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CSA Publishes Proposed Amendments on Offering Memorandum Disclosure Requirements for Real Estate Activities

By James Leech

On September 17, 2020, the Canadian Securities Administrators (“CSA”) published proposed amendments (“**Proposed Amendments**”) to National Instrument 45-106 - *Prospectus Exemptions* (“**NI 45-106**”), which investors who wish to rely on the Offering Memorandum (“**OM**”) exemption set out in section 2.9 of NI-45-106 (“**OM Exemption**”).

In particular, the Proposed Amendments set out new disclosure requirements for issuers engaged in “real estate activities”, and those operating “collective investment vehicles”. A discussion of the amendments relating to “collective investment vehicles” is the subject of a separate paper.

According to the CSA, the OM Exemption was originally designed to be used by small, less sophisticated businesses, to raise early stage capital from a large pool of investors without having to comply with the costlier prospectus regime.

In practice, however, the CSA has found that the OM Exemption is being used by large sophisticated issuers in specific industries, such as real property ownership or development. In 2017, for example, roughly 40% of the issuers relying on the OM Exemption had assets of \$100 million or more, with 17% of issuers being engaged in “real estate activities” (as such term is defined below).

Issuers Engaged in Real Estate Activities

“**Real Estate Activities**” is defined in the Proposed Amendments as an undertaking, the purpose of which is primarily to generate income for shareholders, or other gains from the lease, sale or other disposition of real property, but **does not** include, mining activities, oil and gas activities, and in Quebec, certain contracts and rights relating to immovables.^[1]

Under the Proposed Amendments, an issuer engaged in Real Estate Activities would be subject to new disclosure requirements, including:

- providing an independent appraisal in circumstances where (i) the issuer has acquired or proposes to acquire an interest in real property from a Related Party (as such term is defined in NI-45-106); (ii) the OM discloses a value for an interest in real property (other than in its financial statements); or (iii) the issuer intends to spend a material amount of the proceeds of the offering to acquire an interest in real property;
- providing a general description of the real property, including the nature of the interest held, whether there are any encumbrances on the property, any environmental liabilities, hazards or contamination, any tax arrears, how the property is serviced by utilities, the current and proposed use of the property and a statement why the issuer considers the real property to be suitable for its plans, and if there are any buildings on real property, the type of construction, age and condition, and a description of any units for sale or rental, and occupancy rates therein;
- if the issuer will be developing the real property, it will be required to provide comprehensive disclosure on such development, including the estimated costs to complete the development, any significant assumptions that underlie the cost estimates, when the costs will be incurred, and the milestones and objectives of the project, including the expected timeline, the costs for completing each objective, and the consequences of failing to meet one or more objectives;
- disclosure of penalties, sanctions, bankruptcy, insolvency and criminal or quasi-criminal convictions for parties other than the issuer, such as a developer or manager;
- disclosure of any historical transactions involving the issuer and any Related Party, so investors can better evaluate transactions involving Related Parties;
- disclosure of any future cash calls required by the investors; and
- disclosure of the terms and conditions of any Rental Pool or Rental Management Agreement.

These disclosure obligations would not apply to real property that when taken together would not be significant to a reasonable investor. This exception is intended to ensure that issuers are not subject to an undue disclosure burden.

Compliance reviews conducted by the CSA on issuers engaging in Real Estate Activities indicate that these issuers are often unsure of the disclosure required in an OM. The Proposed Amendments appear to set out a clear disclosure framework for these issuers, giving them greater certainty as to what they must disclose. Given the complexity of these entities, the proposals appear reasonable in the circumstances, and will hopefully lead to investors making more informed investment decisions.

Comment Period

The Comment Period for the Proposed Amendments will be open until December 16, 2020. If you are interested in submitting comments or for further information on navigating NI 45-106, please contact: James Leech at (416) 643-8819 or jleech@torikinmanes.com.

[1] The distribution of either one of the following (i) an investment contract that includes a real right of ownership in an immovable and a rental management agreement; or (ii) a security of an issuer that owns an immovable giving the holder a right of exclusive use of a residential unit and a space in such immovable.

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