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# First impressions

## Disclosure update for real estate

April 2018

On April 12, 2018, the Canadian Securities Administrators ("CSA Staff") released CSA Staff Notice 52-329 Distribution Disclosures and Non-GAAP Financial Measures in the Real Estate Industry (the "Notice") which highlighted shortfalls in two important areas of disclosure for real estate investment trusts (REITs) and real estate operating companies (REOCs): distributions and non-GAAP financial measures. The CSA Staff's review indicates that the quality and completeness of disclosures pertaining to non-GAAP financial measures and distributions in the real estate industry need improvement, and these areas will continue to be assessed in their continuous disclosure and prospectus reviews. The CSA Staff cautioned that they will monitor certain issuers to ensure commitments to prospective changes and enhancements requested have been made. Below is a summary of the Notice and observations made by the CSA Staff.

The CSA Staff reviewed distribution disclosures and assessed the quality and sufficiency of disclosure provided about the sustainability of distributions. For non-GAAP financial measures, they assessed the disclosure with regard to the adjustments made, the prominence of these measures, and how they were used and reconciled by issuers.

They observed diversity in how non-GAAP financial measures, particularly AFFO, are used and reconciled by various real estate issuers.

**Overview of the CSA Staff's Findings[1]:**

– comment letters sent to 72% of the issuers

– 6% of the issuers were required to restate MD&A

– 62% of the issuers agreed to enhance their disclosure prospectively

**CSA Staff highlighted the following areas of concern:**

1. Excess distributions and the sustainability of distributions

The overriding observation was that issuers with excess distributions provided boilerplate disclosure, particularly about the sources of funding. The CSA Staff noted that the better quality disclosures provided entity-specific explanations for the particular items of working capital which led to the excess, such as leasing costs, taxes or transaction costs. Issuers were reminded via the Notice that they should clearly quantify the amount of excess distributions relative to cash flows from operating activities in each reporting period.

2. Non-GAAP Financial Measures

The CSA Staff identified a significant number of disclosures pertaining to non-GAAP financial measures that did not conform to the guidance in CSA SN 52-306 or NP 41-201, being:

– a lack of transparency and lack of disclosure about the adjustments made in arriving at non-GAAP financial measures such as AFFO and a lack of clarity in how management uses each individual non-GAAP financial measure,

– a failure to clearly identify the most directly comparable GAAP measure, and

– non-GAAP financial information being presented more prominently than the GAAP information

Their review mainly focused on adjustments related to maintenance capital expenditures and working capital and discussed in the Notice the diversity in practice amongst real estate issuers in how the maintenance capital expenditures adjustments are determined and disclosed. Examples are provided in the Notice which meet CSA requirements.

- Prominence of disclosures of non-GAAP financial measures

The CSA Staff specifically highlighted Joint Venture disclosures in the MD&A. They observed that issuers with joint ventures sometimes present a full set of non-GAAP financial statements in the form of a columnar reconciliation

within the MD&A that shows separately their pro-rata share of the interest in joint ventures. This presentation of a full set of non-GAAP financial statements within the MD&A effectively creates a non-GAAP financial measure for each financial statement line item. This presentation effectively unwinds the equity method of accounting required by IFRS 11.

The CSA Staff's view is that this extensive and pervasive use of non-GAAP financial measures at pro-rata interest makes it difficult for a reader to interpret the financial performance and financial condition relative to the GAAP financial statements.

Accordingly, CSA Staff required certain issuers to include clarifying disclosure in their MD&A that the issuer does not independently control the unconsolidated joint ventures, and that the presentation of pro-rata assets, liabilities, revenue, and expenses may not accurately depict the legal and economic implications of the issuer's interest in the joint ventures.

- Use of non-GAAP financial measures and reconciliations

The CSA Staff review was primarily focused on the use and reconciliation of AFFO and ACFO.

They noted that there continues to be diversity amongst real estate issuers in how AFFO is utilized:

earnings measure (35%)

cash flow measure (21%)

both (44%)

It was noted that the MD&A disclosure about the purpose and use of AFFO was often boilerplate. The CSA Staff advised that issuers' disclosures should clearly explain why management calculates and uses AFFO, and the reconciliation provided should be consistent with this intended use.

The CSA Staff's review noted that issuers are also using a variety of other non-GAAP financial measures. The CSA Staff advised that issuers should also carefully consider the number of non-GAAP financial measures used to "tell their story" in the MD&A, and avoid using multiple non-GAAP financial measures for seemingly the same purpose.

**The complete CSA Staff Notice 52-329 *Distribution Disclosures and Non-GAAP Financial Measures in the Real Estate Industry* can be found on CSA members' websites.**

[1]The CSA Staff reviewed 47 REITs and REOCs as part of their review (excluding those issuers that did not use non-GAAP financial measures, did not pay distributions, or that had minimal market capitalizations).
Source: Canadian Securities Administrators

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