PROPERTY COUNCIL WHITE PAPER

VOLUNTARY **BEST PRACTICE GUIDELINES** FOR DISCLOSING FFO AND AFFO

A guide to calculating Funds From Operations and Adjusted Funds From Operations

Version 2.1: May 2019

From the President

Investment in commercial markets depends on investor confidence and trust.

The property industry aims to provide investors clear, consistent and meaningful financial information.

In 2013, the Property Council developed voluntary best practice guidelines to enhance direct comparison of Australian real estate organisations. Revised guidelines were issued in 2017 following a post-implementation review to provide greater clarity and guidance for industry.

Version 2.1 of the guidelines incorporate minor amendments in response to changes to international accounting standards, in particular AASB 9 Financial Instruments and AASB 16 Leases.

The Property Council thanks industry members for their thought leadership and support.

Deborah Coakley
President of the Capital Markets Division
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Introduction

These voluntary best practice guidelines (Guidelines) set out principles for determining Funds From Operations (FFO) and Adjusted FFO (AFFO) in Australia.

The Guidelines can be tailored to the needs of individual real estate organisations.

Background

Investors and analysts consistently request additional financial information from real estate organisations to help understand and compare the underlying financial performance of property entities.

Across the globe, there are several alternative performance metrics used by real estate organisations to provide additional financial information. For example:

- National Association of Real Estate Investment Trusts (NAREIT) FFO;
- European Public Real Estate Association (EPRA) Earnings Per Share; and
- Real Property Association of Canada FFO.

No one performance metric has been adopted globally.

Aims of the Guidelines

A standard voluntary performance metric will:

1. enhance direct comparison of Australian real estate organisations;
2. drive better understanding of the performance of an entity and create a practical and meaningful bridge to the audited accounts;
3. improve the confidence of investors, analysts and government in Australia's real estate industry; and
4. help attract global capital to Australian property.

The Guidelines are a working document and will be reviewed periodically. This will ensure the performance metric continues to meet the needs of industry, investors and analysts. Where applicable, supplementary guidance notes may be issued to address changes in accounting standards that impact the Guidelines.

Implementation of revised Guidelines

An entity is recommended to apply the revised Guidelines for annual reporting periods beginning on or after 1 January 2019. Earlier application is permitted.

An entity is also recommended to restate prior periods in line with the revised Guidelines to provide more meaningful comparison.

Adoption of the revised guidelines (including early adoption), and any restatement of prior periods should be accompanied with appropriate disclosures.

How to use the Guidelines

- The Guidelines provide a voluntary framework for determining FFO and AFFO.
- The Guidelines set out adjustments for FFO and AFFO together with principles for determining those adjustments.
- The Guidelines are not intended to represent an exhaustive list of all possible adjustments.
- The adjustments made to statutory profit will depend on each organisation's operations.

  Each organisation should assess whether to apply the adjustments. To the extent an item is not relevant or should be treated differently in an organisation, that entity is not expected to adopt the item. The entity will need to disclose the rationale and difference in the adjustment.

  The FFO and AFFO adjustment for "other unrealised" or "one off items" is intended to give industry scope to adjust for additional unrealised or non-recurring items as necessary. It can be utilised as appropriate to the organisation. Clear explanations should be provided in support of any adjustments.
- To ensure the Guidelines are adopted consistently by the market, and are transparent for users, entities will:
  - reference "Property Council FFO" or "Property Council AFFO" where they use the Property Council definitions and Guidelines;
  - follow the Guidelines applicable to their organisation; and
  - disclose upfront any adjustments that differ from the Guidelines, along with a clear explanation for the change.
- Organisations should calculate and present FFO and AFFO consistently for all periods in their financial reports and analyst briefings.
- Organisations should provide a reconciliation between FFO and statutory profit and provide a clear explanation of how FFO is calculated.
- As part of compliance with existing disclosure regulations, entities will need to present FFO as part of their *AASB 8 Operating Segment* note where it is used by the "chief operating decision maker to make decisions".
- Organisations should be aware of compliance with all accounting standards and ASIC Guidance Notes, including RG 230 "Disclosing non-IFRS financial information".
- This White Paper is not intended to impose a legal obligation on entities to comply with the Guidelines.

Property Council FFO Definition and AFFO Definition

The Property Council reviewed the NAREIT FFO definition in order to draft a suitable Australian FFO definition.

In the NAREIT 2002 White Paper, FFO is defined as:

"FFO means net income (computed in accordance with generally accepted accounting principles), excluding gains (or losses) from sales of property, plus depreciation and amortisation, and after adjustments for unconsolidated partnerships and joint ventures."

While the NAREIT definition is fairly simple and easily understood, it does not fit well in the context of Australian accounting standards.

United States and Australian accounting standards differ significantly. For example, the treatment of lease incentives and fair value adjustments to real estate.

The Property Council FFO and AFFO definitions have been tailored for the Australian marketplace. This will ensure preparers and users of financial information understand the purpose of the measure and how it is determined.

The definitions are not intended to be a measure of cash generated by the entity – this information is already disclosed in an entity's cash flow statement.

Property Council Definition of FFO

*"**Property Council FFO** is the organisation's underlying and recurring earnings from its operations. This is determined by adjusting statutory net profit (under AIFRS) for certain non-cash and other items. FFO has been determined based on guidelines established by the Property Council of Australia and is intended as a supplementary measure of operating performance."*

Property Council Definition of AFFO

*"**Property Council AFFO** is determined by adjusting FFO for other items which have not been adjusted in determining FFO. AFFO has been determined based on guidelines established by the Property Council of Australia and is intended as a supplementary measure of operating performance."*

Property Council FFO Guidelines

The Guidelines set out adjustments to convert AIFRS net profit after tax to Property Council FFO:

Ref	Item	Definition	+/- to net profit
	Statutory AIFRS Net Profit after tax		
A	**Investment Property and Inventory**		
A1	Gains from sales of investment property	The realised gain or loss is the difference between the sale price and the previous carrying value of investment property, net of transaction costs.	-
A2	Losses from sales of investment property		+
A3	Fair value gain on investment property	The non-cash fair value adjustment between the current fair value of the investment property and the built up book value at the date of valuation.	-
A4	Fair value loss on investment property		+
A5	Impairment charges on inventory	Assets classified as inventory are required to be carried at the lower of cost and net realisable value. This assessment should be undertaken on a project by project basis.	+
A6	Reversal of impairment charge on inventory		-
A7	Depreciation on owner occupied property, plant & equipment (PP&E)	Property assets where the owner is a material tenant of the building must be classified as PP&E and held at cost and depreciated. This is the depreciation charge included in the statutory profit.	+
B	**Goodwill and Intangibles**		
B1	Impairment of goodwill or impairment and amortisation of intangibles	Impairment and amortisation charges recognised on goodwill and other intangibles.	+
B2	Reversal of impairment of goodwill or intangibles		-
C	**Financial Instruments**		
C1	Fair value gain on the mark to market of derivatives	Non-cash movement of the unrealised fair value gain/loss on derivative positions held in the balance sheet.	-
C2	Fair value loss on the mark to market of derivatives		+
C3	Fair value movement of equity component of convertible bonds	Fair value movement on the equity component within a convertible bond.	+/-

Ref	Item	Definition	+/- to net profit
C4	Gains relating to changes in estimates of future contractual cashflows on financial assets and liabilities	Non-cash adjustments to reflect the change in estimated future contractual cashflows from financial assets and liabilities	-
C5	Losses relating to changes in estimates of future contractual cashflows on financial assets and liabilities		+
C6	Contractual cashflows on financial assets and financial liabilities where a gain or loss has previously been recognised	Cashflows relating to previously recognised gains and losses arising from changes to future contractual cashflows	+/-
D	**Incentives, straightlining and leasing costs**		
D1	Amortisation of fit out incentives	The non-cash amortisation (over the term of a lease) of the incentives provided to enter into a lease.	+
D2	Amortisation of cash incentives		+
D3	Amortisation of project incentives		+
D4	Amortisation of rent free incentives		+
D5	Amortisation of leasing costs	The non-cash amortisation (over the term of a lease) of the leasing costs incurred to enter into a lease.	+
D6	Rent straightlining	The adjustment made to rental income to reflect leases with fixed rate increases over the term of the lease.	+/-
D7	Movement in right-of-use asset position (excluding initial recognition or remeasurement of right-of-use assets and straight-lining of incentives received and makegood)	The movement in the right-of-use asset will reflect any depreciation and impairment of right-of-use assets.	+
D8	Movement in the leasehold liability position (excluding initial recognition or remeasurement of leasehold liabilities and receipt of incentives and payment of makegood amounts)	The movement in the leasehold liability position will reflect any interest charges and principal repayments.	-

Ref	Item	Definition	+/- to net profit
E	**Tax**		
E1	Non-FFO tax benefits	This represents the tax expenses / benefits of non-FFO items	-
E2	Non-FFO tax expenses		+
F	**Other Unrealised or One Off Items**		
F1	Recycling of Foreign Currency Translation Reserve (FCTR)	The FCTR appears as a separate component of equity in the balance sheet. It represents the cumulative gains and losses on the retranslation of the entity's net investment in foreign operations. On disposal of the foreign operation, the cumulative amount of any exchange differences relating to that operation should be recognised in the income statement together with the gain or loss on disposal of the operation.	+/-
F2	Other unrealised or one off items	To be adjusted in FFO at the discretion of the organisation with clear explanation. These are items which are not viewed by management as part of the underlying and recurring earnings. A one off item is an item that did not occur in the prior period and highly unlikely to reoccur in the following accounting period.	+/-
Property Council Funds from Operations			

FFO Explanatory Notes

A Investment Property and Inventory

A1 Gains from sales of investment property

A2 Losses from sales of investment property

Property assets are classified as investment property under AASB140 only if they are intended to be held in the long term to collect rent.

A3 Fair value gain on investment property

A4 Fair value loss on investment property

As above.

A5 Impairment charges on inventory

A6 Reversal of impairment charge on inventory

Inventory is recognised in the statutory profit and FFO once inventory is sold for an operational profit. Impairment and reversal of impairment, on a project by project basis, is adjusted in determining FFO.

Ref	Item	Definition	+/- to net profit
A7	Depreciation on owner occupied PP&E Property assets are classified as investment property under AASB140 only if they are intended to be held in the long term to collect rent. Through the classification as investment property, the entity is stating that its primary intention is to collect rent from the building rather than trade for active income, therefore adjust statutory profit to show just the underlying income derived from the building (i.e. rent) not the capital movement.		
B	**Goodwill and Intangibles**		
B1	Impairment of goodwill or impairment and amortisation of intangibles		
B2	Reversal of impairment of goodwill or intangibles Impairment would support lower revenue flows in future periods therefore if amount is not added back there will be a double count.		
C	**Financial Instruments**		
C1	Fair value gain on the mark to market of derivatives		
C2	Fair value loss on the mark to market of derivatives Excluded as a non-cash treasury number that does not reflect the underlying performance of the entity's property assets.		
C3	Fair value movement of equity component of convertible bonds Represents a cost of equity rather than a cost of the entity's underlying operations, therefore excluded.		
C4	Gains relating to changes in estimates of future contractual cashflows on financial assets and liabilities		
C5	Losses relating to changes in estimates of future contractual cashflows on financial assets and liabilities		
C6	Contractual cashflows on financial assets and financial liabilities where a gain or loss has previously been recognised. Exclude the one off gains and losses recognised due to changes in estimated future contractual cashflows on financial instruments, as these are non-cash. Actual contracted cashflows should then be recognised in the period in which they occur. Note: Establishment and other similar fees may be recognised over the life of the associated financial instrument.		
D	**Incentives, straightlining and leasing costs**		
D1	Amortisation of fit out incentives		
D2	Amortisation of cash incentives		
D3	Amortisation of project incentives		
D4	Amortisation of rent free incentives		
D5	Amortisation of leasing costs Excluded as doesn't demonstrate the underlying performance of the passing income of the entity's property portfolio.		
D6	Rent straightlining Excluded as the amount included in statutory profit reflects a smoothing of the rent earned over the life of the lease rather than the rent that is contractually received.		
D7	Movements in right-of-use assets and leashold liabilities		
D8	Adjusted so FFO reflects underlying cash payments under the lease arrangement, but allowing the impact of incentives received and makegood to be straight-lined to minimise volatility in FFO.		

Ref	Item	Definition	+/- to net profit
E	**Tax**		
E1	Non-FFO Tax benefits		
E2	Non-FFO Tax expenses FFO should include tax incurred and recognition of available tax losses.		
F	**Other Unrealised or One Off Items**		
F1	Recycling of FCTR Adjusted so FFO represents stabilised / ongoing underlying earnings.		
F2	Other unrealised or one off items Adjusted so FFO represents stabilised / ongoing underlying earnings. Clear explanation to be provided for any adjustments.		

Property Council AFFO Guidelines

The Guidelines set out adjustments to convert Property Council FFO to AFFO:

Ref	Item	Definition	+/- to net profit
	Property Council Funds from Operations		
G1	Derivative close out costs	Early termination costs other than as a result of a change in capital structure (for example due to a property sale).	-
G2	Maintenance Capex	Capital expenditure spent as part of maintaining a building's grade / quality. In principle, this should be capital expenditure from the entity's cash flow statement less development capex.	-
G3	Incentives and leasing costs for the accounting period	The amount of cash and cash equivalent incentives (cash, fitout and rent free etc), and leasing costs incurred to enter into a lease.	-
G4	Other one off items	To be adjusted in AFFO at the discretion of the organisation with clear explanation. A one off item is an item that did not occur in the prior period and highly unlikely to reoccur in the following accounting period.	+/-
Property Council Funds from Operations			

AFFO Explanatory Notes

G	AFFO Adjustments
G1	Derivative close out costs One off items, adjusted to show reduction in operational earnings. However, break costs as a result of a change in capital structure (for example due to a property sale) should not be adjusted.
G2	Maintenance capex Cash spent during the period but not expensed as part of statutory profit or FFO, adjusted to reflect cash earnings for the year.
G3	Incentives given and leasing costs incurred for the accounting period Cash and cash equivalent incentives and leasing costs incurred during the period but not expensed as part of FFO.
G4	Other one off items Adjusted so AFFO represents stabilised/ongoing operational earnings. Clear explanation to be provided for any adjustments.

The Property Council acknowledges and thanks the CFO Roundtable and the Accounting Roundtable for their feedback and guidance in developing the White Paper.

Feedback

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