MORRISON FOERSTER

Frequently Asked Questions about

Non-GAAP Financial Measures for REITs

In this issue

The use of non-GAAP financial measures is nearly ubiquitous for U.S. public companies. According to Audit Analytics, the average number of non-GAAP measures reported by public companies has increased from two and a half to seven and a half over the last two decades.

Many companies believe that non-GAAP financial measures provide meaningful supplemental information to their financial statements that are prepared in accordance with United States generally accepted accounting principles ("**GAAP**"). For real estate investment trusts ("**REITs**"), non-GAAP financial measures have always been important due, in large part, to the impact of GAAP on accounting for real estate, such as the impact of depreciation and amortization on the income statement.

Non-GAAP financial measures can provide valuable financial metrics to investors and research analysts; however, the lack of uniformity in the use of non-GAAP financial measures can result in confusion among investors and potentially misleading disclosures by companies. As a result, non-GAAP financial measures have long been a focus of the U.S. Securities and Exchange Commission (the "**SEC**"), beginning with *cautionary guidance* issued in 2001 and the *adoption of Regulation G and Item 10(e) of Regulation S-K* in 2003. In December 2022, the SEC updated its *Compliance and Disclosure Interpretations* ("**C&DIs**") to clarify and reinforce the SEC's position on the use of non GAAP financial measures due to the increased use and prominence of such measures. In addition, the use of non-GAAP financial measures continues to be one of the most frequent subjects of SEC comment letters and has been the subject of SEC enforcement actions (see *Exhibit A* (Recent SEC Comments for REITs) and "*Have there been any SEC enforcement actions related to non-GAAP financial measures?*" below).

Therefore, it is important for REITs, including their boards of directors, management teams, and advisors, to understand the SEC's rules, regulations, and latest guidance with respect to non GAAP financial measures.

[1] Source: https://viewpoint.pwc.com/dt/us/en/pwc/in_the_loop/assets/nongaapitlupdated.pdf

Understanding Non-GAAP financial measures

What is a "Non-GAAP financial measure"?

Under Regulation G and Item 10(e) of Regulation S-K, a non-GAAP financial measure is defined as a numerical measure of a registrant's historical or future financial performance, financial position, or cash flows that:

- excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the most directly comparable measure calculated and presented in accordance with GAAP in the statement of comprehensive income, balance sheet, or statement of cash flows (or equivalent statements) of the registrant; or
- includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the most directly comparable GAAP measure.

The SEC's 2003 adopting release for Regulation G and Item 10(e) of Regulation S-K further provides that the definition of a non-GAAP financial measure is intended to capture all measures that have the effect of depicting either:

- a measure of performance that is different from that presented in the financial statements, such as income or loss before taxes or net income or loss as calculated in accordance with GAAP; or
- a measure of liquidity that is different from cash flow or cash flow from operations computed in accordance with GAAP.

In other words, if a registrant takes a defined GAAP measure and excludes items that are components of that GAAP measure, or includes items that are not components of that GAAP measure, then the resulting measure is a non-GAAP financial measure.

Are there any exclusions from the definition of Non-GAAP financial measure?

Yes, under SEC rules, non-GAAP financial measures exclude:

- operating and other statistical measures (e.g., occupancy, percentage leased, turnover, average daily rate (ADR), rental rates and RevPAR); and
- ratios or statistical measures calculated using exclusively one or both of:
  - financial measures calculated in accordance with GAAP; and
  - operating measures or other measures that are not non-GAAP financial measures.
- financial measures required to be disclosed by GAAP, SEC rules, or a system of regulation of a government or governmental authority or self-regulatory organization (e.g., the Financial Accounting Standards Board ("**FASB**") and the New York Stock Exchange) that are applicable to the registrant.

See "*Is segment information required under ASC 280 a non-GAAP financial measure?*" below.

Why do REITs use non-GAAP financial measures?

Most REITs believe that there are limitations on the usefulness of certain financial measures prepared in accordance with GAAP (such as net income), and that GAAP measures alone do not convey a full picture of the operating performance, liquidity, and financial position of real estate entities, including REITs. Accordingly, virtually all public REITs present one or more non-GAAP financial measures. Management teams also can present non-GAAP financial measures to provide valuable insight into factors they consider important in operating and assessing the performance of the business.

In addition, REITs may disclose certain non-GAAP financial measures to enhance investors' and research analysts' ability to value companies and compare and evaluate their performance against comparable companies.

What are common examples of non-GAAP financial measures used by REITs?

Common examples of non-GAAP financial measures used by REITs include:

- funds from operations ("**FFO**") as defined by the National Association of Real Estate Investment Trusts, the leading industry trade group for REITs ("**Nareit**"), and variations of FFO, such as adjusted FFO ("**AFFO**"), core FFO, and normalized FFO;
- earnings before interest, taxes, depreciation, and amortization ("**EBITDA**") and variations of EBITDA, such as EBITDAre, adjusted EBITDA, and core EBITDA;
- net operating income ("**NOI**"), cash NOI, and same-store NOI;
- core earnings or adjusted earnings (for mortgage REITs);
- cash or funds available for distribution ("**CAD**" or "**FAD**," respectively); and
- net debt or core debt.

In addition, many REITs use one or more non-GAAP financial measures in certain ratios, including to show their leverage (e.g., net debt to adjusted EBITDA), ability to cover interest expense (e.g., adjusted EBITDA divided by cash interest expense), and ability to cover fixed charges (e.g., adjusted EBITDA divided by fixed charges).

Are there industry standards applicable to non-GAAP financial measures used by REITs?

Yes, in 1991, Nareit published a white paper on FFO in order to promote a uniform, widely accepted standard measure of REIT operating performance. The FFO white paper was supplemented over the years and, in December 2018, was restated to consolidate Nareit's prior guidance (see *the 2018 restatement of Nareit's FFO white paper*). The primary reason that Nareit developed FFO as a supplemental performance measure was "to address the artificial nature of historical cost depreciation and amortization of real estate and real estate-related assets mandated by GAAP." In addition, Nareit-defined FFO excludes gains or losses on the sale of certain real estate assets, as well as impairment write-downs of certain real estate assets, which improves the comparability of companies' period-over-period results.

FFO is defined by Nareit as net income (computed in accordance with GAAP), excluding:

- depreciation and amortization expenses related to real estate;
- gains and losses from the sale of certain real estate assets;
- gains and losses from change in control; and
- impairment write-downs of certain real estate assets and investments in entities when the impairment is directly attributable to decreases in the value of depreciable real estate held by the entity.

Nareit's definition does not specify whether FFO should be presented as FFO attributable to common stockholders or FFO attributable to all common equity holders (i.e., common stockholders and outside limited partners of a REIT's operating partnership). REITs should be mindful to accurately and appropriately label FFO and variations of FFO to reflect the securities to which the reported measure is applicable, which has been a subject of SEC comment letters (see *Exhibit A* (Recent SEC Comments for REITs – Labeling)). For example, UPREITs with outside limited partners should specify whether FFO is presented as "FFO attributable to common stockholders and OP unitholders" or "FFO attributable to common stockholders."

Many REITs also present additional variations of FFO, such as AFFO, core FFO and normalized FFO, in order to show a more consistent comparison of operating performance over time or to report a metric that better explains their dividend policies. These metrics may adjust for additional items such as straight-line rent, non-cash stock-based compensation expense, gains/losses on early extinguishment of debt, capital expenditures and acquisition and pursuit costs. However, there are not uniform approaches to the labeling of, or the adjustments included in, such variations of FFO.

Similar to its white paper on FFO, in September 2017, Nareit published a white paper to create a uniform definition of EBITDA for real estate ("**EBITDAre**"). Similar to FFO, in order to improve the comparability of REITs' period-over-period performance, EBITDAre includes adjustments for gains/losses on the disposition of depreciated property and impairment write-downs of depreciated property. Nareit defines EBITDAre as net income (computed in accordance with GAAP), plus:

- interest expense;
- income tax expense;
- depreciation and amortization expense;
- losses (or minus gains) on the disposition of depreciated property, including losses/gains on change of control;
- impairment write-downs of depreciated property and of investments in unconsolidated affiliates caused by a decrease in value of depreciated property in the affiliate; and
- adjustments to reflect the entity's share of EBITDAre of unconsolidated affiliates.

For additional information, see *Nareit's EBITDAre white paper*.

SEC rules for Non-GAAP financial measures

As noted above, in 2003 the SEC adopted Regulation G and Item 10(e) of Regulation S-K, which govern the use of non GAAP financial measures by SEC registrants.

When does Regulation G apply?

Regulation G applies whenever a registrant, or a person acting on its behalf, publicly discloses or releases material information that includes a non-GAAP financial measure, **even if such information is not furnished or filed with the SEC**. For example, a registrant's investor presentations, press releases, earnings calls, supplemental materials and webcasts are subject to Regulation G.

What are the requirements under Regulation G?

Whenever a registrant, or a person acting on its behalf, publicly discloses material information that includes a non-GAAP financial measure, the registrant must accompany that non-GAAP financial measure with:

- a presentation of the most directly comparable financial measure calculated and presented in accordance with GAAP; and
- a quantitative reconciliation of the non-GAAP financial measure to the most directly comparable GAAP measure.

In addition, Regulation G contains a general requirement that non-GAAP financial measures not be misleading—more specifically, that a registrant not publicly disclose a non-GAAP financial measure that, taken together with the other information presented, "contains an untrue statement of material fact or omits to state a material fact necessary in order to make the presentation of the non-GAAP financial measure, in light of the circumstances under which it is presented, not misleading."

When does Item 10(e) of Regulation S-K apply?

Item 10(e) of Regulation S-K applies when one or more non-GAAP financial measures are included in a filing with the SEC, including registration statements, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K (including certain "furnished" Form 8-Ks, as discussed below), and proxy statements.

What are the disclosure obligations under Item 10(e) of Regulation S-K?

Item 10(e) contains the same quantitative reconciliation requirement as Regulation G, but also includes additional disclosure obligations. Whenever one or more non-GAAP financial measures are included in a filing with the SEC, the registrant must include the following in the filing:

- a presentation, **with equal or greater prominence**, of the most directly comparable financial measure calculated and presented in accordance with GAAP;
- a quantitative reconciliation of the non-GAAP financial measure to the most directly comparable GAAP measure;
- a statement disclosing the reasons why the registrant's management believes the presentation of the non-GAAP financial measure provides useful information to investors regarding the registrant's financial condition and results of operations; and

- to the extent material, a statement disclosing the additional purposes, if any, for which the registrant's management uses the non-GAAP financial measure.

Are there any prohibitions under Item 10(e) of Regulation S-K?

In addition to the affirmative disclosure obligations described above, Item 10(e) of Regulation S-K also contains a number of specific prohibitions, including:

- excluding from non-GAAP liquidity measures (other than EBIT and EBITDA), charges or liabilities that required, or will require, cash settlement, or would have required cash settlement absent an ability to settle in another manner;
- adjusting a non-GAAP performance measure to eliminate or smooth items identified as non-recurring, infrequent or unusual, when the nature of the charge or gain is such that it is reasonably likely to recur within two years or there was a similar charge or gain within the prior two years;
- presenting non-GAAP financial measures on the face of the registrant's financial statements presented in accordance with GAAP or in the accompanying notes;
- presenting non-GAAP financial measures on the face of any pro forma financial information required to be disclosed by Article 11 of Regulation S-X; and
- using titles or descriptions of non-GAAP financial measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures.

Is a registrant's earnings release subject to any provisions of Item 10(e) of Regulation S-K?

Yes, a registrant's earnings release furnished under Item 2.02 of Form 8-K is subject to the affirmative disclosure obligations contained in Item 10(e)(i) of Regulation S-K, including the equal or greater prominence requirement.

Although Item 10(e) of Regulation S-K generally applies only to documents that are filed (as opposed to furnished) with the SEC, the instructions to Item 2.02 of Form 8-K expressly state that the requirements of Item 10(e)(i) of Regulation S-K apply to disclosures under Item 2.02 of Form 8-K.

Does the quantitative reconciliation requirement apply to a registrant's guidance and other forward-looking information?

Yes, a quantitative reconciliation is required for non-GAAP financial measures presented in a registrant's guidance and other forward-looking information, "to the extent available without unreasonable efforts."

Based on additional guidance provided by the SEC staff in the C&DIs, if a registrant is relying on the "unreasonable efforts" exception for a forward-looking non-GAAP financial measure, it must disclose that fact and identify the information that is unavailable and its probable significance in a location of equal or greater prominence.

For recent SEC comments on this topic, see *Exhibit A* (Recent SEC Comments for REITs – Failure to Include Reconciliation).

How do registrants comply with Regulation G for conference calls, webcasts or other oral presentations?

If a non-GAAP financial measure is conveyed orally, telephonically, by webcast, or by similar means, then the affirmative disclosure requirements under Regulation G will be satisfied if:

- the required information is provided on the registrant's website at the time the non-GAAP financial measure is made public; and
- the location of the website is made public in the same presentation in which the non-GAAP financial measure is made public.

Is segment information required under ASC 280 a non-GAAP financial measure?

No. Financial measures that a registrant is required to disclose under GAAP, such as segment information regarding revenue, profit or loss, and total assets under FASB Accounting Standards Topic 280 ("**ASC 280**"), are not considered non-GAAP financial measures and, therefore, are not subject to Regulation G or Item 10(e) of Regulation S-K.

However, segment measures that are not consistent with, or are presented in a context other than in accordance with, the requirements of ASC 280 are non-GAAP financial measures and, therefore, are subject to all applicable provisions of Regulation G and Item 10(e) of Regulation S-K. For example, the SEC staff has clarified in the C&DIs and comment letters that the presentation of a total segment profit or loss measure (e.g., segment NOI) in any context, other than the reconciliation in the notes to a registrant's financial statements required by ASC 280, is considered a non-GAAP financial measure that must comply with Regulation G and Item 10(e) of Regulation S-K.

Do Regulation G and Item 10(e) apply to proxy statements?

Generally, yes. However, there is a limited exception for target levels related to executive officer compensation that are included in a registrant's Compensation Disclosure and Analysis ("**CD&A**") pursuant to Item 402(b) of Regulation S-K. Pursuant to the instructions to Item 402(b), disclosure of target levels that are non-GAAP financial measures are not subject to Regulation G or Item 10(e) of Regulation S-K, but disclosure must be provided as to how the number is calculated from the registrant's audited financial statements.

In the C&DIs, the SEC staff reinforces that this is a limited exception and that disclosures of non-GAAP financial measures in CD&A or in any other part of the proxy statement for any other purpose (such as to explain the relationship between pay and performance or to justify certain levels or amounts of pay) are subject to Regulation G and Item 10(e) of Regulation S-K. In these pay-related circumstances, however, the SEC staff will not object:

- if a registrant includes the required GAAP reconciliation and other information in an annex to the proxy statement with a prominent cross-reference to such annex; or
- if the non-GAAP financial measures are the same as those included in the Form 10-K that is incorporating by reference the proxy statement's Item 402 disclosure as part of its Part III information, a registrant provides a prominent cross reference to the pages in the Form 10-K containing the required GAAP reconciliation and other information.

Do Regulation G and Item 10(e) apply to disclosure relating to proposed business combinations?

Generally, no. There is a limited exception for disclosure relating to proposed business combinations. The requirements of Regulation G and Item 10(e) of Regulation S-K do not apply to non-GAAP financial measures included in disclosures relating to a proposed business combination, the entity resulting therefrom or an entity that is a party thereto, if the disclosure is contained in a communication that is subject to the SEC's communication rules applicable to business combination transactions (i.e., Rule 425 under the Securities Act of 1933, as amended, Rules 14a-12 and 14d-2(b)(2) under the Exchange Act of 1934, as amended (the "**Exchange Act**"), and Item 1015 of Regulation M-A).

The SEC staff has issued several C&DIs to clarify its position on the use of non-GAAP financial measures in disclosures related to business combinations, including the following:

- financial measures provided to a financial advisor are not subject to Regulation G or Item 10(e), if and to the extent:
  - the financial measures are included in forecasts provided to the financial advisor for the purpose of rendering an opinion that is materially related to the business combination transaction; and
  - the forecasts are being disclosed in order to comply with Item 1015 of Regulation M-A or requirements under state or foreign law, including case law, regarding disclosure of the financial advisor's analyses or substantive work;

- the exception described above applies if the same forecasts provided to the financial advisor are also provided to the registrant's board of directors or board committee; and
- if a registrant determines that forecasts exchanged between the parties in a business combination transaction are material and that disclosure of such forecasts is required to comply with the anti-fraud and other liability provisions of the federal securities laws, the financial measures included in those forecasts would be excluded from the definition of non-GAAP financial measures and, therefore, not subject to Regulation G and Item 10(e) of Regulation S-K.

Additional guidance on Non-GAAP financial measures

Can non-GAAP financial measures be presented on a per-share basis?

It depends. Registrants generally may present non-GAAP ***performance*** measures on a per-share basis and should reconcile those measures to GAAP earnings per share.

Non-GAAP ***liquidity*** measures, however, cannot be presented on a per-share basis. Whether per-share data is prohibited depends on whether the non-GAAP financial measure can be used as a liquidity measure, even if management presents it solely as a performance measure.

In the C&DIs, the SEC staff provides that EBIT and EBITDA (and, by extension, EBITDAre) cannot be presented on a per-share basis, even when presented as a performance measure.

The SEC staff also provides in the C&DIs that it will not object to the presentation of Nareit-defined FFO on a per-share basis. Whether a registrant may present an alternative to Nareit-defined FFO (e.g., AFFO or core FFO) on a per-share basis depends on the nature of the adjustments and whether it could be used as a liquidity measure (for example, as a means to determine the REIT's ability to pay dividends, make distributions or service debt).

How does the SEC staff determine whether a non-GAAP financial measure is a performance or liquidity measure?

When analyzing whether a non-GAAP financial measure is a performance or liquidity measure, the SEC staff will focus on the substance of the non-GAAP financial measure and not management's characterization of the measure, which has been a frequent topic of SEC comment letters.

For REITs, this issue can arise when presenting variations of FFO (e.g., AFFO) that are intended to show a REIT's dividend coverage. If the SEC staff believes such non-GAAP financial measures are, in substance, liquidity measures, such measures may not be presented on a per-share basis.

For example, the SEC staff commented that a REIT's presentation of AFFO on a per-share basis was improper because it appeared that the measure could be used as a liquidity measure due to the adjustments, including several non-cash adjustments and an adjustment for recurring capital expenditures, that had the effect of presenting a measure of the REIT's ability to fund dividends. This comment was ultimately resolved by the REIT addressing the SEC's comment through changes to labeling of the measure.

For recent SEC comments on this topic, see *Exhibit A* (Recent SEC Comments for REITs – Liquidity Measures on a Per-Share Basis).

What are some examples of potentially misleading practices regarding non-GAAP financial measures raised by the SEC staff?

As described above, Regulation G contains a general requirement that non-GAAP financial measures not be misleading. The SEC staff has noted the following as examples of potentially misleading practices that could violate Regulation G:

- presenting a non-GAAP performance measure that excludes normal, recurring, cash-operating expenses necessary to operate a registrant's business;
- presenting a non-GAAP financial measure inconsistently between periods (e.g., adjusting

for a particular charge or gain in the current period when similar charges or gains were not adjusted for in prior periods, unless the change between periods is disclosed and the reasons for it explained—depending on the significance of the change, it may be necessary to recast prior periods);

- adjusting a non-GAAP financial measure only for non-recurring charges when there were non-recurring gains that occurred during the same period;
- substituting individually tailored recognition and measurement methods in place of GAAP requirements for revenue and other financial statement line items (often referred to as, "individually tailored accounting principles"); and
- using non-GAAP financial measures with titles or descriptions that are the same as, or confusingly similar to, GAAP measures.

In addition, the SEC staff specifically notes in the C&DIs that non-GAAP financial measures that are calculated differently than EBIT and EBITDA as commonly understood and, as described in *Exchange Act Release No. 34-47226*, should not be characterized as "EBIT" or "EBITDA," and their titles should be distinguished from EBIT and EBITDA by using titles such as "Adjusted EBITDA" or "Core EBITDA." The proper labeling of these non-GAAP financial measures also has been the subject of SEC comment letters.

For recent SEC comments on these issues, see *Exhibit A* (Recent SEC Comments for REITs – Individually Tailored Accounting Principles and – Labeling).

Does Item 10(e) prohibit adjusting a non-GAAP performance measure for recurring charges or gains?

Not necessarily. Item 10(e)(1)(ii)(B) of Regulation S-K prohibits adjusting a non-GAAP performance measure to eliminate or smooth items identified as non-recurring, infrequent, or unusual when the nature of the charge or gain is such that it is reasonably likely to recur within two years or there was a similar charge or gain within the preceding two years. The SEC staff has clarified in the C&DIs that this prohibition is based on the description of the charge or gain that is being adjusted, not the nature of the charge or gain.

A registrant can make adjustments for such charges or gains if they comply with the other provisions of Regulation G and Item 10(e), but they should not be labeled or described as non recurring, infrequent or unusual unless they meet the criteria specified in Item 10(e)(1)(ii)(B) of Regulation S-K. For example, if a registrant adjusted a non-GAAP performance measure for non-operational (but potentially recurring) items that a registrant believed improved the comparability of its performance between periods, the registrant could describe such adjustments as "non-comparable," rather than "non-recurring."

Does the SEC staff provide examples of individually tailored accounting principles that could be misleading?

Yes, the SEC staff notes in the C&DIs that non-GAAP adjustments that have the effect of changing the recognition and measurement principles required to be applied in accordance with GAAP would be considered individually tailored and may cause the presentation of a non-GAAP measure to be misleading. Examples the SEC staff may consider to be misleading include, but are not limited to the following:

- changing the pattern of recognition, such as including an adjustment in a non-GAAP performance measure to accelerate revenue recognized ratably over time in accordance with GAAP as though revenue was earned when customers were billed;
- presenting a non-GAAP measure of revenue that deducts transaction costs as if the company acted as an agent in the transaction, when gross presentation as a principal is required by GAAP, or the inverse,
- presenting a measure of revenue on a gross basis when net presentation is required by GAAP; and
- changing the basis of accounting for revenue or expenses in a non-GAAP performance measure from an accrual basis in accordance with GAAP to a cash basis."

What are some examples of equal-or-greater-prominence issues raised by the SEC staff?

While the SEC staff acknowledges that whether a non-GAAP financial measure is more prominent than its comparable GAAP measure generally depends on the facts and circumstances, it will consider the following types of disclosures of non-GAAP financial measures as more prominent than GAAP measures:

- presenting a non-GAAP measure before the most directly comparable GAAP measure or omitting the comparable GAAP measure altogether, including in an earnings release headline or caption;
- presenting a ratio where a non-GAAP financial measure is the numerator and/or denominator without also presenting the ratio calculated using the most directly comparable GAAP measure(s) with equal or greater prominence;
- presenting a non-GAAP financial measure using a style of presentation (e.g., bold or larger font) that emphasizes the non-GAAP financial measure over the most directly comparable GAAP measure;
- providing discussion and analysis of a non-GAAP financial measure without a similar discussion and analysis of the most directly comparable GAAP measure in a location with equal or greater prominence;
- describing a non-GAAP financial measure as, for example, "record performance" or "exceptional" without at least an equally prominent descriptive characterization of the most directly comparable GAAP measure;
- excluding a quantitative reconciliation with respect to a forward-looking non-GAAP financial measure in reliance on the "unreasonable efforts" exception without disclosing that fact and identifying the information that is unavailable and its probable significance in a location of equal or greater prominence (see "*Does the quantitative reconciliation requirement apply to a registrant's guidance and other forward-looking information?*" above);
- presenting a full income statement of non-GAAP financial measures or presenting a full non-GAAP income statement when reconciling to the most directly comparable GAAP measures;
- providing tabular disclosure of non-GAAP financial measures without preceding it with an equally prominent tabular disclosure of the comparable GAAP measures or including the comparable GAAP measures in the same table; and
- including remarks by an officer of the REIT in an earnings release that discuss non-GAAP financial measures with greater prominence than the corresponding GAAP measure.

For recent SEC comments on these issues, see *Exhibit A* (*Recent SEC Comments for REITs – Equal or Greater Prominence*).

Should a reconciliation begin with the GAAP measure or the non-GAAP financial measure?

The SEC staff has stated in numerous comment letters that a reconciliation required under Regulation G and Item 10(e) of Regulation S-K should start with the GAAP measure and then be reconciled to the non-GAAP financial measure in order to ensure that the non-GAAP financial measure does not receive undue prominence.

Have there been any SEC enforcement actions related to non GAAP financial measures?

Although the SEC most commonly addresses non-compliance with Regulation G and Item 10(e) through the SEC staff's comment letter process, there have been SEC enforcement actions for registrants' non-compliance with these rules.

In September 2020, the SEC announced a settlement of charges with a registrant for, among other reasons, false and misleading disclosures about the calculation of a key non-GAAP financial measure. The registrant presented a non-GAAP financial measure that excluded certain expenses from its pre-tax calculation, while including those expenses as deductions when calculating its tax provision. The SEC found that the registrant misleadingly described its non-GAAP measure in its earnings releases. The registrant settled the action by paying a $1.4 million civil monetary penalty and agreeing to cease and desist from such practices.

In December 2018, the SEC instituted an enforcement action against a registrant for including non-GAAP financial measures in two earnings releases without providing equal or greater prominence to the comparable GAAP financial measures. This enforcement action is notable because it related solely to violations of the equal-or-greater prominence requirement of Item 10(e) of Regulation S-K and because the SEC staff had not issued comments to the registrant directly on this topic prior to commencing enforcement proceedings. The SEC order specifically noted that (i) the registrant presented a non-GAAP financial measure in the headline of the earnings release without mentioning the comparable GAAP measure, and (ii) the bullet point highlights section of the earnings release contained non-GAAP financial measures but did not include the comparable GAAP measures. The registrant settled the action by paying a $100,000 civil monetary penalty and agreeing to cease and desist from such practices.

In January 2017, the SEC instituted an enforcement action against a registrant for, among other reasons, improper use of non-GAAP financial measures. The registrant presented a non-GAAP financial measure that typically adjusted for two items; however, for a period of time, the registrant incorporated a third reconciling item into its calculation without disclosing the change. The SEC also noted that the registrant failed to give GAAP measures equal or greater prominence to non-GAAP financial measures in its earnings releases, despite repeated promises that it would do so. The registrant settled the action by paying a $1.5 million civil monetary penalty and agreeing to cease and desist from such practices.

What is the role of a company's board of directors with respect to a company's non-GAAP financial measures?

The audit committee of a company's board of directors should assist the board of directors in overseeing and monitoring a company's use of, and disclosures regarding, non-GAAP financial measures. Audit committees should confirm that disclosure controls and procedures are in place to ensure compliance with SEC rules regarding non-GAAP financial measures. In addition, audit committee members should question management regarding the company's non-GAAP financial measures, the related adjustments and how they compare to the presentations used by comparable companies.

EXHIBIT A:
Recent SEC comments for REITS

The following are examples of recent comments that REITs have received from the SEC staff regarding non-GAAP financial measures:

Failure to include reconciliation

For Forward-Looking Non-GAAP Financial Measures

- We note you provide guidance for [your] share of Cash NOI and NOI. In future supplemental packages, please reconcile your non-GAAP guidance to the most directly comparable GAAP guidance. Please refer to Item 10(e)(1)(i)(B) of Regulation S-K and Question 102.10 of the Division's Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.
- We note that unlike previous years, when providing core FFO per share guidance in the current year, you have excluded reconciliation to forecasted earnings per share. Please clarify and/or revise future filings accordingly. To the extent you are relying on the "unreasonable efforts" exception in Item 10(e)(1)(i)(B), please revise future filings to disclose this fact and identify any information that is unavailable and its probable significance. Reference is made to Question 102.10 of the Division's Compliance and Disclosure Interpretations for Non GAAP Financial Measures.
- We note you provided guidance ranges for AFFO within Exhibit 99.1. In future earnings releases, please provide the reconciliations required by Item 10(e)(1)(i)(B) of Regulation S-K. To the extent you are relying on the "unreasonable efforts" exception in Item 10(e)(1)(i)(B), please revise future earnings releases to disclose this fact and identify any information that is unavailable and its probable significance. Reference is made to Question 102.10 of the Division's Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.6.

For Historical Non-GAAP Financial Measures

- We note you present property operating income as a Non-GAAP measure. It appears the reconciliation of operating income to property operating income included in prior annual reports has been removed from the current annual report. Please revise your future filings to include this reconciliation to comply with the requirements outlined within paragraph 10(e)(i)(B) of Regulation S-K.
- We note your presentation of "Cash NOI Margin" and "Cash NOI Margin, excluding COVID-19 pandemic expenses and grant income." Please revise your presentation in future filings to clarify how these measures are calculated and comply with footnote 27 of [Release] 33-8176 which requires a reconciliation of each non-GAAP financial measure used in the calculation and presentation of the ratio as calculated using the most directly comparable GAAP financial measure.

- We note your presentation of a non-GAAP measure, adjusted EBITDA, on page 2 of Exhibit 99.1. Please tell us your consideration of providing disclosures required by Item 10(e)(1)(i) of Regulation S-K, including a reconciliation from the most directly comparable measure calculated in accordance with GAAP.
- We note that you present “Total assets, gross” and use this measure to calculate certain debt ratios. Since depreciation has been excluded from your asset base, “Total assets, gross” is a non-GAAP measure. Please revise your disclosure to include a reconciliation to the most directly comparable GAAP measure. Provide us with your proposed disclosure and tell us why you believe a measure calculated based on undepreciated real estate assets provides useful information to your investors.
- We note that you reconcile NOI attributable to common stockholders, a non-GAAP measure, from net income (loss) on your net leased and other real estate portfolios attributable to common stockholders, which also appears to represent a non-GAAP measure. Please reconcile your NOI measure to the most directly comparable financial measure calculated and presented in accordance with GAAP pursuant to Item 10(e)(1)(i)(B) of Regulation S-K.
- We note that you present same-store property operating income on a cash basis, which is a non GAAP measure. Please provide all disclosures required by Item 10(e)(1)(i) of Regulation S-K, including a reconciliation to the most directly comparable GAAP financial measure in future press releases, if presented. Provide us with your proposed disclosure.

Liquidity measures on a per-share basis

- We note that you present Adjusted FFO on a per share basis. It appears that due to the adjustments, including several non-cash adjustments and an adjustment for recurring capital expenditures, this measure can be used as a liquidity measure. We also note your disclosure that AFFO is useful to investors as a tool to further evaluate the ability to fund dividends. Please explain to us why you believe it is appropriate to present this measure on a per share basis. See Question 102.05 of the Division’s Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.
- We note that you present Core FFO and Adjusted FFO on a per-share basis. It appears that the adjustments are non-cash and both measures approximate operating cash flows and could be used as liquidity measures. Please explain to us why you believe it is appropriate to present these measures on a per-share basis. See Question 102.05 of the Division’s Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.
- We note you consider Adjusted funds from operations (AFFO) to be a measure of a REIT’s ability to incur and service debt and to pay distributions to its shareholders. Based on such definition, it appears AFFO can be used as a liquidity measure. Please clarify how you considered Question 102.05 of the Division’s Compliance and Disclosure Interpretations for Non-GAAP Financial Measures, in determining that AFFO can be presented on a per-share basis.
- On page 12, you explain that excluding non-cash income and expense items from AFFO provides useful information regarding income and expense items that have no cash impact and do not provide liquidity to the company or require capital resources of the company. This strongly implies that AFFO is a liquidity measure. Please explain to us why you believe it is appropriate to present this measure on a per share basis. See Question 102.05 of the Division’s Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.

Individually tailored accounting principles

- We continue to believe that your presentation of Core Earnings, which excludes the unrealized portion of the provision for credit losses, appears to substitute individually tailored recognition and measurement methods for those of GAAP and could violate Rule 100(b) of Regulation G, as discussed in Question 100.04 of the Non-GAAP

Financial Measures Compliance and Disclosure Interpretations. Please refrain from disclosing this performance measure, or any other performance measures that exclude the provision for credit losses, or portions of the provision for credit losses, in future filings.

- We note your presentation of Revenue, as adjusted for use in the calculation of Adjusted EBITDA Margin, and that such non-GAAP measure includes an adjustment for the expense line item impairment of non-relate estate investments, as well as adjustments for amounts for select realized gains on non-real estate investments not classified as Revenue within your Statements of Operations. Tell us how you determined that you have not presented an individually tailored measure given the adjustments referenced above; refer to Question 100.04 of the Division's Non-GAAP Financial Measures Compliance & Disclosure Interpretations.
- We note that your non-GAAP measures include a percentage rent adjustment, which appears to adjust net earnings to recognize percentage rent on a cash basis. Please explain to us how you considered the guidance in question 100.04 of the C&DI on Non GAAP Financial Measures when determining the propriety of these adjustments. This comment also applies to your earnings release filed on a Form 8-K.
- We note your disclosure that you modified the definition of Distributable Earnings to allow for the treatment of sales as realized if GAAP would otherwise view them as realized even when not recorded in GAAP earnings. As a result, you made an adjustment to Distributable Earnings to include the cash portion received for the sale of a 20.6% interest in [an affiliated fund] to a third party. Please tell how you considered Question 100.04 of the Compliance and Disclosure Interpretations on Non-GAAP Financial Measures when determining that the adjustment was appropriate.
- We have considered your response to our prior comment. We note that your non-GAAP percentage rent adjustment alters the timing of revenue recognition under GAAP. As such, we are unable to agree with your conclusion that it is an appropriate adjustment. Please revise your disclosure in future filings to eliminate the percentage rent adjustment. Reference is made to question 100.04 of the Division's Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.
- We note the reconciliation of NOI and SSNOI. Please tell us how you determined it was appropriate to present a measure that includes 100% of NOI related to your unconsolidated joint ventures. We refer you to Question 100.04 of the Division's Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.
- We note your calculation of this measure includes development costs as incurred and excludes cost of sales - land under GAAP. Please explain how this does not represent a tailored accounting principle and how you considered Question 100.04 of the Division's Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.
- We note that you exclude the component of premium amortization representing the quarter over-quarter changes in estimated long term constant prepayment rates. Please tell us why this should not be considered an individually tailored recognition or measurement method substituted for the one in GAAP. See Question 100.04 of the Division's Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.

Equal or greater prominence

- We note that your bolded operational highlights focus only on non-GAAP measures, which may result in undue prominence given to them. Please revise in future filings to disclose the most comparable GAAP measures with equal or greater prominence. Refer to Question 102.10 of the Division's Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.
- We note that your disclosure regarding net income and net operating income references a reconciliation that appears to be in the form of a full non-GAAP income statement. In future periodic filings, to avoid a non-

GAAP prominence issue, please include a reconciliation that begins with the most directly comparable GAAP measure, which appears to be Net income, and reconciles down to NOI. Refer to Question 102.10 of the Non-GAAP Financial Measures Compliance and Disclosure Interpretations.

- We note your reconciliation of Total NOI to Net loss attributable to common stockholders for the interim periods presented. In future periodic filings, please disclose the most directly comparable GAAP measure with equal or greater prominence to the non-GAAP measure by reconciling from Net loss attributable to common stockholders to calculate Total NOI. Refer to Question 102.10 of the Division's Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.
- Please revise future press releases to ensure that you do not provide undue prominence to non-GAAP measures. For instance, we note that you discuss Normalized FFO per diluted share and Normalized FFO on pages 1 and 2. However, there is no discussion of actual GAAP revenues or earnings until page 3. You may refer to Question 102.10 of the Division's Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.
- We note that your financial highlights include FFO and AFFO per diluted Operating Partnership unit, without disclosure of the comparable GAAP per [unit] measure. Please revise your disclosure in future earnings releases to present GAAP measures with equal or greater prominence than non-GAAP measures. Refer to Question 102.10 of the Division's Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.
- Please revise future filings to ensure that comments on your results begin with your GAAP results. For instance, we note that the remarks made by your President and CEO do not reference GAAP measures and appear to provide prominence to non GAAP measures
- Please revise future filings to ensure that GAAP measures receive equal prominence in all cases, particularly when describing non-GAAP measures. The use of superlatives such as exceptional and substantial when describing non-GAAP measures appears to provide them prominence not afforded your GAAP measures.

Labeling

- We note your disclosure of Core Earnings and Core Earnings per Diluted Weighted-Average Share. These non-GAAP measures include adjustments for various unrealized gains (losses) and loan loss provision. In light of these adjustments, please tell us how you determined it was appropriate to title these measures as Core Earnings and Core Earnings per Diluted Weighted-Average Share. Further, our understanding is that these measures are commonly used by mortgage REITs as an indicator of dividend paying ability. Please tell us if these measures are used by the registrant's management as an indicator of the registrant's dividend paying ability. If so, please revise your filing to disclose that purpose.
- We note that you present Same-Store Net Operating Income on a "GAAP" basis. Net operating income is not a GAAP measure and should not be labeled as such. To the extent that this measure is presented in future filings, please include a reconciliation to the most directly comparable GAAP measure. Provide us with your proposed disclosure. Please note that this comment is applicable to all non-GAAP measures presented in Exhibits 99.1 and 99.2 that include "GAAP Basis" in their name. Additionally, remove your reference to GAAP in disclosing Property NOI or tell us how you determined this measure is not considered non GAAP.
- We note that you reconcile funds from operations (FFO) from net income (loss) attributable to common stockholders and it appears FFO represents FFO attributable to common stockholders. In future filings, please revise the label of this non-GAAP measure in your reconciliation to indicate that it is FFO attributable to common shareholders and unitholders. This comment is also applicable to the extent this measure is presented in your earnings release filed on Form 8-K.

- We note certain components of long-term debt, net trust assets and mortgage servicing rights that impact your statement of operations besides the changes in fair value remain a part of core loss from operations. As a result, it remains unclear as to how it would be appropriate to label such a non- GAAP measure as “core” earnings or loss. In future filings, please revise the labeling of your non-GAAP performance measure to something other than “core” earnings or loss.
- We note your calculation of EBITDA contains adjustments for items other than interest, taxes, depreciation and amortization. Please revise in future filings to ensure that measures calculated differently from EBITDA are not characterized as EBITDA and have titles that are distinguished from “EBITDA,” such as “Adjusted EBITDA.” Reference is made to Question 103.01 of the Division’s Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.
- Please clearly label Core FFO, AFFO, Adjusted EBITDA, same store NOI cash, Adjusted cash NOI (actual), Adjusted cash NOI (pro forma), Annualized Pro Forma NOI etc. as non-GAAP financial measures throughout Exhibit 99.1.
- In arriving at Funds from operations-NAREIT, you start with net income (loss) attributable to common stockholders and make an adjustment for noncontrolling interests. As a result, it appears Funds from operations - NAREIT, and ultimately Normalized FFO, are attributable to common stockholders. Please clarify and/or revise the labeling of your non-GAAP financial measures in future earnings releases.

About Morrison Foerster

Morrison Foerster’s REIT practice is a collaborative, integrated, multi-office practice involving capital markets, corporate, finance, M&A, investment management, real estate, tax, and other attorneys throughout the firm. Attorneys in the REIT practice area are actively involved in advising listed public REITs, non traded public REITs, private REITs and REIT sponsors, contributors, investors, investment advisers, underwriters, and institutional lenders on all aspects of REIT activity.

Because of the generality of this document, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.

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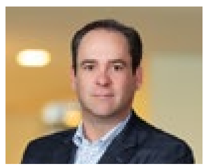

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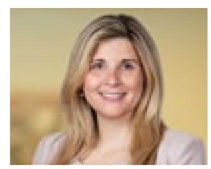

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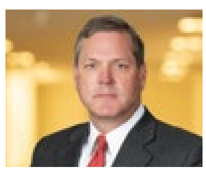

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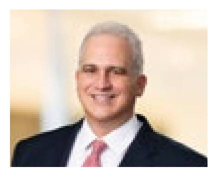

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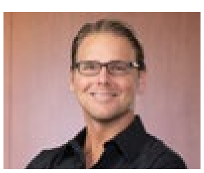

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