

REIS EXPOSURE DRAFT

Proposed Revisions to REIS for Debt Liability Valuation - Issued by the Real Estate Information Standards Council in Conjunction with the Real Estate Information Standards Board

July 7, 2010

Comment Deadline: September 7, 2010

Interested parties wishing to comment on this Exposure Draft must do so in writing by September 7, 2010. Interested parties should submit their comments by e-mail to Marybeth Kronenwetter, REIS Administrator (marybeth@reisus.org).

An electronic copy of this document will remain on the REIS web site until the REIS Board issues the final Adopting Release related to this project. In addition, upon expiration of the public comment period (September 7, 2010) all comments received will be posted on the REIS web site (www.reisus.org) and remain on the web site until the Adopting Release is issued.

Table of Contents

| Section | | Page |
|----------------|--|-------------|
| 1 | Executive Summary | 3 |
| 2 | Background Information, Basis for Conclusions, and Alternatives Considered | 9 |
| 3 | Questions for Consideration by Respondents | 13 |
| 4 | Proposed Real Estate Information Standards changes including appendices | 16 |

1 - Executive Summary

Purpose

01. The purpose of this Exposure Draft is to:

1. Enhance the REIS standards with expanded disclosure requirements around the valuation of debt liabilities (“debt”) within the Fund Report ⁽¹⁾.
2. Introduce the concept of REIS Net Asset Value (REIS NAV) – a separate required calculation of Fair Value NAV to be included in the Fund Report.
3. Modify the REIS standards to maintain a requirement to value debt on open-end funds and change the debt valuation requirement for closed-end funds and separate accounts to a recommendation.

These changes were deemed necessary in order to:

1. Keep the REIS Standards current and to supplement changes made by Foundational Standards Bodies ⁽²⁾ that lacked specific guidance for the real estate industry (i.e. U.S. GAAP (GAAP) for accounting).
2. Maintain REIS position that all debt should be valued while acknowledging the optionality under existing GAAP by shifting the requirement outside the financial statements as described above.
3. Continue to promote and enhance compliance and verifiability of the REIS Standards.

The targeted effective date of the changes would be for Fund Reports issued for periods beginning after December 15, 2010 (i.e., 2011 reporting).

Background

02. In August, 2008, the REIS Council assembled a task force to address whether or not the requirement to value all debt liabilities was appropriate for all fund structures (i.e., open and closed-end funds and single investor investment accounts). The task force [surveyed](#) ⁽³⁾ the industry and concluded that the valuation of debt should remain a REIS requirement for open-end funds but should change from a requirement to a recommendation for closed-end funds and single investor investment accounts. The task force also concluded that expanded disclosures should be required in the audited financial statements in order to provide audit assurance and further transparency surrounding divergent debt valuation practices. Before

(1) Definition of Fund Report in the Fund Reporting Standards (Chapter 4): ... as used herein, the term “Fund” includes all commingled funds and single investor investment accounts. The term “Report” is intended to include the entire quarterly or annual reporting package submitted to Fund investors.

(2) Foundational Standard Bodies are various regulatory, industry, or professional bodies with differing levels of standard-setting authority. Within the REIS Standards, U.S. GAAP, USPAP (Uniform Standards of Professional Appraisal Practice) and GIPS (Global Investment Performance Standards) are the Foundational Standards.

(3) The survey included 24 Plan Sponsors representing approximately \$150 billion in U.S. Real Estate Private Equity Investments and 32 investment management firms representing \$239 billion (NAV) in U.S. Real Estate Private Equity Investments

commencing the process to change the REIS standard, the survey participants asked for industry clarification on “how” to value debt.

03. In January, 2009, the REIS Council assembled another task force to address the aforementioned “how” to value debt issue. The task force discovered divergence in debt valuation practices (e.g., gross method, net method, no valuation). The REIS Council directed the task force to prepare a guidance document which would narrow industry practices with respect to the differing debt valuation perspectives without indication of preferred methodology. The guidance [document](#) *ASC Topic 820 Implementation Guidance for Real Estate Investments* was issued in the third quarter of 2009. In addition to a discussion of the different perspectives, the guidance document provided suggestions for some expanded disclosures and performance attribution analysis that could be helpful to the reader of the Fund Report.
04. In December, 2009, the REIS Council hosted an industry [webinar](#) to discuss the findings of the two task forces and poll the participants ⁽⁴⁾ as to their positions on pertinent, related topics. The answers to polling questions within the webinar reaffirmed the divergence in debt valuation methodologies used by industry participants. In addition, webinar participants were supportive of expanded disclosure requirements.
05. In March, 2010, the REIS Council approved a proposal to evaluate whether modifications to the debt valuation standard within REIS are warranted. During its April meeting, the REIS Board approved a prospectus to form a task force to prepare an exposure draft to enhance the REIS standards with expanded disclosure requirements and performance attribution analysis surrounding the valuation. The expanded disclosures include, but are not limited to: identification of the methodology selected for debt valuation (gross, net or none); an explanation of the valuation process and key valuation assumptions. The Task Force determined that attribution analysis was too broad of an issue to address within the scope of these revisions, but that it should be addressed by a more focused task force at a later date.
06. In addition to enhanced disclosures the Board agreed that the exposure draft would address the industry’s desire to change the REIS standard from a requirement for all funds to value all debt to one which would maintain the existing requirement for all open-end funds to value debt, but would change from required to recommended debt valuation for closed-end funds and single investor investment accounts.
07. During the course of its deliberations, the task force charged with drafting this exposure draft concluded that although the proposed expanded financial statement disclosures would provide further clarity surrounding debt valuation policies, procedures, and results (see paragraph 06 above), REIS needed to facilitate comparability and transparency through the development of a REIS NAV within the Fund Report, which is considered a non-GAAP measure of net asset value. This reconciliation begins with an auditable starting point (i.e.

(4) The approximate 170+ webinar participants were comprised of representatives from plan sponsors, consultants, investment managers and academia from the real estate industry.

GAAP NAV) and ends with a fully valued NAV (i.e. REIS NAV). The results allow for the option to value debt either within GAAP fair value financial statements or in another section of the Fund Report.

The proposed revisions to REIS were made in order to: i) provide increased comparability and transparency of information among and across Funds; ii) foster increased compliance with the REIS standards; and iii) provide a mechanism to accommodate the flexibility provided for in GAAP with respect to debt valuation (i.e. ASC 825: Financial Instruments). In addition, The Fund Reporting Standards (Chapter 4) include required and recommended standards which intend to promote comparability of results when measuring the impact of valuing debt on net asset value.

Proposed Changes to REIS

Fair Value Accounting Chapter (Accounting Chapter) and Fair Value Accounting Policy Manual (Manual)

08. The current Fair Value Accounting Chapter and Manual includes several references to the requirement to value all debt in the financial statements on the investment or fund (hereafter referred to collectively as “the investment”). The practice of valuing debt and recording the effects within the net asset value of the investment has been a wholly required practice within REIS regardless of investment strategy or product type.
09. It had come to the attention of the REIS Council and Board that some Funds, particularly closed-end funds and single investor investment accounts, had not elected the Fair Value Option for notes payable (effective for reporting periods beginning after 12/15/07) as required within the REIS Standards. The Fair Value Option is a one-time election made on an instrument by instrument basis.
10. The proposed changes to REIS which are contemplated within this exposure draft would allow for the owner of the financial statements prepared for closed-end funds and single investor investment accounts to choose whether to record debt at fair value in the financial statements. The proposed changes do not remove the requirement to record debt at fair value for open-end funds.
11. The proposed changes related to the issue surrounding the election can be found in the following sections:
 - a. Chapter 2: Fair Value Accounting Standards – Section 2.02
 - b. Fair Value Accounting Policy Manual – Table of contents for “Fund Level Accounting”
 - c. Fair Value Accounting Policy Manual – Section 2.03 (b)
 - d. Fair Value Accounting Policy Manual – Section 2.04 (c)
 - e. Fair Value Accounting Policy Manual – Section 3.09 (a)

- f. Fair Value Accounting Policy Manual – Section 4.04 (c)
 - g. Fair Value Accounting Policy Manual – Section 4.05 (a) & (b)
12. The proposed changes related to the issue of expanded disclosures within the financial statements can be found in the following sections:
- a. Chapter 2: Fair Value Accounting Standards – Section 2.02
 - b. Chapter 4: Fund Reporting Standards – Section 4.17
 - c. Fair Value Accounting Policy Manual Appendix 1: Illustrative Financial Statements for Operating Reporting Model – Consolidated Statement of Operations
 - d. Fair Value Accounting Policy Manual Appendix 1: Illustrative Financial Statements for Operating Reporting Model – Consolidated Statements of Changes in Net Assets
 - e. Fair Value Accounting Policy Manual Appendix 1: Illustrative Financial Statements for Operating Reporting Model – Example disclosures
 - f. Fair Value Accounting Policy Manual Appendix 1: Illustrative Financial Statements for Non -Operating Reporting Model – Example disclosures

Fund Reporting Standards Chapter and REIS NAV (Appendix 5)

13. All Funds would be required to report debt at value in the Fund Report within the REIS NAV reconciliation (see appendix 5 added to REIS). The task forces concluded, based on the survey and webinar polling mentioned above, that debt valuation is important information which must be reported within the Fund report (but not necessarily within the financial statements). The REIS NAV would allow for:
- a. Disclosure of critical, comparable information to users of Fund reports and as requested by industry participants;
 - b. The optionality to choose to value debt which is currently provided within GAAP; and
 - c. Increased compliance with the REIS standards for investors who may have been previously precluded from compliance because the Fair Value Option was not exercised.
14. The additions to REIS related to the reconciliation of GAAP NAV to REIS NAV can be found in the following sections:
- a. REIS Chapter 4 – Added required element in “Fund Reporting Standards” chart
 - b. REIS Chapter 4 – Added section 4.17
 - c. Added Appendix 5 in its entirety (the appendix has been included in its entirety on the following page)

**Appendix 5 - Reconciliation from GAAP NAV to
REIS NAV**

| | <u>Amount</u> | <u>Per Share</u> |
|--|------------------------------|------------------------|
| NAV per GAAP Financial Statements | \$ 100,000,000 | \$ 40.00 |
| Asset value adjustments | | |
| Adjustment for equity method joint venture assets carried at cost on the balance sheet: | | |
| Carrying value (at share) | \$ 15,000,000 | |
| Fair value (at share) | <u>17,500,000</u> | 2,500,000 |
| | | 1.00 |
| Liability value adjustments | | |
| Liabilities on wholly-owned investments currently carried at cost on the balance sheet: | | |
| Carrying value (at share) | 16,250,000 | |
| Fair value (at share) | <u>15,000,000</u> | 1,250,000 |
| | | 0.50 |
| Adjustment for equity method joint venture liabilities carried at cost on the balance sheet: | | |
| Carrying value (at share) | 7,250,000 | |
| Fair value (at share) | <u>7,500,000</u> | (250,000) |
| | | (0.10) |
| Portfolio-level liability adjustments | | |
| Portfolio-level liabilities currently carried at cost on the balance sheet: | | |
| Carrying value | 10,000,000 | |
| Fair value | <u>\$ 9,500,000</u> | 500,000 |
| | | 0.20 |
| Other value considerations not contemplated in the GAAP financial statements | | |
| Partner specific value (e.g. contractual, tenant, relationship) | | 120,000 |
| | | 0.05 |
| REIS NAV (all assets and liabilities at fair value) | <u>\$ 104,120,000</u> | <u>\$ 41.65</u> |

Notes:

- The Fund did not have access to the requisite information necessary to calculate the value of certain investments and liabilities. These assets are known to be carried on a basis other than fair value. The carrying value of these assets was \$xx,xxx for the period ending June 30, 2009. The carrying value of these liabilities was \$xx,xxx for the period ending June 30, 2009.
- The Account/Fund did not have access to the information necessary to calculate the value of some of the unconsolidated joint venture investments accounted for under the equity method. The net carrying value of these investments was \$xx,xxx for the period ending June 30, 2009.

Sample Disclaimer:

The Fund adopted REIS NAV, as defined by REIS, for computing net asset value because management believes that, subject to the following limitations, REIS NAV provides a basis for comparing our performance and operations to those of open-end funds, other closed-end funds and single investor investment accounts. REIS NAV is not intended as an alternative to "GAAP Net Asset Value" as an indicator of our performance or to "Cash Flows from Operating Activities" as determined by GAAP as a measure of our capacity to pay distributions. The estimated fair values of the assets and liabilities may vary significantly from the prices at which such assets and liabilities would sell or transfer, since market prices can only be determined by negotiation between a willing buyer and seller. Therefore, the amounts ultimately realized from the disposition of the assets and liabilities within the Fund may vary significantly from the REIS NAV presented.

Other Proposed changes to REIS Materials

15. The proposed changes to REIS are intended to update only those sections and subsections devoted to the valuation of debt. However, there are some miscellaneous conforming changes that were made in order to make sure REIS is current with respect to recent industry updates (e.g. FASB codification of FAS 167 to ASC 810).

Request for Feedback

16. The REIS Council and Board are requesting feedback with respect to the notion of debt valuation being required only in the case of open-end funds and recommended in all other cases. The REIS Council is also requesting feedback as to whether the proposed recommended practices in tandem with the additional required disclosures within Chapter 4 are an appropriate alternative approach to reporting value information. Finally, the REIS Council and Board are requesting feedback as to whether the changes to the standards will promote industry compliance and verifiability.

2 - Background Information, Basis for Conclusions, and Alternatives Considered

01. As described in the Executive Summary, the process of proposing these changes to REIS did not come without a significant amount of thought, industry consensus, and consideration for the multiple points of view prevalent in our industry. Underlying all of the debate of the theories governing the fair value of debt, are the existing principles (both accounting and other investor reporting) under which the real estate industry currently reports its net asset value. The consistency, comparability, and verifiability of those principles have always been of paramount concern to the industry and in many cases accounting rules and regulations seem to move in a contradictory fashion to that goal. Moving to a verifiable set of consistent, comparable and transparent standards will remain a goal of REIS and the proposed changes in this exposure draft are intended to bring the industry closer to that goal despite the fact that existing authoritative literature is rarely industry specific.
02. After the task forces (see Executive Summary) dedicated to the project had fully vetted the current requirement to value debt within the REIS standards, the conclusions drawn were determined to be an acceptable *balance* between promoting compliance and verifiability and maintaining consistency in industry practices. While reviewing this document, it should be recognized that the industry still remains divergent in its approach to carrying debt at fair value, but the proposed changes described herein are a compromise among investors, consultants, and investment managers as to the perceived best (or palatable) approach to achieving consistency, comparability, and verifiability.

The bases for the proposed changes are as follows:

03. The issuance of the Fair Value Option (effective for reporting periods beginning after 12/15/07) highlighted the divergence in industry practice surrounding whether debt should be valued. Prior to the issuance of the Fair Value Option, the REIS Standard had required all debt to be valued, *unless precluded by GAAP*. Once the Fair Value Option was issued, there was no longer preclusion from reporting debt at value within GAAP and a conforming change was made to REIS to require election of the Fair Value Option. Subsequently, it came to the attention of the REIS Board and Council that the REIS standard requiring election of the Fair Value Option was not being followed uniformly. This exposure draft serves to revisit the applicability of the REIS standard with respect to recording debt at fair value.
04. As industry specific guidance relating to debt valuation is not available within the REIS Foundational Standards (i.e. GAAP), the Task Force has concluded that irrespective of the determination that debt should or should not be valued, the industry would benefit from additional disclosures surrounding this issue within the financial statements and through the requirement to report REIS NAV.

05. As noted below, there are two prevailing viewpoints on the requirement to elect the Fair Value Option within the REIS standards.

- a. Maintain existing standard. Supporters of this view argue that fair value financial statements should carry all assets and liabilities at fair value. To treat them differently would suggest the financial statements are not holistically presented at fair value. REIS had always required debt to be carried at fair value (unless precluded by GAAP); the issuance of the Fair Value Option stood to support that conclusion. By remaining consistent with the standard, compliance with REIS promotes consistency, comparability and measurability in the financial statements related to the valuation of debt. In addition, supporters of this view point out that the comparability of key performance measures being reported under the REIS standards (e.g., time-weighted returns, internal rates of return, investment multiples, etc.), which use fair value GAAP NAV within the calculation, would lack comparability. Therefore, to change the standard would only move in the direction of less clarity, comparability, consistency, and measurability for users of the reported information.
- b. Optionality for closed-end funds and single investor investment accounts. Supporters of this view argue that the owner of the financial statements should have the ability to exercise the Fair Value Option or not. Not only can an unqualified opinion be received on fair value financial statements that do not value debt, but the investment manager is the best representative of the investors and they should have the choice on presentation. The attempt by REIS to increase compliance failed because the standards have been more stringent than what was required within GAAP (i.e., a requirement in REIS vs. an *option* within GAAP). It is further argued that this lack of compliance is also the driver for a lack of comparability. Evidence suggests this prescriptive approach in REIS has stood to lessen compliance and therefore, would lessen traction within the industry to support REIS. Finally, REIS represents industry standards and the industry has requested optionality – a viable alternative in GAAP. Financial statement and other fund reporting disclosures should supplement the reported information and not affect the financial results.

06. The Task Forces dedicated to the preparation of this exposure draft generated a third and final perspective which constituted a compromise between those who would recommend a change to the REIS standard and those who opposed it. The REIS Council and Board are requesting feedback on this perspective through this exposure draft.

- a. Regardless of approach, the Task Forces concluded that expanded financial statement disclosures were critical. As deliberations continued, the Task Forces noted that the disclosures available within the confines of GAAP were insufficient to provide the necessary information for investors to assess the value of debt in the financial statements.

- b. Those who support optionality were unable to find an allowable approach under GAAP that provided all the necessary information requested by investors. GAAP does not allow for the preparer to disclose or reconcile (as is suggested with the REIS NAV) to what could be construed as an “alternate” NAV to the one reported in the financial statements.
 - c. Investors were generally supportive of external calculations of the measurement of effects of valuing debt as long as the information allowed them to assess the effect of those adjustments on the NAV as presented within the financial statements. Since investors were not getting detailed information necessary to assess the effect of valuing debt in the financial statements, compliance through non-GAAP related reporting was viewed as an acceptable alternative in achieving the goal. Furthermore, investment managers who support GAAP optionality could now comply with REIS via the proposed REIS NAV calculation (see Appendix 5). Where GAAP NAV is the equivalent calculation of REIS NAV, no reconciliation would be required. If there is no need to perform a reconciliation, the investor report must indicate that GAAP NAV is the equivalent of REIS NAV in order to verify that the calculation was considered.
07. This exposure draft proposes a requirement within the REIS Standards for a reconciliation of GAAP Net Asset Value to REIS Net Asset Value.
- a. The fundamental premise for requiring reconciliation of GAAP NAV to REIS NAV is the need for such information to be available to fair market value reporting entities (e.g., ERISA plans) who are investors in various structures of real estate investment vehicles (i.e. open-end funds, closed-end funds, and single investor investment account vehicles). Several of these investors have standard reporting requirements that dictate debt be recorded at fair value and therefore, are required to obtain this data as part of their audit process.
 - b. GAAP will not allow for the presentation of multiple NAVs within the financial statements. By providing a mechanism to reconcile GAAP NAV to REIS NAV, REIS could maintain the spirit of the original standard of fair value reporting of debt in REIS, but allow for the GAAP option desired by many of the financial statement owners. The use of a non-GAAP measure and its corresponding reconciliation, is similar to other real estate companies that have adopted the NAREIT FFO measurement.
 - c. This result described in (b.) was especially important for funds that could no longer elect to fair value their debt because the deadline for the one-time election (as provided for in the Fair Value Option) had passed; hence precluding REIS compliance for those funds.

- d. The Board and the Council recognized that the data necessary to value debt can be valuable to specific investors who represent a large portion of the market capital invested in commercial real estate. This debt valuation information can be applied to more than just financial reporting purposes (e.g. risk management, leverage effectiveness). As a result, a *required* reconciliation approach, to provide that information to those who might require it, was deemed a necessary compromise between investor needs and GAAP limitations.
 - e. The Task Force assumed that although there is no current requirement to reconcile GAAP NAV to REIS NAV, the data necessary to complete this reconciliation is readily available via existing standards within GAAP and REIS and therefore, could be completed with a modest amount of additional effort.
 - f. Finally, in the spirit of continuing towards the path of industry convergence with other international reporting organizations, the reconciliation format suggested would be somewhat similar to one already recommended by the INREV NAV; also a non-GAAP measure of net asset value (INREV is the European Association for Investors in Non-listed Real Estate Vehicles). As investors continue to invest across borders, standardization of these requirements and recommendations make consistent investor reporting an obtainable goal.
08. The Task Force resolved that the REIS guiding principles to provide transparent, consistent, comparable and compliant information in Fund Reports would not be compromised by the changes proposed within this exposure draft. Moreover, these changes would serve to enhance understanding of diverging practices by:
- a. Requiring expanded disclosures for all funds within the financial statements
 - b. Requiring debt valuation in open-end funds where the industry already fully supported the notion and recommending, but not requiring debt valuation for closed-end funds and single investor investment accounts.
 - c. Requiring all funds to reconcile GAAP NAV to REIS NAV in the Fund Report (essentially reporting the impact on NAV had the Fund recorded debt at fair value) to accommodate investor needs for that information and foster comparability between funds.

3 - Questions for Consideration by Respondents

General Information for Respondents

01. Members of NCREIF and PREA, and other interested parties are encouraged to send written comments on all matters proposed in the Exposure Draft. Comments are requested from those who agree with the proposed changes and those who do not agree. Comments are most helpful if the section and paragraph numbers are referenced within the response. (e.g., 3.01 for this paragraph). Respondents should explain their answers where they feel further clarification is needed and where the exposure draft requests an explanation. Finally, respondents should suggest alternative approaches, supported by specific reasoning where deemed necessary.

02. The standard:

Current (Chapter 2 paragraph .02): *“In order to be in compliance with the REIS Standards, the Fair Value Option under ASC 825-10 must be elected for all notes payable (including portfolio level debt).”*

Proposed: *“In order to be in compliance with the REIS Standards, the Fair Value Option under ASC 825-10 must be elected for all notes payable for open-end investment vehicles while such election is recommended for all notes payable within closed-end and single investor investment account investment vehicles.”*

The following questions, which reference specific paragraphs within REIS, are to be considered in your firm’s response to the Exposure Draft:

03. Do you think that the change to REIS described in §3.02 (above) is appropriate?
 Yes No

Please explain the reason(s) for your answer.

04. Do you think the proposed standard is appropriate for the Operating Model (The Operating Model is defined within Fair Value Accounting Standards)?
 Yes No

Please explain the reason(s) for your answer.

05. Do you think the proposed standard is appropriate for the Non-operating model (The Non-operating Model is defined within Fair Value Accounting Standards)?
 Yes No

Please explain the reason(s) for your answer.

06. The exposure draft proposed the following changes to the REIS Fund Accounting and Reporting Standards:

- a. Required enhanced financial statement disclosures (REIS Chapter 2.02 and Chapter 4.17)
- b. Required REIS NAV for Fund Reporting (REIS Chapter 4.18)

Do you agree that these changes to REIS should be made?

Yes No

If not, please explain why?

07. Do you agree that the form of the required REIS NAV reconciliation (shown on page 7 and also in Appendix 5) is acceptable?

Yes No

If not, what changes would you make?

08. It has been suggested that information necessary to calculate the proposed REIS NAV reconciliation is readily available to the preparers of financial statements.

- a. Do you agree that the information necessary to complete the reconciliation is readily available?

Yes No

Please comment and specifically provide some background as to the availability of data and information necessary to complete the reconciliation.

- b. Do you think that preparation of this reconciliation would require an amount of time/resources that would render it unfeasible for your firm?

Yes No

Please explain your answer.

09. Do you agree that the proposed changes to REIS promote compliance and verifiability of reporting within the institutional real estate investment industry?

Yes No

Please indicate why you do or do not agree in your response.

10. Will you prepare, or require the preparation of, the annual REIS NAV calculation in your fund reports?

Yes No

If no, please explain.

Do you think the calculation should be performed quarterly?

Yes No

11. What additional applications might there be for the REIS NAV calculation; including but not limited to performance measurement? Please provide commentary on why these applications would be helpful or not helpful.

12. Are there any other issues, suggestions, or comments you think need to be made with respect to this exposure draft that were not mentioned above?

4 - Proposed Real Estate Information Standards changes including appendices

Revisions List

(Since 2003. 2003 was the last comprehensive rewrite of REIS)

July 7, 2010 Proposed

Revisions to Chapter 2, Chapter 4, Appendix 1: Fair Value Accounting Manual and added Appendix 5 all with respect to the modification in the debt valuation standard

March 11, 2010

Revised Fair Value Accounting Policy Manual: appendix 1

December 8, 2009

Revised Chapter 2, Fair Value Accounting Standards

October 30, 2009

Added FASB codification cross reference to appendix 1,
REIS Fair Value Accounting Policy Manual

March 26, 2009

Revised Chapter 2, Fair Value Accounting Standards
Revised REIS Fair Value Accounting Policy Manual
Added REIS Guidance: Determining Investment Discretion
Added REIS Guidance: REIS Checklist

August 26, 2008

Added Chapter 4, Fund Reporting Standards

March 27, 2008

Revised Chapter 3, Performance Measurement and Reporting Standards

March 16, 2007

Revised REIS Market Value Accounting Policy Manual
Notes Payable, Section 3.03.

November 15, 2006

Revised Chapter 1, Property Valuation Standards

October 13, 2006

Added Glossary as Appendix 2

July 14, 2006

Revised Chapter 2, Accounting
Revised REIS Market Value Accounting Policy Manual

Table of Contents

| [Preface*](#)

| [Required and Recommended Practices*](#)

The Standards Chapters

- | 1. [Property Valuation Standards*](#)
- | 2. Fair Value Accounting Standards
- | 3. [Performance Measurement and Reporting Standards*](#)
- | 4. Fund Reporting Standards

Appendices: REIS Guidance

- | 1. REIS Fair Value Accounting Policy Manual
- | 2. [Glossary*](#)
- | 3. [Determining Investment Discretion*](#)
- | 4. REIS Checklist*
- | 5. [REIS NAV](#)

*Omitted for purposes of this exposure draft.

Chapter 2 - Fair Value Accounting Standards

| Table of Contents | Paragraph Numbers |
|--|--------------------------|
| Introduction | .01 |
| Required and Recommended Practices | .02 |
| History of Accounting Models for Tax-Exempt Investors | .03 |
| The REIS Fair Value Accounting Policy Manual | .04 |
| Effective Date | .05 |

Chapter 2: Fair Value Accounting Standards

Preface

2.01 Introduction

2.01(a) As noted in the Preface to the REIS Standards: The Standards incorporate by reference governance from its foundational standards¹ bodies, where applicable, to the institutional equity real estate investment management community (Industry). The REIS Standards provide guidance in specific areas where accounting standards are silent or subject to interpretation. Within the REIS Standards, GAAP is one such foundational standard. The REIS Standards do not contradict GAAP and **compliance with the REIS Standard for Accounting is predicated on compliance with GAAP**. Where options exist under GAAP, the REIS Standards aim to promote consistency and comparability. The purpose of the fair value accounting standards contained within this chapter of the REIS Standards is to provide current accounting standards and related guidance (in the form of required and recommended practices) that are useful to users and preparers of financial information and that can be complied with and subject to independent verification. These standards promote consistent, comparable, transparent, and verifiable financial information to the U.S. private, tax-exempt institutional real estate community. Therefore, this chapter is organized in sections and provides required and recommended accounting practices at three levels:

- **Fund:** To comply with the Chapter 4, Fund Reporting requirement for, at a minimum, quarterly Condensed Fair Value GAAP financial reporting (Section 4.13) and the annual requirement for Fair Value GAAP financial statements and footnotes (Section 4.14). In addition, Chapter 4 also recommends an annual audit (Section 4.14).
- **Investment:** To provide consistent detailed investment information generally contained in the footnotes to the financial statements as well as within performance measures, which require investment-specific disclosures.
- **Property:** To provide consistent accounting information across funds that is used in attribution analysis (e.g., Portfolio Characteristics per section 4.22 of Chapter 4), benchmark reporting, and reporting to the NCREIF Property Index (NPI).

2.02 Required and Recommended Practices

¹ As noted in the REIS Constitution, foundational standards are established standards from authorized bodies including but not limited to valuation standards established through Uniform Standards of Professional Appraisal Practice (USPAP), accounting standards established by accounting principles generally accepted in the United States of America (GAAP), and the performance measurement and reporting standards promulgated by the CFA Institute known as the Global Investment Performance Standards (GIPS).

Listed below are the required and recommended practices to be utilized for accounting information for each reporting period.

- GAAP Fair Value based financial statements are required at the Fund level of reporting.
- Election of the Fair Value Option for all debt is required at the Fund, Investment and Property level for open-end funds and recommended for closed-end funds and single investor investment accounts.

Comprehensive disclosures surrounding the valuation of debt are required. Disclosures about the practices around valuing debt must be clear and comprehensive. These disclosures should include, but not be limited to, the following:

- Which debt instruments are valued and which are not.
- The magnitude of the impact of not valuing certain instruments.

Please refer to the Fair Value Accounting Manual (Appendix 1) for some examples.

Note: As described within Chapter 2, the REIS Accounting Standards address two accounting models currently utilized in the industry for GAAP fair value based reporting: the Operating Reporting Model and the Non-Operating Reporting Model. Further under the Debt Valuation Guidance it is noted that depending on the reporting method used one might take differing views under GAAP with regard to valuing debt. The determination of the appropriate approach to valuing debt under each of the models is to be made by the entities management in consultation with the entities auditors.

2.03 History of Accounting Models for Tax-Exempt Investors

2.03(a) The fundamental premise for fair value accounting models is based on existing authoritative accounting standards, which require that certain investments held by tax-exempt investors, including defined benefit pension plans and endowments, be reported at fair value. For example, Statement of Financial Accounting Standard (SFAS) No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, which applies to corporate plans, requires that all plan investments be reported at fair value because that reporting provides the most relevant information about the resources of a plan and its present and future ability to pay benefits when due. In addition, Governmental Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, requires government-sponsored pension plans to present investments at fair value in their financial statements. Defined benefit and government-sponsored pension plans often invest in real estate and/or real estate companies. Accordingly, the more traditional historical cost basis of accounting used by other real estate companies, owners, and operators is not appropriate, as it does not provide tax-exempt investors with the financial information they require to comply with authoritative accounting standards.

2.03(b) In 1983, in response to the needs of the investor community, the NCREIF Accounting Committee developed guidelines for fair value accounting to be used by the institutional real estate investment industry. The fundamental premise for fair value based accounting models is based on existing U.S. accounting standards which require that certain investments held by tax-exempt investors, including defined benefit pension plans and endowments are reported at fair value. This model is supported by SFAS 35 and GASB 25 and is referred to throughout Chapter 2 of the REIS Standards as the **Operating Model**.

2.03(c) Over the years, investments made by fund managers have become increasingly complex and it has become apparent that many of these Funds have attributes similar to those of an “investment company,” as set forth in the AICPA Audit and Accounting Guide – *Audits of Investment Companies* (the “Investment Company Guide”). This authoritative guidance supports the use of a fair value accounting model for investment companies. Some Funds use this model as their Fair Value GAAP model for accounting and reporting. This accounting model is referred to throughout Chapter 2 of the REIS Standards as the **Non-Operating Model**.

2.03(d) At present, some funds use the Operating Model as their fair value reporting model and some funds use the Non-Operating Model. Varying interpretations of these two models exist. In addition, other fair value accounting models exist that are not referenced within this chapter. One such model is promulgated by the International Financial Reporting Standards (IFRS). Currently, the REIS Standards are applicable to Funds that are required to present U.S. Fair Value GAAP financial information only. **The determination of the appropriate model to be used by a Fund is made by fund management in consultation with their auditors.**

2.04 The REIS Fair Value Accounting Policy Manual

The REIS Fair Value Accounting Policy Manual (Appendix 1) provides additional guidance to support the required and recommended practices contained in this Chapter 2.

2.05 Effective Date

The effective date for implementation of this revised Chapter 2, Fair Value Accounting Standards is for quarters beginning after December 15, 2010.

Chapter 4 - Fund Reporting Standards

| Table of Contents | Paragraph Numbers |
|---|--------------------------|
| Introduction | .01 |
| Required and Recommended Elements-summary table | .03 |
| Effective Date | .04 |
| Required Elements | |
| Fund Overview | .05 |
| Key Fund Performance Summary | .10 |
| Financial Statements | .13 |
| Additional Required Elements for Closed-end Funds | .17 |
| Recommended Elements | |
| Additional Performance Elements | .20 |
| Characteristics | .22 |
| Investor Capital Accounts | .23 |
| Additional Recommended Elements for Closed-end Funds | .24 |
| Additional Recommended Elements for Open-end Funds | .32 |

Chapter 4-Fund Reporting Standards

Introduction

- .01 In order to promote consistency, comparability, and transparency of information within the private, tax-exempt institutional real estate investment industry in the United States, the development of REIS Fund Reporting Standards resulted from the realization that there should be a requirement to periodically disclose minimum specific information within a Fund Report that is relevant to the investor's decision-making process. The Valuation, Accounting and Performance Measurement Standards established within the REIS Standards describe the policies and practices required and recommended to facilitate analysis of the reported information. Contrasted with the disclosures referenced in the first three chapters of the REIS Standards, the Fund Reporting chapter provides a communication conduit which will promote consistency, comparability, and transparency of information as well as compliance and verifiability of these interdisciplinary standards.
- .02 As used herein, the term "Fund" includes all commingled funds and single investor investment accounts. The term "Report" is intended to include the entire quarterly or annual reporting package submitted to Fund investors. Examples of information typically included in the Report are: letter to investor(s); summary of Fund activities; Fund highlights; market information; performance summary; financial information and such other information which is deemed useful to users. In order for an individual Fund to be REIS compliant, the required elements listed in this Chapter 4 are to be included in a Fund's Report.

Required and Recommended Elements

- .03 For all Funds, the information in the following chart is to be disclosed in the Fund Report, no less frequently than indicated. Note: Items in **bold face** are for illustrative purposes only. (Numbers reference the paragraphs within Chapter 4.)

CHAPTER 4: FUND REPORTING STANDARDS

(Applicable for All Funds Unless Otherwise Noted)

| Element | Frequency | Chapter 4 Reference | |
|--|--|---------------------|----------------|
| REQUIRED ELEMENTS | | | |
| Fund Overview | Fund Name or Identifier | Quarterly | .05 |
| | Fund Contact | Quarterly | .06 |
| | Fund Inception Date | Quarterly | .07 |
| | Fund Structure | Annually | .08 |
| | Fund Style and Strategy | Annually | .09 |
| Key Fund Performance Summary | Fund Level Total Time-Weighted Return (TWR) gross and net of fees | Quarterly | .10 |
| | Benchmark Comparisons | Annually | .11 |
| | Net Asset Value | Quarterly | .12 |
| Financial Information | Condensed U.S. Fair Value (FV) GAAP based financial reporting (at a minimum) | Quarterly | .13 |
| | U.S. FV GAAP based financial statements and footnotes | Annually | .14 |
| | Schedule of Investments | Annually | .15 |
| | Valuation Policy Statement | Annually | .16 |
| | Required disclosures around debt valuation | Annually | .17 |
| | Reconciliation of GAAP NAV to REIS NAV | Annually | .18 |
| Additional Required Elements for Closed-End Funds | Since Inception Internal Rate of Return (IRR), gross and net of fees | Quarterly | .19 |
| | Final Fund Closing Date | Annually | .20 |
| | Fund Scheduled Termination Date | Annually | .21 |

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| <i>RECOMMENDED ELEMENTS</i> | | | |
|---|--|-----------|--------|
| Additional Performance Elements | Management discussion of performance relative to Fund objective | Quarterly | .22 |
| | Leverage Percentage | Quarterly | .23 |
| Characteristics | Portfolio Characteristics by: | | .24 |
| | Investment/Property Type | Quarterly | .24.a. |
| | Region/Location | Quarterly | .24.b. |
| | Nature of Investment (life cycle) | Quarterly | .24.c. |
| | Investment Structure | Quarterly | .24.d. |
| | | | |
| Investor Capital Accounts | Supplemental Schedule of Investor Capital Accounts | Annually | .25 |
| Additional Recommended Elements for Closed-End Funds | Aggregate Capital Commitments | Quarterly | .26 |
| | Aggregate Capital Received to Date | Quarterly | .27 |
| | Unfunded Commitments | Quarterly | .28 |
| | Distributions Since Inception | Quarterly | .29 |
| | Paid-In Capital Multiple | Quarterly | .30 |
| | Investment Multiple | Quarterly | .31 |
| | Realization Multiple | Quarterly | .32 |
| | Residual Multiple | Quarterly | .33 |
| Additional Recommended Elements for Open-End Funds | Fund level component TWR, gross and net of fees, current quarter calculated using the REIS Market Value Accounting Policy Manual | Quarterly | .34 |
| | Total Commitments | Quarterly | .35 |
| | Redemptions for quarter | Quarterly | .36 |
| | Total Redemption Requests | Quarterly | .37 |

Effective Date

- .04 The effective date for implementation of this revised Chapter 4, Fund Reporting Standards is for fiscal years beginning after December 15, 2010.

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REQUIRED ELEMENTS

Fund Overview

- .05 Fund Name or Identifier (*Quarterly*): The label used to identify the Fund. As used herein, the term “Fund” refers to all commingled funds and single investor investment accounts.
- .06 Fund Contact (*Quarterly*): The name of the person, or persons responsible for issues relating to Fund reporting matters. Frequently, this is the Fund’s Portfolio Manager.
- .07 Fund Inception Date (*Quarterly*): The date of the first significant operating, financing or investing activity into the Fund.
- .08 Fund Structure¹ (*Annually*):
- a. Commingled fund: A term applied to all open-end and closed-end pooled investment vehicles. A commingled fund may be organized as a group trust, partnership, corporation, insurance company separate account, or other multiple ownership entity.
 - i. Open-end: A commingled fund with an infinite life, which allows periodic entry and exit of investors, and typically engages in ongoing investment purchase and sale activities.
 - ii. Closed-end: A commingled fund with a stated maturity (termination) date, with few or no additional investors after the final initial closing of the fund. Closed-end funds typically purchase a portfolio of properties to hold for the duration of the fund and, as sales occur, typically do not reinvest the sales proceeds.
 - b. Single Investor Investment Account: Any investment account managed for the benefit of one investor. Single investor investment accounts may include either pools of assets owned by a single entity or individual assets owned by separate legal entities.
- .09 Fund Style and Strategy (*Annually*): In general, a description of Fund strategy includes the Fund’s plan for asset allocations taking into consideration goals, risk tolerance and holding period and includes, at a minimum, the investment style. The definitions provided below describe investment styles/strategies commonly used in the Industry. They have been abstracted from the NCREIF White Paper: [Real Estate Styles Whitepaper](#)¹. (This Whitepaper contains much more detailed information on the classification of funds by strategy and should be considered by managers in describing Fund strategy; however the fund strategy designation is the responsibility of the Fund’s management).

- a. Core: A portfolio that includes a preponderance of core attributes. As a whole, the portfolio will have low leasing exposure and low leverage. A low percentage of non-core assets is acceptable. As a result, such portfolios should achieve relatively high income returns and exhibit relatively low volatility.
- b. Value-added: A portfolio that generally includes a mix of core investments and non-core investments that will have less reliable income streams. The portfolio as a whole is likely to have moderate lease exposure and moderate leverage. As a result, such portfolios should achieve a significant portion of the return from appreciation and are expected to exhibit moderate volatility.
- c. Opportunistic: A portfolio of preponderantly non-core investments that is expected to derive most of its return from appreciation and/or which may exhibit significant volatility in returns. This may be due to a variety of characteristics such as exposure to development, significant leasing risk, high leverage, or a combination of moderate risk factors.

Key Fund Performance Summary

- .10 Fund-level Total Time-weighted return (TWR), gross and net of fees (*Quarterly*):_“Fund-level” is the aggregation of all of the investments made by the entity and the amounts earned or incurred which relate to the entity but are not specifically attributable to a particular investment.

“Time-weighted Return” is a calculation that computes period-by-period returns on an investment and removes the effects of external cash flows, which are generally investor-driven, and best reflects the firm’s ability to manage assets according to a specified strategy or objective. A return is calculated for each equal length period, usually on a quarterly basis for real estate. Returns are then linked to calculate a multi-period return. Each return over the period has an equal weighting; therefore, the timing of the return and the amount invested for a period have no impact on the multi-period return².

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For a single period, the “Total Time-weighted Return” is the sum of the quarterly net income (loss) return and the realized or unrealized valuation adjustment (appreciation or depreciation) return. For longer periods, it is the geometrically-linked total returns for the individual periods within the longer period².

“Gross returns” are before all investment advisory fees and incentive allocations, carried interests, promotes, etc. The Fund Report must clearly disclose what types of fees are deducted from the gross return to arrive at the net return (e.g., advisory fees, incentive fees, incentive allocations, carried interests, promotes, etc.).

“Net returns” are after all compensation to general partners and investment advisors including general partner priority distributions, investment advisory fees and incentive fees. The net of fees returns should be presented for all classes of investors. In situations where

fees are billed separately (outside of the Fund) and/or when different fee arrangements exist for investors within a Fund, the Fund report must include disclosure of the impact of these fees on total TWR, expressed, at a minimum as a basis points range.

- .11 **Benchmark Comparisons** (*Annually*): A benchmark is an independent rate of return (or hurdle rate) forming an objective test of the effective implementation of an investment strategy³. A benchmark should be verifiable, should be appropriate to the investment portfolio to which it is being compared and should have a similar period or vintage year to the investment portfolio under examination. In certain situations, benchmarks may not be stipulated by the Fund's manager. If a benchmark is stipulated it should be disclosed in the Fund report no less frequently than annually and appropriate comparisons of Fund performance to the benchmark should be described. If a benchmark is not stipulated, then the Fund must state that it does not have a stipulated benchmark.
- .12 **Net Asset Value (NAV)** (*Quarterly*): The fair value of real estate and all other assets less total liabilities.

Financial Statements

- .13 **Condensed Fair Value GAAP Based Financial Statements** (*Quarterly*): The condensed financial statements at a minimum must include: a Statement of Assets and Liabilities (which separates key components of assets and liabilities) or equivalent (e.g., Balance Sheet); a Statement of Operations or equivalent (e.g. Income Statement); Net Asset Value; the cumulative impact of debt valuation on the Net Asset Value; Key Valuation Assumptions for Debt Values; Contributions made to the Fund; and Distributions Paid from the Fund to Investors for each quarter presented. The reference to GAAP based fair value financial statements does not suggest that an entity must qualify under GAAP to report investments at fair value. This requirement can be satisfied using a Fund's primary financial statements or a combination of primary financial statements and supplemental financial information.
- .14 **U.S. Fair Value (GAAP Based) Financial Statements and Footnotes** (*Annually*): The Fund Report must contain comprehensive U.S. Fair Value GAAP based financial statements and footnotes that are prepared no less frequently than annually. The Fund report must provide a clear indication of the accounting model used to prepare such information. This requirement can be satisfied using a Fund's primary financial statements or a combination of primary financial statements and supplemental financial information. It is recommended that this information be audited annually and the audit opinion should accompany the Fund Report.
- .15 **Schedule of Investments** (*Annually*): The Schedule of Investments must separately disclose, at a minimum, the following information for all investments.
- Investment Name: The Fund's Identifier
 - Property Type: See Portfolio Characteristics (4.22)

- Investment Structure: See Portfolio Characteristics (4.22)
- Acquisition Date: The year or date acquired by the Fund
- Location: If practical, use City/State, Metropolitan Statistical Area (MSA), or Country if outside of the U.S. If the investment represents a diversified portfolio use Country/Region where the most significant portion of the investment is located.
- Size: Use square footage or other appropriate measure based upon the nature of the investment (ex. Number of rooms for hotels; acres for land)
- Fair Value as of Statement Date: The Fund's share of the fair market value of the investment as reported in the Fund's financial statements.

.16 Valuation Policy Statement (*Annually*): In addition to the required disclosures under GAAP surrounding Valuation Policy, the Fund Report must contain a statement that the Fund complies with the Property Valuation Standards described within Chapter 1 of REIS.

.17 Comprehensive disclosures surrounding the valuation of debt: All disclosures must be in compliance with requirements in section 2.02 of Chapter 2: Fair Value Accounting Standards.

.18 Reconciliation of GAAP Net Asset Value (*Annually*): Because REIS allows for the owner of the financial statements to elect not to value debt as per ASC 825: *Financial Instruments*, and some investors still require information on the value of that same debt, the Fund Report must include a measurement of that impact on the net asset value of the investment or Fund. Therefore, an annual reconciliation of GAAP net asset value to a net asset value at full value assuming the Fair Value Option had been elected (REIS NAV) must be provided to these investors. An example format is shown in appendix 5. If no reconciliation is required because both GAAP NAV and REIS NAV are equal, then this should be disclosed in the investor report to indicate that the reconciliation was considered and no adjustments were required.

Note: If under GAAP debt has been reported in the financial statements at its deemed to be fair value, such determination should not be changed for purposes of the reconciliation. An adjustment should only be made if a determination was not made to fair value debt in the financial statements.

Additional Required Elements for Closed-End Funds:

.19 Since-Inception Internal Rate of Return (IRR), gross and net of fees (*Quarterly*): The IRR is the annualized implied discount rate (effective compounded rate) that equates the present value of all of the appropriate cash inflows associated with an investment with the sum of the present value of all of the appropriate cash outflows accruing from it and the present value of the unrealized residual portfolio.

The Fund Report must disclose (a) the time period for the calculation, and (b) the frequency of the cash flows used in the calculation.

“Gross returns” are before all investment advisory fees and incentive allocations, carried interests, promotes, etc. The Fund Report must clearly disclose what types of fees are deducted from the gross return to arrive at the net return (e.g., advisory fees, incentive fees, incentive allocations, carried interests, promotes, etc.).

“Net returns” are after all compensation to general partners and investment advisors including general partner priority distributions, investment advisory fees and incentive fees. The net of fees returns should be presented for all classes of investors. In situations where fees are billed separately (outside of the Fund) and/or when different fee arrangements exist for investors within a Fund, the Fund report must include disclosure of the impact of these fees on IRR, expressed, at a minimum as a basis points range.

- .20 Final Fund Closing Date (*Annually*): The date of admittance of final investor(s) into the Fund.
- .21 Fund Scheduled Termination Date (*Annually*): The date the Fund is scheduled to liquidate, per the Fund’s legal documents.

RECOMMENDED ELEMENTS

Additional Performance Elements

- .22 Management Discussion of Performance Relative to Fund Objective (*Quarterly*): A summary discussion of the Fund's performance for the quarter including comparisons to established fund objectives and stated investment strategy, benchmarks, and parameters.
- .23 Leverage Percentage⁴ (*Quarterly*): Also known as the Debt to Assets Ratio, the Leverage Percentage indicates what proportion of debt an entity has relative to its assets. Used in conjunction with other measures of financial health, the leverage percentage can be one measure of an entity's level of risk. A leverage percentage greater than 100% indicates that the fair value of the debt exceeds the fair value of the assets. A leverage percentage of less than 100% indicates that the fair value of the assets exceeds the fair value of the debt. There are a variety of calculations that could represent Leverage Percentage. Two calculation methods are listed below.

Note: If a Leverage Percentage is presented within a Fund Report, the formula used to calculate the percentage must be disclosed.

UNCONSOLIDATED METHOD:

$$\text{Debt Percentage} = \frac{\text{Wholly Owned debt (property \& fund) + Fund's Economic Share of JV Debt}}{\text{Total Assets + Fund share of Total JV Liabilities}}$$

CONSOLIDATION:

$$\text{Debt Percentage} = \frac{\text{Wholly Owned debt (property \& fund) + Fund's Economic Share of JV Debt}}{\text{Total Assets - JV Partner Economic Share of RE Partnership Assets}}$$

Characteristics

- .24 Portfolio Characteristics (*Quarterly*): Calculated as a percentage, the value of real estate assets in each category divided by the total value of real estate investments. The basis for the calculation must be disclosed (gross real estate assets or net real estate assets).
- a. By Investment/Property Type⁵: Suggestions include those in the NCREIF Property Index (Office, Industrial, Retail, Apartment, and Hotel) in addition to Timberland and Agriculture, which NCREIF reports as separate indexes.

Other investment/property types might include:

Entertainment (e.g., theaters, golf courses, bowling alleys, restaurants, pubs, casinos)
Healthcare (e.g., hospitals and outpatient clinics)
Land
Manufactured housing (e.g., pre-manufactured housing complexes and mobile home facilities)
Parking
Self-Storage
Senior Living (e.g., Assisted Living, Skilled Nursing, etc.)
Condo conversion
Homebuilding
Infrastructure (e.g. Transport, Regulated Utilities, Communications; Social)
Medical Office
Mixed-use facilities

- b. By Region/location: NCREIF U.S. geographic divisions (Northeast, Mideast, East North Central, West North Central, Southeast, Southwest, Mountain, and Pacific). If a Fund includes non-U.S. investments, include country.
- c. By Nature of Investment (Life Cycle)⁵:
 - i. Forward Purchase Commitment: Fund's commitment to purchase at a pre-specified price when all conditions agreed to in the forward commitment agreement have been met (off-balance sheet).
 - ii. Pre-Development: Raw land or land undergoing property site development.
 - iii. Development: Property under construction, including preparation and installation of infrastructure.
 - iv. Initial Leasing: Completed construction that is less than 60% leased and which has been available for occupancy for less than one year.
 - v. Operating/stabilized: Completed construction that has achieved 60% leasing status since the end of construction or has been available for occupancy for more than one year.
 - vi. Repositioning/Redevelopment: A property that is undergoing significant capital intensive activities such as redevelopment or asset repositioning such as Class B to Class A. This classification can also be used for investment companies undergoing a transformation or repositioning.
- d. By Investment Structure: The investment structure is defined as one of the following: wholly-owned investments; joint ventures; bonds; senior debt; subordinated debt; mezzanine debt; participating mortgages; commercial mortgage-backed securities (CMBS); public real estate security; and private real estate operating company.

Investor Capital Accounts

- .25 Supplemental Schedule of Investor Capital Accounts (*Annually*): The statement of changes in members' equity/partner's capital or statements of changes in net assets included in the financial statements referred to in paragraph 4.14 are required by GAAP to present each class of investor (in the aggregate). A supplemental schedule of changes in individual investor capital accounts for the annual period is also recommended for non-unitized funds. (Unitized funds represents funds with units specifically called for in governing underlying legal or offering documents.) It is recommended that the supplemental schedule of changes in individual investor capital accounts accompany the U.S. Fair Value GAAP based financial statements. Hence, the audit opinion should make reference to such supplemental schedule and assess if the schedule is fairly stated in comparison to the primary financial statements taken as a whole⁶. It should be noted that individual investor names need not be included on the schedule. An account number or other general or generic identifier is satisfactory.

Additional Recommended Elements for Closed-End Funds

- .26 Aggregate Capital Commitments (*Quarterly*): The total amount committed to the Fund by the investors.
- .27 Aggregate Capital Received to Date (*Quarterly*): The total amount of investor capital received by the Fund as of the date of the Fund Report.
- .28 Aggregate Unfunded Commitments (*Quarterly*): As of the date of the Fund Report, Unfunded Commitments represent the difference between Aggregate Capital Commitments and Aggregate Capital Received to Date, increased by capital returned to investors which can be reinvested, if applicable.
- .29 Distributions Since Inception (*Quarterly*): The amount of Distributions Paid from the inception date of the Fund through the date of the Fund Report.
- .30 *Paid-In Capital Multiple* (*Quarterly*): The Paid-In Capital Multiple, also known as the paid-in capital to committed capital multiple (PIC), is computed as the Aggregate Capital Received to Date divided by the Aggregate Capital Commitments.
- .31 Investment Multiple (*Quarterly*): The Investment Multiple, also known as the Total Value to Paid-In Capital Multiple (TVPI), is computed as the sum of Distributions Paid since inception plus NAV at the measurement date, divided by the Fund's Aggregate Capital Received to Date.
- .32 Realization Multiple (*Quarterly*): The Realization Multiple, also known as the cumulative Distributions to Paid-In Capital multiple (DPI), is computed as the sum of Distributions Paid since inception divided by the Fund's Aggregate Capital Received to Date.

- .33 Residual Multiple (*Quarterly*): The Residual Multiple, also known as the Residual Value to Paid-In capital multiple (RVPI), is computed as the Fund's NAV at the measurement date divided by the Fund's Aggregate Capital Received to Date.

Additional Recommended Elements for Open-End Funds

- .34 Fund Level Component TWR (gross and net of fees) calculated using the REIS Market Value Accounting Policy Manual: (current quarter) (*Quarterly*): The Fund Report must provide disclosure of TWR for the applicable periods using data derived from the accounting methodology described in the REIS Market Value Accounting Policy Manual.
- .35 Total Commitments (*Quarterly*): The aggregate total dollar amount of contractual capital subscriptions not yet contributed to a Fund as of the reporting date. The Fund Report should indicate what portion of the amount reported is revocable.
- .36 Redemptions for Quarter (*Quarterly*): The aggregate amount paid to investor(s) exiting the Fund during the reporting period.
- .37 Total Redemption Requests (*Quarterly*): The aggregate total dollar amount of formal requests for redemption which have been received from investors to redeem out of a Fund but that have not been fulfilled as of the end of the reporting period. The Fund Report should indicate what portion of the amount reported is revocable.
- .38 *Footnotes to Disclosure Definitions*

Footnotes:

¹ NCREIF White Paper: Real Estate Investment Styles Whitepaper (Chicago: National Council of Real Estate Investment Fiduciaries, Oct. 2003).

² Real Estate Information Standards (REIS), Appendix 2, Glossary (Chicago: National Council of Real Estate Investment Fiduciaries, 16 Mar. 2007).

³ "Benchmark", Global Investment Performance Standards, February, 2005, Appendix E, Glossary of Terms.

⁴ "Debt Ratio," Investopedia, 18 Jul. 2007 <http://www.investopedia.com/terms/debtratio.rsp>.

⁵ NCREIF Data Contributor Manual (Chicago: National Council of Real Estate Investment Fiduciaries, 2006).

⁶ Statement of Auditing Standards No. 29, Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents (AU 551).

REIS GUIDANCE

REIS FAIR VALUE ACCOUNTING POLICY MANUAL

July 5, 2010

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Table of Contents

Paragraph Numbers

1. Introduction

| | |
|---|------|
| Purpose | 1.01 |
| Organization of Manual | 1.02 |
| Terminology | 1.03 |
| Fair Value | 1.04 |
| Relevant Accounting and Auditing Guidance | 1.05 |
| Disclaimers | 1.06 |

2. Fund Level Accounting

| | |
|--|---------|
| Introduction | 2.01 |
| Net Assets | 2.02 |
| Non-Operating Reporting Model | 2.03 |
| Introduction and Position within GAAP Hierarchy | 2.03(a) |
| Election of The Fair Value Option under ASC 825-10 | 2.03(b) |
| Consolidation and Applicability of ASC 810-10 | 2.03(c) |
| Operating Reporting Model | 2.04 |
| Introduction | 2.04(a) |
| Position within GAAP Hierarchy | 2.04(b) |
| Election of The Fair Value Option under ASC 825-10 | 2.04(c) |
| Consolidation: Applicability of ASC 810-10 | 2.04(d) |
| Consolidation: Accounting | 2.04(e) |
| Equity Method Accounting | 2.04(f) |

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3. Investment Level Accounting

| | |
|--|---------|
| Introduction | 3.01 |
| Investments in Mortgages and Other Loans: | |
| General Discussion | 3.02 |
| Accounting for Non-Participating Mortgage Loans Receivable | 3.03 |
| Accounting for Participating Mortgage Loans Receivable | 3.04 |
| Investments in Joint Ventures: General | 3.05 |
| Investments in Joint Ventures: Accounting | 3.06 |
| Accounting for Contingent Consideration | 3.07 |
| Financing Costs | 3.09 |
| Real Estate Advisory Fees | 3.10 |
| General | 3.10(a) |
| Acquisition Fees | 3.10(b) |
| Asset Management Fees | 3.10(c) |

| | |
|---|---------|
| Disposition Fees | 3.10(d) |
| Incentive Fees | 3.10(e) |
| 4. Property Level Accounting | |
| Introduction | 4.01 |
| Determination of Real Estate Fair Value | 4.02 |
| Determination of the Cost Basis of Real Estate Assets | 4.03 |
| Loans Payable | 4.04 |
| Direct Transaction Costs of Loans Payable | 4.05 |
| Derivative Financial Instruments | 4.06 |
| Other Assets and Liabilities | 4.07 |
| Receivables | 4.08 |
| Other Liabilities | 4.09 |
| Real Estate Revenues and Expenses | 4.10 |
| Realized and Unrealized Gains and Losses | 4.11 |

Appendices:

- 1. Illustrative Financial Statements for Operating Reporting Model**
- 2. Illustrative Financial Statements for Non-Operating Reporting Model**
- 3. Codification Cross Reference Guide**

REIS Fair Value Accounting Policy Manual

1. Introduction

1.01 Purpose

The purpose of the REIS Fair Value Accounting Policy Manual (Manual) is to provide additional guidance to support the required and recommended accounting practices within the REIS Standards. As noted in Chapter 2, Fair Value Generally Accepted Accounting Principles (FV GAAP) is the foundational standard for accounting. Therefore, the REIS Standard for Accounting does not contradict authoritative GAAP, and **compliance with the REIS Standard for Accounting is predicated on compliance with Fair Value GAAP based financial information.** Where applicable guidance is not specified within authoritative GAAP, non-authoritative guidance may be applied. The appropriateness of the sources of non-authoritative GAAP depends on its relevance to particular facts and circumstances, and the specificity of the guidance to the facts and circumstances. The lack of applicable authoritative accounting guidance specific to the institutional real estate investment industry has caused certain fair value accounting practices prevalent in the industry to constitute non-authoritative GAAP. These practices have been included in the Manual.

1.02 Organization of Manual

In addition to this introduction, this Manual has separate sections that address the three levels of accounting within Chapter 2: Fund Level, Investment Level, and Property Level. Included in the appendices are a comparison of the Operating Reporting Model and Non-Operating Reporting Model, and illustrative financial statements for both the Operating Reporting Model and Non-Operating Reporting Model.

1.03 Terminology

Certain terms as used herein are defined as follows:

- Fund: Includes all commingled funds and single-investor investment accounts; a fund has one or more investments
- Investment: A discrete asset or group of assets held for income, appreciation, or both and tracked separately
- Property: A real estate asset
- Financial Accounting Standards Board: FASB
- Accounting Standards Codification: ASC
- Accounting Standards Update: ASU
- Governmental Accounting Standards Board: GASB
- American Institute of Certified Public Accountants: AICPA
- Accounting principles generally accepted in the United States of America: U.S. GAAP or GAAP.

1.04 Fair Value

- 1.04(a) The REIS Standards require fair value financial information, and accordingly, certain information reported for Funds must be reported at fair value. Property and investment information may be maintained on a basis other than fair value (e.g., historical cost, tax basis, cash basis). This information must be converted to fair value for incorporation into the Fund Report. (See Chapter 4, Fund Level Reporting Standards for more information.)
- 1.04(b) Fair value as defined under ASC 820-10-20, *Fair Value Measurements and Disclosures*, is “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.” Accordingly, a primary condition of fair value accounting is that asset and liability carrying amounts, including unrealized gains and losses, would be realized by investors in an assumed transaction at the balance sheet date.

1.05 Relevant Accounting and Auditing Guidance

- 1.05(a) Relevant accounting and auditing guidance contained in authoritative FASB Accounting Standard Codification topics issued through **September 30, 2009**, has been considered in the development of this edition of the Manual. See Codification Cross Reference Guide at Appendix 3.

1.06 Disclaimers

- 1.06(a) This Manual and related appendices do not discuss the application of all GAAP that are relevant to the preparation of financial statements of real estate entities. This Manual and related appendices are directed primarily to those aspects of the preparation of financial statements that are unique to private institutional real estate entities or those aspects that are considered particularly significant to them.
- 1.06(b) For specific reporting issues, the applicable technical literature should be consulted to provide the most recent guidance for the appropriate accounting and disclosure in the financial statements. The purpose of the Manual is to support the REIS Standards for accounting by providing guidance on issues particular to the real estate industry for which no such guidance is available or guidance is unclear and to assist in providing comparable information for users of financial statements and financial information.
- 1.06(c) Users of this Manual and the related appendices should consider pronouncements issued subsequent to those listed above to determine their effect on entities covered by this Manual.

2. Fund Level Accounting

2.01 Introduction

- 2.01(a) The Fund Level represents the aggregation of all investments. (A Fund may include only one investment or multiple investments.) In addition, it includes items that are not specifically allocated to a single investment (i.e., “unallocated”) as well as portfolio level debt.
- 2.01(b) As described within Chapter 2, the REIS Accounting Standards address two reporting models currently utilized in the industry for GAAP fair value based reporting: the **Operating Reporting Model** and the **Non-Operating Reporting Model**. The determination of the appropriate fair value reporting model to use is made by the entity’s management in consultation with the entity’s auditors. Within the REIS Standards, the requirement is to report GAAP Fair Value based financial statements. (See sections 4.13 and 4.14 of Chapter 4, Fund Reporting Standards, for more information.)
- 2.01(c) The information contained in this section is separated based upon the applicable reporting model.

2.02 Net Assets

- 2.02(a) Net assets represent the excess of the fair value of investments owned, cash, receivables and other assets over the liabilities of the Fund. ASC 810-10-45, *Consolidation*, improves the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. An entity should perform an assessment of their noncontrolling interests’ rights and consider whether the noncontrolling interest is a redeemable equity security within the scope of ASC 505-10-50.
- 2.02(b) ASC 810-10-45 is effective for fiscal years beginning on or after December 15, 2008. The statement should be applied prospectively as of the beginning of the fiscal year in which the statement is initially adopted, except for the presentation and disclosure requirements. The presentation and disclosure requirements shall be applied retrospectively for all periods presented, as follows:
- 2.02(b.1) The noncontrolling interest (previously known as minority interest) shall be reclassified to equity, as amended by this standard. For the Operating Reporting Model, this requires such noncontrolling interests to be included within net assets.
- 2.02 (b.2) Consolidated net income shall be adjusted to include the net income attributed to the noncontrolling interest.
- 2.02(b.3) Consolidated comprehensive income shall be adjusted to include the comprehensive income attributed to the noncontrolling interest.

2.02(b.4) The disclosures in ASC 810-10-50-1A and 1B, are required to be provided. (See Appendix 2.)

2.03 Non-Operating Reporting Model

Note: Users of the Operating Reporting Model for Funds should skip to section 2.04 below

2.03(a) Introduction and Position within the GAAP Hierarchy

Funds which are considered Investment Companies follow the AICPA Audit and Accounting Guide – *Audits of Investment Companies* (the “Investment Company Guide”). These Funds may prepare financial statements using the Non-Operating Reporting Model. Consistent with the Operating Reporting Model, investments must be reported at Fair Value. Generally, Net Asset Value (i.e., the total fair value of all assets reduced by the total fair value of all liabilities) should be the same under both reporting models.

2.03(b) ~~The election of~~ The Fair Value Option under ASC 825-10

In order to be in compliance with the REIS Standards, ~~the~~ Fair Value Option under ASC 825-10 must be elected for all notes payable ~~(including portfolio level debt)~~ for open-end investment vehicles while such election is recommended for closed-end funds and single investor investment accounts. Further information can be found in Sections 4.04 and 4.05.

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2.03(c) Consolidation and Applicability of ASC 810-10 and Statement of Financial Accounting

Sections 7.04 through 7.06 of the Investment Company Guide provide guidance on the use of consolidation by investment companies. Accounting Standards Codification subtopic 946-810, *Financial Services-Investment Companies – Consolidation* (“ASC 946-810”), states the effective date for applying the provisions of ASC 810-10 is deferred indefinitely for investment companies.

Deleted: Standards No. 167, Amendments to FASB Interpretation 46(R). SFAS No. 167 has not yet been included in the Accounting Standards Codification as of September 30, 2009.

2.04 Operating Reporting Model

2.04(a) Introduction

2.04(a.1) The fundamental premise for fair value based accounting models is based on existing authoritative accounting standards which require that certain investments held by tax-exempt investors, including defined benefit pension plans and endowments are reported at fair value. ASC 960, *Plan Accounting – Defined Benefit Pension Plans*, which applies to corporate plans, requires that all plan investments be reported at fair value because that reporting provides the most relevant information about the resources of a plan and its present and future ability to pay benefits when due. In addition, Governmental Accounting Standards Board (GASB) Codification Section Pe5, *Pension Plans-Defined Benefit*, and Section Pe6, *Pension and Other Postemployment Benefit Plans—Defined Contribution*, requires

government-sponsored pension plans to present investments at fair value in their financial statements. Defined benefit and government-sponsored pension plans often invest in real estate and/or real estate companies. Accordingly, the more traditional historical cost basis of accounting used by other real estate companies, owners, and operators is not appropriate, as it does not provide tax-exempt investors with the financial information they require to comply with authoritative accounting standards.

2.04(a.2) Both consolidation and equity method accounting are used in the Operating Reporting Model. Consistent with the Non-Operating Reporting Model, investments must be reported at fair value. Generally, Net asset value (i.e., the total fair value of all assets reduced by the total fair value of all liabilities) should be the same under both reporting models (excluding noncontrolling interests). (See Appendix 1 for a comparison of the reporting models.) The objective of the statement of operations is to present the increase or decrease in the net assets resulting from the entity's investment activities and underlying property operations. Net investment income is a measure of operating results. It is primarily intended to provide a measure of operating cash flow over time, exclusive of capitalized expenditures, such as leasing commissions, tenant improvement costs, tenant inducements, and other replacement costs. Rental revenue is recognized when it is contractually billable to tenants. Expenses are generally recognized when the obligation is incurred. Certain expenses may be based on the investment vehicle's unrealized change in net asset value, including, for example, incentive management fees, and are recognized as a component of the unrealized gain or loss.

2.04(b) Position within GAAP Hierarchy

During 2009, GAAP amended its hierarchy from 4 levels (a, b, c and d) to a hierarchy defined in two levels known as authoritative guidance and non-authoritative guidance. All authoritative GAAP is codified within a single source known as the Accounting Standards Codification. Authoritative guidance takes precedent over any non-authoritative guidance. However, non-authoritative guidance is applied for a particular transaction, item, or event when applicable guidance is not specified within authoritative guidance. The lack of applicable authoritative accounting guidance specific to the institutional real estate investment industry has caused fair value accounting practices prevalent in the industry to constitute non-authoritative GAAP and lead to the creation of the Operating Reporting Model.

2.04(c) ~~The election of the Fair Value Option under ASC 825-10~~

Consistent with the Non-Operating Reporting Model, in order to be in compliance with the REIS Standards, the Fair Value Option under ASC 825-10 must be elected for all notes payable liabilities ~~(including portfolio level debt) for open-end investment vehicles while such election is recommended for the closed-end funds and single investor investment accounts.~~ (Further information can be found in Sections 4.04 and 4.05).

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2.04(d) Consolidation: Applicability of ASC 810-10 and Statement of Financial Accounting

Deleted: Standards No. 167, Amendments to FASB Interpretation 46(R). SFAS No. 167 has not yet been included in the Accounting Standards Codification as of September 30, 2009.

Under the Operating Reporting Model real estate investments include investments in real estate assets by an investor, as well as holdings of controlling equity interests in separate legal entities, which invest in real estate assets. Investors should consider existing authoritative guidance to determine whether an investment in an investee (e.g., joint venture) is controlling or not. GAAP in a historical cost reporting environment generally requires an investor to initially determine whether the investee is a variable interest entity under ASC 810-10. In accordance with ASC 810-10-15-12a, an employer shall not consolidate an employee benefit plan subject to the provisions of ASC Topics 712 or 715. The FASB has indicated that it did not intend for the requirements of ASC 810 to supersede the guidance for accounting for employee benefit plans, including the guidance in ASC 960. Management should consult with their auditors to assess the applicability of ASC 810-10: Consolidation to their reporting model.

Deleted: and SFAS No. 167

2.04(e) Consolidation: Accounting

2.04(e.1) Under the Operating Reporting Model, the financial statements of controlled investees must be consolidated with those of the investor. Depending on the type of entity, investors that use the Operating Reporting Model must apply relevant GAAP literature, which include, but are not limited to, ASC 810 and ASC 970-323, to determine if it must consolidate its joint venture investments. While in general the ownership of a greater than 50% voting interest in a Fund is considered to be an indication of control, many joint venture real estate investments contain complex governance arrangements that make assessments of control difficult. All factors must be considered in making a determination of whether consolidation of an investee is appropriate. Under the Operating Reporting Model, if investments in entities are not deemed to be controlling interests then the equity method of accounting should generally be followed.

2.04(e.2) Under the Operating Reporting Model, real estate assets either owned directly by a Fund or reported through the consolidation of an investee are recorded on the balance sheet at their fair value. If the investee is less than 100% owned, a corresponding credit to noncontrolling interest is recorded at fair value for the noncontrolling interest in the investment. The difference between fair value and the adjusted cost basis of an investment is the unrealized gain or loss associated with the asset, and if applicable, the non-controlling interest. Changes in fair value from period to period are reported as changes in unrealized gain or loss on the statement of operations, which is presented separately from net investment income. These gains or losses are realized upon the disposal of an investment; however, in order to record a realized gain, the sale is required to meet the criteria of ASC 360-20, *Real Estate Sales*, and ASC 976, *Real Estate-Retail Land*. Gains, which are deferred in accordance with ASC 360-20, continue to be reported as unrealized.

2.04(e.3) Key changes of the consolidation process required by ASC 810 include that the noncontrolling interest continues to be attributed its share of losses even if that attribution results in a deficit noncontrolling interest balance. This standard also requires the acquirer to measure a noncontrolling interest in the acquiree at its fair value at the acquisition date. These are significant changes from previous guidance.

2.04(e.4) In the footnotes or in the statement of changes in net assets an entity is required to provide a reconciliation of the beginning and the ending carrying amounts of (1) net assets attributable to the parent entity (2) net assets attributable to the noncontrolling interest, and (3) total net assets.

2.04(e.5) In the footnotes, ASC 810-10-50-1A also requires a separate schedule to be provided that shows the effects of any changes in a parent's ownership interest in a subsidiary on the equity attributable to the parent. Entities are required to disclose both a reconciliation of net assets (par. c) and a separate schedule of changes in ownership. (par. d).

2.04(f) *Equity Method Accounting*

Investors in investees (e.g., partners in joint ventures) accounted for under the equity method of accounting should record as investment income only their share of the venture's net investment income or loss, determined in accordance with GAAP on the fair value basis of accounting (exclusive of items such as depreciation, amortization and free rent, as appropriate). ASC 970-323-35-17 suggests that stipulated allocation ratios should not be used if cash distributions and liquidating distributions are determined on some other basis (i.e., income should be allocated first on behalf of any preferred returns or interest, and then to the respective partners in proportion to their contractual ownership interests, etc.). Intercompany items, such as interest on loans by an investor to an investee should be eliminated to the extent of the investor's economic interest in the venture, as if the investee were consolidated.

2.05 *Accounting for Uncertainty in Income Taxes*

ASC 740, *Income Taxes*, provides guidance for how uncertain tax positions should be recognized, measured, presented and disclosed in the financial statements. ASC 740 requires the evaluation of tax positions taken in the course of preparing a Fund's tax returns to determine whether tax positions are "more-likely-than-not" of being sustained by the applicable tax authority. Tax benefits of positions not deemed to meet the more-likely-than-not threshold would be recorded as a tax expense in the current year. ASC 740 became effective January 1, 2008; however for non-public entities the effective date was deferred until January 1, 2009.

In preparing financial statements of real estate entities, tax positions to be reviewed and analyzed may include the following:

- Tax Exempt Entity Status
- REIT Status
- State Tax Determinations/Nexus
- Unrelated Business Taxable Income

3. Investment Level Accounting

3.01 Introduction

3.01(a) This section outlines the required accounting policies to be followed for accounting at an investment level for interests in real estate investments. While, at the Fund Level, funds may follow different fair value accounting and reporting models (i.e., Operating Reporting Model or the Non-Operating Reporting Model), the following are items that are considered applicable to all fair value models.

3.01(b) See the Property Level Accounting in section 4 for information relating to realized and unrealized gains and losses.

3.01(c) The underlying real estate assets of a Fund include all investments in land, buildings, construction in progress, tenant improvements, tenant allowances, furniture, fixtures and equipment, leasing commissions, capitalized leasehold interests, capitalized interest, capitalized real estate taxes, and real estate to be disposed.

3.01(d) Investments in real estate are made using various investment structures. Included in this section of this Manual is guidance relating to the following investment structures:

- Directly owned real estate (see Property Level Accounting in Section 4)
- Investments in Non-Participating Mortgage Loans Receivable
- Investments in Participating Mortgage Loans Receivable
- Investments in Joint Ventures

3.02 Investments in Mortgages and Other Loans Receivable: General Discussion

3.02(a) There are primarily two types of mortgage loan investments held by Funds: non-participating and participating mortgage loans. A non-participating mortgage loan is an investment secured by a lien on real estate that generally entitles the lender to payments of contractual principal and interest that do not increase based on the underlying operating results of a property.

3.02(b) A participating mortgage is an investment also secured by a lien on real estate that generally consists of three parts: (1) “base interest” payments at contractually stated fixed or floating

rates; (2) “contingent interest” payments where the lender is paid a percentage of property net operating income or cash flow after debt service; and (3) “additional contingent interest,” which is in the form of lender participation in the appreciation in value of the underlying property.

3.02(c) Usually the loan terms of a participating mortgage are set somewhat more favorably than what a non-participating mortgage interest rate would be quoted on the same property. Common terms historically include loan-to-value ratios of up to 90%, base interest rates which are lower than comparable non-participating mortgages, and sometimes the structure may allow for a deferral of interest between the basic interest coupon and some lower “pay rate,” typically during lease-up. The deferral may be paid as and when the net operating income is sufficient to do so, or may be added to the loan balance and be payable in full only at maturity.

3.02(d) The contingent interest component of a participating mortgage often represents a right to some portion of the adjusted net cash flow of a property. Typically, certain expenses, such as legal or other professional fees related to ownership rather than property matters, limited borrower overhead, and other similar expenses, are not permitted as deductions from gross income for determining the amount in which the lender participates in contingent interest. Often a reserve for replacements, or for tenant improvements, leasing commissions, and capital expenditures, is set aside from net operating income before the lender participates in the remainder.

3.02(e) The additional contingent interest or equity conversion component often specifies a hurdle rate that the lender is entitled to reach from basic interest, contingent interest and additional contingent interest before the borrower participates in any proceeds from sale.

3.03 Accounting for Non-Participating Mortgage Loans Receivable

3.03(a) Non-participating mortgage loans receivable should be carried on the balance sheet at their fair value. The difference between fair value and the adjusted cost basis of a mortgage loan is the unrealized gain or loss associated with the asset. Changes in fair value from period to period are reported as changes in unrealized gain or loss on the statement of operations, which is presented separately from net investment income. These gains or losses are realized upon the disposal of an investment. The ability to recognize a sale of a mortgage loan is governed by the guidance provided in ASC 860.

3.03(b) The initial cost basis of a non-participating mortgage loan should include all direct costs of originating or obtaining the loan; however, the entity’s management needs to assess if there is a value of such costs under ASC 820 or if an unrealized loss should be recognized upon acquisition of the loan. Such costs include acquisition fees paid to investment advisors associated with the closing of a new investment.

3.03(c) The carrying amounts of interest receivables currently due (generally one year or less) are generally considered to approximate fair value. Therefore, for fair value reporting, interest

receivable currently due may be reported at its undiscounted amount provided that the results of discounting the carrying amount would not be material and that receipt can reasonably be assured.

3.03(d) Interest income associated with any non-participating mortgage loan receivable is reported in net investment income. Valuation adjustments are reported as unrealized gains and losses. The recognition of base interest income should be based on the contractual terms of the loan unless the loan is considered impaired under authoritative accounting guidance for loans. For impaired loans, the recommended method for interest recognition is the cash method where payments of interest received are recorded as interest income provided that the amount does not exceed that which would have been earned based on the contractual terms of the loan. For mortgage loans with fixed and determinable rate changes, interest income should be accounted for based on when the change contractually occurs rather than using an effective interest or straight-line method. However for the Non-Operating Reporting Model ASC 325 should be followed. Contingent interest income from operating cash flows is also recorded by the lender as part of net investment income. Additional contingent interest received from disposal or refinancing of the underlying property is recorded as part of realized gains and losses.

3.03(e) The fair value of a non-participating mortgage loan and any accrued non-current interest should be based on the discounted value of the total future expected net cash flows. The selection of an appropriate discount rate should reflect the relative risks involved and interest rates charged for similar receivables. The determination of fair value must also take into consideration the underlying collateral, credit quality of the borrower, and any related guarantees, as well as the specific terms of the loan agreement. The fair value of the note and any accrued non-current interest should not exceed the value of the underlying collateral and any related guarantees. Accrued non-current interest is typically added to the note balance, whereas current interest receivable is separately disclosed.

3.03(f) Modification of mortgage terms should be accounted for through an adjustment of value.

3.04 Accounting for Participating Mortgage Loans Receivable

3.04(a) Because of the participation feature inherent in these loans, and the fact that the lender usually provides a significant portion, if not all, of the funds necessary to acquire, develop, or construct the property, accounting for participating mortgages should be determined based upon the guidance in ASC 815-15-55. A participating mortgage may have the characteristics of either a loan, a non-controlling equity investment in a joint venture, or a controlling interest subject to consolidation for accounting purposes, depending on the facts and circumstances. For the latter two categories, the investment should be accounted for using the guidance provided in the discussion of joint ventures appearing in Section 3.05 or in the discussion on real estate in Section 4.02.

3.04(b) Participating mortgages not considered joint ventures, or investments in real estate in accordance with the guidance outlined above, should also be carried on the balance sheet at

their fair value. The difference between fair value and the adjusted cost basis of a mortgage loan is the unrealized gain or loss associated with the asset. Changes in fair value from period to period are reported as changes in unrealized gain or loss on the statement of operations, which is presented separately from net investment income. These gains or losses are realized upon the disposal of an investment. The ability to recognize a sale of a mortgage loan is governed by the guidance provided in ASC 860.

- 3.04(c) The initial cost basis of a participating mortgage loan should include all direct costs of making the loan consistent with ASC 310-20. However, the entity's management needs to assess the fair value of the loan under ASC 820 or if an unrealized loss should be recognized on day one of holding the loan. Such costs include acquisition fees paid to investment advisors associated with the closing of a new investment.
- 3.04(d) Interest income associated with any participating mortgage loan is reported in net investment income. Valuation adjustments are reported as unrealized gains and losses. The recognition of base interest income should be based on the contractual terms of the loan unless the loan is considered impaired under authoritative accounting guidance for loans. For impaired loans, the recommended method for interest recognition is the cash method where payments of interest received are recorded as interest income provided that the amount does not exceed that which would have been earned based on the contractual terms of the loan. For mortgage loans with fixed and determinable rate changes, interest income should be accounted for based on when the change contractually occurs rather than using an effective interest or straight-line method. However for the Non-Operating Reporting Model ASC 325 should be followed. Contingent interest income from operating cash flows is also recorded by the lender as part of net investment income. Additional contingent interest received from disposal or refinancing of the underlying property is recorded as part of realized gains and losses.
- 3.04(e) The fair value of a participating mortgage investment is equal to the discounted value of the total future cash flows expected from the investment. The value of the mortgage may not exceed the value of the underlying real estate plus any qualifying guarantees. The discount rate used in the valuation should reflect the risk/return characteristics of the participating investment structure. The valuation may be performed with different discount rates for the different sources of the anticipated cash flows; a "debt" rate may be associated with the nonparticipating cash flows, and an "equity" rate may be associated with the participation cash flows. In all cases the economic substance of the transaction must be taken into account in determining the value of the investment.
- 3.04(f) Any modification of mortgage terms should be accounted for through an adjustment of value and recorded through the unrealized gain/loss in the statement of operations.

3.05 Investments in Joint Ventures: General

- 3.05(a) Joint ventures are a common form of ownership for funds and institutional investors in real estate. The venture is typically a legally formed limited partnership or limited liability company between the fund/institutional investor and a real estate developer/operator.
- 3.05(b) Real estate investments are often structured as joint ventures because these structures provide the ability to share risks and rewards among the participants. The fund/institutional investor typically own the greater share of the joint venture and provide most of the equity invested into the project. Such investment may be in the form of equity capital, loans to the venture, or both. The fund/institutional investor's operating partner is typically the general partner in the venture who is a real estate developer/operator in the specific project type. In consideration for the cash investment that is disproportionate to its stipulated ownership interest, the institutional partner is generally entitled to a preferential distribution of cash flow equal to a preferred return on the capital invested and interest on loans, and to a priority return of its capital investment from a sale or refinancing. Amounts generated by the joint venture in excess of these preferences and priorities are distributed to the participants in accordance with their stipulated ownership interests.

3.06 Investments in Joint Ventures: Accounting

- 3.06(a) The appropriate treatment for accounting for joint ventures in the primary financial statements depends upon the reporting model utilized. See the Fund Section included in this Manual for a discussion of appropriate treatment and sources of additional guidance.
- 3.06(b) When joint ventures are not consolidated, the difference between fair value and the adjusted cost basis of an investment in a joint venture is the unrealized gain or loss associated with the investment. As is discussed in greater detail below, changes in fair value from period to period are reported as changes in unrealized gain or loss on the statement of operations, which is presented separately from net investment income. Unrealized gains or losses are recognized as realized gains or losses upon the disposal of an investment.
- 3.06(c) The initial cost basis of an investment in a joint venture should include all direct costs of obtaining the investment. This includes acquisition fees paid to investment advisors associated with the closing of a new investment.
- 3.06(d) The initial cost basis of an investment in a joint venture is then subsequently adjusted to include the investor's share of joint venture income/loss recorded, as well as capital contributions and distributions. To the extent that the investor has advanced funds to the joint venture in the form of loans, all outstanding principal and non-current interest receivable should also be included in the cost basis. The aggregate investment should be presented on the balance sheet as a single caption, "Investment in Joint Venture." ASC 230-10-45, requires dividends received (returns on investments) to be classified as cash inflows from operating activities. Receipts from returns of investments are classified as cash inflows from investing activities.

3.06(e) The investment in a joint venture is then subsequently adjusted to include the changes in fair value as measured in accordance with ASC 820 and is reflected on the statement of operations as an unrealized gains or loss during the period the change in fair value occurs. To the extent that the investor has advanced funds to the joint venture in the form of loans, all outstanding principal and non-current interest receivable should also be included in the investment account. The aggregate investment should be presented on the schedule of investments as a single investment. The REIS Fund Reporting Standards require an annual presentation of a Schedule of Investments (see Chapter 4.16).

3.06(f) The determination of the fair value of an investment in a joint venture requires: (1) The valuation of the underlying assets and liabilities of the joint venture; and (2) the analysis of a hypothetical liquidation at fair value in accordance with the distribution provisions of the joint venture agreement. Consideration should be given to all incentive fees and preferred returns included in the joint venture agreement in determining the hypothetical liquidation at fair value of the joint venture. Fair value is defined by ASC 820-10-20 as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of an investment may not be directly reduced by transaction costs. However, the transaction costs are deducted when calculating the reversion value in a discounted cash flow model. Hypothetical liquidation at fair value may not necessarily reflect the exit price of an entity's joint venture investment. Consideration should be given to what a market participant would be willing to pay.

Deleted: Transaction costs are not included in determining the fair value of the investment

3.06(g) Amendments to ASC 820 included in ASU No. 2009-12 permit, as a practical expedient, a reporting entity to measure fair value of an investment that is within the scope of the amendments on the basis of net asset value per share of the investment (or its equivalent) if the net asset value of the investment (or its equivalent) is calculated in a manner consistent with the measurement principles of Topic 946 as of the reporting entity's measurement date.

3.07 Accounting for Contingent Consideration

3.07(a) For all acquisitions one should recognize as of the acquisition date, all of the assets acquired and liabilities assumed that arise from contingencies related to contracts (referred to as contractual contingencies), and measure them at their acquisition-date fair values.

3.07(b) For all other contingencies (referred to as *noncontractual contingencies*), the acquirer shall assess whether it is more likely than not as of the acquisition date that the contingency gives rise to an asset or a liability as defined in Concepts Statement 6. If that criterion is met as of the acquisition date, the asset or liability arising from a noncontractual contingency shall be recognized at that date, measured at its acquisition-date fair value. If that criterion is not met as of the acquisition date, the acquirer shall not recognize an asset or a liability at that date. The acquirer shall instead account for a noncontractual contingency that does not meet the more-likely-than-not criterion as of the acquisition date in accordance with other GAAP, including ASC 450 *Contingencies*, as appropriate.

- 3.07(c) Probability weighted discounted cash flows or other complex valuation models may be required to value such contingent considerations. A Fund needs to further determine if such consideration should be recorded as an asset, liability, derivative instrument or equity.
- 3.07(d) Under the Operating and Non-Operating Reporting Models, all acquisitions should be valued at fair value and therefore include as assessment of contractual and noncontractual contingencies.

3.08 [Reserved for Future Use]

3.09 Financing Costs

- 3.09(a) Costs may be incurred in connection with obtaining financing for the Fund or the investment — either secured or unsecured. ASC 825-10-25-3 states that “upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred.” The REIS standards require the adoption of the Fair Value Option under ASC 825: *Financial Instruments* for open-end investment vehicles while such election is recommended for closed-end funds and single investor investment accounts. (See Sections 4.04 and 4.05) Under existing GAAP, for those entities that have not adopted the Fair Value Option under ASC 825-10, debt costs will continue to be deferred and amortized to interest expense using the effective interest method. In order to remain comparable to other institutional investment classes, it is recommended that, subsequent to the adoption of the Fair Value Option under ASC 825-10, such financial costs continue to be treated as a component of net investment income.

3.10 Real Estate Advisory Fees

3.10(a) General

Real estate advisory fees may include acquisition, asset management, disposition, financing, and incentive fees.

3.10(b) Acquisition Fees

Acquisition fees are considered as part of the acquisition cost of a property and, therefore, are included in the cost basis of the real estate asset as are other acquisition-related costs. They are included as part of the cost when comparing cost to value to determine realized or unrealized gain or loss under both the Operating Reporting model and Non-Operating Reporting Model. In circumstances where an investment company or pension plan is making an investment, transaction costs associated with the investment acquisition should be capitalized as part of the cost of the investment.

3.10(c) Asset Management Fees

Asset management fees should be generally expensed in the current period.

3.10(d) Disposition Fees

Disposition fees are typically paid when an investment is sold and calculated as a percentage of the sales price. The fee generally compensates a real estate advisor for their services rendered in an investment disposition, including sales marketing, negotiating, and closing. As this fee is not earned until the work is performed or substantially performed, the fee is generally recognized as a cost of sale in the period in which the investment is sold.

Disposition fees that are substantively incentive fees should be measured and recognized as incentive fees.

3.10(e) Incentive Fees

3.10(e.1) Incentive fee arrangements and calculations vary widely, but generally these fees are paid after a predetermined investment performance return has been attained. For example, these fees may be payable upon actual or constructive sale of a real estate investment or portfolio, or may be payable when cash flows from operating or capital distributions exceed some threshold.

3.10(e.2) Incentive fees should be recognized if they would be payable if all assets were sold and liabilities were settled at the balance sheet date. The calculation of the amount earned is specific to the related real estate advisory agreement, but generally the calculation should assume that the investment or fund is liquidated at its fair value as of the reporting date and cash proceeds are distributed to the investors. A liability should be established for the amount of the incentive fee, although not necessarily currently payable.

3.10(e.3) The related impact of recording a liability for an incentive fee should be either (1) reflected as a component of the investment's net investment income, if the fee resulted from operating results; or (2) reflected as a component of the investment's unrealized gain/loss, if the fee resulted from changes in fair value.

3.10(e.4) Where incentive fees are based on both operating results and changes in fair value, the related impact should be allocated to the applicable components based on the substance of the incentive fee arrangements.

4. Property Level Accounting

4.01 Introduction

- 4.01(a) This section outlines the required accounting policies to be followed for underlying real estate investments accounted for at the property level, in order to provide consistent accounting information across funds for attribution analysis (e.g., Portfolio Characteristics per Chapter 4.22), benchmark reporting, and reporting to the NCREIF Property Index (NPI). In addition, under the Operating Reporting Model, financial statements prepared for wholly owned properties are accounted for in this manner and utilized accordingly for consolidation purposes.
- 4.01(b) Regardless of the form of investment held, the underlying real estate assets include all investments in land, buildings, construction in progress, tenant improvements, tenant allowances, furniture, fixtures and equipment, leasing commissions, capitalized leasehold interests, capitalized interest, capitalized real estate taxes, and real estate to be disposed. Under the fair value basis of accounting, real estate assets are carried on the balance sheet at their estimated fair value. Changes in fair value from period to period are recognized as unrealized gains or losses until sale or disposition of an interest in the real estate investment.
- 4.01(c) Net investment income is not intended to approximate net income determined under the historical cost basis of accounting. Among other differences, net investment income under the fair value financial reporting model does not include the effect of rent normalization under ASC 840-20-25, cost-based depreciation or amortization of most capitalized expenditures, or impairment accounting provisions.

4.02 Determination of Real Estate Fair Value

- 4.02(a) ASC 820 focuses on how to measure fair value. ASC 820 does not introduce any new requirements mandating the use of fair value; instead, it unifies the meaning of fair value within existing GAAP and expands disclosures about fair value measurements. It also introduces a fair value hierarchy to classify the source of information used in fair value measurements (i.e., market based or non-market-based inputs).
- 4.02(b) ASC 820-10-20 defines fair value as, “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.” This definition retains the exchange price notion in earlier definitions of fair value. However, the definition focuses on the price that would be received to sell the asset or paid to transfer the liability (an exit price), not the price that would be paid to acquire the asset or received to assume the liability (an entry price). The fair value of an asset is a market based approach. Therefore, the fair value measurement should be based on the highest and best use assumptions that market participants would use in pricing the asset or liability even if the intended use by the reporting entity is different.

- 4.02(c) The fair value measurement in ASC 820 assumes that the transaction to sell the asset occurs in the principal market for the asset or in the absence of a principal market, the most advantageous market for the asset. The principal (or most advantageous) market (and thus, market participants) should be considered from the perspective of the reporting entity, thereby allowing for differences between and among entities with different activities.
- 4.02(d) ASC 820 requires that a fair value measurement should maximize the use of observable inputs (defined as Level 1 and 2 inputs) and minimize the use of unobservable inputs (Level 3). If the fair value measurement has significant Level 2 and 3 inputs, Level 3 footnote disclosures are necessary. Most real estate valuations are expected to include significant unobservable (Level 3) inputs. Such valuations should reflect the reporting entity's assumptions that market participants would use, including assumptions about risk. Such assumptions should be developed based on the best information available without undue cost and effort. It is the source of the input that drives the classification, not approach or specialist used to determine fair value. For instance, an external appraiser's valuation of a property utilizing a discounted cash flow model based on the specific cash flows of said property would be considered a Level 3 input.
- 4.02(e) The fair value of property that is expected to be held for investment should generally be valued in a manner consistent with the REIS Property Valuation Standards. (See the REIS Property Valuation Standards for more information.)
- 4.02(f) Under ASC 820, transaction costs associated with future sales should be evaluated from a market participant perspective. For entities that follow ASC 960 *Plan Accounting – Defined Benefit Pension Plans*, ASC 960-325-35 provides guidance on fair value and requires fair value to include an estimate of costs to sell.
- 4.02(g) The fair value of a real estate asset should not include any effects of a related above- or below-market mortgage debt, except when debt is assumed on acquisition. Upon assumption of debt, the impact of above/below fair value debt is assigned to the cost basis of the related debt. The real estate and the related mortgage are to be shown separately on the balance sheet.
- 4.02(h) ASC 360-10-35 also requires that the cost basis of "impaired" assets be written down to fair value. Under the REIS Standards, the impairment accounting guidance provided by ASC 360-10-35 is not applicable to the cost basis of real estate assets in a fair value basis presentation.
- 4.02(i) ASC 360-10 also addresses the financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed. Among other things, the guidance in the Impairment or Disposal of Long-Lived Asset Subsections of ASC 360-10 does not apply to intangible assets not being amortized or financial instruments, including investment in equity securities accounted for under the cost or equity method. Although the Impairment or Disposal of Long-Lived Asset Subsections of ASC 360-10 is silent with respect to investments accounted for at fair value under either ASC 960, GASB Codification Section

Pe5 and Pe6, separate accounts under ASC 944, or in accordance with the Investment Company Guide, the Impairment or Disposal of Long-Lived Asset Subsections of ASC 360-10 do not amend any of the guidance provided in these references.

4.03 Determination of the Cost Basis of Real Estate Assets

4.03(a) The initial cost basis of a real estate asset includes direct costs of acquiring the real estate asset under both models. For development properties, the cost basis of these assets should also include costs capitalized during the development period including interest, insurance, and real estate taxes. Authoritative accounting literature, including ASC 835-20, *Capitalization of Interest*, and ASC 970, *Real Estate-General*, provides guidance relating to the appropriate cost capitalization criteria. Direct costs of acquisition are considered as part of the acquisition cost of a property. They are included as part of the cost when comparing cost to value to determine realized or unrealized gain or loss under the Non-Operating Reporting model. Regardless of whether an entity follows the Operating or Non-Operating Reporting Model for the presentation of its financial statements, the investment in real estate should be treated in a manner consistent with paragraph 2.44 of the AICPA Investment Company Guide, and therefore, such costs should continue to be capitalized and be considered as part of the acquisition cost of the property. The valuation of the underlying investment under ASC 820 may result in an unrealized loss on day one.

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4.03(b) Because real estate investments are recorded at fair value each reporting period, none of the components (building, equipment, improvements, lease costs, in-place lease value, lease inducements, lease origination costs, etc.) are depreciated or amortized.

4.03(c) The initial cost basis of a real estate asset should be subsequently adjusted for additional capital costs such as tenant and building improvements, tenant allowances, tenant inducements, tenant leasing commissions, and tenant buyouts. These capital items are generally made to maximize cash flows and generate additional income, which, in turn, influence the fair value of the real estate asset. Because the nature of these costs is such that they have benefits that extend beyond one year, the addition of these items to an asset's carrying value is considered appropriate.

4.03(d) This treatment extends to all generations of tenant related capital costs, even after the tenants to whom they relate have vacated a property. These types of property related costs represent additional investments in the property, which should be considered in any examination of the current fair value of the asset against an investor's investment in it.

4.03(e) Capitalized costs associated with a real estate asset are not depreciated or amortized, as depreciating or amortizing would just be offset by an increase in unrealized appreciation in the same or subsequent periods.

4.04 Loans Payable

4.04(a) Real estate investments are often partially financed using long- or intermediate-term loans whereby the real estate property is pledged as collateral for the loan. In many loan arrangements, the lender has no other recourse against the borrower; however, some arrangements provide for credit enhancements in the form of guarantees or additional pledges from the borrower. Real estate investments can also be financed through loans whereby owners with high credit standing or prearranged lines of credit may be able to borrow on an unsecured basis or using a loan which is secured by collateral other than the underlying real estate investments.

4.04(b) The Fair Value Option under ASC 825-10 permits entities to choose to measure many financial instruments at fair value on a contract-by-contract basis.

4.04(c) **The REIS Standards require that the fair value option under ASC 825-10 be elected for each note payable instrument (i.e., Fund, Investment, and Property) for open-end investment vehicles while such election is recommended for closed-end funds and single investor investment accounts.** The adoption of The Fair Value Option under ASC 825-10 is effective for years beginning after November 15, 2007. For existing notes payable the election to adopt The Fair Value Option must be made at the beginning of the fiscal year that commences after November 15, 2007. Upon adoption, the difference between the carrying amount and the fair value of notes payable shall be recognized as a cumulative effect adjustment to the opening balance of net assets.

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4.04(d) The fair value of loans payable should be reported separately as liabilities. Subsequent to the initial adoption, adjustments to the estimated fair value of loans payable should be reported as unrealized gain (loss) in the statement of operations. Gains and losses realized upon settlement of loans payable, net of transaction and prepayment costs, if any, should be reported as realized gain (loss) in the statement of operations.

4.04(e) The fair value of loans payable is defined within ASC 820 and is based on the amount at which the liability could be transferred in an orderly transaction between market participants at the measurement date, exclusive of transaction costs. The fair value definition of ASC 820 focuses on the price that would be paid to transfer the liability (an exit price), not the price that would be received to assume the liability (an entry price). Therefore, if a market participant was to assume debt, interest expense incurred to date would not be assumed by the buyer and would remain the liability of the entity. Refer to REIS Guidance Document, *FASB ASC Topic 820, Fair Value Measurements and Disclosures: Implementation Guidance for Real Estate Investments* for more information on applying ASC Topic 820.

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4.05 Direct Transaction Costs of Loans Payable

4.05(a) ASC 825-10-25-3 states that “upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred.” Therefore, transaction costs related to loans payable are recorded as a reduction in earnings incurred in the statement of operations. Transaction costs refer to the incremental direct costs to transact

in the principal (or most advantageous) market for the liability. Subsequent to the election of The Fair Value Option under ASC 825-10, transactions costs should be expensed as incurred.

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4.05(b) Prior to the adoption of the Fair Value Option under ASC 825-10 such transaction costs related to the issuance of debt or refinancing were deferred and amortized to interest expense. As of the beginning of an entity's fiscal year commencing after November 15, 2007, it is recommended that such costs for which The Fair Value Option is elected are recorded as a component of net investment income as incurred.

4.05(c) Unrealized gains and losses on notes payable should generally be recognized when market interest rates or credit spreads fluctuate relative to contractually fixed rates or variable rate credit spreads.

4.06 Derivative Financial Instruments

4.06(a) Real estate is often financed through variable rate loans. In an effort to manage the risks associated with fluctuations in market interest rates and to maintain a more neutral position during market interest rate fluctuations, the borrower may purchase derivative financial instruments (derivatives), such as interest swaps, collars, Treasury locks, floors, or capping contracts. The contract can be assigned to a specific property or loan or they can be established in connection with a portfolio of investments. These contracts also involve an up-front cost and generally are transferable to other parties.

4.06(b) All derivative financial instruments should be carried at estimated fair value with the change in fair value being recorded to earnings in accordance with ASC 815, *Derivatives and Hedging*.

4.06(c) The approach used for estimating the fair value of interest rate protection contracts should be consistent with ASC 820. The contract should be carried as an asset or liability, as fair value indicates, and should be adjusted to fair value each reporting period. Any transaction costs associated with obtaining the contracts should be recognized in earnings as incurred and not deferred.

4.07 Other Assets and Liabilities

4.07(a) There are a variety of other assets and liabilities that may result from the acquisition of income producing property. Examples of other assets include prepaid expenses, such as taxes and insurance, supplies inventory, utility deposits, escrow deposits, equipment, etc. Examples of other liabilities include accounts payable, accrued expenses, such as accrued real estate taxes, insurance, repairs and maintenance, property management fees, interest, compensation, utilities and professional fees, and other liabilities, such as security deposits, unearned rental income, and fees payable in the ordinary course of operations.

4.07(b) Other assets or liabilities that are short-term in nature (i.e., expected to be settled within one year of the date of the financial statements) may be reported on the balance sheet at their undiscounted values. This is because of the short-term nature of these items, their

undiscounted balances are considered to approximate their fair values.

- 4.07(c) Other assets or liabilities which are longer-term in nature (i.e., expected to be settled greater than one year from the date of the financial statements) should be reported at their fair value. These other assets and liabilities should be recorded in accordance with standards promulgated in ASC 820. If there is an active market with quoted market prices for other assets and liabilities held, this information should be used in determining fair value. In the absence of quoted market prices, fair values should be determined using a discounted cash flow analysis as long as such values approximate the amount that would be received or paid in a current transaction. The amounts and timing of the cash inflows and outflows associated with other assets and liabilities must be estimated and discounted back to a present value. The discount rate used should reflect a current market rate commensurate with the risks of the specific asset (i.e., risk-free interest rate plus applicable credit spread, or the current market rates applicable to liabilities of similar duration or risk). ASC 820-10-55-56 states, “the reporting entity should consider the effect of its credit risk (credit standing) on the fair value of the liability in all periods in which the liability is measured at fair value because those who might hold the entity’s obligations as assets would consider the effect of the entity’s credit standing in determining the prices they would be willing to pay.”
- 4.07(d) Regardless of the methodology utilized, care must be exercised in evaluating other assets and liabilities to ensure that they have not already been included in the valuation of the real property or the investment.
- 4.07(e) Changes in the fair value of other assets and liabilities from period to period are reported on the statement of operations as unrealized gains and losses, which are reported separately from net investment income. Unrealized gains and losses become realized when the underlying asset or liability is settled or resolved.

4.08 Receivables

- 4.08(a) Various operating transactions may result in notes or accounts receivable. These receivables may be short-term or long-term in nature.
- 4.08(b) The undiscounted carrying value of short-term receivables (e.g., less than one year to maturity) generally approximates fair value due to the relatively short period of time between the reporting date and the expected realization. The use of an undiscounted value is acceptable provided that the results of discounting would be immaterial. An allowance should be established based upon the amount of the receivable expected to be uncollectible. Any such allowance is charged against net investment income; however, industry practice varies as to whether the allowance is charged against revenue or as an operating expense. Generally, allowances related to bad debts should be recorded as an operating expense. Any receivables that are considered in the valuation of the real estate asset should not be established as such amounts are already included in the valuation of the real estate asset.

4.08(c) The fair value of longer-term receivables should be estimated by discounting the expected future cash flows to be received (including interest payments) using a current market rate of similar receivables commensurate with the risks of the specific receivables. Similar receivables are those that have comparable credit risk and maturities. An allowance should be established based upon the present value of the ultimate amount to be uncollectible. Consideration should be given to any underlying collateral.

4.09 Other Liabilities

Other liabilities may include contingent consideration that is part of an investment at the time of the acquisition. Contingent consideration should be recognized and measured at fair value at the acquisition date and each reporting date, rather than recognized and measured as an adjustment to the purchase price in the subsequent period in which the contingency is resolved.

4.10 Real Estate Revenues and Expenses

4.10(a) The ownership of income producing property encompasses real estate revenues directly associated with the underlying property or properties and may include the following: rental income, as well as funds receivable for the recovery of real estate expenses, percentage rent, and miscellaneous tenant charges. Real estate expenses may include utility costs, property management fees, real estate taxes, and normal maintenance expenses.

4.10(b) When reporting property specific information, or when utilizing such information under the Operating Reporting Model real estate revenues should be recorded when contractually earned. Rent concessions (such as free rent, stepped rent) should not be recorded as income until the rent payments are earned and billable. This process matches appraisal methodology which factors in the future rental income in the determination of the property value. Accruing for free rent/stepped rent would in essence be accounting for the same item twice (i.e., once in the property's valuation and again in an accounts receivable/other asset account outside the property base).

4.10(c) Penalties or other lump-sum payments received or receivable from tenants who choose to terminate their lease prior to the end of the lease term should be recorded as income when the following criteria have been met: The tenant loses his right to use the space; the owner has no further obligation to provide services; and when payment is determined to be probable.

4.10(d) Real estate expenses should be recognized when incurred. Companies should consider authoritative accounting literature such as ASC 604-45, *Principal Agent*, for recording of revenues and expenses gross or net.

4.11 Realized and Unrealized Gains and Losses

4.11(a) The periodic valuation of real property, real estate investments, and funds and other non-current assets and liabilities, pursuant to the fair value basis of accounting, results in changes in the reported value of investments and other assets owned, and liabilities owed.

These changes are reported in the statement of operations as unrealized gains and losses. Gains and losses are realized upon disposition of the transaction or the settlement of liabilities; however, sales transactions must also meet the gain recognition criteria set forth in ASC 360-20 and ASC 976. Gains that are deferred in accordance with ASC 360-20 continue to be reported as unrealized.

- 4.11(b) Realized gains and losses and the change in unrealized gains and losses are reported separately from net investment income in the statement of operations. Further, the portion of the change in unrealized gains and losses attributable to dispositions or the settlement of liabilities (i.e., the realization of previously reported unrealized gains/losses) is separately reported or otherwise disclosed, as appropriate, for each period presented in the financial statements.
- 4.11(c) The distinction between realized and unrealized recognition is not applied to items of Net Investment Income (i.e., revenue and expenses), even if such items are not currently recorded as a receivable or payable.
- 4.11(d) A separately disclosed realized gain should be recognized on the extinguishment of debt when real estate is transferred to a lender in satisfaction of non-recourse debt. This gain may be recognized as an unrealized gain prior to reconveyance.

REIS Guidance
REIS Fair Value Accounting Policy Manual
Appendices

Appendix 1:

Illustrative Financial Statements for Operating Reporting Model

The accompanying financial statements are illustrative only and are intended to provide an illustrative format for annual financial statement reporting under the fair value basis of accounting using the **Operating Reporting Model**. The illustrative statements reflect common financial statement presentation and disclosure items typically used in the institutional real estate investment community where the Operating Model is used. Disclosures included in the illustrative financial statements are not intended to be comprehensive and are not intended to establish preferences among alternative disclosures. For specific reporting issues encountered by an individual investment vehicle, the applicable technical accounting literature should be consulted to provide guidance for the appropriate presentation and disclosure in the financial statements.

XYZ Real Estate Account

Financial Statements for the
Years Ended December 31, 2009 and 2008

XYZ REAL ESTATE ACCOUNT

CONSOLIDATED STATEMENTS OF NET ASSETS AS OF DECEMBER 31, 2009 AND 2008 (In thousands)

| | <u>2009</u> | <u>2008</u> |
|--|-------------|-------------|
| ASSETS | | |
| REAL ESTATE INVESTMENTS – At fair value: | | |
| Real estate and improvements (cost: December 31, 2009 and 2008 — \$xx,xxx and \$xx, xxx respectively) | \$ | \$ |
| Unconsolidated real estate joint ventures (cost plus equity in undistributed earnings: December 31, 2009 and 2008 — \$xx,xxx and \$xx,xxx respectively) | | |
| Mortgage and other loans receivable (cost: December 31, 2009 and 2008 — \$xx,xxx and \$xx,xxx respectively) | | |
| Other real estate investments (cost: December 31, 2009 and 2008 — \$xx,xxx and \$xx, xxx respectively) | | |
| Total real estate investments | _____ | _____ |
| CASH AND CASH EQUIVALENTS | | |
| MARKETABLE SECURITIES | | |
| ACCRUED INVESTMENT INCOME (Net of allowance for doubtful accounts; December 31, 2009 and 2008 — \$xx,xxx and \$xx,xxx respectively) | | |
| PREPAID AND OTHER ASSETS, Net | _____ | _____ |
| TOTAL ASSETS | <u>\$</u> | <u>\$</u> |
| LIABILITIES AND NET ASSETS | | |
| LIABILITIES: | | |
| Mortgage loans and notes payable | \$ | \$ |
| Accrued real estate expenses and taxes | | |
| Accrued incentive fees | | |
| Other liabilities | | |
| Total liabilities | _____ | _____ |
| COMMITMENTS AND CONTINGENCIES | | |
| NET ASSETS: | | |
| XYZ Real Estate Account net assets | | |
| Noncontrolling interests | | |
| NET ASSETS | <u>\$</u> | <u>\$</u> |

For illustrative purposes only - Operating Model Financial statements

XYZ REAL ESTATE ACCOUNT

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008 (in thousands)

| | XYZ Real Estate Account | Noncontrolling Interest | TOTAL |
|---|----------------------------|----------------------------|-------|
| NET ASSETS - January 1, 2008 | \$ | \$ | \$ |
| FROM OPERATIONS: | | | |
| Net investment income | | | |
| Net realized and unrealized gain (loss) | | | |
| Increase (decrease) in net assets resulting from operations | | | |
| FROM CAPITAL TRANSACTIONS: | | | |
| Contributions | | | |
| Distributions | | | |
| Increase (decrease) in net assets resulting from capital transactions | | | |
| INCREASE (DECREASE) IN NET ASSETS | | | |
| NET ASSETS - December 31, 2008 | | | |
| FROM OPERATIONS: | | | |
| Net investment income | | | |
| Net realized and unrealized gain (loss) | | | |
| Increase (decrease) in net assets resulting from operations | | | |
| FROM CAPITAL TRANSACTIONS: | | | |
| Contributions | | | |
| Distributions | | | |
| Increase (decrease) in net assets resulting from capital transactions | | | |
| INCREASE (DECREASE) IN NET ASSETS | | | |
| NET ASSETS - December 31, 2009 | \$ | \$ | \$ |

For illustrative purposes only - Operating Model Financial Statements

XYZ REAL ESTATE ACCOUNT

CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

INVESTMENT INCOME:

| | | |
|---|-------|-------|
| Revenue from real estate | \$ | \$ |
| Equity in income of unconsolidated real estate joint ventures | | |
| Interest and equity income on mortgage and other loans receivable | | |
| Income from other real estate investments | | |
| Other income | | |
| | _____ | _____ |
| Total | _____ | _____ |

EXPENSES:

| | | |
|--------------------------------|-------|-------|
| Real estate expenses and taxes | | |
| Interest expense | | |
| Administrative expenses | | |
| Investment management fees | | |
| | _____ | _____ |
| Total expenses | _____ | _____ |

NET INVESTMENT INCOME

NET REALIZED AND UNREALIZED GAIN (LOSS):

| | | |
|---|-------|-------|
| Realized gain (loss) from sales | | |
| Less: previously recorded unrealized (gain) loss on sales | | |
| | _____ | _____ |
| Unrealized gain (loss) on investments held at year end | | |
| <u>Unrealized gain (loss) on liabilities</u> | | |
| Unrealized incentive fees | | |
| | _____ | _____ |
| Net realized and unrealized gain (loss) | _____ | _____ |

INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS

LESS: Portion attributable to noncontrolling interests

INCREASE IN NET ASSETS RESULTING FROM OPERATIONS ATTRIBUTABLE TO XYZ REAL ESTATE ACCOUNT

\$ _____ \$ _____

AMOUNTS ATTRIBUTABLE TO XYZ REAL ESTATE ACCOUNT

| | | |
|---|-------|-------|
| Net investment income | | |
| Net realized and unrealized gain (loss) | | |
| | _____ | _____ |

INCREASE IN NET ASSETS RESULTING FROM OPERATIONS ATTRIBUTABLE TO XYZ REAL ESTATE ACCOUNT

\$ _____ \$ _____

XYZ REAL ESTATE ACCOUNT

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

| | | |
|--|-----------|-----------|
| INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS: | | |
| Net investment income | \$ | \$ |
| Net gain (loss) realized on real estate investments sold | | |
| Net unrealized gain (loss) on real estate investments | | |
| <u>Net unrealized gain (loss) on liabilities</u> | | |
| Less: portion attributable to noncontrolling interests | _____ | _____ |
| Increase (decrease) in net assets resulting from operations | _____ | _____ |
| INCREASE (DECREASE) IN NET ASSETS RESULTING FROM CAPITAL TRANSACTIONS: | | |
| Contributions | | |
| Distributions | | |
| Less: portion attributable to noncontrolling interests | _____ | _____ |
| Increase (decrease) in net assets resulting from capital transactions: | _____ | _____ |
| INCREASE (DECREASE) IN NET ASSETS | | |
| NET ASSETS — Beginning of year, as previously reported | | |
| CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE (Note 2) | | |
| NET ASSETS — Beginning of year, as revised | _____ | _____ |
| NET ASSETS — End of year | <u>\$</u> | <u>\$</u> |

For illustrative purposes only - Operating Model Financial statements

XYZ REAL ESTATE ACCOUNT

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

| | | |
|--|----------|----------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net increase in net assets resulting from operations | \$ | \$ |
| Adjustments to reconcile net assets resulting from operations to net cash flows from operating activities: | | |
| Net realized and unrealized (gains) losses | | |
| Amortization | | |
| Payment of financing costs | | |
| Equity in income of unconsolidated real estate joint ventures | | |
| Income distributions from unconsolidated real estate joint ventures | | |
| Purchase of marketable securities | | |
| Sales and maturities of marketable securities | | |
| Changes in other assets and liabilities: | | |
| Prepaid and other assets | | |
| Accrued investment income | | |
| Accrued real estate expenses and taxes | | |
| Other liabilities | | |
| | _____ | _____ |
| Net cash flow provided by (used in) operating activities | _____ | _____ |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capital distributions from unconsolidated real estate joint ventures | | |
| Capital expenditures on real estate investments | | |
| Investment in real estate joint ventures | | |
| Payment of incentive fees | | |
| Net proceeds from real estate investments sold | | |
| Funding of mortgage and other loans receivable | | |
| Principal payments on mortgage and other loans receivable | | |
| Purchase of marketable securities | | |
| Sales and maturities of marketable securities | | |
| | _____ | _____ |
| Net cash flow provided by (used in) investing activities | _____ | _____ |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from mortgage loans payable | | |
| Principal repayments on mortgage loans payable | | |
| Payment of financing costs | | |
| Distributions | | |
| Capital contributions | | |
| Contributions from noncontrolling interests | | |
| Distributions to noncontrolling interests | | |
| | _____ | _____ |
| Net cash flow provided by (used in) financing activities | _____ | _____ |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | | |
| CASH AND CASH EQUIVALENTS — BEGINNING OF YEAR | _____ | _____ |
| CASH AND CASH EQUIVALENTS — END OF YEAR | \$ _____ | \$ _____ |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Cash paid for interest, net of amounts capitalized of \$_____ | \$ | \$ |
| Cash paid for income taxes | | |

For illustrative purposes only - Operating Model financial statements

Exposure Draft: Debt Liability Valuation

July 7, 2010

Page 68

XYZ REAL ESTATE ACCOUNT

SCHEDULE OF INVESTMENTS* AS OF DECEMBER 31, 2009 AND 2008:

| Property Name | Ownership | City, State | Square Feet Unless Otherwise Indicated (Unaudited) | December 31, 2009 | | December 31, 2008 | |
|---|-----------|--------------------|--|-------------------|------------|-------------------|------------|
| | | | | Cost | Fair Value | Cost | Fair Value |
| REAL ESTATE OWNED AND JOINT VENTURES | | | | | | | |
| APARTMENT | | | | | | | |
| Apt 1 | WO | City, State | xxx units | \$ | \$ | \$ | \$ |
| Apt 2 | CJV | City, State | xxx units | _____ | _____ | _____ | _____ |
| APARTMENT TOTAL | | x % as of 12/31/09 | | _____ | _____ | _____ | _____ |
| HOTEL | | | | | | | |
| Hotel 1 | CJV | City, State | xxx rooms | _____ | _____ | _____ | _____ |
| HOTEL TOTAL | | x % as of 12/31/09 | | _____ | _____ | _____ | _____ |
| INDUSTRIAL | | | | | | | |
| INDUSTRIAL 1 | WO | City, State | xxx | _____ | _____ | _____ | _____ |
| INDUSTRIAL TOTAL | | x % as of 12/31/09 | | _____ | _____ | _____ | _____ |
| OTHER INVESTMENTS | | | | | | | |
| Other | EJV | City, State | N/A | _____ | _____ | _____ | _____ |
| OTHER INVESTMENTS TOTAL | | x % as of 12/31/09 | | _____ | _____ | _____ | _____ |
| OFFICE | | | | | | | |
| Office 1 | EJV | City, State | xxx | _____ | _____ | _____ | _____ |
| OFFICE TOTAL | | x % as of 12/31/09 | | _____ | _____ | _____ | _____ |
| RETAIL | | | | | | | |
| RETAIL 1 | CJV | City, State | xxx | _____ | _____ | _____ | _____ |
| RETAIL TOTAL | | x % as of 12/31/09 | | _____ | _____ | _____ | _____ |
| TOTAL REAL ESTATE OWNED AND JOINT VENTURES | | | | _____ | _____ | _____ | _____ |
| MORTGAGE AND OTHER LOANS RECEIVABLE | | | | | | | |
| LOAN 1 | Loan | | N/A | | | | |
| LOAN 2 | Eloan | City, State | xxx | _____ | _____ | _____ | _____ |
| MORTGAGE AND OTHER LOANS RECEIVABLE TOTAL | | | | _____ | _____ | _____ | _____ |
| OTHER REAL ESTATE INVESTMENTS | | | | | | | |
| OTHER | NR | City, State | N/A | _____ | _____ | _____ | _____ |
| OTHER REAL ESTATE INVESTMENTS TOTAL | | | | _____ | _____ | _____ | _____ |
| TOTAL REAL ESTATE INVESTMENTS | | | | <u>\$</u> | <u>\$</u> | <u>\$</u> | <u>\$</u> |

WO - Wholly Owned Investment

CJV - Consolidated Joint Venture

EJV - Joint Venture Investment accounted for under the equity method

Eloan - Mezzanine loan accounted for under the equity method

NR - Note Receivable

** REQUIRED INFORMATION - AT MINIMUM ALL INVESTMENTS GREATER THAN 5% OF NET ASSETS MUST BE SEPARATELY IDENTIFIED AS AN INVESTMENT. BALANCE CAN BE LISTED AS OTHER WITHIN EACH SEGMENT. RECOMMENDED INFORMATION - THE GREATER OF YOUR TWENTY LARGEST INVESTMENTS OR YOUR 5% INVESTMENTS.*

See accompanying notes to the consolidated financial statements.

XYZ REAL ESTATE ACCOUNT

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED DECEMBER 31, 2009 AND 2008

1. ORGANIZATION

The XXXX Retirement Association has approved certain asset allocations in core equity real estate (the "Account") for which Real Estate Account LLC is the Investment Advisor ("ABC" or "Investment Advisor"). The Account is an investment account in the business of acquiring, improving, operating, and holding for investment, income-producing industrial, office, and residential properties.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation — The accompanying consolidated financial statements of the Account have been presented in conformity with accounting principles generally accepted in the United States of America. The consolidated financial statements of the Account include the accounts of its wholly-owned and controlled subsidiaries. All intercompany transactions are eliminated in the consolidation.

Use of Estimates — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

The real estate and capital markets are cyclical in nature. Property and investment values are affected by, among other things, the availability of capital, occupancy rates, rental rates and interest and inflation rates. As a result, determining real estate and investment values involves many assumptions. Amounts ultimately realized from each investment may vary significantly from the fair values presented.

Investments in Properties — Investments in properties are carried at fair value. Properties owned are initially recorded at the purchase price plus closing costs. Development costs and major renovations are capitalized as a component of cost, and routine maintenance and repairs are charged to expense as incurred. Real estate costs include the cost of acquired property, including all tangible and intangible assets. Tangible assets include the value of all land, building and tenant improvements at the time of acquisition. Intangible assets include the value of any above and below market leases, in-place leases, and tenant relationships at the time of acquisition.

Investments in Joint Ventures — Real estate joint ventures and certain limited partnerships are stated at the fair value of the Account's ownership interests of the underlying entities. The Account's ownership interests are valued based on the fair value of the underlying real estate, any related mortgage loans payable (either at fair or carrying value), and other factors, such as ownership percentage.

ownership rights, buy/sell agreements, distribution provisions and capital call obligations. Upon the disposition of all real estate investments by an investee entity, the Account will continue to state its equity in the remaining net assets of the investee entity during the wind down period, if any that occurs prior to the dissolution of the investee entity. The Account's real estate joint ventures and limited partnerships are generally classified within level 3 of the valuation hierarchy.

[AND/OR]

With some investments in joint ventures, the fair value of real estate investments was determined using the Fund's share of the underlying net asset value of the investment at the valuation date. Referred to as a "practical expedient" approach within Topic 820: Fair Value Measurements and Disclosures, the investor can carry its investments at its share of net asset value when information about the market or the investment itself are not readily available and the investor is not aware of any adjustments that may be required for specific events or circumstances that could affect the value of these investments. The value of investments using the practical expedient was \$xx,xxx and \$xx,xxx for the periods ending December 31, 2008 and 2009 respectively.

[AND/OR]

The fair value of the underlying mortgage and notes payable in each investment in a joint venture may not be known. Where the Account has adequate control and access to pertinent information, these instruments are carried at fair/carrying value [Note to preparer: A description of the reason for using carrying value should be disclosed here.] The fair value of mortgages and notes payable where these instruments are carried at fair value was \$xx,xxx and \$xx,xxx (at share) for the periods ending December 31, 2008 and 2009 respectively. The carrying value of mortgages and notes payable for instruments where the Fair Value option was not chosen was \$xx,xxx and \$xx,xxx (at share) for the periods ending December 31, 2008 and 2009 respectively.

Investments in Mortgage Loans and Notes Receivable —

Investments in mortgage loans and notes receivable are carried at fair value. Loan acquisition and origination costs are capitalized as a component of cost.

Investment Valuation — Real estate values are based upon independent appraisals, estimated sales proceeds or the Advisor's opinion of value. Such values have been identified for investment and portfolio management purposes only; the Account reserves its right to pursue full remedies for the recovery of its investments and other rights. The fair value of real estate investments does not reflect transaction sale costs, which may be incurred upon disposition of the real estate investments.

As described above, the estimated fair value of real estate related assets is determined through an appraisal process. These estimated fair values may vary significantly from the prices at which the real estate investments would sell, since market prices of real estate investments can only be determined by negotiation between a willing buyer and

Deleted: Investments in joint ventures are carried at fair value and are presented in the financial statements using the equity method of accounting since control of the investment is shared with the respective venture member. Under the equity method, the investment is initially recorded at the original investment amount, plus additional amounts invested, and is subsequently adjusted for the Account's share of undistributed earnings or losses (including unrealized appreciation and depreciation) from the underlying entity. In addition, the Account classifies and accounts for investments in certain participating loans as investments in joint ventures where arrangements have virtually the same risks and rewards of ownership.¶

seller. Although the estimated fair values represent subjective estimates, management believes these estimated fair values are reasonable approximations of market prices and the aggregate estimated value of investments in real estate is fairly presented at December 31, 20x8 and 20x7.

Concentration of Credit Risk — The Account invests its cash primarily in deposits and money market funds with commercial banks. At times, cash balances at a limited number of banks and financial institutions may exceed federally insured amounts. The general partner believes it mitigates credit risk by depositing cash in or investing through major financial institutions. In addition, in the normal course of business, the Account extends credit to its tenants, which consist of local, regional and national based tenants. The general partner does not believe this represents a material risk of loss with respect to its financial position.

Cash and Cash Equivalents — Cash and cash equivalents are comprised of cash and short-term investments with original maturity dates of less than ninety days from the date of purchase.

Mortgage Loans and Notes Payable — Mortgage loans and notes payable are shown at fair value. Subsequent to the election of The Fair Value Option under Accounting Standards Codification subtopic 825-10 (“ASC 825-10”), deferred financing costs are charged to expense as incurred and not deferred. For the years ended December 31, 2009 and 2008 the Account incurred financing costs of \$xx,xxx and \$xx,xxx, respectively. Such amounts are included in interest expense in the accompanying statement of operations.

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[AND/OR]

Mortgage loans and notes payable are shown at amortized cost. Costs associated with obtaining mortgage loans and notes payable have been capitalized and are being amortized over the term of the related loan and note payable on a straight-line basis which approximates the effective interest method, as a component of interest expense. Deferred financing costs of \$xx,xxx and \$xx,xxx are net of accumulated amortization of \$xx,xxx and \$xx,xxx as of December 31, 2009 and December 2008, respectively and are included in [line item] on the accompanying statements of financial position.

Interest Rate Swaps and Caps — The Account records derivative financial instruments, primarily interest rate caps and swaps, at fair value, which is the estimated amounts that the Account would receive or pay in a current exchange transaction at the reporting date, taking into account current interest rates and the current credit worthiness of the respective counter-parties. The Account uses interest rate swaps and caps in order to reduce the effect of interest rate fluctuations of certain real estate investments’ interest expense on variable debt. See Note 6.

Revenue and Expense Recognition — Rental income is recognized on an accrual basis in accordance with the terms of the underlying lease agreements. Interest income is accrued as earned in accordance with the contractual terms of the loan agreements. Operating expenses are recognized as incurred.

Investment Advisory Fees — Investment advisory fees include asset management fees and investment acquisition fees charged by ABC. Such amounts are reflected in the accompanying financial statements when incurred.

Income Taxes — The Account has been classified as a qualified trust under Section 401(a) of the internal Revenue code of 1986 (the “Code”) and management believes it continues to comply with the requirements of Section 501(a) of the code. Accordingly, the Account is exempt from income taxes, and no income tax provision is provided. If an uncertain income tax position were to be identified, the Account would account for such in accordance with Accounting Standards Codification topic 450, *Contingencies*.

Accounting Standards Codification topic 740, *Income Taxes* (ASC 740), provides guidance for how uncertain tax positions should be recognized, measured, presented and disclosed in the financial statements. ASC 740 requires the evaluation of tax positions taken in the course of preparing the Account’s tax returns to determine whether tax positions are “more-likely-than-not” of being sustained by the applicable tax authority. Tax benefits of positions not deemed to meet the more-likely-than-not threshold would be recorded as a tax expense in the current year. The Account adopted ASC 740 effective January 1, 2009 and applied it to all open tax years as of the effective date.

Guarantees — The Account is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing a guarantee. At the inception of guarantees issued, the Account will record the fair value of the guarantee as a liability, with the offsetting entry being recorded based on the circumstances in which the guarantee was issued. The Account did not have any material guarantee liabilities at December 31, 2009 and 2008.

Foreign Currency — For investments held outside the United States of America (the “USA”), the Account uses the local currency of the place of operations as its functional currency. Assets and liabilities are translated to U.S. dollars using current exchange rates at the balance sheet date. Revenue and expenses are translated to U.S. dollars using a weighted average exchange rate during the year. The gains and losses resulting from such translation are reported as a component of unrealized gains and losses on the statement of operations. The cumulative translation gain (loss) as of December 31, 2009 and 2008 was \$_____ and \$_____, respectively. Foreign currency transactions may produce receivables or payables that are fixed in terms of the amount of foreign currency that will be received or paid. A change in the exchange rates between the functional currency and the currency in which the transaction is denominated increases or decreases the expected amount of functional currency cash flows upon settlement of that transaction. That increase or decrease in the expected functional currency cash flows is a foreign currency transaction gain or loss that generally will be included in determining total unrealized gains and losses on the statement of operations. A transaction gain or loss (measured from the transaction date or the most recent intervening balance sheet date, whichever is later), realized upon settlement of a foreign currency transaction generally will be included as a component

of realized gains and losses on the statement of operations. The real estate investments were funded partially through financing based arrangements that are scheduled for settlement, consisting primarily of accrued interest and intercompany loans with scheduled principal payments. For the years ended December 31, 2009 and 2008, the Account recognized realized gains of \$_____ and \$_____, respectively on foreign currency transactions in connection with the distribution of cash from foreign operating investees to the Account.

Risk Management — In the normal course of business, the Account encounters economic risk, including interest rate risk, credit risk, foreign currency risk and market risk. Interest rate risk is the result of movements in the underlying variable component of the mortgage financing rates. Credit risk is the risk of default on the Account's real estate investments that results from an underlying tenant's inability or unwillingness to make contractually required payments. Foreign currency risk is the effect of exchange rate movements of foreign currencies against the dollar. Market risk reflects changes in the valuation of real estate investments held by the Account.

The Account has not directly entered into any derivative contracts for speculative or hedging purposes against these risks. One of the Account's investments (_____), which owns a facility in _____, has entered into a pay-fixed interest rate swap to manage interest rate risk exposure on its variable rate financing. The investee (_____) is potentially exposed to credit loss in the event of non-performance by the counterparty; however, due to the counterparty's credit rating, the Account does not anticipate that the counterparty will fail to meet their obligations.

Changes in Accounting Principle — Accounting Standards Codification section 810-10-45 ("ASC 810-10-45") requires noncontrolling interests (previously referred to as minority interests) to be reported as a component of equity, which changes the accounting for transactions with noncontrolling interest holders. (For purposes of this illustration, assume the Statement is effective as of January 1, 20x8). ASC 810-10-45 is applied prospectively to all noncontrolling interests, except the presentation and disclosure requirements. The presentation and disclosure requirements were applied retrospectively for all periods presented, as follows: (i) the noncontrolling interest was reclassified to equity, and (ii) consolidated net income was adjusted to include the net income attributed to the noncontrolling interest.

Accounting Standards Codification 815-10-65 expands the disclosure requirements for derivative instruments and hedging activities, to require qualitative disclosure about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Account adopted this statement as of January 1, 2009 and has modified its derivative related disclosures as a result.

Accounting Standards Codification 855-10 (ASC 855-10) establishes general standards of accounting for and disclosure of events that occur

Deleted: Accounting Standards Codification topic 820, *Fair Value Measurements and Disclosures* ("ASC 820"), provides guidance for using fair value or measure assets and liabilities. ASC 820 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. ASC 820 includes provisions that require expanded disclosure of the effect on earnings for items measured using unobservable data. The Account adopted ASC 820 effective January 1, 2008.¶
The fair value option under ASC 825-10 permits entities to choose to measure many financial instruments and certain other items at fair value ("Fair Value Option"). Election of the Fair Value Option is made on an instrument-by-instrument basis and is irrevocable. The Account elected the Fair Value Option effective January 1, 20x8. At the adoption date, unrealized gains and losses on financial assets and liabilities for which the Fair Value Option has been elected are reported as a cumulative adjustment to beginning retained earnings. The Account made the election to record its debt at fair value because it believes it is a better representation of the asset value. The Account will report unrealized gains and losses due to changes in fair value in earnings at each subsequent reporting date.

after the balance sheet date but before financial statements are issued or are available to be issued. ASC 855-10 renames the two types of subsequent events as recognized subsequent events or non-recognized subsequent events and to modify the definition of the evaluation period for subsequent events as events or transactions that occur after the balance sheet date, but before the financial statements are issued. It requires the disclosure of the date through which the entity has evaluated subsequent events and the basis for that date. This statement is effective for interim and annual periods ending after June 15, 2009. The Account adopted this statement in June 2009 and determined this statement did not have a material impact on its financial statements.

In June 2009, the FASB issued ASC 810: Consolidation, Amendments to FASB Interpretation No. 46(R) (“SFAS No. 167”). ASC 810 amends the consolidation guidance applicable to variable interest entities (“VIE”). The statements requires a qualitative rather than a quantitative analysis to determine the primary beneficiary of a VIE, requires continuous assessment of whether an enterprise is the primary beneficiary of a VIE and requires enhanced disclosures about an enterprise’s involvement with a VIE. The Statement is effective as of the beginning of each reporting entity’s first annual reporting period that begins after November 15, 2009.

Deleted: SFAS No. 167

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Accounting Standards Update No. 2009-12 (ASU 2009-12) permits, as a practical expedient, a reporting entity to measure fair value of an investment on the basis of net asset value per share of the investment (or its equivalent) if the net asset value of the investment (or its equivalent) is calculated in a manner consistent with the measurement principles of Topic 946 as of the reporting entity’s measurement date. The amendments in ASU 2009-12 also require disclosures by major category of investment about the attributes of investments within the scope of the amendments. The ASU is effective for interim and annual periods ending after December 15, 2009 with early adoption permitted.

Impact of Accounting Standards Not Yet Adopted — [to be tailored to each year]

3. FAIR VALUE MEASUREMENTS

[Note to preparer: The following example disclosures represent the most commonly used methods/policies for the valuation of consolidated, debt-related financial instruments. These are not intended to represent the universe of potential disclosures for such items. It is highly recommended that the preparer of the financial statements closely examine each consolidated instrument within the financial statements and determine the policy surrounding each. If some instruments fall outside the scope of valuation policies in general, it is recommended that the nature of the policies surrounding those instruments be disclosed in addition too, but separate from, the valued instruments.]

In determining fair value, the Account uses various valuation approaches. ASC 820 establishes fair value measurement framework, provides a single definition of fair value, and requires expanded disclosure summarizing fair value measurements. ASC 820 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing an asset or liability.

The standard establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable input be used when available. Observable inputs are inputs that the market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Account. Unobservable inputs are inputs that reflect the Account's assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is measured in three levels based on the reliability of inputs:

Level 1— Valuations based on quoted prices in active markets for identical assets or liabilities that the Account has the ability to access. Valuation adjustment and block discounts are not applied to Level 1 instruments.

Level 2 — Valuations based on quoted prices in less active, dealer or broker markets. Fair values are primarily obtained from third party pricing services for identical or comparable assets or liabilities.

Level 3 — Valuations derived from other valuation methodologies, including pricing models, discounted cash flow models and similar techniques, and not based on market, exchange, dealer, or broker-traded transactions. Level 3 valuations incorporate certain assumptions and projections that are not observable in the market and significant professional judgment in determining the fair value assigned to such assets or liabilities.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The following is a description of the valuation techniques used for investments measured at fair value:

Real Estate Properties — The values of real estate properties have been prepared giving consideration to the income, cost and sales comparison approaches of estimating property value. The income approach estimates an income stream for a property (typically 10 years) and discounts this income plus a reversion (presumed sale) into a present value at a risk adjusted rate. Yield rates and growth assumptions utilized in this approach are derived from market transactions as well as other financial and industry data. The cost approach estimates the replacement cost of the building less physical depreciation plus the land value. Generally, this approach provides a check on the value derived using the income approach. The sales comparison approach compares recent transactions to the appraised property. Adjustments are made for dissimilarities which typically provide a range of value. Generally, the income approach carries the most weight in the value reconciliation.

Investment values are determined quarterly from limited restricted appraisals, in accordance with the Uniform Standards of Professional Appraisal Practice ("USPAP"), which include less documentation but nevertheless meet the minimum requirements of the Appraisal

Standards Board and the Appraisal Foundation and are considered appraisals. In these appraisals, a full discounted cash flow analysis, which is the basis of an income approach, is the primary focus. Interim monthly valuations are determined by giving consideration to material investment transactions. Full appraisal reports are prepared on a rotating basis for all properties, so each property receives a full appraisal report at least once every three years.

Since appraisals take into consideration the estimated effect of physical depreciation, historical cost depreciation and amortization on real estate related assets has been excluded from net investment income.

The values of real estate properties undergoing development have been prepared giving consideration to costs incurred to date and to key development risk factors, including entitlement risk, construction risk, leasing/sales risk, operation expense risk, credit risk, capital market risk, pricing risk, event risk and valuation risk. The fair value of properties undergoing development includes the timely recognition of estimated entrepreneurial profit after such consideration.

During 2009 and 2008, all appraisals for the Account were prepared by independent external appraisers. The external appraisals are reviewed by an external appraisal management firm. All appraisal reports and appraisal reviews comply with the currently published USPAP, as promulgated by the Appraisal Foundation. The Account's real estate properties are generally classified within level 3 of the valuation hierarchy.

Real Estate Joint Ventures and Limited Partnerships — Real estate joint ventures and certain limited partnerships are stated at the fair value of the Account's ownership interests of the underlying entities. The Account's ownership interests are valued based on the fair value of the underlying real estate, the [fair/carrying] value of any related mortgage loans payable, and other factors, such as ownership percentage, ownership rights, buy/sell agreements, distribution provisions and capital call obligations. Upon the disposition of all real estate investments by an investee entity, the Account will continue to state its equity in the remaining net assets of the investee entity during the wind down period, if any, that occurs prior to the dissolution of the investee entity. The Account's real estate joint ventures and limited Accounts are generally classified within level 3 of the valuation hierarchy.

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Marketable Securities — Equity securities listed or traded on any national market or exchange are valued at the last sale prices as of the close of the principal securities exchange on which such securities are traded or, if there is no sale, at the mean of the last bid and asked prices on such exchange, exclusive of transaction costs. Such marketable securities are classified within level 1 of the valuation hierarchy.

Debt securities, other than money market instruments, are generally valued at the most recent bid price of the equivalent quoted yield for such securities (or those of comparable maturity, quality, and type). Money market instruments with maturities of one year or less, are valued in the same manner as debt securities or derived from a pricing

matrix. Debt securities are generally classified within level 2 of the valuation hierarchy.

Mortgage Loans and Notes Receivable — The fair value of mortgage loans and notes receivable held by the Account have been determined by one or more of the following criteria as appropriate: (i) on the basis of estimated market interest rates for loans of comparable quality and maturity, (ii) by recognizing the value of equity participations and options to enter into equity participations contained in certain loan instruments and (iii) giving consideration to the value of the underlying collateral. The Account's mortgage loans and notes receivable is classified within level 3 of the valuation hierarchy.

Mortgage Loans and Notes Payable — The fair values of mortgage loans and notes payable are determined by discounting the future contractual cash flows to the present value using a current market interest rate. The market rate is determined by giving consideration to one or more of the following criteria as appropriate: (i) interest rates for loans of comparable quality and maturity, and (ii) the value of the underlying collateral. The Account's mortgage loans and notes payable are generally classified within level 3 of the valuation hierarchy. The fair value of mortgage loans and notes payable valued using the gross methodology was \$XXX.XX and \$XXX.XX for the periods ending December 31, 2XX8 and 2XX9 respectively.

[AND/OR]

Some consolidated mortgage loans payable are not carried at fair value (i.e. the Fair Value Option was not elected). [Note to preparer: A description of the reason for this should be disclosed here.] The unamortized cost of investments not valued in the financial statements was \$XXX.XX and \$XXX.XX for the periods ending December 31, 2XX8 and 2XX9 respectively. [Note to preparer: If information is available, the following disclosure should be made.] The fair value of the instruments was \$xx,xxx and \$xx,xxx for the periods ending December 31, 2008 and 2009 respectively.

The following are the major categories of assets and liabilities measured at fair value on a recurring basis during the year ended December 31, 2009, using unadjusted quoted prices in active markets for identical assets (Level 1); significant other observable inputs (Level 2); and significant unobservable inputs (Level 3):

| Description | Level 1: Quoted Prices in Active Markets for Identical Assets | Level 2: Significant Other Observable Inputs | Level 3: Significant Unobservable Inputs | Total at December 31, 2009 |
|--|--|--|---|----------------------------------|
| Real estate properties | \$ | \$ | \$ | \$ |
| Real estate joint ventures and limited partnerships | | | | |
| Marketable securities — real estate related | | | | |
| Marketable securities — debt securities | | | | |
| Mortgage loans and notes receivable | _____ | _____ | _____ | _____ |
| Total investments | <u>\$</u> | <u>\$</u> | <u>\$</u> | <u>\$</u> |
| Mortgage loans and notes payable* | <u>\$</u> | <u>\$</u> | <u>\$</u> | <u>\$</u> |

* The illustrated example above assumes the account had elected the fair value option in accounting for each mortgage loans and notes payable.

The following is a reconciliation of the beginning and ending balances for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the year ended December 31, 2009:

| | Real Estate Properties | Real Estate Joint Ventures and Limited Partnerships | Mortgage Loan and Notes Receivable | Total Level 3 Investments | Mortgage Loans Payable |
|--|------------------------|---|------------------------------------|---------------------------|------------------------|
| Beginning balance — January 1, 2009 | \$ | \$ | \$ | \$ | \$ |
| Total realized and unrealized gains (losses) included in changes in net assets | | | | | |
| Purchases, issuances, and settlements | _____ | _____ | _____ | _____ | _____ |
| Ending balance — December 31, 2009 | \$ _____ | \$ _____ | \$ _____ | \$ _____ | \$ _____ |

4. REAL ESTATE

The following is a summary of the fair value basis assets, [fair/carrying] value of liabilities, and operating results underlying the Account's joint venture investments at December 31, 2009 and 2008, and for the years then ended:

| | 12/31/2009 | 12/31/2008 |
|--|-------------------|-------------------|
| Land and buildings | \$ | \$ |
| Other assets | | |
| Mortgage loans | | |
| Other liabilities | _____ | _____ |
| Net assets | \$ _____ | \$ _____ |
| Account's share of real estate joint venture net assets | \$ _____ | \$ _____ |
| Year Ended | 12/31/2009 | 12/31/2008 |
| Revenues | \$ | \$ |
| Property operating expenses | | |
| Interest expense | _____ | _____ |
| Net investment income | \$ _____ | \$ _____ |
| Account's equity in income of real estate joint ventures | \$ _____ | \$ _____ |

[Note to preparer: The following example disclosures represent the most commonly used methods/policies for the valuation of unconsolidated investments. This is not intended to represent the universe of potential disclosures for such items. It is highly recommended that the preparer of the financial statements closely examine each unconsolidated investment within the financial statements and determine the policy surrounding each.]

The real estate joint ventures includes investments in several real estate funds that invest primarily in U.S commercial real estate. The fair

values of the investments in this category have been estimated using the net asset value of the Account's ownership interest in partners' capital. The joint ventures have (or have not) elected to carry their mortgages and notes payable at fair value. These investments can never be redeemed with the funds (or these investments may be redeemed quarterly with XX days' notice). Distributions from each fund will be received as the underlying investments of the funds are liquidated. It is estimated that the underlying assets of the funds will be liquidated over the next XX to XX years. XX% of the total investment is planned to be sold. However, the individual investments that will be sold have not yet been determined. Because it is not probable that any individual investment will be sold, the fair value of each individual investment has been estimated using the net asset value of the Account's ownership interest in partners' capital. The Fund's unfunded commitments related to real estate joint ventures were \$XXX, XXX at December 31, 20x8. *Sample disclosure requirement under ASU 2009-12 which is effective for interim and annual periods ending after December 15, 2009 with early adoption permitted.*

Real estate joint ventures and certain limited partnerships are stated at the fair value of the Company's ownership interests of the underlying entities. The Company's ownership interests are valued based on the fair value of the underlying real estate, any related mortgage loans payable, and other factors, such as ownership percentage, ownership rights, buy/sell agreements, distribution provisions and capital call obligations. Upon the disposition of all real estate investments by an investee entity, the Company will continue to state its equity in the remaining net assets of the investee entity during the wind down period, if any that occurs prior to the dissolution of the investee entity. The Company's real estate joint ventures and limited partnerships are generally classified within level 3 of the valuation hierarchy. The gross value of mortgage loans and notes payable valued using the net methodology was \$xx,xxx and \$xx,xxx for the periods ending December 31, 2008 and 2009 respectively.

The fair value of real estate joint ventures and certain limited partnerships was determined using the fund share of the underlying net asset value of the investment at the valuation date. Referred to as a "practical expedient" approach within Topic 820: Fair Value Measurements and Disclosures, the investor, under certain circumstances, can carry its investments at its share of net asset value when information about the market or the investment itself are not readily available and the investor is not aware of any adjustments that may be required for specific events or circumstances that could affect the value of these investments. The value of investments using this practical expedient was \$xx,xxx and \$xx,xxx for the periods ending December 31, 2008 and 2009 respectively.

5. MORTGAGE LOANS AND NOTES PAYABLE

Mortgage loans and notes payable consist of the following as of December 31, 2009 and 2008:

| | 2009 Loan Balance at Fair Value | 2009 Principal Balance Outstanding | 2008 100% Loan Balance at Fair Value | Interest Rate ¹ | Maturity Date | Terms ⁵ |
|---|--|---|---|-------------------------------|------------------|--------------------|
| Mortgages on Wholly Owned Properties and Consolidated Partnerships | | | | | | |
| Property Name | \$ | \$ | \$ | x.xx% | 2011 | P&I, PP |
| Property Name | | | | LIBOR (30-day) + x.xx% | 2015 | I |
| Property Name | | | | LIBOR (30-day) + x.xx% | 2015 | I |
| Property Name | | | | LIBOR (30-day) + x.xx% | 2015 | I |
| Property Name | | | | LIBOR (30-day) + x.xx% | 2015 | I |
| Property Name | | | | LIBOR (30-day) + x.xx% | 2017 | I |

Total Mortgage Loans Payable

* Where The Fair Value Option was elected.

- ¹ As of December 31, 2009, 30 day LIBOR was x.xxxx%.
- ² Represents the Account's interest in the loan based upon the estimated percentage of net assets which would be distributed to the Account if the Accounts were liquidated at December 31, 2009. It does not represent the Account's legal obligation.
- ³ This is an average rate calculated on staggering tranches at LIBOR + x.xx%.
- ⁴ The loan has a floating interest rate of x.xx% over LIBOR however the venture is obligated to pay a fixed rate of x.xx% with the venture partner assuming all interest rate risk or benefit.
- ⁵ Loan Terms PP=Prepayment penalties applicable to loan, I=Interest only, P&I=Principal and Interest
- ⁶ The Account's weighted average interest rate for the year ending December 31, 2009 was x.xx%. The weighted average interest rate was calculated using the Account's annualized interest expense for each loan (derived using the same percentage as that in (***) above), divided by the Account's derived share of total debt.
- ⁷ The Weekly Variable Rate shall be the minimum rate of interest necessary, in the professional judgment of the Remarketing Agent, taking into consideration prevailing market conditions, to enable the Remarketing Agent to remarket all of the Bonds on the applicable Rate Determination Date at par plus accrued interest on the bonds for that week.

Mortgage loans payable for wholly owned properties and consolidated Accounts are collateralized by real estate investments with an aggregate estimated value of \$xx,xxx as of December 31, 2009. The loans agreements contain financial and non-financial covenants, including requirements regarding net assets, leverage ratio, and debt service coverage ratio. The Account believes it was in compliance with all covenants as of and for the year ended December 31, 2009.

As of December 31, 2009, principal amounts of mortgage loans payable and notes payable on wholly owned properties and consolidated Accounts are payable as follows:

Year Ended December 31

| | |
|--------------|-----------------|
| 20x9 | \$ |
| 20x0 | |
| 20x1 | |
| 20x2 | |
| 20x3 | |
| Thereafter | _____ |
| Total | \$ _____ |

The mortgage loans and notes may be prepaid, in whole or in part, at any time without premium or penalty.

6. INTEREST RATE SWAPS AND CAPS

Certain of Account's equity method and consolidated joint ventures entered into interest rate swap and cap transactions ("Swaps and Caps") with unrelated major financial institutions. The Account has agreements with each derivative counterparty that contain a provision where if the Account defaults on any of its indebtedness, then the Account could also be declared in default on its derivative obligations.

The Account has recorded the fair values of the Swaps and Caps as of December 31, 20x9 and 20x8, which have been reflected in "Unconsolidated Real Estate joint ventures" for equity method joint ventures and "Other liabilities" for consolidated ventures on the Consolidated Statements of Net Assets. The resulting unrealized gain (loss) on the equity Accounts is reflected in the Consolidated Statements of Operations in "Change in unrealized gain (loss) on real estate investments". The resulting unrealized gain (loss) for consolidated ventures is reflected in the Consolidated Statements of Operations in "Change in unrealized gain (loss) on interest rate swaps and caps" and "Portion attributable to noncontrolling interests".

As of December 31, 2009, Interest Rate Swaps and Caps are summarized as follows:

| Consolidated Joint Ventures and Wholly Owned: | Type of Contract | Notoinal Amount | Rate | Fair Value at December 31, | | Maturity Date |
|---|---------------------|-----------------|-------|----------------------------|-------|---------------|
| | | | | 2009 | 2008 | |
| Property 1 | Pay — Fixed Swap | \$ | x.xx% | \$ | \$ | July 20x8 |
| Property 2 | Pay — Floating Swap | | x.xx% | | | July 20x8 |
| Property 3 | Cap | _____ | | _____ | _____ | July 20x6 |
| Total Consolidated Joint Ventures | | _____ | | _____ | _____ | |
| Equity Joint Ventures: | | | | | | |
| Property 1 | Pay — Fixed Swap | | x.xx% | | | January 20x6 |
| Property 2 | Pay — Fixed Swap | | x.xx% | | | March 20x0 |
| Property 3 | Pay — Fixed Swap | | x.xx% | | | February 20x2 |
| Property 4 | Cap | _____ | | _____ | _____ | April 20x9 |
| Total Equity Joint Ventures | | _____ | | _____ | _____ | |
| Total | | \$ | | \$ | \$ | |

7. PORTFOLIO DIVERSIFICATION

At December 31, 2009, the Account had real estate investments located throughout the United States of America. The diversification of the account's holdings based on the estimated fair values and established NCREIF regions is as follows:

| Region | Net Asset Value | Region % |
|--------------------|------------------------|------------------|
| East North Central | \$ | 64 % |
| Mideast | | 18 % |
| Mountain | | 18 % |
| Northeast | | 9 % |
| Pacific | | 9 % |
| Southeast | | 9 % |
| Southwest | _____ | 9 % |
| Total | \$ _____ | <u>100 %</u> |

8. INVESTMENT ADVISOR FEES

Investment advisory fees for investments under management by ABC are billed at a rate of 15.0 basis points per quarter for the first \$200 million of gross asset value, 13.5 basis points per quarter for the next \$300 million of gross asset value, and 12.0 basis points per quarter thereafter, in arrears. ABC also earns acquisition fees equal to 75 basis points on acquisition costs.

For the years ended December 31, 2009 and 2008 total management fees earned by ABC totaled \$1,250 and \$1,000, respectively. Management fees of \$350 were unpaid as of December 31, 2009.

9. LEASING

At December 31, 2009, minimum future rental payments to be received under non-cancelable operating leases having a term of more than one year are as follows:

| Year Ending December 31 | Properties | Joint Ventures |
|--------------------------------|-------------------|-----------------------|
| 2010 | \$ | \$ |
| 2011 | | |
| 2012 | | |
| 2013 | | |
| 2014 | | |
| Thereafter | _____ | _____ |
| TOTAL | \$ _____ | \$ _____ |

The above future minimum base rentals exclude residential lease agreements with terms of less than one year, which accounted for approximately xx% of the Account's annual rental income for the years ended December 31, 2009. Rental income for the years ended

December 31, 2009 and 2008 included approximately \$xx,xxx and \$xx,xxx, respectively, recovered from tenants for common area expenses, other reimbursable costs, and percentage rents.

10. FINANCIAL HIGHLIGHTS (UNITIZED) – EXAMPLE 1

| | <u>For the Year Ended December 31,</u> | |
|--|--|-------------|
| | <u>2009</u> | <u>2008</u> |
| PER SHARE (UNIT) OPERATING PERFORMANCE(*): | | |
| Net Asset Value, beginning of period | \$ | \$ |
| INCOME FROM INVESTMENT OPERATIONS: | | |
| Investment income, before management fees | | |
| Net realized and unrealized gain (loss) on investments | _____ | _____ |
| Total from investment operations, before management fees | | |
| Management fees | _____ | _____ |
| Total from investment operations | | |
| Deemed contributions and cancellation of units for management fees | _____ | _____ |
| Net Asset Value, end of period | <u>\$</u> | <u>\$</u> |
| Total Return, before Management Fees (a): | x.xx% | x.xx% |
| Total Return, after Management Fees (a): | x.xx% | x.xx% |
| RATIOS/SUPPLEMENTAL DATA: | | |
| Ratios to average net assets (b): | | |
| Total Expenses | x.xx% | x.xx% |
| Net Investment Income | x.xx% | x.xx% |

(*) All amounts are shown net of amounts allocated to noncontrolling interests

- (a) Total Return, before/ after management fees is calculated by geometrically linking quarterly returns which are calculated using the formula below:

$$\frac{\text{Investment Income before/after Management Fees} + \text{Net Realized and Unrealized Gains/Losses}}{\text{Beg. Net Asset Value} + \text{Time Weighted Contributions} - \text{Time Weighted Distributions}}$$

- (b) Average net assets are based on beginning of quarter net assets.

10. FINANCIAL HIGHLIGHTS (CLOSED-END/ FINITE LIVED) – EXAMPLE 2

| | For the Year Ended December 31, 2009 |
|--|---|
| Total Return: | |
| Internal Rate of Return (a) | x.xx% |
| | |
| Ratios/Supplemental Data: | |
| Net Assets, end of period | \$ _____ |
| | |
| Ratios to average net assets (b): | |
| Total investment expenses | |
| Incentive Allocation | x.xx% |
| Total Expenses and incentive allocation | x.xx% |
| Net Investment Income | x.xx% |
| | |
| Ratio of total contributed capital to committed capital | x.xx% |
| | |
| (*) All amounts are shown net of amounts allocated to noncontrolling interests | |

- (a) Total return is calculated based on a dollar-weighted internal rate of return methodology net of fees and incentive allocations. Internal rate of return is computed on a cumulative, since inception basis using annual compounding and the actual dates of cash inflows received by and outflows paid to limited partners and including ending net asset value as of each measurement date.
- (b) Average net assets are calculated based on an average of beginning quarterly net assets.

A table presenting the required disclosures for the year ended December 31, 2008 is not presented. The presentation of these ratios and returns is not meaningful, since no capital was contributed during 2008.. ratios to average net assets and internal rate of return are calculated for the limited partners as a whole. The computation of such ratios and returns for an individual partner may vary from these ratios and returns based on different management fee and incentive arrangements. The net investment income ratio does not reflect the effects of any incentive allocation.

11. COMMITMENTS AND CONTINGENCIES

Accounting Standards Codification topic 460, *Guarantees* (“ASC 460”), specifies the accounting for and disclosures to be made regarding obligations under certain guarantees.

The Account may issue loan guarantees to obtain financing agreements and/or preferred terms related to its investments. These guarantees include mortgage and construction loans and may cover payments of principal and/or interest. These guarantees have fixed termination dates and become liabilities of the Account in the event the borrower is unable to meet the obligations specified in the guarantee agreement. The Account may also be liable under certain of these guarantees in the event of fraud, misappropriation, environmental liabilities, and certain other matters involving the borrower.

The Account is a guarantor of the following outstanding recourse obligations:

| Real Estate Investment | Expiration Date | Maximum Obligation | Fair Value of Guarantee Liability (a) |
|------------------------|-----------------|--------------------|---------------------------------------|
| | | \$ | \$ |

- (a) The fair value of guarantees are included in other liabilities on the balance sheet with a corresponding adjustment to the cost basis of the related investment.

In the normal course of business, the Account enters into other contracts that contain a variety of representations and warranties and which provide general indemnifications. The Account's maximum exposure under these arrangements is unknown, as this would involve future claims that may be made against the Account that have not yet occurred. However, based on experience, management expects the risk of loss to be remote.

As of December 31, 2009, the Account had the following outstanding commitments to purchase real estate or fund additional expenditures on previously acquired properties, which are expected to be funded in 2015:

| Property Type | Commitment |
|---------------|------------|
| Apartment | \$ |
| Retail | |
| Office | |
| Industrial | |
| Loan | _____ |
| Total | \$ _____ |

Certain purchases of real estate are contingent on a developer building the real estate according to plans and specifications outlined in the pre-sale agreement and other conditions precedent. It is anticipated that funding will be provided by operating cash flow, real estate sales, deposits from clients and Account's line of credit.

The Account purchased various real estate during 2009 that include earn-out provisions. An amount of \$xxx,xxx has been accrued as of December 31, 2009 and is included in Accrued Real Estate Expenses and Taxes on the Consolidated Statements of Assets and Liabilities.

There were various legal actions relating to the properties in the Account in the ordinary course of business. In the opinion of the Account's management, the outcome of such matters will not have a

material effect on the Account's financial condition or results of operations.

12. SUBSEQUENT EVENTS

We have evaluated events subsequent to December 31, 2009, through XXXX X, 20XX, the date of financial statement issuance, for disclosure. Through and including XXXX X, 20XX, we have not identified any significant events relative to our financial statements as of December 31, 20XX that warrant additional disclosure.

or

We have evaluated events subsequent to December 31, 2009, through XXXX X, 20XX, the date of financial statement issuance, for disclosure.

Subsequent to year end, on January 15, 20XX, the Account purchased a 115,000 square foot office property in Washington D.C. for \$xxx,xxx.

* * * * *

Appendix 2:

Illustrative Financial Statements for Non-Operating Reporting Model

The accompanying financial statements are illustrative only and are intended to provide an illustrative format for annual financial statement reporting under the fair value basis of accounting using the **Non-Operating Reporting Model**. The illustrative statements reflect common financial statement presentation and disclosure items typically used in the institutional real estate investment community where the Non-Operating Reporting Model is used. Disclosures included in the illustrative financial statements are not intended to be comprehensive and are not intended to establish preferences among alternative disclosures. For specific reporting issues encountered by an individual investment vehicle, the applicable technical accounting literature should be consulted to provide guidance for the appropriate presentation and disclosure in the financial statements.

XYZ Real Estate Fund, LP

Financial Statements for the Years
Ended December 31, 2009 and 2008

XYZ REAL ESTATE FUND LP**STATEMENT OF ASSETS AND LIABILITIES****AS OF DECEMBER 31, 2009 AND 2008****(Dollars in Thousands)**

| | 2009 | 2008 |
|----------------------------------|-----------------|-----------------|
| ASSETS: | | |
| Real estate investments | \$ | \$ |
| Cash and cash equivalents | | |
| Other assets | _____ | _____ |
| TOTAL | \$ _____ | \$ _____ |
| LIABILITIES: | | |
| Mortgage loans and notes payable | \$ | \$ |
| Other liabilities | _____ | _____ |
| Total liabilities | _____ | _____ |
| NET ASSETS | \$ _____ | \$ _____ |

For illustrative purposes only – Non-operating reporting model financial statements

XYZ REAL ESTATE FUND LP

STATEMENT OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008 (Dollars in Thousands)

| | 2009 | 2008 |
|--|-------------|-------------|
| INCOME: | | |
| Income distributions from real estate equity investments | \$ | \$ |
| Interest income on real estate debt investments | | |
| Other | _____ | _____ |
| Total income | | |
| EXPENSES | | |
| Interest expense | | |
| Administrative expenses | | |
| Investment management fees | _____ | _____ |
| Total expenses | _____ | _____ |
| NET INVESTMENT INCOME | _____ | _____ |
| NET REALIZED AND UNREALIZED GAIN (LOSS): | | |
| Realized gain (loss) from sales | | |
| Less: Previously recorded unrealized (gain) loss on sales | _____ | _____ |
| Net realized gain (loss) | | |
| Unrealized gain (loss) on investments held at year end | | |
| Unrealized incentive fees | _____ | _____ |
| Net unrealized gain (loss) | _____ | _____ |
| Net realized and unrealized gain (loss) | _____ | _____ |
| NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS | \$ _____ | \$ _____ |

For illustrative purposes only – Non-operating reporting model financial statements

XYZ REAL ESTATE FUND LP

STATEMENT OF CHANGES IN NET ASSETS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008 (Dollars in Thousands)

| | General Partner | Limited Partners | Total |
|--|--------------------|---------------------|-----------|
| NET ASSETS — December 31, 2007 | \$ | \$ | \$ |
| Increase in net assets from operations | | | |
| Capital contributions | | | |
| Income distributions | | | |
| Return of capital distributions | | | |
| NET ASSETS — December 31, 2008, as previously reported | — | — | — |
| Cumulative effect of change in accounting principle (Note 2) | | | |
| NET ASSETS — December 31, 2008, as revised | — | — | — |
| Increase in net assets from operations | | | |
| Capital contributions | | | |
| Income distributions | | | |
| Return of capital distributions | | | |
| NET ASSETS — December 31, 2009 | <u>\$</u> | <u>\$</u> | <u>\$</u> |

For illustrative purposes only – Non-operating reporting model financial statements

XYZ REAL ESTATE FUND LP

STATEMENT OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008 (Dollars in Thousands)

| | 2009 | 2008 |
|---|----------|----------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net increase in net assets resulting from operations | \$ | \$ |
| Adjustments to reconcile net assets resulting from operations to net cash flows provided by operating activities: | | |
| Net realized and unrealized (gain) loss | | |
| (Increase) / decrease in other assets | | |
| Increase / (decrease) in other liabilities | | |
| Capital distributions from real estate investments | | |
| Funding of real estate investments | | |
| Proceeds from real estate investments sold | _____ | _____ |
| Net cash flow provided by operating activities | _____ | _____ |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from mortgage loans payable | | |
| Principal repayments on mortgage loans payable | | |
| Distributions | | |
| Capital contributions | _____ | _____ |
| Net cash flow used in financing activities | _____ | _____ |
| Net change in cash and cash equivalents | | |
| CASH AND CASH EQUIVALENTS — Beginning of year | _____ | _____ |
| CASH AND CASH EQUIVALENTS — End of year | _____ | _____ |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Cash paid for interest on mortgage loans | \$ _____ | \$ _____ |
| Cash paid for income taxes | \$ _____ | \$ _____ |

For illustrative purposes only – Non-operating reporting model financial statements

XYZ REAL ESTATE (ACCOUNT / FUND LP)

SCHEDULE OF INVESTMENTS* FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

| Property Name | City, State | Square Feet Unless Otherwise Indicated (Unaudited) | December 31, 2009 | | December 31, 2008 | |
|--|--------------------|--|-------------------|------------|-------------------|------------|
| | | | Cost | Fair Value | Cost | Fair Value |
| REAL ESTATE EQUITY INVESTMENTS | | | | | | |
| APARTMENT | | | | | | |
| Apt 1 | City, State | xxx units | \$ | \$ | \$ | \$ |
| Apt 2 | City, State | xxx units | _____ | _____ | _____ | _____ |
| APARTMENT TOTAL | x % as of 12/31/09 | | _____ | _____ | _____ | _____ |
| HOTEL | | | | | | |
| Hotel 1 | City, State | xxx rooms | _____ | _____ | _____ | _____ |
| HOTEL TOTAL | x % as of 12/31/09 | | _____ | _____ | _____ | _____ |
| INDUSTRIAL | | | | | | |
| INDUSTRIAL 1 | City, State | xxx | _____ | _____ | _____ | _____ |
| INDUSTRIAL TOTAL | x % as of 12/31/09 | | _____ | _____ | _____ | _____ |
| OTHER INVESTMENTS | | | | | | |
| Other | City, State | N/A | _____ | _____ | _____ | _____ |
| OTHER INVESTMENTS TOTAL | x % as of 12/31/09 | | _____ | _____ | _____ | _____ |
| OFFICE | | | | | | |
| Office 1 | City, State | xxx | _____ | _____ | _____ | _____ |
| OFFICE TOTAL | x % as of 12/31/09 | | _____ | _____ | _____ | _____ |
| RETAIL | | | | | | |
| RETAIL 1 | City, State | xxx | _____ | _____ | _____ | _____ |
| RETAIL TOTAL | x % as of 12/31/09 | | _____ | _____ | _____ | _____ |
| TOTAL REAL ESTATE OWNED | | | | | | |
| MORTGAGE AND OTHER LOANS RECEIVABLE | | | | | | |
| LOAN 1 | | N/A | | | | |
| LOAN 2 | City, State | xxx | _____ | _____ | _____ | _____ |
| MORTGAGE AND OTHER LOANS RECEIVABLE TOTAL | x % as of 12/31/09 | | _____ | _____ | _____ | _____ |
| OTHER REAL ESTATE INVESTMENTS | | | | | | |
| OTHER | City, State | N/A | _____ | _____ | _____ | _____ |
| OTHER REAL ESTATE INVESTMENTS TOTAL | x % as of 12/31/09 | | _____ | _____ | _____ | _____ |
| TOTAL REAL ESTATE INVESTMENTS | | | \$ | \$ | \$ | \$ |

* REQUIRED INFORMATION - AT MINIMUM ALL INVESTMENTS GREATER THAN 5% OF NET ASSETS MUST BE SEPARATELY IDENTIFIED AS AN INVESTMENT. BALANCE CAN BE LISTED AS OTHER WITHIN EACH SEGMENT. RECOMMENDED INFORMATION - THE GREATER OF YOUR TWENTY LARGEST INVESTMENTS OR YOUR 5% INVESTMENTS.

For illustrative purposes only – Non-operating reporting model financial statements

XYZ REAL ESTATE FUND LP

NOTES TO FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

A. ORGANIZATION

XYZ Real Estate Fund LP (the "Fund") was formed on January 1, 19x1 for the purpose of generating income and appreciation on real estate investments in the United States of America. The investment advisor of the Fund is ABC Real Estate Advisors, L.P. ("ABC" or the "Advisor"). The aggregate committed capital for the Fund is \$200 million. The limited partners committed \$190 million and the general partner committed \$10 million. The terms of the partnership agreement do not generally provide for new subscription or redemption of partners' interests. The general partner of the Fund is ABC, L.P., an affiliate of the Advisor. At December 31, 20x2, the ratio of total contributed capital to committed capital was 90%.

See standard disclosures in the Operating model illustrative financial statements. Disclosures unique to the Non-Operating model are provided below.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation — *See operating model illustrative financial statements.*

Use of Estimates — *See operating model illustrative financial statements.*

Real Estate Equity Investments — Investments in real estate are carried at fair value. Cost to acquire real estate investments are capitalized as a component of investment cost. In certain investment arrangements, the Fund's equity percentage interest in the investment may be reduced by third party residual interests for returns realized in excess of specific hurdle rates of return. Such residual interests have been considered in the related investment valuation.

Investments in Mortgage Loans and Notes Receivables — *See operating model illustrative financial statements.*

Investment Valuation — The fair values of real estate investments are estimated based on the price that would be received to sell an asset in an orderly transaction between marketplace participants at the measurement date. Investments without a public market are valued based on assumptions made and valuation techniques used by the Advisor. Such valuation techniques include discounted cash flow analysis, prevailing market capitalization rates or earnings multiples applied to earnings from the investment, analysis of recent comparable sales transactions, actual sale negotiations and bona fide purchase offers received from third parties, consideration of the amount that currently would be required to replace the asset, as adjusted for obsolescence, as well as independent external appraisals. In general, the

Advisor considers multiple valuation techniques when measuring the fair value of an investment. However, in certain circumstances, a single valuation technique may be appropriate. The Fund's policy is to obtain independent external appraisals for investments every 12 months. Investments in publicly traded equity securities are valued based on their quoted market prices.

The fair value of real estate investments does not reflect the Fund's transaction sale costs, which may be incurred upon disposition of the real estate investments. Such costs are estimated to approximate 2% - 3% of gross property fair value. The Fund also reflects its real estate equity investments net of investment level financing. Valuation adjustments attributable to underlying financing arrangements are considered in the real estate equity valuation.

The Fund may invest in real estate and real estate related investments for which no liquid market exists. The market prices for such investments may be volatile and may not be readily ascertainable. In addition, there continues to be significant disruptions in the global capital, credit and real estate markets. These disruptions have led to, among other things, a significant decline in the volume of transaction activity, in the fair value of many real estate and real estate related investments, and a significant contraction in short-term and long-term debt and equity funding sources. This contraction in capital includes sources that the Fund may depend on to finance certain of its investments. These market developments have had a significant adverse impact on the Fund's liquidity position, results of operations and financial condition and may continue to adversely impact the Fund if market conditions continue to deteriorate. The decline in liquidity and prices of real estate and real estate related investments, as well as the availability of observable transaction data and inputs, may have made it more difficult to determine the fair value of such investments. As a result, amounts ultimately realized by the Fund from investments sold may differ from the fair values presented, and the differences could be material.

Concentrations of Credit Risk — See operating model illustrative financial statements.

Cash and Cash Equivalents — See operating model illustrative financial statements.

Mortgage Loans Payable — See operating model illustrative financial statements.

Interest Rate Swaps and Caps — See operating model illustrative financial statements.

Income and Expense Recognition — Distributions from real estate equity investments are recognized as income when received to the extent such amounts are paid from earnings and profits of the underlying investee. Interest income on real estate debt investments is generally accrued as earned in accordance with the effective interest method. For loans in default, interest income is not accrued but is recognized when received. Expenses are recognized as incurred.

The Fund generally records realized gains and losses on sales of real estate investments pursuant to the provisions of Accounting Standards Codification subtopic 360-20, *Real Estate Sales* (“ASC 360-20”). The specific timing of a sale is measured against various criteria in ASC 360-20 related to the terms of the transaction and any continuing involvement in the form of management or financial assistance associated with the property.

Investment Advisory Fees — See operating model illustrative financial statements.

Income Taxes — As a partnership, the Fund itself is not subject to U.S. Federal income taxes. Accordingly, income taxes are not considered in the accompanying financial statements since such taxes, if any, are the responsibility of the individual partners. Income from non-U.S. sources may be subject to withholding and other taxes levied by the jurisdiction in which the income is sourced. If an uncertain income tax position were to be identified, the Fund would account for such in accordance with Accounting Standards Codification topic 450, *Contingencies*.

Accounting Standards Codification topic 740, *Income Taxes* (ASC 740), provides guidance for how uncertain tax positions should be recognized, measured, presented and disclosed in the financial statements. ASC 740 requires the evaluation of tax positions taken in the course of preparing the Fund’s tax returns to determine whether tax positions are “more-likely-than-not” of being sustained by the applicable tax authority. Tax benefits of positions not deemed to meet the more-likely-than-not threshold would be recorded as a tax expense in the current year. The Fund adopted ASC 740 effective January 1, 2009 and applied it to all open tax years as of the effective date.

Guarantees — See operating model illustrative financial statements.

Foreign Currency — See operating model illustrative financial statements.

Risk Management — See operating model illustrative financial statements.

Change in Accounting Principle — See operating model illustrative financial statements.

C. FAIR VALUE MEASUREMENTS

Accounting Standards Codification topic 820, *Fair Value Measurements and Disclosures* (“ASC 820”), provides a definition of fair value which focuses on an exit price rather than an entry price, establishes a framework for measuring fair value which emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and requires expanded disclosures about fair value measurements. The Fair Value Option under Accounting Standards Codification subtopic 825-10 (“ASC 825-10”) provides companies with the option to report eligible financial assets and financial liabilities at fair value on an instrument-by-instrument basis. This option is available when an entity first recognizes a financial asset or financial liability or upon signing a firm commitment. ▼

Deleted: In addition, the Fair Value Option under ASC 825-10 allows a one-time election for existing qualifying financial assets and liabilities. Upon election of the Fair Value Option under ASC 825-10, the Fund elected to account for its debt liabilities at fair value in part to comply with industry reporting standards that require all debt liabilities to be reported at fair value.

The Fund elected not to carry some or all of its debt liabilities at fair value. [Note to preparer: A description of the reason for this should be disclosed here.] The unamortized cost of investments not valued in the financial statements was \$xx,xxx and \$xx,xxx for the periods ending December 31, 2008 and 2009 respectively. [Note to preparer: If information is available, the following disclosure should be made.] The fair value of these liabilities was \$xx,xxx and \$xx,xxx for the periods ending December 31, 2008 and 2009 respectively.

Accounting Standards Codification topic 805 (“ASC 805”) and Accounting Standards Codification section 810-10-45 (“ASC 810-10-45”) require most identifiable assets, liabilities, noncontrolling interests, and goodwill acquired in a business combination to be recorded at “full fair value” and require noncontrolling interests (previously referred to as minority interests) to be reported as a component of equity, which changes the accounting for transactions with noncontrolling interest holders. (For purposes of this illustration, assume both standards were effective as of January 1, 20x8). ASC 805 is applied to business combinations occurring after the effective date. ASC 810-10-45 is applied prospectively to all noncontrolling interests, except the presentation and disclosure requirements. The presentation and disclosure requirements were applied retrospectively for all periods presented, as follows: (i) the noncontrolling interest was reclassified to equity, and (ii) consolidated net income was adjusted to include the net income attributed to the noncontrolling interest.

To increase consistency and comparability in fair value measurements and related disclosures, the Fund utilizes the fair value hierarchy required by ASC 820 which prioritizes the inputs to valuation techniques used to measure fair value into three broad levels:

Level 1 — Quoted prices in active markets for identical securities.

Level 2 — Prices determined using other significant observable inputs. Observable inputs that other market participants would use in pricing a security, including quoted prices for similar securities.

Level 3 — Prices determined using significant unobservable inputs. Unobservable inputs reflect the Fund’s own assumptions about the factors market participants would use in pricing an investment, and would be based on the best information available in the circumstances.

A summary of the inputs used, as of December 31, 2009, involving the Fund’s assets and liabilities carried at fair value, is as follows (dollars in thousands):

| Description | Total | Level 1 | Level 2 | Level 3 |
|--------------------------------|-------|---------|---------|---------|
| Real estate equity investments | \$ - | \$ - | \$ - | \$ - |
| Real estate debt investments | \$ - | \$ - | \$ - | \$ - |
| Mortgage loans payable | \$ - | \$ - | \$ - | \$ - |

Real estate equity investments include investments in several real estate funds that invest primarily in U.S commercial real estate.

The fair values of the investments in this category have been estimated using the net asset value of the Fund’s ownership interest in partners’

capital. In some circumstances, the fair value of real estate investments was determined using the Fund's share of the underlying net asset value of the investment at the valuation date. Referred to as a "practical expedient" approach within Topic 820: Fair Value Measurements and Disclosures, the investor, under certain circumstances, can carry its investments at its share of net asset value when information about the market or the investment itself are not readily available and the investor is not aware of any adjustments that may be required for specific events or circumstances that could affect the value of these investments. The value of investments using this practical expedient was \$XXX.XX and \$XXX.XX for the periods ending December 31, 2XX8 and 2XX9 respectively.

These investments can never be redeemed with the funds (or These investments may be redeemed quarterly with XX days' notice). Distributions from each fund will be received as the underlying investments of the funds are liquidated. It is estimated that the underlying assets of the funds will be liquidated over the next XX to XX years. XX% of the total investment is planned to be sold. However, the individual investments that will be sold have not yet been determined. Because it is not probable that any individual investment will be sold, the fair value of each individual investment has been estimated using the net asset value of the Fund's ownership interest in partners' capital. The Fund's unfunded commitments related to these investments were \$XXX, XXX at December 31, 20x8.

[Note to preparer: Sample disclosure for ASU 2009-12 which is effective for interim and annual periods ending after December 15, 2009 with early adoption permitted.]

The following is a reconciliation of assets and liabilities for which significant unobservable inputs (level 3) were used in determining fair value (dollars in thousands):

| | Real Estate Equity Investments | Real Estate Debt Investments | Mortgage Loans Payable* |
|---|---|---|--|
| Beginning balance | | | |
| Realized and unrealized gains | | | |
| Cost of purchases | | | |
| Proceeds of sales | | | |
| Principal repayments | | | |
| Ending balance | | | |
| Amount of unrealized gain/loss reported in the statement of operations attributable to investments held at year end | | | |

* The illustrated example above assumes the account had elected the fair value option in accounting for each mortgage loans and notes payable.

D. MORTGAGE LOANS PAYABLE — *See operating model illustrative financial statements*

E. INTEREST RATE SWAPS AND CAPS — *See operating model illustrative financial statements*

F. PORTFOLIO DIVERSIFICATION — *See operating model illustrative financial statements*

G. INVESTMENT ADVISOR FEES — *See operating model illustrative financial statements*

Investment advisory fees for investments under management by ABC are billed at a rate of 15.0 basis points per quarter for the first \$200 million of gross asset value, 13.5 basis points per quarter for the next \$300 million of gross asset value, and 12.0 basis points per quarter thereafter, in arrears. ABC also earns acquisition fees equal to 75 basis points on acquisition costs.

For the years ended December 31, 2009 and 2008, total management fees earned by ABC totaled \$1,250,000. Management fees of \$350,000 were unpaid as of December 31, 2009 and 2008.

Partners' capital contributions and distributions are made in proportion to respective committed capital amounts until cumulative distributions have provided limited partners with a realized internal rate of return of 8%. Thereafter, incentive distributions will be made to the general partner equal to 20% of subsequent distributions. Income and loss is allocated among the partners so as to conform to expected distributions. At December 31, 2009 and 2008, aggregate unrealized incentive allocations made to the general partner were \$800,000 and \$700,000, respectively.

H. FINANCIAL HIGHLIGHTS

The following summarizes the Fund's financial highlights, consisting of total return and expense and net investment income ratios, for the years ended December 31, 2009 and 2008:

| | 2009 | 2008 |
|---|-----------------|-----------------|
| | Limited | Limited |
| | Partners | Partners |
| Total return ¹ | | |
| End of period since-inception internal rate of return | % | % |
| Beginning of period since-inception internal rate of return | % | % |
| Expense ratios ² | | |
| Operating expense | % | % |
| Incentive allocation | % | % |
| Total expenses and incentive allocation | % | % |
| Net investment income ratio ³ | % | % |

¹ Total return is calculated based on a dollar-weighted internal rate of return methodology net of fees and incentive allocations. The internal rate of return is computed on a since-inception basis using annual

compounding and the actual dates of cash inflows received by and outflows paid to investors and including ending net asset value as of each measurement date. Because total return is calculated for the limited partners taken as a whole, an individual limited partner's return may vary from these returns based on different management fee and incentive arrangements (as applicable) and the timing of capital transactions.

² The expense ratios are calculated for the Limited Partners taken as a whole using weighted average net assets for the period. The computation of such ratios based on the amount of expenses and incentive allocations assessed to an individual Limited Partner's capital may vary from these ratios based on different management fee and incentive arrangements (as applicable) and the timing of capital transactions.

³ The net investment income ratios are calculated for the Limited Partners taken as a whole using weighted average net assets for the period. The computation of the net investment income ratio based on the amount of net investment income assessed to an individual Limited Partner's capital may vary from these ratios based on different management fee arrangements (as applicable). The net investment income ratio does not reflect the effects of any incentive allocation.

I. COMMITMENTS AND CONTINGENCIES— *See operating model illustrative financial statements*

J. SUBSEQUENT EVENTS— *See operating model illustrative financial statements*

* * * * *

REIS GUIDANCE DOCUMENT

Appendix 5

**Reconciliation of GAAP NAV to REIS NAV-
Guidance for calculating the REIS NAV and providing related
disclosures as required in the Fund Reporting Standards**

**Reconciliation from GAAP NAV to
REIS NAV**

| | <u>Amount</u> | <u>Per Share</u> |
|--|------------------------------|------------------------|
| NAV per GAAP Financial Statements | \$ 100,000,000 | \$ 40.00 |
| Asset value adjustments | | |
| Adjustment for equity method joint venture assets carried at cost on the balance sheet: | | |
| Carrying value (at share) | \$ 15,000,000 | |
| Fair value (at share) | <u>17,500,000</u> | 2,500,000 1.00 |
| Liability value adjustments | | |
| Liabilities on wholly-owned investments currently carried at cost on the balance sheet: | | |
| Carrying value (at share) | 16,250,000 | |
| Fair value (at share) | <u>15,000,000</u> | 1,250,000 0.50 |
| Adjustment for equity method joint venture liabilities carried at cost on the balance sheet: | | |
| Carrying value (at share) | 7,250,000 | |
| Fair value (at share) | <u>7,500,000</u> | (250,000) (0.10) |
| Portfolio-level liability adjustments | | |
| Portfolio-level liabilities currently carried at cost on the balance sheet: | | |
| Carrying value | 10,000,000 | |
| Fair value | <u>\$ 9,500,000</u> | 500,000 0.20 |
| Other value considerations not contemplated in the GAAP financial statements | | |
| Partner specific value (e.g. contractual, tenant, relationship) | 120,000 | 0.05 |
| REIS NAV (all assets and liabilities at fair value) | <u>\$ 104,120,000</u> | <u>\$ 41.65</u> |

Notes:

- The Fund did not have access to the requisite information necessary to calculate the value of certain investments and liabilities. These assets are known to be carried on a basis other than fair value. The carrying value of these assets was \$xx,xxx for the period ending June 30, 2009. The carrying value of these liabilities was \$xx,xxx for the period ending June 30, 2009.
- The Account/Fund did not have access to the information necessary to calculate the value of some of the unconsolidated joint venture investments accounted for under the equity method. The net carrying value of these investments was \$xx,xxx for the period ending June 30, 2009.

Sample Disclaimer:

The Fund adopted REIS NAV, as defined by REIS, for computing net asset value because management believes that, subject to the following limitations, REIS NAV provides a basis for comparing our performance and operations to those of open-end funds, other closed-end funds and single investor investment accounts. REIS NAV is not intended as an alternative to "GAAP Net Asset Value" as an indicator of our performance or to "Cash Flows from Operating Activities" as determined by GAAP as a measure of our capacity to pay distributions. The estimated fair values of the assets and liabilities may vary significantly from the prices at which such assets and liabilities would sell or transfer, since market prices can only be determined by negotiation between a willing buyer and seller. Therefore, the amounts ultimately realized from the disposition of the assets and liabilities within the Fund may vary significantly from the REIS NAV presented.