ALBERTA SECURITIES COMMISSION

Notice of Implementation
ASC Rule 45-509
Offering Memorandum for Real Estate Securities

August 18, 2004

This Notice accompanies the following documents:

- ASC Rule 45-509 *Offering Memorandum for Real Estate Securities* (Rule),
- Form 45-509 *Offering Memorandum for Real Estate Securities* (Form) and
- Companion Policy 45-509CP to the Rule (Companion Policy).

The Alberta Securities Commission (ASC) has approved the Rule and Form as rules of the ASC and has adopted the Companion Policy as an ASC policy. The Rule, Form and Companion Policy will come into force **September 15, 2004**.

Substance and Purpose

The purpose of the Rule is to require issuers to use a form of offering memorandum tailored specifically to offerings of "real estate securities", as defined in the Rule, if the issuer distributes those securities using the offering memorandum exemption in Multilateral Instrument 45-103 *Capital Raising Exemptions* (MI 45-103). MI 45-103 requires an offering memorandum to be prepared in accordance with one of the two forms listed in section 8.1 of MI 45-103. Despite section 8.1, however, the Rule requires issuers of real estate securities, who wish to rely on the offering memorandum exemptions in subsections 4.1(3) or (4) of MI 45-103, to prepare an offering memorandum in accordance with the Form instead.

The Rule defines the term "real estate security" and the Companion Policy provides some additional guidance. The definition has three components:

- the real estate security is an investment contract,
- the purchaser's economic entitlement under the investment contract is to a material extent attributable to a real estate project, and
- the occupation or use by the purchaser of the real property that is the subject of the real estate project is prohibited or materially restricted.

The first component of the definition specifies that the real estate security must be an "investment contract". If the issuer is offering another type of security, for example a common share of a company engaged in the real estate business, then that type of security would not come within the definition of a "real estate security". Instead that issuer, like all issuers of common shares, would prepare its offering memorandum in accordance with one of the forms listed in section 8.1 of MI 45-103. The second component of the definition connects the investment contract to a real estate project. The definition of "real estate project" is intentionally broad to capture a wide range of real estate projects – for example, from undeveloped land development to an operating condominiumized hotel.

Although the Rule requires exempt offerings of real estate securities by offering memorandum to use the Form, all other requirements of securities legislation pertaining to offering memorandum exemptions still apply to these offerings.

The Form requires issuers to disclose information that is specific to an offering of real estate securities. It expands on certain requirements of Form 45-103F1 *Offering Memorandum for Non-Qualifying Issuers* and removes other requirements of Form 45-103F1 we considered irrelevant for these types of offerings.

The Companion Policy provides guidance about the use of the Rule and Form. For guidance about the offering memorandum exemption in general, readers should refer to the companion policy to MI 45-103. The discussion in the Companion Policy includes guidance about

- the meaning of "real estate security", to help issuers determine when such a security has been created,
- the "issuer", highlighting the fact that the issuer might include more than one person or company in some instances,
- the requirement for independent appraisals and disclosure of historical ownership,
- how an issuer can prepare a disclosure document that complies with the Form if they also have to prepare a disclosure document that complies with other legislation, and
- divisional and carve-out financial information because, in some cases, financial statements for a real estate project may have to be taken from the financial statements of another business.

Public Comments on Proposed Versions

On April 16, 2004 we published, for a 60-day comment period, a proposed version of the Rule, Form and Companion Policy (collectively, the "Proposed Version"). We received 4 submissions, which we posted to our website. When we posted the submissions to our website we extended the comment period by another 2 weeks to see if we would receive any further comments; however, none were submitted. The appendix to this memo lists the commenters' names, summarizes their comments and provides the ASC's response to their comments.

In our Notice of April 16, 2004 we requested comments on the following two issues:

1. To what extent should independent appraisals of the real property or real estate project be required to support values that an issuer discloses in an offering memorandum?

2. Should issuers be required to disclose the historical ownership of the real property and, if so, for how long? Should this information be required in addition to, or perhaps instead of, disclosure of market values that are supported by independent appraisals?

In brief, all four commenters agreed that we should require independent appraisals whenever the issuer voluntarily disclosed a value for the real property or real estate project in the offering memorandum. However, one of the commenters did not agree that an issuer be required to obtain and disclose an independently appraised value for the property whenever the project underlying the real estate security was a development-stage real estate project (i.e. real estate projects involving the development of land). We have carefully considered the commenter's

arguments, but have retained this requirement for the reasons set out in our response to the comments.

While one commenter was in favour of requiring issuers to disclose historical ownership of the real property for the 5 years preceding the date of the offering memorandum, another commenter did not agree that any such disclosure should be required. As discussed below, we have retained the requirement but have reduced the time period for that disclosure from 5 years to 2.

Changes from Proposed Version

The principal changes from the Proposed Version are summarized below. Other more minor changes, which are not described below, were made to clarify the drafting.

1. We moved from the Form to the Rule the following:

   - the requirement that the issuer obtain an independent appraisal for any value of the real property or real estate project disclosed in the offering memorandum, whether that value is required to be disclosed under subsection 3.3(1) of the Form or is disclosed voluntarily,
   - the requirement that the issuer provide the appraisal referred to above to a purchaser of the real estate security, and
   - the requirements pertaining to future-oriented financial information.

   Those requirements are more properly located in the Rule than the Form because the only purpose of the Form is to set out what information is to be disclosed in the offering memorandum.

2. We decreased the time frame in section 3.4 *History of Ownership of the Real Property* from 5 years preceding the date of the offering memorandum to 2.

   The purpose of this section is to inform prospective purchasers of the real estate security of the amount the underlying real property was recently bought and sold for, and whether a related party, as defined in the Form, bought or sold the real property. Although one commenter supported disclosure of historic costs for 5 years, another commenter was critical of the requirement to disclose any such costs.

   On reflection, we thought it would be sufficient to require disclosure of historic costs for the 2 preceding years rather than 5. We agreed with the commenter, who was critical of the requirement, that information about sales of the underlying real property becomes less relevant for a purchaser of a real estate security the further back in time a transaction occurred. Therefore we thought that transactions within the 2 preceding years would be sufficient. We also noted that if any related parties bought or sold the real property within the 3 years preceding the date of the offering memorandum, the issuer would be required, under section 3.9 of the Form, to describe that transaction.

3. National Policy 48 *Future-Oriented Financial Information* (NP 48) requires all future-oriented financial statements (FOFI) to be audited. We had originally proposed that if the offering memorandum did not contain audited financial statements then FOFI in that

offering memorandum did not have to be audited. We have removed that exception in response to concerns raised by one of the commenters. Therefore, as set out in NP 48, all FOFI in an offering memorandum for real estate securities will have to be audited.

We had originally proposed this exception because we thought that auditors were unlikely to agree to audit FOFI if they were not also auditing financial statements. We were concerned that if FOFI had to be audited, issuers would not put it into the offering memorandum, but instead provide it to purchasers in a separate document. We thought that if unaudited FOFI were permitted in the offering memorandum then, at the very least, management and directors would have to certify the FOFI when they certified the contents of the offering memorandum. However, the commenter suggested that FOFI is often provided for marketing purposes, can be overly optimistic and sometimes misleading, and that NP 48 contains an audit requirement to curtail those tendencies. The commenter argued that FOFI in an offering memorandum for real estate securities should not be treated any differently than FOFI in other offering documents. On reflection we agree with the commenter and have made the FOFI requirements, which are now in Rule 45-509, consistent with requirements in NP 48 as follows:

- FOFI must be audited,
- the offering memorandum must be updated if, before the issuer accepts the agreement by a purchaser to purchase the offered real estate security, a change occurs in the events or assumptions used to prepare the FOFI that has a material affect on the FOFI, and
- the issuer must file and send to the purchaser a comparison of the FOFI to the actual results for the same period.

4. At the suggestion of one of the commenters we have added another example of a risk factor – outstanding material litigation that relates to the real estate project, or a past real estate project, against the issuer, a director, officer, promoter or control person of the issuer, or a promoter of the real estate project.

5. We have made the following changes to clarify what the issuer must discuss concerning restrictions on resale of the real property and the purchaser's interest in the real property:

- In its disclosure about the real property the issuer must describe any requirements, consents or procedures that pertain to a sale or disposition of the real property. (For this disclosure we are thinking specifically of situations where numerous owners, each of whom have an undivided interest in the real property, must consent to the sale of the real property.)
- In its disclosure about resale restrictions the issuer must describe any restrictions on the purchaser's ability to resell the purchaser's interest in the real property, including whether the purchaser has to obtain consent from others before the purchaser can sell.

In our view none of the changes made to the Proposed Version, either separately or taken together, amount to a material change. Therefore, we have implemented the Rule and Form as ASC rules, and the Companion Policy as an ASC policy, to come into force September 15, 2004.

Questions
Questions regarding the above may be directed to:

Jo-Anne Bund
Senior Legal Counsel
Alberta Securities Commission
Telephone: (403) 297-7274
e-mail: joanne.bund@seccom.ab.ca

Shawn Taylor
Legal Counsel
Alberta Securities Commission
Telephone: (403) 297-4770
e-mail: shawn.taylor@seccom.ab.ca

Appendix to

Notice of Implementation
ASC Rule 45-509
Offering Memorandum for Real Estate Securities

Summary of Public Comments and ASC Responses

After we published the Rule, Form and Companion Policy on April 16, 2004 we received four submissions from the following:

1. The Appraisal Institute of Canada (Alberta Association)
2. Bennett Jones, LLP
3. M. Berizon
4. Melcor Developments Ltd.

We thank the commenters for their submissions, which we found helpful and posted on our website. This appendix summarizes the comments, grouped by topic, contained in the submissions, and the ASC's response.

Valuations

1. The Appraisal Institute of Canada suggested that the reference to "current member of the Appraisal Institute of Canada" be changed to "accredited member of the Appraisal Institute of Canada in good standing".

   Response: We have made this change.

2. The Appraisal Institute of Canada suggested that a definition of "market value" be referred to so as to clarify the value being reported.

   Response: We have not defined "market value" in the offering memorandum because the Appraisal Institute of Canada defines that term in its standards ("The Canadian Uniform Standards of Professional Appraisal Practice") and requires its members to adhere to those standards when they carry out their valuations. However, to clarify the issuer's disclosure we added, in subsection 3.3(2) of the Form, a requirement that the issuer disclose the definition of "value" used by the qualified appraiser.

3. Three of the four commenters supported the proposed requirement for independent valuations. The fourth commenter agreed with the requirement that values voluntarily disclosed in an offering memorandum be supported by an independent qualified appraiser. However, that commenter did not agree with the requirement that an issuer obtain and disclose an independently determined value for the property if the real estate project is a proposal to develop a tract of undeveloped land. The commenter asserted that this information would not "aid purchasers in deciding to make an investment... [because] the purchaser [of a real estate security] is generally investing based on the future prospects of a project as reflected in the purchaser's faith in the management team, location of the property and, if applicable, any forward looking financial projections." The commenter also stated that "value, particularly with respect to undeveloped land, is

primarily market driven ... and the valuation provided may be unreliable even before the expiry of the offering."

The commenter further noted "in a prospectus, a document which rightly requires a greater detail of disclosure than an offering memorandum, an issuer is not required to provide a valuation of the securities being sold to the public. What is required is merely disclosure of those things material to the issuer's business and the price at which the securities are being offered. A purchaser determines whether the offering price is a fair reflection of his or her assessment of the underlying value and prospects for the business." The commenter stated that the mandatory valuation is creating a special and more onerous disclosure requirement for the offering memorandum of a market participant in the real estate sector than is mandated at the prospectus level for market participants in other sectors.

Response: We have retained this requirement because we think that that type of financial information about the real property is important information for purchasers of a real estate security, particularly where the real estate project underlying the real estate security is a proposal to develop a tract of land. As part of their investment the purchaser is (1) acquiring an interest in land and (2) assuming the risk that the proposed real estate project may not be completed, in which case the purchaser would only be left with their interest in the land. Although information about the real estate project and the management team are important, we think it is reasonable, for these types of development-stage projects, to offset the lack of financial statements about the real estate project with certain financial information about the key asset of the project – the land. Therefore we have required the issuer to disclose the following financial information about the real property:

- *current market value, and*
- *amounts paid for the land within the 2 years preceding the date of the offering memorandum.*

We believe it is important for the purchaser to understand how much of the real estate security's price can be notionally attributed to the property and how much can be notionally attributed to the real estate project. Broadly speaking, we view this type of financial information to be analogous to information provided in a company's financial statements. In its financial statements, a company will disclose historical cost of its tangible assets and will attribute a value to its intangible assets, such as goodwill. An investor will use that information to assess whether the company's underlying assets support the value of its shares. In the case of a real estate security relating to a development-stage real estate project, the only tangible asset that underlies that real estate security is likely land, and until the proposed real estate project is completed, the project is only an intangible asset. If the purchaser is paying a higher price for the real estate security than is attributed to its only tangible asset – the land – then the issuer should explain in the offering memorandum why that premium is justified.

We do not believe that the mandatory valuation necessarily creates a special and more onerous requirement for offering memorandums for real estate securities than would

otherwise arise under the prospectus process. The prospectus process has some built-in checks and balances, which are not part of the offering memorandum process, that would likely trigger a valuation of the real property – for example, a valuation would likely be required by an underwriter as part of their due diligence or by a stock exchange as part of their listing requirements.

4. One commenter thought that the language in subsection 3.3(1), which restates the second prong of the definition of "real estate project", was ambiguous and that it should be modified to make clear that independent appraisals and the disclosure of the market value of real property is not required with respect to sales of undeveloped land.

Response: Not all sales of undeveloped land will trigger the required independent valuation. That requirement will only be triggered if:

- *the interests in the land are bundled with other attributes that, when taken together, amount to an investment contract, and*
- *the seller wishes to rely on the offering memorandum exemption to sell those investment contracts.*

Historic Costs

5. One commenter did not agree with the requirement that the issuer disclose the amount and form of consideration paid for the real property in the 5 years preceding the date of the offering memorandum. The commenter argued that that information is of minimal value to prospective purchasers and may prejudice a purchaser's assessment of a project's value or prospects. The commenter stated that the historical cost will not reflect any of the conditions under which the original acquisition was undertaken or the potential discount a project manager may achieve through purchasing greater quantities of real property than a purchaser could purchase as an individual. The commenter suggested that the historical cost has less value the farther one gets from the original purchase date and recommended that if we kept the requirement that it be reduced to 2 years from 5.

· *Response: We believe a purchaser of a real estate security should know how much the real property underlying the real estate security was recently bought and sold for and whether those transactions were with a related party. The issuer may provide additional information in the offering memorandum to explain the amount; for example, by describing the context of the transaction including particular conditions or any discount that may be attributed to the purchase of large quantities of real property.*

We have retained this requirement but have decreased the time frame for which the information is required from the five years preceding the date of the offering memorandum to 2. We noted that if any related parties bought and sold the real property within the 3 years preceding the date of the offering memorandum that information would still be required to be disclosed under section 3.9.

Consistency with Requirements in B.C.

6. One of the commenters noted that the British Columbia Securities Commission, in its BC Form 45-906F *Offering Memorandum for Real Estate Securities*, does not require the inclusion of valuation information or historical cost information and suggested that the

ASC make the form of offering memorandum consistent with that required in British Columbia.

Response: The BCSC is proposing to repeal its BC Form 45-905F with a form of offering memorandum (the BC Proposed OM) that is generic for all industries. Chapter C of BC Proposed OM sets out supplemental information that an issuer of real estate securities will be required to provide purchasers. With respect to financial information required in those offering memorandums, BCSC's proposed rule 111 states "the requirement to include financial statements in the offering memorandum does not apply to an offering of real estate securities provided the prospective purchaser receives financial information about the project that will allow the purchaser to make an informed investment decision"(emphasis added). Chapter C discusses the financial information issuers should consider providing in order to rely on rule 111.

As a result, for offerings of real estate securities, both the BCSC and the ASC will require financial statements for real estate projects that are operating businesses. However, for development-stage real estate projects the ASC has determined that, at a minimum, the issuer should disclose the following financial information about the underlying real property:

- *the market value of the real property as determined by an independent qualified appraiser and*
- *the amount and form of consideration paid for the real property in the 2 years preceding the date of the offering memorandum.*

The issuer may include additional financial information if it wishes.

In our view, our requirements do not conflict with what the BCSC currently requires or is proposing to require. The forms of offering memorandum are flexible with respect to the presentation of information. An issuer can include other information than that required by the forms, or "wrap" the offering memorandum around disclosure required by other legislation. We believe that an issuer should be able to prepare an offering memorandum that will meet the requirements of both jurisdictions.

Related Party Transactions

7. One of the commenters stated that we should treat the disclosure about related party transactions in the offering memorandum in a manner more similar to that required in Form 45-103F1 *Offering Memorandum for Non-Qualifying Issuers*, which requires such disclosure under a discussion of the material agreements to which the issuer is currently a party and which are expected to materially affect the real estate security.

Response: We determined that the section requiring disclosure about material agreements did not sufficiently capture all of the information about related party transactions that we think is important for these types of offerings. Therefore, we have retained section 3.9, which is substantially based on a similar disclosure requirement for related party transactions in Form 51-102F2 Annual Information Form.

Future-Oriented Financial Information

8. One of the commenters recommended that future-oriented financial information (FOFI) provided in an offering memorandum be required to be audited even if the offering memorandum does not include audited financial statements. The commenter stated that the auditor's report provides a valuable safeguard against misleading marketing of securities based upon incorrect or overly optimistic FOFI.

Response: We re-analyzed whether we should provide an exception to the requirement that FOFI in an offering memorandum be accompanied by an auditor's report in situations where no audited financial statements are included with the offering memorandum. We agreed with the concerns raised by the commenter and have removed this exception. All FOFI must be audited.

Risk Factors

9. One of the commenters suggested that we add as a risk factor any outstanding material litigation against the issuer, any promoter of the real estate project or members of the issuer's management team, which relates to either the current or a past real estate project.

Response: We agreed and have added this as another example of a risk factor in item 5.

Resale Restrictions

10. One of the commenters suggested that the disclosure concerning resale restrictions would not apply where undeveloped land underlies the real estate security and the purchaser appears on title to that land.

Response: An issuer will rely on Rule 45-509 to sell a real estate security in reliance on the offering memorandum exemption under Multilateral Instrument 45-103 Capital Raising Exemptions. Absent any further exemption the resale rules in securities legislation will apply to the resale of that real estate security (which, by definition, is a "security" because it is an investment contract) to the same extent that those rules apply to other types of securities, regardless of whether the purchaser of the real estate security also acquired an interest in land and is on title. We have not created a further exemption from the resale restrictions for real estate securities because we do not believe that those purchasers ought to be in any different position than those who purchase an exempt security of a non-reporting issuer. Both types of investors will be able to resell their exempt securities to those who are permitted, under the exemptions from the prospectus and registration requirements, to buy those exempt securities.

If for some reason the investment contract terminates (for example, the real estate project fails) then the purchaser of a real estate security may be left with only an interest in land. In that situation, if the purchaser wishes to resell the interest in the land (which interest, by itself, is not a security) then that resale will not be subject to restrictions under securities legislation. However, because the resale of the purchaser's interest in land may be subject to other restrictions (for example, those that arise under the nature of ownership of the interest) the section on resale restrictions also requires an issuer to discuss those types of resale restrictions.