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RE: Working Draft of AICPA Accounting and Valuation Guide, *Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies,* Released May 15, 2018
Prepared by the PE/VC Task Force

August 15, 2018

Dear PE/VC Task Force:

This letter represents the NCREIF PREA Reporting Standards Board's (RS Board) and Council's comments to the PE/VC Task Force on the working draft of AICPA accounting and valuation guide: *Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies.* We commend the PE/VC Task Force for providing expanded guidance and best practices of the valuation of investments in both equity and debt instruments. We agree that the overall goal of the working draft has been largely achieved.

We appreciate the reference to the real estate industry in scope paragraphs .07 and .08 of the Introduction and throughout the guide, however, we suggest that additional references, guidance and examples specific to investments in real estate would be beneficial. Our comments and suggestions to sections of the guide are included in Appendix 1 to this letter.

Respondent

The NCREIF PREA Reporting Standards (Reporting Standards) is an industry initiative co-sponsored by the National Council of Real Estate Investment Fiduciaries (NCREIF) and the Pension Real Estate Association (PREA) with a mission to establish, manage and promote transparent and consistent reporting standards for the real estate industry to facilitate informed investment decision making. NCREIF is an association of institutional real estate professionals which includes investment managers, plan sponsors, academicians, consultants, and other service providers who share a common interest in the industry of private institutional real estate investment. NCREIF serves the institutional real estate community as an unbiased collector and disseminator of real estate performance information, most notably the NCREIF Property Index (NPI), which consists of over 7,600 investment properties with a fair value of approximately $581 billion. PREA is a non-profit organization for the global institutional real estate investment industry. PREA's mission is to serve its members engaged in institutional real estate investment through the sponsorship of objective forums for education, research initiatives, membership interaction and the exchange of information. PREA investor members hold over $11 trillion in total assets including over $800 billion in real estate.

A detailed description of the Reporting Standards, its sponsorship, team and initiatives, can be found on our website, www.reportingstandards.info.

Comments

Refer to Appendix 1.

We would be pleased to discuss our comments/suggestions with you at your convenience. Please feel free to contact Marybeth Kronenwetter, Director, Reporting Standards at 630-469-4088.

Yours truly,

Jerry Silvey
NCREIF PREA Reporting Standards Board Chair

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Appendix 1:

1. Paragraph 1.02 defines private equity as "a term often used to refer to illiquid closed- end investment funds which are offered only to sophisticated investors…". We are recommending a reference to open-end investment fund vehicles, which are commonly used in the real estate industry. In addition, we suggest it would be beneficial to note limited partners' ability to withdraw their capital from an open-end investment vehicle via redemptions.

2. Under the 'Other Industry Guidance' in Chapter 2, we are proposing the addition of the following:

   NCREIF PREA Reporting Standards

   2.42 The NCREIF PREA Reporting Standards (Reporting Standards) is an industry initiative co-sponsored by the National Council of Real Estate Investment Fiduciaries (NCREIF) and the Pension Real Estate Association (PREA) with a mission to establish, manage and promote transparent and consistent reporting standards for the real estate industry to facilitate informed investment decision making. The Reporting Standards initiative was created to specifically address certain institutional real estate investment and investor reporting issues, while increasing transparency within the industry.

   2.43 The Reporting Standards Fair Value Accounting Policy Manual provides a consistent set of accounting standards when preparing financial statements for the institutional real estate investment community. These accounting standards are supported by authoritative U.S. GAAP and non-authoritative accounting guidance when U.S. GAAP does not sufficiently address a particular topic.

3. Paragraph 5.29 – We propose the inclusion of the following metric to examples currently listed:
   - price per unit or price per square foot in the real estate industry

4. Chapter 6 – Valuation of Debt Instruments: There are number of principles that are well stated and applicable to the real estate industry. Paragraphs 6.20, 6.24 and the first bullet point of 6.29 are particularly good. However, paragraphs 6.12 through 6.18 on deriving a synthetic credit spread is not often applicable for the valuation of real estate debt. Given real estate is specifically identified as within the scope of the guide in Scope .07, it would be helpful to either specify on what type of debt a synthetic credit would be applicable or to explicitly mention the synthetic credit spread methodology is not often applicable for real estate debt.

5. Chapter 6 – Valuation of Debt Instruments: Paragraph 6.21 – Outside of unusual circumstances, determining the upper and lower bounds of equity is not a common practice for the calculation of the fair value of debt in real estate.

6. Chapter 6 – Valuation of Debt Instruments: It would be helpful if there were real estate examples to outline the Fair Value of Debt Instruments (when Debt is the Unit of Account) and Value of Debt for the Purpose of Valuing Equity. If such examples are added, we recommend a recirculation of Chapter 6 for review.

7. Chapter 11 – Backtesting: Given the number of references to subsequent events, we suggest renaming this chapter to "Backtesting and Subsequent Events".

8. Paragraph 13.92 is describing a waterfall but does not explicitly state as such. We propose reference to the definition of a waterfall included in the Glossary.

9. We are proposing the following Q&A to be included in Chapter 14 – Frequently Asked Questions:

   Question: How might the principle of calibration apply to a real estate transaction?

   Answer: Similar to other investments with unobservable inputs, "it is important to calibrate these inputs to any observed transactions in the investment itself, providing an initial set of assumptions that are consistent with the transaction price when the transaction price represents fair value." For a real estate investment it is important to consider changes to relevant supply and demand characteristics as well as any physical, economic or legal changes at the investment since the transaction date.

10. Comment on Appendix C - Case Study 4: The valuation of real estate investments is a broad discipline with well-established industry guidance. Our recommendation is to make a statement such as "This guidance is not a substitute for reading and understanding relevant professional literature. On the topic of real estate valuation, a number of organizations publish relevant guidance including but not limited to The Appraisal Institute, The Appraisal Foundation (sets the Uniform Standards of Professional Appraisal Practice-USPAP).the International Valuation Standards Council, and the Royal Institute of Chartered Surveyors," Additionally, while this case study does a good job outlining a specific real estate development valuation example, clarity is needed on the intended use of the case study. For instance, several caveats stated at the beginning of Appendix C should be restated or highlighted within the case study itself including the following important, but relatively hidden statements:
    - C.00.03 "These case studies are not intended to provide 'how to' guidance with respect to calculating fair value for each industry, type of instrument or fact pattern presented. The purpose of these case studies is to highlight examples of the exercise of informed judgement and to help users of the guide understand the factors that market participants may consider in making valuation estimates."
    - C.00.04 "…a fund may utilize multiple valuation approaches to estimate fair value to the extent applicable. For simplicity, each case study focuses only on one or two valuation methods"
    - C.00.08 "These case studies are by no means an exhaustive look at the situations that practitioners might encounter in the course of making valuation judgements. Nor do the approaches presented in the case studies necessarily represent the only possible means by which to evaluate the circumstances in each illustration."

11. Glossary – NCREIF PREA Reporting Standards along with INREV (the association for non-listed real estate vehicles in Europe) and ANREV (the Asian counterpart of INREV) recently released The Global Definitions Database (GDD) which provides a common glossary of non-listed real estate terms. We propose to include the following definitions which are referenced within the AICPA accounting and valuation guide:
    - **Closed end** - An investment Vehicle with a fixed amount of capital and a finite life. Limited liquidity, with the redemption of units provided for at the end of the life of the Vehicle.
    - **Development** - Property under construction, including preparation and installation of infrastructure.
    - **Joint Venture** – A vehicle with at least two parties with a common investment objective. Control over significant investment and risk management decisions is not transferred to an external manager, but is exercised by members in the venture per the Vehicle Documentation.
    - **Land** - Undeveloped land parcels.
    - **Non-Controlling Equity Interests (Minority Interest)** - An ownership position that does not meet the requirements of control according to the governing accounting literature.
    - **Prepayment Penalty** - Fees paid by borrowers for the privilege of retiring a loan early. Such charge is provided for in the debt instrument and normally is expressed as a percentage of the loan, an additional interest charge, or a flat fee.
    - **Residual Value** - The remaining equity in a fund or asset.