

Minutes of Real Estate Information Standards (REIS) Council Meetings
WEDNESDAY, OCTOBER 11 and FRIDAY, OCTOBER 13, 2006
(Revised March 16, 2007)

The REIS Council met on Wednesday afternoon and Friday morning during the NCREIF conference held in Hilton Head. The agendas included progress reports on various REIS initiatives including: the re-write of Chapter 1, Valuation; progress on the re-write of Chapter 3, Performance Measurement; an update on the Survey relating to the impact of the AICPA Audit Guide for Investment Companies (“Guide”); voting to approve the glossary; and a status report on the Debt Accounting workbook. In addition, on Wednesday, most of the Council time was devoted to a Town Meeting relating to issues facing the industry resulting from the implementation of the Guide.

Town Meeting

The town meeting entitled “Bridging the GA(A)P: Issues Facing the Industry Resulting from Implementation of the Audit Guide for Investment Companies” was moderated by NCREIF’s President-elect, Anne Pheiffer (JP Morgan) and included John Baczewski (REFS); Peter Crosson (Alaska Electrical Pension Fund); Jeff Kiley (PwC); Carol Kuta (UBS); and Doug Poutasse (AEW) as panelists. A summary of the topics considered by the panelists is attached as Exhibit A and are an integral part of these minutes.

Survey

John Baczewski provided a brief update on the survey. The Schedule of Differences was nearly completed and each of the committees would be given one final opportunity to comment on it during the Thursday meetings. The survey is on track for distribution on or about December 1. The Council indicated that it wanted time to review and comment on the questions before distribution. A special meeting of the REIS Council and members of the survey team was held in Boston on November 10. At that time the survey was substantially completed and during the full day session participants were afforded the opportunity to express comments which were evaluated by the survey team and incorporated as appropriate. Survey results will be reviewed at the March meeting in Orlando. Guidance will be developed as appropriate.

Chapter 1, Valuation

Alyce DeJong reported that the public comments received with respect to the proposed new version of Chapter 1, Valuation were not significant. The REIS Council members had received the final document prior to the meeting. On Friday, the document was unanimously approved to be submitted to the Board for its approval. Subsequently, an adopting release, which included the Council approved version of Chapter 1 and which memorialized the basis for the conclusions reached was prepared and submitted to the Board for its approval. Once approved by the Board, the new version of Chapter 1 will be incorporated into REIS.

Chapter 3, Performance Measurement

Scott Brown reviewed proposed changes to Chapter 3. Several Council members questioned whether the proposed compliance decision tree depicted the process required

to achieve REIS compliance for both discretionary and non-discretionary portfolios. After discussion, it was agreed that Council members be afforded more time to review and comment on the proposed chapter changes and that suggestions should be sent to Scott by October 27. Scott agreed he would reassemble the task force to review the comments and make suggested changes to the document which would be resubmitted to the REIS Council for review.

Glossary

Chris Meyer reported that no further changes were incorporated into the glossary since it was last given to the REIS Council. The Council unanimously approved the glossary for submission to the Board. On Friday, the Board approved the glossary, requesting that a definition of NCREIF be added and reference made to the FASB's definition of Fair Value in the glossary definition. These minor edits were made and the glossary was incorporated into REIS as Appendix 2.

EXHIBIT A TO REIS COUNCIL MINUTES FROM OCTOBER 2006 MEETINGS

Town Meeting

Bridging the GA(A)P: Issues Facing the Industry Resulting from Implementation of the Audit Guide for Investment Companies October 11, 2006

Introduction

In September, 2006, the Financial Accounting Standards Board cleared the long-awaited Statement of Position, Clarification of the Scope of the Audit and Accounting Guide *Investment Companies* and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies (the "Scope SOP"). The effective date is for fiscal years beginning after December 15, 2007. In general, commingled funds and insurance company separate accounts investing in all asset classes including real estate are faced with a US GAAP mandate to comply with the accounting requirements of the AICPA Audit and Accounting Guide *Investment Companies* (the "Guide") upon its effective date. Real estate investment accounts in which public and private pension plans directly own property ("Direct Investment Accounts") are not faced with this mandate - yet. No other US GAAP standard to date has had such a profound impact on reporting in our industry including: standards established within REIS; financial reporting; performance measurement and NCREIF data products.

Background

The traditional REIS accounting and reporting model (the "Traditional Model"), which was developed in the 1980's, has its roots established within the historical cost basis accounting model used by US operating companies. The Traditional Model uses historical cost as its base and adjusts that historical cost for changes in market value. Investment income is a measure of accrual based operating cash flow exclusive of capitalized expenditures such as leasing costs, tenant improvement costs as well as recurring and non-recurring capital improvement costs. The Traditional Model was chosen by the industry because it was believed to be aligned well with the information needs of investors who required market value reporting. This model also became accepted as US GAAP as accounting rules state that in the absence of authoritative guidance (there was none), prevalent accounting practices used in an industry form a basis for GAAP in that industry.

The Traditional Model also recognized that many real estate commingled funds and insurance company separate accounts have attributes similar to investment companies as defined in the Guide. In essence, the Guide establishes that investment companies are required to report investments at fair value while it effectively prohibits operating companies from reporting investments at fair value. The Guide also recognizes investment income generally as cash payments are received from investments by the fund (the "Dividend Model"). The Dividend Model is currently used by all mutual funds, hedge funds, private equity funds, bond funds and the majority of other non-real estate entities that are considered to be investment companies.

Scope SOP Applicability

The Scope SOP requires each reporting entity to make a determination as to whether it is required to follow the Guide. This determination may be complex and conclusions should be determined by entity management with adequate consultation with its accountants. Although each situation may be unique, it is likely that many commingled funds and all insurance company separate account arrangements will be required to follow the Guide.

Key Question for industry:

1. *Will your reporting entities be required to follow the Dividend Model of the Guide upon the effective date of the Scope SOP?*

Are Two Accounting Models considered a Standard?

Since not all reporting entities will be required to follow the Dividend Model required by the Guide, it is possible we will no longer have a single industry accounting standard on January 1, 2008. For example, while most commingled funds and all insurance company separate accounts will be required to use the Dividend Model on that date, direct investment accounts will not be required by US GAAP to change to a Dividend Model at that time. The AICPA expects it will take several years before US GAAP guidance for Direct Investment Accounts is conformed to the Guide to require use of the Dividend Model. It would also appear there is no current prohibition for Direct Investment Accounts to use the Dividend Model since substantially all non-real estate investment held by such accounts are accounted for using the Dividend Model today.

Key Questions for REIS:

1. *Should REIS require a single accounting model as its standard and if so, should it be the Traditional Model or the Dividend Model?*
2. *If REIS requires one accounting model, is there a risk that that model would not be GAAP for certain reporting entities? If so, how would audit opinions differ?*
3. *If REIS allows a dual accounting model, can we effectively manage comparability of reporting to investors?*

Impact on Fund Time-Weighted Returns

NCREIF's accounting committee has concluded that total time-weighted returns calculated under the Dividend Model will be the same as total time-weighted return under the Traditional Model. Component returns however, will be different and most frequently, the income return calculated under the Traditional Model will be more than 100 basis points higher than under the Dividend Model. Currently the NFI-ODCE collects fund data from some managers that utilize the Dividend Model. This data is combined with data from other managers that are using the Traditional Model. Any interpretation of component data which is combined in this manner may be misleading.

Key Questions for Index Policy Committee:

1. *How should returns be reported for the NFI-ODCE and other NFI indices when two accounting models are utilized in the industry? Should only*

total returns be disclosed? Should the same data elements be captured so that the data can be combined and the component results can be interpreted meaningfully?

Impact on NPI

Data collected for the NPI is similar to that produced under the Traditional Model. The NPI is an index of property operating performance, not fund performance. Many managers use the NPI as a base to benchmark performance of its funds. The NPI is not directly impacted by the US GAAP accounting changes referred to above as the US GAAP changes only pertain to fund level accounting guidance.

Key Questions for Index Policy Committee:

- 1. What is the risk associated with production of Indices using two different accounting models, which although not theoretically comparable, are often compared?*
- 2. Should NPI return components continue to be reported even if NFI-ODCE returns do not include components?*

Key Questions for Industry

- 1. Should benchmarks which are based on NPI change when the Guide is implemented?*

GIPS Verifications

Disclosure of income and capital appreciation component returns is required in GIPS. Each component of return (income, appreciation, total) is chain-linked, and for periods longer than one year, are annualized. For GIPS verification, performance returns are generally calculated from fair value-based information contained in the audited financial statements. Linking component returns using two different methodologies may produce misleading results and results which cannot be meaningfully interpreted.

Key Questions for Industry:

- 1. Will the audited financial statements be utilized as the source for GIPS return calculations irrespective of the accounting model? If the audited financial statements are not the source document, is a GIPS verification possible?*
- 2. Will presentations and disclosures of GIPS compliant information change as a result of changes in the accounting model?*

Guidance Development

As part of evaluating the issues described herein, the REIS Council expects to establish appropriate industry standards for reporting by all investment vehicles for periods beginning after December 15, 2007. An industry survey will be conducted in the 4th quarter of 2006 to quantify what percentage of the industry will be required to comply with the Guide. In addition, the survey will inquire about existing and prospective financial and performance information to determine which elements are most relevant to the financial statement users. The survey results will be considered when developing appropriate guidance, which is likely to include supplemental reporting. It will be of paramount importance to develop guidance which will be: a) implemented and utilized in all industry financial reports, and b) encompassed by the audit opinion.