NCREIF FALL CONFERENCE 2023

Accounting Committee

Walt Disney World Swan – Orlando, FL
November 14-15

DAY 1 AGENDA

Introductions

NCREIF PREA Fair Value Manual Update

Accounting Technical Update

Debt and Derivative Task Force

NCREIF PREA Reporting Standards Project Updates

Hot Topics

CHAIR INTRODUCTIONS

Megan Hess, DWS

Christy Daniels, Principal

Mark Wojteczko, Deloitte

WELCOME TO OUR NEW CO-CHAIR:

Amy Pearce, SS&C

ABOUT US

- NCREIF is a Not - For - Profit Premier Industry Association
- Membership is comprised of Real Estate Investment Managers, Industry Consultants and Service Providers, Investors and Academicians.
- Leading source of institutional real estate performance data and information.

ABOUT US

Accounting Committee – Mission Statement

To enhance the consistency, transparency, and verifiability of accounting and reporting for institutional real estate assets held in a fiduciary setting.

Reviews, develops, documents and promotes standards for accounting and reporting with the intention to supplement and in some cases, clarify, but not replace other established standards from authorized bodies, including but not limited to US GAAP.

Monitors the actions of applicable standard-setting and supervisory agencies and works with the Reporting Standards Council to ensure the entire organization is aware of these agencies' activities and as appropriate assists the Reporting Standards Council in communication with these agencies.

Provides members with tools and/or resources created through the collective efforts of the membership, and supports the activities of other NCREIF committees by supplying information and research when appropriate.

WHO IS IN THE ROOM?

Raise Your Hands!

Who is at NCREIF for the First Time?

- First Time
- Not First Time

What industry to do you work in?

- Real Estate Investment Advisor
- Public Accounting
- Fund Administration
- Other

NCREIF PREA FAIR VALUE ACCOUNTING MANUAL - ANNUAL UPDATE

OVERVIEW

- The purpose of the NCREIF PREA Reporting Standards (“Reporting Standards”) Fair Value Accounting Policy Manual (the “Manual”) is to provide a consistent set of accounting standards when preparing financial statements for the institutional real estate investment community.
- Not intended to supersede established standard-setting organizations (e.g. FASB and the CFA Institute – GIPS), but addresses specific institutional real estate investment and investor reporting issues not included in U.S. GAAP or GIPS.
- Includes illustrative financial statements under two reporting models; Operating Model and Non-operating Model

CONTENTS

- The Manual is broken down into several sections:
  - Introduction
  - Fund level accounting background
  - Investment level accounting background
  - Property level accounting background
  - Appendices:
    - Operating model financial statements and footnotes
    - Non-operating model financial statements and footnotes

ANNUAL UPDATE PROCESS

- There is a task force of Accounting Committee members that support the annual update
- We hosted a series of 4 separate calls discussing potential changes and enhancements to the guide
- All sections are reviewed and changes tracked and submitted for two layers of approval:
    - Accounting committee approval
    - NCREIF PREA Reporting Standards Council Approval

2023 KEY UPDATES – POLICY SECTION

- Section 2.03(g) Fund Level Organization Costs – added language acknowledging that certain LPAs or offering documents may allow fund to capitalize and amortize initial org costs over a predetermined period of time, resulting in a different traded NAV than US GAAP NAV
- Section 3.09(a) Accounting for Forward Purchase Commitments – added commentary around valuation considerations
- Section 4.04 Loans Payable – added commentary around valuation considerations if you have debt on a property under water (in instances when you have / have not elected the fair value option on debt)
- Section 4.12 Lease Accounting – brand new in the policy section with information around lessee and lessor accounting to maintain documentation from prior year's financial statements upon adoption of ASC 842
- Most other updates were enhancements, changing sequential order of certain items, or better clarifying points of consideration

2023 KEY UPDATES – FINANCIAL STATEMENTS

- NAV under both operating model and non operating model agrees!

CONSOLIDATED STATEMENTS OF NET ASSETS
AS OF DECEMBER 31, XXCY AND XXPY (in thousands)

		XXCY
Assets:		
Real estate investments - at fair value:		
Real estate investments and improvements		
(cost of $116,000 and $111,300, respectively)	$	139,650
Unconsolidated real estate joint ventures (cost of $46,850 and $43,500, respectively)		53,200
Mortgage and other loans receivable (cost of $11,200 and $11,150, respectively)		12,100
Marketable securities - at fair value (cost of $61,650 and $52,700, respectively)		65,225
Total real estate investments		270,175
Cash and cash equivalents		80,635
Restricted cash		10,000
Accounts Receivable		
(net of allowance for doubtful accounts of $580 and $500, respectively)		18,620
Right of use assets - ground leases, at fair value		5,000
Prepaid and other assets		42,000
Total assets		**426,430**
Liabilities:		
Mortgage loans and fund level notes payable - at fair value		77,220
(cost of $80,760 and $70,290, respectively)		
Accrued real estate expenses and taxes		1,350
Accrued incentive fees (*)		260
Lease liabilities - ground leasesy, at fair value		5,000
Other liabilities		2,900
Total liabilities		**86,730**
Net assets:		
XYZ Real Estate Account net assets		318,162
Noncontrolling interests		21,538
Net assets	**$**	**339,700**

XYZ REAL ESTATE FUND, LP

STATEMENTS OF NET ASSETS
AS OF DECEMBER 31, XXCY AND XXPY (in thousands)

		XXCY
Assets:		
Real estate investments - at fair value (cost of $XXX and $XXX, respective	$	325,687
Cash and cash equivalents		12,450
Other assets		160
Total assets		**338,297**
Liabilities:		
Fund level notes payable - at fair value (cost of $XXX and $XXX, respectiv		19,500
Other liabilities		375
Accrued incentive fees		260
Total liabilities		**20,135**
Net assets	**$**	**318,162**

2023 KEY UPDATES – FINANCIAL STATEMENTS

- Operating Model
  - Balance Sheet – Few changes to move marketable securities within RE Investments and clarify that debt is both mortgage loans and fund level notes payable
  - Organization Footnote – provided two examples
    - Separate account with single investor
    - Comingled fund with limited and general partners
    - Added in disclosure of committed capital and unfunded amounts
  - Non consolidated JV Footnote – provided information on statement of cash flow treatment for distributions received
  - Lease Accounting Footnote – updated to remove year of adoption language
  - Financial highlights – Added in beginning of year IRR (when required) and a new line for the incentive allocation ratio

2023 KEY UPDATES – FINANCIAL STATEMENTS

- Non-Operating Model
  - Financial statements – each financial statement has been updated to align and mirror the operating model current and prior year activity

2023 TASK FORCE

THANK YOU TO ALL OF THOSE THAT CONTRIBUTED!

- Peter Bloomfield – KPMG
- Michael Bartman - PwC
- Stephen Crisafulli - PwC
- Charles Campany - PwC
- David Swerling – PwC
- Megan McEmery – Deloitte
- Eddie Bava - Deloitte
- Daniel Kalish - Aztec Group
- Benay Kirk – Alter Domus
- Amy Pearce – SS&C
- Veronica Bulman – RSM
- Erol Wallace – RMS
- Thomas James – PGIM
- Richard Ziobro – PGIM
- Clinton John - EY

NCREIF
National Council of Real Estate Investment Fiduciaries

ACCOUNTING AND FINANCIAL REPORTING TECHNICAL UPDATE

NCREIF 2023 A&A update

Presented by Ernst & Young LLP

Anand Patel, Senior Manager

November 2023

EY
Building a better working world

Disclaimer

- The views expressed by the presenters are not necessarily those of Ernst & Young LLP or other members of the global EY organization.
- These slides are for educational purposes only and are not intended to be relied upon as accounting, tax, legal or other professional advice. Please refer to your advisors for specific advice.

Agenda

- Adoption of current expected credit loss standard
- Going concern
- Debt modifications including reference rate reform
- Recent Securities and Exchange Commission rules
- Closing and Q&A

Adoption of current expected credit loss standard

What is the current expected credit loss standard?

What is CECL?

- Current expected credit loss (CECL) is an accounting standard update issued by the Financial Accounting Standards Board in 2016 impacting Accounting Standards Codification (ASC) 326, *Financial instruments – Credit Losses.*
- The standard establishes principles guiding an entity's calculations of their allowance for credit losses.
- CECL replaces the incurred loss methodology.
- Allowance for credit loss under CECL will be presented separately as a contra-asset deducted from the asset's amortized cost.

What are the scope exceptions?

- The guidance is not applicable to the following:
  - Financial assets measured at fair value through net income
  - Receivables arising from operating leases accounted for in accordance with ASC 842, *Leases*
  - Available-for-sale debt securities
  - Other financial instruments

When is adoption necessary?

- CECL is effective for annual periods beginning after December 15, 2022 and interim period therein.

What is the impact of CECL?

- The CECL model requires the use of more judgment and is expected to increase earnings volatility.

Basic principles: core concepts

Recognize an allowance for credit losses that results in the financial statements reflecting the net amount expected to be collected from the financial asset.

Based on an asset's amortized cost

Amortized cost basis includes unpaid principal balance, accrued interest, unamortized premiums and discounts, foreign exchange adjustments and fair value hedge adjustments.

Reflect the risk of loss

The standard requires a pool-based approach when similar risk characteristics exist, and entities should consider the risk of loss even when that risk is remote.

Consider available relevant information

Entities will consider information about past events, current conditions and forecasts about the future that are reasonable and supportable.

Reflect losses over an asset's contractual life

Contractual life will be adjusted for prepayments.

Basic principles: core concepts (continued)

- Expected loss refers to the portion of a financial asset's amortized cost basis that an entity does not expect to collect.
  - Calculation of the allowance depends on the entity's approach (e.g., discounted cash flow).
- Under ASC 326, expected credit losses are required to be recognized even if that risk is remote.
  - An entity is generally not permitted to assume a loss of zero on a financial instrument secured by collateral simply because the current value of the collateral exceeds the financial asset's amortized cost basis.
  - If similar risk characteristics do not exist, an entity must measure the allowance on an individual-asset basis.
- The estimate of expected credit losses should reflect available information that is relevant to assessing the collectability of cash flows, including historical loss data, current conditions, and a reasonable and supportable forecast of future economic conditions.
- Expected credit losses should reflect losses that are expected over the remaining contractual life of an asset.
  - When determining an asset's contractual life, consider if there are terms that can affect the timing of repayment (e.g., prepayment options, renewal options, call options, extension options).
  - Do not consider extensions not explicitly provided for in the contracts.

Going concern

Going concern
Overview

- Current macro- and microeconomic factors have increased the focus on an entity's ability to continue as a going concern.
- ASC 205-40, *Presentation of Financial Statements — Going Concern*, requires management to evaluate whether there are conditions and events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern.
- This is particularly important for funds that provide guarantees for investment-level debt.
- Evaluation and documentation should be commensurate with level of risk.
- The period to be evaluated includes the period one year from the date financial statements are issued (or available to be issued).
  - December 31, 2023 through February 2025 — if financial are issued end of February 2024
  - December 31, 2023 through March 2025 — if financials are issued end of March 2024

Going concern (continued)

Step 1 — determine whether conditions or events raise substantial doubt

- Conditions or events that raise substantial doubt about an entity's ability to continue as a going concern typically relate to the entity's ability to meet its obligations as they become due.
- Evaluate only conditions and events that are known and reasonably knowable at the date that the financial statements are issued (or available to be issued, when applicable).
- Management considers the entity's ability to meet its obligations, which includes the following:
  - The entity's current financial condition, including its liquidity sources (for example, unfunded capital commitments, reserve capital commitments, available liquid funds and available access to credit) at the date that the financial statements are issued (or available to be issued, when applicable).
  - The entity's conditional and unconditional obligations due or anticipated within one year after the date that the financial statements are issued (or available to be issued, when applicable), regardless of whether those obligations are recognized in the entity's financial statements.
  - The funds necessary to maintain the entity's operations considering its current financial condition, obligations and other expected cash flows within one year after the date that the financial statements are issued (or available to be issued, when applicable).
  - Other conditions and events, such as debt covenants, that, when considered in conjunction with the items listed above, may adversely affect the entity's ability to meet its obligations within one year after the financial statements are issued (or available to be issued, when applicable).

Going concern (continued)

Step 1 — determine whether conditions or events raise substantial doubt

- Example of adverse conditions or events that may raise substantial doubt:
  - Indications of possible financial difficulties; for example, defaults on loans or similar agreements, a need to restructure debt to avoid default, noncompliance with statutory capital requirements and a need to seek new sources or methods of financing or to dispose of substantial assets
  - Very limited sources of capital, which include there being no additional unfunded capital commitments, a lack of reserve capital commitments and assets difficult to realize
  - Negative financial trends; for example, recurring operating losses, negative cash flows from operating activities and adverse key financial ratios
  - External matters; for example, legal proceedings, legislation or similar matters that might jeopardize the entity's ability to operate, and an uninsured or underinsured catastrophe such as a hurricane, tornado, earthquake or flood

Going concern (continued)

Step 2 — consider management's plan if substantial doubt is raised

- If conditions or events indicate that substantial doubt is raised about the entity's ability to continue as a going concern (Step 1), management is required to evaluate whether its plans that are intended to mitigate those conditions and events, when implemented, will alleviate substantial doubt about the entity's ability to continue as a going concern.
- ASC 205-40 specifies that management may consider its plans only when both of the following criteria are met:
  - It is probable that management's plans will be effectively implemented within one year after the date that the financial statements are issued.
  - It is probable that management's plans, when implemented, will mitigate the relevant conditions and events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the financial statements are issued (or available to be issued, when applicable).
- Examples of management's plans.

Going concern (continued)
Disclosure requirements

The following disclosures are required under ASC 205-40 when substantial doubt was raised but was alleviated by management's plans:

- Principal conditions or events that raise substantial doubt about the entity's ability to continue as a going concern (before consideration of management's plans)
- Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations
- Management's plans that alleviated substantial doubt about the entity's ability to continue as a going concern

Going concern (continued)
Disclosure requirements

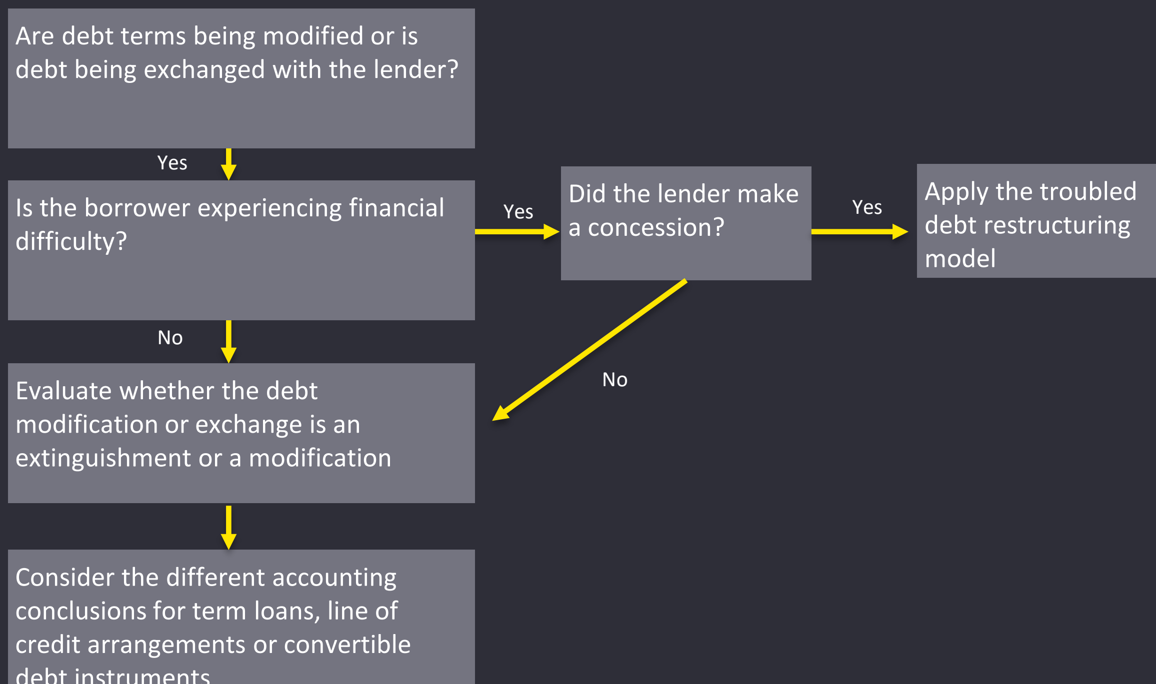
The following disclosures are required under ASC 205-40 when substantial doubt is raised and it is **not** alleviated by management's plans (substantial doubt exists):

- A statement in the notes to the financial statements indicating that there is substantial doubt about the entity's ability to continue as a going concern
- The entity also is required to disclose:
  - Principal conditions or events that raise substantial doubt about the entity's ability to continue as a going concern
  - Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations
  - Management's plans **that are intended** to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern

Debt modifications including reference rate reform

Debt modifications

In accordance with ASC 470, *Debt*, when debt modifications are executed, the entity will have to first determine whether such a transaction is a troubled debt restructuring or debt modification. The entity may utilize the following decision tree to assist in evaluating the facts and circumstances specific to the transaction:



Debt modifications (continued)
Trouble debt restructuring vs. debt modifications

Key factors to consider in the determination of whether a transaction is a troubled debt restructuring or debt modification under ASC 470:

- Borrower is experiencing financial difficulty
  - Borrower is currently in default on any of its debt.
  - Borrower has declared bankruptcy or is in the process of doing such.
  - There is significant doubt as to whether the borrower will continue to be a going concern.
  - Based on estimates and projections that only encompass the current business capabilities, borrower forecasts that its entity-specific cash flows will be insufficient to service the debt (both interest and principal) in accordance with the contractual terms of the existing agreement through maturity.
  - Absent the current modification, borrower cannot obtain funds from sources other than existing creditors at an effective interest rate equal to the current market interest rate for similar debt for a non-troubled borrower.

  These indicators are examples of financial difficulties, and no single indicator is determinative of whether the borrower is experiencing financial difficulties. All aspects of the debtor's current financial situation should be considered in making this determination.

- Lender makes a concession
  - For a lender to be considered to have granted a concession, the effective borrowing rate on the restructured debt must be less than the effective borrowing rate on the old debt immediately prior to the restructuring.

Debt modifications (continued)
Debt extinguishments vs. modifications

Key factors to consider in the determination of whether a transaction is a debt extinguishment or debt modification under ASC 470:

- Debt is considered extinguished if the terms of the new debt and original instrument are substantially different.
  - Substantially different — when the present value of cash flows under the terms of the new debt instrument is at least 10% different than the present value of the remaining cash flows under the terms of the original instrument
- If debt is considered extinguished, the original debt is derecognized and new debt is initially recorded at fair value, with the difference recognized as an extinguishment gain or loss.

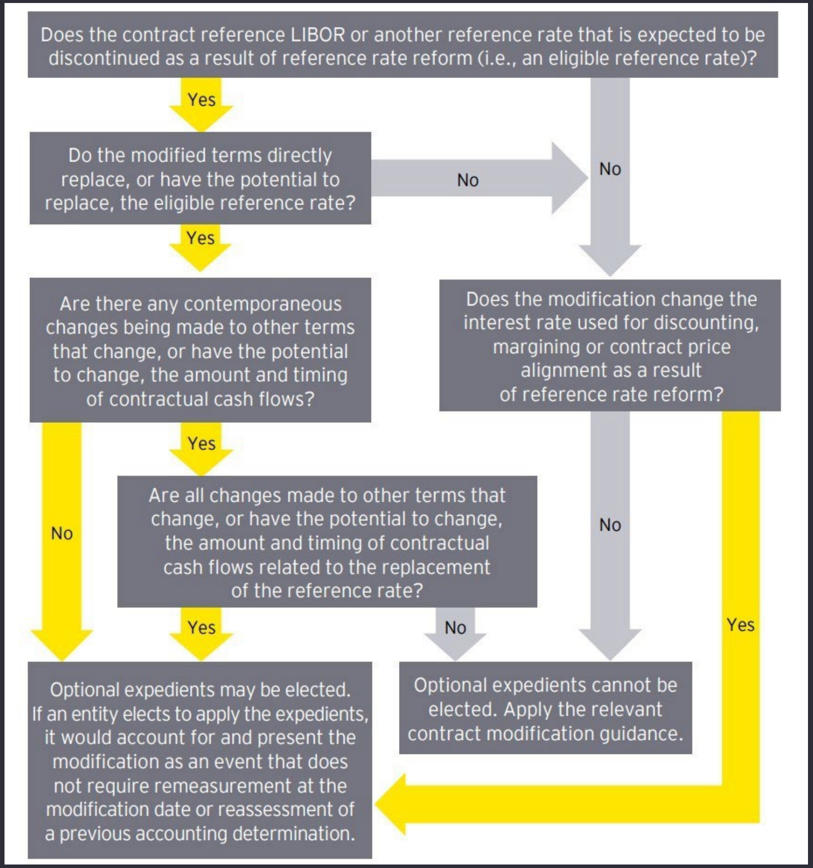
Debt modifications (continued)
Reference rate reform

Impact of the market transition from London Interbank Offered Rate (LIBOR) to Secured Overnight Financing Rate (SOFR)

- ASC 848, *Reference Rate Reform*, provides temporary optional expedients and exceptions to certain guidance in US GAAP to ease financial reporting burdens related to the transition.
- In accordance with the guidance, contracts that are modified as a result of reference rate reform are eligible for relief from modification accounting requirements in US GAAP if certain criteria are met. Accordingly, an entity that modifies a contract as a result of the rate reform is not required to determine whether a modification results in the establishment of a new contract or the continuation of the existing contract. That is, the modified contract is accounted for and presented as a continuation of the existing contract.
- The relief provided in ASC 848 is temporary and cannot be applied to contract modifications that occur after December 31, 2024.

Debt modifications (continued)
Reference rate reform

The following decision tree illustrates how an entity would evaluate whether a modified contract qualifies for the relief previously discussed (i.e., key criteria is met).



Recent Securities and Exchange Commission rules

Securities and Exchange Commission rules

The newly adopted rules by the Securities and Exchange Commission (SEC) require the following from registered private fund advisors:

Quarterly statements

Covering fund fees, expenses and performance

Audit requirement

Obtaining an annual audit for each advised private fund

Restrictions on preferential treatment

Placing restrictions on certain activities and prohibiting all private fund advisors from providing certain treatment deemed preferential unless it is disclosed and/or with consent

Fairnesss and valuation opinions

Obtaining a fairness or valuation opinion if the advisor leads a secondary transaction

Securities and Exchange Commission rules (continued)

Quarterly statements

Key aspects regarding expenses to be disclosed in the quarterly statements:

Types of fees and expenses

- All compensation, fees and other amounts allocated or paid by the private fund to the advisor or related persons during the period, with separate lines for each category of expense
- All fees and expenses allocated to or paid by the private fund during the reporting period with separate line items for each expense category (i.e., accounting, legal, organizational, due diligence)
- Any rebates/offsets carried forward to reduce future payments or allocations to the advisor or related persons
- Consider and include property level fees, as applicable

Considerations to apply

- No materiality threshold is applicable — thus, no “other” or “miscellaneous” category is allowable
- Disclose how all expenses, payments, allocations, rebates, waivers and offsets are calculated
- Disclose and cross-reference to governing documents that allow expenses to be charged to the fund

Securities and Exchange Commission rules (continued)

Quarterly statements

Key aspects regarding fund performance to be disclosed in the quarterly statements:

Considerations to apply	Nature of fund performance information
• Liquid vs. illiquid funds • Disclosure of criteria utilized and assumptions made in calculating fund performance metrics	• Liquid funds — net total return on annual basis for 1-, 5- and 10-year periods and on a cumulative basis as of the most recent fiscal quarter end • Illiquid funds — internal rates of return and multiples of invested capital since inception and statement of contributions and distributions

Securities and Exchange Commission rules (continued)

Rules related to conflict of interest and preferential treatment

- Advisors are prohibited from providing certain preferential terms to investors unless those related to material economic terms are disclosed by written notice to a prospective investor before investing in the fund and all preferential terms are disclosed after the investment and annually thereafter.
  - Previous terms are grandfathered in but still require disclosures
- Restricts advisors from doing the following:
  - Charging/allocating to private fund
    - Advisor's regulatory, examination or compliance fees or expenses, unless disclosed
    - Fees or expenses related to a portfolio investment on a non-pro rata basis
    - Fees or expenses related to investigation of the advisor or related parties
  - Borrowing/receiving an extension of credit from a fund client without disclosure to and consent from fund investors

Securities and Exchange Commission rules (continued)

Compliance and other matters

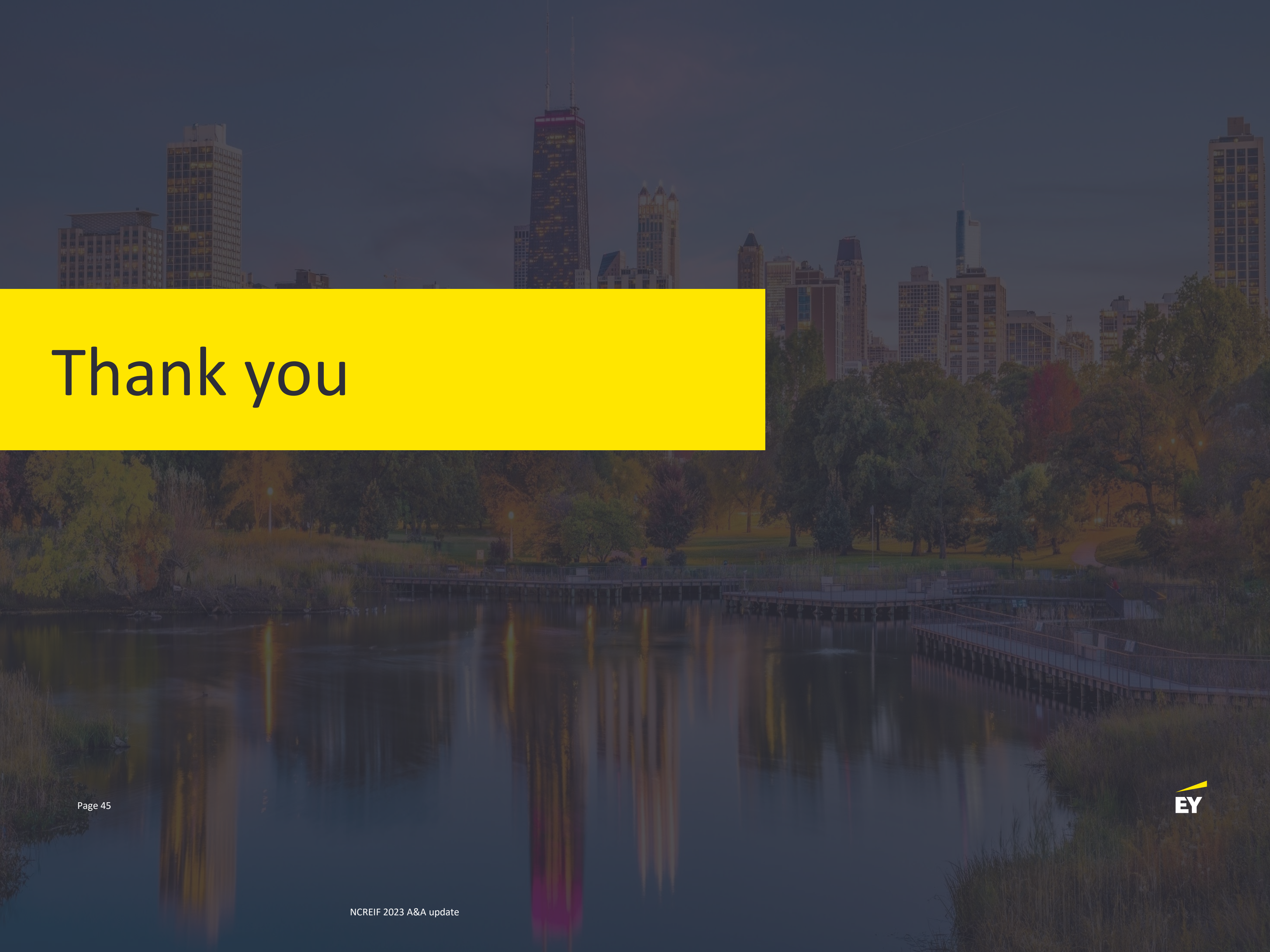
- All registered advisors, including those that don't advise private funds, are required to document the annual review of their compliance policies/procedures in writing beginning 60 days after publication in the Federal Register.
- Compliance timeline:
  - Quarterly statement and audit rules — 18 months after final rules are published in the Federal Register
  - Compliance with other rules is required 12 or 18 months after publication in the Federal Register depending on the amount of assets an advisor manages
- Pending and proposed rules and the auditor notification of modified opinion to the SEC.
  - SEC proposal requiring advisors to enter into written agreement with the firm performing the audit that requires the firm to notify the SEC upon issuance of a modified opinion

Closing and Q&A

Thought leadership

See below links to EY publications for additional information

- Financial Reporting Developments — Credit impairment under ASC 326 | EY – US
- Financial Reporting Developments — Issuer's accounting for debt and equity financings (after the adoption of ASU 2020-06, Accounting for Convertible Instruments and Contracts in an Entity's Own Equity) | EY – US
- Technical Line — A closer look at the FASB accounting relief related to reference rate reform | EY – US
- To the Point — SEC requires private fund advisers to disclose more to investors and restricts certain activities | EY - US



Thank you

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DEBT AND DERIVATIVES TASK FORCE

POLLING QUESTION

How do you record debt issuance costs incurred in connection with obtaining financing?

a) Expense immediately
b) Amortize utilizing the straight-line method
c) Amortize utilizing the effective interest method
d) Both expense and amortize by instrument

Results:

a) 53%

b) 27%

c) 14%

d) 6%

ACCOUNTING FOR DEBT ISSUANCE COSTS – DEBT LIABILITY

- Upfront costs and fees related to items for which the Fair Value Option is elected shall be recognized in earnings as incurred and not deferred

- Under GAAP, for those entities that have not adopted the Fair Value Option under ASC 825-10, debt costs will continue to be deferred and amortized to interest expense using the effective interest method.

ACCOUNTING FOR DEBT ISSUANCE COSTS – DEBT LIABILITY

- Unamortized financing costs be presented as a reduction of the carrying amount of the related debt balance on the statement of assets and liabilities, rather than separately presented as an asset

- GAAP ASC 835-30

ACCOUNTING FOR DEBT ISSUANCE COSTS – DEBT LIABILITY

- The Fair Value Option under ASC 825-10 permits entities to elect a one-time option that is irrevocable to measure financial instruments including, but not limited to, notes payable and portfolio level debt at fair value on an instrument-by-instrument basis

- Comparability to other investment classes

ACCOUNTING FOR DEBT ISSUANCE COSTS – DEBT LIABILITY

- Related to financing costs associated with a line-of-credit arrangement. These costs will continue to be presented as an asset and amortized over the term of the arrangement.

ACCOUNTING FOR DEBT ISSUANCE COSTS – DEBT LIABILITY

- Extension Fees
- Exit fees

POLLING QUESTION

How do you record origination fee income earned in connection with debt receivables?

a) Record 100% as income on day 1
b) Amortize over the life of the loan
c) Other
d) I don't have debt receivables

Results:

a) 43%

b) 27%

c) 9%

d) 29%

ACCOUNTING FOR DEBT ORIGINATION FEES – DEBT ASSET

ASC 946 does not provide specific guidance pertaining to fee income associated with loan originations.

1. Loan origination fees may be recognized as income when received rather than amortized (assumes non-refundable)
2. Record as deferred income and "amortize" over the life of the asset
    - Discussion on value of the liability

NON-PERFORMING LOANS – DEBT ASSET

Accounting for interest income

- For non-performing loans (e.g. the borrower is unable to fulfill its payment obligations), interest income is recognized under a cash method whereby payments of interest received are recorded as interest income provided that the amount does not exceed that which would have been earned based on the contractual terms of the loan.

ACCOUNTING CONSIDERATIONS – FV OF PROPERTY < DEBT

- Recourse - is an enforceable obligation under which a default by the borrower entitles the lender to pursue recovery from the borrower beyond the direct collateral

- Non-Recourse - is an enforceable obligation under which a default by the borrower entitles the lender to pursue recovery from the borrower up to the collateral

ACCOUNTING CONSIDERATIONS – FV OF PROPERTY < DEBT

- Question – To extent the fair value of the property falls below the value of the debt instrument what should the value of the property be reported at?

  - Non-operating
  - Operating

ACCOUNTING CONSIDERATIONS – FV OF PROPERTY < DEBT

- Question – To extent the fair value of the property falls below the value of the debt instrument what should the value of the property be reported at?
- Let’s assume the debt balance owed to the lender is $50M and the value of the property is $42M.
    - Recourse
    - Nonrecourse

ACCOUNTING CONSIDERATIONS – FV OF PROPERTY < DEBT

	Recourse	Non-Recourse
Fair Value Of RE	$42,000,000	$42,000,000
Fair Value of Debt	$(50,000,000)	($42,000,000)
Nav	$(8,000,000)	$(0)

ACCOUNTING CONSIDERATIONS – FV OF PROPERTY < DEBT

- Question – To extent the fair value of the property falls below the value of the debt instrument what should the value of the property be reported at?

- Let's assume the debt balance owed to the lender is $50M and the value of the property is $42M. <u>The investment has total net working capital of $5M.</u>
    - Recourse
    - Nonrecourse

- Do you adjust the debt balance to the property value or the property value + working capital ($47M)?

ACCOUNTING CONSIDERATIONS – FV OF PROPERTY < DEBT

	Recourse	Non-Recourse
Fair Value Of RE	$42,000,000	$42,000,000
Working Capital	$5,000,000	$5,000,000
Fair Value of Debt	$(50,000,000)	($47,000,000)
Nav	$(3,000,000)	$(0)

ACCOUNTING CONSIDERATIONS – FV OF PROPERTY < DEBT

- Facts - You have an asset that has declined in value such that the intent is to covey the property to the lender to satisfy the debt obligation. The fair value of the asset and debt is marked to the same value (debt marked down to asset value as the intent is to convey). The lender forecloses on the asset and the keys are turned over to the lender.
- Question –How would you recognize the previously unrealized gains/losses on the property value and the debt? As the debt is retired as part of the asset give back. In non-investment management accounting we would have a gain on extinguishment of debt for the difference between the asset and the debt?

ACCOUNTING CONSIDERATIONS – FV OF PROPERTY < DEBT

- A separately disclosed realized gain should be recognized on the extinguishment of debt when real estate is transferred to a lender in satisfaction of non-recourse debt. This gain may be recognized as an unrealized gain prior to reconveyance.

ACCOUNTING CONSIDERATIONS – FV OF PROPERTY < DEBT

- How would this change if there is for example a $10M guarantee on the debt that would be required to pay as part of the foreclosure. Would that reduce any gain on extinguishment or realized gain on the debt?

- Timing

ACCOUNTING CONSIDERATIONS – FV OF PROPERTY < DEBT

- Same facts however rather than just taking the asset the lender forces a sale by the Company with the proceeds going to the lender to repay the debt (with the remainder forgiven) does the recognition of gains change?

- Would there be a change to the SCF?

POLLING QUESTION

How do you present unrealized gain/loss on derivatives on the statement of operations?

a) As a separate line of unrealized gain/loss
b) Included in interest expense
c) Other

Results:

a) 90%

b) 8%

c) 2%

ACCOUNTING FOR DERIVATIVES

Option products

*Think….**caps**, floors, swaptions*

- Establish a “worst-case” outcome
- **Payment:** 1x upfront premium (T+2)
- **Prepayment/breakage**: Can’t be a liability after premium payment
- **Expected property hold period**: Less important with no two-way breakage
- **Credit**: No credit underwriting of the entity, therefore often purchased from third party providers
- **Drivers of pricing**: Volatility, forward rates, term, strike

Hybrid products

Think…

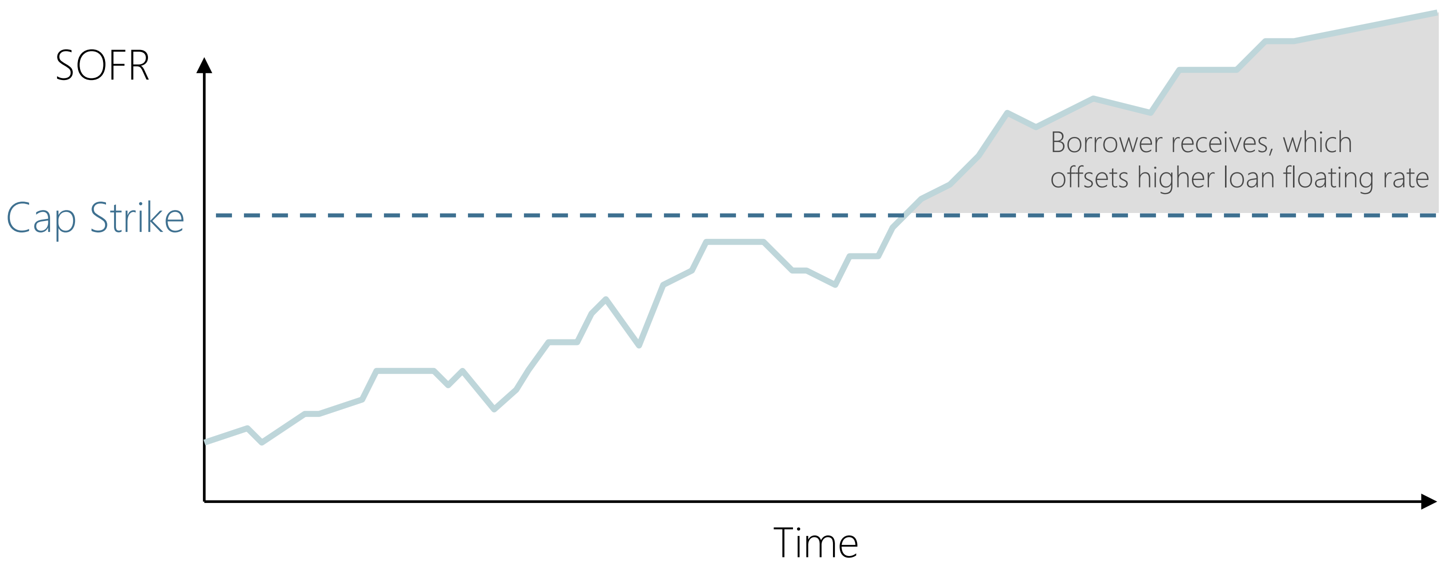
- *Collars*
- *Cancellable swaps*
- *Floored swap*
- *Deferred premium caps*
- *Corridors*

Lock products

*Think….**swaps**, Treasury locks*

- Establish a fixed interest rate
- **Payment**: No upfront cost, bank margin baked into fixed rate (credit charge)
- **Prepayment/settlement**: Can be an asset or liability, changing over time
- **Expected property hold period** : Should line up with tenor of hedge, breakage can be cost prohibitive
- **Credit**: Credit intensive due to future contingent payments to be made/received, therefore executed with lending bank(s)
- **Drivers of pricing**: Forward rates, bank charges

Interest rate caps



ACCOUNTING FOR DERIVATIVES

Increased upfront premiums, valuations, and cash settlements have led to a focus on the treatment and classification of these instruments

- Case study
  - Interest Rate Cap Purchased Feb 2021
    - Notional: USD 100,000,000
    - Index: 1 mo. USD-LIBOR
    - Strike: 1.75% Strike (1 mo. USD-LIBOR at time of purchase = 0.12%)
  - Initial Cap Premium - $57k (Feb 2021)
  - Cap Valuation 12/31/2022 - ~$3.6M

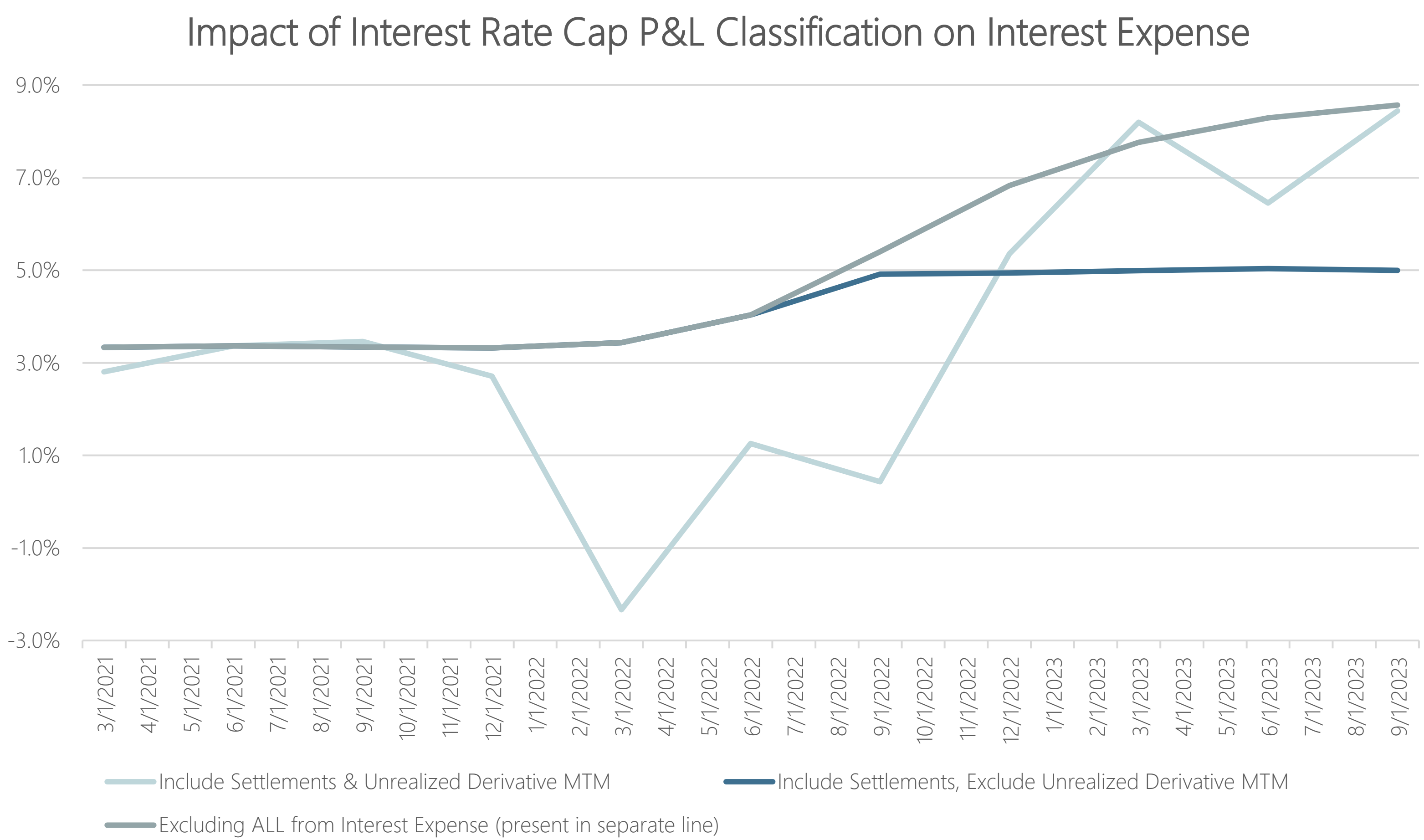
ACCOUNTING FOR DERIVATIVES

- Initial and subsequent measurement
  - 815-10-35-1 All derivative instruments shall be measured subsequently at <u>fair value</u>
  - 815-10-35-2 The accounting for changes in the fair value (that is, gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, if so, on the reason for holding it. Except as noted in the following paragraph, the <u>gain or loss on a derivative instrument not designated as a hedging instrument shall be recognized currently in earnings</u>.

ACCOUNTING FOR DERIVATIVES

- P&L Presentation
  - ASC 815 is silent on classification in the income statement of gains and losses related to derivatives that are not in qualifying hedging relationships - Consequently, there is diversity in practice
  - SEC staff expressed a view in a speech in 2003 that it would be inappropriate for an entity to present gains and losses on a nonhedging derivative under multiple captions in its income statement
  - Discussion - REIS Manual – Operating Model Sample shows separate gain/loss for derivative

ACCOUNTING FOR DERIVATIVES



ACCOUNTING FOR DERIVATIVES

Cash Receipts and Payments Related to Hedging Activities

ASC 230-10-45-27

- Under ASC 230-10-45-27, a cash receipt or payment related to a hedging derivative should "be classified according to its nature without regard to whether it stems from an item intended as a hedge of another item. For example, the proceeds of a borrowing are a financing cash inflow even though the debt is intended as a hedge of an investment, and the purchase or sale of a futures contract is an investing activity even though the contract is intended as a hedge of a firm commitment to purchase inventory."
- However, an entity may classify the cash flows from a derivative instrument that is accounted for as a fair value hedge or a cash flow hedge (*and that does not contain an other-than-insignificant financing element at inception*) in the same category as the cash flows from the items being hedged as long as the entity has elected and disclosed such classification as its accounting policy.
- Otherwise, the entity should classify the cash flows from the derivative either (1) as an investing activity under ASC 230-10- 45-27 or (2) in accordance with the nature of the derivative instrument and how the derivative is used in the context of the entity's business. If periodic settlement payments are required for the hedging derivative in a fair value or cash flow hedging relationship, the cash flow classification of any termination or settlement payment should generally be consistent with the classification of the periodic settlements.

ACCOUNTING FOR DERIVATIVES

- Cash flow presentation

Increased upfront premiums & cash received in settlement have led to a focus on the cash flow treatment of these instruments

Specific guidance if an other-than-insignificant financing element exists – see next slide

If no such financing element exists, generally two acceptable classifications:

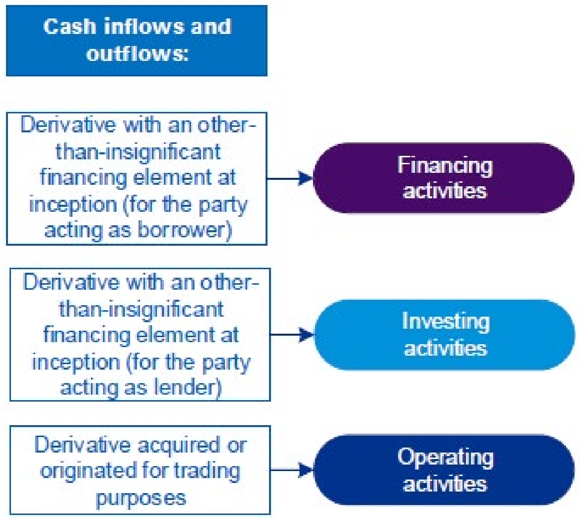
Investing Activities

Operating activities in accordance with the nature of the derivative instrument and how it is used in the context of the entity's business (hedge of interest expense)

ACCOUNTING FOR DERIVATIVES

- Cash flow presentation – Other-than-insignificant financing element

230-10-45-23
Another example where cash receipts and payments include more than one class of cash flows involves a derivative instrument that includes a financing element at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments, because the borrower's cash flows are associated with both the financing element and the derivative instrument. For that derivative instrument, <u>all cash inflows and outflows shall be considered cash flows from financing activities by the borrower</u>.



POLLING QUESTION

Have you experienced seller financing (i.e. you sell an asset and you provide the buyer a loan receivable) ?

a) Yes – executed a deal
b) Yes – talking about it
c) No

Results:

a) 26%

b) 14%

c) 60%

SELLER FINANCING

- Two key considerations to consider when determining if a sale can be recognized:

  - Collectability of financed amount from the buyer (and therefore whether a contract exists such that a gain can be recognized under ASC 610-20)

  - Whether control has been transferred to the buyer.

SELLER FINANCING - COLLECTABILITY

- Assessing collectability in real estate sales
  - The contract existence criteria needs to be met before a sale can be recorded in accordance with ASC 606 or ASC 610
  - Collectability of substantially all of the consideration to which the entity expects to be entitled affects this evaluation.
  - If collection is not probable, then no contract is deemed to exist

ASC 606-10-25-1(e): It is probable that the entity will collect substantially all of the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer (see paragraphs 606-10-55-3A through 55-3C). In evaluating whether collectibility of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession (see paragraph 606-10-32-7).

SELLER FINANCING - CONTROL

- ASC 606-10-25-30 outlines certain criteria to consider when evaluating a transfer of control, such as:
  - The entity has a present right to payment for the asset
  - The customer has legal title to the asset
  - The entity has transferred physical possession of the asset
  - The customer has the significant risks and rewards of ownership of the asset
  - The customer has accepted the asset

- Be careful – structuring of the seller financing is important
  - Is it a true note receivable
  - Preferred equity in a joint venture – need to demonstrate control has changed

2023 TASK FORCE

THANK YOU TO ALL OF THOSE THAT CONTRIBUTED!

- Brett Johnson – EY
- Clinton John - EY
- Jason Aguiar - EY
- John Confrey - Mazars
- Chase Schmitt – Chatham
- Lauren Demartini - Metlife
- Thomas James – PGIM
- Richard Ziobro – PGIM

NCREIF

National Council of Real Estate Investment Fiduciaries

NCREIF PREA REPORTING STANDARDS UPDATE

BENAY KIRK, ALTER DOMUS

SEC PRIVATE FUNDS RULE

On August 23, 2023, the Securities and Exchange Commission (SEC) voted to adopt new rules and amendments to enhance the regulation of private fund advisers. The new rules would require the private fund advisers <u>registered with the SEC</u> to:

- Provide investors with quarterly statements detailing information regarding private fund performance, fees, and expenses;
- Obtain an annual audit for each private fund; and
- Obtain a fairness opinion or valuation opinion in connection with an adviser-led secondary transaction.

SEC PRIVATE FUNDS RULE

The new rules would require that <u>all private fund advisers</u>:

- Prohibit engaging in certain activities and practices that are contrary to the public interest and the protection of investors unless they provide certain disclosures to investors, and in some cases, receive investor consent; and
- Prohibit providing certain types of preferential treatment that have a material negative effect on other investors and prohibit other types of preferential treatment unless disclosed to current and prospective investors.

Additionally, the amendments would require all registered advisers, including those that do not advise private funds, to document in writing the annual review of their compliance policies and procedures.

SEC PRIVATE FUNDS RULE

Collaboration with other industry organizations will be key to the success of this project. Questions will arise throughout this project regarding scope, clarification, and definitions of terms contained within the final rules and the Reporting Standards recognizes its limited direct connection to the SEC. The following individuals have been consulted thus far and have agreed to work alongside the Reporting Standards:

Lou DeFalco, RS Council Member, PwC
Mark Wojteczko, Accounting Committee Chair, Deloitte
Clinton John, EY
Peter Bloomfield, KPMG
Neal Prunier, ILPA
Ken Robinson, CFA Institute

SEC PRIVATE FUNDS RULE

The Oversight Task Force will be comprised of the following:

Jamie Kingsley, RS Director
Jim Allen, RS Board Chair
Sally Ann Flood, RS Board Vice Chair (incoming Chair 2024)
John Caruso, RS Council Chair
John Kjelstrom, RS Council Vice Chair (incoming Chair 2024)
Kathryn Gernert, RS Board Member
Jim Strezewski, RS Board Member
Diane Wild, RS Council Member

SEC PRIVATE FUNDS RULE

Task Force Members for Quarterly Statement Rule: Fees and Expenses

Jamie Kingsley, RS Director
Joe D'Alessandro, NCREIF
Benay Kirk, RS Council, Alter Domus
Christy Daniels, Accounting Committee Chair, Principal
Michelle Clements, Citco
Lauren DeMartini, MetLife
Maria Ramaglia, GID
Matt Racketa, Townsend Group

SEC PRIVATE FUNDS RULE

<u>Task Force Members for Quarterly Statement Rule: Performance Reporting</u>

Jamie Kingsley, RS Director
Joe D'Alessandro, NCREIF
Diane Wild, RS Council, LaSalle
David DiPaolo, RS Council, Clarion Partners
Benay Kirk, RS Council, Alter Domus
Ken Robinson, CFA Institute
Samantha King, Performance Committee Chair, JP Morgan
Rosellen Bounds, Performance Committee Chair, ACA Group
Brienna Mancuso, JP Morgan
Karol Vogel, Principal
Christina Metcalf, GID
Kim Everaerts, Walton Street
Bob Redican, Nuveen
Julian Worthington, QuadReal Property Group
Brenden Fullum, Rockpoint

DEBT FUNDS PHASE II: DEBT VALUATION SUMMARY

Next Phase for Debt Funds

- Finalize Task Force(s)
- Begin work on a Debt Manual to include in Handbook Volume II. This is likely to include clarifications on structural and financial leverage, style definitions, debt type definitions, debt investment and collateral valuation topics, impairment, treatment of certain transaction/selling costs and leverage.
- Concurrently update FV Accounting Manual, Performance Manual and Valuation Manual as needed.
- Circulate to committees for feedback by 1/15/24

ASSET LEVEL REPORTING

Provide enhanced reporting on individual investments

- Proposal would amend and expand FR 04: Schedule of Investments
- Increase frequency from Annually to Quarterly
- Elements will be recommended or required by Open-end, Closed-End Funds, SMA's and Debt Funds

ASSET LEVEL REPORTING PROPOSED DATA POINTS

- Informational – Legal Property Share (Contractual Ownership), Effective Property Share (Effective Ownership).
- Financial Statement - Gross Asset Value, Net Asset Value, TTM NOI.
- Performance - Gross and Net Inception to Date IRR, TVPI, Gross and Net Time Weighted Return.
- Real Estate Operations – Life Cycle, Lease Percent, Average WALT.
- Leverage - Loan Principal Balance, Loan Market Value, LTV, DSCR, Interest Rate, Associated Derivative Type, Derivative Maturity date (if different), Debt Maturity Date, Fully Extended Maturity Date.
- Valuation - Discount Rate, Terminal Rate, Going in Cap Rate, Contract Rent, Market Rent, Expense Ratio, Three Year Rent Growth, Ten Year Rent Growth.
- Business Plan - Projected Exit Date, Gross and Net Projected IRR.
- Debt Investment KPIs - Total Commitment, % Funded, Investment Type, Fixed Rate, Variable Rate, Reference Rate, Maturity Date, Extension Options, Collateral Type.

ASSET LEVEL REPORTING

Next Steps:

- Send to Reporting Standards Council for feedback this week
- Send to NCREIF Committees for feedback by January 15, 2024

GROUND LEASE IMPACT

- Task force met several times during the period Sept '23 - November '23
- Created sample calculations showing the impacts on ratios using the Operating Model Sample Financial Statements included in the RS Accounting Manual.
- Currently collecting feedback from constituents in order to finalize recommendations.
- Finalizing guidance document with the recommendations of the task force.

STANDARDIZED DDQ – GLOBAL INITIATIVE WITH INREV/ANREV

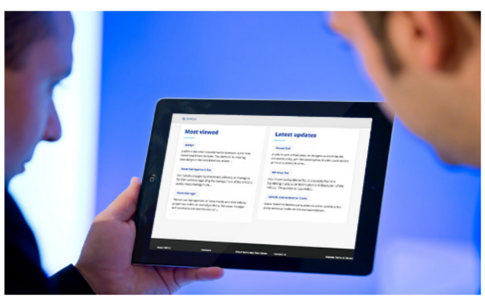
- Mapping exercise with major consultant DDQs has been completed with 100 common elements identified.
- Template under final review and to be sent to ILPA for comments.
- Scheduling discussions with consultants.
- Reviewing mapping to INREV to understand alignment/differences.

GLOBAL DEFINITIONS DATABASE

https://reportingstandards.info/global-standards/

Added in 2023 – 54 Terms

Global Definitions Database



The Global Definitions Database (GDD) is the leading global source of definitions for the non-listed real estate sector.

Global definitions are an important step towards producing global standards and aligning the INREV Guidelines with the NCREIF PREA Reporting Standards. The GDD provides a common glossary of non-listed real estate terms. Many terms have been agreed to globally, while others are specific to Asian, European and North American standards, guidelines and data products.

A common set of terms is a critical component of the global standardisation initiative and our interactive online tool makes them easily accessible. This provides the industry with one unique depository of definitions that will help increase transparency and align the industry globally.

ANREV INREV NCREIF PREA Reporting Standards

SHOW ALL DEFINITIONS

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HOT TOPICS

- Gross IRR
- Basis of Accounting

GROSS IRR

- For closed ended funds that present Gross IRR
- What cash flow adjustments are you making are you making from your Net IRR

BASIS OF ACCOUNTING – ASC 960

Question: For an entity (joint venture) with a tax-exempt LP investor, is there a minimum ownership percentage of the tax-exempt investor for the joint venture to qualify for fair value reporting on a stand alone audit basis under ASC 960?

THANK YOU!

Questions?

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