

REIT IPOs

A QUICK GUIDE

**MORRISON
FOERSTER**

REIT IPOs – A Quick Guide

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AN INTRODUCTION TO REITS

Real estate investment trusts (“REITs”) were created in 1960 after Congress passed legislation to provide for a new tax-advantaged method by which all types of investors could have the opportunity to invest in a professionally managed portfolio of real estate assets. Any entity that qualifies as a REIT is entitled to special and beneficial federal income tax treatment so long as it satisfies various requirements relating to organization, ownership, distributions and the nature of assets and income.

Over the past several years, the popularity of REITs has waxed and waned. However, fundamentals across many REIT sectors remain strong and initial public offerings (“IPOs”) of REITs remain both a key path to the realization of REIT and real estate investor liquidity and a potential long-term corporate finance strategy for real estate companies seeking to access the public capital markets.

A REIT is an investment vehicle designed to allow investors to pool capital to invest in real estate assets. REITs have certain advantages over other investment vehicles; in particular, a REIT is not subject to corporate-level U.S. federal income tax on the taxable income that it distributes to stockholders even if its equity is publicly traded. REITs remain attractive to investors for this reason, despite the impact of the recently enacted tax code reform. Investors seeking current income through regular distributions choose to invest in REITs because REITs must distribute at least 90% of their taxable income in order to maintain REIT status. REITs generally finance their activities through equity and debt offerings. Although there is an active private market for REIT securities, REIT sponsors often have chosen to pursue IPOs.

The industry and asset focus of REITs is diverse. 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 a market segment (for instance, office, retail, commercial, residential or industrial properties) or a specific industry segment (e.g., healthcare or lodging properties).

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 (such as first mortgages, distressed debt or mezzanine financings). Although it is not unusual for REITs to invest in multiple property types, there are relatively few hybrid REITs that, in the ordinary course of executing their investment strategy, invest in both operating real property and debt instruments secured by interests in real property.

2017	Nine REIT IPOs raised approximately \$2.9 billion of gross proceeds
2018	Five REIT IPOs raised approximately \$3.3 billion of gross proceeds

Source: Nareit®

GOING PUBLIC AS A REIT

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.

The Benefits of Going Public

There are a variety of reasons why sponsors and management teams may decide to pursue an IPO. Some of the key benefits of an IPO often include:

- Enhanced liquidity for owners of real estate assets;
- Access to the public debt and equity capital markets to fund future growth;
- Enhancement of the company's public profile and reputation;
- Greater ability to recruit and retain senior management and employees; and
- More favorable debt financing terms than were achievable as a private real estate company.

PLANNING FOR AN IPO

Most companies must make legal and operational changes before proceeding with an IPO. A company cannot wait to see if its IPO is likely to be successful prior to implementing most of these changes. Many corporate governance matters (including those arising under the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley")) and federal securities law requirements (including audited financial statements), as well as applicable securities exchange requirements, must be satisfied when the IPO registration statement is confidentially submitted or filed with the SEC, or the company must commit to satisfy them within a set time period.

A company proposing to list securities on a national securities exchange should review the governance requirements of the different exchanges, as well as their respective financial listing requirements, before determining which exchange to choose. Although

SARBANES-OXLEY ACT OF 2002

Sarbanes-Oxley requires publicly traded companies to implement corporate governance policies and procedures that are intended to provide minimum structural safeguards to investors. Certain of these requirements are phased in after the IPO, and some requirements have been made less burdensome for Emerging Growth Companies (EGCs) under the JOBS Act.

Key provisions include:

- Requirements related to the company's internal control over financial reporting, including (1) management's assessment and report on the effectiveness of the company's internal controls on an annual basis, with additional quarterly review obligations, and (2) audit of the company's internal controls by its independent registered public accounting firm. However, a company will not need to comply with the auditor attestation requirement as long as it qualifies as an EGC.
- Prohibition of most loans to directors and executive officers (and equivalents thereof).
- Certification by the CEO and CFO of a public company of each SEC periodic report containing financial statements.
- Adoption of a code of business conduct and ethics for directors and senior executive officers.
- Requires "real time" reporting of certain material events relating to the company's financial condition or operations.
- Disclosure of whether the company has an "audit committee financial expert" serving on its audit committee.
- Disclosure of material off-balance sheet arrangements and contractual obligations.
- Audit committee approval of any services provided to the company by its audit firm, with certain exceptions for *de minimis* services.
- Whistleblower protections for employees who come forward with information relating to federal securities law violations.
- Compensation disgorgement provisions applicable to the CEO and CFO upon a restatement of financial results attributable to misconduct.
- The stock exchanges' listing requirements contain related substantive corporate governance requirements regarding independent directors, audit, nomination and compensation committees and other matters.

most REITs list on the New York Stock Exchange, a company proposing to list its securities may choose to list elsewhere for business or other reasons. See page 22 for a brief comparison of the quantitative listing requirements of the [New York Stock Exchange and NASDAQ](#).

A company must also address other corporate governance matters, including board and committee structure and composition, director independence, related party transactions, and director and officer

liability insurance. The company should undertake a thorough review of its existing and contemplated compensation for its directors and officers as well, particularly its use of stock-based compensation. See [*“Executive Compensation”*](#) on page 17.

Most public REITs are formed as corporations in Maryland under the Maryland General Corporation Law (MGCL) or as under the Maryland REIT law, as a result of Maryland’s well-developed history as a REIT-focused jurisdiction. This is in contrast to other operating companies, which typically incorporate in Delaware if they are preparing for an IPO.

Primary and Secondary Offerings

An IPO may consist of the sale of newly issued shares by the company (a “primary” offering), a sale of shares owned by existing stockholders (a “secondary” offering) or a combination of both. Underwriters typically prefer a primary offering because the company will retain all of the net proceeds to acquire additional assets, to repay indebtedness or for other general corporate purposes. However, some IPOs include the sale of secondary shares, either as part of the base offering or as part of the underwriters’ option to purchase up to an additional 15% of the shares to cover overallocments. An issuer must also consider whether any of its stockholders have registration rights that could require the REIT to register the resale of shares held by existing stockholders, either as part of the IPO or thereafter, which could potentially put downward pressure on the share price in the aftermarket.

Governance and Board Members

A public company must comply with significant corporate governance requirements imposed by the federal securities laws and the regulations of the applicable securities exchanges, including with regard to the oversight responsibilities of the board of directors and its committees. A critical matter is the composition of the board itself. All exchanges require that, except under limited circumstances, a majority of the directors be “independent,” as defined by both the federal securities laws and stock exchange listing rules. In addition, boards should include individuals with appropriate financial expertise and relevant real

estate industry experience, as well as an understanding of risk management issues and public company experience. A company should begin its search for suitable directors early in the IPO process even if it will not appoint the directors until the IPO is completed. The company can turn to its large investors as well as its counsel and underwriters for references regarding potential director candidates.

In recent years, REITs, management teams, investors, and proxy advisory and governance firms have placed a higher priority on ensuring that REIT boards of directors and management teams are diverse in terms of experience and personal background. Although there is continuing debate around the benefits of board diversity, several studies have demonstrated a positive link between board diversity and financial performance. Regardless of whether or not a causal link exists, the benefits of diversity of experience and background should be considered to ensure that decision-making reflects diverse perspectives. In recognition of the value of diversity, Nareit recently established the Dividends Through Diversity and Inclusion (DDI) Initiative to promote the recruitment, inclusion and advancement of women and members of other diverse groups in REITs and the broader commercial real estate industry.

THE OFFERING PROCESS

As described in more detail below, the IPO process is divided into three periods:

- **The pre-filing period** between determining to proceed with an IPO and the filing of the IPO registration statement with the SEC. During this time, the company is in the “quiet period” and subject to limits on public disclosures relating to the IPO. This period typically commences when the lead investment banks have been mandated to lead the IPO.
- **The waiting or pre-effective period** is the time period between the SEC filing date and the date on which the SEC declares the IPO registration statement “effective.” During this period, the company may make oral (or alternatively written) offers but may not enter into binding agreements to sell the offered security.

EMERGING GROWTH COMPANIES (“EGCs”)

The JOBS Act amended the Securities Act and the Exchange Act to include a new type of issuer called an emerging growth company. An issuer qualifies as an EGC if it has a total gross revenue of less than \$1.07 billion (originally \$1 billion, but adjusted for inflation in 2017) during its most recently completed fiscal year subject to inflationary adjustment by the SEC every five years. An issuer will not be able to qualify as an EGC if it first sold its common stock in an SEC-registered offering before December 8, 2011.

A company that elects to file as an EGC can benefit from the following reduced disclosure obligations:

- Disclosure of only two years of audited financials (instead of three);
- No requirement to include financial information in selected financial data or in Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) disclosure for periods before those required to be presented in the IPO prospectus;
- Option to rely on certain scaled disclosures available to smaller reporting companies (such as for executive compensation);
- Ability to “test the waters” with Qualified Institutional Buyers (QIBs) and institutional accredited investors to gauge interest before or after filing (See “*The Pre-Filing Period*” below);
- Exemptions from:
 - Advisory stockholder votes on executive compensation (“say-on-pay”) and golden parachute payments;
 - Disclosing the relationship between executive compensation and financial performance;
 - Disclosing CEO pay-ratio;
 - Auditor attestation of internal controls under Section 404 of Sarbanes-Oxley; and
 - Compliance with new or revised accounting standards until the date the standard becomes broadly applicable to private companies.

An issuer will remain an EGC until the earliest of:

- The last day of the first fiscal year after the issuer’s annual revenues exceed \$1.07 billion;
- The last day of the fiscal year following the fifth anniversary of the issuer’s IPO;

- The **post-effective period** is the time period between effectiveness of the IPO registration statement and the 25th day after effectiveness. During this period, the underwriters may sell the securities by delivering the prospectus contained in the IPO registration statement or a notice with respect to its availability.

Diligence and Preparing for Filing

A company should keep in mind that underwriters have at least two conflicting responsibilities—to sell the IPO shares on behalf of the company and to recommend to potential investors that the purchase of the IPO shares is a suitable and worthy investment.

In order to better understand the company—and to provide a defense in case the underwriters are sued in connection with the IPO—the underwriters and their counsel typically spend a substantial amount of time performing business, financial and legal due diligence in connection with the IPO.

During the pre-filing period, key management personnel will generally make a series of presentations to the underwriters covering the company’s business and industry, market opportunities and financial performance. The underwriters typically will use these presentations as an opportunity to ask questions and establish a basis for their “due diligence” defense. In particular, underwriters will want to visit the most significant properties owned by equity REITs as well as analyze the mortgage loan portfolios of mortgage REITs. Furthermore, it is important that any material items identified during the due diligence process are appropriately reflected in the IPO prospectus to ensure that there are no material misstatements or omissions in the disclosure. From the first all-hands organizational meeting forward, all statements concerning the company should be reviewed by the company’s counsel to ensure compliance with applicable rules.

Pre-Filing Correspondence with the SEC

REIT formation transactions can be complex, resulting in significant accounting and financial reporting issues. The SEC is available to discuss these accounting and structuring issues even in advance of a confidential submission or public filing of a registration statement, and it is advisable to approach the SEC early in the process to avoid costly delays. See “*Financial Reporting and Accounting*” below.

Communications Matters

Communications by an issuer more than 30 days prior to the date on which the registration statement is publicly filed are permitted as long as they do not reference the securities offering. Statements made within 30 days of filing a registration statement that could be considered an attempt to condition the market or pre-sell the IPO may be considered an illegal prospectus, creating a “gun jumping” violation, which may result in the SEC delaying the IPO or requiring disclosure in the prospectus regarding these potential securities law violations. Press interviews, participation in investment banker-sponsored conferences and new advertising campaigns are generally discouraged during this period.

Testing-the-Waters

The JOBS Act has softened the gun-jumping fears. If the company is an EGC under the JOBS Act, it can engage in test-the-waters communications with certain sophisticated investors referred to as QIBs and institutional accredited investors to gauge interest in the IPO during both the pre-filing period and after filing without being required to file written

communications with the SEC. However, the SEC will ask to review copies of any written materials used for this purpose. Current market practice has been to use test-the-waters communications, which usually take place after the first confidential submission of a registration statement. An issuer should consult with its counsel and the underwriters before engaging in any test-the-waters communications.

In February 2019, the SEC voted to propose an expansion of the test-the-waters accommodations that would allow all issuers (including non-EGCs) to gauge market interest in a proposed registered securities offering, including an IPO, by permitting discussions with QIBs and institutional accredited investors prior to the filing of a registration statement. As of the date of this IPO Guide, the proposed rules have not been adopted.

IPO Disclosure – The Prospectus

The prospectus describes the offering terms, the anticipated use of proceeds, the company, its industry, business (including competitive strengths and growth strategies), management and ownership, and its results of operations and financial condition. Although it is principally a disclosure document, the prospectus is also crucial to the marketing and sale process. A good prospectus sets forth a compelling investment proposition.

As a disclosure document, the prospectus functions as an “insurance policy” of sorts in that it is intended to limit the issuer’s and underwriters’ potential liability to IPO purchasers. If the prospectus contains all SEC-required information, includes robust risk factors that explain the risks and uncertainties that the company faces, and has no material misstatements or omissions, it will be challenging for investors to recover their losses in a lawsuit if the price of the stock drops following the IPO.

A prospectus should not include “puffery” or overly optimistic or unsupported statements about the company’s future performance. Rather, it should contain a balanced discussion of the company’s business, along with a detailed discussion of risks, operating and financial trends, and material uncertainties that may affect its financial condition, results of operations and prospects.

INTERNALLY AND EXTERNALLY MANAGED REITs

A REIT can be either internally or externally managed. In a REIT with an internal management structure, the REIT’s own officers and employees manage the portfolio of assets. In a REIT with an external 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 external manager receives a base fee and an incentive fee for managing the REIT’s portfolio of assets.

An external manager will typically receive a base management fee and an incentive fee. The base management fee is often based on a percentage of stockholders’ equity or the value of assets under management, while the incentive fee is often based on the achievement of targeted levels of earnings calculated based on GAAP or non-GAAP measures.

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 general form for an IPO by a U.S. domestic entity is Form S-1. Real estate companies, such as REITs, however, are instead required to use Form S-11. In addition to the same kinds of disclosures required by Form S-1, Form S-11 sets forth the following disclosure requirements:

- Investment policies with respect to investments, mortgages and other interests in real estate in light of the issuer's prior experience in real estate;
- Location, general character and other material information regarding all material real properties held or intended to be acquired by or leased to the issuer or its subsidiaries; for this purpose, "material" means any property which has a book value of 10% or more of the total assets of the consolidated issuer or the gross revenues from which are at least 10% of the aggregate gross revenues of the consolidated issuer for the last fiscal year;
- Operating data of each improved property, such as occupancy rates, number of tenants, and principal provisions of the leases; and
- Arrangements with respect to the management of the issuer's real estate and its purchase and sale of mortgages.

Furthermore, and in contrast to the general requirements of Form S-1, Form S-11 and Industry Guide 5 contain detailed requirements regarding real estate ownership, investment policies, operating data, descriptions of real estate assets and, with respect to blind pool REITs, disclosures about the prior performance of sponsors and their affiliates.

Blind pool REITs, which are REITs that do not own assets and do not identify specific real properties or real-estate related debt instruments to be acquired with the net proceeds from the potential IPO (with the properties or loans being determined after the closing of the IPO in accordance with a predetermined investment strategy), are also subject to the SEC's

Industry Guide 5, which sets forth the following additional disclosure requirements:

- 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) real estate limited partnership 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.

Depending on the nature of the specific REIT—UPREIT, DownREIT (a partnership agreement between a property owner and REIT), equity, mortgage, externally managed, internally managed, or internally administered blind pool, etc.—there are additional necessary disclosures. In July 2013, the SEC issued guidance regarding disclosure by non-traded REITs, particularly the applicability of certain provisions of Industry Guide 5, which may also be instructive for REITs that intend to list on a national securities exchange.¹ If the transaction meets the SEC definition of a "roll-up transaction," there are additional disclosure obligations (see "UPREITs and Roll-Ups" on pages 2 and 3).

In addition, the federal securities laws, particularly Rule 10b-5 under the Exchange Act, require that documents used to sell a security contain all of the information material to an investment decision and do not omit any information necessary to avoid misleading potential investors. Federal securities laws do not define materiality; the basic standard for determining whether information is material is whether a reasonable investor would consider the particular information important when making an investment decision. That simple statement is often difficult to apply in practice.

Most new REITs will qualify, however, as EGCs and can take advantage of the scaled disclosure requirements available for smaller public reporting

¹ CF Disclosure Guidance: Topic no. 6, "Staff Observations Regarding Disclosures of Non-Traded Real Estate Investment Trusts" (July 16, 2013), available at <http://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic6.htm>.

companies (see “*Emerging Growth Companies*” on page 6). Regardless of EGC status, however, an issuer should be prepared for a time-consuming drafting process, during which the issuer, investment bankers and their respective legal counsel work together to craft the prospectus disclosure.

Submitting Form S-11 to the SEC

While there is no prescribed time period, typically four to six weeks will pass between the distribution of a first draft of the registration statement to the working group and its filing with, or confidential submission to, the SEC. To a large extent, the length of the pre-filing period will be determined by the amount of time that is necessary to prepare the required financial statements.

An issuer may confidentially submit a draft registration statement for non-public review but must publicly file (referred to as “going live” on the filing) its registration statement publicly at least 15 days prior to commencing the IPO road show. The confidential submission process allows an issuer to commence the SEC review process without publicly disclosing sensitive information and to work through the SEC comment process without the glare of publicity and without competitors becoming aware of the proposed IPO. Furthermore, if the issuer determines that the market will not be receptive to the IPO or that other alternatives are more appealing, it can withdraw from the process without the stigma of a failed deal.

To ensure that the SEC has the opportunity to fully review and comment on the company’s proposed disclosures to investors, any confidential submission or public filing should be materially complete—companies that make significant changes to the prospectus disclosure after the initial submission or filing of the registration statement run the risk of generating new, potentially significant, comments from the SEC, which could result in a delay in the IPO process.

The Waiting Period

Responding to SEC Comments

An integral part of the IPO process is the SEC’s review of the registration statement. Once the registration statement is filed or confidentially submitted, a team of SEC Staff members is assigned to review the filing. The team consists of accountants and lawyers, including examiners and supervisors.

The SEC’s principal focus during the review process is on disclosure. In addition to assessing compliance with applicable requirements, the SEC considers disclosures through the eyes of an investor in order to determine the type of information that would be considered material. The SEC’s review is not limited to just the registration statement. The SEC Staff will closely review websites, databases, and magazine and newspaper articles, looking in particular for information that the SEC Staff thinks should be in the prospectus or that contradicts information included in the prospectus.

The review process is time-consuming, and it can often take two to four months to clear comments with the SEC. This depends on the complexity of the company’s business and the nature of the issues raised in the review process.

Initial comments on Form S-11 are typically provided in approximately 30 days—depending on the SEC’s workload and the complexity of the filing, the receipt of first-round comments may be sooner or later. The initial letter for REITs typically contains about 20 to 30 comments, with a significant number of the comments addressing accounting issues, although some recent IPOs have received far fewer comments in the first round. The company and its counsel will prepare a complete and thorough response. In some instances, the company may not agree with the SEC Staff’s comments and may choose to schedule calls to discuss the matter with the SEC Staff. The company will file or confidentially submit an amendment revising the prospectus and provide the response letter along with any supplemental information. The SEC Staff generally tries to address response letters and amendments within 14 days, but timing varies considerably.

After the SEC has provided its initial set of comments, the issuer and the underwriters will often have more clarity with respect to when the registration process is likely to be completed and the road show can commence. In most cases, offering participants delay the offering process and avoid distributing a preliminary prospectus until all material changes suggested by the SEC Staff have been addressed satisfactorily.

Frequent Areas of SEC Comment

Overall, the SEC Staff looks for a balanced, clear presentation of the information required in the registration statement. Experienced legal counsel, underwriters and audit firms can generally anticipate many of the matters that the SEC will raise in the comment process. After a certain period of time after an IPO, the SEC makes the comment letters and responses available on its website. As a result, it is possible to determine the most typical comments raised during the IPO process by reviewing the comments and responses relating to other companies' recent IPO registration statements.

Some of the most frequent comments raised by the SEC Staff on disclosure, other than the financial statements, include:

- **Front cover and gatefold:** On the theory that “a picture is worth a thousand words,” does the artwork present a balanced presentation of the company’s business, properties, tenants and geographies?
- **Prospectus summary:** Is the presentation balanced? Is it too lengthy to provide a true summary of the disclosures found elsewhere in the prospectus?
- **Risk factors:** Are the risks specific to the company and devoid of mitigating language? The following are risk factors as to which recent SEC comments have been issued:
 - Adequate disclosure of the consequences if one or more risks were to be realized;
 - With respect to externally managed REITs, risks related to the external manager such as internalization of management functions or difficulty in terminating or not renewing the contract of the manager due to poor performance;
 - Conflicts of interest;
 - Liquidity events;
 - Geographic or asset concentrations;
 - Any guarantee obligations in connection with related financing transactions; and
 - Change investment strategies and financing strategy without stockholder approval
- **Use of proceeds:** Is there a specific allocation of the net proceeds among identified uses, and, if funding acquisitions is a designated use, are acquisition plans identified? Will debt be repaid with all or a portion of the net proceeds?
- **Financial information:** Are certain proposed acquisitions of real estate assets or businesses identified in the prospectus “probable” so that financial information relating to the acquisitions must be included in the prospectus? Does the presentation of non-GAAP financial measures comply with SEC rules? Does the presentation of pro forma financial information comply with the

THE MAGIC PAGE

The “Magic Page” is where a REIT discloses its dividend policy and distribution plans using a pro forma presentation that shows anticipated dividend payouts relative to cash available for distribution. The issuer, the underwriters and their respective advisors should begin contemplating the Magic Page presentation early in the IPO process to give the SEC ample time to review the issuer’s presentation and avoid SEC comments challenging the presentation closer to the launch of the road show.

The SEC has provided several comments addressing acceptable content for the Magic Page, including the application of both U.S. Generally Accepted Accounting Principles (“GAAP”) and non-GAAP financial measures. For more information about non-GAAP financial measures, please see our publications, *Non-GAAP Explained*, *Practice Pointers on Non-GAAP Financial Measures* and *Practice Pointers on Anticipating and Addressing SEC Comments on Non-GAAP Financial Measures*.

SEC's rules, including with respect to the appropriateness of the various adjustments?

- **MD&A:** Does the discussion address known material trends, events, commitments, demands or uncertainties, including the impact of the economy, trends with respect to liquidity and critical accounting estimates and policies?
- **Business:** Does the company provide support for statements about market position and other industry or comparative data? Is the disclosure free of, or does it explain, business jargon? Are the relationships with customers and suppliers, including concentration risk, clearly described?
- **Management:** Is the executive compensation disclosure clear and presented in compliance with SEC rules?
- **Prior performance information:** Is the description of prior performance by related real estate entities complete, responsive to disclosure requirements, and balanced?
- **Exhibits:** Do any other agreements need to be filed based on disclosure in the prospectus?
- **Distribution Policy:** Are the adjustments that the company is making on the "Magic Page" appropriate and supportable?

The Underwriting Agreement and the Comfort Letter

Prior to and during the waiting period, the issuer, the underwriters, their respective legal counsel and the company's independent auditor will negotiate a number of agreements and other documents, particularly the underwriting agreement and the auditor's "comfort letter."

The underwriting agreement is the agreement pursuant to which the issuer will sell, and the underwriters will purchase, the shares being offered in the IPO. In a firm-commitment underwriting, the underwriters agree to purchase all of the shares (at a discount) and re-sell them to investors at the IPO price. Generally speaking, only a handful of provisions in the underwriting agreement raise substantive business or legal points that must be negotiated. Those provisions include, among others, representations and warranties of the parties, the

allocation of costs of the IPO, certain "lock-up" provisions (see "*Controlling Your Shares and Lock-Ups*," below), the right for the underwriters to terminate the underwriting agreement and indemnification obligations.

The underwriting agreement will also require (i) the issuer's and underwriters' respective legal counsel to deliver legal opinions (including a REIT tax opinion from the issuer's legal counsel) and a negative assurance letter to the underwriters and (ii) the issuer's auditor to deliver comfort letters at the time of pricing the IPO and at closing. The purpose of the "comfort letter" is to assist the underwriters in establishing their due diligence defense against potential liability under the federal securities laws with respect to financial information included in the prospectus. In the comfort letter, the auditor affirms (i) its independence from the company and (ii) the compliance of the financial statements with applicable accounting regulations and SEC rules.

The auditor will also note period-to-period changes in certain financial items. These statements follow prescribed forms and are usually not the subject of significant negotiations. The underwriters will also usually require that the auditor undertake certain "agreed-upon" procedures, which can be subject to significant negotiations, in which it compares financial information in the prospectus (outside of the financial statements) to the issuer's accounting records to confirm its accuracy. Although different auditors may have different internal policies governing what can be included in the comfort letter, the contents of the comfort letter are generally governed by Statement on Auditing Standards No. 72 ("SAS 72"), which provides guidance to accountants on the preparation of comfort letters, including their scope and form. (SAS 72 is also referred to as "AU Section 634," where it was subsequently codified.) The guidance includes various examples in order to help ensure that all relevant or required items are covered by the letter. For more information regarding auditor's comfort letters, see our publication titled "*Frequently Asked Questions Relating to Comfort Letters and Comfort Letter Practice*."

Marketing the Offering

Towards the end of the waiting period, the underwriters will market the IPO shares. The only written sales materials that may be distributed during this period are the preliminary prospectus (which must include an estimated price range for the IPO), additional materials known as “free writing prospectuses,” which must satisfy specified SEC requirements, and any written EGC test-the-waters communications described above.

While binding purchase commitments cannot be accepted during this period, the underwriters will receive indications of interest from potential investors, indicating the price they would be willing to pay and the number of shares they would purchase at various price levels. Once SEC comments are resolved, or it is clear that there are no material open issues, the issuer and underwriters will undertake a one-to-two-week “road show,” during which company management will meet with prospective investors. As noted above, an issuer must publicly file the confidentially submitted registration statement, along with any amendments, at least 15 days before commencing the road show. Once SEC comments are cleared and the underwriters have assembled indications of interest for the offered securities, the company and its counsel will request that the SEC declare the registration statement “effective” at a certain date and time, usually after the close of business of the U.S. securities markets on the date scheduled for pricing the offering.

The Post-Effective Period

Once the registration statement has been declared effective, the underwriters will set the price (in consultation with the company) at which time the shares will be offered to the public. The company and the underwriters will also execute the underwriting agreement. On the date of pricing and after the underwriting agreement has been executed, the comfort letter will also be delivered by the auditors.

Within two business days of pricing the IPO, the company must file a final prospectus with the SEC that contains the final offering information. On the second or third business day following pricing, the closing occurs, the shares are issued and the issuer

CONTROLLING YOUR SHARES AND LOCK-UPS

To provide for an orderly market and to prevent existing stockholders from dumping their shares into the market immediately after the IPO, underwriters will require the issuer as well as directors, executive officers and large stockholders (and sometimes all pre-IPO stockholders) to agree not to sell their shares of common stock, except under limited circumstances, for a period of time following the IPO (typically, 180 days), effectively “locking up” such shares. Exceptions to the lock-up include issuances of shares in acquisitions and in compensation-based grants. Stockholders may be permitted to exercise existing options (but not to sell the underlying shares), transfer shares to family trusts and sometimes make specified private sales, provided that the acquirer also agrees to be bound by the lock-up restrictions. These lock-up exceptions will often be highly negotiated.

Note that, in an UPREIT structure, the OP Unitholders may also be subject to the lock-up agreement, but they may also be subject to a longer holding period before they can tender their OP Units for redemption.

receives the net proceeds (after underwriting discounts and commissions).

The closing completes the IPO process. Then, for the next 25 days, aftermarket sales of shares by dealers must be accompanied by the final prospectus or a notice with respect to its availability. If during this period there is a material change that would make the prospectus misleading, the company must file an amended prospectus.

In addition, in order to ensure an orderly market for the IPO shares, after the shares are priced and sold, the underwriters are permitted in many circumstances to engage in certain stabilizing transactions to support the stock. Typically, the company will grant the underwriters a 30-day option to purchase up to an additional 15% of the shares offered in the IPO (at the IPO price, less discounts and commissions) to cover overallocments resulting from selling more shares in the IPO than they are required to purchase from the company. “Covered” short sales are sales made in an amount not greater than the underwriters’ overallocation option described above. Depending on the post-IPO trading price, the underwriters may close out any covered short position by either exercising their overallocation option or purchasing shares in the open market.

UPREITS AND ROLL-UPS

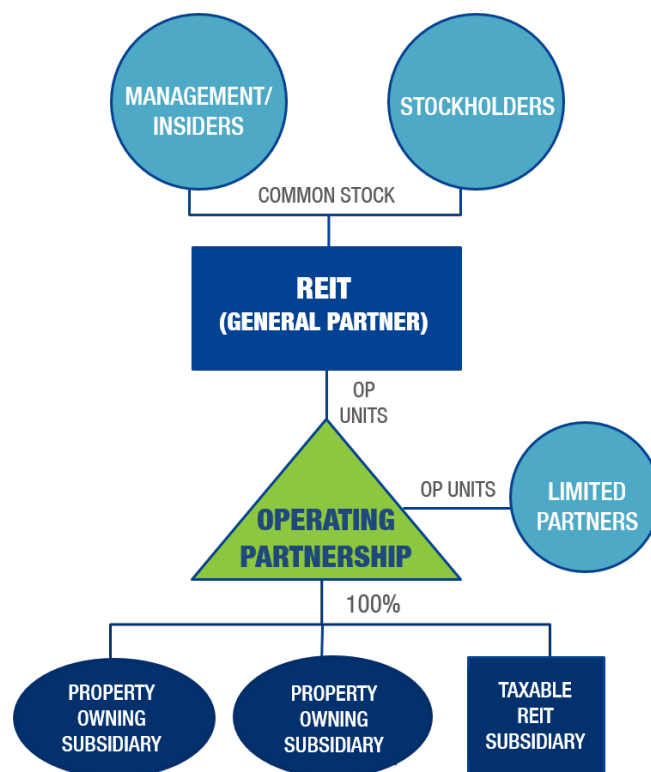
UPREITS

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.

In addition to controlling the Operating Partnership, the REIT typically owns a majority 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 are ordinarily held by outside limited partners (“**OP Unitholders**”) who received their OP Units by 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 in exchange for the OP Units. 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:



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. 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 the built-in gains, generally until they elect to tender their OP Units for redemption. 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 those payments usually occur at the same time. 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.

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.

Roll-Ups

A REIT can either acquire a property, mortgage loan or other real estate asset directly or through a “roll-up” process in which the REIT acquires the entities (partnerships or limited liability companies) that own the real estate asset in exchange for securities of the REIT or its Operating Partnership.

As noted above, the UPREIT structure provides tax deferral advantages. From the securities law side of the transaction, the question is whether the REIT is conducting an offering of its securities to the holders of the interests in the entities. The REIT could effect the roll-up transaction as a registered offering separate from the IPO; however, this approach is not typical, as registering a roll-up involves significant time and expense. The more common process is one or more private placements by the REIT or the Operating Partnership to the holders of the real estate assets.

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,” Congress enacted Section 14(h) “and related provisions of the Exchange Act in 1993 and the Financial Industry Regulatory Authority (“FINRA,” then the National Association of Securities Dealers) also issued rules governing the responsibilities of broker-dealers in roll-up transactions. 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 with an option to receive or retain a security under substantially the same terms and conditions as the original issue. See our publication titled *“Frequently Asked Questions About Real Estate Investment Trusts”* for more information regarding transactions that are not “limited partnership roll-up transactions.”

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, Section 14(h) of the Exchange Act and Items 902 through 915 of Regulation S-K will require significant additional disclosures 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.

There have been few public roll-up transactions in recent years, and most roll-up transactions are currently conducted as private placements, particularly following the SEC’s 2007 interpretive guidance (Release No. 33-8828) on public/private integration issues. The rules promulgated under the Jumpstart Our Business Startups Act (“JOBS Act”) that allow general solicitation and advertising in certain private securities offerings under Rule 506 and Rule 144A so long as the securities are sold to accredited investors or qualified institutional buyers (“QIBs”) also lessen the securities law integration risk.

Any roll-up transaction, whether or not it meets the SEC and FINRA definitions, will have complex accounting and structuring issues that must be addressed with the accountants and counsel early in the IPO planning process, including relating to the identification of the REIT’s “predecessor” and “accounting acquirer” and the presentation of historical and pro forma financial statements.

TAX MATTERS

General

In general, a REIT is able to offer publicly traded equity through an IPO without altering the tax treatment of the REIT. The issuer and underwriter will need to perform a substantial amount of due diligence to confirm that the issuer is and will be eligible to be taxable as a REIT, including confirmation that the issuer will satisfy applicable shareholder composition, asset, income and distribution requirements. If the issuer qualifies as a REIT, its income will typically not be subject to tax at the REIT level to the extent distributed to stockholders. Instead its stockholders will generally be taxed on amounts distributed by the REIT. Ordinary REIT dividends are usually taxable to domestic stockholders as ordinary income. However, with the enactment of the Tax Cuts and Jobs Act, individual REIT stockholders can generally deduct 20% of the aggregate amount of ordinary dividends distributed by a REIT, subject to certain limitations, which reduces the effective tax rate for individuals on the receipt of such ordinary dividends from a maximum federal income tax rate of 37% to a maximum federal income tax rate of 29.6%.

As noted above, in order to maintain REIT qualification, a REIT must satisfy several tests regarding the nature and value of its assets. Generally, these tests must be satisfied at the end of each calendar quarter of each tax year of the REIT, subject, in certain circumstances, to a 30-day grace period. At least 75% of a REIT's assets must consist of "real estate assets" (such as ownership or leasehold interests in real property or mortgages), cash, cash items and government securities. No more than 20% of the value of a REIT's total assets can consist of securities of a taxable REIT subsidiary (a "TRS"), which is a wholly owned subsidiary of a REIT that is taxed as a regular C corporation. No more than 5% of the value of the REIT's assets may consist of the securities of any one issuer, other than a TRS, and a REIT may not hold more than 10% of the voting power or value of the securities of any one issuer (other than a TRS).

At least 75% of a REIT's gross income must be attributable to real property, such as "rents from real property." In addition, at least 95% of a REIT's gross income must consist of income items qualifying for the 75% income test as well as dividends, non-mortgage interest and gain from sales of stock and securities. Thus, only 5% of a REIT's gross income can come from categories (such as service income) not qualifying for the 75% or 95% income tests.

In general, a REIT must make qualifying distributions equal to 90% of its taxable income in order to maintain its REIT qualification, although in practice REITs typically distribute in excess of their taxable income.

If a REIT engages in a prohibited transaction, the gains from that transaction are subject to a 100% tax. A prohibited transaction is the sale or other disposition of property held primarily for sale to customers in the ordinary course of business, commonly referred to as "dealer" property. REITs can avoid prohibited transactions by ensuring that any potential transactions meet certain "safe harbor" requirements.

In the process of converting from a corporation to a REIT, built-in gains with respect to assets transferred from the corporation to the REIT may be subject to tax. The direct or indirect transfer of property by a regular C corporation to a REIT will cause the REIT to be taxable as a regular C corporation on any net built-in gain of the property transferred to the REIT if such property is sold during the five-year period following the date of transfer. Similar rules may apply to a partnership that transfers property to a REIT if the partnership has direct or indirect corporate partners.

Careful tax planning is required to address these concerns.

RIDEA

The REIT Investment Diversification and Empowerment Act of 2007 ("RIDEA") was signed into law in July 2008, enabling healthcare REITs to structure their investments in a manner that is similar to hotel REITs. Rent received from a corporation in which a REIT owns 10% or more of the total voting power or total value of shares is excluded as "rent

from property” under the income tests described above. Hotel REITs are exempt from this rule if they use an eligible independent contractor to manage the hotel facilities. After the enactment of RIDEA, healthcare REITs are similarly exempt.

Non-Traditional REITs

Over the years, REITs have expanded to assets beyond office, retail, apartment and commercial buildings, such as timber and farmland, self-storage, data centers, single-family homes, document storage facilities, cell-phone towers, casinos, private correctional facilities and billboards.

On August 31, 2016, the Treasury Department published final regulations (the “Final Regulations”) adding clarity to what constitutes a “good” REIT real estate asset for purposes of the REIT rules. The Final Regulations flesh out the definition of “real property” contained in regulations promulgated in 1962 to include the types of property for which the IRS previously provided favorable private letter rulings. The Final Regulations define “real property” to include land, inherently permanent structures and structural components; specify certain assets that are “real property” for purposes of the REIT rules and adopt a framework using a facts and circumstances approach to determine whether other assets are real property. This guidance provided welcome certainty for REITs.

Because of the tax benefits of a REIT and the growing market for dividend-paying securities in a low-yield environment, there has been increased interest in REIT conversions by corporations and other business entities. However, due to the requirements to qualify as a REIT and to maintain REIT status as discussed below, converting into a REIT is a complicated process and requires careful consideration and significant restructuring. In addition, tax-free spin-offs of real estate in the form of a REIT by non-REIT businesses (for example, restaurant businesses that own their underlying real property) were largely curtailed with the enactment of the Protecting Americans from Tax Hikes Act (the “PATH Act”) in 2015.

FINANCIAL REPORTING AND ACCOUNTING

An IPO registration statement must include: audited financial statements for the last three fiscal years (two years for EGCs); financial statements for the most recent fiscal interim period, compared with interim financial information for the corresponding prior fiscal period (which may or may not be audited depending on the circumstances); and, in certain cases, selected income statement and balance sheet information for the last five years (and the earliest two years may be derived from unaudited financial statements) and interim periods presented. The SEC also requires special income statement and balance sheet captions for REITs.

A REIT may not be able to provide full financial statements with respect to significant real estate assets or businesses that were recently acquired or that are probable candidates for acquisition. For most equity REITs, the SEC will require audited statements of revenue and certain expenses (i.e., financial statements required pursuant to Rule 3-14 of Regulation S-X) with respect to significant real estate assets to be acquired; however, some REITs must prepare audited financial statements in accordance with Rule 3-05 of Regulation S-X, which is required when an issuer acquires a significant business. For instance, lodging REITs must prepare audited Rule 3-05 financial statements with respect to acquisitions of hotels that are “significant” in accordance with Rule 3-05 of Regulation S-X.

THE FAST ACT

Under the Fixing America’s Surface Transportation Act (the “FAST Act”), enacted in December 2015, issuers can omit financial information for historical periods otherwise required to be submitted in their draft registration statements if they reasonably believe that such financial information will not be required at the time of the contemplated offering. Interim financial information that will be included in a historical period that a non-EGC reasonably believes will be required to be included at the time of its first public filing may not be omitted from its filed registration statements.

If an issuer is unable to prepare the necessary financial statements or is uncertain with respect to its identification of the REIT's "predecessor" or "accounting acquirer," the issuer should seek relief from the SEC in the form of a "pre-clearance" letter, which may result in the SEC allowing the issuer to include more limited financial information than would otherwise be required under the SEC's rules.

Early on, the issuer should identify any problems associated with providing the required financial statements (including any complex predecessor analysis or similar issues in a "roll-up" IPO) in order to seek necessary accommodations from the SEC. These statements must be prepared in accordance with GAAP, as they will be the source of information for the MD&A disclosures.

Measuring Performance

Funds from Operations ("FFO")

The real estate industry discloses a unique operating metric that the SEC has traditionally allowed. FFO is the most common financial metric used to measure a REIT's operating performance. Nareit defines FFO as net income (computed in accordance with GAAP) excluding gains or losses from sales of most property and depreciation of real estate. REIT professionals believe that FFO provides a more accurate picture of the REIT's cash performance than earnings calculated in accordance with GAAP, which includes non-cash items. FFO is not the same as Cash from Operations, which includes interest expenses.

FFO was originally defined by Nareit in its White Paper in 1991 and subsequently revised from time to time, including most recently in December 2018. Most REITs disclose a modified or adjusted FFO, although the SEC requires them to present the standard Nareit definition as well. For more information, please read the "[*Nareit Funds from Operations White Paper – 2018 Restatement*](#)."

Other Performance Measures

Most REITs now disclose a variety of non-GAAP financial measures such as net operating income ("NOI"), adjusted FFO ("AFFO"), and cash/funds available for distribution ("CAD/FAD"). NOI is the operating income after operating expenses but before

income taxes and interest are deducted. AFFO is equal to FFO after adjustments for certain non-comparable items. Depending on the adjustments, the AFFO calculation varies from company to company, which can make a comparability analysis difficult. CAD/FAD is used to measure a REIT's ability to generate cash and to distribute dividends and is generally equal to FFO minus recurring capital expenditures.

Additionally, mortgage REITs may use other non-GAAP financial measures such as "core earnings" (or other similarly titled measures). Core earnings is typically defined as net income (loss) excluding realized and change in unrealized gains (losses), gains (losses) on financial derivatives and any other nonrecurring items of income (loss). Core earnings and similar metrics are typically useful for mortgage REIT investors because they assess a mortgage portfolio's performance by evaluating its effective net yield.

SEC Treatment of Non-GAAP Financial Measures

Regulation G requires issuers to include a reconciliation and general disclosure with respect to any non-GAAP financial measures that are publicly disclosed. The reconciliation requirement provides that whenever an issuer publicly discloses (whether in an SEC-filed report or in an earnings call or investor presentation) material information that includes a non-GAAP financial measure, it must accompany that non-GAAP financial measure with (i) a presentation of the most directly comparable financial measure calculated and presented in accordance with GAAP and (ii) a quantitative reconciliation of the differences between the non-GAAP financial measure and the most directly comparable GAAP financial measure.

In addition, the GAAP measure must be presented with equal or greater prominence, which generally means that the most directly comparable GAAP measure should be presented before the Non-GAAP measure.

Regulation G and Item 10(e) of Regulation S-K permit a public REIT to disclose FFO as defined by Nareit as a non-GAAP financial measure. As described in further detail below, the disclosure of FFO must be quantitatively reconciled with the most directly comparable GAAP financial measure (generally, net income) used by the REIT.

EXECUTIVE COMPENSATION PLANNING

- **Systematizing compensation practices.** Compensation decisions should be made more systematically—doing so will require:
 - Establishing an independent compensation committee of the board of directors; and
 - Using more formal market information to set compensation, which can often be achieved by engaging a compensation consultant familiar with the REIT industry; and establishing a regular compensation grant cycle.
- **Adopting plans.** An issuer will have greater flexibility to adopt equity compensation plans (including employee stock purchase plans) prior to its IPO. Accordingly, planning ahead is essential. In consultation with the lead underwriters and its legal counsel, an issuer should develop and adopt the equity incentive and other plans it will use to make awards as a public company. The number of shares reserved for future equity grants, after giving effect to any equity grants that will be made to directors and officers at the closing of the IPO, should be sufficient to enable the REIT to make equity awards for the first two or three years after the closing of the IPO. When the number of shares available for future issuance under the equity plan is reduced to a point that could make it challenging for the REIT to attract, recruit and retain directors and officers, the REIT will be required to obtain stockholder approval to amend the equity plan to increase the share authorization or to adopt new plans.
- **Section 162(m).** Section 162(m) of the Code ("Section 162(m)") generally precludes a publicly held corporation from taking a federal income tax deduction for annual compensation in excess of \$1 million provided to certain of its executive officers. Before the Tax Cuts and Jobs Act of 2017 ("TCJA") was signed into law in 2017, compensation that qualified as "performance-based" under Section 162(m) was not subject to Section 162(m). Under the TCJA, this performance-based exception was repealed and the coverage of Section 162(m) was expanded to include additional executive officers. In REITs that utilize the UPREIT structure, compensation is typically paid at the Operating Partnership level and not by the parent REIT. The IRS has previously issued a private letter ruling holding that Section 162(m) does not apply to compensation paid to employees of a REIT's operating partnership. Consistent with that ruling, many REITs have taken a position that compensation expense paid and incurred at the level of the Operating Partnership or its subsidiaries is not subject to the Section 162(m) limit. Because private letter rulings are applicable only for the taxpayer who obtains the ruling, there can be no assurance that the IRS will not challenge the position that Section 162(m) does not apply to compensation paid at the Operating Partnership level.

On May 17, 2016, the SEC Staff issued updated Compliance and Disclosure Interpretations ("CD&Is") on the use of non-GAAP financial measures. The updated C&DIs included certain updates to the use of the FFO and AFFO performance metrics. The SEC staff stated that it continues to accept Nareit's definition of FFO, as in effect as of May 17, 2016, as a performance measure and does not object to such presentation on a per share basis. The SEC staff also stated that a REIT may present FFO on a basis other than as defined by Nareit (such as AFFO), provided that any adjustments made to FFO must comply with the requirements of Item 10(e) of Regulation S-K for a performance measure or a liquidity measure. If AFFO is intended to be a liquidity measure, it may not exclude charges or liabilities that are required, or will require, cash settlement, and may not be presented on a per share basis. For more information, please read the [*SEC's Guidance on Non-GAAP Financial Measures*](#).

Internal Controls Over Financial Reporting

An issuer will not be required to include either a management's report on its internal controls over financial reporting or an auditor's report on such internal control until the second annual report following its IPO. However, as long as the company is an EGC under the JOBS Act, it will be exempt from providing an auditor's report on the effectiveness of such internal controls.

Executive Compensation

Well before its IPO, an issuer should begin to approach executive compensation in a manner that is similar to a public company's approach. The IPO registration statement requires the same enhanced executive compensation disclosures that public companies provide in their annual proxy statements, including a discussion of compensation philosophy, an analysis of how compensation programs implement that philosophy and a discussion of the effects of risk when taking on compensation decisions. In mortgage REITs and REITs that are not self-managed or self-administered, the REIT will also be required to provide extensive disclosure of both the compensation paid to the managers and the process to manage conflicts of interest.

Under the JOBS Act, an EGC is required to include only summary compensation information in the IPO registration statement rather than the more extensive discussion and analysis of compensation required for a non-EGC. However, an EGC should always keep in mind that it may be required to include more substantial executive compensation disclosure in future filings.



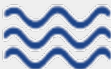



A FINAL THOUGHT

While favorable IPO market windows open and close, and REITs and their advisors may have different views concerning the right moment to commence active and intense preparation for an IPO, it is rarely too early to undertake the advance planning described in this Guide. Because the IPO markets are often unpredictable, companies seeking to go public should complete their preparations as soon as reasonably possible in order to achieve greater flexibility to quickly complete the IPO when market conditions become favorable. And, even if an IPO does not turn out to be the option of choice, this preparatory work should prove valuable in facilitating other funding opportunities, or even an acquisition by another company.

INDICATIVE IPO TIMELINE

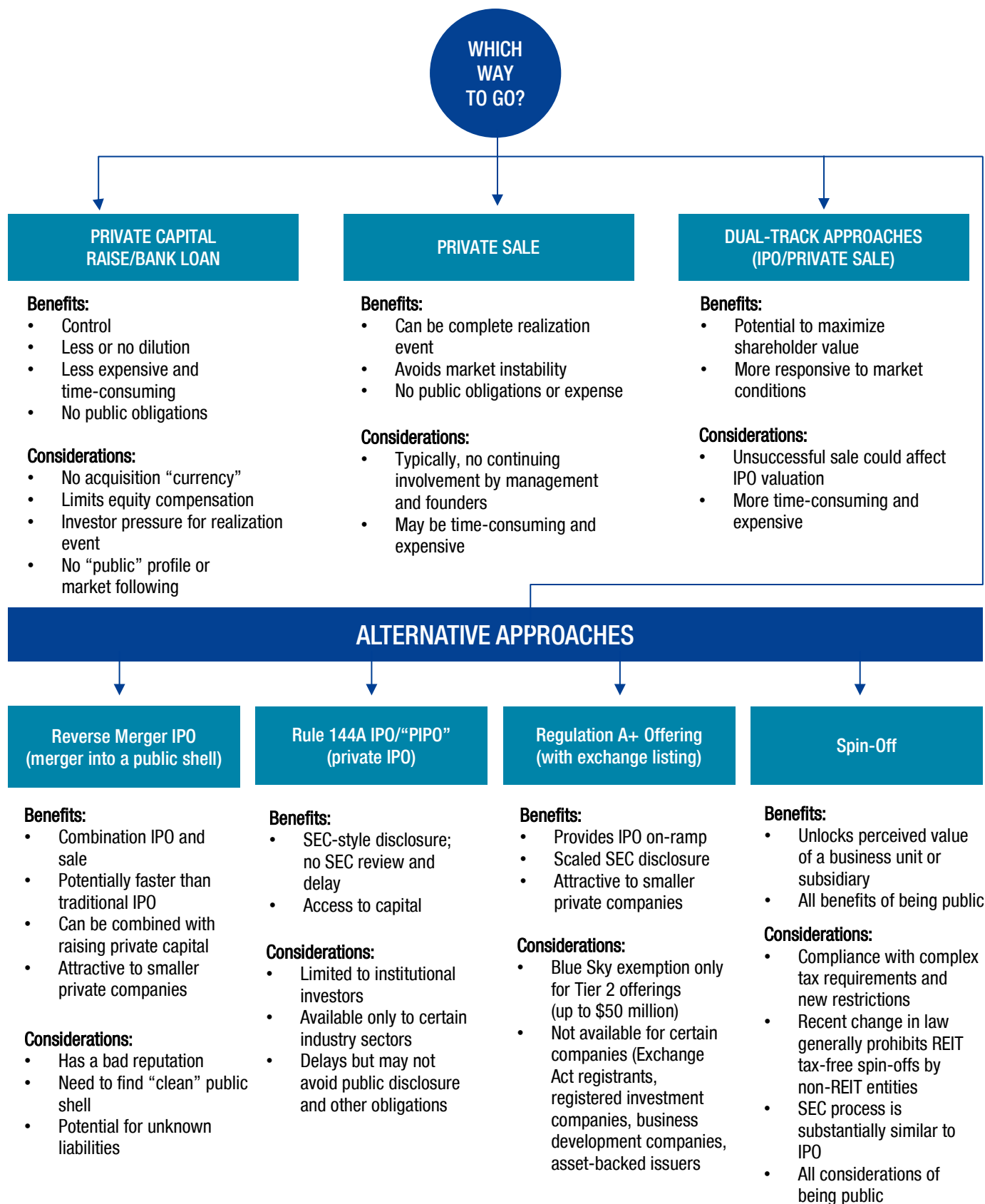


IPO ACCOMMODATIONS FOR EGCs

AVAILABLE ACCOMMODATIONS	AN EGC	A NON-EGC
 <p>Confidential Submission?</p>	Yes, an EGC may submit its IPO registration statement to the SEC for confidential review as a result of JOBS Act provisions. Confidentiality is established by statute. Securities Act Section 6(e)(2).	New policy allows a non-EGC to submit its registration statement to the SEC for confidential review. A non-EGC must request confidential treatment for its submission under Rule 83.
 <p>When must registration statement be filed publicly?</p>	15 days prior to commencement of a traditional road show.	15 days prior to commencement of a traditional road show.
 <p>Test-the-waters?</p>	Yes.	No, but the SEC has proposed an expansion of the test-the-waters accommodation to non-EGCs.
 <p>Disclosure accommodations?</p>	Yes. These are discussed earlier under “EGC Accommodations.”	No.
 <p>Financial information that may be omitted?</p>	Confidential submissions may omit annual and interim financial statements that will not be required to be presented at the time of the offering.	In reliance on new guidance, confidential submissions may omit annual and interim financial statements that will not be required to be presented at the time of the first public filing.
 <p>Governance and other SOX-related accommodations?</p>	Yes. These are discussed earlier under “EGC Accommodations.”	No.

THE LIKELY ALTERNATIVES

A growing real estate company has a number of financing alternatives, in addition to a traditional firm commitment underwritten IPO.



NYSE VS. NASDAQ: PRINCIPAL QUANTITATIVE LISTING REQUIREMENTS

The following table summarizes the principal quantitative listing requirements; there are also qualitative requirements. The overwhelming majority of REITs are listed on the NYSE.

SELECTED LISTING REQUIREMENT	NYSE	NASDAQ GLOBAL MARKET
Minimum Number of Stockholders	400 round lot holders	Same ¹
Minimum Number of Publicly Held Shares	1,100,000 ³	Same, with similar exclusions
Minimum Aggregate Market Value of Publicly Held Shares	\$40 million ³	Any of: <ul style="list-style-type: none"> \$8 million under the Income Standard; \$18 million under the Equity Standard; or \$20 million under the Market Value Standard⁴ or the Total Assets/Total Revenue Standard.⁵
Minimum Price per Share	At least \$4.00 at initial listing ³	Same ⁶
Minimum Number of Market Makers	N/A	Four, unless company qualifies for listing under the Income or Equity Standards, which each require three. ⁷
Minimum Financial Standards	One of the following: <ul style="list-style-type: none"> Earnings Test: Adjusted pre-tax earnings from continuing operations must total (1) \$10 million for the last three fiscal years,⁹ including a minimum of \$2 million in each of the two most recent fiscal years and positive amounts in all three years, or (2) if there is a loss in the third fiscal year, \$12 million for the last three fiscal years, including a minimum of \$5 million in the most recent fiscal year and \$2 million in the next most recent fiscal year;¹⁰ or Global Market Capitalization Test: \$200 million in global market capitalization (existing public companies must meet the minimum global market capitalization for a minimum of 90 consecutive trading days prior to listing on the NYSE); or REIT Test:¹¹ \$60 million in stockholders' equity.³ 	One of the following: ⁸ <ul style="list-style-type: none"> Income Standard: (1) \$1 million in annual pre-tax income from continuing operations in most recently completed fiscal year or in two of the three most recently completed fiscal years; and (2) stockholders' equity of \$15 million; or Equity Standard: (1) stockholders' equity of \$30 million; and (2) two-year operating history; or Market Value Standard: N/A for IPOs; or Total Assets/Total Revenue Standard: total assets + total revenue of \$75 million each for the most recently completed fiscal year or two of the three most recently completed fiscal years.

- For the Nasdaq Global Select Market, at least 550 total holders and an average monthly trading volume over the prior 12 months of at least 1,100,000 shares; or at least 2,200 total holders; or a minimum of 450 round lot holders. For the Nasdaq Capital Market, a minimum of 300 round lot holders.
- The number of stockholders includes stockholders of record and beneficial holders of shares held in street name. Shares held by directors, officers or their immediate families and other concentrated holdings of 10% or more are excluded.
- The NYSE will rely on a written commitment from the underwriters for firm commitment underwriting with respect to the issuer's compliance with the listing standard.
- Market Value Standard is not applicable to IPOs.
- For the Nasdaq Global Select Market, \$45 million. For the Nasdaq Capital Market, \$15 million under the Equity or the Market Value of Listed Securities Standards and \$5 million under the Net Income Standard.
- For the Nasdaq Capital Market, \$4 bid price or \$2 closing price under certain conditions.
- For the Nasdaq Capital Market, three.
- The other tiers (Nasdaq Global Select Market and Nasdaq Capital Market) have different requirements.
- Under certain circumstances, a company may qualify with \$10 million in aggregate for two years and nine months.
- A company that qualifies as an EGC and avails itself of the provisions of the Securities Act and the Exchange Act permitting EGCs to report only two years of audited financial statements can qualify under the Earnings Test by meeting the following requirements: pre-tax earnings from continuing operations, as adjusted, must total at least \$10 million in the aggregate for the last two fiscal years together with a minimum of \$2 million in both years.
- Only for REITs with less than three years of operating history.

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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.

CONTRIBUTORS

Justin Salon
(202) 887-8785
justinsalon@mofo.com

David Slotkin
(202) 887-1554
dslotkin@mofo.com

Dave Lynn
(202) 778-1603
dlynn@mofo.com

Lauren Bellerjeau
(202) 887-8772
lbellerjeau@mofo.com

Andy Campbell
(202) 887-1584
andycampbell@mofo.com

Ali Connaughton
(202) 887-1567
aconnaughton@mofo.com

Heath Linsky
(404) 490-4444
hlinsky@mofo.com

Jay Blaivas
(212) 336-4261
jblaivas@mofo.com

Shane Shelley
(858) 720-5169
sshelley@mofo.com

Emily Beers
(202) 887-8726
ebeers@mofo.com

John Hensley
(202) 778-1654
jhensley@mofo.com

Mary Katherine Rawls
(404) 490-4445
mrawls@mofo.com

Jessica Stern
(415) 268-6836
jstern@mofo.com

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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



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