

NCREIF Fall Conference

St. Pete, FL

Tuesday November 8, 2011



Tuesday Agenda

- Introductions
- Rules
- CPE – sign in sheet for each day
- REIS Council Update
- REIS Handbook
- Investment Property Entity & Company Exposure Task Force Update
- Fair Value Accounting Manual Update
- Best Practices – Managing Internal Controls of Service Providers
- Hot Topics

Wednesday Agenda

- Joint Session: Risk Management
- Joint Session: Daily Value and Trade Funds Panel Discussion
- General Session: Attribution Analysis
- Accounting Committee Technical Update
- Investment Property/Company Standards Discussion
- Closing General Session and Awards
- Closing Reception

REIS Council Update

- REIS Handbook Volume I released (8/30)
- Responded to OSCRE Investment Reporting Specification
- New REIS Council Members Appointed
 - Bob Hess - Independent Research Consultant
 - Paul Mouchakkaa - Pension Consulting Alliance
 - Nathan Zinn - Teacher Retirement System of Texas
 - Bruce Frank - E&Y, Maritza Matlosz – BlackRock, and Barbara McDowell – ORG Portfolio Management terms extended
 - Neal Armstrong – RREEF, Tim Schlitzer - MassPRIM, and Candice Todd – Morgan Stanley RE terms expired
- REIS standards incorporated into PREA Investor Toolkit
- To respond to IASB ED on Investment Entities
- Plans for roll out of compliance and education initiatives

REIS Handbook

- Volume I issued on 8/30
- Contains the REIS standards, compliance, glossary and checklists
- Replaces the REIS standards document previously issued on 12/29/10
- Effective date is 1/1/2012
- Volume II will be issued by 12/31/21
- Volume II will contain all REIS reference materials, including but not limited to REIS FV Accting Manual, PM Resource Manual, & Topic 820 Guidance Document

Investment Property Entity (IPE) & Company (IC) Exposure Task Force Update

- Multi-disciplinary Task Force Assembled
 - Performance Measurement
 - Valuations
 - Research
 - Accounting
 - Pending: Portfolio Management / Plan Sponsors
- REIS Response due by January 5, 2012
- December wrapping up letters
- January – REIS Board Approval

Investment Property Entity (IPE) & Company (IC) Exposure Task Force Update

- The big issues:
 - Investment Company Consolidation
 - Equity Investments
 - At fair value?
 - How to treat – FASB position on components
 - Scoping for:
 - Existing funds – is anyone out?
 - Hotels
 - Senior living
 - Timber Agriculture
 - Opportunity funds
 - Debt
 - Asset
 - Liability
 - Other Investments – diverging NAV?

Fair Value Accounting Manual Update

- Updated annually for GAAP conforming changes
- Update Task Force
 - Neal Armstrong, RREEF
 - Donnett Campbell, State Street Global Services
 - Eric Keilman, KPMG
 - Jim Strezewski, LaSalle Investment Management
 - John Venezia, TIAA-CREF
- Significant edits/updates
 - Sections 2.03 (b) and 2.04 (c)
 - Addition to ASC 310-40 reference
 - Forward purchase commitments
 - ASU 2011-04
- Approval Process

Sections 2.03 (b) and 2.04 (c)

- *2.03(b) Election of The Fair Value Option under ASC 825-10*
The Fair Value Option under ASC 825-10 permits entities to elect a one-time option that is irreversible to measure financial instruments including, but not limited to, notes payable and portfolio level debt at fair value on a contract-by-contract basis. Further information can be found in Sections 4.04 and 4.05.
- *2.04 (c) Election of the Fair Value Option under ASC 825-10*
Consistent with the Non-Operating Model, the Fair Value Option under ASC 825-10 permits entities to elect a one-time option that is irreversible to measure financial instruments including, but not limited to, notes payable and portfolio level debt at fair value on a contract-by-contract basis. (Further information can be found in Sections 4.04 and 4.05).
- Deleted 4.04 (c)

Addition to ASC 310-40 reference

- 3.02(f) See ASC 310-40, *Receivables – Troubled Debt Restructurings by Creditors*, for guidance on troubled debt restructurings, foreclosures, and receipt of assets in full satisfaction of receivables.

Forward Purchase Commitments

■ **3.08 Accounting for Forward Purchase Commitments**

If ASC 810-10 is applied to the entity reported under the operating model, management would need to consider whether the forward purchase commitment would be a variable interest in the entity that holds the real estate. Management should refer to ASC 810-10-55-5 through ASC 810-10-55-41. Particular consideration should be given as to whether the fund a) has rights to terminate the forward purchase commitment for any reason, including if the third party, i.e. the developer, does not perform, AND b) those rights are substantive. The forward purchase commitment's terms should be evaluated to determine, based on all the facts and circumstances, whether the parties have a substantive right to terminate the contract. If a variable interest does exist, management will need to apply the provisions of ASC 810-10 to determine if the entity that holds the real estate should be consolidated.

Some disclosures a Fund might consider for its forward purchase commitments are as follows: project name, property type, location, authorized commitment, costs spent to date, expected funding date, and any other significant terms or considerations.

ASU 2011-04

- The Financial Accounting Standards Board released ASU 2011-04 in May 2011 which requires the additional disclosures below that are pertinent to entities that report on a fair value basis. These additional disclosures are required prospectively and are effective for the first reporting period beginning after December 15, 2011 for public entities and for annual periods beginning after December 15, 2011 for nonpublic entities. Early application by public entities is prohibited; however nonpublic entities may apply the amendments early, but no earlier than for interim periods beginning after December 15, 2011:
 - i) quantitative disclosure (i.e. in tabular format) about unobservable inputs used for all Level 3 fair value measurements;
 - ii) for fair value measurements categorized as Level 3, *qualitative* disclosures (i.e. narrative form) about the sensitivity of the fair value measurement to changes in unobservable inputs used if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement;
 - iii) if applicable, a reporting entity's use of a nonfinancial asset in way that differs from the asset's highest and best use when that asset is measured or disclosed at fair value;

ASU 2011-04 (cont.)

iv) for fair values disclosed but not reported in the financial statements include:

- the level in which the fair value is categorized;
- for Level 2 and 3 fair values a description of the valuation techniques and inputs used, and the reason for any change in the valuation technique, if applicable;
- if the highest and best use of a nonfinancial asset differs from its current use, disclose that fact and why the nonfinancial asset is being used in a manner that differs from its highest and best use;

(v) *any* (no longer just significant) transfers between Level 1 and Level 2 fair value measurements on a gross basis, including the reasons for those transfers;

(vi) In addition to the existing disclosures for the transfers in and out of Level 3, the related policy supporting such transfers.

(vii) For recurring and nonrecurring fair value measurements categorized within Level 3, a description of the valuation process used by the reporting entity.

All new disclosures indicated in (i) through (vii) are required by public entities. Private entities are required to disclose items (i), (iii), (vi), and (vii).

Fair Value Accounting Manual Update

- Approval by Accounting Committee – today
- Approval by REIS Council – Thursday
- Approval by REIS Board – December
- Incorporated into Volume II of REIS Handbook and posted to website by 12/31

Hot Topics

■ Acquisition costs

- Direct costs of acquisition are considered as part of the acquisition cost of a property and capitalized. The valuation of the underlying investment under ASC 820 may result in an unrealized loss on day one. Section 4.03 (a) of FV Accounting Manual

■ Disposition costs

- 4.02(f) Under ASC 820, transaction costs associated with future sales should be evaluated from a market participant perspective. For entities that follow ASC 960 *Plan Accounting – Defined Benefit Pension Plans*, ASC 960-325-35 provides guidance on fair value and requires fair value to include an estimate of costs to sell.

■ Investor NAV Reports

This document was presented during the 2011 NCREIF Fall Conference.

The author(s) take full responsibility for all content.

This posting is for informational purposes only; neither NCREIF nor its Board express any opinion of the content presented herein.

Managing Internal Controls of Service Providers