Mapping the differences across regional industry practices

Introduction

There have been requests from industry players for common metrics to report and compare performance globally. For example, time-weighted returns are a common measure of performance for open-end funds while for closed-end funds investment multiples are commonly calculated and reported. These calculations (and likely others) require Net Asset Value (NAV) as an input to the denominator. This paper summarizes the main accounting NAV differences across regional industry practices and looks at whether the development of a global NAV would facilitate strategic decision-making for global investors.

As part of its mission to develop a global set of standards which are transparent, useful and comparable for the industry, the global Standards Steering Committee started to address the relevance, applicability and calculation associated with a global NAV. There are a number of challenges to arrive at a globally converged NAV. For example, fair value accounting principles are not consistent across the globe and investment managers may use different NAV adjustments for reporting performance and or pricing units. In addition, investors may have different reasons to invest in real estate including strategic and economic considerations for investment in one country versus the other. Any attempt to create a global NAV calculation should therefore provide for adjustments on material differences only and preserve the investor's investment experience.

It is important to note that the concepts described in this paper focus principally on accounting differences; however, the unique strategy employed by an investment manager for a particular product may reflect other important considerations within a global NAV framework which may not be addressed herein.

Fair Value Accounting

General

Fair value generally accepted accounting principles (GAAP) exist around the globe. However, since fair value GAAP is generally principles based and not rules based (ie, prescriptive), interpretations of fair value GAAP may vary significantly based on facts and circumstances. The US has a single GAAP, which is issued by the Financial Accounting Standards Board (FASB).

It is important to note that the nature of fair value implies the use of estimates and how those estimates are determined can be subject to interpretation within a fair value GAAP framework and the results can lead to significant differences. For example, within the US, there is optionality surrounding whether debt is marked to market within fair value financial statements.

Contrasted with US GAAP, the International Accounting Standards Board (IASB) issues the International Financial Reporting Standards (IFRS). Although many IFRS and US GAAP principles are similar, they are not universally the same. This is further exacerbated as different interpretations and applications of fair value may vary by country, thus creating a local country GAAP (eg, German GAAP, French GAAP, etc).

INREV and the NCREIF PREA Reporting Standards have, and as GAAP changes, will continue to offer guidance surrounding interpretations of fair value GAAP and the resulting NAV for real estate investment vehicles which are incorporated in the NCREIF PREA Reporting Standards and the INREV Guidelines.

INREV NAV

In 2007, INREV created INREV NAV. Currently, this is one of the most widely adopted INREV standards used by 89% of INREV members, according to the INREV annual membership survey. In Europe, more and more investment vehicles disclose INREV NAV in their quarterly reports to investors. INREV NAV is an adjusted NAV designed to reflect a more accurate economic value of the investment in a vehicle. This means, among others, ensuring the underlying assets and liabilities are measured at fair value, and adjusting for the spreading of costs that will benefit different generations of investors through capitalization and amortization of setup costs and acquisition expenses. As part of the calculation of INREV NAV, adjustments are made to local country GAAP or IFRS to develop a measure of fair value. INREV NAV can be audited by users. For some European vehicles, INREV NAV principles are used to establish pricing of units.

When performing these calculations, it is important to understand the local country GAAP financial statements in order to determine which adjustments are necessary.

US GAAP NAV
Within the US, the NCREIF PREA Reporting Standards (Reporting Standards) considers US Fair Value GAAP, as established by the Financial Accounting Standards Board (FASB), as its foundational standard for accounting. The Reporting Standards do not contradict US Fair Value GAAP but may provide interpretive guidance for real estate in order to promote consistency of application of US GAAP principles for the industry.

Open-end funds generally trade (ie, price) units based on fair value, US GAAP based NAV. Some may choose to spread costs (eg, organization costs transfer and acquisition expenses) over a selected amortization period (which may differ by fund). In the US these costs may be material or immaterial to the fund, whereas outside of the US these costs generally have a material effect. Regardless, there is a view that initial investors are bearing the entire expense when future investors are unfairly benefiting.

Economics
Although accounting differences in NAV can be isolated and adjusted where deemed appropriate and necessary, there are strategic decisions associated with the decision to invest in one country versus another. In addition, there are numerous types of investment vehicles around the globe. These vehicles may have significantly different characteristics and can be subject to different tax regimes, including those of ownership, entry and exit provisions and fee structures.

As it is very important to understand the economic impact relating to these issues, clear disclosures (provided for within the footnotes to the financial statements or through other investor reporting) are a first important step to achieve the consistency and comparability needed for strategic analysis and decision making.

Summary of differences

The table below details the likely differences between INREV NAV and US GAAP NAV. It also illustrates to what extent the potential impact could make a difference, ranging from small differences, to potential differences to conceptual differences.

As previously stated, it is important to note that the use of estimates, which are inherent within a fair value framework, may result in variances not encompassed in this summary.

Conclusions

The global NAV principles presented in this paper are limited to a discussion of the differences within NAV as calculated around the world. With the accounting inconsistencies identified, we now know that a global NAV can be calculated. The global Standards Steering Committee will now assess whether additional work is needed and consider carrying out associated research or collating further feedback. It is important to note that this paper does not require or recommend a specific calculation of NAV as part of compliance with either the NCREIF PREA Reporting Standards or the INREV Guidelines.

We hope that this paper helps industry players to compare regional NAV calculations of real estate investment vehicles that operate across various regions of the globe.

About the global Standards Steering Committee
The global Standards Steering Committee (SSC) was established in 2015 by INREV, NCREIF, PREA (collectively the Sponsorship) and by acknowledgement, ANREV (as licensee of the INREV Guidelines) to prioritize and direct the Global Standards initiative.

Table 1: Differences between INREV NAV and US GAAP NAV

		Summary of potential adjustments	High level analysis	Considerations on identified differences
SMALL DIFFERENCE	1.	Revaluation to fair value of investment property held for sale - treatment of costs to sell	IFRS and INREV NAV adjust to fair value less costs to sell for assets held for sale. US GAAP excludes any costs for assets held for sale.	Costs to sell should be adjusted for investment property held for sale.
SMALL DIFFERENCE	2.	Revaluation to fair value of real estate held as inventory - treatment of costs to sell	IFRS and INREV NAV adjust to fair value less costs to sell for assets held as inventory. US GAAP excludes any costs for assets held as inventory.	Costs to sell should be adjusted for assets held as inventory.
SMALL DIFFERENCE	3.	Contractual fees	In general, for both INREV and US GAAP contractual fees should be deducted if that might lead to an outflow in the future. Most of these fees are normally accrued under IFRS accounting rules. In rare circumstances these fees are not recognized as they may not meet the criteria for recognition as a provision or liability in accordance with IFRS.	Recommend the consistent treatment of carried interest charged by the investment manager to be incorporated within a global NAV. Presumed to already be the case, however to add clarification to ensure consistency.
SMALL DIFFERENCE	4.	Effect of dividends recorded as a liability which have not been distributed	US GAAP requires dividends to be accrued as a liability if the distributions have not been made. As per IFRS, dividends proposed or declared after the end of the reporting period are not typically recognized as a liability; only in certain specific circumstances dividends classify as a liability. For INREV NAV, these accrued dividends should be reversed to the NAV.	Recommend being consistent with INREV NAV calculation.
CONCEPTUAL DIFFERENCE	5.	Acquisition expenses	US GAAP and IFRS require such costs to be capitalized and are considered to have zero fair value. INREV NAV requires that acquisition expenses should be capitalized and amortized over a period of five years.	In order to determine the long-term performance of an investment vehicle through a global NAV, this element could be material. Options to consider include amortizing over five years.
CONCEPTUAL DIFFERENCE	6.	Set-up costs	US GAAP requires expensing of such costs. Under IFRS, vehicle set-up costs are charged immediately to income or equity after the inception of a vehicle. INREV NAV requires that set-up costs should be capitalized and amortized over a period of five years.	Could be material for the early life cycle of vehicles. Options to consider include amortizing over five years.

		Summary of potential adjustments	High level analysis	Considerations on identified differences
POTENTIAL DIFFERENCE NEEDS FURTHER RESEARCH	7.	Revaluation to fair value of savings of purchaser's costs such as transfer taxes	Transfer taxes and purchaser's costs which would be incurred by the purchaser when acquiring a property are generally deducted when determining the fair value of investment properties under IFRS (IAS 40). The effect of an intended sale of shares in a property-owning vehicle, rather than the property itself, should be considered when determining the amount of the deduction of transfer taxes and purchaser's costs, to the extent this saving is expected to accrue to the seller when the property is sold. Similar adjustments would be required under US GAAP to the event that they impact the exit price. INREV NAV adjustment represents the positive impact on the NAV of the possible reduction of the transfer taxes and purchaser's costs for the benefit of the seller based on the expected sale of shares in the property-owning vehicle.	To determine if the intended sale of units vs asset should be adjusted for in NAV. Can be driven by differences between US, European and Asia Pacific tax structures.
NOT ADDRESSED	8.	Effect of reclassifying shareholder loans and hybrid capital instruments (including convertible bonds) that represent shareholders' long-term interests in a vehicle	US GAAP and IFRS provide guidance on transactions with investors. The classification may vary based on the terms of the instrument. For INREV NAV, shareholder loans and hybrid capital instruments should be included as a component of equity and reclassified as such if they have been classified as liabilities in the financial statements of the vehicle.	Research further if a global NAV will focus on performance (total return) metrics; if the case one should evaluate the treatment of shareholder loans as an additional interest in the vehicle.
NOT ADDRESSED	9.	Effect of subsidiaries having a negative equity (non-recourse)	US GAAP requires investments to be recorded as a liability to the extent that they are recourse to an entity. Indirect investments in real estate, such as investments in associations and joint ventures, have different accounting treatments and carrying values under IFRS. Such investments can be valued at cost, fair value or NAV. The adjustment for INREV NAV represents the positive impact on the NAV of the partial or full reversal of the negative equity of the specific subsidiary. If the vehicle has granted shareholder loans to the subsidiary, these should be considered.	To determine if this should be called out separately when non-recourse.