

Private Real Estate in DC: Ten Key Principles Recommended for Daily Valuation of Private Equity Real Estate Investments

Overall Goals of the Valuation Process: Transparency, High Integrity, Objectivity and Consistency

<p>Third-Party Appraisal of Each Asset, Performed at Least Annually</p>	<p>Each property should be appraised <u>at least annually</u> by an external, independent appraiser. Appraisals should be signed by an appraiser holding the Appraisal Institute’s MAI designation (or equivalent in non-U.S. markets) and prepared in accordance with the Appraisal Foundation’s Uniform Standards of Professional Appraisal Practice (“USPAP”). For non-U.S. assets, International Valuation Standards (“IVS”) or other accepted standards should be followed.</p>
<p>Objectivity of Valuation Process</p>	<p>In order to maintain independence and objectivity in the appraisal process, valuation oversight should be provided by an established, independent real estate valuation firm (“Valuation Consultant” or “Valuation Manager”).</p>
<p>The Valuation Process Should Incorporate a Procedure to Recognize Material Events on a Timely Basis</p>	<p>The Valuation Process should provide for the recognition of unexpected property specific events and/or market events that may occur and that are estimated to have an impact on value. A Fund should report these events to the Valuation Manager or appraiser so that they can assess whether the event may impact the value of a specific asset (or assets), which in turn could have a material impact on the net asset value of the Fund. Examples of property level events that may trigger an adjustment to the projected cash flow or value include unanticipated new leases, tenant abandonment, or unexpected changes in expenses or capital costs. Examples of market events or capital market events may include recent market sales evidencing a shift in investor required returns, or macroeconomic events. Such events may result in an immediate value change for the asset.</p>
<p>Current Accepted Daily Valuation Practices</p>	<p>In addition to periodic appraisals and having systems in place to provide for the timely recognition of Material Events, current industry practices have incorporated two primary concepts for capturing a daily value for a fund’s private equity real estate: 1) the daily accrual of net</p>

	<p>income; and 2) intra-quarter value adjustments to appraised property values. The processes for the daily accrual of net income consider the following: (a) a fund’s actual/budgeted income and expenses, and (b) daily monitoring of changes that occur to the actual/budgeted income and expenses based upon material property level or market events. The processes for intra-quarter value adjustments consider one or more of the following: (a) quarter-end value estimate based upon factual anticipated cash flows and property specific events for all assets; (b) quarter-end value estimates based upon known and reasonably estimated changes for all assets as they occur throughout the quarter; (c) a rolling portfolio monthly appraisal process that incorporates property-level appraisals as they are completed; and/or, (d) daily incorporation of property level or market events which could materially impact property capital values as they occur.</p>
<p>Transparent Valuation Policies and Procedures that are Verifiable and Consistently Applied</p>	<p>A daily valuation process should have documented policies and procedures which should be (a) applied in a consistent manner and (b) reviewed and updated periodically (at least annually) through an established process. The methods used and data sources should be verifiable in an audit.</p>
<p>Information Technology Infrastructure</p>	<p>A typical best practice is to use a technology-based data management system operated internally by the fund manager or by a third party (a) to control the flow of valuation data, (b) for distribution and storage of appraisal reports, (c) for communication of appraisal review comments, and (d) to enable easy interactive access to the reports and data by the fund manager and Valuation Manager.</p>
<p>Property Level Debt Valuation</p>	<p>There are a number of accepted methods of property level debt valuation currently in practice – using either a fair value methodology (“mark-to-market”) or a face value methodology. The methods follow GAAP and FASB guidance. However, NCREIF and others are working now to bring more consistency and refinement to the debt valuation methods, and guidance is expected in late 2016. Whichever method is used, the procedures should be well documented and consistently applied.</p>

<p>Valuation of Partnership Interests</p>	<p>Funds may co-invest in property through a joint venture with a partner or fund where the ownership is in the form of a partnership interest. Hypothetical sale methodology is typically employed in valuing real estate partnership interests for fair value financial reporting purposes. This methodology assumes a sale of the real estate asset as of the measurement date and allocates that value to the various partnership interests per the terms in the partnership agreement. The process and reporting of the valuation of partnership interests should be in accordance with GAAP and partnership law.</p>
<p>Valuation of Other Assets and Liabilities</p>	<p>Valuation of other fund assets and liabilities like cash, debt investments and derivatives should follow GAAP convention. Guidance for specialized assets/liabilities can also be found in the PREA-NCREIF Reporting Standards.</p>
<p>Clear Internal Roles and Accountability in Valuation Process</p>	<p>All parties involved in valuation – internal valuation staff, asset management, portfolio management, property and fund accounting – should have specific responsibilities for monitoring properties and for ensuring that any material changes are communicated internally and approved by the Valuation Manager.</p>
<p>Existing Resources Commonly Used and Reviewed:</p> <ul style="list-style-type: none"> • Reporting Standards, Handbook Volume I and II, sponsored by the National Council of Real Estate Investment Fiduciaries (NCREIF) and the Pension Real Estate Association (PREA) • FASB Accounting Standards Codification under Topic 820, Fair Value Measurements and Disclosures • The Uniform Standards of Professional Appraisal Practice (USPAP), published by the Appraisal Foundation 	