FREQUENTLY ASKED QUESTIONS ABOUT
REAL ESTATE INVESTMENT TRUSTS

REIT BASICS

What is a REIT?
A REIT refers to a “real estate investment trust,” which is an entity entitled to beneficial federal income tax treatment if it satisfies various requirements relating to its organization, its ownership, its distributions and the nature of its assets and income.

What types of REITs are there?
Most broadly, there are equity REITs and mortgage REITs. Equity REITs primarily own interests in income-producing real property that is leased to tenants. Equity REITs typically concentrate on one or more asset classes (for instance, industrial, office, healthcare, lodging, residential, retail or self-storage properties). In contrast, mortgage REITs primarily own loans and other real estate-related debt instruments secured by interests in real property. Mortgage REITs typically focus on originating or acquiring loans made to certain types of real estate borrowers (for instance, loans made to developers or distressed borrowers) or on particular loan types (for instance, first mortgages, distressed debt or mezzanine financings). Although it is not unusual for equity REITs to invest in multiple property types, there are relatively few hybrid REITs that, in the ordinary course of executing their investment strategy, focus on owning and acquiring both operating real property and debt instruments secured by interests in real property. However, many equity REITs maintain a small portfolio of acquired or originated debt instruments, primarily secured by the same type of real property held in their operating property portfolio.

REITs are also often characterized by whether they are public or private and whether they trade on a national securities exchange. Listed REITs are public companies that trade on a national securities exchange such as the NYSE or NASDAQ and are required to make filings with the Securities and Exchange Commission (the “SEC”). REITs that are required to make filings with the SEC, but that do not trade on a national securities exchange, are referred to as non-traded or non-listed REITs. See “Non-Traded REITs” below. Finally, private REITs are REITs that neither make filings with the SEC nor have securities that trade on a national securities exchange.

When and why were REITs created?
Congress passed the original REIT legislation in 1960 in order to provide a tax-preferred method by which all types of investors could invest in a professionally managed portfolio of real estate assets. Many of the limitations imposed upon the operation of REITs and the taxes to which they are potentially subject are perhaps best understood in terms of the original notion that the activities of REITs were to consist predominantly of passive investments in real estate.

Do other countries have REITs?
A number of countries, including Australia, Brazil, Bulgaria, Canada, Finland, France, Germany, Ghana, Hong Kong, India, Japan, Malaysia, Mexico, Nigeria, Pakistan, Philippines, Saudi Arabia, Singapore and the United Kingdom, have REIT-type legislation. The details of the rules may vary from the U.S. rules and from country to country.

STRUCTURING A REIT

What types of entities can be REITs?
Virtually any type of entity can qualify as a REIT, including corporations, trusts, partnerships and limited liability companies, as long as the entity would be taxed as a domestic corporation if it did not qualify to be treated as a REIT. The relevant regulations provide that an entity eligible to elect to be taxed as a corporation will be deemed to have so elected as a result of electing REIT status.
How is a REIT formed?

A REIT is formed by organizing an entity under the laws of one of the 50 states or the District of Columbia as an entity eligible to be taxed as a corporation for federal income tax purposes, and by electing to be treated as a REIT. An entity may elect to be treated as a REIT for any taxable year by filing with its tax return for that year an election to be a REIT.

Where are REITs typically formed?

Most public REITs are formed in Maryland as corporations under the Maryland General Corporation Law (the “MGCL”) or as real estate investment trusts under the Maryland REIT law. The popularity of Maryland as the preferred jurisdiction of formation for most REITs can be attributed primarily to statutory provisions that are REIT-friendly and a state judiciary that has developed expertise in REIT matters.

There also are other benefits to forming in Maryland. For instance, while some jurisdictions impose franchise taxes and other costs of being incorporated (which can be as high as $200,000 annually), Maryland has no franchise tax. The MGCL also permits a Maryland corporation to eliminate the potential liability of directors and officers to stockholders with only two very narrow exceptions—actual receipt of an improper personal benefit and active and deliberate dishonesty. Furthermore, Maryland has an explicit statutory standard of conduct that governs the duties of directors rather than relying primarily on ever-developing case law. The MGCL also permits the board of directors of a Maryland corporation to increase the aggregate number of authorized shares of stock the corporation without stockholder approval. The Maryland REIT Law, applicable to trust REITs, offers even more flexibility than the MGCL, although the statute does provide less structure.

What are the requirements for qualification as a REIT?

In order to qualify as a REIT, an entity must:

- have a valid REIT election in effect;
- use a calendar tax year;
- be managed by one or more trustees or directors (or pursuant to comparable constructs, in the case of LLCs or partnerships);
- have transferable shares or interests;
- be taxable as a domestic corporation but for its qualification as a REIT;
- not be a “financial institution” or “insurance company”;
- have at least 100 shareholders for 335/365 days of every year (other than its first REIT year);
- not be owned, actually or constructively, more than 50%, by value, by five or fewer “individuals” during the last half of any taxable year (other than its first REIT year);
- satisfy annual income and quarterly assets tests (described below);
- annually distribute, or be deemed to have distributed, at least 90% of its ordinary taxable income; and
- not have any undistributed non-REIT earnings and profits (either from years prior to electing REIT status, or from an acquisition of a C corporation or its assets in a tax-free transaction) at the end of any taxable year.

See “Tax Matters” below.

Do REITs limit share ownership?

Yes, almost always. To qualify as a REIT, an entity must not be “closely held,” meaning, at any time during the last half of the taxable year, more than 50% in value of its outstanding stock cannot be owned, directly or indirectly, by five or fewer individuals (referred to as the “5/50 test”). Although not legally required, all REITs, including listed public REITs, typically adopt ownership and transfer restrictions in their articles of incorporation or other organizational documents that provide that no person shall beneficially or constructively own more than 9.8% or 9.9% in value of the outstanding shares of the entity, and any attempted transfer of shares that may result in a violation of this ownership limit will be null and void. Depending on the circumstances, the REIT’s board of directors or board of trustees, as applicable, may determine that it is in the best interests of the REIT and its stockholders to grant a waiver of the ownership limitations for a particular stockholder. The board’s decision to grant or deny a waiver is often based on a variety of considerations, including the identity of the stockholder (i.e., is it a REIT-dedicated fund, a hedge fund or an investor that is likely to be a long-term holder?), the existence of outstanding waivers for other stockholders and the impact on the REIT’s ability to satisfy the 5/50 test, the amount of securities in excess of the ownership limit the stockholder is seeking to acquire and other factors bearing on whether or not the grant of an ownership limit waiver is in the best interests of the stockholders.

In addition, larger holders, typically sponsors or founders of a REIT, who own more than 9.9% are usually “grandfathered,” potentially requiring a related decrease in the ownership limit to ensure continued compliance with the 5/50 test. For instance, if the founder of a REIT and his or her affiliates are grandfathered and permitted by the board of directors to collectively own up to 20% of the REIT’s outstanding shares, the ownership limit in the REIT’s charter would be lowered to 7.4% or less to ensure continued compliance with the 5/50 test.

Investors may view REIT ownership limit provisions as an anti-takeover device for publicly traded REITs because the board of directors may grant or deny a waiver at its discretion. To alleviate stockholder concerns that a REIT will
use its ownership limits as an anti-takeover device, some REITs have affirmatively stated in their articles of incorporation/declaration of trust or public disclosures that the ownership limits will not be used for that purpose.

**What is an UPREIT?**

A common operating structure for publicly traded equity REITs is the umbrella partnership real estate investment trust ("UPREIT") structure. In a typical UPREIT structure, the REIT holds substantially all of its assets, and conducts substantially all of its operations, through a single operating partnership subsidiary (the “Operating Partnership”). In most cases, the REIT or a wholly owned subsidiary of the REIT serves as the sole general partner of the Operating Partnership and, as a result, the REIT has the exclusive power and authority to manage the Operating Partnership’s business, subject to certain limited rights maintained by holders of units of limited partnership interest (“OP Units”) in the Operating Partnership pursuant to the partnership agreement of the Operating Partnership (the "Partnership Agreement").

In addition to controlling the Operating Partnership, the REIT typically owns a majority, and in some cases all, of the outstanding OP Units. These OP Units were obtained by the REIT in exchange for the contribution by the REIT of the net cash proceeds from the REIT’s IPO or other equity capital raise. The remaining OP Units, if any, are ordinarily held by outside limited partners (“OP Unitholders”) who received their OP Units in exchange for contributing real estate assets that were previously owned by them (or their interests in the entities that previously owned such real estate assets) to the Operating Partnership. Determining the value of the contributed assets and the allocation of the OP Units being issued as consideration to the property contributors often involves significant analysis and negotiation and, in certain instances, may involve third-party valuation firms.

In the typical UPREIT structure, after an initial holding period, OP Unitholders may tender their OP Units for redemption by the Operating Partnership for cash or, at the option of the REIT, for shares of the REIT, typically on a 1:1 basis. The customary justification for such exchange ratio is that the OP Units and the REIT shares represent interests in essentially the same pool of assets and, therefore, should have the same *pro rata* interest in such assets.

A typical UPREIT structure is depicted in the diagram below:

What are the primary benefits of the UPREIT structure and OP Unit transactions?

The UPREIT structure can provide a number of advantages over a typical all-cash real estate transaction, including the following:

- **Tax-Advantaged Consideration** – The most significant benefit of operating through an UPREIT structure is the ability to issue securities (i.e., OP Units) on a tax-deferred basis to sellers of real property in connection with property acquisitions by the REIT. When contemplating the disposition of real property, sellers who have a low tax basis in the property may be reluctant to sell for cash or REIT shares because the sale would trigger significant tax liability. By accepting OP Units as consideration for the contribution of their properties, sellers can defer the tax on their built-in gains, generally until they elect to tender their OP Units for redemption or until there is a taxable disposition of their contributed properties. Under certain circumstances, sellers may even be able to extract some cash in the transaction on a tax-deferred basis as well. Furthermore, OP Unitholders may also tender their OP Units over time, thereby spreading out their tax liability. OP Units also provide favorable tax benefits for estate planning purposes, as discussed below.
• **Enhanced Liquidity** – Unlike real property, for which there is limited liquidity, an OP Unitholder has the ability to obtain liquidity “on demand” by exercising its redemption rights. Pursuant to the Partnership Agreement, OP Unitholders typically have the right to tender their OP Units to the Operating Partnership for redemption. OP Unitholders generally must wait a certain period of time before they can exercise their redemption rights (typically, one year from the date of the issuance), but once the holding period has been satisfied, OP Unitholders generally can tender OP Units at times, and in amounts, of their choosing, subject to applicable limitations set forth in Partnership Agreement. Although the redemption of OP Units will trigger the recognition of the taxable gain that was deferred at the time of the property contribution, OP Unitholders have the flexibility to decide when to monetize their holdings and, accordingly, when the tax liability will be triggered.

• **Current Income Through Distributions** – Holders of common OP Units generally receive the same quarterly distribution payments in respect of their OP Units as stockholders receive in respect of their REIT shares, and the payment dates usually coincide. As a result, the ownership of OP Units generally provides holders with current income in the form of regular (typically quarterly) cash distributions.

• **Liability Allocations** – As a partner in the Operating Partnership, an OP Unitholder will receive an allocation, for income tax purposes, of the liabilities of the Operating Partnership. An OP Unitholder’s adjusted tax basis in his or her OP Units will be increased by the amount of such allocation. Among other things, an increased tax basis from an allocation of liabilities may enhance an OP Unitholder’s ability to (i) receive cash distributions in excess of earnings on a tax-deferred basis and (ii) absorb and use net losses, if any, generated by the Operating Partnership.

• **Investment Diversification** – The UPREIT structure offers property contributors the ability to diversify their holdings. Indeed, by contributing interests in a single property or a small group of properties that are concentrated in terms of geography, asset type or tenants in exchange for OP Units, a seller/contributor receives an interest in an entity (i.e., the Operating Partnership) that owns multiple properties, often in multiple real estate markets, which can diversify the contributor’s investment holdings and, as a result, mitigate the impact of a decline in the value or performance of any particular property.

• **Depreciation Deductions** – In the case of a newly acquired or developed real estate property, OP Unitholders will receive a share of the depreciation deductions from the depreciable asset in accordance with their respective interests in the Operating Partnership. These depreciation deductions will reduce the taxable income allocated to the OP Unitholders by the Operating Partnership with respect to their OP Units. However, OP Unitholders may be subject to limitations in their ability to use depreciation deductions and to subsequent adverse tax consequences in the future, such as depreciation recapture upon a later disposition of either the depreciated property or their OP Units, including pursuant to a redemption as described above.

• **Estate Planning** – OP Units are helpful for estate planning purposes. For example, an OP Unitholder can transfer OP Units to multiple beneficiaries as part of estate planning, and each beneficiary can choose either to hold his or her OP Units and receive quarterly distributions or tender the OP Units for redemption for cash or, at the REIT’s election, for REIT shares. In addition, when an individual partner holds the OP Units until death, the tax rules generally allow for a “step up” in tax basis of the OP Units, effectively permitting the beneficiaries to subsequently tender the OP Units for cash or REIT shares without incurring tax on the built-in gain in the OP Units at the time of death.

For more information regarding public UPREITs and OP Unit transactions, including securities law, tax law and other considerations, see our publication entitled “Frequently Asked Questions about UPREITs and OP Unit Transactions for Public REITs.”

Are there any drawbacks to the UPREIT structure or engaging in an OP Unit transaction?

Yes, despite the benefits described above, UPREIT structures can have some drawbacks that should be considered by sponsors and property sellers. UPREIT structures introduce a level of complexity that would not otherwise exist within a REIT structure that does not include an Operating Partnership subsidiary. Additionally, the disposition of property by an UPREIT may result in a conflict of interest with the contributing partner because any disposition of that property could result in gain recognition for that partner. As a result, contributing partners often negotiate mandatory holding periods and other provisions to protect the tax deferral benefits they expect to receive through contribution of appreciated property to an UPREIT.

What is a DownREIT?

DownREITs are similar to UPREITs in that both structures enable holders of real property to contribute that property to a partnership controlled by the REIT on a tax-deferred basis. The primary difference between the two structures is that DownREITs typically hold their assets directly and/or through multiple operating partnerships or other subsidiaries (each of which may hold only one property or a small subset of properties), whereas UPREITs typically hold all of their assets through a single operating partnership subsidiary. The DownREIT structure enables existing REITs to compete with UPREITs by allowing them to offer potential...
sellers a way to dispose of real estate properties on a tax-deferred basis.

As with an UPREIT structure, in a DownREIT, limited partnership interests in an operating company are redeemable for cash based upon the fair market value of the REIT shares or, at the REIT’s election, for REIT shares. As distinguished from an UPREIT, however, for a DownREIT, the value of each DownREIT partnership unit is not necessarily directly related to the value of the REIT shares, because, unlike UPREITs, where the value of REIT shares is determined by reference to all of the REIT’s assets, for a DownREIT, the value of each DownREIT unit is determined by reference to the specific assets held in only one of the DownREIT’s partnerships. As a result, there is not necessarily a correlation between the value of each DownREIT partnership’s assets and the value of the REIT shares. However, as a practical matter, almost all DownREIT agreements tie the redemption to a 1:1 ratio. Such a structure raises additional issues regarding the tax-free nature of a contribution by a property seller to a DownREIT partnership.

The following diagram shows a typical DownREIT structure:

![DownREIT Structure Diagram]

Are there Investment Company Act considerations in structuring and operating a REIT?

In addition to a REIT’s beneficial federal income tax treatment, a REIT has other regulatory advantages. For example, under Section 3(c)(7) of the Investment Company Act of 1940, as amended (the “Investment Company Act”), a REIT can qualify for an exemption from being regulated as an “investment company” if its outstanding securities are owned exclusively (subject to very limited exceptions) by persons who, at the time of acquisition of such securities, are “qualified purchasers” and the issuer is neither making nor proposing to make a public offering (as defined under the Investment Company Act).

In addition, a REIT can qualify for an exemption under Section 3(c)(5)(C) of the Investment Company Act, which is available for entities primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. The exemption generally applies if at least 55% of the REIT’s assets are comprised of qualifying assets and at least 80% of its assets are comprised of qualifying assets and real estate-related assets. For these purposes, qualifying assets generally include mortgage loans and other assets that are the functional equivalent of mortgage loans, as well as other interests in real estate.

Rule 3a-7 of the Investment Company Act excludes from the definition of “investment company” any asset-backed issuer that holds specified assets, issues fixed-income securities and meets the Rule’s other conditions.

If a REIT does not meet the exemption requirements provided in Section 3(c)(5)(C) or Section 3(c)(7), unless the REIT qualifies for another exemption under Section 3(b) or other provisions of Section 3(c) of the Investment Company Act, the REIT will be viewed as an investment company and required to comply with the operating restrictions of the Investment Company Act. These restrictions are generally inconsistent with the operations of a typical mortgage REIT. Therefore, most mortgage REITs monitor their Investment Company Act compliance with the same level of diligence they apply to monitoring REIT tax compliance, as a violation of either set of rules can lead to adverse consequences.

For more information regarding the application of the Section 3(c)(5)(C) exemption provided in the Investment Company Act, see the Capital Trust I, Capital Trust II and Great Ajax SEC no-action letters.

OPERATING A REIT

What types of assets do REITs own and manage?

Broadly speaking, REITs generally own real property or interests in real property and/or loans secured by real property or interests in real property.
What are the limitations on the types of assets REITs may own and manage?

Entities must satisfy various income and assets tests in order to qualify for treatment as a REIT. These tests effectively limit the types of assets that REITs can own and manage to real estate or real estate related assets.

How does a REIT maintain compliance with REIT tax requirements?

The types of assets that a REIT can hold and the types of income it can earn are limited by the REIT rules. Therefore, a REIT must establish procedures, typically in coordination with its outside auditors, tax preparers and legal counsel, to ensure that it is investing in the correct types and proportions of assets and earning the right types and amounts of income. See “Tax Matters” below.

How does a REIT finance its activities?

Because a REIT must annually distribute at least 90% of its ordinary taxable income in order to maintain its REIT status, a REIT may not retain earnings like other companies. As a result, REITs often require capital from outside sources to buy additional assets and to fund operations. A REIT generally finances its activities through equity offerings of preferred and/or common stock and debt offerings, including subordinated and senior debt, as well as through financing agreements (credit agreements, term loans, revolving lines of credit, etc.) with banks and other lenders. Mortgage REITs may also securitize their assets. An equity REIT may also incur ordinary course mortgage debt on its real property assets.

What is the difference between internally and externally managed REITs?

In a REIT with an internal management structure, the REIT’s own officers and employees manage the portfolio of assets. A REIT with an external management structure usually resembles a private equity style arrangement, in which the REIT does not have its own employees and the external manager or advisor receives fees and certain expense reimbursements for managing the REIT’s portfolio of assets. Many non-traded REITs and listed mortgage REITs are externally managed or advised.

What fees does a manager of an externally managed REIT receive?

The types of fees that an externally managed REIT pays to its manager vary, depending upon the type of assets the REIT is focused on acquiring, as well as whether it is structured as a “finite life” or “perpetual life” REIT. With respect to asset management, an external manager typically will receive a base management fee and an incentive fee. The base management fee often is based on a percentage of stockholders’ equity or the value of assets under management, while the incentive fee often is based on the achievement of targeted levels of earnings (calculated based on GAAP or non-GAAP measures) and is subordinated to a minimum investor return threshold. In addition, an external manager may receive fees such as property management, acquisition, disposition, development, loan coordination and leasing fees and may be reimbursed for certain operating expenses.

PUBLIC REITS

How can REITs go public?

REITs become public companies in the same way as non-REITs, although REITs have additional disclosure obligations and may need to comply with specific rules with respect to roll-ups, which are discussed below. Like other companies, REITs may also take advantage of the more lenient requirements available to “emerging growth companies” (“EGCs”) under the Jumpstart our Business Startups (JOBS) Act of 2012. On June 29, 2017, the SEC announced that the Division of Corporation Finance will permit all companies (no longer limited to EGCs) to submit draft registration statements relating to initial public offerings and certain follow-on registration statements for review on a nonpublic basis.

For more information regarding REIT IPOs, see our publication entitled “REIT IPOs – A Quick Guide.”

Are there special disclosure requirements for public REIT offerings?

Yes. In addition to the statutes and regulations applicable to all public companies, REITs that are not eligible to use a short-form registration statement on Form S-3, including REITs conducting an initial public offering, must comply with the disclosure requirements of Form S-11. In addition, REITs conducting a blind pool offering, including non-traded REITs, must comply with the SEC’s Industry Guide 5.

What is Form S-11?

SEC rules set forth specific disclosures to be made in a prospectus for a public offering of securities as well as for ongoing disclosures once the issuer is public. The registration form for an initial public offering by a U.S. domestic entity is Form S-1. Real estate companies, including REITs, are instead required to register the initial public offering of their shares on Form S-11. In addition to the same kinds of disclosures required by Form S-1, Form S-11 sets forth several additional disclosure requirements, which are summarized on Exhibit A to these FAQs.

REITs conducting a blind pool offering, including non-traded REITs, are also subject to the SEC’s Industry Guide 5, as discussed below.

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What is a blind pool REIT Offering?

A blind pool REIT offering is a public offering by a REIT that does not identify specific real properties or real-estate related debt instruments to be acquired with the net proceeds from its public capital raise; rather, after capital has been raised, the REIT’s sponsor or external manager or advisor will recommend investments in assets for the REIT based on a predetermined investment strategy disclosed in the prospectus. Therefore, the reputation and past experience of the sponsor is critical when establishing a blind pool REIT because an investor may make investment decisions based on the sponsor’s reputation and its track record. Accordingly, the prospectus for a blind pool REIT offering may be required to include information regarding the prior performance of similar investments by the sponsor in order for the investor to make an informed investment decision. Most non-traded REIT public offerings and offerings by private REITs are blind pool offerings. In addition, a public REIT offering may still be deemed a blind pool offering if more than 25% of the proceeds of the offering (as disclosed in the “Use of Proceeds” section of the prospectus) are not allocated to specified uses, such as acquisitions or debt repayment.

What is Industry Guide 5?

In addition to the enhanced disclosure obligations applicable to real estate companies, including REITs, under Form S-11, REITs conducting blind pool offerings are subject to the SEC’s Industry Guide 5, which sets forth the following additional disclosure requirements, among others:

- Risks relating to: (i) management’s lack of experience or lack of success in real estate investments; (ii) uncertainty if a material portion of the offering proceeds is not committed to specified properties; and (iii) REIT offerings in general;
- General partner’s or sponsor’s prior experience in real estate; and
- Risks associated with specified properties, such as competitive factors, environmental regulation, rent control regulation, and fuel or energy requirements and regulations.

In addition, REITs conducting a blind pool offering also must make certain undertakings in their registration statements pursuant to the SEC’s Industry Guide 5, including, but not limited to, an undertaking to file a sticker supplement for reasonably probable acquisitions of properties, and consolidate such stickers into a post-effective amendment (a “20D Amendment”) at least once every three months that must include audited financial statements meeting the requirements of Rule 3-14 of Regulation S-X. Non-traded REITs are permitted to continue offering shares after a 20D Amendment is filed with the SEC and before it is declared effective.

Depending on the nature of the specific REIT—UPREIT, DownREIT, listed, non-traded, equity, mortgage, externally managed, internally managed, etc.—there are additional necessary disclosures under the SEC’s Industry Guide 5. In July 2013, the SEC issued guidance regarding disclosure by non-traded REITs, particularly the applicability of certain provisions of Industry Guide 5.

The SEC’s Industry Guide 5 also includes requirements regarding sales literature. In particular, Item 19.D of Industry Guide 5 provides that “any sales material that is intended to be furnished to investors orally or in writing . . . should be submitted to the staff supplementally, prior to its use.” Pursuant to SEC Staff guidance, if the Staff does not comment on submitted sales literature within 10 calendar days, it may be used by the non-traded REIT. Further, many states have codified the requirement for non-traded REITs to submit sales literature to the states prior to use. Finally, it is best practice for broker-dealers selling non-listed REIT securities to submit sales literature to FINRA and receive a “no objections” notice for use of such sales literature.

What is a limited partnership roll-up transaction?

In the late 1980s, the management of a number of finite life entities, whether public or private, decided to convert their entities into, or to cause interests in such entities to be exchanged for securities of, publicly traded perpetual life REITs. Typically, these transactions involved a number of these entities being “rolled up” into one publicly traded REIT. The SEC saw a number of conflicts and abuses arising from this process. In response, the SEC issued rules on “roll-up transactions,” and, in 1993, Congress enacted Section 14(h) and related provisions of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and the Financial Industry Regulatory Authority (“FINRA”) also issued rules governing the responsibilities of broker-dealers in roll-up transactions. In addition, the Statement of Policy Regarding Real Estate Investment Trusts (the “NASAA REIT SOP”) adopted by the North American State Securities Administrators Association (“NASAA”) included restrictions regarding roll-up transactions in the NASAA REIT SOP when it was initially adopted in 1993.

Federal Roll-Up Rules

Section 14(h)(4) of the Exchange Act defines a limited partnership roll-up transaction as a transaction involving the combination or reorganization of one or more limited partnerships, directly or indirectly, in which, among other things, investors in any of the limited partnerships involved in the transaction are subject to a significant adverse change with respect to voting rights, the term of existence of the entity, management compensation, or investment objectives; and any of such investors are not provided an option to receive or retain a security under substantially the same

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terms and conditions as the original issue. Section 14(h)(5) of the Exchange Act provides that the following transactions are not “limited partnership roll-up transactions”:

- the transaction only involves a limited partnership that retains cash available for distribution and reinvestment in accordance with the SEC requirements;
- in such transaction, the interests of the limited partners are redeemed in accordance with a preexisting agreement for securities in a company identified at the time of the formation of the original limited partnership;
- the securities to be issued or exchanged in the transaction are not required to be, and are, registered under the Securities Act of 1933, as amended (the “Securities Act”);
- the issuers are not required to register or report under the Exchange Act before or after the transaction;
- unless otherwise provided in the Exchange Act, the transaction is approved by not less than two thirds of the outstanding shares of each of the participating limited partnerships and the existing general partners will receive only compensation set forth in the preexisting limited partnership agreements; and
- unless otherwise provided in the Exchange Act, the securities were reported and regularly traded not less than 12 months before the securities offered to investors and the securities issued to investors do not exceed 20% of the total outstanding securities of the limited partnership.

See also Item 901 of Regulation S-K.

If the transaction is a limited partnership roll-up not entitled to an exemption from registration, in addition to the requirements of Form S-11 and SEC Industry Guide 5 (see “What is Form S-11?” and “What is Industry Guide 5?” above), Section 14(h) of the Exchange Act and Items 902 through 915 of Regulation S-K will require significant additional disclosure on an overall and per partnership basis, addressing changes in the business plan, voting rights, form of ownership interest, the compensation of the general partner or another entity from the original limited partnership, additional risk factors, conflicts of interest of the general partner and statements as to the fairness of the proposed roll-up transaction to the investors, including whether there are fairness opinions, explanations of the allocation of the roll-up consideration (on a general and per partnership basis), federal income tax consequences and pro forma financial information. Because of the significant additional disclosure burdens, most sponsors seek to enable any potential roll-up transaction to qualify for an exemption from registration under the Securities Act.

State Roll-Up Rules (Non-Traded REITs)

The NASAA REIT SOP imposes significant requirements with respect to the entry into a roll-up transaction by a non-traded REIT. The NASAA REIT SOP defines a roll-up transaction as a transaction involving the acquisition, merger, conversion or consolidation, directly or indirectly, of the REIT and the issuance of securities of an entity that would be created or would survive after the successful completion of the transaction (referred to as the “roll-up entity”), but excluding:

- a transaction involving securities of the REIT that have been listed on a national securities exchange for at least 12 months; or
- a transaction involving the conversion to corporate, trust or association form of only the REIT if, as a consequence of the transaction, there will be no significant adverse change in:
  - stockholder voting rights;
  - the term of the REIT’s existence;
  - compensation to the REIT’s external advisor; or
  - the REIT’s investment objectives.

Among other protections, an appraisal of the REIT’s assets as of a date immediately prior to the announcement of the proposed roll-up transaction must be obtained from an independent expert in connection with any roll-up transaction. In addition, stockholders who vote against any proposed roll-up transaction must be given the choice of (i) accepting the securities of the roll-up entity or (ii) either (a) remaining as stockholders of the REIT and preserving their interests therein on the same terms and conditions as existed previously or (b) receiving cash in an amount equal to their pro rata share of the appraised value of the net assets of the REIT.

Further, non-traded REITs are prohibited from participating in any roll-up transaction: (i) that would result in the REIT’s stockholders having voting rights in a roll-up entity that are less than those provided in the REIT’s charter, (ii) that includes provisions that would operate to materially impede or frustrate the accumulation of shares by any purchaser of the securities of the roll-up entity, except to the minimum extent necessary to preserve the tax status of the roll-up entity, or which would limit the ability of an investor to exercise the voting rights of its securities of the roll-up entity on the basis of the number of shares held by that investor, (iii) in which an investor’s rights to access of records of the roll-up entity will be less than those provided in the REIT’s charter or (iv) in which any of the costs of the roll-up transaction would be borne by the REIT if the roll-up transaction is not approved by at least a majority of the REIT’s outstanding shares.

Are there any specific FINRA rules that affect REITs?

FINRA rules regulate the activities of registered broker-dealers. As with any offering of securities of a non-REIT, a public offering by a REIT involving FINRA members requires the FINRA member to comply with FINRA Rule 5110, known as the “Corporate Financing Rule.” In
addition to Rule 5110, a public offering by a non-traded REIT must comply with FINRA Rule 2310.4

Rule 2310 prohibits members and persons associated with members from participating in a public offering of a non-traded REIT unless the specific disclosure requirements and organization and offering expense limitations of Rule 2310 are satisfied. Rule 2310 requires firms, prior to participating in a public offering of a non-traded REIT, to have reasonable grounds to believe that all material facts are adequately and accurately disclosed and provide a basis for evaluating the offering. The rule enumerates specific areas to be reviewed by the member, in particular compensation, descriptions of the physical properties, appraisal reports, tax consequences, financial stability and experience of the sponsor and management, conflicts of interest and risk factors. A member may not submit a subscription on behalf of a prospective investor unless the prospective investor is informed about the liquidity and marketability of the investment. In addition, if the sponsor has offered prior programs or non-traded REITs with respect to which a date or time period at which the program or REIT might be liquidated was disclosed in the offering materials, then the prospectus for the current non-traded REIT offering must include information about whether the prior program(s) or REIT(s) in fact liquidated on or around that date or during that time period. Under Rule 2310, the total amount of underwriting compensation (as defined and determined under FINRA rules) shall not exceed 10% of the gross proceeds of the offering (not including proceeds from the sale of shares pursuant to a distribution reinvestment plan), and the total organization and offering expenses, including all expenses in connection with the offering, shall not exceed 15% of the gross proceeds of the offering. Rule 2310 also identifies, and imposes limitations and restrictions with respect to, non-cash compensation.

Rule 2310 and FINRA Rule 2340 prohibit members from participating in a public offering by a non-traded REIT unless the REIT agrees to disclose a per share estimated value in its periodic reports. FINRA permits a “net investment” value to be used until up to 150 days after the second anniversary of breaking escrow in the initial public offering. The “net investment” value is the offering price less upfront selling commissions and fees as well as issuer organization and offering expenses. FINRA permits an “appraised value” to be used at any time and requires it to be used when the net investment value is no longer permitted. The “appraised value” is a value determined at least annually by or with the material assistance of an independent valuation firm and derived from a methodology that conforms to standard industry practice. Rule 2340 also requires members to include certain disclosure on customer account statements, including disclosure concerning the illiquidity of an investment in a non-traded REIT. As with the SEC and exchange rules, FINRA Rule 2310 also contains detailed rules on compliance in connection with limited partnership roll-up transactions.

All REIT offerings are excluded from FINRA Rule 5121, which restricts member firms’ participation in an entity’s public offering when the member has a conflict of interest.

What are common examples of non-GAAP financial measures used by REITs?

Common examples of non-GAAP financial measures used by REITs include:

- funds from operations (“FFO”) as defined by the National Association of Real Estate Investment Trusts, the leading industry trade group for REITs (“Nareit”), and variations of FFO, such as adjusted FFO (“AFFO”), core FFO and normalized FFO;
- earnings before interest, taxes, depreciation and amortization (“EBITDA”) and variations of EBITDA, such as EBITDAre, adjusted EBITDA and core EBITDA;
- net operating income (“NOI”), cash NOI and same-store NOI;
- core earnings or adjusted earnings (for mortgage REITs);
- cash or funds available for distribution (“CAD” or “FAD,” respectively); and
- net debt or core debt.

In addition, many REITs use one or more non-GAAP financial measures in certain ratios, including to show their leverage (e.g., net debt to adjusted EBITDA), ability to cover interest expense (e.g., adjusted EBITDA divided by cash interest expense) and ability to cover fixed charges (e.g., adjusted EBITDA divided by fixed charges).

Are there industry standards applicable to non-GAAP financial measures used by REITs?

FFO

In 1991, Nareit published a white paper on FFO in order to promote a uniform, widely accepted standard measure of REIT operating performance. The FFO white paper was supplemented over the years and, in December 2018, was restated to consolidate Nareit’s prior guidance (see the 2018 restatement of Nareit’s FFO white paper). The primary reason that Nareit developed FFO as a supplemental performance measure was “to address the artificial nature of historical cost depreciation and amortization of real estate and real estate-related assets mandated by GAAP.” In addition, Nareit-defined FFO excludes gains or losses on the sale of certain real estate assets, as well as impairment write-downs of certain real estate assets, which  

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4 FINRA Rule 2310 applies to direct participation programs and non-traded REITs. Under Rule 2310(a)(4), a “direct participation program” is a program that provides for flow-through tax consequences regardless of the structure of the legal entity or vehicle for distribution or industry. REITs are excluded from the definition of a “direct participation program.”
improves the comparability of companies’ period-over-period results.

FFO is defined by Nareit as net income (computed in accordance with GAAP), excluding:

- depreciation and amortization expenses related to real estate;
- gains and losses from the sale of certain real estate assets;
- gains and losses from change in control; and
- impairment write-downs of certain real estate assets and investments in entities when the impairment is directly attributable to decreases in the value of depreciable real estate held by the entity.

The reconciling items should include amounts to adjust earnings from consolidated partially-owned entities and equity in earnings of unconsolidated affiliates to FFO, or such adjustments could be presented as a single line item. Nareit’s definition does not specify whether FFO should be presented as FFO attributable to common stockholders or FFO attributable to all common equity holders (i.e., common stockholders and outside limited partners of a REIT’s operating partnership). REITs should be mindful that they accurately and appropriately label FFO and variations of FFO to reflect the securities to which the reported measure is applicable, which has been a subject of SEC comment letters. For example, UPREITs with outside limited partners should specify whether FFO is presented as “FFO attributable to common stockholders and OP unitholders” or “FFO attributable to common stockholders.”

Many REITs also present additional variations of FFO, such as AFFO and core FFO, in order to show a more consistent comparison of operating performance over time or to report a metric that better explains their dividend policies. These metrics may adjust for additional items such as straight-line rent, non-cash stock-based compensation expense, gains/losses on early extinguishment of debt, capital expenditures and acquisition and pursuit costs. However, there are not uniform approaches to the labeling of, or the adjustments included in, such variations of FFO.

**EBITDAre**

Similar to its white paper on FFO, in September 2017, Nareit published a white paper to create a uniform definition of EBITDA for real estate (“EBITDAre”). Similar to FFO, in order to improve the comparability of REITs’ period-over-period performance, EBITDAre includes adjustments for gains/losses on the disposition of depreciated property and impairment write-downs of depreciated property. Nareit defines EBITDAre as net income (computed in accordance with GAAP), plus:

- interest expense;
- income tax expense;
- depreciation and amortization expense;
- losses (or minus gains) on the disposition of depreciated property, including losses/gains on change of control;
- impairment write-downs of depreciated property and of investments in unconsolidated affiliates caused by a decrease in value of depreciated property in the affiliate; and
- adjustments to reflect the entity’s share of EBITDAre of unconsolidated affiliates.

For additional information, see Nareit’s EBITDAre white paper.

For more information regarding the most commonly used non-GAAP measures presented by REITs, see our publication entitled “Frequently Asked Questions about Non-GAAP Measures for REITs.”

**What are the stock exchange rules applicable to LISTED REITs?**

REITs seeking to be listed on a securities exchange like the NYSE or NASDAQ are generally subject to the same rules as non-REITs. However, for a REIT that does not have a three-year operating history, the NYSE will generally authorize listing if the REIT has at least $60 million in stockholders’ equity, including the funds raised in any IPO related to the listing. For more information regarding the stock exchange listing requirements for traded REITs, see our publication entitled “REIT IPOs – A Quick Guide.”

In addition, NASDAQ Rule 5210(h) provides that securities issued in a limited partnership roll-up transaction are not eligible for listing unless, among other conditions, the roll-up transaction was conducted in accordance with procedures designed to protect the rights of limited partners as provided in Section 6(b)(9) of the Exchange Act (which section was adopted at the same time as Section 14(h) and requires exchanges to prohibit listing securities issued in a roll-up transaction if the procedures are not satisfied), a broker-dealer that is a member of FINRA participates in the roll-up transaction, and Nasdaq receives an opinion of counsel stating that the participation of that broker-dealer was conducted in compliance with FINRA rules. NYSE Manual Section 105 contains similar provisions regarding the listing of securities issued in a limited partnership roll-up transaction.

**Are there any recent corporate governance issues that are specific to public REITs incorporated in Maryland?**

Public REITs confront many of the same corporate governance issues that confront other public companies, such as majority voting in director elections, proxy access (i.e., allowing stockholders to include a nominee for director in a company’s proxy materials) and gender diversity on boards of directors. However, public REITs that are incorporated in Maryland (as most REITs are) are also subject to certain corporate governance issues that are specific to REITs.
Beginning with the 2017 proxy season, Institutional Shareholder Services Inc. (“ISS”) began recommending against incumbent directors on a company’s governance committee if there were any undue restrictions on the stockholders’ right to amend the bylaws. Under the MGCL, the charter or bylaws of a Maryland corporation can vest the power to amend the bylaws solely with its board of directors, while Delaware law requires that, in addition to the board of directors, stockholders have the right to amend the bylaws of a Delaware corporation. Until ISS’s policy change, this issue was uncontroversial, and the vast majority of public Maryland REITs gave their boards the exclusive or near-exclusive power to amend the bylaws. Since this policy change, some REITs adopted the ISS position in order to avoid a negative voting recommendation from ISS, while other REITs either took no action or adopted a compromise position (e.g., allowing a stockholder, or a group of up to 20 stockholders, to amend the bylaws but requiring the stockholder or group to maintain a minimum ownership percentage of 1% or 3% for a holding period of one to three years) due to, among other reasons, that, while directors owe duties to the corporation, stockholders do not have a duty to take action which is in the best interests of a company. ISS will recommend a withhold vote for directors serving on the Nominating and Corporate Governance Committee at companies that have restrictions greater than those imposed by Rule 14a-8 under the Exchange Act (i.e., ownership of at least $2,000 of a company’s stock for one year), but certain institutional investors have been willing to accept some form of a compromise position. On the other hand, many Maryland companies continue to vest in their boards of directors the exclusive power to amend their bylaws.

Subtitle 8 of Title 3 of the MGCL (“Subtitle 8”) permits the board of directors of a Maryland corporation to classify (i.e., stagger) the board of directors without stockholder approval, as well as to elect to be subject to certain other statutory provisions, as long as the corporation has a class of equity securities registered under the Exchange Act and at least three independent directors. A classified board is a board of directors that is comprised of different classes of directors, each of which has different service terms—for example, one-third of the directors on a classified board would stand for election each year, whereas all directors of a non-classified board stand for election each year. The ability to classify the board of directors quickly and without stockholder approval provides an important protection against a hostile proxy contest — indeed, it slows the pace of a hostile stockholder by preventing it from replacing the entire board of directors at a single stockholders’ meeting. Classified boards, however, are almost universally viewed unfavorably by proxy advisors, institutional investors and activists that believe classified boards contribute to director entrenchment and result in less accountability to stockholders because not all directors stand for re-election in a given year. As a result, some public REITs (particularly lodging and gaming REITs) have received stockholder proposals or other pressure to permanently opt out of Subtitle 8 (i.e., agreeing that they will not opt into Subtitle 8 in the future without stockholder approval). In addition, REITs seeking to go public increasingly have been opting out of Subtitle 8.

Are REITs considered “alternative investment funds” subject to the European Union’s Alternative Investment Fund Managers Directive?

Any REIT, whether traded or non-traded, conducting a securities offering in the European Economic Area should evaluate whether it may be considered an alternative investment fund (“AIF”) subject to the European Union’s Alternative Investment Fund Managers Directive (“AIFMD”). Although the AIFMD was intended to regulate private funds, such as hedge funds, the AIFMD defines “alternative investment fund” quite broadly to include any number of collective investment vehicles with a defined investment strategy. There is no exemption for U.S. REITs or for SEC-registered securities. As a result, any REIT that would like to offer its securities in European jurisdictions should assess whether it is an AIF, in which case it would be subject to certain disclosure and compliance requirements, or an “operating company,” which is not an AIF. Mortgage REITs and externally managed REITs are more likely to be AIFs than equity REITs and internally managed REITs, but each REIT is different, and all facts and circumstances should be assessed in making the AIF determination.

NON-TRADED REITS

What is a non-traded REIT?

“Non-traded REITs” are REITs that have offered securities to the public pursuant to the Securities Act and are subject to the ongoing disclosure and other obligations of the Exchange Act, but are not listed on a national securities exchange. Most non-traded REITs are externally managed.

Non-traded REITs are generally characterized as “finite life” or “perpetual life.” Finite life REITs are REITs that plan to consider and execute a liquidity event (such as a listing, merger or liquidation) during a predetermined window. Many non-traded REITs that have adopted a finite life strategy disclose in the prospectus for their public offerings that they plan to consider a liquidity event within a certain number of years following their capital raise, and are bound by such liquidity event deadlines in their governing documents. Perpetual life REITs do not have a targeted liquidity date, raise capital through multiple continuous public offerings and provide liquidity to investors through their share repurchase programs. Many perpetual life REITs allocate a portion of their portfolios to listed REIT shares and other real estate-related securities in order to maintain liquidity to support their share repurchase programs.
Non-traded REITs typically structure their public offerings as blind pool offerings (see “What is a blind pool REIT offering?” above). The public offerings are “best efforts” offerings, meaning that participating broker-dealers do not make a firm commitment to distribute any portion of the offering, but rather agree to use their best efforts to distribute the offering. In addition, the initial public offering of a non-traded REIT is structured as a minimum/maximum offering, meaning that the REIT establishes a maximum offering amount, and a minimum threshold amount must be subscribed for before the REIT can break escrow and close on the sales. Once the minimum is met and escrow has broken, a non-traded REIT is able to continuously raise and deploy capital (for up to three and a half years from the date the offering becomes effective with the SEC) and may raise additional capital in successive follow-on offerings.

In the absence of a trading market, how is the value of non-traded shares determined?

Although not subject to market pricing, most non-traded REITs have adopted the practice of determining the per share net asset value (“NAV”) of their shares on a regular basis (after selling shares at a price arbitrarily determined by the board of directors for some period following the commencement of the initial public offering). These NAV determinations provide investors with greater transparency regarding the value of their investment and may be made on a daily, monthly, quarterly or annual basis, typically with the assistance of an independent valuation firm and in accordance with the provisions of Practice Guideline 2013-01, Valuations of Publicly Registered Non-Listed REITs, issued by the Institute for Portfolio Alternatives in April 2013.

How do holders of non-traded REIT shares obtain liquidity for their shares?

Non-traded REITs are generally considered illiquid because there is not an active secondary trading market for non-traded REIT shares. However, in addition to potential liquidity events for finite life non-traded REITs, non-traded REITs may provide liquidity to their investors (in most cases, investors who have held their shares for at least one year) through share repurchase programs. These programs are subject to certain restrictions and limitations – share repurchase programs for perpetual life non-traded REITs typically cap repurchases at 20% of the REIT’s NAV on an annual basis, and finite life non-traded REITs typically cap repurchases at 5% of the number of the REIT’s outstanding shares of common stock as of the most recent calendar year end. Most share repurchase programs are funded with proceeds received from the issuance of shares under the non-traded REIT’s distribution reinvestment plan.

Are REIT securities offerings subject to review by state securities regulators?

It depends. Prior to the enactment of the National Securities Market Improvement Act of 1996 (the “NSMIA”), state securities regulators retained concurrent authority with the SEC to regulate securities offerings conducted in their respective states. As a result of the enactment of the NSMIA, the nature of the states’ regulation over certain securities offerings was modified. In particular, the NSMIA’s amendments to Section 18 of the Securities Act provided for federal preemption of the states “Blue Sky” registration and oversight of “covered securities,” which includes, among others, securities that are listed or authorized for listing on a national securities exchange. Consequently, offerings by listed REITs are not subject to review by state securities regulators.

Unlike public offerings by listed REITs, however, public offerings conducted by non-traded REITs are subject to significant oversight and regulation by the states, which require non-traded REIT offerings to comply with applicable state Blue Sky rules and regulations, which are based substantially upon the NASAA REIT SOP. The states impose restrictions and limitations with respect to various matters, including governance, stockholder rights, investments, leverage, related party transactions and the compensation paid to the REIT’s external advisor. In addition to standard disclosure requirements, a number of states undertake a merit review of the offering. Generally, state registrations expire each year, and a non-traded REIT is required to renew its state registrations on an annual basis in all states in which it is offering securities. In addition, broker-dealers transacting in securities of non-traded REITs are subject to additional FINRA rules, as described under “Are there any specific FINRA rules that affect REITs?” above.

MORTGAGE REITS

What are common investment strategies for mortgage REITs?

Mortgage REITs currently generally have one of the following three investment strategies:

- **Arbitrage** – these REITs acquire government backed mortgage securities and other high quality mortgage securities with leverage. The mortgage securities are good REIT assets, and the REITs earn an arbitrage spread. The assets can be residential mortgage-backed securities (RMBS) and, in some cases, commercial mortgage-backed securities (CMBS).

- **Operating** – these REITs originate and/or acquire residential, commercial mortgage, mezzanine or other loans. They use a taxable REIT subsidiary (“TRS”) for non-qualifying activities, such as servicing. These REITs may securitize the mortgages to enhance returns. For more information regarding TRSs, see “What is a taxable REIT subsidiary?” below.
• **Distressed** – These REITs invest in distressed mortgages, which can be somewhat tricky for a REIT because of the foreclosure property rules (see “Under what other circumstances can a REIT be subject to federal income tax?” below). In general, a REIT can foreclose on a mortgage and, for a temporary period, can earn income on the foreclosed real estate, which can pass through to stockholders. The REIT, however, cannot take advantage of the foreclosure property rules if it has acquired the mortgage with intent to foreclose. Accordingly, these REITs will have to make decisions about which mortgages to purchase. Alternatively, they can acquire the properties in a TRS to avoid foreclosure property issues.

What other regulatory compliance obligations may mortgage REITs have?

Mortgage REITs are subject to the lending requirements of Fannie Mae and Freddie Mac and general mortgage lending laws and regulations, such as the Dodd-Frank Wall Street Reform and Consumer Protection Act, Home Ownership and Equity Protection Act of 1994, Housing and Recovery Act 2008, Truth in Lending Act, Equal Credit Opportunity Act, Fair Housing Act, Real estate Settlement Procedures Act, Home Mortgage Disclosure Act and Fair Debt Collection Practices Act. In addition, mortgage REITs must continually assess the availability of exemptions from the Investment Company Act. See “Are there Investment Company Act considerations in structuring and operating a REIT?” above.

PRIVATE REITS

How are private REITs established?

A REIT, like any other company, may issue equity securities without registration under the Securities Act if there is an available exemption from registration, such as Section 4(a)(2) of the Securities Act (often in accordance with Regulation D) or Regulation S or Rule 144A under the Securities Act. Private REITs are commonly used in private equity and other private real estate investment structures and by public REITs in joint ventures in order to allow beneficial tax treatment for investments in real estate by certain types of investors, including non-taxable U.S. investors, such as public pension funds, and foreign investors, including sovereign wealth funds, among others.

Are there constraints on private REITs that are not relevant for public REITs?

Yes. Private REITs are subject to restrictions on how many stockholders they may have even though they must have at least 100 holders. For example, Section 12(g) of the Exchange Act requires a company to register under the Exchange Act and be subject to its periodic reporting and other obligations if it has at least 2,000 stockholders of record or 500 stockholders who are not accredited investors, and the Investment Company Act requires registration of investment companies that have more than 100 holders who are not qualified purchasers unless another exemption (such as under Section 3(b) or Section 3(c) of the Investment Company Act) is available.

Further, while the Protecting Americans from Tax Hikes Act of 2015 (the PATH Act), passed by Congress on December 18, 2015, repealed the preferential dividend rule with respect to REITs that file annual and periodic reports with the SEC under the Exchange Act, the preferential dividend rule continues to apply to private REITs. Therefore, distributions that are not made (i) pro rata, (ii) with no preference to any share of stock as compared with other shares of the same class and (iii) with no preference to one class of stock as compared to another class except to the extent the former is entitled to such preference, will be considered “preferential dividends,” in which case, the entire amount of such dividend would be ineligible for the dividends paid deduction and for consideration in determining if the REIT met the 90% distribution test.

In addition, the equity securities of private REITs are not traded on public stock exchanges and generally have less liquidity than those of listed public REITs. However, many private REITs offer their equity holders some form of interim liquidity similar to non-traded REITs.

Can a private REIT satisfy the ownership and holder requirements?

Yes. In a typical private REIT structure, one or a handful of stockholders may own all the common stock, while a special class of preferred shares may be owned by at least 100 holders in order to satisfy the requirement of having at least 100 stockholders. A private REIT also must satisfy the 5/50 test, but, in most cases, it is not an issue because the holders of shares in the private REIT will be corporations or partnerships with many investors. The 5/50 test is applied by looking through those entities to their investors. Special considerations can apply when direct or indirect stockholders are tax-exempt.

How do private REITs comply with the ownership and holder requirements?

If there are no willing “friends and family,” there are companies that provide services to help a private REIT fulfill the 100 stockholder requirement. They may also provide administrative services relating to the ownership and holder requirements, such as maintaining the stockholder base, creating and maintaining all stockholder records and keeping track of the ownership changes.

TAX MATTERS

What are the tax benefits of qualifying as a REIT?

The primary tax benefits of qualifying as a REIT are: (1) the REIT generally is not subject to tax on its income and gain to
the extent it annually distributes all such income and gain
(as a result of the dividends paid deduction to which a REIT
generally is entitled upon the payment of dividends); and
(2) non-corporate stockholders of a REIT generally are
entitled to a 20% deduction on ordinary dividends received
from a REIT.

How is REIT status elected?
A REIT election is made by filing a tax return on a
Form 1120-REIT for the first year for which REIT status is
desired (if an extension is filed, the extension must indicate
that REIT status will be elected).

How is REIT status lost or revoked?
REIT status is lost if there is a failure to meet one or more of
the REIT requirements (described below), and no exception
to disqualification or ability to cure such failure is available.
REIT status also can be revoked voluntarily by filing a
statement to that effect with the IRS, provided such
revocation occurs on or before the 90th day of the taxable
year for which the revocation is to be effective.

What are the consequences of losing or revoking REIT
status?
For any taxable years for which REIT status has been lost or
revoked, the entity will be subject to tax as a domestic
corporation. Additionally, the entity (and certain successor
tentities) may not re-elect REIT status until the fifth taxable
year after which REIT status was lost or revoked (unless, in
the case of a loss of REIT status, such loss was not due to
willful neglect or fraud).

What are the REIT asset test requirements and restrictions
on ownership of securities?
The REIT asset tests (including the REIT securities
ownership restrictions) are tested as of the last day of each
calendar quarter of the REIT’s taxable year (March 31,
June 30, September 30, and December 31). A REIT that is a
partner in a partnership generally will be treated as owning
its proportionate share of the assets of the partnership based
on the REIT’s capital interest in the partnership.

- **Real estate asset requirement** – At least 75% of the
gross value of the REIT’s assets must consist of interests in
real property, mortgages, shares in other qualified REITs,
debt instruments of publicly offered REITs, cash and cash
equivalents, government securities and certain receivables.
REITs also may own certain stock and debt acquired with
certain new capital for the first year after such capital was
obtained, which assets will qualify as “good” assets for
purposes of the 75% test.

- **Securities ownership restrictions** – A REIT may not
own the following securities (generally excluding securities
that do qualify for purposes of the 75% asset test):
(i) securities of TRSs that represent more than 20% of the
value of the REIT’s total assets; (ii) securities (other than
securities of a TRS) that represent more than 10% of the

value or vote of any issuer (other than, in the case of value
only, certain specific securities, including “straight debt,”
individual debt and rent receivables); and (iii) securities
(other than securities of a TRS) of any one issuer
representing more than 5% of the value of the REIT’s total
assets. Additionally, not more than 25% of the REIT’s total
assets may consist of debt (other than mortgages) of publicly
offered REITs (which otherwise qualify under the REIT 75% asset test).

- **Asset values and subsequent changes in asset values** – REITs use various methods to determine the
values of their assets under the foregoing rules. The REIT
requirements expressly respect the good faith value
determinations of the directors or trustees of a REIT. A
REIT generally will not fail the asset tests solely as a result of
fluctuations in the values of its assets (and not attributable
to the acquisition of any additional asset).

What ability does a REIT have to cure an asset test
violation?
Upon a failure of any of the asset tests (other than de minimis failures of the 5% or 10% securities ownership
restrictions, described below), REIT status will not
terminate, provided: (i) the REIT files with the IRS a
schedule describing the assets resulting in such failure;
(ii) the failure was due to reasonable cause; (iii) the failure is
corrected within 6 months of discovery; and (iv) the REIT
pays a penalty of $50,000 or, if greater, the highest
corporate tax rate generally multiplied by the net income
generated by the assets causing the failure.

- **De minimis failure of 5% or 10% securities ownership restriction** – Additionally, upon a failure of
the 5% or 10% securities ownership restrictions, REIT status
will not terminate if: (i) the failure is due to ownership of
assets valued at the lesser of (a) 1% of the REIT’s total assets
or (b) $10,000,000; and (ii) the failure is cured within 6
months.

What are the REIT income test requirements?
For each taxable year, a REIT must satisfy the following
two gross income tests. A REIT that is a partner in a
partnership generally will be treated as earning a
proportionate share of each item of partnership gross
income, based on its capital interest in the partnership.

- **75% Income Test** – A REIT must derive at least 75% of its
annual gross income (excluding income from prohibited
transactions, discussed below) from “rents from real
property,” qualifying interest on mortgages (and amounts
paid for entering into agreements to make such loans or to
purchase or lease real property or mortgages), gains from
the sale of real property or mortgages not held as a “dealer,”
dividends and gain with respect to other REIT stocks not
held as a “dealer,” income attributable to stock or debt
instruments from the investment, for up to one year, of
pursuant to a DRIP) or (ii) publicly offered debt with
• **95% Income Test** – At least 95% of the REIT’s annual gross income (excluding income from prohibited transactions, discussed below) must consist of items qualifying under the 75% test, plus dividends, non-mortgage interest income and gains from sales of stock or securities not held as a “dealer.”

What are the consequences of a REIT failing one or more of the REIT qualification requirements?

Generally, if a REIT fails any of the above requirements for qualification as a REIT, and no exception applies, its REIT status will terminate for the taxable year of the failure, and the REIT (and certain successor entities) may not re-elect REIT status until the fifth taxable year after which REIT status was lost or revoked (unless the loss of REIT status was not due to willful neglect or fraud). However, an entity’s REIT status will not terminate if any such failure is due to reasonable cause and the REIT pays the applicable penalty for such failure ($50,000 for failures of requirements other than the asset and income tests and formulaic penalties for failures of the asset and income tests).

A failure of either the 75% or 95% gross income tests will not result in termination of REIT status, provided (i) the failure was due to reasonable cause; and (ii) the REIT files with the IRS a schedule describing each item of its gross income qualifying under those tests. Additionally, the REIT will be required to pay a penalty equal to the amount by which it failed the relevant test or tests, multiplied by a fraction that is intended to reflect the REIT’s overall profitability.

What are the requirements to qualify as “rents from real property”?

Subject to the exceptions below, amounts generally will qualify as “rents from real property” if they are attributable to the use of, or the right to use, real property of the REIT, and personal property leased in connection with real property, provided not more than 15% of the rent under any lease for any year is attributable to personal property.

Payments received from hotel guests and residents of healthcare or nursing/long-term care facilities will generally not qualify as “rents from real property,” since the portion of the payments attributable to services provided are so significant relative to the portion for the mere use of space (see “How can a REIT earn qualifying ‘rents from real property’ from hotels or healthcare facilities?” below).

What types of rents do not qualify as “rents from real property”?

Subject to certain limited exceptions, the following do not qualify as “rents from real property”:

- Rents from personal property leased with real property, if the personal property exceeds 15% of the total rent;
- Rents based, in whole or in part, on the income or profits derived by any person from the property, e.g., a percentage of the net (as opposed to gross) income of a tenant;
- Rents from any person in which the REIT owns, actually or constructively, a 10% interest; and
- Rents from any property if the REIT provides services to the tenants, other than (i) services not rendered primarily for the benefit of or those customarily provided in connection with the leasing of space for occupancy only (such as heat, lighting, common area maintenance, etc.), which services may be provided directly by the REIT; (ii) services provided through an “independent contractor” from whom the REIT does not derive or receive any income (provided separately charges are imposed on the tenant for non-customary services); or (iii) services provided through a TRS (regardless of whether separate charges are imposed).

What is a Taxable REIT Subsidiary?

A taxable REIT subsidiary (“TRS”) is a corporation that is owned directly or indirectly by a REIT and has jointly elected with the REIT to be treated as a TRS for tax purposes. A TRS is subject to regular corporate income tax.

The primary function of a TRS is to engage in activities and/or earn income or gain that could not be earned by the REIT itself without resulting in negative tax consequences to the REIT or even potential REIT disqualification. Any transactions between a REIT and its TRS must be on arms-length terms, and a TRS must be adequately compensated for any services it provides for the REIT or its tenants.

Some examples of how a TRS may be utilized include:

- the lease by a REIT of lodging or healthcare properties to its TRS (as described below), which, if operated by or on behalf of the REIT itself, would generate non-qualifying REIT income;
- the provision by a TRS of certain impermissible services to tenants of the REIT, which, if provided directly by the REIT, could result in the disqualification of some or all of the rental income earned by the REIT from such tenants;
- the holding and sale by a TRS of property that, in the hands of the REIT, could be characterized as “dealer property,” the gain on which would be subject to a 100% prohibited transactions tax; and
- earning certain mortgage servicing fees that would be non-qualifying income in the hands of the REIT.
How can a REIT earn qualifying “rents from real property” from hotels or healthcare facilities?

A REIT can lease to its TRS a “qualified lodging facility” or a “qualified healthcare property.” A The rents earned by the REIT can be qualifying rents from real property even though the REIT owns in excess of 10% of the TRS. However, all of the other exclusions to “rents from real property” will apply to these TRS leases (including the exclusion of rents based on net income and rents attributable to personal property that exceed 15% of total rents).

Are there any special requirements in order for rents from these leases to qualify?

The lodging or healthcare facility must be managed by a third-party contractor that is in the business of managing these properties for others. Additionally, as with any other transactions between a REIT and its TRS, the terms of the lease must be arms-length.

What are the REIT distribution requirements?

A REIT generally is required to distribute to its stockholders at least 90% of its ordinary taxable income each year. A REIT generally will be subject to corporate income tax on income or gain not currently distributed to its stockholders. As a result, many REITs distribute 100% of their ordinary taxable income each year.

When must a REIT make these required distributions?

A REIT generally must make these required distributions during the taxable year in which the relevant income is earned. However, there are two circumstances in which a REIT can make such required distributions in the subsequent taxable year:

- **January Dividends** – Any dividends declared in the 4th quarter of a year, payable to stockholders of record on a date during that quarter, and distributed during January of the following year, will be treated, for all purposes, as having been paid on December 31 of the year declared.

- **Subsequent-Year Dividends** – Additionally, a REIT may declare and pay dividends in a subsequent taxable year, and elect to treat such dividends as having been paid in the prior year for purposes of the REIT distribution requirements, provided the dividend is (i) declared prior to the due date for the filing of the REIT’s return for the prior year and (ii) actually paid during the subsequent year, as part of or prior to the first regular dividend payment made after such declaration. These dividends are treated as paid by the REIT in the prior year, but as received by the stockholders in the year actually paid. A REIT will be subject to a 4% excise tax to the extent these subsequent-year dividends exceed the sum of 15% of the REIT’s ordinary taxable income for the prior taxable year, plus 5% of its capital gain net income for such year.

Can a REIT satisfy its distribution requirements without making cash payments?

- **Consent Dividends** – A REIT can satisfy its distribution requirements on a non-cash basis with respect to common stockholders who consent to be treated as having received a dividend in a specified amount. Assuming the dividend would have otherwise been qualifying if paid in cash, the REIT will be treated as having actually distributed such dividend on the last day of its taxable year, with a deemed contribution of such dividend by the stockholders back to the REIT. Practically, this option likely is not viable for a public or widely held non-traded REIT.

- **Stock Dividends** – Under certain circumstances, a REIT can satisfy all or a portion of its distribution requirement through the distribution of its own stock.

Are there any restrictions on the manner in which these distributions are made?

Dividends paid by a REIT, other than a public REIT, must not be preferential as to amount or timing, as between stockholders of the same class of stock, or as between stockholders of different classes of stock, other than pursuant to the dividend rights of each class. Consent dividends, described above, will not be preferential solely because some stockholders consent to such a deemed dividend and others actually receive money or other property.

Under what other circumstances can a REIT be subject to Federal income tax?

A REIT is subject to a 100% tax on any gain from the sale of property it held for sale in the ordinary course of its business (i.e., dealer property), unless a safe-harbor exception applies (which requires, among other things, that the REIT has held the property for at least 2 years and, if real property, 2 years for the production of income). Additionally, a REIT that acquires built-in gain assets (i.e., assets with a value in excess of basis) from a “C” corporation in certain tax-free transactions generally is subject to tax on the gain recognized on the subsequent disposition of such asset within 5 years from the date of acquisition.

How are REIT stockholders taxed on REIT distributions?

- **Distributions of E&P** – Distributions to the extent of a REIT’s earnings and profits (“E&P”) generally will be taxable income to taxable U.S. stockholders (as ordinary income, except to the extent attributable to capital gains that the REIT elects to distribute as capital gains dividends, which generally will be taxable as long-term capital gains).

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5 A “qualified lodging facility” generally includes a hotel or motel or other establishment if (i) more than one-half of the dwelling units are used on a transient basis and (ii) wagering activities generally are not conducted. A “qualified healthcare property” generally includes a hospital, nursing facility, assisted living facility, congregate care facility, qualified continuing care facility (as defined in Section 7872(g)(4) of the Code), or other licensed facility that extends medical or nursing or ancillary services to patients.
Additionally, non-corporate shareholders generally will be entitled to a 20% deduction against the amount of ordinary dividends received from a REIT.

- **Distributions in Excess of E&P** – To the extent REIT distributions exceed its E&P, they will be treated as a non-taxable return of capital to the stockholders, to the extent of their basis in their REIT stock, and as capital gain to the extent such non-E&P distributions exceed their basis in their REIT stock.

What are the tax benefits of contributing property to an Operating Partnership of an UPREIT?

The contribution of property directly to a REIT generally will be entitled to tax-free treatment only if: (i) the contributor(s) are in “control” of the REIT (generally 80% of both vote and value of all REIT stock) immediately after the contribution transaction; and (ii) the contributions do not result in the diversification of the contributors’ interests (which, subject to certain potential exceptions, generally would result upon a contribution by one contributor of non-identical assets to those already in the REIT, or upon a contribution by two or more contributors of non-identical assets to each other and/or to existing assets in the REIT). See “What are the primary benefits of the UPREIT structure and OP unit transactions?” above and our publication entitled “Frequently Asked Questions about UPREITs and OP Unit Transactions.”

In contrast, a contribution of property to a partnership (including an UPREIT Operating Partnership) generally can be contributed in a tax-free transaction, regardless of the percentage interest in the partnership received in return by the contributors (i.e., no “control” requirement), and, unless the partnership holds mostly stocks and securities, regardless of whether the contributor’s interest becomes diversified as a result of the contribution.

What are the primary tax considerations for Operating Partnership contributors?

The primary tax considerations relevant to a contributor of built-in gain property (and/or property encumbered by liabilities in excess of the tax basis in the property) to an UPREIT Operating Partnership relate to the potential recognition of some or all of that built-in gain either in connection with the contribution transaction itself, or upon a subsequent disposition of the contributed property by the Operating Partnership.

- **Gain Recognition on Contribution** – Recognition of gain on the contribution may result from a number of factors, including (i) the reduction in the contributor’s share of liabilities secured by the contributed property, or of its share of all liabilities of the Operating Partnership relative to its share of liabilities prior to the contribution (since, subject to certain exceptions, such reductions are treated as distributions of money to the contributing partner), and (ii) the distribution of cash or other property by the Operating Partnership that is treated as being part of a “disguised sale” of the contributed property and does not fall within certain exceptions.

- **Gain Recognition on Disposition of Contributed Property** – Upon a taxable disposition of a contributed property by the Operating Partnership, gain will be allocated to the contributing partner up to the amount of the built-in gain of the property at the time of the contribution, as adjusted to the date of the disposition (including for the disproportionate allocation of items relating to such property, including depreciation, as required to reduce, over time, the amount of built-in gain).

What is the purpose of a tax protection agreement?

The main purpose of a tax protection agreement (“TPA”) is to protect a contributor of built-in gain property (and/or property encumbered by liabilities in excess of tax basis in the property) from recognizing gain upon the contribution transaction and for a specified period thereafter (typically 7-10 years). This is accomplished by the Operating Partnership agreeing that, for the specified period: (i) there will be sufficient Operating Partnership liabilities allocated, for income tax purposes, to the contributing partner and/or available to be guaranteed by the contributing partner to prevent the recognition of gain; and (ii) the Operating Partnership will not dispose of the contributed property in a taxable transaction that triggers the taxable built-in gain to the contributing partner. While fairly common, TPs can be viewed negatively by investors and public market analysts, especially when their terms are “off market.” Because the additional costs associated with indemnifying the contributor from tax liabilities resulting from the pay down of debt or sale of the contributed assets, the terms of the TPs may restrict the REIT’s ability to sell one or more properties or pay off indebtedness when it would otherwise be favorable or prudent.

What are some of the key terms of tax protection agreements?

TPAs typically address some or all of the issues just discussed and certain other tax matters, particularly to the extent such issues and matters are outside a contributor’s control after the OP Unit transaction. For example, a TPA may require the Operating Partnership to indemnify a contributor if the Operating Partnership (i) sells the contributed real estate asset in a taxable transaction, triggering the original built-in gain to the contributor, (ii) engages in certain taxable M&A transactions that trigger such gain, or gain in the OP Units received by the contributor, or (iii) fails to maintain sufficient liabilities so that the contributor is allocated liabilities sufficient to cover its “negative tax basis” or “negative tax capital account.” The TPA may require, with varying degrees of exceptions, that the Operating Partnership allocate liabilities under the nonrecourse liability sharing rules (more contributor-favorable) or pursuant to a guarantee of the
contributor (less contributor-favorable, particularly given the inability to use “bottom-dollar” guarantees).

Other issues TPAs may cover include the overall tax treatment of the OP Unit transaction and the “Section 704(c) method,” which governs how the Operating Partnership will allocate taxable income and loss in relation to the built-in gain in the contributed real estate assets. The “traditional” method is by far the most common, with the “remedial” method generally not used, given that it undermines the tax-deferral purpose of the OP Unit transaction by creating “phantom” income for the contributor.

TPAs are often subject to significant negotiation, especially with respect to (i) length of term, meaning how long the Operating Partnership must indemnify the contributor, which ranges significantly in the market but often falls within the range of 7 to 10 years, and (ii) the nature of protection, if any, with respect to liability allocations, which may require an Operating Partnership to maintain an amount or type of debt that is suboptimal from a business perspective.

The tax rules underpinning OP Unit transactions, such as those governing “disguised sales,” the allocation of liabilities and the “Section 704(c) methods,” can be dauntingly complex, and contributors and Operating Partnerships typically require significant input from legal counsel and other advisors to understand and negotiate the issues at play.
We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, and technology and life sciences companies. We’ve been included on the American Lawyer’s A-List for 14 years, and Fortune named us one of the “100 Best Companies to Work For.” Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. Visit us at www.mofo.com.

Morrison & Foerster’s REIT practice is a collaborative, integrated, multi-office practice involving capital markets, corporate, finance, M&A, investment management, real estate, tax and other attorneys throughout the firm. Attorneys in the REIT practice area are actively involved in advising listed public REITs, non-traded public REITs, private REITs and REIT sponsors, contributors, investors, investment advisers, underwriters and institutional lenders on all aspects of REIT activity. Attorneys in the REIT practice area also have been active and influential in Nareit and other industry organizations and in legislative affairs affecting the REIT industry. For more information on our REIT practice, refer to http://www.mofo.com/reits-services.

Because of the generality of this guide, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.

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**ADDITIONAL REIT RESOURCES FROM MORRISON & FOERSTER LLP**

FAQs – REITs
Quick Guide to REIT IPOs
FAQs – Non-GAAP Financial Measures

IREI Podcast About Taking REITs Public
FAQs – Form 8-K Relevant to Public REITs
FAQs – UPREITs and OP Unit Transactions

Nareit Interview: Challenging IPO Market
FAQs – Rule 144 and Rule 145
Nareit Interview: REITs Adapting to Governance Changes
EXHIBIT A
ENHANCED DISCLOSURE OBLIGATIONS UNDER FORM S-11

Form S-11, which may be used for the registration of securities by REITs or other registrants engaged primarily in the acquisition and holding of real estate interests, requires certain disclosures that are not applicable to offerings by non-REITs/real estate companies. Specifically, Form S-11 requires registrants to disclose, among other things, the following information in addition to the information required under Form S-1 for most U.S. domestic issuers:

POLICIES WITH RESPECT TO CERTAIN ACTIVITIES (ITEM 12 OF FORM S-11):

Generally requires the registrant to describe its policies with respect to:

- issuing securities;
- borrowing money;
- loaning money;
- investing in the securities of other companies for the purpose of exercising control;
- underwriting the securities of other companies;
- purchasing and selling investments;
- offering securities in exchange for property;
- repurchasing or otherwise reacquiring its securities; and
- making annual reports to security holders.

INVESTMENT POLICIES OF REGISTRANT (ITEM 13 OF FORM S-11)

Generally requires the registrant to describe its policies with respect to the following:

- Investments in real estate or interests in real estate, including the following policies most commonly applicable to equity and mortgage REITs:
  - the geographic areas in which the registrant intends to acquire real estate interests;
  - the real estate assets classes in which the registrant intends to invest (such as industrial, lodging, multifamily, office, retail, self-storage, etc.);
  - the proposed method of operating and financing its real estate assets;
  - limitations on the amount or percentage of the registrant’s assets that will be invested in any particular property; and
  - any other material policies adopted by the registrant with respect to its real estate activities.

- Investments in real estate mortgages, including the following:
  - the types of mortgages, such as first or second mortgages, whether such mortgages are insured and limitations on the amount or percentage of the registrant’s assets that may be invested in each type of mortgage or any particular mortgage;
  - each type of mortgage activity in which the registrant intends to engage, such as originating, servicing and warehousing of mortgages; and
  - the types of real estate asset classes subject to mortgages in which the registrant intends to invest (such as industrial, lodging, multifamily, office, retail, self-storage, etc.).
DESCRIPTION OF REAL ESTATE (ITEM 14 OF FORM S-11)

Generally requires the registrant to describe the following, among others, with respect to each “materially important real property”:  
- the location and general character of the properties owned or intended to be acquired or leased by the registrant, including the present or proposed use of those properties;  
- the nature of the registrant’s interest in such properties (e.g., fee simple, joint tenancy, etc.) and all material mortgages or other encumbrances to which the property is subject, including the principal amount of any material encumbrance and its payment provisions;  
- the principal terms of any lease or any option or contract to purchase or sell any such properties;  
- the general competitive conditions to which such properties are subject; and  
- whether, in the opinion of management, the registrant’s real properties are adequately covered by insurance.

OPERATING DATA (ITEM 15 OF FORM S-11):  

Generally requires the following disclosure with respect to each “materially important real property” described in Item 14 of Form S-11:  
- occupancy rate for each of the last five years, expressed as a percentage;  
- number of tenants occupying 10% or more of the rentable square footage (i.e., “material tenants”) and the principal business of each of those tenants;  
- the principal provisions of the leases with each material tenant, including annual rental rates, the lease expiration date and the existence of lease renewal options;  
- the average effective annual rental rate per square foot or per unit for each of the last five years;  
- a schedule of lease expirations for each of the next 10 years, starting with the year in which the Form S-11 is filed, which must include (i) the number of tenants whose leases will expire; (ii) the total square feet subject to expiring leases; (iii) the annual rental revenue (typically, annualized base rent) associated with expiring leases; and (iv) the percentage of gross annual rental revenue represented by expiring leases;  
- each of the properties and components thereof (i.e., land, building, improvements, FF&E, etc.) upon which depreciation is taken, which generally includes disclosure of the federal tax basis, depreciation rate, the estimated useful life and the depreciation method (i.e., straight-line, MACRS, double declining, etc.); and  
- the realty tax rate, annual realty taxes and estimated taxes on any improvements.

TAX TREATMENT OF REGISTRANT AND ITS SECURITY HOLDERS (ITEM 16 OF FORM S-11)

Generally requires disclosure of the material aspects of the Federal tax treatment of the registrant and its securityholders with respect to distributions by the registrant, including the tax treatment of gains from the sale of securities or property and distributions in excess of annual net income.

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6 For purposes of Item 14 of Form S-11, a “materially important real property” is a property whose book value is 10% or more of the registrant’s and its consolidated subsidiaries’ total assets, or the gross revenue generated from such property is 10% or more of the registrant’s and its consolidated subsidiaries’ total gross revenues for the last fiscal year.