NCREIF PREA Reporting Standards Leverage Reporting Standards Webinar
November 18, 2014
Questions and Answers
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Note: The following Q&A is a summary of selected questions posed during the November 18 webinar. Such Q&A is presented to facilitate a smoother transition to the adoption of the new required standards beginning with fiscal years which begin on or after December 15, 2014.

LTV vs. Fund T1 Leverage Percentage

1. **Q: If our fund documents require us to calculate LTV in a manner that is different from these new Reporting Standards, how should this be handled? Are people quoting two different LTV numbers in their reports? Is this footnoted somewhere?**

   A: Fund documents establish reporting requirements between investment manager and client and the Reporting Standards do not replace any requirements therein. The measures in the Reporting Standards are specific, comparable calculations which underlying definitions may be different than what is provided within the fund documents. For example, LTV as required per the fund document may be different than the **Fund T1 Leverage Percentage**. The intent of these new standards is to improve the comparability of leverage measures between funds. In order to be Reporting Standards compliant the measures of **Fund T1 Total Leverage** and the **Fund T1 Leverage Percentage** must be provided along with the required disclosures. This may serve to minimize confusion between different measures and facilitate any reconciliation which may be provided.

Cost vs. Fair Value considerations

1. **Q: Isn't the LTV[1] based on par value instead of the FV?**

   A: No. The **T1 Leverage percentage** is based on remaining principal balance, on a cost basis. The examples presented during the webinar assumed that debt on the financial statements was reported on a cost basis. When debt is reported on the financial statements at fair value, adjustments must be made to bring the debt to cost for purposes of reporting both the **Fund T1 Total Leverage** and the **Fund T1 Leverage Percentage**.

   Currently, some funds adjust outstanding debt to fair value while others do not, and the methods for computing debt fair value vary from fund to fund. However, all funds know remaining principal balance; this metric facilitates the consistent calculation of **Fund T1 Total Leverage** and **Fund T1 Leverage Percentage** by all funds. Keep in mind that although the **Fund T1 leverage Percentage** resembles the "loan-to-value" (LTV) ratio applied in banking to secured loans, it is a fund-level concept. **Fund T1 Leverage** includes not only mortgages on properties for which one can compute

[1] Several questions posed in the webinar referenced LTV (loan-to-value) rather than the Fund T1 leverage Percentage. The Fund T1 Leverage Percentage is a fund level concept (whereas LTV is more commonly used at the investment level) with specific elements of leverage included within Tier 1 and also considers the fund's economic share of total gross assets (as defined). In order to be compliant with the Reporting Standards the Fund T1 Leverage and the Fund T1 Leverage Percentage must be presented within the quarterly fund reporting to investors.

an LTV, but also fund-level debt which has no LTV-like interpretation. The name **"Fund T1 Leverage Percentage"** deliberately distinguishes this concept from the LTV.

2. **Q: Leverage is reported at cost while the gross asset value is reported at fair market value. Should leverage be marked to market too? Otherwise the LTV[1] ratio is biased.**

   A: No. In developing the **Fund T1 Leverage Percentage** we researched and discussed whether debt should be reported at cost, fair value or whatever was in the financial statements. We concluded that the Fund T1 Leverage percentage would be most comparable across all funds if the cost (i.e., remaining principle balance) was used. We are aware that industry practice is widely divergent with respect to debt valuation methodologies-with some funds marking debt to market and some not and some assuming that the cost balance is the market value (because that often represents settlement price for loans secured by real estate). Because of these inconsistencies, because cost is always known (where fair value may not be), and because cost basis provides comparability across all funds, the Performance and Risk Workgroup concluded that this was the best approach.

3. **Q: Was any consideration given to prepayment penalties in the LTV[1] calculation?**

   A: As the **Fund T1 Leverage Percentage** is calculated based on cost. Prepayment penalties would not be considered until incurred.

Economic Ownership (share)

1. **Q: How do you determine economic ownership of leverage in a JV structure in which ownership is based on a hypothetical liquidation?**

   A: The fund's economic share is the fund's percentage of the total proceeds distributed through a hypothetical liquidation. The hypothetical liquidation considers all returns each partner is entitled to throughout the holding period including such items as guarantees and preferred distributions. That is, go through the process of considering a liquidation at quarter end, distributing the hypothetical proceeds of asset sales less liabilities to the venture partners under the terms of the venture contract. The funds economic ownership share is simply the cash proceeds the fund would receive divided by the total of hypothetical proceeds to all venture partners under this total liquidation.

2. **Q: Please elaborate on "Economic Share" of Total Gross Assets. Is this the fund's proportional share of ALL JV assets?**

   A: Generally, yes it is the fund's economic share of all JV assets upon a hypothetical liquidation, if the information is available. If however such information is not available, the Reporting Standards include required disclosures to facilitate further transparency. If Tier 1 leverage associated with investments is excluded from the calculation, disclosures should be made including an explanation of why the leverage is being excluded from the leverage calculation, along with what percent or dollar amount of the investment is included in total gross assets.[2]

3. **Q: When calculating the fund's proportional share in a JV asset, do you agree that a promote that is accrued as payable to the JV partner should reduce the Fund's economic share of Total Gross Assets?**

   A: Yes, provided that the NAV of the joint venture does not change, then the promote payable to the JV partner would reduce the Fund's economic share of Total Gross Assets.

Investments in Mortgage loans

1. **Q: How do we treat a loan investment?**

   A: A loan investment (which is included as an asset on the balance sheet) is included in the "total GROSS assets" but is not included in the numerator as it is not a liability.

Data submission to sponsor indexes

1. **Q: As I understand it most ODCE funds submit their LTV to the ODCE Index using FMV of debt today. Is the intention to change those to be based on cost now?**

   A: No. ODCE Index data submission currently requires an LTV. Based upon Reporting Standards' Council member discussions with ODCE fund managers, most but not all ODCE funds report debt at FMV within their financial statements as well as within the data submission to the ODCE Index. The data collection requirement for LTV for ODCE states: Total debt divided by total assets at fair value. Further, the data collection manual states that debt is either at fair value or cost, or a combination thereof (consistent with the basis that is used in the "fair value" financial statements taken as a whole).

   Members of the Reporting Standards Council and members of NCREIF's fund index team are meeting to discuss the potential for additions to the Index data collection manuals to report **Fund T1 Total Leverage** and the **Fund T1 Leverage Percentage**. Until such changes are made to the NCREIF Data Collection and Reporting Procedures Manual, LTV should continue to be submitted for Index reporting using fair value or cost, or a combination thereof (consistent with the basis that is used in the "fair value" financial statements taken as a whole)[3]. For compliance with the Reporting Standards, both **Fund T1 Total Leverage** and the **Fund T1 Leverage Percentage** must be reported in quarterly reporting to investors at cost. (Please note that the Reporting Standards do not preclude the reporting of additional information within the quarterly reporting to investors.) As more

[2] Reporting Standards Handbook Volume I, March 31 version, PR.04 and PR.05 and Reporting Standards Performance and Risk Manual, March 12, 2014 version, page 56.
[3] NCREIF Fund Data Collection & Reporting Procedures Manual, *Revised November 2014,* page 59.

information becomes available, we will post such information to the Reporting Standards website at www.reportingstandards.info

Operating and Non-operating reporting models

T1 Leverage Elements

1. **Q: For T1 Leverage, should balance of subscription lines drawn be included if they are only outstanding on a "short-term" basis (i.e., less than 90 days)?**

   A: No. The T1 leverage requirement would include only the drawn balance of subscription lines that have the ability to be outstanding for more than 90 days and/or when the advisor has the ability to extend the term, is included in Tier 1 debt. In these cases, the subscription line has more leverage characteristics.[4]

2. **Q: Was any consideration given to swap/cap values?**

   A: Swaps and caps are not included in **T1 Total Leverage**. As described in the *Performance and Risk Manual,* the Leverage Spectrum includes three (3) tiers. Swaps and caps are included as a part of Tier 2 leverage. Tier 2 elements are "debt-like", as subject to certain conditions and contingencies, and have the same impact as debt in that they put the Fund's investor's capital at risk. Unlike Tier 1 (T1), these items are generally not thought of as traditional debt. In addition, unlike the elements in Tier 3, T2 leverage elements such as these interest hedging agreements are more easily quantifiable[5].

[4] Reporting Standards Standards Handbook Volume I, March 31 version, PR.04 and PR.05 and Reporting Standards Performance and Risk Manual, March 12, 2104 version, page 50.
[5] Reporting Standards Performance and Risk Manual, March 12, 2014, page 50-51.