WHITE PAPER ON FUNDS FROM OPERATIONS

Real Property Association of Canada
Association des biens immobiliers du Canada

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White Paper on Funds From Operations
February 10, 2009

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Note: As of March 31, 2005, the Association changed its name from the Canadian Institute of Public and Private Real Estate Companies ("CIPPREC") to the Real Property Association of Canada ("REALpac"). All references to CIPPREC throughout this White Paper have been updated with the REALpac name.

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I. INTRODUCTION

Since the introduction of the REALpac Handbook in 1972, REALpac has promoted Funds from Operations ("FFO") as the industry-wide standard measure of a real estate entity's operating performance. The definition, initially labeled as cash flow from operations, has been clarified and amended a number of times to address new issues since that time. The definition historically has been one that was consistent with generally accepted accounting principles ("GAAP"). However, with the release on November 21, 2003 of the Revised Canadian Securities Administrators' Staff Notice 52-306, *Non-GAAP Financial* Measures, REALpac has determined that FFO should no longer be disclosed in financial statements. Rather, it should be included in other continuous disclosure documents of reporting issuers, both corporations and real estate investment trusts ("REITS").

Prior to the release of this White Paper, REALpac's definition of FFO was consistent with what many real estate entities often disclosed in their statements of cash flows.

> FUNDS FROM OPERATIONS is the equivalent of income before extraordinary items adjusted for future income taxes, depreciation and amortization of capital items and deferred leasing costs, any gain or loss on sale or provision against capital items and undistributed profits of equity accounted investees and non-controlling interests.

With the release of the White Paper and consistent with Staff Notice 52-306, REALpac has determined that FFO should no longer be reported within financial statements and therefore has modified its definition. The new definition, effective November 1st, 2004 is as follows:

> **FUNDS FROM OPERATIONS means net income (computed in accordance with generally accepted accounting principles), excluding gains (or losses) from sales of depreciable real estate and extraordinary items, plus depreciation and amortization, plus future income taxes and after adjustments for equity accounted for entities and non-controlling interests. Adjustments for equity accounted for entities and joint ventures and non-controlling interests are calculated to reflect funds from operations on the same basis as the consolidated properties.**

Historical cost accounting for real estate assets implicitly assumes that the value of real estate assets diminishes predictably over time. Historically real estate values instead have risen or fallen with market conditions. Accordingly, many industry investors have considered presentations of operating results for real estate companies that use historical cost accounting to be insufficient by themselves. The term FFO was created to address this problem. It was intended to be a standard measure of operating performance that excluded historical cost depreciation from — or “added it back” to — GAAP net income.

Since the introduction of the definition, the term has come to be widely used by Canadian public companies and REITs. In the view of REALpac, this use combined with the primary GAAP presentations required by the Canadian Institute of Chartered Accountants has been fundamentally beneficial, improving the understanding of operating results of reporting issuers among the investing public and making it easier than before to compare the results of one real estate reporting issuer with another.

This White Paper has been prepared to provide reporting issuers and investors with greater guidance on the definition of FFO and to help promote more consistent disclosures in reporting issuers’ continuous disclosures.

With the exception of the treatment of future income taxes and impairment losses, the concepts and content of this White Paper are substantially consistent with the approach adopted by the National Association of Real Estate Investment Trusts. (“NAREIT”).

II. HISTORY AND INTENDED USE OF FFO DEFINITION

REALpac recognizes that the management of each of its public member entities has the responsibility and authority to publish financial information that it regards as useful to the financial community, within the limits prescribed by law and regulation. Nevertheless, REALpac has been and remains convinced that the industry benefits from having a supplement to net income as a measure of operating performance.

In particular, GAAP historical cost depreciation of real estate assets is generally not correlated with changes in the value of those assets, whose value does not diminish predictably over time, as historical cost depreciation implies. For this reason, comparisons of the operating results of reporting issuers that rely solely on net income have been less than satisfactory. Some analysts have also concluded that comparing or measuring prices of reporting issuers’ stocks solely in terms of conventional price/earnings (“P/E”) multiples is not as useful as also using a supplemental metric.

REALpac has adopted the term FFO in the belief that it would be useful if consolidated income plus future income taxes, depreciation and amortization was used as a supplemental measure of operating performance. In particular, it was hoped that prices of various reporting issuers’ stocks could be compared with each other and in terms of the relationship between stock prices and FFO. Thus, the original intent was that FFO be used for the sake of determining a supplemental capitalization multiple similar to a P/E ratio.

However, the underlying premise of the definition of FFO was not to sanction deviations from GAAP in the name of calculating FFO. In fact, the definition specifically refers to GAAP net income as the starting point in the calculation of FFO.

Importantly, FFO was also not intended to be used as a measure of the cash generated by a reporting issuer nor of its dividend paying capacity. REALpac feels that the statements of cash flows provided for by GAAP financial statements are adequate for analysts to assess the cash generated and used by reporting issuers. Similarly, REALpac continues to believe that the dividend/distribution paying capacity of a reporting issuer results from the economic characteristics of its assets, the degree of risk in matters of capital structure decided upon by individual companies, and other financial policy matters that are properly the province of management. While dividends can be analyzed in comparison to FFO, much as they are analyzed in comparison to net income in other industries, it was and is not REALpac's intent to imply that FFO is a measure of the sustainable level of dividends/distributions payable by a reporting issuer.

Given that FFO is not intended to be a measure of cash generated or of dividend paying capacity, REALpac realizes that most analysts, in an attempt to evaluate dividend/distribution policy may make a variety of adjustments to FFO, with the desire to adjust it so that it would be a better measure of cash generated or dividend/distribution capacity. These calculations generally are referred to by their authors as Funds Available for Distribution, Cash Available for Distribution or Adjusted FFO ("AFFO"). Although there is some considerable overlap among analysts as to what might be appropriate adjustments to FFO that would make it a better measure of dividend/distribution paying capacity, REALpac believes that there is not adequate consensus among preparers and users of reporting issuers' financial statements to allow agreement on a single definition of AFFO. Further, REALpac does not believe that there is a single measure of distributable cash that is consistently applicable to all reporting issuers. Accordingly, REALpac has prepared this White Paper to help reporting issuers provide a consistent starting point for the analysts in their analyses.

The following sections address the most important of the interpretive issues under the definition of FFO, along with REALpac's views on them.

III. DISCUSSION OF FFO DEFINITION

A. Amortization and depreciation.

REALpac urges all member companies reporting FFO to add back only those items that are uniquely significant to the real estate industry. Examples of items that should be added back include real property depreciation, amortization of capitalized leasing expenses including those assigned to in-place leases in a building acquisition, capitalized tenant improvements, depreciation of capitalized long-term replacement items and values assigned to customer relationships in a building acquisition. Specifically excluded are the add back of items such as the amortization of financing costs including those related to imputed interest rate adjustments, depreciation of computer software, company office improvements, and other items commonly found in other industries and required to be recognized as expenses in the calculation of net income.

B. Future income taxes

Future income taxes should be added back to net income to help ensure consistency between reporting issuers that are corporations and all REITS. In addition, since future income taxes are often impacted by substantively enacted changes in income tax rates, the add back removes any distortion arising from this factor.

C. Gains and losses on sale of properties

To help maintain comparability, net income should be adjusted for the gain or loss on previously depreciated operating properties in the calculation of FFO.

A number of entities sell undepreciated property incidental to their main business, most often sales of securities or parcels of land peripheral to operating properties, sometimes referred to as inventory. The prohibition against the inclusion of gains or losses on property sales in FFO is not meant to address this kind of activity. Those entities that choose to include such gains or losses on sales of marketable securities or undepreciated land in their FFO should disclose the amount of such gains or losses for each applicable reporting period. Those that do not should address the amount of such gains or losses in their reconciliation of net income to FFO.

D. Impairment losses

Impairment write-downs of previously depreciated operating properties are often early recognition of losses on prospective sales of depreciable property. Since such losses are excluded from FFO, it is consistent and appropriate that write-downs in advance of the realization of losses should also be excluded.

The Securities Exchange Commission in the United States has indicated that impairment write-downs should not be excluded from FFO.

E. Results of discontinued operations

FFO related to assets held for sale, sold or otherwise transferred and included in results of discontinued operations should continue to be included in consolidated FFO. The inclusion will exclude any gain or loss on sale as indicated in (C.) above.

F. Treatment of other non-recurring and extraordinary items

REALpac's original intent in the creation of FFO was to try to produce a measure of consolidated operating performance that was recurring in nature. Given the diversity in practice that has developed with respect to non-recurring events, REALpac now believes that FFO should include non-recurring events, except for those in (C.) and (D.) above and those that are defined as "extraordinary items" under GAAP. Accordingly, gains or losses from debt extinguishments would be included in FFO. Provision against property other than previously depreciated operating property would be accounted for on a basis consistent with the gain or loss on sale as set out in (C.) above.

G. Equity accounted for entities

An entity's share of net income of equity accounted for entities should be adjusted for adjustments to convert the entity's share of net income to FFO.

H. Non-controlling interests

An entity's non-controlling interests expense should be adjusted for non-controlling interests' share of other adjustments of the entity to convert net income to FFO.

I. Disclosure of FFO

REALpac encourages its members that are reporting issuers to report their FFO in all continuous disclosure filings. In accordance with the Revised Canadian Securities Administrators' Staff Notice 52-306, *Non-GAAP Financial* Measures, issuers should:

1. state explicitly that the non-GAAP financial measure does not have any standardized meaning prescribed by GAAP and is therefore unlikely to be comparable to similar measures presented by other issuers;
2. present with equal or greater prominence than the non-GAAP financial measure the most directly comparable measure calculated in accordance with GAAP;
3. explain why the non-GAAP financial measure provides useful information to investors and how management uses the non-GAAP financial measure;
4. provide a clear quantitative reconciliation from the non-GAAP financial measure to the most directly comparable measure calculated in accordance with GAAP, referencing to

the reconciliation when the non-GAAP financial measure first appears in the disclosure document;
5. explain any changes in the composition of the non-GAAP financial measure when compared to previously disclosed measures.

The format for the statement of FFO should reconcile to net income from the statement of operations and include a line-item breakdown of each of the adjustments being used in the calculation of FFO. The reconciliation should be sufficiently detailed to provide readers with a clear understanding of the material differences between net income and FFO.

REALpac recommends the reconciliation be presented in comparative form to the extent appropriate as follows:

<u>FFO/GAAP Net Income Reconciliation</u>

Net income (*Note 1*)..$x,xxx,xxx

Adjustments:

Future income taxes ....xxx,xxx

Depreciation of real estate assets ....xxx,xxx

Depreciation of capitalized tenant improvements...........................xxx,xxx

Amortization of capitalized leasing costs ....xxx,xxx

Amortization of values ascribed in a building acquisition to in-place leases ....xxx,xxx

Amortization of values ascribed in a building acquisition to customer relationships ....xxx,xxx

Gains/losses from sales of previously depreciated operating properties including the gain or loss included within discontinued operations ....xxx,xxx

Gains/losses from sales of other real estate and securities (*Note 2*) ....xxx,xxx

Reduction in carrying value of previously depreciated operating properties...xxx,xxx

Other items:

Discontinued operations...xxx,xxx

Extraordinary items...xxx,xxx

Adjustments for non-controlling interests ....xxx,xxx

Adjustments for equity accounted for entities ....xxx,xxx

FFO ....$x,xxx,xxx

Note 1 - For practical purposes, some companies begin the reconciliation with income from continuing operations. This practice eliminates the need to provide certain adjustments for discontinued operations, extraordinary items and non-controlling interests.

Note 2 - Section III.C, Gains and Losses on Property Sales, above provides guidance on gains/losses from sales of other real estate and securities.

As a result of the above, there would be no adjustment to net income in determining FFO for the following:

- Unusual items including gains or losses from debt extinguishments
- Depreciation of computer software, company office improvements and other items commonly found in other industries
- Expenditures on long-term replacement items recoverable from tenants that are deemed repairs and expensed
- Amortization of financing costs including those related to imputed interest rate adjustments
- Funds from operations of income-producing properties held for sale, sold or otherwise transferred and now reported in “results of discontinued operations”
- Loss on trade receivables
- Expense arising from stock options
- Amortization of mark-to-market rate leases arising from a building acquisition
- Non-cash effect of straight-line rents
- Unrealized changes in fair value of financial instruments

IV. IMPLEMENTATION

REALpac believes that implementation of the recommendations contained in this White Paper is up to the business judgment of the management of each reporting issuer. The recommendations are intended to be guidelines for management, rather than a mandatory set of inflexible rules; they are not an indication that REALpac or any of its members or advisors believe that any of the information is material to investors in reporting issuers. Nothing contained herein is intended or shall be construed to impose any legal obligation to follow these guidelines or any liability under the securities laws or otherwise for any failure to do so.

REALpac recognizes that in some situations it may be difficult to reconstruct comparable information for prior periods. Nevertheless, REALpac encourages all companies to calculate and present FFO consistently for all periods presented in financial statements or tables.

REALpac believes that public confidence in the quality of reported results, and the adequacy of disclosures as to the method of calculation of those results, is of paramount importance to the public real estate development industry as a whole.

Disclosures in accordance with this White Paper are expected to be implemented by REALpac members for fiscal years commencing on or after January 1st, 2005 with prior period amounts restated to conform to the new definition. Earlier application is encouraged.

REALpac Financial Best Practices Committee
November 30th, 2004, with revisions February 1st, 2007 and February 10, 2009

SCHEDULE "A"

FFO COMPARISON: REALPAC V. NAREIT FFO DEFINITIONS
FEBRUARY 10, 2009

Balance/Transaction	REALpac Definition 803.5 et supra	NAREIT Definition (to February 2004)
Net income	Yes	Yes
Extraordinary items	Adjust	Adjust
Unusual items including gains or losses from debt extinguishments	No adjustment	No adjustment
Future income taxes	Adjust	No adjustment other than for current or deferred taxes directly associated with a gain or loss on disposition of a property not included in FFO.
Depreciation and amortization of capital items that are uniquely significant to the real estate industry	Adjust	Adjust
Depreciation of computer software, company office improvements and other items commonly found in other industries	No adjustment	No adjustment
Amortization of capitalized leasing costs (includes capitalized leasing expenses, tenant improvements and the like)	Adjust	Adjust

Balance/Transaction	REALpac Definition 803.5 et supra	NAREIT Definition (to February 2004)
Amortization of values ascribed to in-place leases arising on a building acquisition	Adjust	Not mentioned. Expectation is that REITs would adjust
Amortization of values ascribed to customer relationships arising on a building acquisition	Adjust	Not mentioned. Expectation is that REITs would adjust
Expenditures on long-term replacement items recoverable from tenants that are deemed repairs and expensed (Feb. 10/09)	No adjustment	Not mentioned. Practice is thought to vary.
Amortization of financing costs including those relating to imputed interest rate adjustments	No adjustment	No adjustment
Gain/losses on sales of previously depreciated operating properties, i.e., income-producing properties including the gain or loss included within discontinued operations	Adjust	Adjust
Income or loss on sale of property held for sale, i.e., land peripheral to operating properties, recorded as other than discontinued operations, i.e., where the proceeds are recorded as revenue	Choice is allowed, but disclosure is required	Choice is allowed, but disclosure of approach is required. Expectation is that REITs would not adjust

Balance/Transaction	REALpac Definition 803.5 et supra	NAREIT Definition (to February 2004)
Gain or loss on sale of marketable securities	Choice is allowed, but disclosure is required	Choice is allowed, but disclosure of approach is required. Expectation is that REITs would not adjust
Impairment write-downs of previously depreciated operating properties	Adjust	The SEC has advised that impairment write-downs must be included in FFO. NAREIT has formally amended its FFO definition to reflect this fact.
Provision for loss on property other than previously depreciated operating property	Account for consistent with gain or loss on such property	Not specifically mentioned. Given the SEC view of impairment write-downs, expectation is that REITs would not adjust
Funds from operations from income-producing property held for sale, sold or otherwise transferred and now reported in "results from discontinued operations	Included in FFO	Included in FFO
Adjustments for non-controlling interests	Adjust to eliminate the non-controlling interests' share of adjustments to convert net income to FFO	Adjust to eliminate the non-controlling interests' share of adjustments to convert net income to FFO
Adjustments for equity accounted for entities	Include all adjustments to convert the entity's share of net income from unconsolidated affiliates to FFO	Include all adjustments to convert the entity's share of net income from unconsolidated affiliates to FFO

Balance/Transaction	**REALpac Definition 803.5 et supra**	**NAREIT Definition (to February 2004)**
Loss on trade receivables	No adjustment	Not mentioned. Expectation is that REITs would not adjust
Expense arising from stock options	No adjustment	Not mentioned. Expectation is that REITs would not adjust
Amortization of mark-to-market rate leases arising from a building acquisition	No adjustment	Not mentioned. Expectation is that REITs would not adjust
Non-cash effect of straight-line rents (Feb. 1/07)	No adjustment	Not mentioned. Expectation is that REITs would not adjust
Unrealized changes in fair value of financial instruments (Feb. 1/07)	No adjustment	Not mentioned. Expectation is that REITs would not adjust

Two differences remain in that in Canada, entities would add back future income taxes and impairment losses in the calculation of Funds From Operations ("FFO") while in the United States, Real Estate Investment Trusts would not add back deferred income taxes nor impairment losses. Corporations in Canada would add back future income taxes in calculating funds from operating activities since it is a non-cash item. REALpac believes that it is important to be consistent with that disclosure for purposes of the REALpac definition of FFO. Furthermore, future income taxes are often impacted by substantively enacted changes in tax rates that are unrelated to the operation of the properties. To eliminate any distortion arising from this factor, it was determined that such costs should be added back. In addition, entities in Canada would add back impairment losses recognized on previously depreciated operating properties in calculating FFO. REALpac believes that impairment write-downs are often early recognition of losses on prospective sales of property. Since losses from sales of previously depreciated operating properties are excluded from FFO, it is consistent and appropriate that write-downs in advance of the realization of losses should also be excluded. However, in the United States, the SEC does not agree with this reasoning and has ruled that real estate entities include all impairment write-downs in the calculation of FFO. NAREIT has amended its FFO definition to reflect this fact (per NAREIT bulletin dated October 1, 2003).