



## **Understanding how Financial Reporting presentation models impact comparability of Performance Measurement**

**March 17, 2021**

# Agenda

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- Operating Model (Gross or Net) and Non-operating Model Overview
  - Overview of each model
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- Survey Questions
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# Background

## Understanding How Financial Reporting Presentation Models Impact Comparability of Performance Measurement

- There are alternative fair value financial reporting presentation models used in the industry, and these models impact the presentation of the balance sheet and the income statement for funds and separate accounts.
- The financial reporting presentation model impacts the fund level time-weighted return (TWR) calculations for appreciation and income (the total return calculation remains the same across all financial reporting presentation models).
- When comparing TWRs to ODCE, managers and investors should consider the comparability of their fund's financial reporting presentation to ODCE. For example, the component returns for the non-operating presentation model are not comparable to ODCE.

**The intention of this presentation is to educate NCREIF members on the differences in the financial reporting presentation models and the potential for performance comparability issues.**

# Operating (Gross or Net) and Non-Operating Models

## Overview



## Reporting Standards Volume II, Section 2, Fund Level Accounting

- Section 2.01(b) - The Operating Model and the Non-operating Model provide alternative presentations while generally resulting in the same net asset values; diversity exists when determining which model is presented. The determination of the appropriate fair value reporting presentation to use is made by the entity's management based on a review of the relevant accounting literature. Reporting Standards require FV GAAP through application of either one of these presentations.
- Section 2.02 – FV NAV reported by a reporting entity under both presentations is generally expected to be similar because both presentations require investments to be reported at fair value in accordance with ASC 820.

# Operating (Gross or Net) and Non-Operating Models



## Overview – Comparison Table

	<b>Operating Model - Gross Presentation</b>	<b>Operating Model - Net Presentation<sup>1</sup></b>	<b>Non-operating Model</b>
Statement of Net Assets Presentation	Separate line items for the gross assets and gross liabilities of the Fund's investments in real estate	One line item for the Fund's fair value of its net equity position in each of its real estate investments	One line item for the Fund's fair value of its net equity position in each of its real estate investments
Revenue Recognition - Investment Income	Gross investment/property level revenue and expenses	One line approach; Fund's share of investment earnings and loss on the accrual basis	Revenue recognized when dividends are received from the investee; dividend income is presented as a component of Net Investment Income
Revenue Recognition - Unrealized Gain/(Loss)	The difference between fair value and the adjusted cost basis of an investment is the unrealized gain or loss associated with the asset and liability, and if applicable, the noncontrolling interest	The difference between fair value and the adjusted cost basis of an investment (at Fund's ownership) is reported as unrealized gain or loss	The difference between fair value and the adjusted cost basis of an investment (at Fund's ownership) is reported as unrealized gain or loss

<sup>1</sup> Operating Model Net Presentation is not currently included in the Appendix section of the Fair Value Accounting Policy Manual

# Models Presentation - Example



	Operating Model (Gross)	Operating Model (Net)	Non-Operating Model (Dividend Income)
<b>Consolidated Statements of Net Assets</b>			
Real estate investments	\$ 500	\$ 200	\$ 200
Notes payable	300		
<b>Net Assets</b>	<b>\$ 200</b>	<b>\$ 200</b>	<b>\$ 200</b>
<b>Consolidated Statements of Operations</b>			
Revenue from real estate investments	20		
Earnings from real estate investments		13	
Income distributions from real estate equity investments (div income)			8
Total Income	20	13	8
Real estate expenses and taxes	7		
<b>Net Investment Income</b>	<b>\$ 13</b>	<b>\$ 13</b>	<b>\$ 8</b>
Net realized and unrealized gain (loss):			
Realized gain from sales of real estate invest.	6	6	11
Less: Previously recorded unrealized gain on sales of real estate invest.	(2)	(2)	(3)
Net realized and unrealized gain from the sale of real estate invest.	4	4	8
Unrealized gain (loss) on real estate investments and improvements	5	5	6
<b>Net realized and unrealized gain</b>	<b>\$ 9</b>	<b>\$ 9</b>	<b>\$ 14</b>
<b>Net increase in net assets resulting from operations</b>	<b>\$ 22</b>	<b>\$ 22</b>	<b>\$ 22</b>



# Models Presentation - Return Example

	Operating Model (Gross)	Operating Model (Net)	Non-Operating Model (Dividend Income)
Net Investment Income	\$ 13	\$ 13	\$ 8
Net realized and unrealized gain	\$ 9	\$ 9	\$ 14
Net increase in net assets resulting from operations	\$ 22	\$ 22	\$ 22
<b>Time Weighted Returns (fund level, single period)</b>			
Income Return	7.20%	7.20%	4.43%
Appreciation Return	4.99%	4.99%	7.76%
Total Return	12.19%	12.19%	12.19%
<b>ODCE Performance</b>			
Income Return	8.10%	8.10%	8.10%
Appreciation Return	4.23%	4.23%	4.23%
Total Return	12.33%	12.33%	12.33%
<b>Fund vs. ODCE Performance</b>			
Income Return	-0.90%	-0.90%	-3.67%
Appreciation Return	0.76%	0.76%	3.53%
Total Return	-0.14%	-0.14%	-0.14%



# Survey

## Question 1

**Which reporting model do you predominantly use/see for ODCE reporters for open-end funds?**

- a. Operating Model – Gross Presentation
- b. Operating Model – Net Presentation
- c. Non-operating Model
- d. N/A public accounting firm or other industry stakeholder
- e. N/A non-ODCE reporter



# Survey

## Question 2

**Which reporting model do you predominantly use/see for Non-ODCE reporter for open-end funds?**

- a. Operating Model – Gross Presentation
- b. Operating Model – Net Presentation
- c. Non-operating Model
- d. N/A public accounting firm or other industry stakeholder
- e. N/A ODCE reporter



# Survey

## Question 3

**Which reporting model do you predominantly use/see for closed-end funds?**

- a. Operating Model – Gross Presentation
- b. Operating Model – Net Presentation
- c. Non-operating Model
- d. N/A public accounting firm or other industry stakeholder

# Survey

## Question 4



**What is the main reason which drives your selection of a financial reporting presentation model?**

- a. Investment strategy for the fund
- b. Investor desire for a particular model
- c. Familiarity with a particular model
- d. Combination of multiple factors described above
- e. Other (Please use chat function to write-in response)



# Survey

## Question 5

**Which financial reporting presentation model do you predominantly select for a Core Investment Strategy?**

- a. Operating Model – Gross Presentation
- b. Operating Model – Net Presentation
- c. Non-operating Model
- d. N/A – do not have this strategy



# Survey

## Question 6

**Which financial reporting presentation model do you predominantly select for a Core-Plus Investment Strategy?**

- a. Operating Model – Gross Presentation
- b. Operating Model – Net Presentation
- c. Non-operating Model
- d. N/A – do not have this strategy



# Survey

## Question 7

**Which financial reporting presentation model do you predominantly select for a Value Add Investment Strategy?**

- a. Operating Model – Gross Presentation
- b. Operating Model – Net Presentation
- c. Non-operating Model
- d. N/A – do not have this strategy



# Survey

## Question 8

**Which financial reporting presentation model do you predominantly select for a Opportunistic Investment Strategy?**

- a. Operating Model – Gross Presentation
- b. Operating Model – Net Presentation
- c. Non-operating Model
- d. N/A – do not have this strategy



# Survey

## Question 9

**Do you encounter consistency issues when comparing fund level component returns to ODCE for investor reporting?**

- a. Yes
- b. No
- c. N/A public accounting firm /other industry stakeholder
- d. N/A do not compare to ODCE or don't know



# Survey

## Question 10

**If using a Non-operating Model, do you adjust fund level performance component returns for comparison to ODCE?**

- a. Yes
- b. No
- c. N/A do not use the Non-operating Model
- d. N/A public accounting firm / other industry stakeholder
- e. N/A do not compare to ODCE



# Survey

## Question 11

**Do you encounter any of the below when preparing financial statements using the Operating Model – Gross Presentation?**

- a. Consolidation issues
- b. Audit issues
- c. Availability of information
- d. All of the above
- e. N/A public accounting firm / other industry stakeholder or does not use Operating Model – Gross Presentation



**Feedback/Questions?**



# Next Steps

- Review presentation and more detailed example (excel model) and solicit feedback from key stakeholders
- Assessing responses to survey questions
- Additional outreach with all stakeholders
- Consider future applicability of Operating Model (Net)



**Thank You**