

Goodmans^{LLP} Update

Canadian Securities Regulators Outline Disclosure Expectations for Real Estate Reporting Issuers

On April 12, 2018, the Canadian Securities Administrators (CSA) published CSA Staff Notice 52-329 *Distribution Disclosures and Non-GAAP Financial Measures in the Real Estate Industry*, which details findings of a recent review of two areas of disclosure for real estate reporting issuers, including real estate investment trusts (REITs) and real estate operating companies (REOCs).

The two areas reviewed were:

1. distribution disclosures relative to National Policy 41-201 *Income Trusts and Other Indirect Offerings* (NP 41-201); and
2. non-GAAP financial measure disclosures relative to CSA Staff Notice 52-306 (Revised) *Non-GAAP Financial Measures* (CSA SN 52-306).

In the notice, the CSA outlined the findings of its review of 47 real estate reporting issuers and indicated that overall, disclosure in these areas needs improvement.

Distribution Disclosures

In its review of distribution disclosure, the CSA found the disclosure was generally adequate, except in cases where “excess distributions” were made. Excess distributions occur when declared distributions during a quarterly or annual period exceed cash flows from operating activities. The CSA found a number of REITs and REOCs did not disclose the sources of cash used to fund the excess, or such disclosure used boilerplate language.

NP 41-201 requires reporting issuers that make excess distributions to: (i) quantify the excess amount; (ii) identify the reasons for excess distributions and the sources of cash used to fund them; and (iii) disclose risk factors related to excess distributions and any impact on the sustainability of future distributions. The CSA noted it is not sufficient for issuers to simply state they believe current distributions are sustainable.

Non-GAAP Financial Disclosures

The CSA found a number of disclosures pertaining to non-GAAP financial measures did not comply with requirements in CSA SN 52-306 or NP 41-201. The issues identified included:

- a lack of transparency and disclosure about the adjustments made in arriving at non-GAAP financial measures;
- 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
- a more prominent presentation of the non-GAAP financial information as compared to the GAAP information in the issuer’s continuous disclosure documents and investor presentations.

The CSA noted issuers should provide sufficient explanation for all adjustments, including why and how they were determined. Where the adjustments are an estimate, issuers should explain how the estimate was determined. The CSA focused on two adjustments in particular:

- *Maintenance expenditure reserve*: If an issuer uses a maintenance capital expenditure reserve in calculating a non-GAAP measure, it should provide additional disclosure in the MD&A on how such reserve was determined by management, including: (i) the method by which management determined the reserve; (ii) why that method was chosen and why it is appropriate; (iii) how the reserve amount compares to actual maintenance capital expenditures in the period and historically; and (iv) why management’s estimate is more relevant than the actual expenditure. The CSA also recommended comparing the reserve to actual historical maintenance capital expenditures.

- *Working capital adjustments:* A working capital adjustment to a non-GAAP measure should be accompanied by disclosure outlined in section 2.7 of NP 41-201, which includes a: (i) discussion of the nature of the adjustment; (ii) description of the underlying assumptions used in preparing each element (including how those assumptions are supported); and (iii) discussion of the specific risks and uncertainties that may affect the assumption.

The goal is to ensure investors understand the adjustments being made as part of the reconciliation to the most directly comparable GAAP measure.

In addition to guidance on the presentation of non-GAAP measures generally, the CSA also provided guidance to issuers with equity-accounted joint venture arrangements where non-GAAP disclosure is provided to show the issuer's pro rata interest in the joint venture. The notice reminds real estate issuers that where non-GAAP disclosure is provided in these circumstances, the equivalent GAAP measures must be presented with equal or greater prominence and the non-GAAP measures must be identified (and named) in a manner that clearly distinguishes them from GAAP measures.

Conclusion

Real estate reporting issuers should review their continuous disclosure materials to ensure their (i) distribution disclosure meets the requirements of NP 41-201, particularly where they have excess distributions, and (ii) non-GAAP financial measures comply with the guidance set out in CSA SN 52-306.

For further information on these reporting requirements, please contact any member of our Corporate Securities Group.

Key Contacts



Bill Gorman
bgorman@goodmans.ca
416.597.4118



Rosel Kim
rkim@goodmans.ca
416.849.6979



Brad Ross
bross@goodmans.ca
416.849.6010

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