TWR for closed-end funds, the reasons why IRR are viewed as more important required further research and analysis by the task force. There are instances where the IRR is more representative of an investor's return. One example of this pertains to value-add and development deals, which experience a "J-curve effect". The TWR in the first several quarters can often be negative or very low, due to the costs necessary to fund projects, and the minimal or negative income earned. Typically, these projects are sold shortly after completion with significant gains. Although this large "pop" in value at sale is somewhat diminished if fair values (along with appreciation) are calculated throughout the development phase, there is still likely significant appreciation upon completion when the development or leasing risk is fully eliminated. Since each quarter/period of the TWR is weighted equally, the many periods of low or negative returns can outweigh or understate the few periods of high returns. In these cases, an IRR may be more appropriate. While the J-curve effect is still a factor, the dollar-weighting of IRR will produce more reasonable results.

An additional scenario where the IRR may be more meaningful pertains to funds where cash flows into and out of the fund is controlled by the manager and they will re-invest cash flow and typically don't distribute until final liquidation. In this instance, interim cash flows don't exist and time weighted returns may not be relevant and could even be "managed". TWRs are most meaningful for core operating funds with no control over inflows of capital and regular cash flow distributions and frequent valuations.

Although infrequent, there can potentially be issues with the TWR becoming incalculable in the event that the asset is temporarily "under water" (in a negative equity position). Algebraically it may also yield largely skewed returns in periods of high income or appreciation with corresponding low equity denominators or even nonsensical returns in periods of negative income with a corresponding negative denominator. Often these assets are held until the market or property conditions improve, but the TWR calculation is no longer reasonable. Typically in these instances IRRs are calculable and more reflective of the actual performance, particularly when the asset/fund recovers.

Moreover, IRR's are integral in analyzing closed-end funds and properties because Managers are often evaluated based on targeted fund or property IRRs. Advisors and joint ventures may earn incentive compensation and promotes based upon achieving cash flows above certain IRR hurdles. Details of such fee arrangements are included in fund reporting and may also warrant the disclosure of IRRs.

Foundational Standards Review

Overview

Prior to reaching conclusions as to any warranted changes to the Reporting Standards, the Foundational Standards were reviewed. The Reporting Standards strive to remain consistent with these foundational standards and supplement their guidance by providing interpretations and additional standards that serve to further the mission of the Reporting Standards.

The GIPS standards

General

As stated in the Reporting Standards Handbook Volume I, the performance and risk elements draw upon the GIPS standards for basic ethical principles such as full disclosure and fair representation of investment performance and for other specific methodologies and disclosures. The Reporting Standards do not conflict with the GIPS standards and compliance with the Reporting Standards is not predicated on compliance with the GIPS standards. However, it is important to note that the GIPS standards apply on a firm-wide basis while the Reporting Standards apply more specifically to Account/Fund reporting. As such, the performance and risk measurement elements of the Reporting Standards do not incorporate all elements of the GIPS standards. Similarly, the Reporting Standards contain elements which the GIPS standards do not address.

Real Estate Closed-end Fund Requirements

The GIPS standards include specific chapters on real estate as well as private equity. In general, these chapters supplement other chapters within the GIPS standards but not each other. For closed-end funds, the Reporting Standards include all the applicable closed-end fund requirements within the GIPS real estate chapter including:

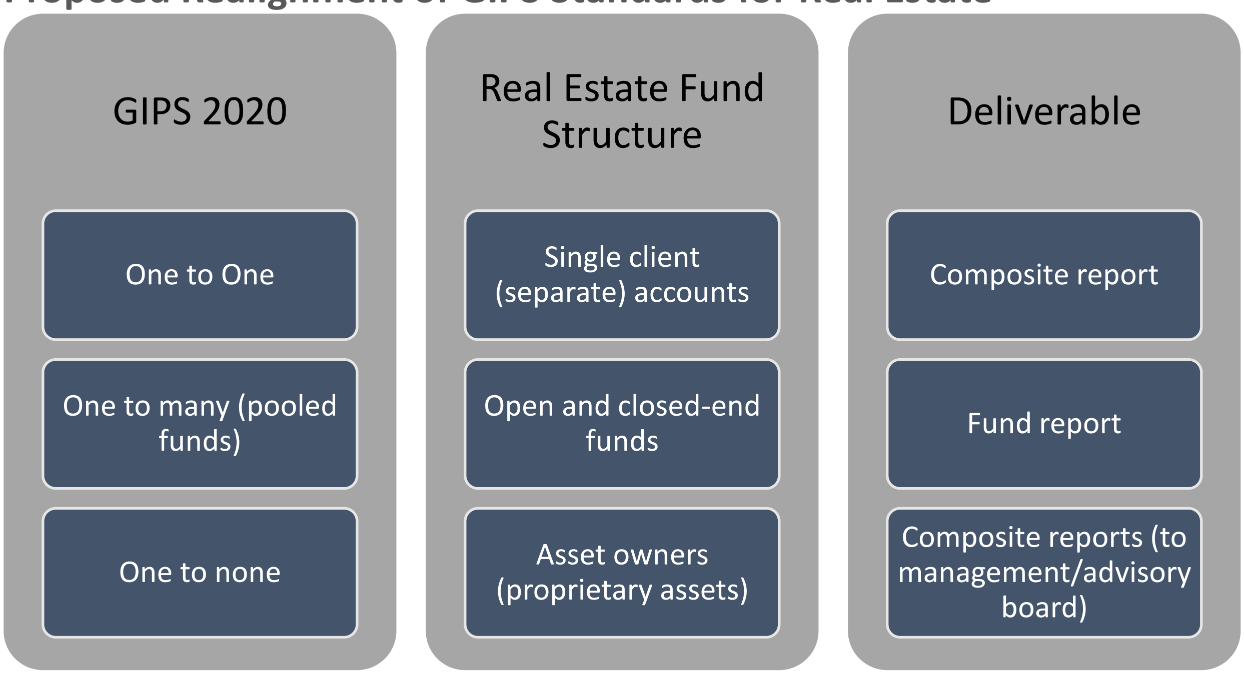
- Time-weighted returns
- IRRs
- Investment multiples

It should be noted that only IRRs and investment multiples are required within the Private Equity chapter of the GIPS standards. Many closed-end real estate funds have similar attributes as private equity funds. The GIPS standards specifically exclude all real estate funds from private equity[5].

GIPS 20/20 Consultation Paper
The CFA Institute GIPS Executive Committee (Executive Committee) recognizes that there has not been widespread adoption among alternative investment managers and managers of pooled funds and that improvements to the GIPS standards can be made to facilitate adoption for the benefit of investors as well as to understand the challenges faced by investment managers with respect to compliance with the GIPS standards.[6] In May 2017, the Executive Committee issued the GIPS 20/20 Consultation Paper ("GIPS 20/20"), soliciting feedback with the goal to re-issue the GIPS standards effective in 2020.

Under this re-design, the Executive Committee contends that the principal defining criterion for how performance should be presented is the relationship between the party presenting the performance and the recipient of the performance. Accordingly, it is contemplated that GIPS 20/20 will be organized into three "pillars" which for real estate investments will complement the notion of structure based standards. The concept is illustrated in Figure 8 below:

Proposed Realignment of GIPS Standards for Real Estate



[5] GIPS Handbook, 2010 version: Page 251, Scope: Real estate closed-end funds must follow Section 6 in Chapter 1 of the GIPS standards.

[6] GIPS 20/20 Consultation Paper, May 2017.

One to many

It is important to note that under this re-design, open and closed-end real estate funds, private equity and alternatives will be included in the one to many pillar. The intent, in part, is reduce the number of asset class specific requirements, acknowledging as an example, the overlap between private equity and real estate closed-end fund requirements with minimal differences.[7]

In the one to many pillar, the GIPS Executive Committee acknowledges that there is not a "one size fits all" with respect to appropriate requirements and recommendations for these asset classes which includes all alternatives. For example, in the Consultation Paper, there is a question posed with respect to whether reporting of TWR or IRR should be based upon the structure of the pooled fund. Under the current GIPS standards, the return required to be used is based on the underlying investments in the portfolio. They recognize that structure (where investment managers either control (closed-end funds) or not control (open-end funds) the cash flows) may impact the calculation methodology decision. For open-end funds and composites with separate accounts, TWR would be required. For closed-end, fixed life, fixed commitment funds, firms would be allowed to present IRR or TWR.

Private equity and real estate

The redesign of GIPS puts both real estate and private equity in the same pillar, one to many. Although there are overlaps and "minimal differences" it is important to recognize that the key differences relate to the closed-end fund reporting of TWRs vs. IRRs, valuation frequency and external appraisals. Private equity requires IRRs and does not require quarterly valuations or external appraisals.

Distribution of Reports

As the focus of the current GIPS standards is on marketing to potential clients rather than existing clients, they do not contain a requirement whereby existing clients are provided with GIPS compliant presentations. Rather, the current GIPS standards recommend that firm provide a compliant presentation to each existing client.[8] In GIPS 20/20, the Executive Committee recognized that existing clients are a significant source of new business, and as such compliant presentations should be provided to both existing and potential clients. Two approaches to the distribution of reports are being considered:

- Requiring firms to make every reasonable effort to provide the composite compliant presentation or pooled fund report to existing clients/fund investors on an annual basis; or
- Requiring firms to make an offer to provide the composite compliant presentation or pooled fund report to existing clients/fund investors on an annual basis. [9]

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[8] GIPS standards 2010 as adopted by the GIPS Executive Committee on 29 January, 2010, provision O.B.4

[9] GIPS 20/20 Consultation Paper, May 2017, page 5.

As indicated in the second bullet point above, it is interesting to note that compliance with the GIPS standards could be achieved using this approach to selected required reporting elements.

Collaboration

The Reporting Standards Council and Board frequently collaborate with members of the GIPS team. This connection ensures timely communication between the groups and also appropriate levels of feedback to issues of mutual concern. We anticipate a significant level of direct and indirect involvement establishing the appropriate level of distinctions between real estate and other alternative investment asset classes within pillar 2 as the Executive Committee works to reissue the GIPS standards.

US GAAP

Investment managers issue fund reports to investors which follow either the FASB Accounting Standards Codification (ASC) 946, *Financial Services-Investment Companies* (Investment Company Accounting) or ASC 960, *Plan Accounting-Defined Benefit Plans* or the Government Accounting Standards Board (GASB) 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* (Pension Fund Accounting). Within the Reporting Standards, two models are used to present and report information in accordance with US GAAP- the Operating Model and the Non-operating Model. The *NCREIF PREA Reporting Standards Fair Value Accounting Policy Manual* (Accounting Policy Manual) provides interpretive accounting guidance as well as sample financial statements for reporting.

Investment Company Accounting requires the presentation and disclosure of certain financial highlights. Within these disclosures is a requirement to report an "investment return" which can be either a time-weighted return or an IRR. US GAAP dictates when IRR reporting is required. Generally, closed-end real estate funds which are classified as investment companies will be required to report an IRR. The open-end real estate funds which are also investment companies generally report time-weighted returns (TWR) within their financial highlights. Regardless of whether TWR or IRR is reported, both must be reported both gross and net of all fees and incentives and for all investor classes (e.g., general partner and limited partners). [10]

Pension Fund Accounting under US GAAP does not require reporting of returns.

[10] FASB Accounting Standards Codification (ASC) 946, Financial Services, Investment Companies; 946-205 Presentation of Financial Statements and 946-204-50 Disclosure.

Proposed solutions

General

From the information presented above, the Council suggests that adding an element of optionality for reporting TWRs will serve to balance divergent views and increase compliance with the reporting standards for closed-end funds, while not compromising the overall integrity of the Reporting Standards.

Adding Optionality: making an offer to provide TWR to investors

We recognize that TWRs are important to many investors. In addition, based on the survey, conversations and research described herein, keeping TWRs in the Reporting Standards ensures a greater level of consistency and transparency than might be achieved if they were not part of the Reporting Standards. Moving the inclusion of TWR's from a requirement to a recommendation was considered, however, this would most likely result in diversity of practice. Therefore, the Council rejected this notion.

As noted in the review of the GIPS standards, optionality is a concept contemplated for GIPS 20/20. If incorporated into GIPS 20/20, compliance with the GIPS standards could be achieved by requiring firms to make an offer to provide reports to existing clients. It is interesting to note that compliance with the GIPS standards could be achieved using this approach to selected required reporting elements.

By applying optionality to the requirement for TWRs for closed-end funds, an appropriate compromise position can be achieved. In essence, the requirement is kept for those that want it-whether the investor or the investment manager. As proposed, an investment manager may choose to report the information without providing an option. As a number of closed-end managers (particularly those which currently report to NFI-CEVA) report this information already, they will continue to report the TWR to all investors without documenting an offer to provide.

Accordingly, we are proposing that the TWR requirement for closed-end funds be changed from:

- Quarterly, TWR-gross and net of fees

To:

- At fund inception, agree to report or make an offer to provide TWR gross and net of fees; and
- When reported to provide TWR-gross and net of fees on a quarterly basis

Additional feedback from the industry is needed before a conclusion can be reached.

> *Question 1a: Do you agree that the Reporting Standards should change the requirement to the two requirements shown above?*
>
> > *Yes*
> >
> > *No*
> >
> > *Please explain your answer*
>
> *Question 1b: If you answered yes to Question 1a, please indicate how you think TWR should be distributed (indicate "yes" or "no" to each of the following :)*

- *Distribute TWR to all investors unless the investor specifically indicates that they do not want the TWRs*
  Yes
  No
- *Distribute TWR to only those investors who specifically accept the offer made by the manager to provide TWR*
  Yes
  No

Comments:

Question 1c: If you answered no to question 1a, do you think that the Reporting Standards should move the existing requirement for TWRs for closed-end funds to a recommendation?

Yes
No
Please explain your answer

Disclosures Accompanying TWR and IRR

General

In order to enhance transparency and consistency surrounding TWR, certain disclosures are required. These disclosures include calculation methodology, periodicity, types and treatments of fees, etc., as detailed below:

- ✓ **Gross of fees:** The Account Report must clearly disclose what types of fees are deducted from the gross return to arrive at the net return.

- ✓ **Net of fees:** The Account Report must clearly present the net of fees returns presented for all investor classes. In situations where fees are billed separately (outside of the Account) and/or when different fee arrangements exist for investors within an Account, the Account Report must disclose the impact of these fees on TWR expressed, at a minimum, as a basis points range.

- ✓ **Period:** The definition of period must be disclosed and applied consistently within each metric. Quarterly is the minimum period option.

- ✓ **Calculation methodology:** The performance returns should clearly disclose the calculation methodology, including level (property, investment, Account), use of leverage (leveraged or unleveraged), and fee type (before or after investment management fees).

- ✓ **Valuation and accounting policy and fees:** For each period presented, the Account's valuation policy, types of fees and basis of accounting must be disclosed and be consistent with or made in reference to the information contained with the Reporting Standards' Financial and Valuation information elements. Disclose each type of investment management fee. In addition, the recording methodology (i.e., capitalized or expensed, or billed separately outside of the Account) and the effect on the gross and net of fees performance calculations must be disclosed.

- ✓ **Treatment of activity before initial contribution:** If an Account commences operations and incurs operating activity prior to the initial cash contribution from the investors (e.g., an Account line of credit is used to finance 100% of initial operations), the Account should disclose how this activity is treated in the return calculations.

The Performance and Risk Manual provides a thorough definition of time-weighting and various detailed calculations and examples using the industry-standard Modified-Dietz return methodology. Without such disclosures, the TWR itself may not be sufficient for comparative analysis. As part of its work, the task force researched whether additional disclosures should accompany the TWR for closed end funds.

Start Dates-TWR

There is variation in practice pertaining to the start dates used when calculating quarterly time-weighted returns. The most common methods used are detailed in the Performance and Risk Manual (along with the pros and cons of each method), and are briefly outlined below:

- **Method I:** Use actual start and end dates for TWR calculations (i.e. keep partial periods)
- **Method II:** Start with the first full quarter after first investment acquisition and end on the last full quarter before disposition (i.e. drop partial periods)
- **Method III:** Hybrid – start with the first full quarter after the first investment acquisition and end on actual disposition date (hybrid method; drop first partial only).

The survey polled investors and investment managers regarding their methodologies used. The results are shown in Figures 9 and 10 below:

Figure 9:

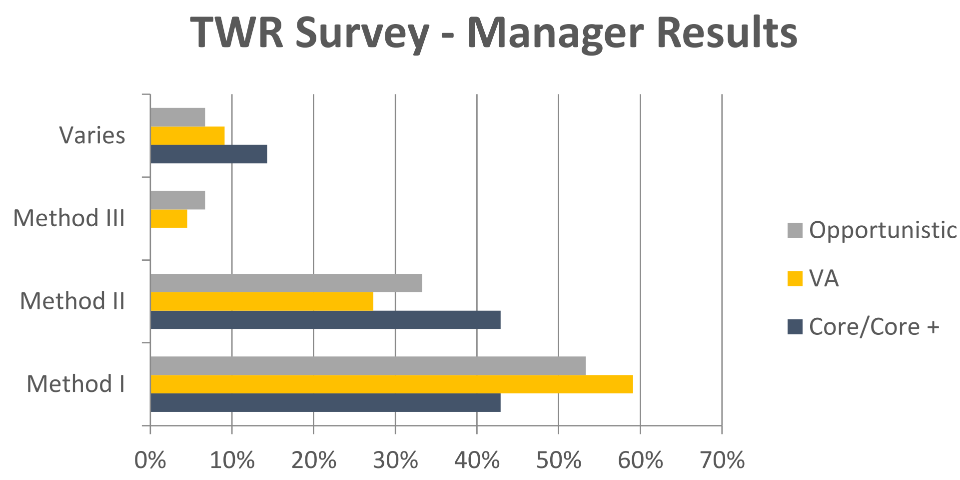
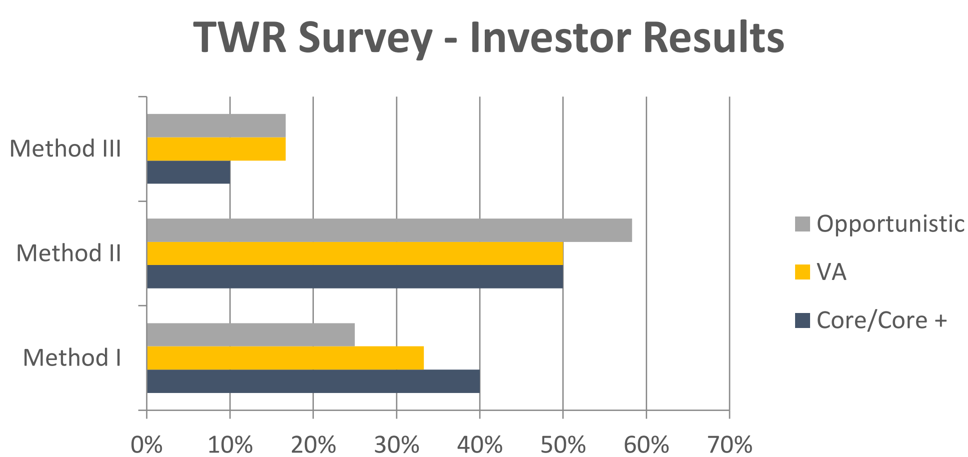


Figure 10:



No singular method is used by either Managers or Investors. In addition there is variation in approaches used among the current NCREIF benchmarks/indices; the NCREIF Property Index follows Method III, while the NCREIF ODCE, NFI-CEVA, Timberland, NCREIF Open End and NCREIF/INREV/ANREV Global Real Estate Fund Index all follow Method II. This broad variation in practice supports allowing the manager/investor to chose which methodology works best. The chosen method must be applied consistently and properly documented in the firm's performance measurement disclosures and policies. The required disclosures accompanying TWR in Handbook Volume 1 did not previously address start dates. The Council concluded that the following disclosure be added to further enchance comparative analysis.

- **Time-weighted performance return start and end dates:** If an Account Report includes since-inception returns, the performance inception date must be clearly disclosed. Likewise, performance end dates must be clearly identified. The treatment of partial period activity must be provided.

  Question 2: Do you agree that the above disclosure be added as a required element within Handbook Volume I?

  Yes

  No (please explain)

Start and End Dates-IRR

In addition to disclosures which must accompany TWR, Handbook Volume I also requires disclosures to accompany IRR. These disclosures include periodicity and types and treatment of fees. While the survey did not address IRR calculation methodology and disclosure, anecdotal evidence suggests a disparity in industry practice with regard to start dates. The GIPS standards define the inception date of an IRR to commence with the initial cash flow of the composite. The Performance and Risk Manual elaborates further on fund level IRRs, stating "in general, the IRR calculation should start with the initial cash flow on the date of the first capital contribution and end with the final cash flow on the date of the final liquidating distribution".

The language suggested in the GIPS standards as well as in the Performance and Risk Manual is subject to interpretation. For example, the treatment of financed cash flows (e.g., lines of credit and subscription lines) is not readily apparent and is inconsistently interpreted. Therefore, the Council proposes the following additional disclosures to accompany IRR.

- **IRR Start Date:** If an Account commences operations and incurs operating activity prior to the initial cash contribution from the investors (e.g., and Account line of credit is used to finance 100% of initial operations), the Account Report must disclose how this financed cash flow is treated in the IRR calculation.

  Question 3: Do you agree that the above disclosure be added as a required element within Handbook Volume I?

  Yes

  No (please explain)

Similar to inconsistencies in practice relating to IRR start dates, there is inconsistency in practice with respect to how IRR end dates are determined when final net assets of the fund have not as yet been distributed. Examples include the treatment of various reserves withheld for representations and warranties.

- **Realized IRR End Date:** The Account must disclose the ending date of the realized IRR calculation. If the final net assets of the fund/property haven't been distributed as of the IRR end date the method used in determining the final distribution and IRR end date must be disclosed.

Question 4: Do you agree that the above disclosure be added as a required element within Handbook Volume I?

Yes

No (please explain)

Note that upon successful conclusion of this exposure draft process, the Performance and Risk Manual will be revised to provide clarifying language with respect to IRR start and end dates.

Next steps

Investor Level Reporting

In addition to fund level reporting and in order to ascertain the relevance and applicability of TWR for closed-end funds, investor and investment manager survey respondents were asked about the relative importance of TWR at the investor level. It is important to note that the Reporting Standards do not currently encompass investor specific reporting. However, the results of the survey lend further support to a near term new strategy of the Reporting Standards initiative which includes developing investor specific standards. As a first step, this task force considered segregating the required and recommended performance reporting for closed-end funds between fund reporting requirements and investor reporting requirements. Significant differences can exist between fund level information and investor specific information. Within the Reporting Standards (and consistent with GAAP), TWRs are to be reported for each investor class. For closed-end funds this would be at a minimum, the general partner (GP) and all limited partners (LPs). Particularly within closed-end funds, the ownership interest of each LP to the fund may not be pro-rata to all other LPs. In fact, significant variances can result.

Question 5: Do you agree that the Council should pursue reporting standards for investor specific reporting?

Yes

No

Please explain

Valuation topics

The initial outreach to closed-end fund managers indicated two requirements which impeded their compliance with the Reporting Standards: TWR and conducting annual external appraisals. Analysis of the survey results and preliminary research led the Council to conclude that more research and analysis is necessary before conclusions can be reached with respect to the annual external appraisal requirement. Inconsistencies surrounding valuation policies and procedures across closed-end products are common. Therefore, the existing requirement cannot be modified without further research and analysis on the following key topics specifically as they relate to closed-end funds:

- Reviewing the adequacy of the Foundational Standards in establishing minimum practical guidelines for developing valuations (whether internal or external)

- Understanding the importance of independence in determining frequency and type of valuations
- Researching how a consistent valuation policy for managers with both open-end and closed-end vehicles should or should not impact policies for managers with closed-end vehicles.
- Understanding the role of the auditor in the valuation process

The Council formed a task force to conduct the necessary research and analysis. Results will be presented in an exposure draft to be issued during 2018.