

## **Compliance is Easier Than You Think:**

The Real Estate Managers  
Path to Compliance with the  
Global Investment Performance  
Standards (GIPS®)

# Executive Summary

In an ever-evolving industry, the demand for more information and transparency from asset managers continues to increase. Investors seeking comparability amongst asset managers, including real estate firms, now effectively require managers to comply with voluntary ethics-based reporting guidelines such as the Global Investment Performance Standards (GIPS®). While real estate firms targeting institutional dollars have likely heard of the GIPS standards, a focus on core business activities often takes precedence and these firms are often unable to find the time or resources necessary to learn the intricacies and the potential benefits of the GIPS standards that can be gained. As SEC registered firms assess the impact of the new SEC Marketing Rule to their current practices, firms may find GIPS compliance to be a good way to manage those key changes.

From our work with various managers over the years, we have developed an in-depth understanding of how the real estate investment market has evolved in relation to the GIPS standards.

Here is a sampling of some observations:

- » The demand for transparency from investors continues to drive real estate managers to claim compliance with the GIPS standards.
- » The GIPS Report, required by the GIPS standards, strives to enhance comparability for prospective investors to make an apples-to-apples comparison of investment performance across managers.
- » Claiming compliance with voluntary reporting guidelines such as the GIPS standards is one way firms can differentiate themselves.
- » Within the framework of the 2020 GIPS standards, real estate managers adhere to many of the same core requirements as firms in other investment industries. However, some minor differences do exist, including requirements for valuation, input data, and presentation reporting.

- » The GIPS standards served as a foundational element of the National Council of Real Estate Investment Fiduciaries (NCREIF) and Pension Real Estate Association (PREA) Reporting Standards; however, the focuses are different: prospective clients vs. client reporting.
- » Internal valuation frequency as well as the requirement for and frequency of external appraisals continues to evolve, yet still poses a challenge to certain market segments.
- » Managers tend to be more familiar with property-level returns due to National Council of Real Estate Investment Fiduciaries Property Index; however, the GIPS standards require the investment-level methodology.
- » Other issues real estate firms must consider with regard to the GIPS standards include the treatment of non-real estate assets in a portfolio, selection of an appropriate benchmark, use of subscription lines of credit, and identification of and adherence to the requirements for pooled real estate funds.

In the current real estate investment environment, many firms want to understand the core components of the GIPS standards before committing the resources needed to attain compliance. Firms that already claim compliance seek to mitigate the risk of becoming noncompliant. This paper provides useful information for both objectives.

The 2020 GIPS standards cover the baseline requirements and principles of presenting real estate performance. However, some scenarios exist where explicit guidance is lacking. This paper focuses on unique issues facing real estate managers and the common solutions to those issues. We provide a market overview and cover frequent concerns for firms claiming compliance with the GIPS standards, as well as a brief comparison of the GIPS standards to the National Council of Real Estate Investment Fiduciaries (NCREIF) and the Pension Real Estate Association (PREA) Reporting Standards (formerly known as the Real Estate Information Standards (REIS)).

## Real Estate Firms and the GIPS Standards

A study by State Street noted that “while institutional investors show an increasing appetite for real estate assets, they have learned from their experience during the crisis and are seeking more control over their real estate exposure.”<sup>1</sup> The fundamental appeal of real estate as an asset class remains unchanged, but investors now demand more transparency when firms present investment performance.

The strength of this demand has increased the appeal of GIPS compliance and verification for investment managers. As of October 1, 2020, the eVestment database contained data from 116 real estate managers that report performance.<sup>2</sup> The eVestment statistics reveal that a high percentage of real estate managers claim compliance with the GIPS standards and elect to receive verification, as shown in Figures 1 below. (We consider the data as a good proxy for the overall market.)

The data shows that a large number of real estate managers are claiming compliance with the GIPS standards. In addition, there appears to be a positive correlation to compliant firms that choose to be verified. This data coincides with a periodic survey dating back to 2009 that ACA has conducted with eVestment. Initially, only 75% of responding firms claimed compliance with the GIPS standards and 84% of those firms received a firm-wide verification.<sup>4</sup> Fast forward to 2018 and the survey results show an increase to 84% of firms claiming GIPS compliance, along with 94% of firms that claim compliance and also receive a firm-wide verification.

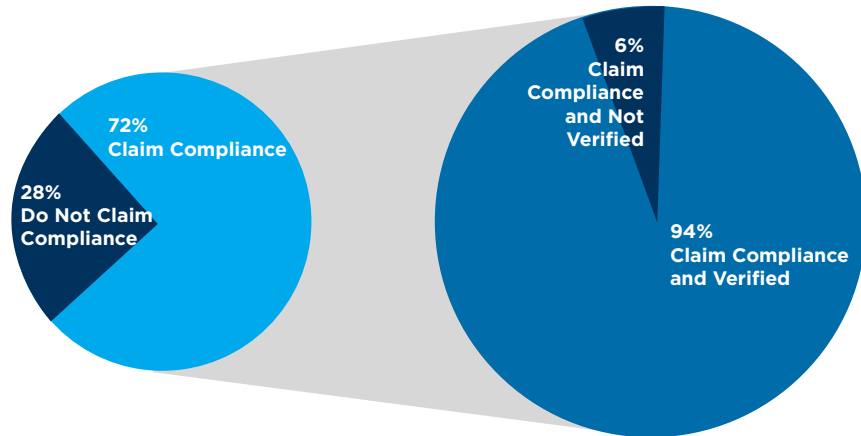


Figure 1. Percentage of real estate firms claiming GIPS compliance and percentage choosing to receive firm-wide verification.<sup>3</sup>

<sup>1</sup> “Real Estate: New Opportunities for Institutional Investors,” VisionFocus, State Street Corporation (2011)

<sup>2</sup> eVestment database, accessed October 1, 2020, <https://www.evestment.com/global/Datasets/Global-Database2.aspx>.

<sup>3</sup> Ibid

<sup>4</sup> “The Value of GIPS Compliance: An industry Survey,” ACA Group and eVestment (2018)

	2009		2012		2014		2018	
	eVestment Data	Survey	eVestment Data	Survey	eVestment Data	Survey	eVestment Data	Survey
GIPS Compliance	68%	75%	73%	75%	74%	72%	74%	84%
Verified	75%	84%	80%	82%	82%	85%	87%	94%

Table 1. GIPS compliant and verified data from eVestment and “The Value of GIPS Compliance: An industry Survey.”

From these statistics, it is apparent that firms continue to see the value in complying with the GIPS standards.

## Definition Of Real Estate

It is important for firms claiming compliance with the GIPS standards to have established guidelines for determining which assets are considered real estate. The definition of real estate, according to the GIPS standards, is as follows.

Considered As Real Estate (Wholly Or Partially Owned)	Not Considered As Real Estate
<ul style="list-style-type: none"> <li>» Wholly owned or partially owned properties</li> <li>» Investments in land, including products grown from the land (e.g., timber, or crops)</li> <li>» Buildings under development, completed buildings, and other structures or improvements</li> <li>» Real estate comingled funds, separate accounts, and unit trusts</li> <li>» Unlisted private placement securities issued by private real estate investment trusts (REITs) and real estate operating companies</li> <li>» Equity-oriented debt (e.g., participating mortgage loans) or any private interest in a property where some portion of the return to the investor is related to the performance of the underlying real estate assets</li> </ul>	<ul style="list-style-type: none"> <li>» Publicly traded real estate securities</li> <li>» Mortgage-backed securities (MBS, CMBS)</li> <li>» Private debt investments, including commercial and residential loans where the expected return is solely related to the contractual interest rates without any participation in the economic performance of the underlying real estate</li> </ul>

Table 2. Classification of “Real Estate” under the GIPS standards.<sup>5</sup>

<sup>5</sup> 2020 GIPS Standards for Firms

Using Table 2 to define real estate within the GIPS standards, it is intuitive for most industry participants to classify the first three bullets in the left-hand column as real estate. Some of the other classifications, however, are less straightforward. With regard to private placement securities issued by REITs, the real estate category is private, illiquid, and less affected by general market conditions. On equity-oriented debt or other related property interests, firms commonly struggle with security-specific characteristics that make the real estate classification difficult. More specifically, firms find it difficult to determine at what level the investment participates in the performance of the real estate asset.

We find that most questions actually revolve around what is not real estate. It may be tempting to designate a publicly traded REIT as real estate, but these securities have different characteristics than private real estate assets. As a CIRE article further explains, “traded REITs are more directly subject to the volatility of the exchange on which they are listed and broader equity markets in general, while non-traded REITs are separated from the daily volatility of the equity markets and are more closely associated with the underlying value of the real estate in their portfolio.”<sup>6</sup>

**Question:** We purchase distressed mortgages to acquire property at a more attractive price. While the mortgages may not technically be participating loans, we expect a return greater than the contractual interest rate through acquiring the property. Should we consider these assets real estate?

**Answer:** Given that the expected return is not solely related to the contractual interest rate, as the primary intent is property acquisition, most firms would consider these assets as real estate. The complicating factor is the loan may not be strictly categorized as participating. We suggest discussing the intent internally and with a verifier. Review the client agreement and any other documents that may be pertinent to this decision. It is also important to create and maintain thorough documentation justifying the decision. The decision to classify an asset as real estate primarily affects the valuation and disclosure requirements.

**Question:** If our MBS portfolios are backed by real estate mortgages, why could we not consider these assets real estate when complying with the GIPS standards?

**Answer:** The classification decision is based on the expectation of performance derived from the underlying real estate asset. With respect to an MBS, one of the times the fair value will change, due to changes in the underlying property, is when market conditions cause the mortgage on the property to be underwater, resulting in the MBS value declining due to higher credit risk. If the underlying property were to double in market value, the MBS would experience little or no change in market value. As these assets are less affected by the property’s performance, the GIPS standards do not consider them real estate assets and thus they are not subject to Real Estate requirements.

6 M. Jason Mattox, “Know Your REITs,” Commercial Investment Real Estate Magazine (July-August 2006).

# Fundamentals for Compliance

## Firm Definition

The definition of the firm is one of the fundamental requirements of the GIPS standards. The first step a firm must consider when claiming compliance is how to define itself. It is common for the firm definition to mirror the legal definition for SEC registration purposes. It is also acceptable for the firm definition to differ for purposes of GIPS standards. Within the GIPS standards, a firm should be defined as broadly as possible and mirror how it holds itself out in the marketplace.

The firm definition will essentially draw a circle around the assets to be included in total firm AUM in the GIPS Report. According to the GIPS standards, “firms should adopt the broadest, most meaningful definition of the firm.”<sup>7</sup> Factors to consider include the actual legal entity, a distinct target market, and the use of a distinct investment process.

The diagram below is common amongst managers when defining the firm under the GIPS standards. Under Option 1, ABC Real Estate Management has chosen to define the firm narrowly, in accordance with how the firm is held out to the marketplace. Note that only separate accounts and funds investing in Core, Value, and Opportunistic real estate properties are included, while other business lines are excluded. Under Option 2, ABC Capital, both business units are included and represents the broadest, most meaningful firm definition. While Option 2 is preferable, both options are allowable within the GIPS standards.



Figure 2. Narrow and broad firm definitions acceptable under the GIPS standards.

A third scenario, which is really just an expansion of the options presented above, would be a large global asset manager with multiple divisions that has defined the firm at the broadest corporate level. Under this scenario, the real estate division is included under the parent company’s firm definition for purposes of the GIPS standards. Alternatively, the real estate division may hold itself out as a separate business unit and thus opt to define itself separately from the parent company as allowed by the GIPS standards. **Ultimately, claiming compliance with the GIPS standards must be accomplished on a firm-wide basis rather than in terms of a single investment, fund, or property.**

<sup>7</sup> 2020 GIPS Standards for Firms

## Definition of Discretion

The second key issue under the GIPS standards is defining investment discretion. The term discretion may have a slightly different meaning in the context of the GIPS standards than it does in the regulatory world. While the definition of discretion from the SEC's perspective relates to contractual discretion (i.e. trading authority), the definition of discretion from a GIPS perspective relates to a firm's ability to implement the intended strategy without significant client restrictions. The GIPS standards explains that "the firm must determine if the restrictions will, or could, interfere with the implementation of the intended strategy to the extent that the portfolio is no longer representative of the strategy."<sup>8</sup> Each firm has the opportunity to define discretion distinctly, and the key is consistently applying the definition of discretion across portfolios.

Since real estate portfolios are generally subject to more restrictions than equity or fixed income portfolios, the GIPS standards have provided additional guidance on discretion. The key considerations for real estate firms to contemplate when defining discretion are "determining investment search and selection, acquisitions, dispositions, investment structuring, financing, capital improvements, leasing, and operating budgets."<sup>9</sup> Unlike traditional asset portfolios, it is common for investment constraints such as leverage limits, tax considerations, or client consent requirements to exist in real estate. Yet firms still may classify the real estate portfolio as discretionary. **The challenges surrounding investment discretion for real estate managers are significant. Some examples of issues managers should consider when evaluating discretion follow.**

<sup>8</sup> 2020 GIPS Standards for Firms, pg 146.

<sup>9</sup> Global Investment Performance Standards (GIPS) Guidance Statement on Real Estate, CFA Institute (2010)

1. **Account 1** is a real estate portfolio with a mandate to invest in multi-family residential properties that are at least 80-percent leased at the time of purchase. The account agreement allows the manager to select, purchase, and finance the properties, as long as the leverage does not exceed 60-percent loan-to-value. Under this scenario, the manager is limited by the property type, occupancy rate, and a maximum leverage rate. While the restrictions are client directed, they are not typically considered to be excessive. Thus, the portfolio should be deemed discretionary.
2. **Account 2** is a real estate portfolio that requires the account owner to approve all acquisitions and dispositions, but leaves the financing decisions up to the manager. The investor always agrees with and provides timely response to the manager's recommendations.

Even though the investor must approve all transactions, the investor agrees with the manager's investments and also leaves financing decisions to the manager. This account is typically deemed discretionary, as the strategy implementation is not materially affected. If, however, an investor regularly took, say, 30 to 60 days to respond to a manager's recommendation and thus the recommended deal is no longer available, a firm may categorize this portfolio as non-discretionary.

3. **Account 3** is owned by the pension fund of XYZ Manufacturing and has hired Real Estate Capital Advisors to manage the properties owned in the fund. All real estate transactions must be initiated by the fund's investment committee, so the manager is not allowed to acquire or dispose of any property. The manager can provide investment recommendations, but cannot initiate any transactions. The pension fund is also responsible for all financing decisions, which limits the manager's responsibility to recommend favorable financing terms to the investment board.

In this case, the restrictions imposed by the client are so severe that the investment manager does not have discretion to implement the intended strategy, and the firm would likely deem the account non-discretionary. The pension assets would still be included in firm AUM, but not in a composite.

4. **Account 4** is managed to a value mandate for a high-net-worth client. The manager’s typical value account purchases distressed properties, stabilizes the properties, and then liquidates the stabilized property, earning a premium for the manager’s ability to restore declining properties. The manager meets with the client and informs her of the intent to sell several properties in the next 12 months in order to realize gains from stabilizing the properties.

The investor instructs the manager to not sell any properties, as she is looking at a significant tax burden this year from the sale of her business.

Even if a portfolio is classified as discretionary at inception, it is possible for a client restriction to alter the discretionary status. In a situation where a client’s instructions change the portfolio from discretionary to non-discretionary, or vice versa, the manager must follow the inclusion and exclusion policies described in the firm’s policy manual.

## Composite Construction

After defining the firm and defining discretion, the next step is to group portfolios with similar investment objectives into composites. Most real estate composites are defined by strategy according to the real estate style—for example, opportunistic, value-added, or core. The strategy may be further segregated into property types such as retail, office, industrial, or multi-family. Additional considerations may be environment, geography, and leverage. Composite construction is relatively straightforward for real estate managers. However, there are a few points worth mentioning.

Depending on how a firm manages real estate assets and the preference for marketing performance, firms must determine whether to define composites narrowly or broadly.

	Less Risk		More Risk
Broader	Core	Value-Added	Opportunistic
	North America Core	Western Euro Value-Added	East Asia Development
Narrower	Atlantic Coast Core Office	German Distressed Retail	Japanese Opportunistic Manufacturing

Table 3. Potential composites based on investment risk and mandate.

This decision could result in a lower number of composites with broad definitions or a higher number of composites with more refined definitions. The table below shows examples of composites defined using the aforementioned criteria. For those managers that are registered with the SEC, this exercise of grouping similarly invested account will align with the new requirement to present related accounts performance.<sup>10</sup> Table 3 highlights the flexibility given to firms in defining real estate composites. The primary objective is to ensure each composite definition is strategy based and meaningful.

<sup>10</sup> SEC Guide to Presentation of Performance under New Marketing Rule, final compliance date of November 4, 2022.

## Defining Account Type

The 2010 edition of the GIPS standards (and prior versions) required firms to include all fee-paying, discretionary accounts in at least one composite. Previously determining account type i.e. segregated account or pooled fund was not a consideration; however, this fourth and last fundamental step is now key in 2020 for helping firms determine if an account must be included in a composite or not. Effective January 1, 2020, firms must bifurcate portfolios into two categories: segregated accounts and pooled funds (limited distribution pooled funds and broad distribution pooled funds). If an account is determined to be a segregated account (and is discretionary and fee-paying), it is required to be included in a composite. If a pooled fund is discretionary and fee-paying and is managed to the same strategy as any segregated accounts, then it must also be included in a composite. Sub-advised accounts must be included in a composite. If an account is determined to be a pooled fund (and does not follow an existing composite strategy and is not offered as a segregated account), it is not required to be included in a composite.

This is a paradigm shift from the past adage that all accounts regardless of type must be in a composite. The rigidity of earlier standards has been removed and opened the gateway for firms to have flexibility in not only compositing, but furthermore in valuation, calculation, and most importantly presentation.

# Input Data and Calculation Methodology

Within the GIPS standards, valuation frequency is one of the key areas where real estate assets are treated differently from other assets. Table 4 presents a simplified illustration of the valuation requirements for a segregated account calculating a time-weighted return under the current GIPS standards.

## Valuation Frequency in the GIPS Standards<sup>10</sup>

	1/1/06 - 1/1/08	1/8/08 - 1/1/12	1/12/12 - 12/31/19	POST 1/1/20
<b>Internal</b>	Annually	Quarterly	Quarterly	Quarterly
<b>External</b>	36 months	36 months	Annually	Annually

Table 4. Internal and external valuation requirements for real estate assets since January 1, 2006.

Beginning January 1, 2011, firms were required to value assets in accordance with the definition of fair value. Fair value is partially defined as “the amount at which an investment could be exchanged in a current arm’s length transaction between willing parties in which the parties each act knowledgeably and prudently.”<sup>11</sup> Both the NCREIF PREA Reporting and GIPS standards released recommended fair valuation hierarchies in 2010 (see Appendix B). Compliant firms can deviate from the hierarchy recommended in the GIPS standards but must address each valuation tier as noted in the recommended hierarchy. This requirement to fair value investments remains unchanged in the 2020 GIPS standards.

<sup>10, 11</sup> 2020 GIPS Standards for Firms, pg 69.

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Account Type	Included in a Composite	Calculation Methodology	Minimum Required Valuation Frequency
<b>Segregated Account</b>	Yes	TWR	Quarterly
<b>Segregated Account</b>	Yes	MWR	Annually
<b>Pooled Fund</b>	Yes	TWR	Quarterly
<b>Pooled Fund</b>	No	TWR	Annually
<b>Pooled Fund</b>	Yes	MWR	Annually
<b>Pooled Fund</b>	No	MWR	Annually

Table 5. Valuation & calculation requirements for real estate investments effective January 1, 2020.

Another key change to the valuation requirements in the 2020 GIPS standards is the differentiation of external valuation methodologies becoming dependent on the type of portfolio. If real estate is included in an open-end fund, there must be an external valuation at least once every 12 months.

<sup>12</sup> 2020 GIPS Standards for Firms

For real estate investments that are *not included* in an open-end fund, firms have two options. Firms must obtain an external valuation at least once every 12 months unless client agreements stipulate otherwise. In that case, external valuations must be performed every 36 months or per the client agreement if the client agreement requires external valuation more frequently than 36 months. Alternatively, and recently added, real estate investments can be subject to an annual financial statement audit by an independent public accounting firm. If this route is taken, the assets must be accounted for at fair value in the audit, and a firm may use this to meet the requirement in lieu of obtaining an external valuation.

Additional considerations around external valuations include using independent third parties that are professionally designated or certified property valuer or appraisers, and not using external valuations when the valuer's or appraiser's fee is contingent on the investment's appraised value.

**Question:** When we receive an external appraisal that differs from our internal valuation, we use the average of the internal and external appraisal. Will this affect our ability to comply with the GIPS standards?

**Answer:** No. If a manager obtains different internal and external property values, there are several options. These include using the internal value, using the external value, using a blended value, or using the value from a third-party manager. The selected valuation methodology used at the property level will flow through to the valuation used at the investment level. We recommend that firms remain consistent in their treatment of property valuation procedures and document their basis for final valuation.

## Performance Calculations

A common challenge real estate investment managers face is whether to show property-level or investment-level (portfolio or fund) performance. Real estate managers tend to be more familiar with property-level returns due to the reporting methodology under National Council of Real Estate Investment Fiduciaries (NCREIF) for the NCREIF Property Index (NPI). **However, since the GIPS standards require daily-weighted cash flows for performance calculations, firms can only use investment-level performance.**

Again the GIPS standards align nicely with the new SEC Marketing Rule. To the extent that property level performance is a component of a fund or single portfolio, all property level performance will be considered extracted performance. Under the new rule, when a firm presents extracted performance, the total fund or portfolio from which the performance was extracted, must be shown. Those firms that find value in presenting property level performance, will still need to consider the total fund and how that performance should be calculated.

### Property Level

The property-level method calculates the return of individual properties, generally ignoring the capital structure arrangements. This method reflects how performance is reported to NCREIF for inclusion in the NPI.<sup>13</sup> A quick review of the property-level formula (unleveraged) below shows that capital expenditures and property sales are assumed to occur mid-quarter, whereas income distributions occur equally at each month end over a quarter.

### Investment Level

The investment-level method generally reflects the full impact of the capital structure in weighting cash flows for capital expenditures, property sales, and income distributions the day the flows occur. Below, we have highlighted the differences in the formulas for the property-level and investment-level time-weighted returns (TWR).

<sup>13</sup> Frequently Asked Questions about NCREIF and the NCREIF Property Index (NPI), NCREIF (2011), p. 8, [http://www.ncreif.org/public\\_files/Users\\_Guide\\_to\\_NPI.pdf](http://www.ncreif.org/public_files/Users_Guide_to_NPI.pdf)

## Property-Level - Unlevered Formula

$$\text{Total Return} = \frac{\text{NOI} + (\text{EMV} - \text{BMV}) + \text{PS} - \text{CI}}{\text{BMV} + \frac{1}{2} \text{CI} - \frac{1}{2} \text{PS} - \frac{1}{3} \text{NOI}}$$

## Investment-Level - Levered Formula\*

$$\text{Total Net of Fees Return} = \frac{\text{NII} + (\text{EMV} - \text{BMV}) + \text{PS} - \text{CI}}{\text{BMV} + (\text{CFi} \times \text{Wi})}$$

\* Only methodology allowed under the GIPS standards

### Where:

EMV is the ending market value. BMV is the beginning market value

CF is the net total external cash flows for the period (including Capital Improvements, Partial Sales, and Net Operating Income distributions)

CI is the total capital improvements during the period. PS is the total partial sales during the period

NOI is the total net operating income for the period. NII is the total net investment income for the period

$\sum (\text{CFi} \times \text{Wi})$  is the sum of each external cash flow, CFi, multiplied by its weight, Wi

$$\text{Wi} = \frac{\text{CD} - \text{Di}}{\text{CD}}$$

### Where:

CD is the total number of calendar days in the period

Di is the number of calendar days since the beginning of the period in which the external cash flow, CFi, occurred

To reiterate, the 2020 GIPS standards require performance to be reported using a time-weighted return methodology; however, if a firm meets certain criteria, the firm may calculate a money-weighted return

(MWR) instead. The TWR method ignores the impact of any client-driven cash flows to performance. In other words, the manager is neither penalized nor rewarded for the timing of external cash flows. The investment-level return calculations are equivalent to the Modified Dietz under the GIPS standards with the exception that real estate is calculated on a quarterly basis, not monthly. If a firm still desires to show property-level returns alongside the investment-level returns with a fully compliant presentation, it may present this as supplemental information.

Historically, the presentation of an Internal Rate of Return (IRR), or Money-Weighted Return (MWR), was reserved for only closed-end real estate funds (CEREFs) and private equity. Effective January 1, 2020, CFA Institute granted additional latitude to firms by stating that if a firm has control over the external cash flows and has at least one of the following characteristics, then a MWR may be shown:

- a. Closed-end
- b. Fixed Life
- c. Fixed Commitment
- d. Illiquid investments are a significant part of the investment strategy

**Question:** If we were historically required to calculate a TWR, but now meet the criteria through control of the timing and amount of capital calls and distributions and one of the specific characteristics can we switch effective January 1, 2020 to present a MWR prospectively?

**Answer:** Yes, a firm may present the MWR, the MWR and TWR, or the TWR only. Once the firm decides what return(s) it will present the firm must consistently present them in the GIPS Report.

**Question:** In addition to the required TWR return, if the firm does not meet the MWR criteria can we show the Internal Rate of Return (IRR) or Since Inception Internal Rate of Return (SI-IRR)?

**Answer:** Yes, either figure may be shown as supplemental information with proper disclosure.

Once a firm has calculated the appropriate investment-level returns, it must calculate the composite or pooled fund returns. The frequency of calculations as referenced in Table 5 must be followed. Succinctly put, the GIPS standards mandate that real estate composite returns be calculated at least quarterly if the portfolio is:

1. calculated using a time-weighted methodology, and
2. included in a composite.

Conversely, if the segregated account or pooled fund is:

1. calculated using a money-weighted methodology, and
2. not included in a composite, the portfolio must be calculated at least annually.

The composite return must be calculated using an asset-weighted method such as weighting portfolio returns by the beginning market value or using the aggregate method. The aggregate method treats all assets within the composite as one account.

# GIPS Reports

Preparing fully compliant GIPS Reports serves as the final stage for claiming compliance with the GIPS standards. Once a firm has created a policy manual, constructed composites (if required), and calculated performance, the firm must build a GIPS Report with all required data and disclosures. The GIPS Report allows prospective investors to make an apples-to-apples comparison of investment performance across managers.

As noted previously, a notable development in the 2020 GIPS standards is the categorization of pooled funds into either a Limited Distribution Pooled Fund or a Broad Distribution Pooled Fund. This bifurcation paved the way for the expansion in various types of GIPS Reports that firms now have the option to create either a GIPS Composite or Pooled Fund Report and furthermore, either report could follow a time-weighted or money-weighted calculation methodology.

Naturally, with four types of GIPS Reports possible, the fundamental requirements of the GIPS standards were enhanced. What was previously housed in one simple requirement is now encompassed in several requirements 1.A.11 through 1.A.14. These often-overlooked standards state that a firm “must make every reasonable effort to provide a GIPS Composite or Pooled Fund Report to all prospective clients/investors initially...and at least every 12 months.” Additionally in 1.A.15 firms are granted the option to provide a GIPS Composite or Pooled Fund Report to a Broad Distribution Pooled Fund Prospective Investor if it contains a Broad Distribution Pooled Fund. To meet this requirement, a firm must define who it considers to be a prospective client and investor. The firm must also have proper controls in place to ensure all prospective clients/investors receive the compliant presentation at least once a year. It must also track which version a prospect receives in case the firm needs to republish performance after a material error.

Regardless of whether the firm is showing a Pooled Fund GIPS Report or a Composite GIPS Report, the required reporting metrics for real estate must include the total return. In GIPS Reports prior January 1, 2020, the income and capital appreciation return along with the total return were all required to be shown. Currently it is a recommendation for firms to include the time-weighted component returns for a composite or pooled fund and the benchmark.

Real estate firms claiming compliance with the 2020 GIPS standards are now only subject to one other disclosure for real estate investments not in an open end fund: either disclose how external valuations are obtained and the frequency or that the firm relies on valuations from financial statement audits. Please see the sample presentation for a real estate composite provided on the next page.

**ABC Capital**  
**Real Estate Composite GIPS Report**  
**January 1, 2016, through December 31, 2020**

Year	Composite		Benchmark (NFI-ODCE)	# of Portfolios	Dispersion (High/Low)	Composite Assets (USD mil)	Total Firm Assets (USD mil)
	Gross Total Return	Net Total Return	Total Return				
2020	18.96%	17.74%	15.96%	5 or fewer	N/A	\$370	\$6,785
2019	-12.32%	-11.35%	-11.01%	5 or fewer	N/A	\$356	\$6,532
2018	-29.18%	-29.99%	-29.76%	7	N/A	\$389	\$6,229
2017	13.53%	12.44%	16.36%	8	16.23% / 10.87%	\$472	\$7,834
2016	16.77%	15.61%	15.92%	6	19.89% / 13.41%	\$391	\$8,418

ABC Capital (ABC) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. ABC has been independently verified for the periods January 1, 2016, through December 31, 2020. The verification report is available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report.

**Firm and Composite Information**

ABC Capital is an investment advisor registered with the Securities and Exchange Commission under the Investment Advisors Act of 1940. ABC Capital is a wholly owned subsidiary of ABC Holdings. Additional information regarding the firm's policies and procedures for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

The Real Estate Composite includes all discretionary fee-paying accounts that invest in institutional quality retail, residential, office, and industrial properties where ABC is responsible for the major investment decisions, including portfolio strategy, investment search and selection, purchases, sales, investment structuring, financing, capital improvements, and operating budgets. The investment decisions, strategies employed, and risk characteristics can vary based upon portfolio specific circumstances such as the length of time under management, the number of properties held, and property type and geographic composition. The target leverage for the composite is 40-55% although, due to market conditions and client constraints, the leverage used may fall outside this target for periods of time.

The composite inceptioned January 1, 2016 and was created in January 2016. A complete list of the firm's composite descriptions, a list of limited distribution pooled fund descriptions, and a list of broad distribution pooled funds are available upon request.

## Benchmark

The composite benchmark is the NFI-ODCE, which is a capitalization-weighted index of the returns of the open-end comingled funds pursuing a core investment strategy reported to NCREIF. The index is reported gross of fees using the same return calculation methodology used by ABC to calculate the composite returns.

## Performance Calculations

Valuations and returns are computed and stated in U.S. Dollars. "Gross-of-fee" returns are calculated using the NCREIF fund level rate of return methodology quarterly. Net-of-fee returns are calculated by netting down this gross return by an annual management fee of 2.00%, which reflects the maximum management fee paid by an account in the composite. The firm's fee schedule is 2.00% of assets under management, which may include a combination of management, acquisition, disposition, financing, and incentive fees. When accounts incur an incentive fee, the fee typically ranges between 10 and 15% of performance in excess of a negotiated hurdle rate. Fees may be subject to negotiation where special circumstances warrant.

NCREIF fund level rate of return methodology: The quarterly, annual, and annualized total returns consist of three components of return: income, capital, and total. The income return measures that portion of total return attributable to the funds' net operating income (NOI). NOI is gross rental income plus any other income less operating expenses (utilities, maintenance, taxes, property management, insurance, etc.). The income return is computed by dividing NOI by the average daily investment for each quarter. The formula takes into consideration any capital improvements and/or any partial sales that occurred during the quarter.

Dispersion shown is the high/low gross return spread for the composite. Dispersion is not presented during periods when the composite contains five or fewer portfolios for the entire year. The three-year annualized ex-post standard deviation for the composite and benchmark are not presented because composite returns are calculated quarterly and monthly returns are not available.

Total composite assets are the total portfolio value net of debt. Leverage percent is defined as debt divided by total portfolio value. Composite returns do not reflect non-management expenses that the account incurred.

## Valuation

Property values in the composite are estimated by third-party appraisers using the cost, sales comparison, discounted cash flow, and/or income capitalization approaches. Securities and cash equivalents held by the composite are marked to market on each valuation date. Internal valuations are determined using the discounted cash flow method. Due to the unique nature of real estate investments, all properties are valued using subjective unobservable inputs.

All properties in the composite are appraised externally annually. The independent directors determine the value of the properties based on input from independent appraisers and all levels of the management team.

Individual account management and construction will vary depending on each client's investment needs and objectives, including liquidity needs, tax situation, risk tolerance, and investment restrictions. Individual accounts may not have the same management fees, expenses, diversification, distributions, and cash flows as the composite. As a result, an account's actual performance may differ from the performance presented above due to, among other things, timing of investment, contributions and withdrawals, and the client's restrictions. In addition, performance does not reflect the effects of taxation, which results in lower returns to taxable investors. An investment in the Real Estate Composite involves a risk of loss, and the value of an investment may decrease as well as increase. Such an investment entails significant risks that are customarily associated with the development and ownership of income-producing real estate, including illiquidity, changes in supply and demand, and inexact valuation. No representation is made that any account will obtain similar results to those shown above.

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Past performance does not guarantee future results.

## Other Considerations

### NCREIF PREA Reporting Standards and the GIPS Standards

The diagram below displays the similarities and differences between NCREIF PREA and the GIPS standards.

#### NCREIF PREA and the GIPS Standards - Strategically Aligned for Private Real Estate.

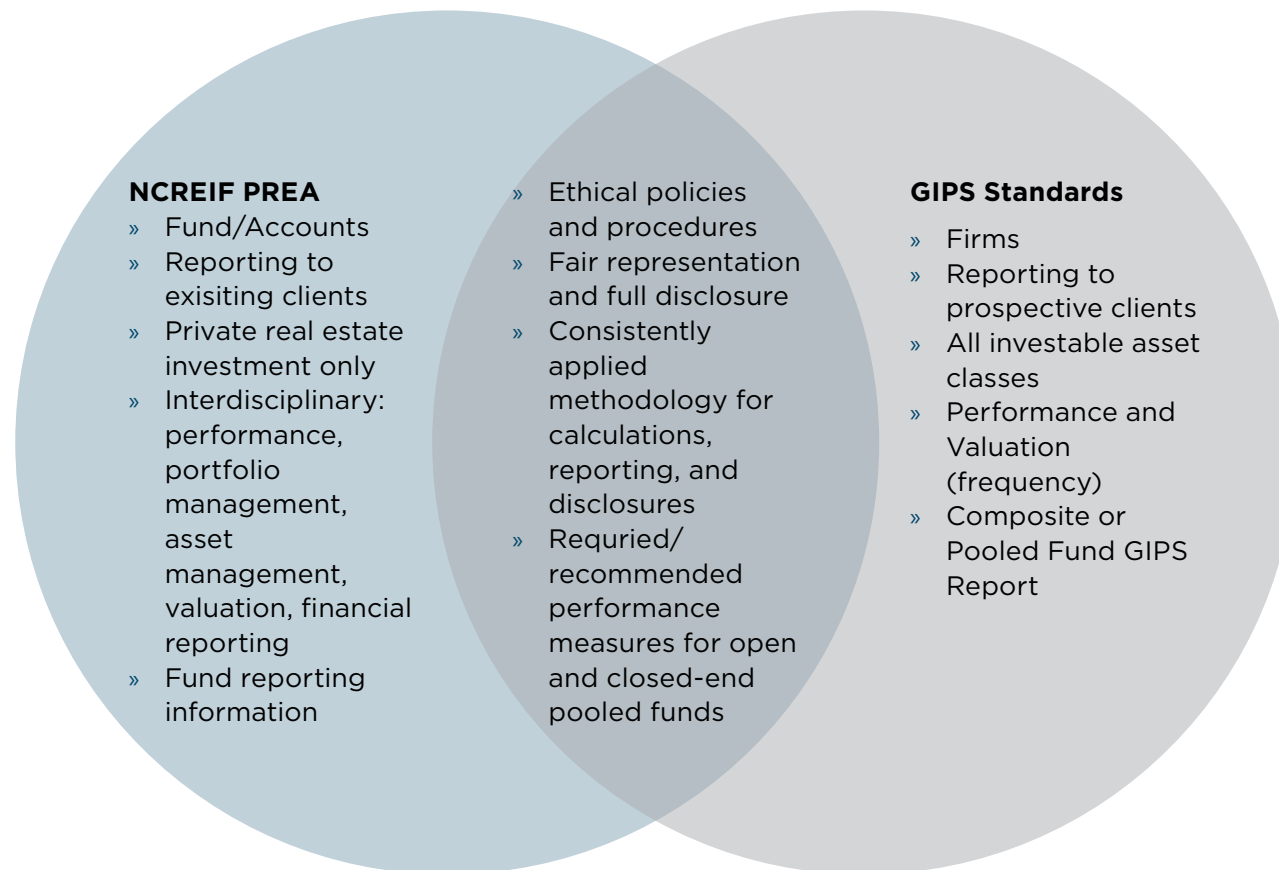


Figure 3. Comparison and contrast between NCREIF PREA and the GIPS standards.

First published in 1995, the NCREIF PREA Reporting Standards' goals are closely aligned with those of the GIPS standards.<sup>14</sup> In fact, the GIPS standards served as a foundation for the creation of the Performance section of the NCREIF PREA standards. However, NCREIF PREA was designed as a set of principles-based standards for reporting performance to existing clients while the GIPS standards focus solely on reporting to prospective clients. Prior to January 1, 2014 firms were allowed to partially adopt the NCREIF PREA standards. **Since early 2008, firms seeking to become NCREIF PREA compliant were required to comply with the GIPS standards, but effective January 1, 2012,**

**this requirement no longer exists.**

Nevertheless, we are frequently asked about the differences between the NCREIF PREA Reporting Standards and GIPS standards and whether one presentation may be used to accommodate both standards. Table 5 highlights some of the common differences between the GIPS standards and NCREIF

Category	Requirement for GIPS Standards	Requirement for NCREIF PREA Standards
Target Audience	Prospective Clients	Existing Clients
Calculation Methodology	Only Investment or Fund-Level Calculations	Property, Investment, or Fund-Level Calculations
Presentation/Report Disclosures	<ul style="list-style-type: none"> <li>» External valuations obtained</li> <li>» Frequency properties are externally valued</li> <li>» Reliance on financial statement audits (non-open-end fund only)</li> </ul>	<ul style="list-style-type: none"> <li>» Portfolio diversification</li> <li>» Investment/property type</li> <li>» Region/location</li> <li>» Nature of investment (life cycle)</li> <li>» Investment structure</li> <li>» Occupancy level by property type</li> <li>» Portfolio-level lease statistics</li> <li>» Consolidation financial statements included with client report</li> <li>» Total Leverage at cost, percentage</li> <li>» TGER</li> </ul>
Partial Compliance	No	No

Table 6. Differences between the GIPS standards and NCREIF PREA Reporting Standards.

Given these differences listed, firms complying with NCREIF PREA will most likely need separate reports meeting the requirements of both sets of standards; however it is possible for one presentation to satisfy both.

<sup>14</sup> See <https://reportingstandards.info/about-us/governance/>

## Non-Real Estate Agents

Firms managing both real estate and non-real estate assets need to know the additional considerations relating to composite construction and calculations.

**Question:** We manage accounts that include both real estate and non-real estate assets as defined by the GIPS standards. How should we treat these accounts? Can we include these in a composite with other accounts comprised entirely of real estate assets?

**Answer:** Firms can include accounts with a mix of real estate and non-real estate assets in the same composite provided the accounts all meet the definition of the composite. The non-real estate assets must be valued monthly, and on the date of large external cash flows, while the real estate assets must be valued at least quarterly. One way to calculate the portfolio return would be to use the beginning market value of both asset types and then carry a “stale” value for the real estate assets through the next two monthly periods. The non-real estate portion is valued monthly, while the real estate portion is valued only at quarter end. The return is struck at each monthly interval and the portfolio quarterly return is accurate.

## Closed-End Real Estate Funds

Historically, firms managing CEREFs were required to follow vehicle-specific guidance unique to CEREFs only. That is no longer the case. As previously mentioned, firms following the 2020 GIPS standards must review 1.A.35 and determine if they meet the characteristics required to present a MWR. If so, the firm will then determine the type of GIPS Report: Composite or Pooled Fund and adhere to the required statistics and disclosures.

This unification of requirements and elimination of vehicle specific guidance provides prospective clients/investors greater comparability across firms.

In fact, provided the type of return calculated and GIPS Report presented are the same, CEREFs are now subject to the same disclosure requirements as private equity managers, including the investment multiples. Lastly, a significant change in the 2020 GIPS standards is the elimination of the requirement for firms to define a CEREF by vintage year and strategy and include it in a composite. Firms have options and may or may not have a CEREF in a composite (as long as it is not offered as a segregated account and does not meet the composite definition of an existing composite).

**Question:** Is it possible to include a single CEREF in two different composites, assuming it meets both composite definitions?

**Answer:** Yes, if the CEREF meets two separate composite definitions, firms can include it in both composites. For example, assume a firm manages three mixed-use core segregated accounts, a mixed-use core open-ended fund, and a mixed-use closed-end fund launched in 2007. At a minimum, there must be at least one mixed-use core composite. The first composite could be called the Mixed-Use Core and contain the three managed accounts, the open-end fund, and possibly the CEREF. If the CEREF is not managed the same as the segregated account and open-ended fund, the firm may create a second composite which would be the Mixed-Use Core 2007 or the firm may opt to not create a composite since it is a pooled fund and a composite is not required.

## Benchmarks

Benchmark selection continues to be a frequently debated topic among real estate managers. In our opinion, the best option is to select a benchmark from one of the fund indices (for example, NFI-ODCE or NFI Townsend returns) that uses the same methodology as the composite. If a manager cannot find a suitable fund index and thus chooses an NPI return as the benchmark in the MWR GIPS Composite or Pooled Fund Report, the firm must, at a minimum, disclose the methodology used to calculate the benchmark return.

A firm presenting the NPI index as the benchmark may include a disclosure like this:

*The benchmark returns are calculated using the following methodologies. The benchmark returns assume no leverage for the properties included. Benchmark returns weight cash inflows mid-period and cash out flows monthly, while composite returns weight cash flows daily. Composite level returns, calculated using the same methodology as the benchmark, are available upon request.*

## Conclusion

According to a State Street study, “investors are insisting on greater levels of transparency, following their experiences during the financial crisis.”<sup>15</sup> As institutional investors search for uncorrelated assets and other ways to diversify portfolios, the demand for real assets is expected to grow accordingly. The emphasis on transparency of information is a result of this demand. Claiming compliance with voluntary reporting standards, such as the GIPS standards, is one way that firms can differentiate themselves from other managers.

As more real estate firms attain compliance with the GIPS standards, additional topics may surface that will require a closer look. Due to the heterogeneous nature of real estate, key areas like discretion and valuation will continue to offer uncertainty for investment managers. However, with the additional guidance provided here, a firm can more easily resolve potential issues. As noted, this paper’s intent is to offer answers to commonly asked questions and to bridge the gap between various industry associations. In addition, firms that explore NCREIF PREA should have a concise understanding of any similarities to and differences from the GIPS standards. We encourage firms with exposure to the GIPS standards to discuss these topics with an expert.

<sup>15</sup> State Street, op cit.



## About ACA Group

ACA Group (“ACA”) is the leading governance, risk, and compliance (GRC) advisor in financial services. We empower our clients to reimagine GRC and protect and grow their business. Our innovative approach integrates consulting, managed services, and our ComplianceAlpha® technology platform with the specialized expertise of former regulators and practitioners and our deep understanding of the global regulatory landscape.

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