

RECAP *The Bottom Line*

Real Estate Commentary, Accounting and Performance

(Previously known as *The Bottom Line—Real Estate Performance*)

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TID “BIPS”

1% Public Comments: Accounting for Investment Companies Scope Project due 3/31/03
http://www.aicpa.org/members/div/acctstd/edo/021217_sop_invest.htm

2% Public Comments: Venture Capital & Private Equity GIPS Provisions due 3/31/03
http://www.aimr.org/pdf/standards/venture_capital.pdf

3% NCREIF Board approves REIS Standards re-draft in March 2003. Submitted to PREA and NAREIM for approval.

4% GIPS Real Estate Provisions public comments being reviewed. Document is anticipated to be finalized in the later part of the year.

5% Retail Properties posted stellar total returns in 2002; 21% per the NAREIT—retail composite of publicly traded equity REITs, and in excess of 30% un-leveraged property returns per selected NCREIF retail sub-indices.

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IRRs and Fund Ratings	Jun '02
TWRs vs. IRRs, Return Calculations	Feb '02

Accounting & Performance—A Mixed Basket of Fruit?

Real Estate investing comes in many different varieties. From an investor perspective, there are institutions, high net worth, mom & pop and foreign investors. From an investment vehicle perspective, there are publicly traded entities, private commingled funds, joint ventures, and direct ownership. From an asset class perspective there are equity, debt and hybrid investments. From an investment objective perspective there are core, value-enhanced, opportunistic and international strategies. From a property type perspective there are traditional (office, retail, industrial, apartments, etc) and non-traditional (parking garages, timberland, farmland, etc) investments.

With all these different perspectives, how does one report the underlying real estate investments on a consistent and “apples to

apples” basis? Should we have a one-size fits all solution or are specialized standards required for different investors and investment vehicles? Do investors care what the underlying accounting basis is, or are they just concerned with performance? But how do you measure and

standards consistent? Is the data accurate and timely to make such comparisons?

In the September 2002 issue of *The Bottom Line – Real Estate Performance* we discussed the evolving financial reporting standards in the areas of valuation, accounting and performance measurement.

The Real Estate Information Standards (REIS), published by the National Council of Real Estate Investment Fiduciaries (NCREIF), Pension Real Estate Association, and

the National Association of Real Estate Investment Managers, were recently re-drafted, approved by the NCREIF Board and are expected to be approved by the others shortly. This works well for reporting to existing tax-exempt institutional investors of core operating properties. The proposed Real Estate Provisions of the Global In-

Should we have a one-size fits all solution for real estate investments or are specialized standards required for different investors and investment vehicles?

Investment Vehicle	Basis of Accounting
Investment Companies	Fair / Market Value
Operating Companies	Historical Cost
REITS - publicly traded	Historical Cost
Closed-end Funds	Fair / Market Value, Historical Cost, Income Tax
Open-end Funds	Fair / Market Value
Direct Ownership	Fair / Market Value, Historical Cost, Income Tax
Foreign Entities	International Accounting Standards, Local GAAP

compare performance of public vehicles to private vehicles, or core stable operating properties to opportunistic development properties? What measures should be used; income, free cash flow, appreciation, total return, time-weighted returns (TWR), dollar-weighted returns (IRR), return multiples, etc? Are the stan-

vestment Performance Standards are anticipated to be released in 2003/2004. This works well for reporting an investment managers historical performance track record to prospective investors of all asset classes. On a broader scale, the Securities and Exchange Commission and the Financial Accounting Standards Board (FASB), which promulgates U.S. Generally Accepted Accounting Principles (GAAP), are planting the seeds for future changes in accounting, auditing and reporting in general. Specifically, the Accounting Standards Executive Committee of the AICPA issued an exposure draft (available for public comment until March 31, 2003), which could result in certain entities having to change their current basis of reporting.

There's a lot at stake for the entire real estate industry! Staying abreast is challenging and at times confusing. If you step back and look at the big picture, you might find some interesting trends. It doesn't matter whether it's stocks, bonds, real estate or widgets, public or private, internal or external, everyone wants information -- more, better, simpler, and faster.

It doesn't matter whether it's stocks, bonds, real estate or widgets, public or private, internal or external, everyone wants information -- more, better, simpler, and faster.

As you may know, NCREIF requires data contributing members to supply property financial information by the 20th of the month following quarter-end to produce the NCREIF Property Index (NPI) by the 25th. They may move up the deadline to the 15th. Why? Investors, tax-exempt institutions in particular, need it earlier to compare their investment results across asset classes and to make better, timely asset allocation decisions. This is a huge change from

are? In general, transactions and investment vehicle structures have become more complex over the years. Some believe this is the result of increased pressures on earnings / returns which have lead to creative accounting and performance measurement techniques that "game" the rules. As a result, industry standards in general are moving from a "rules-based" to a more "principles-based" model. The driving forces behind all the standards seem to be consistency, disclosure and comparability -- presenting information so that both prospective and existing users can compare performance of their investments on an equal basis.

Investment Companies (Guide) provides guidance for entities using fair value-based reporting. While REIS uses this Guide as part of its support for real estate market value reporting, it has adopted certain practices that may differ from those described, primarily because the Guide does not adequately address the reporting needs of institutional tax-exempt investors. There are differences of opinion as to where market value accounting prescribed by REIS fits in. Is the supporting authority from the FASB? Is it a generally accepted standard based on prevalent industry practices, or is it a non-GAAP, other comprehensive basis of accounting?

But which entities are required to follow the Guide? Real estate operating entities, many of which are publicly-traded REITs, typically have internal management and employees, an infinite life, and no restrictions in terms of investor qualifications or the magnitude of dollars invested. Real estate investment entities, many of which are privately-held, typically have external management, no employees, and are traded based on net asset value or are finite life vehicles. Generally, operating entities follow Historical-Cost GAAP and investment entities follow the Guide using Value-Based GAAP.

Investor/Owner	Basis of Accounting
Banks	Historical Cost
Developers	Income Tax, Historical Cost, Cash
Foreign Investors	Local GAAP, International Accounting Standards
Government	Government Accounting Standards
High Net Worth	Historical Cost, Income Tax, Fair / Market Value
Insurance Companies	Historical Cost, Statutory
Lenders	Historical Cost
Mom & Pop	Income Tax, Historical Cost, Cash
Pension Funds	Fair / Market Value

But it's hard to compare when the standards of reporting are different. In the public markets where open market prices and trades are

the not so long ago days when NCREIF required data by the 30th and published the NPI by the 45th day following quarter-end. The SEC is also accelerating reporting deadlines from 45 to 35 days for 10-Q's and 90 to 60 days for 10-K's, phased-in through December 31, 2005. Of course, public entities performance is based on stock prices which are determined daily.

How did we get where we

commonplace, the underlying accounting information is primarily historical cost. In private markets, where values are subjective and transactions are few and far between, the underlying accounting information varies from value-based (fair or market value) to historical cost to tax and/or cash basis of accounting, largely dependent upon the particular investors needs.

The AICPA Audit and Accounting Guide *Audits of*

Similar challenges exist with performance measurement. In public markets, the time-weighted return is the standard. In private markets, it varies. Based on existing AIMR / GIPS standards and proposed provisions, venture capital and private equity use the IRR, along with other performance multiples and ratios, as they argue the manager has more control of the timing of cash flows and therefore should be held accountable for such timing (see February 2002 article for differences between the TWR and IRR). In real estate, the TWR is used in all cases, while the IRR is used in certain circumstances. The TWR works well for core stabilized properties and the IRR works well for development and other opportunistic type investments. The Guide requires the TWR as part of a funds' "Financial Highlights". Yet the IRR is most widely used for pricing, acquisition and performance fee hurdles.

So what does this all mean? At this stage I don't think anyone really knows for sure. It seems that comparability and disclosure are key, but yet it's difficult across and within asset classes, advisors, and products. No one standard

can satisfy everyone, and there appears to be overlap with each. For example, AIMR / GIPS primary focus is perform-

Investment Vehicle	Performance Measure
Public Equity Securities	TWR
Private Equity Real Estate Open-end Funds	TWR
Private Equity Real Estate Opportunity Closed-end Funds	IRR, TWR
Venture Capital & Private Equity Funds	IRR, Return Multiples, Ratios
Compare Manager Performance	TWR
True Investor Performance	IRR
Incentive Fee Hurdles	IRR

ance reporting to prospective investors in all asset classes. The standards for the underlying drivers of performance, accounting and valuation, are governed by other authoritative bodies. The accounting standards were discussed above in detail. The *Uniform Standards of Professional Appraisal Practice* (USPAP) are the generally accepted standards for professional appraisal practices in North America. USPAP contains standards for all types of appraisal services. Standards are included for real estate, personal property, business and mass appraisal. These standards; however, may not fully address the increasing need to value more than just the real estate asset. There appears to be a growing need to value an investors' investment interest, which would include the real estate, financing, and any other

assets or liabilities that may be part of an investor's interest.

On a global basis, consistent and comparable standards are even more challenging. There are wide ranges of practice in accounting, valuation and performance measurement. Industry organizations, are however, trying to bridge the gap, as is evident by the International Accounting Standards Board, the International Valuation Standards Committee and the Global Investment Performance Standards.

Regardless of the standards, what is clear is that we are moving to more transparency, more reliability, more timely and more meaningful information. We must all therefore focus on four critical aspects; 1) data quality (industry standards, relevancy, accuracy and transparency), 2) people (experience, creativity, and judgment), 3) process (efficiency and timely), and 4) technology (warehousing, analyzing and reporting). Whether your company is large or small, high tech or low tech, an advisor or investor, you can't ignore anyone of these areas. Now is

the time to start re-inventing your business reporting model. But where do you begin?

Ask 5 professionals and you'll probably get 10 different answers! You first need a vision and a plan. Brainstorm with key individuals across all disciplines. Talk to the users and look at reports. Get involved in industry organizations. Do research, look at what your competitors are doing. Determine what's important (and it isn't everything!). Don't just focus on financial data. Also look at non-financial data such as strategy, risks, markets, etc. Look at the underlying data, where it comes from and how it is processed. Present a plan and a timeline. Establish short-term (quick wins), mid and long-term goals. Show the costs and the benefits. Get support from senior management. Prioritize tasks. Allocate resources. Provide incentives to get the job done. Work as a team. Communicate. Communicate. Communicate. Monitor progress. Maintain resolve and continually improve.

A special thanks to Amber Degnan, John Baczewski and Jeff Kiley for their help with this article.

Now is the time to start re-inventing your business reporting model.

Did You Know That...

Retail properties had the best total return in 2002?

The NCREIF Property Index (NPI) is a before advisory fee index that includes both leveraged and un-leveraged properties, but returns are calculated on a un-leveraged (free and clear) basis?

The NCREIF Property Index has over 1,000 sub-Indices by Region, Division, Property Type, Sub-type, and MSA?

NCREIF is in the process of developing a Fund Level Database that is anticipated to be available at the end of 2003?

The NCREIF Timberland and Farmland Indices posted an annualized 10.14% and 7.6% total return, respectively, over the past 10 years?

CALPER'S (California Public Employees Retirement System) Single Family Housing Program earned an annualized 23.3% total return (IRR) after advisory fees over the past 10 years?

Equity Office Properties, Equity Residential and recently, American Investment and Management Co., REITs are included in the S&P 500?

NCREIF Index / Sub-Index Name (unless noted otherwise)	Current YR	December 31, 2002		Prior YR	3 YR	5 YR	10 YR	High	Low
		Count	Market Value						
Retail Regional Mall West	30.3%	10	677,066,621	6.0%	15.3%	14.2%	10.3%	30.3%	2.7%
Retail Mountain	21.1%	38	2,069,913,310	5.4%	11.2%	10.6%	8.8%	21.1%	5.0%
NAREIT - Retail	21.1%	Public Equity REIT Index		30.4%	Not Available				
Retail Super-Regional Mall West	21.1%	11	2,909,626,293	7.5%	12.0%	11.2%	7.3%	21.1%	-2.0%
Retail West	19.4%	161	7,253,134,950	8.6%	12.5%	12.4%	9.1%	19.4%	2.2%
Retail Neighborhood Mountain	19.3%	17	270,063,338	10.2%	13.5%	12.1%	8.0%	19.3%	-4.3%
Retail Power Center	18.2%	20	888,486,445	8.5%	12.2%	11.6%	#N/A	18.2%	8.5%
Retail Pacific	17.7%	123	5,183,221,640	10.5%	13.0%	13.0%	9.3%	17.7%	1.7%
NAREIT - Industrial	17.3%	Public Equity REIT Index		7.4%	Not Available				
Retail Regional Mall	16.6%	42	4,970,374,381	4.2%	9.5%	10.1%	7.9%	16.6%	3.7%
Retail Community Mountain	15.7%	10	342,321,424	10.8%	12.5%	12.3%	11.1%	15.7%	7.4%
Retail Community Northeast	15.7%	10	487,893,467	3.5%	8.4%	9.5%	8.1%	15.7%	2.0%
Retail Super-Regional Mall	14.6%	36	8,050,677,798	4.8%	8.4%	9.0%	6.7%	14.6%	1.8%
Retail Neighborhood Southeast	14.1%	44	569,098,667	9.4%	11.4%	12.1%	9.8%	16.5%	1.2%
Retail Community West	13.9%	49	1,735,456,461	11.2%	11.8%	12.3%	9.7%	13.9%	3.5%
Retail Neighborhood West	13.8%	57	1,066,954,337	10.6%	11.7%	12.7%	9.2%	14.4%	3.7%
Retail	13.7%	546	23,369,905,199	6.7%	9.4%	10.1%	7.8%	13.7%	4.0%
Retail Neighborhood South	13.6%	62	872,492,394	9.5%	11.1%	12.7%	11.7%	19.9%	9.5%
Retail Community East	13.4%	30	1,096,577,194	6.3%	8.9%	9.7%	7.1%	13.4%	1.5%
Retail Community Pacific	13.4%	39	1,393,135,037	11.3%	11.6%	12.3%	9.5%	13.8%	3.1%
Retail Regional Mall East	13.3%	13	2,538,642,081	4.3%	7.6%	8.5%	7.1%	13.7%	2.7%
Retail Neighborhood	13.2%	205	3,253,945,463	10.0%	11.3%	12.5%	10.2%	16.3%	6.9%
Retail Southwest	13.1%	58	2,156,716,544	7.1%	8.9%	10.6%	7.2%	14.2%	0.2%
Retail Neighborhood Northeast	12.9%	18	398,542,040	11.2%	#N/A	#N/A	#N/A	12.9%	11.2%
Retail Neighborhood Southwest	12.7%	18	303,393,727	9.7%	10.3%	13.9%	13.5%	25.3%	8.7%
Retail Mideast	12.4%	91	3,085,977,744	4.7%	7.7%	9.1%	6.7%	12.4%	3.1%
Retail Neighborhood East	12.1%	62	1,010,109,074	9.5%	11.7%	11.7%	10.0%	14.9%	-0.8%
Retail Neighborhood Mideast	11.8%	44	611,567,034	7.6%	12.9%	12.9%	9.9%	19.5%	-1.3%
Retail Community	11.8%	166	5,289,118,197	8.9%	9.8%	10.9%	8.9%	12.7%	4.4%
Retail East	11.8%	139	6,568,176,143	5.3%	7.8%	8.7%	6.9%	11.8%	2.4%
Retail Community Mideast	11.7%	20	608,683,727	8.7%	9.4%	9.8%	6.4%	12.6%	-0.3%
Retail Neighborhood Midwest	11.6%	24	304,389,658	9.6%	10.2%	10.0%	9.0%	11.9%	4.9%
Retail Northeast	11.4%	48	3,482,198,399	5.8%	7.8%	8.3%	6.9%	12.3%	1.4%
Retail Neighborhood Pacific	11.2%	40	796,890,999	10.9%	10.8%	12.5%	9.4%	16.2%	3.6%
Retail Neighborhood East North Central	10.6%	17	196,792,930	5.7%	7.0%	7.7%	7.6%	11.3%	4.2%
Retail East North Central	10.5%	61	3,531,190,047	3.6%	6.9%	7.5%	6.7%	10.5%	3.2%
Retail Midwest	10.3%	87	4,328,997,280	4.4%	7.3%	7.9%	7.1%	10.3%	3.9%
Retail South	10.2%	159	5,219,596,826	7.7%	8.3%	10.2%	7.7%	16.6%	3.7%
Retail Community Southwest	10.0%	19	580,919,110	8.4%	9.1%	11.3%	10.4%	15.4%	7.2%
Retail Community South	9.9%	54	1,508,935,774	8.6%	9.0%	11.0%	9.4%	15.0%	6.7%
Retail Community Southeast	9.9%	35	928,016,664	8.8%	9.1%	10.9%	8.8%	15.5%	3.6%
Retail Regional Mall Northeast	9.9%	10	1,575,342,081	5.4%	8.8%	9.1%	7.8%	16.2%	1.6%
Retail West North Central	9.5%	26	797,807,233	7.6%	8.8%	9.6%	8.5%	11.0%	5.5%
Retail Community East North Central	9.3%	21	675,653,081	7.2%	8.0%	8.7%	8.3%	12.5%	5.2%
Retail Regional Mall South	9.1%	10	895,802,593	1.6%	5.2%	5.8%	4.3%	12.2%	-1.2%
Retail Community Midwest	9.1%	33	948,148,768	8.5%	8.8%	9.3%	8.7%	11.6%	5.9%
Apartments	8.8%	783	23,469,102,265	9.4%	10.4%	11.4%	11.4%	14.1%	8.7%
Retail Super-Regional Mall East	8.6%	11	1,697,461,091	4.2%	6.2%	7.6%	6.1%	11.7%	3.2%
Retail Community West North Central	8.5%	12	272,495,687	11.0%	10.3%	10.6%	9.8%	12.5%	7.6%
Retail Southeast	8.3%	101	3,062,880,282	8.1%	7.9%	10.0%	7.9%	18.1%	4.2%
Hotels	7.6%	61	2,797,877,939	-3.6%	3.7%	7.8%	12.4%	30.5%	-3.6%
NCREIF Property Index	6.7%	3,680	121,965,061,509	7.3%	8.7%	10.7%	9.3%	16.2%	1.4%
Industrial	6.7%	1,173	23,257,829,112	9.3%	10.0%	11.5%	10.5%	15.9%	-0.8%
NAREIT - Equity REIT Composite	3.8%	Public Equity REIT Index		13.9%	14.3%	3.3%	10.5%	35.3%	-17.5%
Office	2.8%	1,117	49,070,346,994	6.2%	7.6%	10.8%	9.1%	19.6%	-3.9%
NAREIT - Hotels	-1.5%	Public Equity REIT Index		-8.6%	Not Available				
NAREIT - Apartments	-6.2%	Public Equity REIT Index		8.7%	Not Available				
NAREIT - Office	-6.3%	Public Equity REIT Index		6.7%	Not Available				
Dow Jones Industrial Average	-16.8%	Public Equity Index		-7.1%	-10.1%	1.1%	9.7%	33.5%	-16.8%
S&P 500	-23.4%	Public Equity Index		-13.0%	-15.7%	-1.9%	7.3%	34.1%	-23.4%

Notes to Performance Returns: NCREIF Returns are total return, property level, before advisory fee, presented on a time-weighted annualized (geometric average) basis. All NCREIF Retail Sub-indices are presented except 16 sub-indices with total returns ranging from 31.4% to 8.4% containing less than 10 properties as of 12/31/02. The high and low returns are based on annual returns for periods with available data. All public equity indices represent total returns based on stock price changes and dividends (assuming re-investment). Private market total returns are based on fair-value income and appreciation as determined by property valuations.

Data Sources: NCREIF, NAREIT, Dow Jones and S&P. Return Calculations & Analysis: Real Estate Insights.

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Value Added Services

*Project Assistance/
Management,
Consulting, Outsourcing
and Training
Accounting, Reporting,
Systems, Process
Improvements, Performance
Measurement, Analysis,
Benchmarking, Marketing,
Research, and Due Diligence*

Dear Real Estate Professional:

I hope you find **RECAP-The Bottom Line** informative, useful and entertaining. If there are subject matters you would like me to address, or if you would like to contribute to future newsletters, advertise, or if you have feedback, please don't hesitate to contact me.

Are your resources stretched? Do you need assistance with recurring work or special projects? I can provide help in many aspects of the business, including new product development, research, marketing strategies/RFP's, merger and acquisitions, property due diligence, operations/process improvements, financial reporting/analysis, performance measurement, benchmarking, systems/spreadsheets, training, and industry compliance — just to mention a few! My area of expertise is performance measurement, reporting and analysis. I'm an active member of the AIMR/GIPS Real Estate Sub-Committee and the NCREIF Performance Measurement and Education Committees.

I will provide your team with new perspectives, creative ideas, and solutions to problems. My background, skills, experiences, and representative assignments are highlighted below. I look forward to helping you achieve your goals.

Best regards,

Joe D' Alessandro, CPA

Representative Assignments

Policies and Procedures

Established internal policies framework for an advisory firm's Investment Committee to comply with operating agreements and fiduciary standards, including flowcharting key processes and decision making.

Accounting and Reporting

Created first time executive summary and detail annual budget / business plan and quarterly internal and external reporting templates.

Training and Marketing

Educated finance, operations, and marketing groups about institutional investor reporting, industry organizations and standards, and performance measurement and benchmarking.

System Design

Assisted business and technology personnel with a system design project to calculate and analyze performance returns.

Compliance

Performed reviews of back office operations to ensure compliance with industry standards and recommended process efficiencies.

Research

Analyzed public pension plan investment profiles, including investment allocations, guidelines, historical performance, portfolio composition and advisor selections.

Resume

15+ years experience

*Active member of AIMR / GIPS Real Estate Sub-Committee,
NCREIF Performance Measurement / Education Committees*

Diversity

Internal / external reporting, technology, budgeting, tax, audit, marketing, treasury, project management

Expertise

Performance measurement, benchmarking, process efficiencies, system design, strategic planning

Leadership

Visionary, people oriented, motivator, team player, mentor

Skills

Creative, resourceful, problem solver, proactive, enthusiastic

Training

Institutional Investor Reporting, Rate of Return Theory
Performance Returns Workbook Seminar
Performance Measurement Nuts & Bolts
AIMR / GIPS Compliance, Data Collection & Reporting
Excel Tips and Tricks

Results

Founded a strategic performance reporting department, implemented a critical ERP business intelligence performance return system project, chaired the leading industry performance measurement committee