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The Secretary
Ontario Securities Commission
20 Queen Street West, 22 Floor
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Submitted via electronic email

Re: CSA Consultation Paper 51-404 Considerations for Reducing Regulatory Burden for Non-Investment Fund Reporting Issuers

Dear Ontario Securities Commission,

Thank you for the opportunity to comment on the CSA Consultation Paper 51-404 *Considerations for Reducing Regulatory Burden for Non-Investment Fund Reporting Issuers*.

The Real Property Association of Canada ("REALPAC") is Canada's senior-most voice for Canada's commercial investment real estate industry. Our members include the largest publicly traded real estate companies and real estate investment trusts (REITs) in Canada.

REALPAC and its members are very supportive of the CSA's initiative to ease the regulatory burden on non-investment fund reporting issuers. In particular we support:

1. An option to permit semi-annual reporting
2. Removing or modifying the criteria to file a BAR
3. Reducing the regulatory burdens associated with the prospectus rules and offering process
4. Simplifying continuous disclosure obligations and eliminating overlap in regulatory requirements

Reducing ongoing disclosure requirements

1. AN OPTION TO PERMIT SEMI-ANNUAL REPORTING

REALPAC supports implementing the option to report on a semi-annual basis for all reporting issuers. The real estate industry, for example, is focused on long term value creation through acquiring, developing and holding long term real estate assets. We believe that quarterly reporting is inconsistent with a long-term value creation strategy and encourages reporting issuers to focus too heavily on short term results.

As noted in the CSA Consultation Paper, a semi-annual reporting model has been utilized effectively in Australia and the UK. The UK, in particular, serves as an example of how a move to quarterly reporting was "tested" and abandoned. In 2007, the UK mandated quarterly reporting. In 2014, this requirement was abandoned after a government

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review found that quarterly reporting requirements seemed to be promoting a short-term focus by companies, investors and market intermediaries.

Other jurisdictions are also considering ways to decrease regulatory burdens. In the U.S., the Securities and Exchange Commission ("SEC") recently acknowledged that public companies are weighed down with too much regulation, and that increased disclosures and other burdens are making the public markets less attractive. In his address on July 2017, SEC Chairman Jay Clayton stated that, "(w)hile there are many factors that drive the decision of whether to be a public company, increased disclosure and other burdens may render alternatives for raising capital, such as the private markets, increasingly attractive to companies that only a decade ago would have been all but certain candidates for the public markets. And, fewer small and medium-sized public companies may mean less liquid trading markets for those that remain public. Regardless of the cause, the reduction in the number of U.S.-listed public companies is a serious issue for our markets and the country more generally."

We disagree with the premise that the elimination of quarterly reporting would deprive investors of timely financial disclosure. REALPAC consulted a group of our analyst and investor contacts and heard strong support for the move from quarterly to semi-annual reporting. Many noted that information included in quarterly reports was of little use because of how little changes in a 3-month period.

Further, as a result of on-going disclosure obligations required by securities regulation, issuers will report any transactions or events deemed material to their business, thus keeping investors and other stakeholders apprised in any interim period between reporting periods. We support the premise that quarterly reporting encourages reporting issuers and the users of these reports to focus too heavily on short-term financial results.

In addition, some argue that companies are choosing the private market over public markets when faced with the prospect of producing onerous quarterly reports.

Question 23. What are the benefits of quarterly reporting for reporting issuers? What are the potential problems, concerns or burdens associates with quarterly reporting?

While quarterly reporting provides timely information, REALPAC questions the relevance of the information being reported on in such a short time frame. In industries where the focus is on long term value creation and long term holding and developing of long term assets – such as real estate – the amount of change that occurs in a short three-month period is insignificant. In fact, quarterly reporting on financial results where the business strategy is long-term is arguably detrimental as it focuses both management and investors on short-term results and changes at the expense of focusing resources on long term strategy.

Even those who advocate for quarterly reporting often concede that much of the information in quarterly reports is redundant, duplicative and/or largely irrelevant to investors. The costs of producing these reports is staggering in terms of both dollar amounts and resources. Permitting semi-annual reporting would alleviate these costs

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and free up resources, allowing them to be redirected towards long-term strategy and value creation. For an average REIT, external costs alone for a single interim review account for approximately 1 – 1.5% of annual general and administrative costs. When internal costs are taken into account, this cost doubles. On a dollar basis, this amounts to between $160,000 to $460,000 per quarter.

Question 24. Should semi-annual reporting be an option provided to reporting issuers and if so under what circumstances? Should this option be limited to smaller reporting issuers?

The semi-annual reporting option should be available to all reporting issuers. The notion of limiting the option to smaller issuers seems counter intuitive, as one could expect to see more fluctuation in earnings or asset values within shorter time periods in small entities than in larger, more established ones. This supports the argument that investors would be more interested in these large changes in smaller entities than smaller changes in larger ones.

In addition, under current securities regulation, companies are required to report material changes. As such, the markets are provided with timely updates when transactions or events that may be significant to investors occur. Quarterly reporting is not needed in order to keep market participants adequately updated on significant occurrences.

Question 25: Would semi-annual reporting provide sufficiently frequent disclosure to investors and analysts who may prefer to receive more timely information?

Yes. As noted above, continuous disclosure requirements under securities law already require the reporting of material changes, and as such, investors are already provided with significant timely information in between reporting periods. Mandatory quarterly reporting is not required to provide timely information.

Question 26: Similar to venture issuers, should non-venture issuers have the option to replace interim MD&A with quarterly highlights?

Yes. Allowing this option reduces duplication of information and reporting results where changes in the intervening period are insignificant.

2. REMOVING OR MODIFYING THE CRITERIA TO FILE A BAR

REALPAC supports either removing or modifying the criteria to file a BAR.

Question 18. Does the BAR disclosure, in particular the financial statements of the business acquired and the pro forma financial statements, provide relevant and timely information for an investor to make an investment decision? In what situations does the BAR not provide relevant and timely information?

No. In many circumstances, in respect of the acquired business, financial statements are not readily available, in particular where the acquired business has been held by private entities. Financial statements of the business acquired, as well as pro forma financial statements are not reflective of the combined business afterwards. This is simply a historical mathematical exercise that does not accurately represent the future state of the combined business.

Question 19. Are there certain BAR requirements that are more onerous or problematic than others?

Yes. The cost of filing a BAR as well as the BAR cross-over rules relating to a Short Form Prospectuses are particularly onerous.

The cost of filing a BAR is very high. This is due to the fact that:

- audited financial statements are required for one year of the financial statements prepared;
- the property being acquired normally does not have historical separate financial statements available, thus requiring that the statements be carved out from the vendor's financial statements (i.e. start from scratch to create);
- it requires cooperation from the vendor and typically from the vendor's auditor/accountant who generally will extract some "premium" fee for getting the work done;
- the additional cost of the REIT's auditors who would normally be engaged to review the pro forma statements prepared for the BAR; and,
- the duplicate costs for audits and reviews that arise when the BAR information must be incorporated in a prospectus initially and then updated when the acquisition actually closes.

In addition, the BAR rules that cross-over to the rules relating to Short Form Prospectuses per National Instrument 44-101 ("NI 44-101") are onerous. The rules of NI 44-101 (specifically Section 10.2 of Form 44-101F1) state that the reporting issuer must include in the prospectus information about significant acquisitions that have either been completed or are highly likely to be completed. In order to satisfy this requirement, the financial statements or financial information provided in the prospectus must include the information that will be required for a BAR filed under Part 8 of NI 51-102.

Therefore, if a BAR has already been filed, then the BAR may simply be incorporated by reference in the prospectus. However, if no BAR has been filed, as may be the case if a reporting issuer is raising capital before an acquisition is completed, the BAR information must be created to be placed within the body of the prospectus. This creates a significant amount of work and cost and significantly complicates the process of raising capital.

Most smaller and growth-oriented REITs need to raise capital in order to finance proposed acquisitions. The prospectus requires that detailed information be provided on proposed acquisitions. This also means that the BAR requirements are included in the prospectus. Therefore, in order to meet the requirements of the BAR, the REIT must obtain the necessary audited financial statements from the vendor before the prospectus can be filed. This can take weeks to complete and could delay the REIT's plans to raise capital when markets are favourable. It leads to uncertainty of market execution which affects every "bought deal" financing as investment banks need assurance that no regulatory obstacle will impact the execution of an offering. Several REITs have noted instances where deals have been delayed or abandoned as a result of the onerous requirements of filing a BAR.

Question 20. If the BAR provides relevant and timely information to investors: (a) Are each of the current significance tests required to ensure that significant acquisitions are captured by the BAR requirements?

No. Part 8 rules provide three specific tests to assess whether an acquisition is "significant": an asset test; an investment test, and a profit or loss test. In simple terms, if an acquisition represents 20% of the reporting issuer's total assets or total net income, the acquisition is considered significant.

The biggest issue with the BAR rules is the "profit and loss test". The profit and loss test does not make any sense in respect of a real estate entity and in no way reflects how the real estate industry measures operating performance or asset value. For many small REITs/REOCs, most property acquisitions will fail the profit and loss test because of how net income is determined under IFRS accounting standards.

The profit and loss test measures the net income of the property against the net income of the reporting issuer. Where the net income of the property is greater than 20% of the reporting issuer's net income, the acquisition is deemed significant. For purposes of this test, if the net income of the reporting issuer is in fact a loss, the absolute value of the loss is used for the calculation. Therefore, ironically, the larger the loss a reporting issuer incurs, the less likely the significance test will be met. This is one of the many nonsensical results arising from this test.

a) Net income of a property:
Net income of a property will represent primarily Net Operating Income ("NOI") of the property, less mortgage interest if a mortgage exists, plus/minus fair value changes on investment property. The property level net income will not include any allocation of trust/company G&A, nor trust/company level financing expenses (e.g. convertible debentures, operating lines, unsecured debentures, etc.)

b) Net income of a real estate entity (for purposes of this discussion we will refer to the real estate entity as a "REIT"):
Net income of the REIT will include all trust level expenses which for most REITS drive low net income or net losses. The net income is the reported IFRS/GAAP net income from continuing operations. Specifically, the key issues affecting net income of a REIT are:

> i) Fair Value Changes of Re-Measuring Investment Property – under IFRS, the fair value swings of investment property will cause volatility in the income statement. Should capitalization rates increase in a notable fashion, all REITs will be recording significant fair value losses which could easily wipe out all of the income of the REIT. In that case, it is not only the small REITs that would be impacted by the BAR significance test regarding profit and loss.

ii) Accounting for Class B Units of Open-ended Trusts – the accounting standards applied under IFRS for Class B units of an open-ended trust (with redeemable units) result in two items that cause volatility and additional expenses in the income statement:

a. Class B Units are accounted for as liabilities, and they are measured at fair value each reporting period, of which the fair value is typically based on the unit price of the REIT. This introduces volatility to the income statement as unit prices move up and down and are sometimes impacted by greater market factors rather than the REIT's business itself. Ironically, if the unit price of a REIT increases, a fair value loss is recorded as the liability increases, therefore driving the net income down.

b. Since the Class B Units are considered liabilities, the distributions paid out on the units are treated as interest expense, driving net income down.

iii) Transaction Costs – under IFRS, more transaction costs are expensed, several which can be quite significant. For example, if any acquisition is deemed a "business combination" in accordance with IFRS 3, the transaction costs (which include land transfer taxes) are expensed immediately in the income statement. Second, for convertible debentures measured at fair value, which for many open-ended REITs this is the case when convertible debentures are issued, all related transaction costs are expensed (including the underwriters' fees).

iv) Other fair value changes under IFRS – under IFRS, many items are measured at fair value (derivatives, stock-based compensation units), thus creating volatility to the income statement.

v) Depreciation and Amortization (for those entities choosing the cost model under IFRS) – real estate entities have large depreciation and amortization charges which are recorded when using the cost model under accounting rules. Even older properties are being constantly renovated/redeveloped, thus never allowing depreciation charges to wind down.

Net income of a real estate entity has traditionally been and continues to be an irrelevant operating metric. That is the reason why the real estate industry created non-GAAP/non-IFRS measures to assess the operating performance of a real estate entity nearly forty years ago. The industry globally has widely adopted operating measures such as NOI, Funds From Operations ("FFO") and Adjusted Funds From Operations ("AFFO") as appropriate and relevant operating metrics.

The point being, the profit and loss test almost guarantees that any acquisition made by a smaller REIT will require that a BAR be filed regardless if an acquisition is deemed not significant under the asset test, investment test, or by another measure (i.e. where the acquisition represents less than 20% of the REIT's asset base or less than 20% of the REITs NOI).

REITs may apply for exemptive relief from the BAR requirements – which many have done and continue to do. The REITs typically request that the profit and loss test use another measure other than net income such as NOI, or that net income be adjusted for items such as depreciation and there are many precedents that exist where the OSC (and other provincial regulators) have granted relief. However, the issues around this solution are that:

a) it may take anywhere from 3-4 weeks to obtain the necessary relief – this may have an impact on the REIT's ability to raise capital on a timely basis as the REIT may be seeking relief in order to be able to issue a prospectus without the BAR requirements but cannot do so unless it is certain it will obtain the relief;

b) the OSC (or other provincial regulator) may not issue the relief; and

c) the application for relief is costly (legal fees).

Given that the OSC (and other provincial regulators) have granted relief to REITs on numerous occasions, it speaks to the fact that the profit and loss test is not working for the real estate industry.

(b) To what level could the significance thresholds be increased for non-venture issuers while still providing an investor with sufficient information with which to make an investment decision?

Ideally, the threshold of 20% should be increased to 50% or 75%. Using such a low threshold of 20% guarantees that most acquisitions for smaller, growing entities are subject to filing a BAR. As noted above, many factors that impact net income under IFRS are not truly representative of a REITs' operating income and artificially suppress income under various circumstances. As the costs associated with meeting the BAR requirements are very significant, they act as a hindrance to raising capital. Given the issues with how IFRS net income is calculated for REITs, increasing the threshold will arguably provide investors with better information as it will only highlight transactions that are actually significant to the REITs, rather than focusing on every single time a smaller, growing REIT is simply adding a property to its portfolio and distracting the management team from building a stronger operating base.

(c) What alternative tests would be most relevant for a particular industry and why?

In addition to increasing the threshold for significant acquisitions, we offer two additional alternatives for the real estate industry.

1) eliminating the income test, and relying on the asset test; or
2) creating a new profit or loss measure for the real estate industry

In real estate, "net operating income" (NOI) is a profit or loss measure commonly used and widely-accepted across the industry. NOI is reported by virtually all REITs and is also a key component in driving a property acquisition's value and price. For example, when analyzing a potential purchase, NOI is used by capitalizing it at the property's capitalization rate to arrive at the property's value; thus, NOI is highly relevant to REITs. Further, by referencing NOI, it excludes any financing impact relating to debt the seller may have placed on the sold property, which in most cases will not be assumed by the acquiring entity nor reflect the acquiring entity's cost of borrowing.

Additionally, in most cases, the significance of an acquisition measured using NOI for the profit and loss test tracks virtually in the same proportion as the significance of an acquisition using the Asset Test or Investment Test. That is, if an acquisition represents 10% of a REIT's assets, the NOI of the property will represent approximately 10% of the REIT's NOI. As such, when using the appropriate "income" test for REITs, the resulting impact on a threshold is essentially the same as per an "asset" test. Therefore, completing both the income test and the asset test is redundant when related to applying a threshold test.

(d) Do you think that the disclosure requirements for a significant acquisition under Item 14.2 of 51-102F5 (information circular) should be modified to align with those required in a BAR, instead of prospectus-level disclosure? Why or why not?

REALPAC supports any initiative that aligns the requirements of separate rules that address the same transaction. Therefore, REALPAC does support modifications to Item 14.2 of 51-102F5 such that it aligns with requirements of a BAR. Currently Item 14.2 introduces additional disclosure requirements over and above and different from those required in a BAR for an acquisition deemed significant in Part 8 of NI 51-102. Yet, the intent of the BAR is to provide users information about the acquired company and as such unnecessary duplication arises with Item 14.2.

3. *REDUCING THE REGULATORY BURDENS ASSOCIATED WITH THE PROSPECTUS RULES AND OFFERING PROCESS*

REALPAC supports easing the burdens surrounding the capital raising process.

<u>Streamlining public offerings for reporting issuers</u>

11. Is the current short form prospectus system achieving the appropriate balance (i.e., between facilitating efficient capital raising for reporting issuers and investor protection)? If not, please identify potential short form prospectus disclosure requirements which could be eliminated or modified in order to reduce regulatory burden on reporting issuers, without impacting investor protection, including providing specific reasons why such requirements are not necessary.

No. Currently, raising capital is a costly and onerous process, that is hindering activities in the public markets. REALPAC members have directly experienced situations in which accessing the public markets was either delayed or abandoned as a result of the requirements. Had some of these burdens been less onerous, several more transactions would have taken place and on a more efficient (and less costly) basis.

The most significant cost of completing a prospectus is obtaining the comfort letter from the issuer's auditors for the underwriters. As a result of the vast number of documents that are required to be included in a prospectus (for example, financial statements for interim and annual reporting periods), an enormous amount of work is required to gain comfort on every document included as well as all documents that are cross-referenced therein (for example, Annual Information Form (AIF) and Management Information Circular (MIC)). In most instances, the comfort process has *no materiality limit* and any financial number is highlighted in the comfort letter report to underwriters if inconsistent by +/- one (1) from source documents.

While this creates a lucrative business for those reviewing or auditing those documents, it does so at great expense to companies operating in the public markets. It is not surprising that studies show decreasing activities in the public markets as many entities are pushed to chose the private markets as a result of these onerous costs.

Eliminating the number of documents incorporated by reference in a short form prospectus, as well as easing the requirements for multiple periods of financial results, would help ease this burden and allow for more and nimble activity in the public markets.

13. Are conditions right to propose a type of alternative prospectus model for reporting issuers?

Yes. While historical information is relevant when analyzing a transaction, having a large amount of such information included in a prospectus may mislead investors into relying too heavily on the historical information rather than the opportunity and risk factors of the future investment they are buying into.

REALPAC supports an alternative prospectus model for reporting issuers that is more closely linked to continuous disclosures. We also support an alternative prospectus model where reporting issuers and dealers participating in an offering would assume liability for any misrepresentation in the reporting issuer's disclosure base and all written marketing communications pertaining to the offering or the securities offered.

If an alternative prospectus model is utilized for reporting issuers:
(a) What should the key features and disclosure requirements of any proposed alternative prospectus model be?

REALPAC supports the suggestions included in the CSA Consultation Paper, including:

- a detailed description of the securities offered
- intended use of proceeds
- the plan of distribution
- consolidated capitalization
- material risk factors associated with the offering and the offered securities
- conflicts of interest, if any
- investors' statutory rights of withdrawal, damages and rescission

(b) What types of investor protections should be included under such a model (for example, rights of rescission)?

- investors' statutory rights of withdrawal, damages and rescission

(c) Should an alternative offering model be made available to all reporting issuers? If not, what should the eligibility criteria be?

Yes. As noted above, more focus should be placed on the specific facts of the offering and risk factors of the investment, with less emphasis on referenced historical information.

4. SIMPLIFYING CONTINUOUS DISCLOSURE OBLIGATIONS AND ELIMINATING OVERLAP IN REGULATORY REQUIREMENTS

27. Would modifying any of the above areas in the MD&A form requirements result in a loss of significant information to an investor? Why or why not?

No. As noted above, REALPAC welcomes any alignment of requirements of separate regulation that address the same disclosure objective.

All form requirements can be referenced in other documents and the availability of this information is easily accessible. Any changes or additional risks can be noted in the MD&A as part of continuous disclosure requirements thereby providing investors with relevant information as opposed to repetition.

28. Are there other areas where the MD&A form requirements overlap with existing IFRS requirements?

Yes, there are several MD&A requirements that overlap existing IFRS requirements as follows:

- Related party transactions and disclosures
- Commitments
- Accounting policies
- Judgments and estimates
- Future accounting policies
- Subsequent events

29. Should we consolidate the MD&A, AIF (if applicable) and financial statements into one document? Why or why not?

Since the financial statements are typically subject to audit, REALPAC recommends retaining the financial statements as a standalone document. However, the MD&A and AIF are both disclosure documents, prepared and certified by management, and governed by securities regulation. There are a number of overlapping disclosure requirements between the AIF and the MD&A and REALPAC supports creating a more efficient document that will eliminate duplication of disclosures. The MD&A and AIF duplicating disclosures include:

- Acquisitions and dispositions
- Financing activities
- Details in respect of an issuer's assets (in the case or real estate, all aspects of its investment property portfolio)

- Capital structure
- Related party transactions
- Risk factors

30. Are there other areas of overlap in continuous disclosure rules? Please indicate how we could remove overlap while ensuring that disclosure is complete, relevant, clear, and understandable for investors.

As per Question 29 above, duplication between the MD&A and AIF.

As addressed in Question 11 above, the inclusion by reference, of public documents within a prospectus (e.g. the inclusion of financial statements, MD&A, AIF, MIC within a prospectus, when all are filed for public disclosure)

We thank the OSC for the opportunity to provide our input on the CSA Consultation Paper 51-404 *Considerations for Reducing Regulatory Burden for Non-Investment Fund Reporting Issuers*. If you would like to discuss our comments, please contact Nancy Anderson, REALPAC's Vice President Financial Reporting and Chief Financial Officer, at 416-642-2700 x226.

Respectfully submitted,

[redacted]

Nancy Anderson, Vice President, Financial Reporting and Chief Financial Officer
REALPAC