

**INVESTMENT PERFORMANCE COUNCIL  
ADOPTION OF REAL ESTATE PROVISIONS  
FOR THE GIPS® STANDARDS**

**SUMMARY:** In March 2000, the Investment Performance Council (IPC) created the Real Estate Subcommittee to develop new provisions for the Global Investment Performance Standards (GIPS®) to address the calculation and presentation of performance for real estate investments. The Subcommittee established a process to identify current practices in several markets with the goal of developing a comprehensive set of globally applicable provisions that would promote the comparability of real estate investment returns and increase transparency of performance of this asset class to investors.

In June 2001, the IPC released the proposed globally applicable provisions and interpretive guidance for a six-month public comment period. During this period, the IPC received nineteen comment letters from individuals, country sponsors, and organizations from various countries.

**ADDITIONAL INFORMATION:** For further information on these Provisions and the GIPS standards, contact AIMR's Professional Standards and Advocacy Department via e-mail at [gips@aimr.org](mailto:gips@aimr.org), via facsimile at +1-434-951-5320, or at 560 Ray C. Hunt Drive, P.O. Box 3668, Charlottesville, VA 22903-3668.

## **I. SUMMARY OF COMMENTS**

Below is a summary of the comments received during the public comment period and the action taken by the RES and IPC in response. The firm or individual making each comment is indicated using the following abbreviations:

<b>AMF</b>	Anne Marie French
<b>Anon 1</b>	Anonymous 1
<b>Anon 2</b>	Anonymous 2
<b>API</b>	Australian Property Institute
<b>IVSC</b>	International Valuation Standards Committee
<b>JAREA</b>	Japanese Assoc of Real Estate Appraisal
<b>NCREIF</b>	National Council of Real Estate Investment Fiduciaries
<b>NSFA</b>	The Norwegian Society of Financial Analysts
<b>PvdB</b>	Pieter van den Berg
<b>PwC</b>	PricewaterhouseCoopers
<b>PREI</b>	Prudential Real Estate Investors
<b>RICS</b>	Royal Institution of Chartered Surveyors
<b>RREEF</b>	RREEF Real Estate Investment Managers
<b>SAAJ</b>	Security Analysts Association of Japan
<b>SBA</b>	Swiss Bankers Association
<b>UBSAM</b>	UBS Asset Management
<b>UBS</b>	UBS Realty Investors LLC
<b>UKIPC</b>	UK Investment Performance Committee
<b>VBA</b>	VBA GIPS Committee

## 1. General Valuation Comments

The original public comment document did not include any specific guidance on the determination of a value for real estate investments. The provisions addressed the frequency of valuations, but permitted firms to develop their own valuation procedures.

*Comment: Valuations should meet certain conditions, including that of an explicit open-market orientation. They should also comply fully with all national/regional agreements as to best practice methods, rules, and prerequisites both at the individual asset level and across all assets in each relevant portfolio. (UKIPC)*

*Comment: As valuations can be very subjective, the IPC should introduce a general framework and/or guidelines for valuing real estate investments to ensure that they are fair and comparable. At a minimum, the framework should stipulate that valuations must be updated at the time that a lease is added or subtracted from the investment. (Anon2)*

*Comment: IVSC would encourage AIMR to embrace the linkage to International Valuation Standards, which would provide standards immediately upon adoption. (IVSC)*

*Comment: We recommend that AIMR provide definitions and accepted assumptions for the various valuation methods, and disclosures should be required when the procedures applied do not align to those definitions and assumptions. (PwC)*

The IPC believes that real estate investments must be valued at a market value at least once every twelve months and have provided a specific definition of market value for real estate investments as well as general guidance as to how firms should derive market values. However, due to the maturity of the industry, the IPC does not agree that real estate assets should be held to strict guidelines for determining market values and leave the detail standards up to each regional regulatory body.

***Revision: None.***

## 2. Quarterly Valuation Comments

In an effort to standardize global valuation practices, the original document proposed that the GIPS Real Estate provisions initially required firms to value real estate investments at market value at least once every twelve months, and by 1 January 2005, upgrade the frequency to quarterly. The provisions also recommended firms implement quarterly valuation before 1 January 2005.

*Comment: We fully support the movement to a quarterly valuation requirement in 2005. (Anon1, Anon2, NCREIF, NSFA)*

*Comment: We propose a recommended target of a quarterly valuation by January 2005, converting to a requirement by January 2007. (UKIPC)*

*Comment: Quarterly valuation (starting 2005) will hardly be feasible unless standardized, cheap, and opened valuation methods (or algorithms) are developed (no black-box methods). At the moment we consider quarterly valuation as unrealistically high. Market valuations of real estate investments do not change dramatically within a quarter when no developments or renovations have been made. (SBA)*

In an attempt to obtain the most accurate valuation input for a performance return calculation, the IPC believes real estate investments must be valued on a frequent basis to capture market movements and events. The final provisions contain no explicit rules for how a firm must determine a market value, only that a value is struck every twelve months. Ultimately, the IPC is pressing the industry to conduct more frequent valuations so that beginning 1 January 2008, firms must value real estate investments at least quarterly.

The provisions make no distinction between what is considered a valuation and what is considered by some in the real estate industry as a “review.” Instead, the judgment is left to the firm to determine what processes they must implement to satisfy the market valuation requirement.

The provisions also contain a definition of market value: the most probable price which a property will command in a competitive and open market transaction under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus.

***Revision: None.***

### **3. External, Independent Valuation Comments**

The IPC originally proposed a requirement that firms conduct periodic, independent appraisals to determine real estate values for direct investments at least once every thirty-six months. Further, the IPC proposed that mandatory appraisals be conducted every twenty-four months by 1 January 2005. Firms were encouraged to conduct appraisals every twenty-four months prior to 2005.

The proposal defined what was considered an “independent valuation” and what constituted a “professionally designated, certified, or licensed valuer/appraiser”. It also provided dispensation in markets where neither professionally designated nor sanctioned valuers/appraisers were available, indicating the firm should take the necessary steps to ensure that only well-qualified property valuers are utilized.

*Comment: Make external valuations mandatory every 12 months. A gap of 24 months between external valuations is too lengthy. Any issues arising from a shift from 24 months to 12 months could be offset by delaying its introduction to 2010 to encourage greater acceptance, if necessary. (UBSAM)*

*Comment: The use of external valuation should be recommended at least the first 5 years after launching the real estate standards, but not a requirement as proposed. It could also be stated that it will become a requirement in the future the real estate provisions have been in GIPS for a period of 5 years (i.e., 2010 (or 2005 + 5). After this period external valuation might start each 3rd year, ending yearly). (NSFA)*

*Comment: The requirement to value real estate investments every 24 months is too strict. The costs involved in such a valuation are substantial; we recommend it be set to 36 months. Further, we would like to stress the importance of a revaluation model and would suggest a change in 6.A.4 in which an external party should verify on a regular base the revaluation model used by the firm. (VBA)*

*Comment: Unlike the public markets where there is little or no cost to an investor to determine the value of an investment, determining the value of a private instrument is costly. In considering all of the above situations, the industry must balance the cost of compliance with the value of standardization. (PREI)*

*Comment: The “gold standard” which should be aimed for is for all valuations to be carried out by external or independent valuers and the minimum frequency for this to be annually rather than bi-annually by 2005 (ideally sooner). This is not only to produce a credible set of performance standards and thereby raise the quality of the information available in the marketplace on managers’ performance in property investments, but also to increase the accuracy and meaningfulness of the benchmarking service provided by bodies such as the IPD in the UK. It is more the case for property investments than most other asset classes that peer groups are the only credible benchmarks, therefore there is an added onus on the AIMR to ensure these standards are right as they affect both fund and benchmark results. (AMF)*

*Comment: We propose to make external valuation mandatory on an annual regime by January 2005; to include a requirement to report when the scale of the manager’s total business with the valuing firm as a proportion of that firm’s total turnover exceeds a threshold of say 5%; and to make independent valuation – perhaps in accordance with something like the UK Red Book definition (enclosed) – a recommendation. We are not proposing this as the ideal valuation standard, but would advocate further consultation upon the definition of full independence. (UKIPC)*

*Comment: It is stated that the provisions recommend firms implement the twenty-four month independent appraisal before 2005. Under Recommendations, item 6.B.2 states, “Direct real estate investments should be valued by an external valuer or appraiser at least once every twelve months.” As written, these statements contradict each other. We support a recommendation to implement the twenty-four month independent appraisal before 2005. (PwC)*

*Comment: I recommend that the frequency of independent appraisals should depend on the required frequency of quarterly valuations. If quarterly valuations are required in the final provisions, then independent appraisals are not needed as frequently (every 36 months). If valuations are only required to be done on an annual basis, then independent appraisals should be conducted more frequently (every 12 or 24 months). (Anon2)*

Comment: Real estate should be valued annually by an independent, professionally designated appraiser. It should be assessed on site every three years. In special cases, such as renovations, purchases and sales of properties, valuations should be done ad hoc. The same applies to augmentation of capital, rentals to related companies and so on. The results should be reflected in the quarterly reports. (SBA)

Comment: R.E. must be valued by an independent appraiser. This is correct, but since the frequency is less than the disclosure cycles we are in favor of valuation adjustments by internal management within the professional valuation framework. (PvdB)

Comment: IVSC supports the acceleration of the frequency of independent appraisals. Before adopting a specific frequency of valuation, IVSC suggests more research be conducted to establish the accuracy and reliability of valuations when conducted at intervals as frequent as quarterly. There is already existing research in the UK and US. (IVSC)

Comment: Many firms are opposed to the proposed twenty-four month independent appraisal frequency. A thirty-six month frequency is consistent with many existing client contracts mandates. I believe there is no measurable significant benefit in requiring an independent valuation more frequent than thirty-six months. (Anon2)

Comment: NCREIF supports the requirement for a thirty-six month independent valuation as opposed to the proposed twenty-four month frequency beginning January 1, 2005. The thirty-six month frequency is consistent with the requirements of many client mandates in the United States. (NCREIF)

Comment: RICS does not support the recommendation that “Independent Valuation” is the standard which should be sought. In our view, the requirement should be for an “External Valuer”, although we would recommend that the standard include a further disclosure requirement, where other fee earning relationships exist, regarding the proportion of non-valuation fee income derived from the client. Following recommendations we are making in other reports, we are promoting public disclosure over a 5% threshold of fee income for any particular client against the total income of the valuer’s business. We note that there is a difference in terminology and we recommend the definitions should refer to “External Valuer” (and “Independent Valuer” if this is retained) rather than “Valuation” in order to maintain consistency with the valuation definitions of the International Valuation Standards Committee and RICS Red Book. (RICS)

Comment: Some client contracts state "no independent external valuation is required" and therefore prohibit the cost of such appraisals to be paid for by the client/fund. Thus, if we were to continue to be GIPS compliant, we would have to bear the cost of unnecessary independent valuations. (PREI)

Comment: Pension funds investing in real estate through individual accounts mandate the frequency with which independent appraisals are to be performed. The client typically pays the cost of external appraisals and an independent appraisal frequency of thirty-six months is

*common. Given the express direction provided by many clients, it would not be appropriate for the GIPS to require more frequent independent appraisals in conflict with such direction. UBS Realty believes it is acceptable to value real estate investments by an independent appraiser no less frequently than once every thirty-six months if the investor(s) so specify. (UBS)*

*Comment: The cost of independent valuations would unnecessarily reduce performance. (SBA)*

*Comment: Internal valuation, up to four times a year, may not impose a serious problem for managers but getting “fair” market value poses an issue. Capital gains from a sale at a future date has long been the most preeminent factor for real estate acquisition in Japan, and many managers may continue to find market value far from “fair” value until the market fully digests and is ready for a pricing mechanism such as the discounted cash flow method. (SAAJ)*

The IPC agrees that there are different opinions regarding how frequently external appraisals must be completed. In order to standardize the frequency by which real estate investments are externally valued, the IPC has determined to require real estate investments to be externally valued by a professionally designated, certified, or licensed valuer/appraiser at least once every thirty-six months. This means firms must conduct the first external valuation no later than 31 December 2007. Firms are encouraged to complete an External Valuation sooner than 2007.

Based on the comments received, the IPC determined that the costs of moving the frequency of external appraisals to twenty-four months did not outweigh the benefits. Therefore, the IPC will keep the requirement for external appraisals to thirty-six months.

***Revision: Remove the reference to accelerating the frequency of real estate assets to twenty-four months. Clarify that the first external appraisal must be completed no later than 31 December 2007.***

#### **4. Effective Date**

The IPC has agreed to follow an evolutionary approach to the expansion of GIPS, which involves a strategy of not introducing major changes to GIPS before 1 January 2005. However, the IPC considered adopting, when approved, additional sections for new asset categories such as real estate and venture capital, provided that these new provisions will not impinge on or conflict with the existing provisions of GIPS. At the time of the release of the real estate proposal, the IPC had not committed to a date by which the real estate provisions would be incorporated into the GIPS standards.

*Comment: So long as the real estate provisions are fully researched as to practicality and achievability, with the tougher requirements being appropriately phased in, the provisions should be included in the GIPS standards as soon as possible. (AMF, NCREIF, RICS, UKIPC)*

*Comment: We would be happy to see an early introduction, but feel that to gain greater acceptance in the industry, a period of 12 months in order to digest and prepare for their introduction would be appropriate. (UBSAM)*

*Comment: UBS Realty believes 2005 is a reasonable and appropriate target to allow all countries time to implement GIPS. (UBS)*

*Comment: We recommend postponing the inclusion of real estate as a requirement to 2005. It could be included as recommendation from 2002, to allow managers to include portfolios including real estate in GIPS compliant presentations, if wanted by the investment manager. Generally all elaboration and definitions of the current core GIPS will be very helpful when implementing GIPS in new countries. (NSFA)*

*Comment: The proposed provisions on real estate should not be included in GIPS before 2005. (SAAJ, SBA)*

The IPC has determined that a 1 January 2005 is an appropriate effective date for the real estate provisions. Firms are encouraged to adopt them sooner, if possible.

***Revision: Modify the effective date of the real estate provisions to 1 January 2005.***

***Note: Since the publication of this document, the IPC and AIMR Board of Governors have moved the effective date of the GIPS Real Estate Provisions to coincide with the effective date of the “gold” GIPS standards – 1 January 2006.***

## **5. Disclosures**

The original proposal required firms to disclose several critical elements relating to how the performance had been calculated and presented.

*Comment: We do not believe the range of performance returns for the individual accounts in the composite is meaningful, because the range does not take into account the weighting based on net assets. (UBS)*

*Comment: On disclosing performance spreads, whilst it is appreciated that it is difficult to prescribe rules for unambiguously reporting the range of performance returns for the individual accounts in a composite, it might be appropriate to at least exemplify options. The UK PPR Code grappled with this point and concluded that in an era of increasing transparency anonymously quoting fund-by-fund returns remains far simpler and more effective than reporting decile/quartile points or other distribution statistics. It may also be relevant to recommend the presentation of other key features of individual accounts – again anonymously and with client permission – such as size and asset allocation profile. (UKIPC)*

*Comment: The calculation method requirement at present relates only to the combination of component returns. Formula should be reported for each component, along with an indication of reasons for any departure from the broad definitional guidelines. (UKIPC)*

*Comment: It would seem sensible, with an asset class as complex to analyze as real estate, to require disclosure of the source of each portfolio’s measurement, together with an explicit itemization of any asset exclusions, variations in computation methods, or non-standard approaches to input data definition. In this way, return statements, which are internally*

*produced, without the benefit of independent construction/verification, can be clearly identified. (UKIPC)*

While the IPC agrees that many of these additional disclosures may provide key information to prospective clients, it did not feel the need to require these disclosures for compliant firms. Therefore, firms are able to provide this information, but are not required to disclose it in order to claim compliance.

***Revision: None.***

## **6. Differentiation of Direct and Indirect Property**

The original real estate provisions applied to all private equity real estate investments where returns are achieved primarily from the holding, trading, development, or management of real estate assets. Certain valuation and disclosure provisions applied differently depending on the extent to which the investor has control over the management of the investment. Two categories of investment were used: "direct", which generally means the investor has unmediated responsibilities for these activities, and "indirect", where another investor or manager assumes responsibility for these actions and decisions.

*Comment: The definitions for “direct” and “indirect” real estate provided in the proposal appear to conflict with customary practices in the real estate industry and are likely to cause confusion among advisors attempting to comply with GIPS. It is typical for advisors to manage wholly owned properties utilizing the types of investment entities and structures outlined in the proposed GIPS provisions while maintaining discretion for buying, selling, leasing, valuation and other areas of the real estate business. Although it is not commonplace in the real estate industry for investments in “fund-of-funds” structures to contrast with private equity and hedge funds, such structures are viewed by investors as “indirect” investment in real estate. UBS Realty believes that the “indirect” category should apply only to fund-of-fund arrangements, but not to the entities and structures listed. (UBS)*

*Comment: The definitions for direct and indirect real estate do not provide sufficient clarity for investments where the owner has less than a 50% interest or has joint, but not absolute control over property decisions. (PwC)*

*Comment: It should be made clear that “direct” interests in real estate include portfolios outsourced to fund managers, so that the “indirect” category will generally be restricted to interests in collective investment vehicles. This point relates primarily to the distinction drawn in the introduction to the paper. (UKIPC)*

*Comment: Additional clarification is needed for the definition of direct versus indirect investments. What are the implications of the disclosure of the requirements for direct and indirect investments and is the distinction of the differences necessary? (NCREIF)*

*Comment: Separate disclosure requirements for direct and indirect real estate may create confusion and inconsistency, particularly when composites contain accounts that invest in both*

*direct and indirect real estate. Further guidance should be provided on how to address presentation requirements in such instances. Separate appraisal recommendations for direct real estate may create unnecessary costs, administration and compliance maintenance requirements for advisors, particularly when certain accounts invest in both direct and indirect real estate. (PwC)*

*Comment: The disclosure requirements differentiate between “direct” and “indirect” real estate investments, but there is no compelling reason to do so and we oppose the formulation as included in the proposed GIPS standards. (UBSAM, UBS)*

*Comment: The obligation of the manager to ensure that all of the requirements of the Standards are met for all included indirect real estate investments, is too onerous because the source of much of the input data is typically derived from a third party over whom the manager has no direct control. This should be converted into a disclosure item, so that the manager is simply required to identify the proportion of the capital employed in each fund for which the source is third party information. (UKIPC)*

*Comment: For indirect R.E. one depends on third party information and one must ensure that the third party info meets the GIPS. The third party has to meet the GIPS criteria itself. If not, the presenting firm is not always in the position to change the third party’s opinion but the presenting firm has to adjust the third party info by itself-according to GIPS. (PvdB)*

The IPC agreed there was no reason to have different valuation and disclosure provisions for indirect real estate investments. However, in order to carry out its due diligence, the IPC released a short, focused survey after the public comment period asking the industry whether there should be different provisions for direct and indirect real estate investments. The overwhelming response from the industry was that there should be no difference in the requirements for direct and indirect investments. Therefore, the final RE provisions make no distinction, i.e., require that both types real estate investments are subject to the same provisions.

***Revision: Modify so that all provisions are applicable to direct and indirect real estate assets.***

## **7. Glossary Terms**

*Comment: The definition of capital employed appears internally inconsistent. Most European standards and measurement regimes now encompass income reinvestment within the specification of the capital employed, and this seems to be both precluded and demanded in the current definition as it stands (from which an extract is quoted highlighting the apparent contradiction):*

*“ .. Capital employed should **not include any income** or capital return accrued during the measurement period ...” (UKIPC)*

***Revision: Removed sentence in order to clarify the definition.***

*Comment: A portfolio of real estate can include gearing or leverage. 6.A.6 states that the total return must be split into income and capital appreciation. Capital appreciation is defined as "The change in the market value of the real estate investments and cash/cash equivalent". The change in value of debt should be considered included in the definition. (NSFA)*

*Comment: The definition of Total Return, Capital Return, and Income Return do not distinguish between the investment level and the property level as discussed in AIMR-PPS. As the return formulas between the property level and the investment level have different assumptions, we recommend that additional guidance be provided on whether there is an intention to distinguish between the two levels, and whether there is a preferred level of presentation. (PwC)*

There was no intention to distinguish between the investment level and property level.

**Revision: None.**

## **8. Separation of Returns**

The original proposal required the presentation of income and capital appreciation component returns in addition to the total return for the composite.

*Comment: NCREIF supports a requirement to present a total return. NCREIF would support changing the provision for presenting component returns to a recommended disclosure rather than required. (NCREIF)*

*Comment: We urge rejection of the requirement that the total real estate return be separated into components called "income" and "capital." No other asset class makes this distinction, nor is it necessary. Furthermore, the definition of these components combined with the requirement of chain-linking their periodic results, produces figures that are devoid of economic meaning. (REEEF)*

*Comment: We believe that consideration should be given to concerns raised against the bifurcation of income and appreciation returns from total return which are partly based on the following:*

- (1) it provides little value to a potential investor as a means of distinguishing the performance between investment advisors without a detailed understanding the investment portfolios and the local markets where they are invested;*
- (2) it adds to the perception that real estate is uniquely different than other investment classes, which is opposite to the goal of establishing consistent investment performance standards;*
- (3) over time, real estate investments do not generate funds equivalent to the income reported, primarily, because most recurring capital expenditures are never deducted from the income return measure;*
- (4) proposed accounting standards in the United States of America may cause a significant reduction or volatility in income returns even with no changes in the underlying economics of the real estate; and*

*(5) different accounting standards between countries may result in inconsistencies in arriving at net investment income.*

*While we do not have a strong preference whether disaggregate returns are presented, we recommend that AIMR carefully consider such concerns in addition to providing further guidance in this area to ensure that the presentation of disaggregate returns have a defined purpose. (PwC)*

*Comment: The componentization of performance returns provides a “quick look” measure for prospective clients and should be required. Most prospective clients find the component returns very valuable and request these figures from the investment management firms. (Anon2)*

The IPC gave these comments special attention, as many of the commentors believed that component returns should not be required. However, the Real Estate Subcommittee and the IPC believe these measures are valued by prospective clients and therefore, will continue to require the presentation of component returns.

***Revision: None.***

## **9. Specific Comments**

*Comment: The first sentence of the document should be restated to say, “These provisions apply to all investments where returns are generated from the management of private equity real estate through holding, trading, and development.” (PwC)*

***Revision: Modify as proposed.***

*Comment: We agree that the party responsible for engaging valuation services should take the necessary steps to ensure that only well-qualified property valuers are utilized. To help ensure that this occurs, we recommend that a required disclosure be added to state the professional designation of the valuer or the relevant qualifications of the valuer should they not hold any professional designation or government certification or license. (PwC)*

***Revision: Add to the Input Data requirement 6.A.2. “External Valuations must be completed pursuant to the valuation standards of the local governing appraisal body. In markets where there are no valuation standards or where there are no Professionally Designated, Certified, or Licensed Valuer/Appraisers are not available and valuers or appraisers from other countries bearing such credentials do not commonly operate, then the party responsible for engaging such services locally shall take necessary steps to ensure that only well-qualified property valuers are utilized.”***

*Comment: The exclusion of non-discretionary mandates should be restricted to cases where the management contract specifies that the client, rather than the manager, is directly responsible for all major investment decisions and that the manager is thereby not accountable for portfolio performance. (UKIPC)*

The guidance provided regarding discretionary and non-discretionary management follows the same guidance provided for the wider GIPS standards and is based on client imposed investment restrictions.

*Revision: None.*

## 10. General Comments

Comment: *The provisions and guidance should include a sample presentation that satisfies all of the requirements. (UKIPC)*

**Revision:** *Include a sample presentation.*

Comment: *We believe the industry could benefit from further guidance on return calculations on a gross and net basis. We believe there is inconsistency in the industry concerning how gross and net returns should be calculated. (UBS)*

The IPC has adopted provisions and guidance for the treatment of fees, which address the issue of consistency and provide standard terminology for the industry. The Fees provisions and guidance can be found at [www.aimr.org/standards](http://www.aimr.org/standards).

**Revision:** *None.*

Comment: *The verification section should be modified to reflect the additional responsibilities that verifiers must test based on the new provisions. (NSFA)*

This comment will be passed to the Verification Subcommittee of the IPC, who is currently working to modify the Verification Section of GIPS to incorporate several new sections of GIPS.

**Revision:** *None.*

Comment: *To the extent that real estate can be accommodated within the GIPS design, we believe it should be treated and reported on as much like other assets as possible. Thus, we believe that the Proposed Section 6 should be rejected in its entirety, and that the sole instance where real estate cannot satisfy the letter of GIPS as written be inserted alongside the relevant paragraph. (RREEF)*

While the IPC agrees that the real estate asset class should be accommodated within the GIPS standards as much as possible, asset categories such as real estate and private equity are by necessity treated differently within GIPS – especially with regard to valuation sources and methods and disclosure elements.

**Revision:** *None.*

Comment: *RICS would strongly support the IPC referring to International Valuation Standards in the GIPS Real Estate Provisions, as the international valuation standard which is supported by RICS and the vast majority of the world's leading valuation associations. We confirm that the RICS is revising its standards to adopt unequivocally the IVS definition of Market Value, and is actively promoting its adoption. (RICS)*

**Revision:** *None.*

*Comment: The proposal should include a requirement for private equity real estate assets to provide both TWRR and IRR calculations, as there is benefit to both calculations. (Anon2, PwC)*

While firms are not prohibited from showing both time-weighted rate of return (TWRR) and internal rate of return (IRR) calculations, the IPC believes the TWRR is the most appropriate return to present prospective clients when showing a composite return. However, the IPC will add a recommendation to show a since inception- IRR (SI-IRR) for each period.

***Revision: Add a recommendation for firms to present SI-IRR returns.***

*Comment: The comment that the GIPS carve-out provisions be applied when a portfolio contains a mixture of private equity real estate and other investments that are not equity real estate is likely to result in confusion in application unless additional guidance is provided. How, for example, should a composite that contains an account that invests in public real estate securities, private real estate operating companies, fixed rate mortgages and participating mortgages (each without separate cash allocations) present the performance results? Should a sub-composite carve-out be created that contains the performance results of just the public real estate securities and fixed rate mortgages from the account? Should four return columns be presented in the main composite for the real estate income and appreciation returns, the total non-real estate return and the total composite return? Additionally, how should this account's presentation be addressed beginning January 1, 2005, when GIPS requires that carve-out returns not be included in single asset class composite returns unless the carve-outs are actually managed separately with their own cash allocations? (PwC)*

The IPC is working to finalize separate guidance regarding the use of carve-out segments of multiple-asset portfolios – to review the proposed version, visit the AIMR Website at [http://www.aimr.org/pdf/standards/carve\\_outs.pdf](http://www.aimr.org/pdf/standards/carve_outs.pdf) .

***Revision: None.***

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*Effective Date: 1 January 2005*  
*Retroactive Application: No*  
*Public Comment Period: Jul – Dec 2002*

## **INVESTMENT PERFORMANCE COUNCIL (IPC)**

### **Real Estate Provisions for the GIPS® Standards**

*Note: Pages 1-3 represent new provisions being added to the GIPS standards. Capitalized terms are defined in the Glossary (pages 5-6).*

## **6. Real Estate**

### *Introduction*

The following provisions apply to all Private Equity Real Estate where returns are primarily from the holding, trading, development, or management of real estate assets. Real estate includes land, buildings under development, completed buildings, and other structures or improvements held for investment purposes. The rules apply regardless of the level of control the firm has over management of the investment. The rules apply irrespective of whether a real estate asset or investment is producing revenue and also apply to real estate investments with leverage or gearing.

Investment types not considered as real estate and therefore addressed elsewhere in the general provisions of GIPS include:

- Publicly traded real estate securities including any listed securities issued by public companies,
- Commercial mortgage backed securities (CMBS),
- Private debt investments including commercial and residential loans where the expected return is solely related to contractual interest rates without any participation in the economic performance of the underlying real estate.

If a portfolio includes a mix of Private Equity Real Estate and other investments that are not equity real estate, then these requirements and recommendations only apply to the Private Equity Real Estate portion of the portfolio and the GIPS carve-out provisions (Sec II.3.A.7.) must also be applied.

### **6.A. Requirements**

Following are provisions that apply to the calculation and presentation of real estate assets. The real estate provisions supplement all of the required and recommended elements of GIPS

(outlined in Section II.1. through Section II.5.), except where the real estate provisions override the existing GIPS provisions for valuation.

### **Input Data Requirements**

- 6.A.1. Real estate investments must be valued at Market Value at least once every twelve months. For periods beginning January 1, 2008, real estate investments must be valued at least quarterly. (See GIPS Section II.1.A.2. for portfolio valuation requirement.)
- 6.A.2. Real estate investments must be Externally Valued by a Professionally Designated, Certified, or Licensed Valuer/Appraiser at least once every thirty-six months. (Thus, the first External Valuation must be completed no later than December 31, 2007. Firms are encouraged to complete an External Valuation sooner than 2007.) External Valuations must be completed pursuant to the valuation standards of the local governing appraisal body. In markets where there are no valuation standards or where there are no Professionally Designated, Certified, or Licensed Valuer/Appraisers are not available and valuers or appraisers from other countries bearing such credentials do not commonly operate, then the party responsible for engaging such services locally shall take necessary steps to ensure that only well-qualified property valuers are utilized.

### **Disclosure Requirements**

- 6.A.3. In addition to the other disclosure requirements of GIPS, performance presentations for Private Equity Real Estate investments must disclose:
- a. The calculation methodology for component returns (i.e., component returns are 1) calculated separately using chain-linked time weighted returns, or 2) adjusted such that the sum of the Income Return and the Capital Return is equal to the Total Return),
  - b. The firm's description<sup>1</sup> of discretion,
  - c. The valuation methods and procedures (e.g., discounted cash flow valuation model, capitalized income approach, sales comparison approach, the valuation of debt payable in determining the value of leveraged real estate, etc.),
  - d. The range of performance returns for the individual accounts in the composite,
  - e. The source of the valuation (whether valued by an external valuer, internally prepared, or whether values are obtained from a third party investment Manager) for each period,
  - f. The asset-weighted percent of total Market Value of composite total real estate assets valued by an External Valuation for each period, and

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<sup>1</sup> A description may be more abbreviated than the full definition, but should include all salient features.

- g. The frequency of valuation by external valuers.

### **Presentation and Reporting Requirements**

- 6.A.4 The Income and Capital Appreciation component returns must be presented in addition to Total Return.

### **Input Data Recommendations**

- 6.B.1. Real estate investments should be valued at least quarterly.
- 6.B.2. Real estate investments should be valued by an external valuer or appraiser at least once every twelve months.
- 6.B.3. If calculating and presenting Internal Rate of Return performance measures, firms should use quarterly cash flow aggregations at a minimum.

### **Disclosures Recommendations**

- 6.B.4. If Since Inception-Internal Rate of Return (SI-IRR) performance results are shown, firms should disclose the time period that is covered as well as the frequency of the cash flows used in the calculation.

### **Presentation and Reporting Recommendations**

- 6.B.5. The Income and Capital Appreciation component returns of the appropriate real estate benchmark should be presented when available.
- 6.B.6. Firms are recommended to present the Since Inception-Internal Rate of Return (SI-IRR) for the composite.
- 6.B.7. The following items are recommended to be presented, especially in those circumstances when the investment Manager has the ability to control the timing of investor capital call tranches during the real estate fund's or portfolio's initial acquisition period:
  - a. Gross- and Net-Of-Fees (including incentive allocations) annualized since inception Time-Weighted Rate of Return and Internal Rate of Return (**terminal value based on ending Market Value of the composite's net assets**) to the last year reported for the composite.
  - b. Gross- and Net-Of-Fees (including incentive allocations) annualized since inception Time-Weighted Rate of Return and Internal Rate of Return (**based on realized cash flows only, excluding unrealized gains**) to the last year reported for the composite.
  - c. In addition, other performance measures may provide additional useful information for both prospective and existing investors. The GIPS Private Equity Provisions

provide guidance with regard to such additional performance measures, including, investment and realization multiples, and ratios relating to paid-in-capital.

## **GUIDELINES FOR DETERMINING THE PRESENCE OF DISCRETIONARY MANAGEMENT FOR REAL ESTATE**

The GIPS standards require that all fee paying discretionary portfolios be included in at least one composite, although the determination of discretion remains with the firm. The following guidelines are recommended to facilitate appropriate and consistent classification of real estate portfolios as discretionary or nondiscretionary.

### **DISCRETIONARY MANAGEMENT:**

Real estate portfolios are considered discretionary if the Manager has sole or primary responsibility for major investment decisions. Major decisions may include portfolio strategy, purchases, sales, investment structuring, financing, capital improvements, and operating budgets. Investors rarely delegate complete investment discretion to Managers for real estate investments, but in many cases the constraints imposed do not inhibit the Manager's investment policy or decision making to any significant extent. Therefore, the existence of client-imposed investment restrictions such as leverage limits or required client approval of major decisions does not preclude classification of a real estate portfolio as discretionary. Acceptance of primary responsibility by the Manager may be inferred if a portion of the Manager's compensation is tied to performance or the Manager's success is assessed based on comparison of the Manager's performance to a selected industry benchmark.

### **NONDISCRETIONARY:**

Real estate portfolios are considered nondiscretionary if client imposed investment limitations and restrictions hinder or prohibit application of the Manager's desired investment strategy. As an example, taxable clients may prohibit or significantly limit repositioning of their portfolios through active sales in order to minimize capital gains taxes. Alternatively, clients may mandate liquidation of their portfolios at a time when the Manager believes pricing is not optimal. Additionally, Managers may accept special assignments such as portfolios taken over from other Managers with mandates that are not consistent with their own investment strategy.

## REAL ESTATE GLOSSARY

- Capital Employed:*** The denominator of the return expressions, defined as the “weighted average equity” (weighted average capital) during the measurement period. Beginning capital is adjusted by weighting the cash flows (contributions and distributions) that occurred during the period.
- Capital Return:*** Typically computed as a percentage of the Capital Employed through the measurement period, it is the return that reflects the change in the Market Value of the real estate investments and cash/cash equivalent assets held throughout the measurement period (ending Market Value less beginning Market Value) adjusted for all capital expenditures (subtracted) and the net proceeds from sales (added). Synonyms: capital appreciation return, appreciation return.
- External Valuation:*** An assessment of Market Value performed by a third party who is a Professionally Designated, Certified, or Licensed Valuer/Appraiser. External Valuations must be completed pursuant to the valuation standards of the local governing appraisal body.
- Income Return:*** Typically computed as a percentage of the Capital Employed through the measurement period, it is the return that reflects investment income accrued on all assets (including cash and cash equivalents) during the measurement period net of all non-recoverable expenditures, interest expense on debt, and property taxes.
- Internal Valuation:*** The Manager's best estimate of Market Value based on the most current and accurate information reasonably available. An Internal Valuation should consider professional industry approaches to estimating value such as income (e.g., discounted cash flow and/or overall capitalization rate), sales comparison approach, cost approach, and a review of all significant events (both general market and asset specific) deemed to have a material impact on the investment's value. Prudent assumptions must be used, and the process must be applied consistently from period to period, except where a change would result in more accurate estimates of Market Value.
- Manager*** Anyone who has a direct interest via the ownership or management of the real estate assets.
- Market Value*** The most probable price which a property will command in a competitive and open market transaction under all conditions

requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

- a) Buyer and seller are typically motivated.
- b) Both parties are well informed or well advised, and each acting in what they consider their own best interests;
- c) A reasonable time is allowed for exposure in the open market;
- d) Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and,
- e) The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

**Private Equity  
Real Estate:**

Private Equity Real Estate Investments include:

- Wholly owned or partially owned properties,
- Commingled funds, property unit trusts and insurance company separate accounts,
- Unlisted, private placement securities issued by private real estate investment trusts (private REITs) and real estate operating companies (private REOCs), and
- Equity-oriented debt such as participating mortgage loans or any private interest in a property where some portion of return to the investor at the time of investment is related to the performance of the underlying real estate.

***Professionally Designated,  
Certified or Licensed  
Valuer/Appraiser:***

A Professionally Designated, Certified, or Licensed Valuer/Appraiser must be authorized by the professional or government body overseeing valuation standards in each country or state. In Europe, Canada and parts of southeast Asia, the predominant professional designation is that of the Royal Institution of Chartered Surveyors ("RICS"). In the United States, the professional designation is Member of the Appraisal Institute ("MAI"). In addition, each state regulates real estate appraisers and, based upon one's experience, body of work and test results, is then registered, licensed or certified.

***Total Return:***

The change in the Market Value of the portfolio, adjusted for all capital expenditures (subtracted), net proceeds from sales (added), and accrued investment income (added) during the measurement period, expressed as a percentage of the Capital Employed in the portfolio over the measurement period.