



FALL CONFERENCE 2023

Walt Disney World Swan – Orlando, FL
November 15





JOINT SESSION

ACCOUNTING, PERFORMANCE AND
VALUATION COMMITTEES

Debt - Both Sides of the Coin

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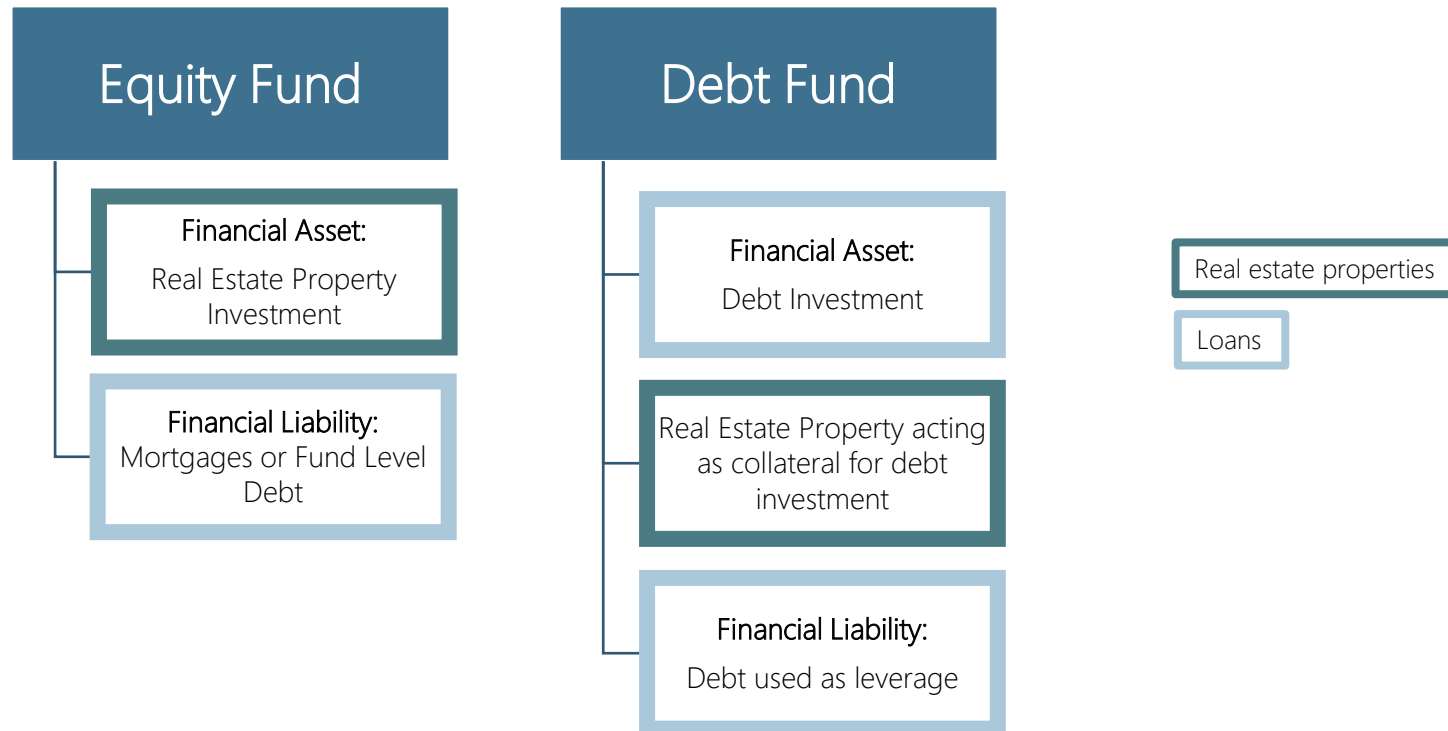
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HISTORY OF DEBT VALUATION

- **2009:** NCREIF Reporting Standards releases Debt Valuation Guidance Paper introducing gross and net methodologies
- **2014-2019:** NCREIF Valuation Committee creates a Valuation Manual
 - **2015:** ODCE Survey on Debt Valuation Methodology
 - **2015:** Reporting Standards Task Force created to revise debt valuation methodology
 - **2016:** Presentation of recommended debt valuation methodology to ODCE Managers
 - **2019:** Valuation manual approved including recommended debt valuation methodology
- **2021-2023:** Reporting Standards launches Debt Fund Task Force
 - **2021:** Debt Fund Survey
 - **2023:** Reporting Standards updates Handbook Volume I to include standards for debt funds
- **2023:** ODCE Survey on Debt Valuations
- **2024+:** Reporting Standards to update Handbook Volume II to include debt funds

INVESTMENT MANAGEMENT

Investment managers with debt and equity funds are responsible for managing a variety of real estate and debt positions that sit on both sides of the balance sheet.



VALUATION PRINCIPLES

If a fair value election is made, the value should:

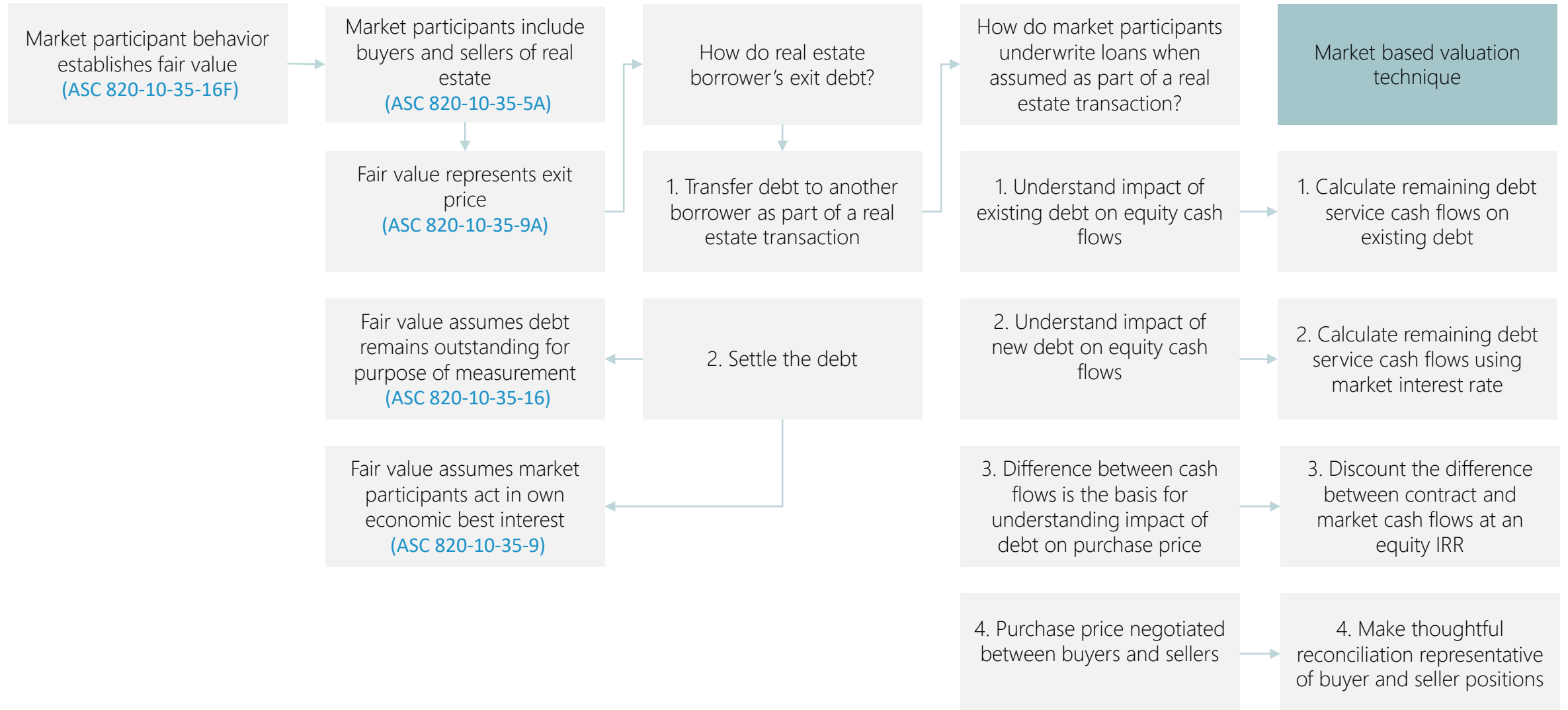
- Represent an **exit price** in **the principal market** between willing **market participants** (ASC 820-10-05-1B)
- Use **one or more relevant valuation techniques**, including market approach, cost approach, and income approach (820-10-35-24A-B)
- Include **impact of above or below market interest rates** (ASC 820-10-55-10)
- Consider the **most likely cash flows** (ASC 820-10-55-10)
- Consider the **risk profile** of the investment (ASC 820-10-05-1C)
- Require **judgement** (ASC-820-10-35-37A)



DEBT – AS A LIABILITY



USING ASC820 TO BUILD A METHODOLOGY – DEBT LIABILITY



ODCE FUNDS – VALUATION OF DEBT LIABILITIES

On average, in 2015, debt valuation methodologies for liabilities within ODCE funds were **54% comparable** to each other. As of 2023, they are **83% comparable**.

2015 Areas of Inconsistency

- Net vs. Gross
- Remaining term vs. constant term market interest rates
- Assumability of Debt
- Market Adjustments/Reconciliation

2023 Areas of Inconsistency/Hot Topics

- Loans marked to par within a year of maturity
- Valuation of swapped floating rate loans

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 debt/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

	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

- Let's assume the debt balance owed to the lender is \$50M and the value of the property is \$42M.

The investment has total net working capital of \$5M.

- Recourse
- Nonrecourse

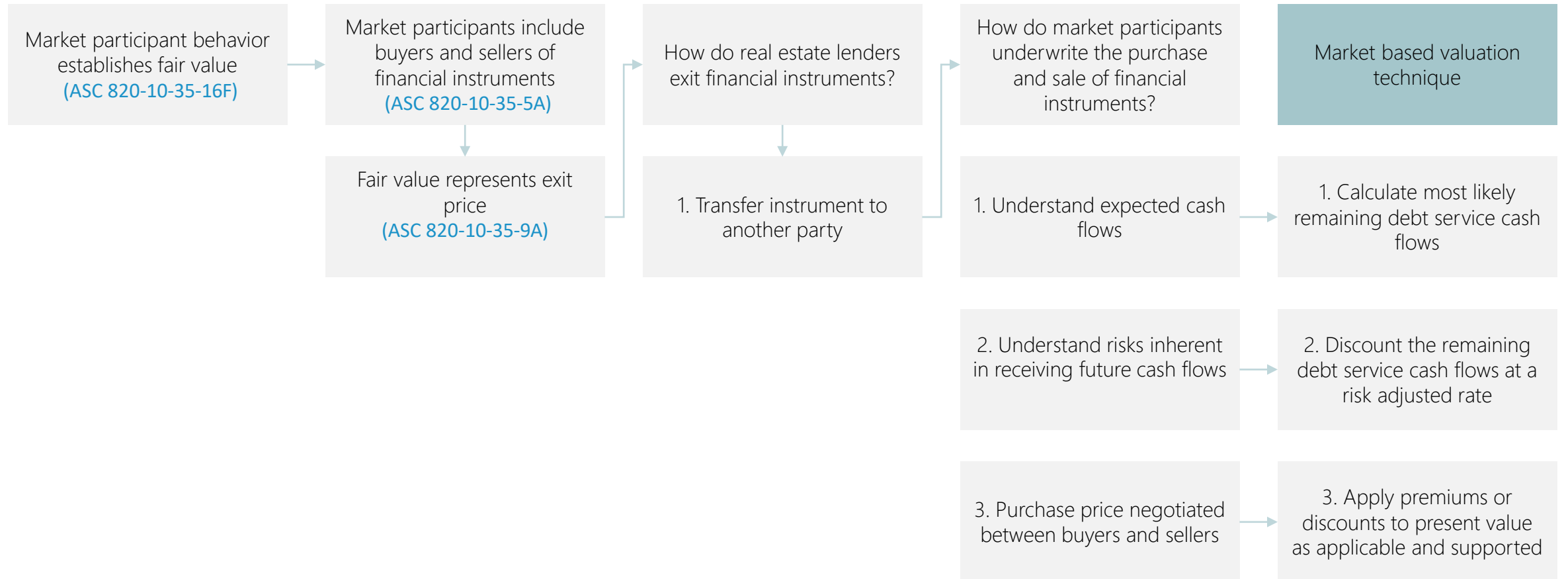
	Recourse	Non-Recourse
Fair Value Of RE	\$42,000,000	\$42,000,000
Working Capital	\$5,000,000	\$5,000,000
Fair Value of Debt	\$(50,000,000)	\$(47,000,000)
Nav	\$(3,000,000)	\$(0)



DEBT – AS AN INVESTMENT



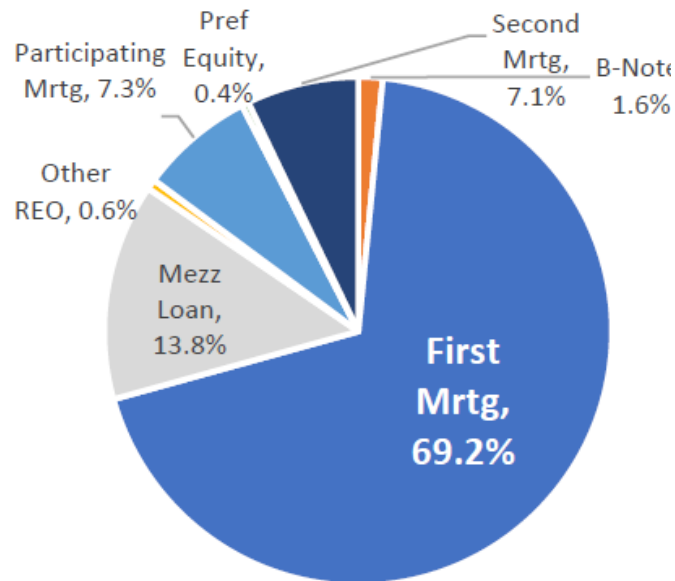
USING ASC820 TO BUILD A METHODOLOGY – DEBT INVESTMENTS



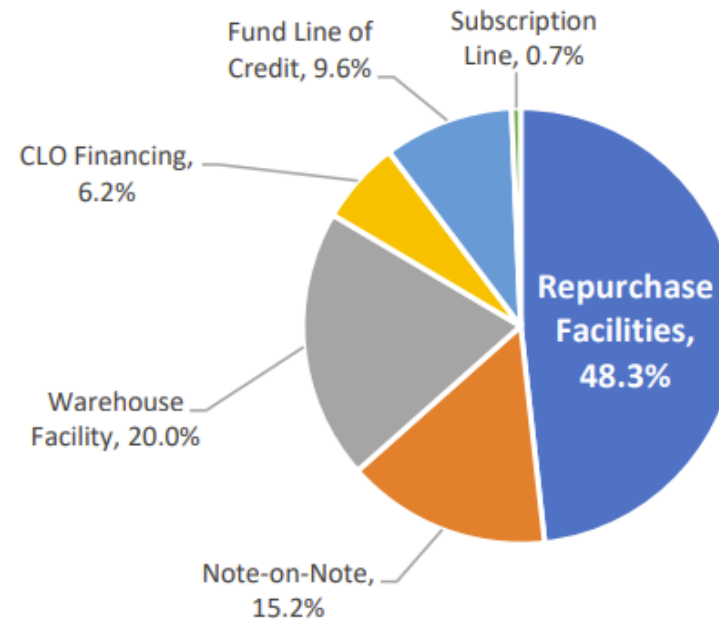
DEBT FUNDS – VALUATION OF DEBT INVESTMENTS

Increase in popularity of debt funds and desire to create benchmarks and aggregates is exposing regarding the make-up of debt funds and existing policies

Debt Asset Type Breakdown



Liability Type Breakdown



Reported Investment Metrics

LOAN INVESTMENT METRICS

All-in Rate-Loan Investments (annualized)	7.9%
Wgt Avg Remaining Term (x/extensions)	2.4 yrs
First\$Risk LTV% (attach point of sub loans)	56.5%
Last\$Risk LTV% (detach point of sub loans)	74.1%
DSCR (NOI / [interest + principal])	1.0x
Debt Yield Annualized (noi / loan balance)	6.8%
Future Fundings % of Principal Outstanding	9.1%
# of Loan Investments	616

[metrics are equal-weighted across ALL funds]

ODCE FUNDS – VALUATION OF DEBT INVESTMENTS

2023 Hot Topics

- Assessment of underlying collateral and impact
- Definitions or evaluation of “distress” of debt investments
- Valuation policies and procedures
- Controls and oversight
- Seller Financing

DEBT INVESTMENTS AND “DISTRESS”

Based on conversations with market participants, the below all represent different definitions of “distress” with varying implications on fair value conclusions.

1. Performing loan, collateral value is above the principal balance, **current market rate is above the contract rate**
2. Performing loan, current market rate equal to contract rate, **collateral value is below the principal** balance
3. Potential **Risk of default**. Could mean risk of significant capital outflows, potential breach of covenants, approaching maturity date, lack of liquidity in the market, etc.
4. **Non-performing loan, in default**
5. **In foreclosure**

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

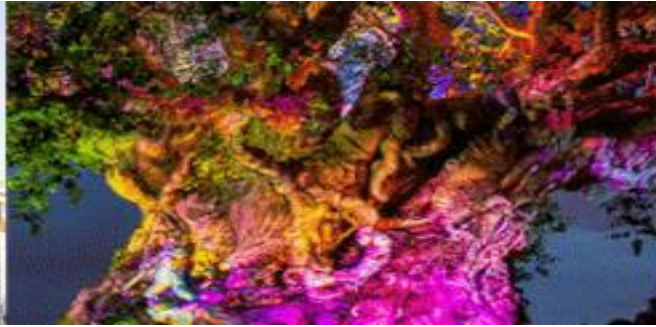
ASC 606-10-25-1(e): It is probable that the entity will collect substantially all of the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer (see paragraphs 606-10-55-3A through 55-3C). In evaluating whether collectibility of an amount 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

NEXT STEPS

- Reporting Standards will be leading a task force on creating a Debt Manual for Debt Funds
- To support the creation of the Debt Manual and further clarity and consistency around hot topics, launch task forces to explore the following:
 - Collateral valuation policies
 - Distress definitions and methodology
 - Seller Financing
- Conduct Phase II of the policy and methodology survey including additional debt fund managers



THANK YOU!

Questions?

