

REIS Compliance & Verifiability Project

Issue #1: Applicability

In 2005, NCREIF formed the Compliance & Verifiability Task Force (the “CVTF”), which was tasked with reviewing the current Real Estate Information Standards (“REIS” or the “Standards”) to determine whether or not firms could state they were in compliance with the Standards, and developing a framework for possible independent verification of such compliance. The following Issue Summary relates to the overall CVTF project.

Description of the Issue

In determining whether or not the REIS represent a set of standards that can be complied with in a manner that could be independently verified, the initial issue that must be addressed is at what level compliance will be evaluated. At the two extremes, compliance with the REIS could be a firm level concept or an account level concept. Firm level compliance would infer that a firm complies with all REIS requirements across all eligible accounts that it manages, and could therefore state that it is a REIS compliant firm. Account level compliance would infer that the valuation, financial and performance data for an individual account has been prepared and presented in accordance with the REIS. Measuring REIS compliance at the account level would allow an advisor or investor to state that the results for a particular account have been prepared and completed in accordance with the REIS without regard to whether or not all accounts at the firm are handled in such a manner.

Alternative Views

Firm Level Compliance

Proponents of a firm level approach to REIS compliance believe that a primary objective of having the REIS in a format that can be complied with and verified is so that an investment firm can provide existing investors and potential investors with valuation, accounting and performance data that is credible because it complies with REIS. In this case, being REIS compliant would be a distinguishing characteristic that investors would evaluate in selecting an advisor. Theoretically an advisor who administers its accounts and provides data in accordance with the REIS Standards would be more attractive to potential investors than one that does not, and in this manner industry-wide compliance with the Standards would be driven by advisors who want to be able to state that they are a compliant firm. Proponents also believe that such consistency facilitates investor analysis.

Opponents of this approach cite difficulty firms may have in convincing all of their clients, especially large separate account clients, to change existing policies and apply REIS compliant policies in administering their accounts. Because clients have the right to dictate non-compliant policies, there will need to be exceptions in any compliance framework for accounts where advisors do not control policies over valuation, accounting and performance data. In other words, in order to claim compliance with the REIS, advisory firms will need to show only that they applied REIS compliant policies to those accounts where they control all policy making decisions. This may leave a number of significant large accounts outside the REIS framework and provide no motivation for investors to utilize REIS compliant procedures because their advisors will still be able to state that they are compliant themselves. It may also render firm level valuation, accounting and performance data (for example discretionary investment performance composites) less meaningful and inconsistent with competitors’ data because such

information may not have been generated using appropriate valuation methods, accounting methods or investment performance calculation and presentation methods.

Account Level Compliance

Proponents of an account level approach to REIS compliance believe that it is meaningful to focus on whether or not the valuation, financial and performance results of a particular account have been prepared in accordance with the REIS Standards. They point out that account level compliance does not prevent or inhibit firm level REIS compliance. While they consider it important that an advisory firm can state that it can administer an account in accordance with the REIS Standards, they believe that any movement to drive compliance with standardized policies and procedures will ultimately be determined by the investor community. In other words, they believe that managing boards and directors of investors will drive compliance if an individual account is labeled as either REIS compliant or not. If the Standards are in place and familiar to those with oversight over investor activity, the adoption of non-compliant procedures by investor staff will raise concern. Proponents of an account level approach also note that such an approach allows advisors to establish a positive path toward firm level compliance, allowing advisors to “walk” with account level compliance before they learn to “run” with firm level compliance.

Opponents of the account level approach point out the need for credible and comparable firm level data (and particularly discretionary investment performance composites) that complies with a consistent industry standard (REIS). They also believe that allowing a percentage of accounts to use inconsistent valuation, accounting, and performance standards results in a notable loss of credibility for industry indices. Others believe that the lack of a requirement for an advisory firm to administer all of the accounts over which it controls policy in accordance with the REIS Standards will lead to limited application of the Standards. They also believe that the inability for an advisory firm to be verified as a compliant firm will not meet one of the primary investor needs driving the move towards compliance and verifiability. They do not feel that those with oversight over the industry’s investors will adequately drive the move towards acceptable Standards in the same way that a firm level approach to compliance would.

CVTF Conclusions

At first look some form of a combined firm and account level approach may be the best solution to this issue. Under a combined approach, compliance with the REIS Standards would be both an account and firm level concept. An individual account could claim compliance if all of the policies used to administer that account were in compliance with the REIS. Likewise, an advisory firm could also then claim compliance if all of the accounts over which it controlled valuation, accounting and performance policies were administered in accordance with the REIS. In both cases either an account’s or a firm’s statement of compliance could, if necessary, be evaluated and verified by a third party.

This combined approach may, however, present initial implementation issues. Clearly firm level compliance will be more difficult to achieve at implementation given the number of accounts each firm may have to alter policies for, evaluate and potentially verify. Account level compliance will be easier to initially implement, assess and verify if desired. In addition, it is believed that account by account compliance will encourage investors to drive a requirement to have their accounts administered in compliance with the Standards which will, in turn, lead to greater implementation of the Standards more broadly by advisory firms. An account level approach would also not preclude a later move to a firm level concept of compliance as well.

As such, the CVTF Task Force has concluded that NCREIF should adopt an account level concept to REIS compliance. The Task Force believes that REIS Compliance should not only be utilized as a mechanism that helps provide for efficient allocations of new capital to advisory firms but should also apply to and be driven by existing investors with regard to their existing accounts. The concept of investors being able to receive standardized REIS compliant reports regardless of advisor utilized versus an advisory firm being able to advertise that it administers all accounts it controls in accordance with the Standards seems to be more in line with NCREIF's objectives in initiating the compliance project. These facts plus the ease with which such a concept could be initially implemented over a firm level approach and the fact that account level compliance does not prevent or inhibit firm level compliance make the account level option appear to be a necessary and positive addition to REIS compliance at this time. The Task Force plans to continue its discussions in regard to firm level compliance.

To: NCREIF Board

From: Jeff Kiley and Marybeth Kronenwetter

Date: September 29, 2006

RE: REIS Compliance and Verifiability – Firm Compliance - Update

Purpose

To communicate to the Board, and solicit feedback from it, with respect to the steps undertaken by the REIS Council in order to ultimately position REIS as a standard which can be complied with and subject to verification. The attached issue summary document, approved by the REIS Council, is the initial issue that must be addressed which is "at what level (firm or account) should REIS compliance be measured". The issue summary concludes that achieving firm compliance within REIS is a significant goal, leading to enhanced credibility within the industry, comparability and transparency of data flow. However, divergent practices currently exist which make firm compliance not readily achievable. Therefore in order to establish a positive path towards firm level compliance the REIS Council thinks that measuring compliance at the account level is an important initial step.

Summary

The attached document describes the issues, summaries the divergent viewpoints and elaborates on the conclusion described above.

Action Items

As it is currently written, REIS is not verifiable, rendering compliance with it nearly impossible. It should be noted however, that some consultants are asking the question: "Do you comply with REIS?" within their selection criteria. As this suggests, the industry appears poised to embrace the notion of REIS compliance and verification.

Each discipline (valuation, accounting and performance measurement) and the REIS Council will consider the ongoing notion of describing the appropriate evidence necessary for verification when recommending changes to REIS.

The Compliance and Verifiability Task Force (CVTF) is poised to prepare issue summaries (similar to the one attached relating to Compliance Applicability) which will document its position (and serve as its communication to the REIS Council and the Board) with respect to the following questions relating to REIS compliance:

- Is compliance binary? (i.e. “except for” not allowed)
 - Within disciplines and cross disciplines?
 - Should “except for” language be allowed during the compliance phase in period? (i.e., discretionary accounts, non-discretionary accounts, separate accounts, etc.)
- What is the impact of non- U.S. investments on REIS compliance?
- How does the GIPS definition of “firm” impact REIS compliance?
- What kind of certification should be expected to evidence REIS compliance?

The CVTF will propose a time table for completion of the issue summaries for each topic during the forth quarter. Upon clearance from the REIS Council, the documents will be submitted to the Board for its information and in order to provide directional feedback to the Council.

After the issue summaries have been approved, language will be drafted within REIS to explain how compliance and verifiability can be established. Revisions to REIS will follow the process outlined in the Constitution which includes exposure to the public for comment.

Pending its positive reaction to the process outlined herein, we recommend that the Board continue to promote the notion of REIS compliance and verifiability. This can be accomplished through communication and REIS education. A plan for REIS education is being developed and is expected to be initially presented at the March meeting. Education and communication will provide the catalysts necessary in order to achieve firm compliance for REIS and establish REIS as a standard which can be complied with and independently verified..