NAREIT National Policy Bulletin

July 8, 1999

Guidelines for Reporting Performance on a Per Share Basis

Editor's Note: This National Policy Bulletin has been prepared at the recommendation of NAREIT's Best Financial Practices Council. The Council continues to believe that consistency in financial reporting among member companies could be advanced by providing guidelines on the application of generally accepted accounting principles (GAAP). The guidelines contained in this bulletin were approved by the NAREIT leadership in March, and are intended to create greater uniformity in reporting company performance on a per share basis. They should not be confused with the Council's review of the industry's supplemental performance measure. Because these guidelines are GAAP-based, they should remain applicable to any future modifications or adjustments that are made to the industry's supplemental performance measure.

In addition to consistent reporting of performance on a per share basis, the Council also recommends that when calculating FFO and FFO per share, the industry supplemental performance measure should reflect GAAP accounting for derivative instruments, hedging activities and straight-line rents.

We appreciate the valuable assistance of all who helped in the preparation of these guidelines, including representatives of Arthur Andersen, KPMG and PriceWaterhouseCoopers, as well as analysts from Cohen & Steers, CIBC Oppenheimer, Legg Mason, BankBoston Robertson Stephens and J.P. Morgan.

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NAREIT's Best Financial Practices Council is issuing industry guidance on reporting performance on a per share basis in a manner consistent with the way earnings per share (EPS) is reported by public companies. Real estate companies report Funds From Operations (FFO) per share in earnings releases and disclosures that typically accompany these releases. Presenting FFO per share is still prohibited in Securities and Exchange Commission (SEC) filings. Nevertheless, the Council believes that adopting a GAAP-based framework will improve uniformity, transparency, and credibility in reporting the industry's supplemental performance measure on a per share basis.

New guidance on EPS, FASB Statement No. 128, became effective for financial statements for both interim and annual periods ending after December 15, 1997. During the first quarter of 1999, NAREIT surveyed member companies, investors, and analysts to assess how the Statement is being applied in the calculation and reporting of FFO per share. Although most REITs reported FFO per share in accordance with the Statement, the diversity in practice revealed by the survey prompted NAREIT to develop the following guidance.

Application of FASB Statement No. 128 to FFO per Share

Survey results from member companies, investors, and analysts indicated overwhelming support for adoption of an industry-wide uniform practice for reporting basic and diluted FFO per share. Moreover, respondents also supported consistency with GAAP by using the methodology under FASB Statement No. 128 in the calculation of FFO per share. FASB Statement No. 128 simplified the computation of EPS by eliminating common stock equivalents in computing primary EPS. In addition, primary EPS is now called "basic" EPS, while fully diluted EPS is now "diluted" EPS.

Summary of Survey Findings

Presenting FFO Per Share in Accordance with FASB Statement No. 128

Most real estate companies have:

- reported FFO on a per share basis in earnings releases in accordance with FASB Statement No. 128.
- disclosed both basic and diluted FFO per share.
- included minority interests and operating partnership units when computing FFO per share.
- included earnings/losses from third-party subsidiaries when computing FFO per share.

Most real estate companies support:

- adoption of an industry-wide uniform practice for reporting basic and diluted FFO per share.
- presentation of FFO per share without the inclusion of extraordinary items in the numerator.
- disclosing a reconciliation of the numerator and denominator as provided by FASB Statement No. 128.
- adoption of the FASB Statement No. 128 computation for diluted FFO per share and prohibition of including antidilutive securities in the calculation.

Based on the survey findings, NAREIT's Best Financial Practices Council recommends that FFO per share should be calculated and disclosed in a manner consistent with FASB Statement No. 128 with the substitution of FFO for net income. The following examples illustrate situations in which FASB Statement No. 128 is not being correctly applied by some member companies and recommended approaches that are in conformance with the Statement:

- **Incorrect application:** Presenting only diluted FFO per share.

  Correct application: Presenting both basic and diluted FFO per share. (FASB Statement No. 128, paragraph #36)

- **Incorrect application:** Including *antidilutive* securities in the calculation of diluted FFO per share.

  Correct application: Only those securities that are dilutive should be included in the calculation of diluted FFO per share. Further, when computing the incremental effect for each group or series of potential common shares, companies should not rely on the same computation used to calculate EPS. Some securities that are dilutive for EPS might be antidilutive for FFO per share, and some securities that are antidilutive for EPS might be dilutive for FFO per share. Therefore, it is necessary to make a separate calculation for each security to determine if it is dilutive or antidilutive for FFO per share. (FASB Statement No. 128, paragraphs #13 through #16)

- **Incorrect application:** Excluding minority interests resulting from UPREIT or DownREIT units in diluted FFO per share, or including minority interests resulting from UPREIT or DownREIT units in basic FFO per share.

  Correct application: Because UPREIT or DownREIT units may be "potential common shares," the associated minority interest and shares/units should only be considered in the calculation of diluted FFO per share. By only considering UPREIT or DownREIT units in the calculation of diluted FFO per share, basic FFO per share will reflect FFO available to common shareholders, while diluted FFO per share will provide a performance measure reflective of the entire entity. This is consistent with the methodology used in the Statement. (FASB Statement No. 128, paragraphs #8 and #11)

Disclosure Requirements

To be consistent with FASB Statement No. 128, the following disclosures are recommended for each period in which an income statement is presented:

- A reconciliation of the numerator and denominator used in calculating basic and diluted FFO per share from continuing operations.
- The "potential common shares" not included in the computation of diluted FFO per share because of their antidilutive effect.
- A description of any transaction occurring after the end of the period being reported, but before the financial statements are issued, that would materially change the number of common shares or potential common shares outstanding had the transaction taken place during the reporting period.

Key Formulas

$$\text{Basic FFO per share} = \frac{\text{FFO available to common shareholders}}{\text{Weighted average number of common shares}}$$

$$\text{Diluted FFO per share} = \frac{\text{FFO available to common shareholders + adjustments}}{\text{Weighted average number of common shares + potential common shares}}$$

Recommended Presentation Format

As required by the Statement, all prior-period data should be restated to conform to the new guidelines. The Best Financial Practices Council recommends the following format for presenting FFO per share:

	Basic	Diluted
FFO per share from continuing operations or before extraordinary items*	$x.xx	$x.xx
Extraordinary items**	x.xx	x.xx
FFO per share after extraordinary items	$x.xx	$x.xx

* Continuing operations as defined and calculated under GAAP.

** Can also include intermediary items known as discontinued operations and cumulative effect of an accounting change. Under FASB Statement No. 128, EPS from continuing operations and net income must be presented on the income statement. If the company has discontinued operations, extraordinary items, or a cumulative effect of an accounting change (intermediary items), the EPS for each intermediary item must be disclosed either on the income statement or in the notes to the financial statements. Accordingly, intermediary items should also be individually disclosed on an FFO per share basis.

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