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Structuring REIT Roll-Ups, Conversions and Spin-Offs to Maximize Asset Value

Navigating Complex Tax Requirements, Securities Regulations and More

THURSDAY, AUGUST 28, 2014

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Structuring REIT Conversions, Roll-Ups Spin-Offs and IPOs

August 28, 2014

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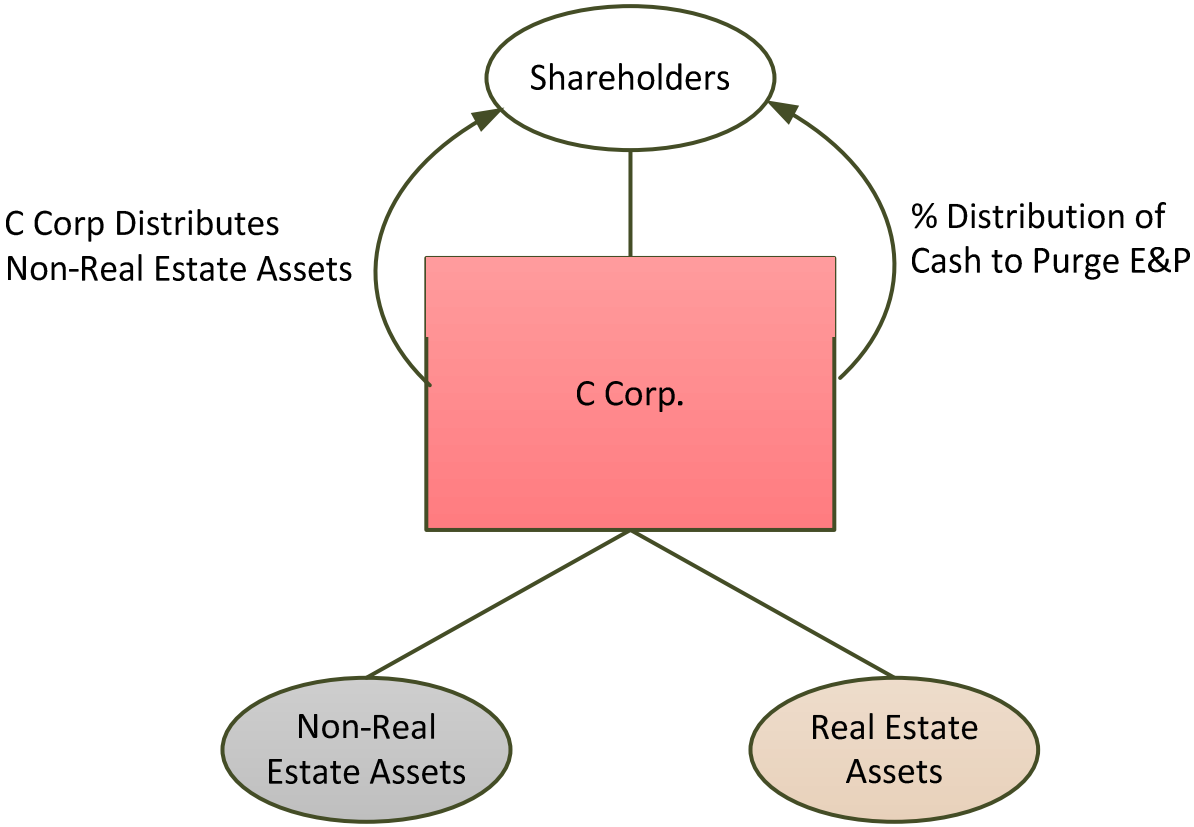
Outline

- **Background**
- **Tax and Securities Law Considerations with Various REIT Structures**
  - Conversion of Existing C Corporation to REIT
  - REIT Spin-Offs
  - REIT Roll-Ups
  - REIT IPOs
- **New Proposed Treasury Regulations on "Real Property"**

Possible Transaction Structures

- Conversion of C Corporation to REIT
  - C Corporation distributes all non-real estate assets to its shareholders and converts to a REIT
- Spin-Off of Real Estate Assets:
  - C Corporation contributes real estate assets to a newly formed subsidiary.
  - C Corporation distributes the subsidiary's stock to its shareholders and retains all non-real estate assets.
  - Newly formed corporation makes an election to convert to a REIT.
- REIT Roll-Up
  - Sponsor forms an UPREIT structure with a REIT parent and an operating partnership ("OP") subsidiary through which it will own substantially all of its assets.
  - The OP acquires the sponsor's properties (and potentially other properties) through a tax-free contribution. Sponsor and other contributors receive OP Units that can be exchanged for REIT shares to provide liquidity.
  - Investors purchase REIT shares for cash, potentially in an IPO. The cash can be used to acquire additional properties.

Conversion Structure



REIT Conversions: Background

Why Convert?

- Tax Savings at the Corporate Level
  - REITs are entitled to deduct all dividends paid as long as they distribute substantially all of their income in the taxable year
  - Results in little to no entity level tax
- Provides Liquidity
- Provides Diversification
- Certain investors (e.g. tax-exempts) find comparatively high level of income distributed advantageous
- REITs “block” UBTI and ECI
- Character of income as ordinary or capital gains is retained in hands of shareholders

REIT Conversions: Background

Why Not Convert?

- Compliance with complex REIT qualification rules
  - 95% of gross income must be passive; 75% of gross income must be from real estate related activities
  - 75% of gross assets must be real estate assets, cash, government securities and receivables
  - Limitation on percentage of assets that can consist of equity in taxable REIT subsidiary
  - Rules limit flexibility with respect to investment and business activities
  - Annual distribution requirements
  - Necessary amendments to charter and related stockholder approvals

Tax Issues: Conversion of Existing C Corporation to a REIT

Built In Gains

- Under Treas. Reg. §1.337(d)-7(e), the direct or indirect transfer of property by a C Corporation to a REIT triggers the built in gain requirement of Section 1374 of the Code unless deemed sale treatment is elected.
- Without a deemed sale election, Section 1374 would cause a REIT to be taxable as a C Corporation on the net built-in gain existing on the date of the conversion from a C Corporation to a REIT if any of the property transferred to the REIT were sold during the 10-year period following the date of transfer.
- Under a deemed sale election, investors in the contributing partnership that are classified as taxable C corporations would be required to recognize their distributive share of the built-in gain on the date the property is transferred by the partnership to the REIT as if the property were sold for its fair market value.

Tax Issues: Conversion of Existing C Corporation to REIT

Distribution to Purge E&P

- A corporation is not eligible for REIT treatment for a tax year unless as of the close of the tax year, the corporation has no earnings and profits accumulated in a tax year in which the REIT provisions did not apply to the corporation.
- Accordingly, a C corporation which has accumulated E&P must distribute those earnings and profits before it can qualify to make an election to be a REIT for the first time.
  - In the case of a spin-off, the distributing corporation must distribute an amount of E&P that is allocable to the real estate subsidiary.
  - Under Treas. Reg. §1.312-10(b), E&P is allocated in proportion to the relative value of the assets distributed to the real estate subsidiary.

Tax Issues: Conversion of Existing C Corporation to a REIT

Distribution to Purge E&P

- The prohibition of non-REIT earnings and profits has prevented many existing corporations from electing REIT status, since the distribution of the non-REIT earnings and profits would cause the existing shareholders to incur a substantial tax cost.
- Alternatively a stock distribution can be used if it is disproportionate (i.e. the shareholders are offered the option of selecting either stock or cash) or otherwise structured to be treated as a dividend under Section 305 of the Code.

Securities Issues: Conversion of Existing C Corporation to a REIT

Amending Existing Articles of Incorporation

- Existing articles must be amended as necessary to provide appropriate restrictions on stock ownership and transfer designed to protect REIT status.
  - Limit shareholders to owning no more than 9.8% (in value or in number of shares, whichever is more restrictive) of any class of equity
  - Limit share ownership that would cause REIT to be "closely held" or otherwise fail to qualify as a REIT
  - Provide that any transfer that, if effective, would result in shares being beneficially owned by fewer than 100 Persons is void
  - Include complex mechanisms for an automatic transfer of "excess shares" that would cause a violation of share ownership restrictions into a charitable trust
  - Provisions requiring holders of more than 5% of outstanding shares to provide notice and certain other information to the REIT

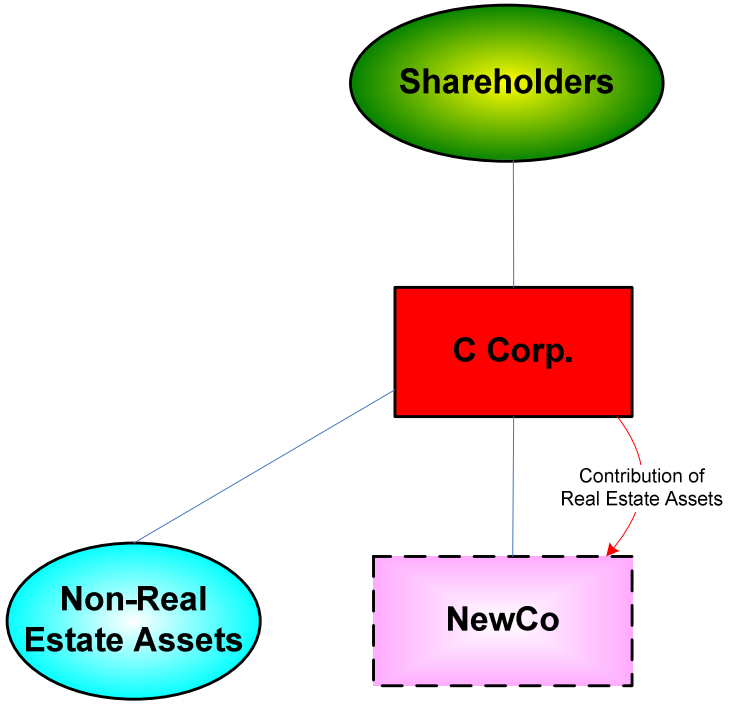
Securities Issues: Conversion of Existing C Corporation to a REIT

Amending Existing Articles of Incorporation (cont.)

- Number of shares of authorized stock must be sufficient to satisfy needs going forward (*e.g.*, to issue shares in an E&P purging distribution, if stockholder will be allowed option to elect stock and/or cash, or to issue shares in a roll-up or IPO)
- Consider additional charter provisions that will be necessary going forward (*e.g.*, NYSE corporate governance requirements if an exchange listing is contemplated, NASAA REIT Guidelines provisions if the new REIT will be a non-listed public REIT)
- Amending Existing Articles of Incorporation Will Require Stockholder Approval
  - Preparation of detailed proxy statement regarding amendments to organizational documents and underlying rationale for amendments (*i.e.*, REIT election)
  - Calling special stockholders meeting to approve amended organizational documents
  - Conversion to REIT status itself typically does not require stockholder approval
- Consider State Law Nuances

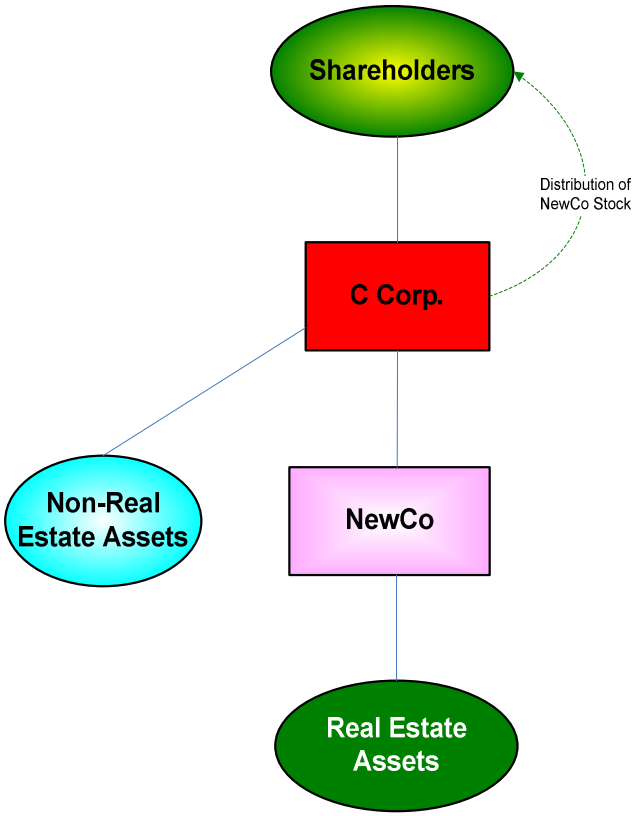
Spin-Off Structure

Spin-Off Transaction
Step 1 – Contribution of Real Estate Assets to NewCo



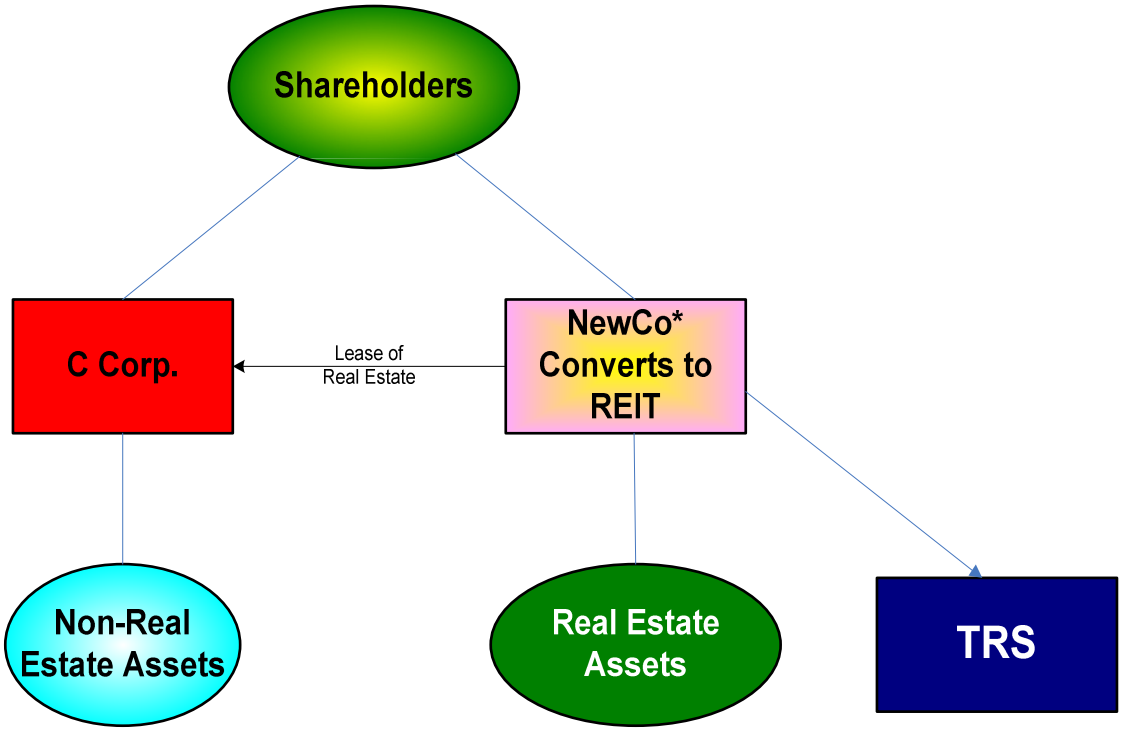
Spin-Off Structure

Spin-Off Transaction
Step 2 – Distribution of NewCo Stock to Shareholders



Spin-Off Structure

Spin-Off Transaction
Final – NewCo converts to a REIT, Forms a TRS to Provide Services, and Leases Real Estate Assets to C Corp.



Spin-Offs: Background

REIT Spin-Offs

- It was not until 2013 that the first REIT spin-off took place, when Penn National Gaming, Inc. spun off its casino-related real estate assets through a newly formed REIT.
  - It was also the first time that the Internal Revenue Service ("IRS") issued a ruling formally approving a REIT spin-off.
- In the same year, CBS Corp. announced the tax-free spin-off of its outdoor advertising subsidiary, CBS Outdoor.
  - Although the ruling does not discuss the qualification of CBS Outdoor as a REIT following the spin-off, CBS Corp. has stated that it has received a separate IRS ruling approving CBS Outdoor's REIT status.

Spin-offs: Background

- Also in 2013, The Ensign Group, Inc., a provider of skilled nursing and rehabilitative care services, announced the tax-free spin-off of its real estate business through a newly formed subsidiary which will elect to be treated as a REIT.
- The proposed spin-off by Windstream Holdings Inc. would be the fourth REIT spin-off in two years, and the third IRS ruling approving such transactions.

Tax Issues: Spin-Off Structure

Potential Issues in Obtaining Tax-Free Spin Off Treatment

- **Active business requirement: Immediately post-distribution both the distributing and distributed corporations must actively conduct a business**
  - REITs are generally regarded as passive entities
  - Rev. Rul. 2001-29: REIT can be engaged in the active conduct of a trade or business solely by virtue of functions that produce rents from real property
- **Business Purpose: For a separation to qualify as a tax-free spinoff, the transaction must be carried out for one or more corporate business purposes which must be real and substantial nonfederal tax purposes that are germane to the business of the distributing corporation or controlled corporation.**
  - "The potential for the avoidance of federal taxes by the distributing or controlled corporation . . . is relevant in determining the extent to which an existing corporate business purpose motivated the distribution."
  - Typically, significant purpose in restructuring to facilitate a REIT structure is tax reduction.
  - Possible business purposes include facilitation of an acquisition or the "fit and focus" business purpose.

Tax Issues – Spin-Off Structure

Potential Issues in Obtaining Tax-Free Spin-Off Treatment

- **Continuity of Interest: At least 40 percent of the proprietary interest in the controlled corporation must be exchanged for the distributed corporation's stock.**
  - Treas. Reg. §1.368-1(e)(1)(ii) provides that a proprietary interest is not preserved to the extent that consideration received by the target shareholders before the potential reorganization, either in a redemption or distribution with respect to stock, is treated as "other property or money received in the exchange."
  - Thus, the pre-merger taxable distribution designed to purge the corporation's E&P prior to converting to REIT status detracts from the ability to meet the continuity of interest test.
- **Not a Device: A spin-off cannot be tax-free if it is used "principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both."**
  - A pro rata spin-off is prima facie evidence of a device. Post-distribution intercorporate dealings also provide evidence of a device.
  - "Nondevice" factors include the existence and strength of the business purpose as well as the fact that the distributing corporation is publicly traded and widely held.

Tax Issues: Spin-Off Structure

Related Party Rents

- **For purposes of the REIT 95% and 75% income tests, "rents from real property" does not include any amount received or accrued, directly or indirectly, from any entity in which the REIT owns, at any time during the taxable year, a 10% or greater interest (except for a taxable REIT subsidiary if certain conditions are met).**
  - In the case of corporations, the REIT must not own 10% or more of the total combined voting power of all classes or total value of shares of all classes of stock outstanding.
  - In the case of any other type of entity, the REIT must not own 10% or more of its assets or net profits.
  - Even if a REIT does not own a 10% ownership interest in a tenant, a portion of the rent received may be disqualified from "rents from real property" if the tenant subleases any part of the property to a sublessee in which the REIT holds a 10% ownership interest.

Tax Issues – Spin-Off Structure

Related Party Rents

- Constructive attribution rules apply to determine whether an entity is a "related party".
- Where the real estate assets of an existing business are transferred a REIT, the natural lessee would be the transferring corporation. Thus, care must be taken to ensure that the remaining business is not related to the REIT.

Securities Issues: Spin-Offs

- Spin-Off That Is Not Preceded by an IPO
  - Example is the 2013 spin-off of Care Trust REIT, Inc. by The Ensign Group, Inc.
  - Primary disclosure document in connection with a spin-off that is not preceded by an IPO is a registration statement on Form 10 filed by the spin-off company. The Form 10 registers the class of shares of the spin-off company being distributed under the Exchange Act.
  - Form 10 contains (as an exhibit) an information statement that is disseminated to all parent shareholders and provides disclosure with respect to the spin-off company similar to disclosure that would appear in an IPO prospectus.
  - Form 10 typically reviewed by the SEC, which may result multiple amendments. However, Form 10 becomes automatically effective 60 days after filing.
  - Form 10 also must include audited financial statements of the spin-off company, including two years of balance sheets, three years of income statements, cash flows and statements of shareholder equity, as well as unaudited stub period financials for interim quarters. Therefore, if the spin-off company does not already have audited financials, audit work should commence on preparing carve-out financials in sufficient time to be completed for the initial Form 10 filing.

Securities Issues: Spin-Offs

- Spin-Off That Is Not Preceded by an IPO (cont.)
  - Registration under the Securities Act of the parent company's distribution of the shares of the spin-off company to the parent's stockholders is generally not required. The SEC's staff has specified five conditions that must be met to avoid registration of the distribution of the spin-off shares under the Securities Act in a spin-off not preceded by an IPO:
    - the parent stockholders do not provide consideration for the spun-off shares;
    - the spin-off is made *pro rata* to parent's stockholders;
    - the parent provides adequate information about the spin-off to its stockholders and the trading markets through a document such as a Form 10 information statement;
    - the parent has a valid business purpose for the spin-off; and
    - if the parent spins off "restricted securities," it has held those securities for at least two years (although this requirement does not apply where the parent forms the subsidiary being spun off, rather than acquiring the business from a third party).

Securities Issues: Spin-Offs

- Spin-Off Preceded by an IPO
  - Example is the 2013 spin-off of CBS Outdoor Americas, Inc. by CBS Outdoor.
  - Spin-off company files a registration statement on Form S-11 (the registration form prescribed for REITs) with the SEC, registering its IPO, and applies for listing on an exchange
  - A Form 10 is not required to be filed by the spin-off company; however a short-form registration statement on Form 8-A will be required upon the listing of its shares on an exchange.
  - Following the close of the IPO, the spin-off company files a Form S-4 registering under the Securities Act the shares of the spin-off company's stock that will be issued in a tax-free "split-off" exchange-offer, pursuant to which the parent will offer its stockholders the option to exchange shares of parent's stock for shares of the spin-off company's stock.
  - The parent company's exchange offer also will be subject to the tender offer rules, which require that the parent file a Schedule TO.

Securities Issues: Spin-Offs

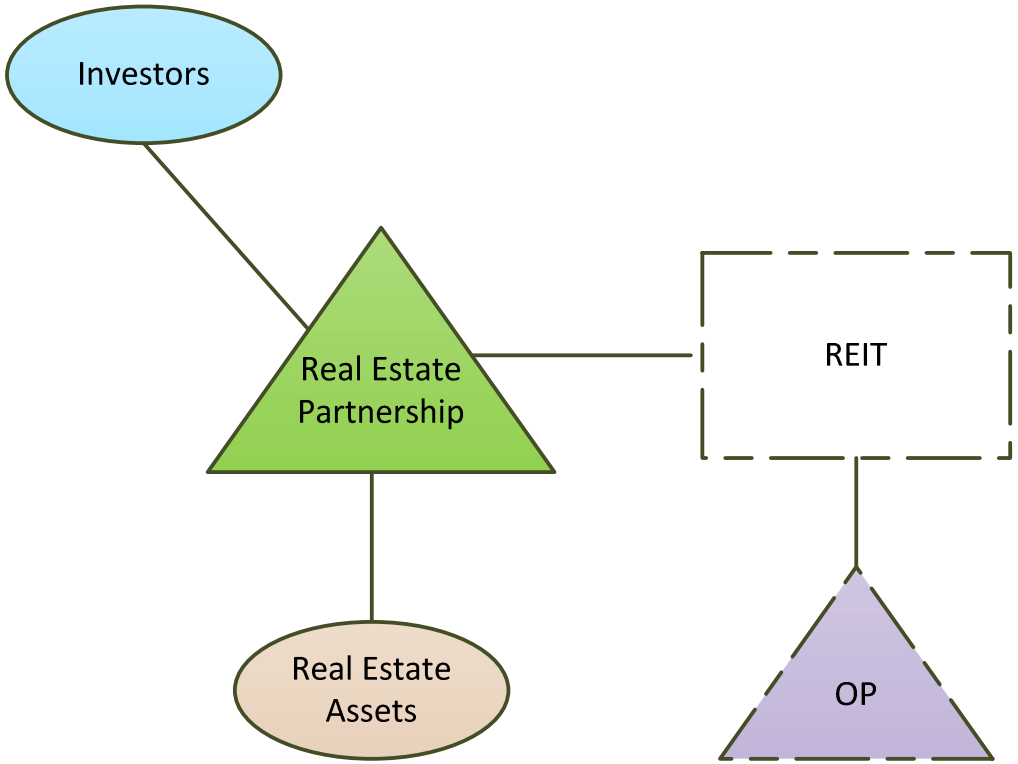
- Eligibility to Use Form S-3
  - A spin-off company may desire access to the public equity and/or debt markets soon after a spin-off is consummated, for example, to refinance short-term debt.
  - The SEC Staff has stated that a spin-off company may inherit its former parent's Exchange Act reporting history for purposes of becoming eligible to use a short-form registration statement on Form S-3 if:
    - it was eligible to use Form 10 in the spin-off;
    - the parent is current in its Exchange Act reporting; and
    - the spin-off company will have substantially the same assets, business and operations as a separate segment in the parent's financial reporting for at least 12 months before the spin-off.
- The spin-off company also typically files one or more registration statements on Forms S-8 to register the issuance of equity under its employee benefit plans.

Securities Issues: Spin-Offs

- Section 16 Reporting: The directors and executive officers and significant stockholders of the spin-off company will need to make Section 16 filings such as Forms 3 and 4.
- Form 8-K Reporting: Upon completion of the spin-off, the spin-off company typically files a Form 8-K reporting its entry into material agreements with the parent, amendments to its organizational documents and any press releases. If the spin-off constitutes a disposition of significant assets under Form 8-K Item 2.01, the parent will need to file pro formal financial information reflecting such disposition on Form 8-K.
- Exchange Act Reporting: Once the SEC declares the spin-off company's Form 10 effective—or, if the spin-off will be preceded by an IPO, once the Forms S-11 and Form 8-A are effective—the spin-off company will be subject to the Exchange Act's reporting requirements and proxy rules, as well as the Sarbanes-Oxley Act. Companies should consider the timing of actions undertaken in connection with the spin-off in light of these requirements.

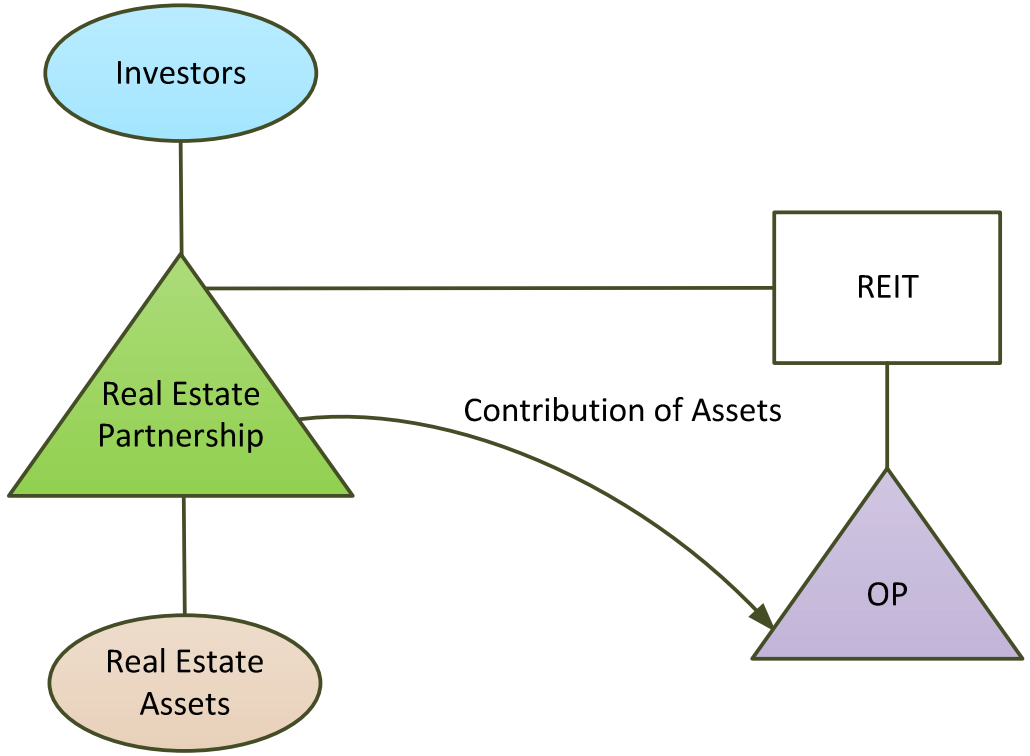
REIT Roll-Up Structure

Roll-Up Transaction
Step 1 — Formation of REIT and OP



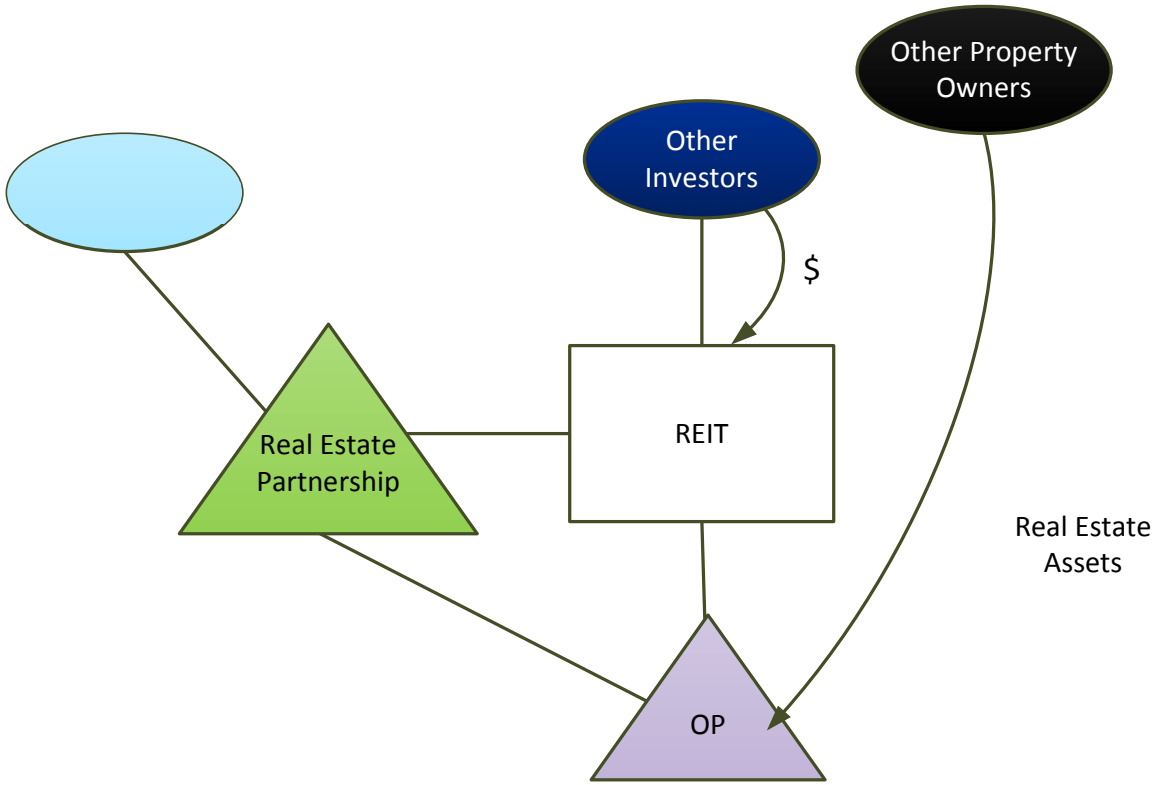
REIT Roll-Up Structure

Roll-Up Transaction
Step 2 — Initial Contribution of Real Estate Assets

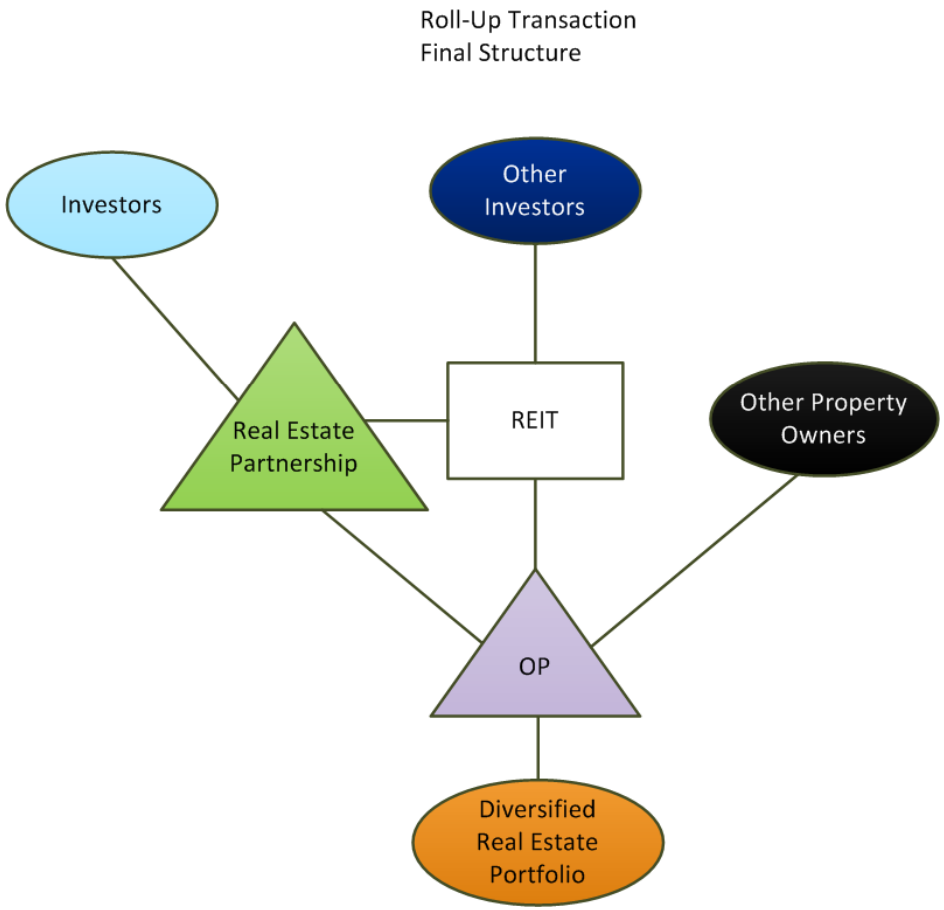


REIT Roll-Up Structure

Roll-Up Transaction
Step 3 — Contributions by Other Investors



REIT Roll-Up Structure



Tax Issues: REIT Roll-Up Transactions

General Structuring Objectives

- The contribution of property to a partnership in exchange for a partnership interest is generally a tax-free transaction.
- The partnership acquires the contributed property with a carryover tax basis and the contributor's initial tax basis in its partnership interest is equal to the tax basis it had in the contributed property.
- The contribution of low-basis mortgaged property may result in gain recognition by contributor if its share of the OP's liabilities is significantly less than the debt assumed.
  - Often contributor and OP enter into a Tax Protection Agreement.

Tax Issues: Roll-Up Transaction

- Conversion of OP Units into REIT shares is a taxable transaction.
- When contributed property is sold, or depreciation is taken with respect to such property, under Section 704(c), allocations of income and loss must take into account the difference between the book value of the property and its tax basis.
  - As a result built-in gain recognized on the sale of the contributed property must be allocated to the contributor.
  - Depreciations deductions with respect to the contributed property are disproportionately allocated to the REIT.

Securities Issues: Roll-Up Transactions

- Form a securities law perspective, the issuance of REIT stock/operating partnership (OP) units to holders of contributed interests in a roll-up is a private placement of securities.
  - An exemption from the registration requirements of the Securities Act is necessary for the issuance – typically under Regulation D. This requires that each REIT stock/OP unit recipient qualify as an "accredited investor." Non-accredited investors are typically offered solely cash.
  - In the past, the private placement process had to be essentially complete before the REIT's registration statement for its IPO was publicly filed. The concern was that the private offering of the REIT stock/OP units in the roll-up transaction could be "integrated" with the public sale of the REIT's shares in the IPO, which could lead to application of the SEC's onerous roll-up transaction rules and securities liability for failure to register the REIT shares and OP units issued.

Securities Issues: Roll-Up Transactions

- Most roll-ups qualify for an exemption from the SEC's roll-up transaction rules because the REIT shares and OP units issued to contributors are issued in unregistered private placements.
- If the SEC's rules on roll-up transactions are deemed to apply to a roll-up, 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 public 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, and statements as to the fairness of the proposed roll-up transaction to the investors, including whether there are fairness opinions.

Additional legal Issues: Roll-Up Transactions

- In order to consummate a typical roll-up, each holder of an interest in a participating partnership must agree to contribute its interests to the operating partnership, OR the transactions must be consummated through a series of merger transactions pursuant to which non-consenting holders can be dragged along.
- The organizational documents of each participating partnership must be reviewed to determine whether it is possible to drag along minority holders, and if so, what threshold of approval must be obtained from such holders.
- In addition, lender consents may be required to consummate the UPREIT roll-up, and a review of the underlying debt documents should be conducted.
- All other material contracts should also be reviewed for consent issues.

Additional legal Issues: Roll-Up Transactions

- Risks to Contributors in Roll-up Transactions
- Loss of control is the primary risk. OP units typically do not have voting rights at the REIT level and have only limited voting rights at the OP level. In addition, the REIT can incur leverage, sell properties, or suffer a change of control or an insolvency without contributor consent.
- Liquidity is not guaranteed. The REIT could be delisted from the exchange or not have an effective registration statement (including as a result of a sale of the REIT to a private buyer), in which case there would be little or no liquidity for contributors.
- If the contributor becomes an “affiliate” of the REIT, though board membership or a large ownership of common stock, the contributor may be subject to liquidity traps under insider trading prohibitions or the short swing profits rule of Section 16 of the Exchange Act.
- If the contributor is relying on the contribution to defer tax obligations, loss of control can be a particularly sensitive issue because it may lose control of future events that would cause it to incur a tax liability.

Additional legal Issues: Roll-Up Transactions

- The SEC's 2007 interpretive guidance (Release No. 33-8828) on public/private offering integration issues and the new rules promulgated under the JOBS Act that allow general solicitation and advertising in certain private offerings under Rule 506 so long as the securities are sold to accredited investors or qualified institutional buyers (QIBs) lessen the "integration" risk for roll-ups conducted as private placements.

REIT IPOs: Background

- 19 REIT IPOs in 2013, raising a total of $5.71 Billion, the largest amount raised in the largest number of IPOs since 2004
- Listed REITs raised a total of $76.96 billion of equity and debt in 2013, an amount that surpassed 2012's prior record of $73.33 billion
- Year-to-date activity for REIT IPOs much slower: two REIT IPOs completed as of July 1st.

REIT IPOs: Basics

- An "IPO" is the initial public offering by a company of its securities
- REIT IPOs are registered with the SEC under the Securities Act of 1933 pursuant to a registration statement on Form S-11
- REIT shares offered are typically listed on the New York Stock Exchange, and less often on one of the NASDAQ markets
- The process of "going public" is complex and expensive
- Upon the completion of an IPO, a company becomes a "public company," subject to all of the regulations applicable to public companies, including those of the Securities Exchange Act of 1934.

REIT IPO: Advantages

- Access to capital
  - Unlike a private offering, no restrictions with respect to number or type of investors or the dollar amount of securities that may be sold
  - Raises capital without selling a "control" block
  - Access to expansion capital for accelerated growth
  - Following listing, ability to use equity in lieu of cash or more costly debt financing
- Liquidity
  - Public marketplace provides investors liquidity at any time and founders can monetize portions of their investment over time
- Market recognition
  - Media and analysts have greater economic incentive to cover a public company than a private company
- Ability to use equity compensation
  - Stock-based compensation aligns employees' interests with those of company and allows company to attract top talent

REIT IPOs: Factors to Success

- Growth story – essential to capital raising
- FFO/Dividend – compare to peer set; coverage issues
- Management team – public company experience
- Independent directors – known to REIT institutional investors

REIT IPOs: Principal Parties

- Issuer (the company/registrant)
- Underwriters (investment banks)
- Counsel to the issuer
- Counsel to the underwriters
- Auditors (independent registered public accounting firm)
- Seller of contributed properties (if use of proceeds is a roll-up)
- Transfer agent
- Financial printer

REIT IPOs: Major Periods

- The IPO process can generally be divided into three distinct time-periods:
  - Pre-filing period
    - Begins with internal decision to pursue a public offering/organizational meeting
    - "Quiet period" during which oral/written offers of any kind are prohibited. The SEC interprets “offer” very broadly – the Company and other offering participants must be careful to restrict communications such as interviews and press releases
  - Waiting period
    - Begins with filing of the registration statement with SEC
    - Written offers can be made only pursuant to a preliminary prospectus; oral offers are permitted; no acceptances (or sales) are permitted
    - “Tombstone” ads containing limited information regarding the offering are permitted
  - Post-effective period
    - Begins when the registration statement is declared effective by SEC
    - Sales may be completed

REIT IPOs: Pre-Filing Period

- Select company legal counsel
  - Prepare registration statement and offering documentation and represent the company's legal interests throughout IPO process
  - Coordinate legal due diligence and issue legal opinions
  - Crucial to select counsel with appropriate industry and sector expertise and a proven track record of executing the REIT IPO process
- Select auditors
  - Accounting due diligence
  - Comfort letters
  - Financial statements
- Select underwriters (lead bookrunners)
  - Coordinate working group and due diligence efforts
  - Clearly communicates methodology for valuation
  - Actively markets to retail and institutional investors
  - Recommends pricing and terms of the offering
  - Underwriters final sale of the securities
  - Should be chosen based on relationship with the company, industry expertise, expertise, track record in executing IPOs, distribution platform and market-making ability

REIT IPOs: Pre-Filing Period

- Select exchange
  - NYSE vs. NASDAQ
  - Majority of REITs list on NYSE
  - Each market has specific listing requirements such as earnings history, shareholders' equity, market capitalization and corporate governance
- IPO valuation
  - Timing and market demand
  - Prices of similar successful offerings and comparison to comparable public companies based on valuation multiples
  - Demand generated during road show
  - "IPO discount"; generally 10-15%

REIT IPOs: Pre-Filing Period

- Corporate housekeeping
  - Ensure sufficient authorized shares for IPO and future issuances
  - Board composition
    - Must have a majority of "independent" directors, as defined by the applicable exchange
    - "Financial expert," as defined by SEC rules, required to serve on audit committee
    - 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
    - Begin search for suitable directors early in the IPO process
    - The practice of combining the role of CEO and chairman of the board, once common, has recently fallen out of favor. Many companies are now splitting the two positions or are creating the role of “lead director.”

REIT IPOs: Pre-Filing Period

- Underwriters due diligence
  - Ensures accuracy and completeness of registration statement and prospectus
  - Establishes due diligence defense for underwriters and directors
- Business and accounting due diligence
  - Interview key employees (ie – CEO, CFO, VP of Operations, etc.)
  - Property visits
  - Review management's financial projections
  - Identify accounting issues
- Legal due diligence
  - Company counsel and underwriters' counsel present due diligence request lists
  - Identify disclosure issues such as pending litigation, environmental matters, regulatory matters, etc.
  - Supports the legal opinions required by the underwriters to be delivered as a condition to closing in the underwriting agreement

REIT IPOs: Pre-Filing Period

- Organizational meeting
  - Kick-off meeting with the company and its counsel, the auditors and the underwriters and their counsel
  - The company provides a brief overview of its business, use of proceeds and strategic plans
  - Establish IPO timeline
    - A carefully planned schedule will provide sufficient time for the due diligence process, preparation of registration statement and SEC review of and comment on the registration statement
    - Timeline will culminate in a road show and pricing tat occurs outside of marketing "dead zones," such as the last two weeks in August and in December
    - Generally, 3-4 months from kick-off meeting for underwritten offering; longer timeline for roll-up transaction
  - Allocate responsibilities
  - Discuss any significant issues identified thus far

REIT IPOs: Pre-Filing Period – The Registration Statement

- Form S-11 prescribed for REITs
- Form S-11 is divided into two parts. Part I includes the prospectus, the primary selling document, and contains essential facts regarding business operations, financial condition and management details. Part II contains additional information not required to be included in the prospectus.
- Prospectus
  - Prospectus summary
    - Due to capsule form and placement at the front of the document, vital to marketing
  - Risk factors
  - Use of Proceeds
  - Description of business and investment policies
  - Description of properties and real estate assets
  - Management and executive compensation information
  - Management's Discussion and Analysis, or "MD&A"
  - Dividend Policy; aka the "Magic Page"
  - Underwriting (prepared by underwriters counsel)
- Most new REITs will qualify as "Emerging Growth Companies" under the JOBS act and will be eligible for scaled-down disclosure requirements

REIT IPOs: Waiting Period

- Commences upon filing of S-11 with the SEC. During waiting period, the registration statement is subject to regulatory review by both the SEC and FINRA
- "Emerging Growth Companies" as defined under the JOBS Act may submit a draft IPO registration statement to the SEC for nonpublic review (but must file publicly at least 21 days prior to conducting a roadshow)
- SEC review
  - SEC will typically issue initial comment letter within 30 days of filing the registration statement
  - Issuer will file formal response letters and pre-effective amendments to the registration statement in response to SEC comments
  - SEC comment letters and issuer responses are publicly released 45 days after the review of the registration statement is complete, unless confidential treatment is formally requested

REIT IPOs: Waiting Period

- Submit listing application
  - Formal listing application must be filed, along with a listing agreement, a listing fee and various supporting corporate e-documents and other documentation
  - NYSE requires a confidential review of eligibility before a listing application may be filed
- Negotiate Underwriting Agreement and Auditor's Comfort Letter; FINRA filings
  - IPO cannot proceed until the underwriting arrangement terms have been approved by FINRA

REIT IPOs: Waiting Period

- Marketing the offering: "Road show"
  - 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"
  - Road show is a marketing process whereby the company and its underwriters engage in meetings with potential investors, securities analysts and brokers
  - Successful road show has a large impact on the offering price and on the initial aftermarket trading and is a critical marketing effort
  - Road show "message" must be consistent with the disclosure in the preliminary prospectus
  - The road show may be either "live" or electronic
  - Emerging Growth Company must publicly file a confidentially submitted registration statement, along with any amendments, at least 21 days before the beginning of the road show

REIT IPOS: Sample Timeline

Time	To-do's
6 – 12 months before IPO	• Company rounds out management team (if needed) • Focus on "corporate cleanup" • Identify real estate assets that may be acquired"
4 - 6 months before IPO	• Company decides formally to undertake IPO • Appoint underwriter • Publicly restrictions commence • Finalize structure – UPREIT, DownREIT, etc. • Analyze valuation of real estate assets • Begin process to effect roll-up transaction
2 months before first SEC filing	• Conduct due diligence • Complete prospectus drafting • Complete audit and review of interim financials • Complete any private offering • Add independent directors to board (if necessary)

REIT IPOs: Sample Timeline

Time	To-do's
Initial SEC filing or confidential submission	• File Form S-11 with SEC or submit confidentially to SEC • Submit application to exchange
30 days after first SEC filing	• Receive first SEC comments
1-2 weeks after receipt of SEC comments	• File amended Form S-11
Comments at 2-4 week intervals	• Respond to second (and third and fourth) round of SEC comments
Typically 2 – 4 months after first filing	• Resolve material SEC comments • Listing approval • Bulk print preliminary ("red") prospectus
21 days prior to road show for EGCs	• File registration statement
Typically 1 – 2 weeks	• Road show
Transaction effective	• Form S-11 declared effective • Price deal • Commence public offering
3 – 4 days after pricing	• Close offering

Traditional Definition of "Real Property"

- **"Real property" includes structural components of buildings or other inherently permanent structures and "interests in real property."**
  - In determining what constitutes real property, local law is not controlling.
- **"Interests in real property" include fee ownership or co-ownership of land or improvements thereon, leaseholds of land or improvements and options with respect to such land.**
- **Treas. Reg. §1.856-3(d) treats the following assets contained in a building as "real property":**
  - wiring;
  - plumbing systems;
  - central heating or central air-conditioning machinery;
  - elevators or escalators installed in the building;
  - pipes or ducts; and
  - structural components of a building or other permanent structures.

Traditional Definition of "Real Property"

- **By contrast, Treas. Reg. §1.856-3(d) provides that assets accessory to the operation of a business are not "real property" even though such items may be termed fixtures under local law. Examples include the following:**
  - machinery;
  - transportation equipment which is not a structural component of the building;
  - office equipment;
  - refrigerators;
  - individual air-conditioning units;
  - grocery counters;
  - and furnishings of a motel, hotel, or office building.

Traditional Definition of "Real Property"

- **In private letter rulings, the IRS has applied a "moveability" criterion for purposes of classifying property as "real property" based on an analogy to rulings involving the former investment tax credit under Section 48.**
  - For example, in PLR 8931039, the IRS ruled that manufactured homes are "inherently permanent structures," and, therefore, are real property, notwithstanding that the manufactured homes were treated as personal property for local law purposes based on the manner of attachment to the land and how permanently the property was designed to remain in place.
- The issuance of the Proposed Regulations follows an Internal Revenue Service ("IRS") moratorium on issuing private letter rulings ("PLRs") with respect to REITs to take time to evaluate prior IRS rulings and "modernize" the existing Treasury Regulations to provide regulatory guidance for less traditional types of property.

Proposed Treasury Regulations

- The issuance of the Proposed Regulations follows an Internal Revenue Service ("IRS") moratorium on issuing private letter rulings ("PLRs") with respect to REITs to take time to evaluate prior IRS rulings and "modernize" the existing Treasury Regulations to provide regulatory guidance for less traditional types of property.
- There were not many surprises. The Proposed Regulations generally expand the definition of "real property" in the existing Treasury Regulations to include the types of property for which the IRS provided favorable rulings and the more recently issued PLRs.
- The goal of the IRS is to reduce need for taxpayers to seek rulings with respect to specific types of property.

Proposed Treasury Regulations

- The Proposed Regulations:
  - define "real property" to include land, inherently permanent structures and structural components,
  - specify certain assets that are *per se* "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.
- Land is defined to include water and air space superjacent to land and natural products and deposits that are unsevered from the land.
- The Proposed Regulations define an "inherently permanent structure" as any building or other structure permanently affixed to land.
  - In general, inherently permanent structures must serve a passive function such as housing rather than an active function such as manufacturing.

Proposed Treasury Regulations

- The Proposed Regulations define structural components as any distinct asset that is a constituent part of and integrated into an inherently permanent structure, serves the inherently permanent structure in its passive function and, even if capable of producing income other than consideration for the use or occupancy of space, does not produce or contribute to the production of such income.
  - A structural component is real property only if it is held by the taxpayer together with the taxpayer's interest in the inherently permanent structure to which the structural component is functionally related.