

JANUARY 27, 2015

OSC Provides New Guidance on Disclosure Regarding REIT Distributions

Authors: [Brooke Jamison](#) and James R. Reid

The Ontario Securities Commission has conducted a review of the disclosure of selected Real Estate Investment Trusts (REITs), and on January 26, 2015 published [OSC Staff Notice 51-724 – Report on Staff's Review of REIT Distributions Disclosure](#). The Notice identifies four areas in which the OSC believes that REITs should improve their disclosure relating to distributions:

- the content of disclosure where excess distributions are paid;
- consistency of disclosure about excess distributions;
- timely disclosure where a reduction or termination of distributions occurs; and
- presentation of non-GAAP metrics such as adjusted funds from operations.

REITs are issuers that own income-producing real estate assets and generally distribute their taxable income to unitholders. With bond yields at historic lows, REITs have become more popular as investors seeking yield have increasingly looked to equity issuers that pay regular dividends or distributions. The Notice focuses on disclosure relating to cash flow and situations in which a REIT distributes more cash than it generates from operations, referred to as “excess distributions”.

Of the 30 REITs reviewed by the OSC, 33% paid excess distributions. The OSC believes that more prominent and transparent disclosure about the potential risks of this practice should be provided to investors. Such disclosure would include quantifying the distributions funded from non-operating sources, identifying the sources of cash used to fund excess distributions and discussing the related risks and implications, including any impact on the sustainability of distributions.

The Notice points out that whether a REIT pays excess distributions may be affected by whether it has elected to classify borrowing costs as a financing activity or an operating cash flow item. The OSC states that if distributions do not exceed cash flow from operations only because the REIT elected to classify interest as a financing activity, it should in any event provide disclosure about excess distributions as if it had classified interest as an operating cash flow item.

The Notice highlights the importance of REITs disclosing trends and risks that may result in a possible reduction or elimination of distributions. Sufficient advance notice of any prospective distribution reduction should be provided to investors as soon as possible. The OSC notes that such a reduction or elimination may constitute a material change.

The Notice addresses the use of adjusted funds from operations (AFFO), the non-GAAP (generally accepted accounting principles) metric most commonly used by REITs to measure the cash generated by a REIT's operations that is available for distribution. The Notice states that adjustments included in the determination of AFFO should be consistent from year to year and that disclosure of AFFO should include the following:

- a statement that AFFO does not have a standard meaning under International Financial Reporting Standards;
- a reconciliation of AFFO to cash flow from operations (the most comparable GAAP measure); and
- no greater emphasis in presentation on AFFO than on cash flow from operations.

The OSC sent comment letters to 50% of the REITs it reviewed, of which 67% were asked to enhance their disclosure in the future. No REIT was asked to refile or restate any of its continuous disclosure documents. The guidance in the Notice builds upon similar guidance previously outlined in National Policy 41-201 – *Income Trusts and Other Indirect Offerings*.

Key Contact: [Brooke Jamison](#)

This information and comments herein are for the general information of the reader and are not intended as advice or opinions to be relied upon in relation to any particular circumstances. For particular applications of the law to specific situations the reader should seek professional advice.