Goodmans LLP Update

REITs and Income Securities

January 27, 2015

OSC Releases Staff Notice on REIT Distributions Disclosure

The Ontario Securities Commission (OSC) has released new guidance on public disclosure expectations for real estate investment trusts (REITs), particularly those whose distributions exceed cash flow from operations.

Staff Notice 51-724 - *Report on Staff's Review of REIT Distributions Disclosure* (the "**Notice**"), published on January 26, 2015, follows a recent review by OSC Staff of the quality and sufficiency of disclosure by REITs relating to the sustainability of their distributions. OSC Staff reviewed the public disclosure of 30 REITs with head offices in Ontario. As part of the review, the OSC sent comment letters to 50% of the REITs that were reviewed and of this group, the OSC requested that 67% enhance their disclosure on a prospective basis. None of the reviews identified the need to refile or restate continuous disclosure filings.

OSC Staff found that REITs were generally fulsome in their disclosures but identified four areas where disclosure should be improved, particularly in circumstances where distributions paid exceed the cash flows generated by the REIT's underlying properties, as outlined below.

1. **The content of disclosure where excess distributions are paid**

According to the Notice, 33% of the REITs reviewed paid distributions which exceeded cash flow from operations and did not provide the level of disclosure expected by OSC Staff.

The Notice states that REITs declaring distributions in excess of cash flow from operations should disclose and discuss this fact in their MD&A and Annual Information Form in accordance with the requirements for such documents. Boilerplate language regarding excess distributions should be avoided.

OSC Staff go on to suggest that where a REIT pays non-cash distributions (including distributions paid in connection with a distribution reinvestment plan) it should disclose this and explain the effect such non-cash distributions may have on the sustainability of cash distributions over time.

2. **Consistency of disclosure about excess distributions**

For 10% of the REIT's reviewed, distributions did not exceed cash flow from operations solely because interest paid by the REIT was recorded on the REIT's statement of cash flows as a financing activity, rather than as an operating activity, as permitted under International Financial Reporting Standards (IFRS).

OSC Staff recognise that a REIT may choose to classify interest paid as a financing activity in accordance with IFRS, but the REIT must consider whether distributions would exceed cash flow from operations if interest paid were reclassified as an operating cash flow item. If so, the REIT must present the required "excess distribution" disclosures.

3. **Timely disclosure where a reduction or termination of distributions occurs**

The Notice points out that a reduction or elimination of distributions may constitute a material change in the business of the REIT. Accordingly, sufficient advance notice of any prospective distribution reduction should be provided to investors as soon as practicable. OSC Staff state that REITs should discuss in their MD&A any trends and risks which may result in a possible reduction or elimination of future distributions.

4. **Presentation of metrics common to the real estate industry, such as adjusted funds from operations (AFFO)**

OSC Staff also discuss the use of cash flow measures such as AFFO by REITs. The Notice provides that where AFFO is used to represent a measure of the net cash available for distribution to securityholders, disclosure should be consistent with the expectations for non-GAAP measures outlined in item 2.5 of NP 41-201. This requires, among other things, that:

(i) the nearest GAAP measure be presented with equal or greater prominence to the non-GAAP measure;

(ii) AFFO be reconciled to cash flow from operations;

(iii) the disclosure includes a statement indicating that AFFO does not have a standard meaning under IFRS and may not be comparable to AFFO as quantified by other entities; and

(iv) the disclosure includes an explanation of how AFFO provides useful information to investors and how management uses it as a financial measure.

Please contact any member of our REITs and Income Securities Group to discuss these latest guidelines and their implications for the REIT sector.