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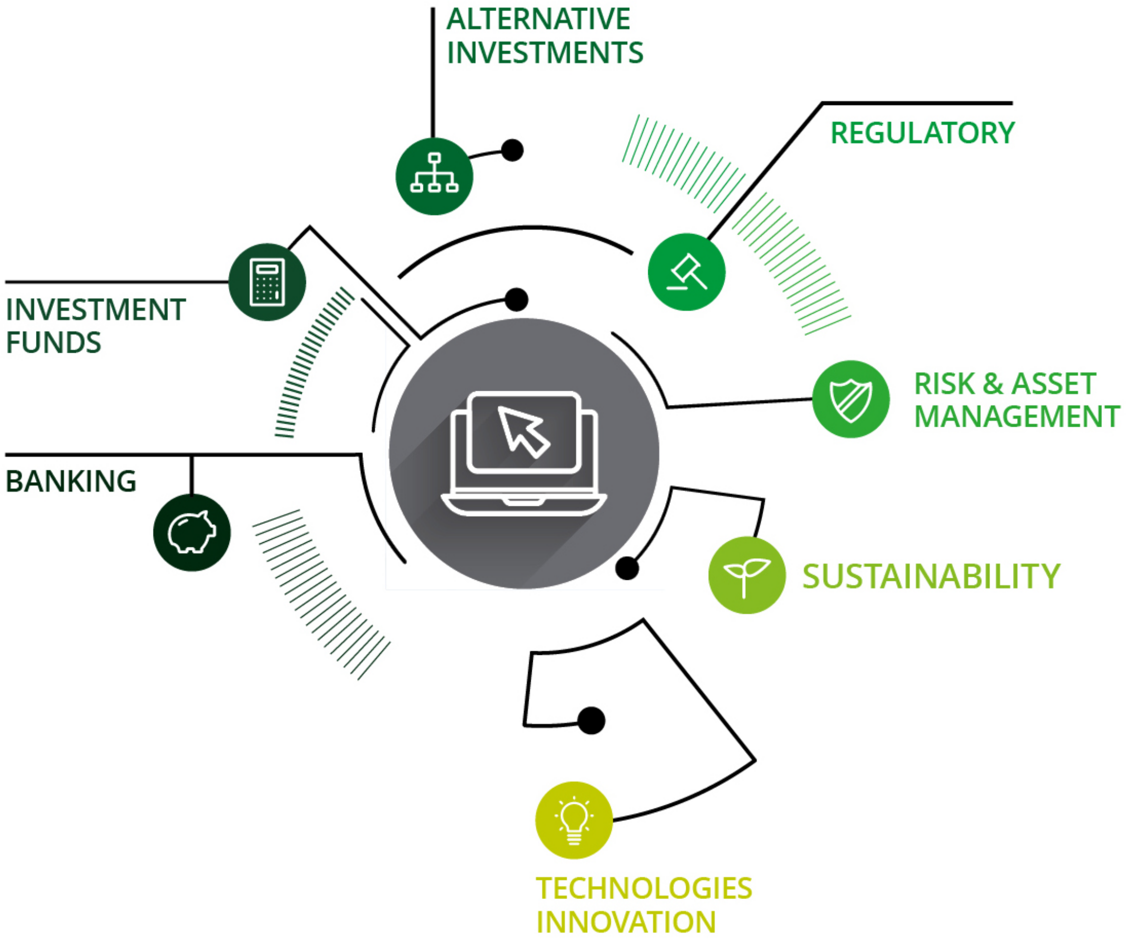

Alternative investments | Accounting: GAAP and NAV differences to consider for RE / Alternative funds

Link'n Learn – 10 January 2024

Getting Started

Here with you today

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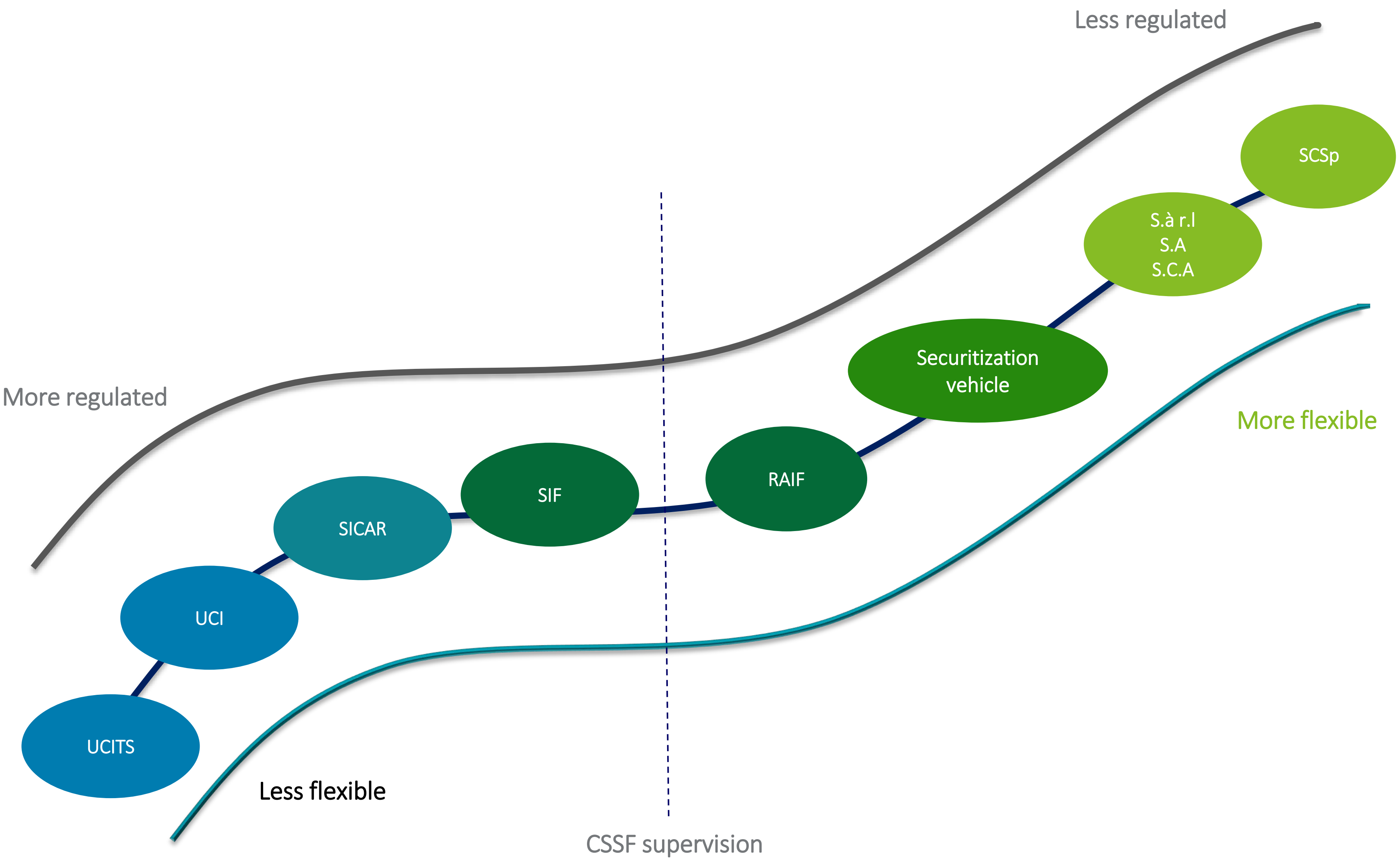
Agenda

1. GAAP differences to consider for alternative funds
2. INREV NAV

Luxembourg Alternatives Space

Type of fund vehicles and primary accounting frameworks

Overview of Investment Vehicles in Luxembourg



Financial Reporting Requirements

SICAR

- Luxembourg GAAP
- IFRS (EU)
- Law dated 15 June 2004

SIF

- Luxembourg GAAP
- IFRS (EU)
- Law dated 13 February 2007

RAIF

- Luxembourg GAAP
- IFRS (EU)
- Law dated 15 June 2004

S.A./S.à r.l.

- Luxembourg GAAP
- IFRS (EU)

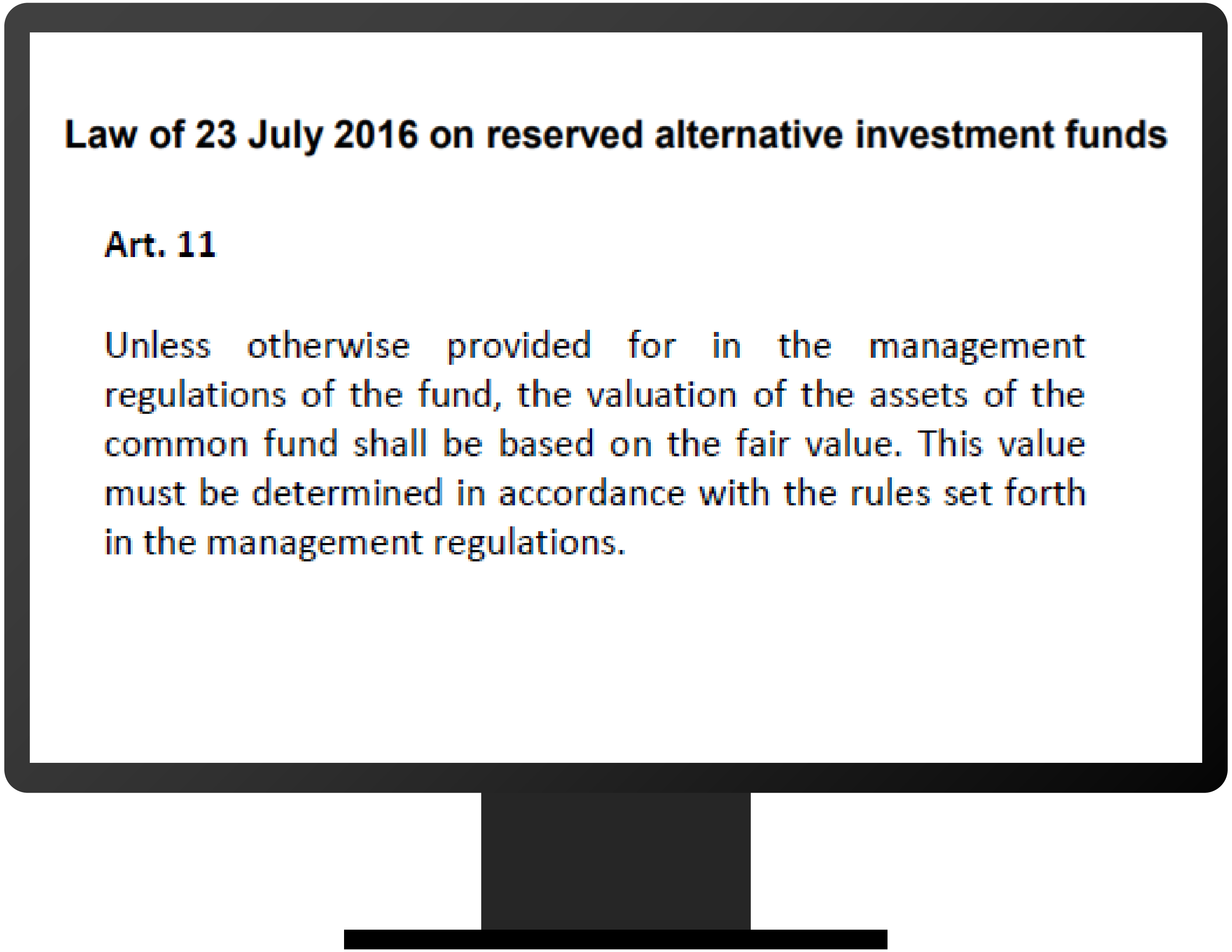
S.C.S

- Luxembourg GAAP
- IFRS (EU)
- Companies having a turnover less than 100,000 EUR - other, if specified in Limited Partnership Agreement («LPA»)

S.C.Sp

- Luxembourg GAAP
- IFRS (EU)
- Other, if specified in Limited Partnership Agreement («LPA»)

Financial Reporting Requirements



Law of 23 July 2016 on reserved alternative investment funds

Art. 11

Unless otherwise provided for in the management regulations of the fund, the valuation of the assets of the common fund shall be based on the fair value. This value must be determined in accordance with the rules set forth in the management regulations.

Industry Specific Guidance

Three sets of accounting standards typically applied in Luxembourg for investment funds

IFRS – does not provide specific guidance for investment funds. An investment company must follow generic IFRS

Luxembourg GAAP – derived from Luxembourg laws and regulations, and is primarily shaped by the EU directives (AIFMD)

US GAAP – specific guidance is available for investment companies (FASB ASC 946)

Available Deloitte Resources

GAAP comparison for investment funds

This publication provides a summary of the key differences between the most common accounting frameworks for investment management financial reporting. It includes a comparison of IFRS, US GAAP and Luxembourg GAAP as applied to investment funds.

https://www2.deloitte.com/lu/en/pages/audit/articles/comparison-investment-funds.html

IFRS versus LUX GAAP

This brochure provides you with a summary and a clear and practical oversight of the key differences between the requirements of IFRS and LUX GAAP.

https://www2.deloitte.com/lu/en/pages/audit/articles/ifrs-versus-lux-gaap.html

Illustrative annual accounts in accordance with Lux GAAP

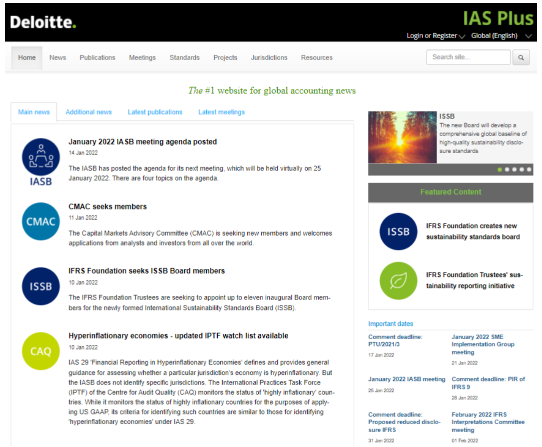
Available template for Annual Accounts giving example of presentation for Balance Sheet, Profit and Loss Account and Notes to the Annual Accounts.

https://www2.deloitte.com/lu/en/pages/audit/articles/illustrative-annual-accounts.html

IAS Plus website

Deloitte's IAS Plus a comprehensive source of global accounting news and resources, featuring an extensive collection of information about International Financial Reporting Standards (IFRS), the International Accounting Standards Board (IASB), and broader international financial reporting developments.

https://www.iasplus.com/en



IFRS, Luxembourg GAAP, and U.S. GAAP

Financial Statement Presentation & Disclosures Comparison

IFRS, Luxembourg GAAP, and U.S. GAAP

Financial Statement Presentation & Disclosures Comparison

XYZ REAL ESTATE ACCOUNT

CONSOLIDATED STATEMENTS OF NET ASSETS
AS OF DECEMBER 31, XXCY AND XXPY (in thousands)

	XXCY	XXPY
Assets:		
Real estate investments and improvements	139,650	121,500
Unconsolidated real estate joint ventures	53,200	46,600
Mortgage and other loans receivable	12,100	11,800
Other real estate investments	22,125	15,600
Total real estate investments	227,075	195,500
Cash and cash equivalents	80,635	49,255
Restricted cash	10,000	10,000
Marketable securities	43,100	38,500
Accounts Receivable	18,620	16,200
Prepaid and other assets	42,000	29,200
Total assets	**421,430**	**338,655**
Liabilities:		
Mortgage loans and notes payable	77,220	64,870
Accrued real estate expenses and taxes	1,350	1,330
Accrued incentive fees	260	250
Other liabilities	2,900	2,055
Total liabilities	**81,730**	**68,505**
Net assets:		
XYZ Real Estate Account net assets	318,162	253,356
Noncontrolling interests	21,538	16,794
Net assets	**$ 339,700**	**$ 270,150**

XYZ REAL ESTATE ACCOUNT

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, XXCY AND XXPY (in thousands)

	XXCY	XXPY
Investment income:		
Revenue from real estate investments	$ 32,150	$ 31,750
Equity in income of unconsolidated real estate joint ventures	21,450	20,500
Interest income on mortgage and other loans receivable	8,300	7,800
Income from other real estate investments	7,100	6,900
Other income	4,600	4,100
Total investment income	**73,600**	**71,050**
Expenses:		
Real estate expenses and taxes	12,250	12,100
Interest expense	3,600	3,250
Administrative expenses	5,400	4,410
Financing Costs	-	690
Investment management fees	1,250	1,000
Total expenses	**22,500**	**21,450**
Net investment income	**51,100**	**49,600**
Net realized and unrealized gain (loss):		
Realized gain from sales of real estate investments	1,100	800
Less: previously recorded unrealized gain on sale of real estate investments	(795)	(500)
Net realized and unrealized gain from the sale of real estate investments	305	300
Unrealized gain (loss) on real estate investments and improvements	14,550	(8,000)
Unrealized gain (loss) on unconsolidated real estate joint ventures	3,250	(1,120)
Unrealized gain on mortgage and other loans receivable	250	100
Unrealized gain on other real estate investments	2,175	1,500
Unrealized gain on interest rate caps and swaps	-	-
Unrealized (loss) gain on mortgage loans and notes payable	(1,880)	1,000
Net realized and unrealized gain (loss)	**18,650**	**(6,220)**
Increase in net assets resulting from operations	**69,750**	**43,380**
Less: Portion attributable to noncontrolling interests	(4,754)	(4,230)
Increase in net assets resulting from operations attributable to XYZ Real Estate Account	**$ 64,996**	**$ 39,150**

XYZ REAL ESTATE FUND, LP

STATEMENTS OF NET ASSETS
AS OF DECEMBER 31, XXCY AND XXPY (in thousands)

	XXCY	XXPY
Assets:		
Real estate investments	273,913	229,841
Cash and cash equivalents	40,635	19,255
Other assets	31,120	18,400
Total assets	**345,668**	**267,496**
Liabilities:		
Loans payable	10,000	-
Other liabilities	760	805
Total liabilities	**10,760**	**805**
Net assets	**334,908**	**266,691**

XYZ REAL ESTATE FUND, LP

STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, XXCY AND XXPY (in thousands)

	XXCY	XXPY
Income		
Income distributions from real estate equity investments	$ 28,060	$ 41,057
Interest income on real estate debt investments	8,300	1,268
Other	3,170	120
Total income	**39,530**	**42,445**
Expenses		
Interest expense	2	-
Administrative expenses	1,183	4,500
Investment management fees	1,250	1,000
Total expenses	**2,435**	**5,500**
Net investment income	**37,095**	**36,945**
Net realized and unrealized gain (loss):		
Realized gain from sales of real estate investments	-	760
Less: previously recorded unrealized gain on sales of real estate investments	-	(475)
Net realized and unrealized gain from the sale of real estate investments	-	285
Unrealized gain on real estate investments held at year end	31,322	3,981
Unrealized incentive fees	-	-
Net realized and unrealized gain	**31,322**	**4,266**
Increase in net assets resulting from operations	**$ 68,417**	**$ 41,211**

IFRS, Luxembourg GAAP, and U.S. GAAP

Financial Statement Presentation & Disclosures Comparison

	IFRS	Luxembourg GAAP	U.S. GAAP
Realized and Unrealized Gains (Losses) on Investments	IFRS require gains and losses to be presented separately for each category of financial instrument, either in the statement of profit or loss and other comprehensive income or in the notes. The gains and losses on financial instruments designated at fair value must be disclosed separately from the gains and losses on financial instruments measured mandatorily at fair value.	For AIFs, realized gains and losses and unrealized gains and losses are required to be disclosed separately rather than netting gains and losses into a single line item (i.e., grossed up)	Net realized gains (losses) and net changes in unrealized appreciation (depreciation) should be disclosed separately.

IFRS, Luxembourg GAAP, and U.S. GAAP

Financial Statement Presentation & Disclosures Comparison

	IFRS	Luxembourg GAAP	U.S. GAAP
Renumeration Disclosures	Disclosure is required of the total compensation paid to key management personnel, as well as for each of the following categories: • Short-term employee benefits; • Post-employment benefits; • Other long-term benefits; • Termination benefits; and • Share-based payment.	An AIF must disclose in its annual report: • The total amount of remuneration for the financial year, split between fixed and variable remuneration, paid by the AIFM/Management Company to its staff, and the number of beneficiaries. For an AIF, if relevant, carried interest paid by the AIF. • The aggregate amount of remuneration broken down by senior management and members of staff of the AIFM/ Management Company whose actions have a material impact on the risk profile of the AIF.	In accordance with Topic 946, certain expenses are commonly reported separately on the income statement, including the investment management fee, administration fees paid to an affiliate, distribution expenses, and director or trustee fees. Additionally, under Topic 850, amounts paid to affiliates or related parties should be disclosed.

IFRS, Luxembourg GAAP, and U.S. GAAP

Accounting Comparison

IFRS, Luxembourg GAAP, and U.S. GAAP

Accounting Comparison

	IFRS	Luxembourg GAAP	U.S. GAAP
Consolidation	Where an entity qualifies as an investment entity, it is not required to consolidate a subsidiary in accordance with the consolidation provisions of IFRS 10, but must instead measure its investment in the investee at FVTPL in accordance with IFRS 9. This does not apply to any subsidiaries of the investment entity providing services that relate to the investment entity's investment activities.	Funds subject to the various product laws in Luxembourg and their subsidiaries are exempt from the obligation to consolidate companies owned for investment purposes. Real estate or private equity funds with subsidiaries often opt to consolidate.	Consolidation of an investee that is not an investment company is not appropriate for an investment fund except in the case of operating subsidiaries providing services to the investment fund. Wholly-owned blocker entities should generally be consolidated into the investment fund.
Master-feeder structures	The parent of an investment entity is required to account for its investments in controlled investees at FVTPL, even if the investment entity subsidiary was formed for specific regulatory, legal or tax purposes, e.g., in a master-feeder structure.	The feeder financial statements should disclose: • A description of the master-feeder structure; • The investment objective and policy of the master fund; • The percentage ownership of the feeder fund in the master fund at year-end; and • The total aggregated expenses of the feeder fund and its share of the total expenses of the master fund, expressed as a percentage of the average NAV of the master/feeder fund.	The feeder fund's statement of assets and liabilities will show an investment in the master fund, which is the feeder fund's sole or primary investment. A schedule of investments is not presented by the feeder fund, unless there are other investments aside from the investment in the master fund. The statement of operations for the feeder fund should disclose the feeder fund's allocated share of income, expenses, and realized gains and losses from the master fund, along with any fund-specific income and expenses.

IFRS, Luxembourg GAAP, and U.S. GAAP

Financial Statement Presentation & Disclosures Comparison

Investment Entity per IFRS 10	*Investment Company* per ASC 946
1. Obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services	1. Obtains funds from one or more investors and provides the investor(s) with investment management services
2. Commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and	2. Commits to its investor(s) that its business purpose and only substantive activities are investing the funds solely for returns from capital appreciation, investment income, or both
3. Measures and evaluates the performance of substantially all of its investments on a fair value basis	3. The entity or its affiliates do not obtain or have the objective of obtaining returns or benefits from an investee or its affiliates that are not normally attributable to ownership interests or that are other than capital appreciation or investment income

Luxembourg GAAP consideration of investment company: reference to Avis CNC (Commission des Normes Comptables) n° 2-1 and reference to article 30 of the Law of 19 December 2002 and to the SIF law.

IFRS, Luxembourg GAAP, and U.S. GAAP

Accounting Comparison

	IFRS	Luxembourg GAAP	U.S. GAAP
Carried interest	Accounting treatment depends on the nature of the carried interest, which is typically set out in the entity's offering documents. In practice, there are two possible accounting models: i) Ownership model: carried interest is accounted as a re-allocation of profits between the partners ii) Service model: carried interest is recorded either as financial liability or a provision/contingent liability.	Two possibilities are generally accepted: i) NAV re-allocation ii) Expense recognition	Carried interest may be accounted for as: i) NAV re-allocation from the limited partners' capital account to the general partners' capital account ii) Expense recognition if structured as an incentive or performance fee
Transaction costs	Transaction costs that relate to investments recorded at fair value through profit and loss are recognized in the income statement. Financial instruments that are not at fair value through profit or loss are initially measured at their fair value plus or minus the transaction costs directly attributable to the acquisition or issue of the financial asset or financial liability.	Transaction costs are commonly recognized as part of an investment's cost, except for AIFs opting to expense transaction costs.	Transaction costs are recognized as part of an investment's cost.
Set-up costs	Set-up costs should be expensed when incurred.	Formation expenses can be either expensed, or capitalized and amortized over a maximum period of 60 months.	Organization costs should be charged to expense as they are incurred. Offering costs are treated differently based on the operational nature of the entity, as outlined in Topic 946.

Introduction to INREV NAV

Introduction to INREV

Why was it necessary?

No Harmonization

- IFRS or other local GAAP standards
- No industry-wide accepted methodology
- Fund managers developed their own standards for NAV adjustments
- Investors were using their own methodologies to value investments in non-listed real estate funds

INREV Objectives

- Guidance on how to calculate and disclose an adjusted NAV in financial reports of non-listed European real estate funds
- Transparency and comparability of the performance of different types of funds and enables investors to understand the information provided

Definition – INREV Principle 12

INREV NAV should reflect a more accurate economic value of the investment (units) based on the fair value of the underlying assets and liabilities, as at the balance sheet date, as adjusted for the spreading of costs that will benefit different generations of investors, than the NAV based on generally accepted accounting principles.

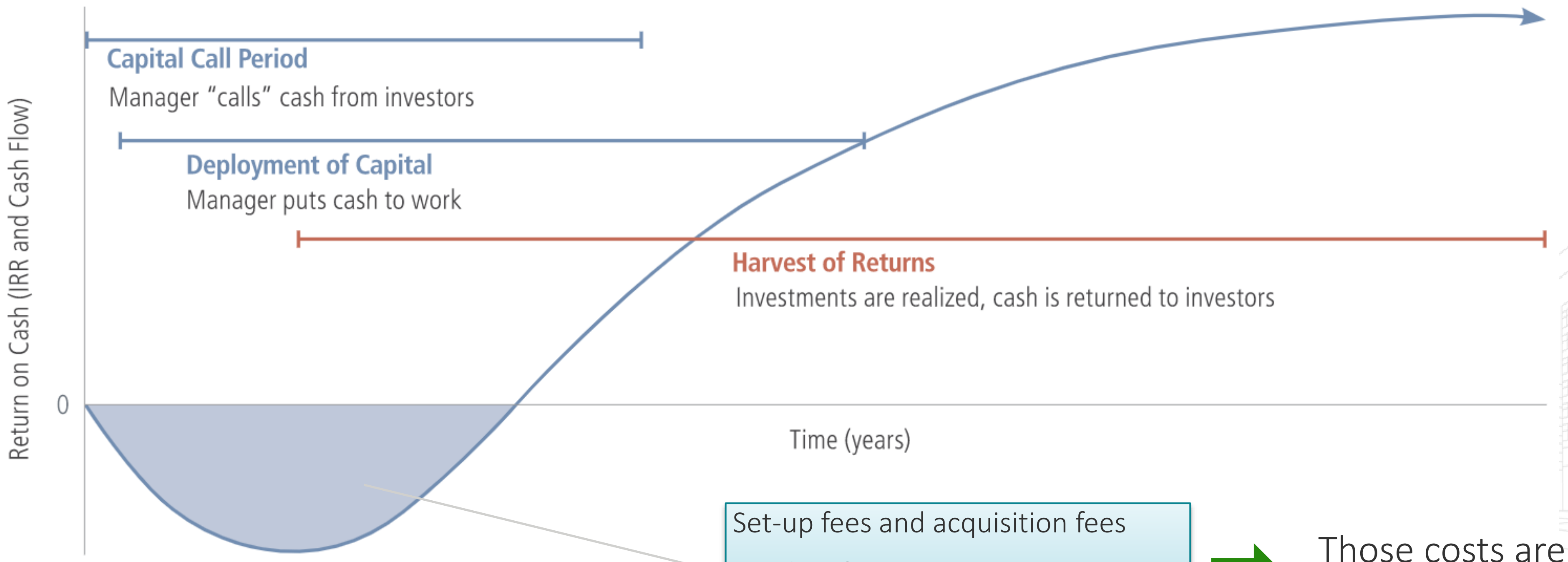
Increase in Transparency and Comparability

Not for pricing purposes (not a goal of INREV) VS Open End Fund Pricing

Fair value of assets and liabilites

Fair value of financial assets and liabilities

Internal rate of return of a private equity fund.



Source: https://www.nb.com/en/global/insights/white-paper-private-equity-in-focus

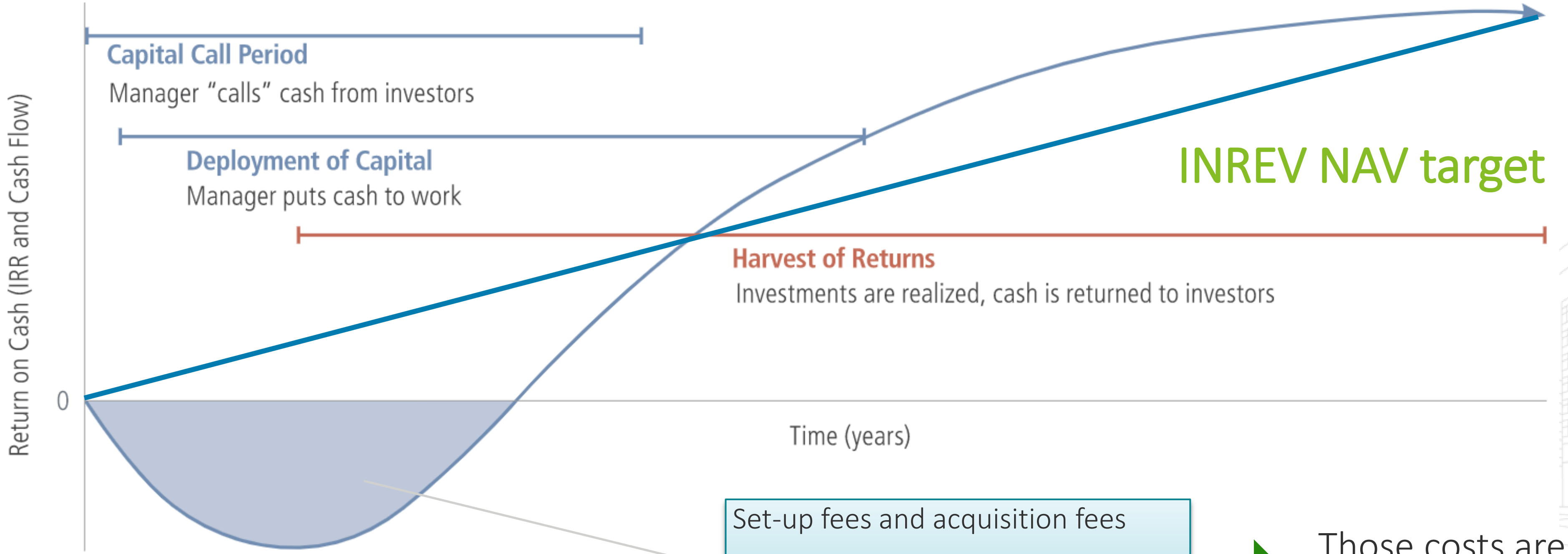
- Set-up fees and acquisition fees
- Funding fees
- Taxes

Those costs are part of the overall value chain

Fair value of assets and liabilites

Fair value of financial assets and liabilities

Internal rate of return of a private equity fund.



- Set-up fees and acquisition fees
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- Taxes

Those costs are part of the overall value chain

Source: https://www.nb.com/en/global/insights/white-paper-private-equity-in-focus

NAV Adjustments

NAV Adjustments

Overview as per INREV Guidelines

NAV per the IFRS financial statements	x
Reclassification of certain IFRS liabilities as components of equity	
a) Effect of reclassifying shareholder loans and hybrid capital instruments (including convertible bonds) that represent shareholders long term interests in a vehicle	x
b) Effect of dividends recorded as a liability which have not been distributed	x
NAV after reclassification of equity-like interests and dividends not yet distributed	x
Fair value of assets and liabilities	
c) Revaluation to fair value of investment properties	x/(x)
d) Revaluation to fair value of self-constructed or developed investment property	x/(x)
e) Revaluation to fair value of investment property held for sale	x/(x)
f) Revaluation to fair value of property that is leased to tenants under a finance lease	x/(x)
g) Revaluation to fair value of real estate held as inventory	x/(x)
h) Revaluation to fair value of other investments in real assets	x/(x)
i) Revaluation to fair value of indirect investments not consolidated	x/(x)
j) Revaluation to fair value of financial assets and financial liabilities	x/(x)
k) Revaluation to fair value of construction contracts for third parties	x/(x)
l) Set-up costs	x/(x)
m) Acquisition expenses	x/(x)
n) Contractual fees	x/(x)
Effects of the expected manner of settlement of sales/vehicle unwinding	
o) Revaluation to fair value of savings of purchaser's costs such as transfer taxes	x/(x)
p) Revaluation to fair value of deferred taxes and tax effect of INREV NAV adjustments	x/(x)
q) Effect of subsidiaries having a negative equity (non-recourse)	x/(x)
Other adjustments	
r) Goodwill	(x)
s) Non-controlling interest effects of INREV adjustments	x/(x)
INREV NAV	x

Once a Real Estate Fund is applying INREV NAV, all INREV needs to be considered.

In case just a few adjustments are adopted, and other adjustments ignored, the calculated NAV is an “Adjusted NAV” and not an “INREV NAV”.

Fair value of assets and liabilites

Fair value of financial assets and liabilities

Set-up costs

Under **IFRS**, vehicle set-up costs are charged immediately to income after the inception of a vehicle.

Such costs should be capitalized and amortized over the first five years of the term of the vehicle.
The rationale for capitalizing and amortizing set-up costs is to better reflect the duration of the economic benefits to the vehicle.

When capitalizing and amortizing set-up costs, a possible impairment test should be taken into account every time the adjusted NAV is calculated when market circumstances change and it is not expected that the capitalized set-up costs can be recovered through the sale of units of a vehicle.
For instance, when a decision is made to liquidate the vehicle or stakeholders no longer expect to recover the economic benefit of such capitalized expenses, they should be written down.

Fair value of assets and liabilites

Fair value of financial assets and liabilities

Acquisition expenses

Under the fair value model, acquisition expenses of an investment property are effectively charged to income when fair value is calculated at the first subsequent measurement date after acquisition. This results in the fair value of a property on subsequent fair value measurement being lower than the total purchase price of the property, all other things being equal.

- Property acquisition expenses should be capitalized and amortized over the first five years after acquisition of the property.
- The rationale for capitalizing and amortizing acquisition expenses is to better reflect the duration of the economic benefits to the vehicle of these costs.

When capitalizing and amortizing acquisition costs, a possible impairment test should be taken into account every time the adjusted NAV is calculated when market circumstances change and it is not expected that the capitalised acquisition costs can be recovered through the sale of units of a vehicle.

➔ E.g. When a property is sold during the amortization period or is classified as held for sale, the balance of capitalised acquisition expenses of that property should be expensed.

Fair value of assets and liabilites

Fair value of financial assets and liabilities

Acquisition expenses

The rationale to spread these one-off costs over a defined period of time is

- to smooth the effect of the write-off of costs on the vehicle's performance.
- a simple mechanism to spread costs between different investor group entering or leaving the vehicle's equity at different times.

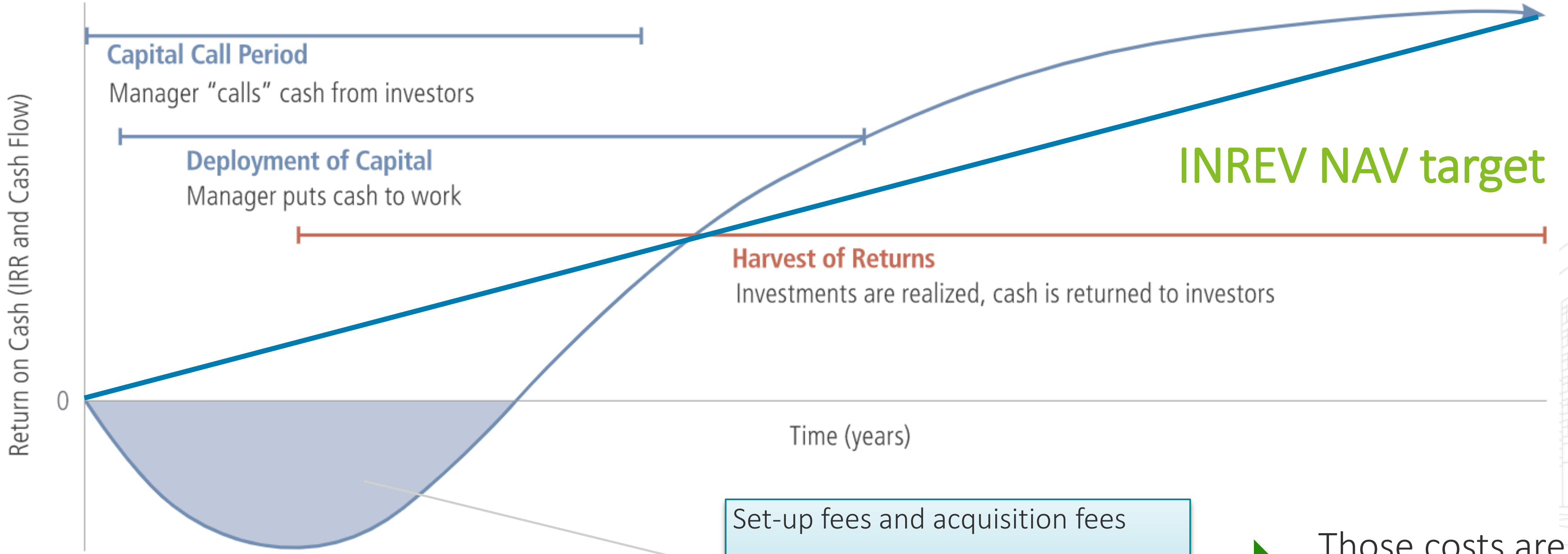
In practice, there are many other ways in which vehicles address such issues for pricing, valuation, or other purposes including using bid-ask spreads for issue premium or redemption discounts on the NAV calculated on the basis of set percentages, the capitalization and amortization of such costs over different time periods or, indeed, not taking into account such costs at all in the calculation of the vehicle NAV.

Since the INREV NAV is primarily intended to facilitate comparability between different vehicles, the INREV approach is a simple but fixed methodology.

Fair value of assets and liabilites

Fair value of financial assets and liabilities

Internal rate of return of a private equity fund.



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- Set-up fees and acquisition fees
- Funding fees
- Taxes

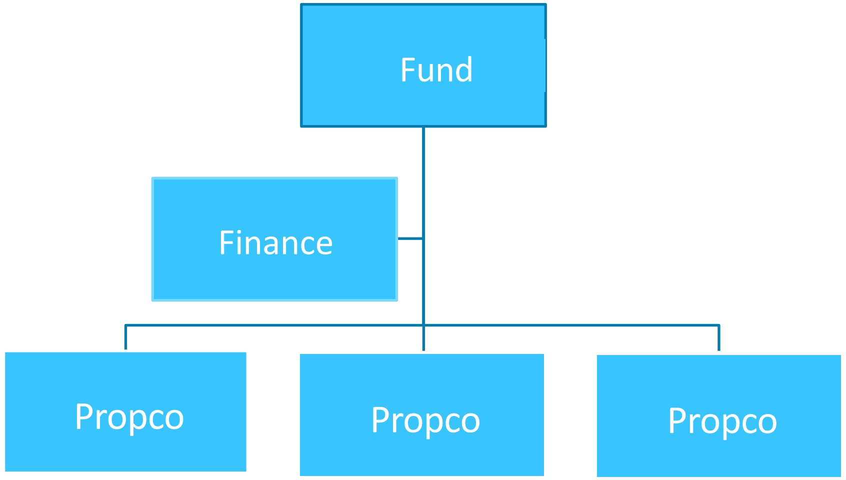
Those costs are part of the overall value chain

Fair value of assets and liabilites

Effects of the expected manner of settlement of sales/fund unwinding

Revaluation to fair value of savings of purchaser’s costs such as transfer taxes

- Transfer taxes and purchaser’s costs are generally deducted when determining the fair value of investment properties under IAS 40
- Usually, the structure of the exit intends to generate benefits for the purchaser that are split between purchase and seller especially by selling per share deal rather than asset deal
- The adjustment therefore represents the positive impact on the NAV of the possible reduction of the transfer taxes and purchaser’s costs for the benefit of the seller based on the expected sale of shares in the property-owning vehicle.
- Disclosure should be made on how the estimate of the amount the manager expects to **benefit from intended disposal strategies** has been made. Reference should be made to both the **current structure** and prevailing **market conditions**.



Fair value of assets and liabilites

Effects of the expected manner of settlement of sales/fund unwinding

- Investment Property is hold by a SPV. Management intends to sell by share deal. Sale will not lead to tax payments. Usually, deferred tax liability will be settled between seller and purchaser by 50% each.
- Tax Rate is 25%

Tax Rate	25%					
	Tax Base	Fair Value	Temporary difference	Deferred tax liability / (asset)	NAV adjustment	Deferred tax after adjustment
Investment Property	17.000	25.000	8.000	2.000	50,00%	1.000

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Next Link’n Learn webinar

Date: ***31/01/2024***

Topic: **L&L | Investment Funds | Cross-border distribution and marketing of foreign funds: hot topics, latest trends and new opportunities**