Earnings Before Interest, Taxes, Depreciation and Amortization for Real Estate

Now that real estate is a top-line sector in the equities market, it will be useful to have a common EBITDA-related reference point for real estate companies from which they may choose to adjust to explain and highlight their enterprise-wide investment attributes.

While dedicated REIT investors have long been accustomed to utilizing the industry's supplemental measures (*e.g.*, funds from operations (FFO) and net operating income (NOI)) to evaluate the investment quality of REITs as real estate companies, NAREIT believes that it would be helpful to generalist investors for REITs as real estate companies to also provide a more widely known and understood supplemental measure of performance – EBITDA for real estate (EBITDA*re*).

INTRODUCTION

On Aug. 31, 2016, S&P Dow Jones Indices and MSCI moved stock-exchange listed Equity REITs and other listed real estate companies from the Financials Sector of their Global Industry Classification Standard (GICS®) to a new Real Estate Sector. GICS® is the industry classification methodology that investors rely on for their proprietary stock market indices and it serves as the primary classification system for equities for investors around the world. The Real Estate Sector is the first new headline sector added since GICS® was created in 1999. Equity REITs make up about 98 percent of the equity market capitalization of this Real Estate Sector in the U.S. in 2017. Some real estate management and brokerage companies make up the remainder.

Similarly, in a Sept. 6, 2017 press release, FTSE Russell, the other leading operator of a global classification system for equities, announced that listed real estate companies that currently are included in the Financials industry of its Industry Classification Benchmark (ICB) will be moved to a newly created 11th headline industry named Real Estate at the market close on Dec. 31, 2018.

Considering these changes and the expectation that they will bring about greater interest in REITs as real estate companies among investors over the long term, at its meeting on Feb. 23, 2016, NAREIT's Executive Board discussed the merits of NAREIT developing a standardized performance measure based on Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) that would provide additional relevant information about REITs as real estate companies in support of growing interest among generalist investors. The conclusion was reached that, while dedicated REIT investors have long been accustomed to utilizing the industry's supplemental measures (*e.g.*, funds from operations (FFO) and net operating income (NOI)) to evaluate the investment quality of REITs as real estate companies, it would be helpful to generalist investors for REITs as real estate companies to also provide a more widely known and understood supplemental measure of performance – EBITDA for real estate.

In this context, it is important to underline that the development of a uniform definition of EBITDA for real estate (*i.e.*, EBITDA*re*) is not intended to replace NAREIT-defined FFO as a supplemental performance measure. FFO, a defined measure that NAREIT standardized in 1991, provides a uniform supplemental basis for evaluating the earnings performance of REITs considering the unique capital structure of each REIT. The SEC staff has accepted NAREIT's definition of FFO in effect as of May 17, 2016 as a performance measure and does not object to its presentation on a per share basis as reflected in the Answer to Question 102.01 of its Compliance and Disclosure Interpretations on Non-GAAP Financial Measures issued on May 17, 2016. FFO is often used as a basis to measure the equity value of a REIT by applying valuation multiples to FFO. NAREIT anticipates that EBITDA*re* will become an additional supplemental non-GAAP performance measure independent of a company's capital structure that will provide a uniform basis to measure the enterprise value of a company.

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MANAGEMENT RESPONSIBILITY

NAREIT reiterates its long-held belief that the management of each of its member companies has the responsibility and authority to provide accurate and material financial information that it regards as useful to the investment community, within the limits prescribed by securities laws and regulations. NAREIT-defined EBITDA*re* provides REIT management with an optional reporting tool to provide an additional performance measure to investors to facilitate the evaluation and comparison of REITs operating as real estate companies.

EBITDA*re* is a non-GAAP measure and, therefore, its reporting is subject to SEC rules governing the reporting of non-GAAP measures. Companies should refer to SEC guidance in Regulation S-K, Item 10-(e) *Use of non-GAAP financial measures in Commission filings*[1], and Regulation G *General Rules regarding disclosure of non-GAAP financial measures* for relevant guidance on disclosure, reconciliation and presentation requirements for reporting non-GAAP measures.

Under certain circumstances, a REIT may choose to report an adjusted version of EBITDA*re* not consistent with the definition in this White Paper. In these cases, the REIT should clearly label the measure as adjusted EBITDA*re*. The label EBITDA*re* should only be used when the related measure is calculated in accordance with the NAREIT definition described in this White Paper. Any measure derived from NAREIT-defined EBITDA*re* should be labeled appropriately to distinguish it from NAREIT-defined EBITDA*re*. In addition, any adjusted EBITDA*re* measure should be reconciled to EBITDA*re* as defined in this White Paper.

DEFINITION OF EARNINGS BEFORE INTEREST, TAXES, DEPRECIATION AND AMORTIZATION FOR REAL ESTATE

NAREIT has defined EBITDA*re* as follows:

GAAP Net Income

Plus, interest expense

Plus, income tax expense

Plus, depreciation and amortization

Plus, or minus losses and gains on the disposition of depreciated property, including losses/gains on change of control

Plus, impairment write-downs of depreciated property and of investments in unconsolidated affiliates caused by a decrease in value of depreciated property in the affiliate

Adjustments to reflect the entity's share of EBITDA*re* of unconsolidated affiliates

Equals **EBITDA*re***

If a REIT reports both EBITDA*re* and adjusted EBITDA*re* and provides earnings guidance based on adjusted EBITDA*re*, it would be important to provide guidance based on NAREIT-defined EBITDA*re* as well.

REPORTING GUIDANCE

Reconciliation and Prominence

EBITDA*re*, like any other non-GAAP measure, must be quantitatively reconciled to the most comparable measure calculated in accordance with GAAP. In addition, the GAAP measure should be given equal or greater prominence.

Adjustments to GAAP Net Income should include adjustments necessary to translate equity in earnings of unconsolidated affiliates included in GAAP Net Income to equity in EBITDA*re* of unconsolidated affiliates.

NAREIT-defined EBITDA*re* of the reporting entity includes 100 percent of EBITDA*re* of consolidated

[1] See, SEC, *Conditions for Use of Non-GAAP Financial Measures and Use of Non-GAAP Financial Measures in Commission Filings* (March 28, 2003), available at https://www.sec.gov/rules/final/33-8176.htm.

See also, SEC, *The Use of Non-GAAP Financial Measures* (May 17, 2016) available at https://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm affiliates with non-controlling interests. The rationale for this treatment is that 100 percent of the debt of these entities is reported in the consolidated balance sheet of the reporting entity. Therefore, consolidated EBITDA*re* would provide a valid comparison with consolidated debt.

In addition, including 100 percent of EBITDA*re* of all consolidated affiliates, including those with non-controlling interests, is consistent with GAAP in calculating Net Income under the same circumstances.

Adjusted EBITDAre

As indicated above, EBITDA*re* may be used for various financial analyses. Thus, it may be appropriate to adjust NAREIT-defined EBITDA*re* to facilitate these analyses. For example, some companies may want to present an adjusted EBITDA*re* to mirror EBITDA defined in debt covenants. Other companies may want to report adjusted EBITDA*re* that appropriately reflects the relationship between EBITDA*re* and reported debt to allow a rational debt-to-EBITDA*re* relationship. And still other companies may want to report EBITDA*re* applicable to specific security holders (*e.g.*, EBITDA*re* applicable to common shares).

NAREIT cautions companies to clearly label any adjusted EBITDA*re* metric reported (*e.g.*, Adjusted EBITDA*re*, excluding the non-controlling interest in EBITDA*re* of consolidated entities). In addition, these adjusted EBITDA*re* metrics should be reconciled to NAREIT-defined EBITDA*re*, in addition to Net Income.

Interest Expense

If interest expense reported on the income statement includes gains/losses on early extinguishment of debt and/or interest income, such amounts should be disclosed.

Depreciation and Amortization

The adjustments to Net Income for depreciation and amortization may be different than the depreciation and amortization adjustments used in the calculation of FFO. The depreciation and amortization expense added back to Net Income in the calculation of FFO should only include depreciation and amortization of assets uniquely significant to real estate. See NAREIT's FFO White Paper for further clarification. Depreciation and amortization adjustments to calculate EBITDA*re* should include all depreciation and amortization included in GAAP Net Income.

Gains and Losses on the Disposition of Depreciated Property

As with FFO, to provide a supplemental performance measure that provides a basis for understanding comparable period–to-period operating performance and a basis for forecasting on-going operating performance, NAREIT's definition of EBITDA*re* excludes gains and losses on the disposition of depreciated property.

Some REITs sell assets, including undepreciated property, incidental to their main business, most often sales of securities or parcels of land peripheral to operating properties. The prohibition against the inclusion of gains or losses on property sales in EBITDA*re* was not meant to address this kind of activity, but rather the gain or loss on previously depreciated operating properties. Those REITs that choose to include such gains or losses on sales of securities or undepreciated land in their EBITDA*re* 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 EBITDA*re*.

Impairment Write-downs

As with FFO, the rationale for excluding impairment write-downs from EBITDA*re* is that these write-downs generally represent the early recognition of losses on disposition of depreciated properties, which are excluded from the EBITDA*re* measure.

EBITDAre is Not Intended to be a Measure of a REIT's Cash Flow

Importantly, EBITDA*re* is not intended to be used as a measure of cash generated by a REIT's operations nor of its dividend-paying capacity. NAREIT believes that the statement of cash flows prepared in accordance with GAAP, along with a company's supplemental disclosures, provide adequate information for investors and analysts to assess the current and prospective cash generated and used by REITs.

DEVELOPMENT OF EBITDA*re*

NAREIT examined non-GAAP measures reported by REITs other than NAREIT FFO. This examination revealed that many REITs report EBITDA in addition to FFO and NOI. It also revealed that these EBITDA measures are based on a wide range of definitions. Many adjustments are made to "normalize" reported EBITDA to provide comparable EBITDA measures between reporting periods for a specific company. These adjustments included, but were not limited to, the following:

- Stock–based compensation;
- Restructuring charges;
- Gains/losses on early extinguishment of debt;
- Acquisition transaction costs; and,
- Costs of legal and regulatory defense costs.

Similar adjustments to arrive at "adjusted EBITDA" are made by companies in sectors outside of real estate. There is no uniform definition of "adjusted EBITDA" in the other sectors.

Views of Industry Investors, Analysts and Others

EBITDA is used by investors and analysts in a number of ways in evaluating the investment quality of a company, including:

- As an overall screening tool;
- As the basis of measuring enterprise value;
- As an indicator of cash flow generated by operations;
- As a supplemental performance measure; and,
- To measure debt service and fixed cost coverage.

NAREIT discussed with financial statement preparers and users whether a common definition of EBITDA reported by REITs would be useful to both dedicated real estate and generalist investors and investment analysts. In a NAREIT survey, most generalist investors indicated that they adjust reported EBITDA to make uniform comparisons between companies and agreed that a common definition would be useful in comparing the operating performance and various measures derived from EBITDA between REITs.

NAREIT Executive Board Task Force and Best Financial Practices Council Assistance and Review

In 2016, a NAREIT task force was created to provide advice and guidance for NAREIT's work on this initiative. The task force consisted of the chief financial officers of REITs represented on NAREIT's Executive Board. The task force discussed the matter of REITs reporting EBITDA*re* and provided constructive input. Further, NAREIT consulted with its Best Financial Practices Council in developing the White Paper. NAREIT's Best Financial Practices Council consists of financial executives of NAREIT member companies, investors, sell-side analysts, and representatives from the major public accounting firms.

IMPLEMENTATION AND NOTICES

NAREIT believes that public confidence in the quality of reported results, and the adequacy of disclosures as to the method of calculation of those results, are of paramount importance to the REIT industry. NAREIT also believes that certain non-GAAP supplemental information relating to operating performance can be valuable in explaining and clarifying financial results for REIT investors. But these non-GAAP measures should be considered only in addition to, not as a substitute for, the information prepared in accordance with U.S. GAAP and should never be used to obscure or diminish the prominence of GAAP-reported results.

EBITDA*re* is an optional supplemental non-GAAP measure. Accordingly, the implementation of the recommendations in this White Paper should be subject to the business judgement of the management of each company. These recommendations are intended to be guidelines for management rather than a mandatory set of inflexible rules. They are not an indication that NAREIT or any of its members or advisors believe that any of the information discussed herein, measures or formulas are material to the investors of any REIT, or to the REIT sector. 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.

NAREIT recognizes that in some situations it may be difficult to reconstruct comparable information for prior periods. Nevertheless, NAREIT encourages all companies to calculate and present EBITDA*re* consistently for all periods presented in supplemental financial information.

EFFECTIVE DATE

NAREIT recommends that companies that report an EBITDA performance measure also report EBITDA*re* in all financial reports for periods beginning after Dec. 31, 2017.