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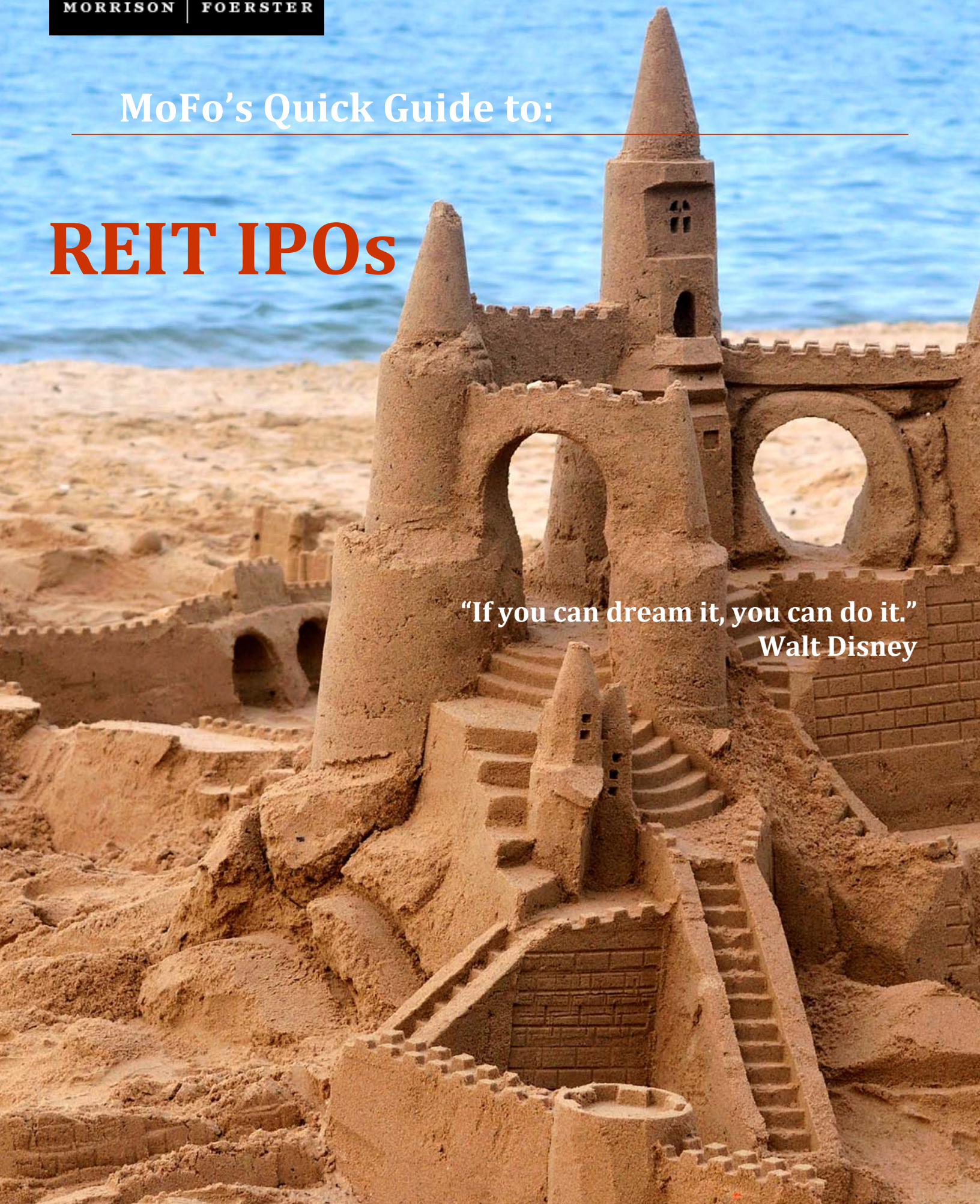
MoFo's Quick Guide to:

REIT IPOs



"If you can dream it, you can do it."
Walt Disney

During the last 12 months, we have seen a resurgence in real estate investment trusts ("REITs"). REIT market participants have started de novo REITs, including equity REITs and mortgage REITs. Both new REITs and private REITs have filed registration statements with the Securities and Exchange Commission ("SEC") for proposed initial public offerings. This new generation of REITs is simply another chapter in the evolution of REITs. A REIT is an investment vehicle designed to allow investors to pool capital to invest in real estate assets. It has certain advantages over other investment vehicles; in particular a REIT is entitled to pass-through taxation even if its equity is publicly traded. REITs generally finance their activities through equity capital and debt offerings. Although there is an active private market for REIT securities, REIT sponsors often have chosen to pursue IPOs.

ADVANCE PLANNING

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. This can be particularly difficult for a newly formed REIT if it does not own the assets prior to commencement of the IPO process. Many corporate governance matters, federal securities law requirements (including Sarbanes-Oxley), as well as applicable securities exchange requirements must be met when the IPO registration statement is filed, or the issuer must commit to satisfying them within a set time period.

> Nine of 63 IPOs completed in the United States in 2009 were REITs.

A company proposing to list securities on an exchange should review the differing governance requirements of each exchange, as well as their respective financial listing requirements, before determining which exchange to choose. An issuer must also address other corporate governance matters, including board structure, committees and member criteria, related party transactions, and director and officer liability insurance. The company should undertake a thorough review of its compensation scheme for its directors and officers, as well, particularly its use of equity compensation.

While Delaware is the state of incorporation favored by operating companies preparing to go public, many public REITs form in Maryland as either a corporation or a business trust because Maryland has a special REIT law and is perceived as business-friendly to REITs. We do not address in this guide the factors to be considered in choosing a Maryland or Delaware domicile. Except as briefly discussed in "Roll-ups and UPREITs," we do not address the complex issues involved in forming a REIT, particularly if the REIT is created from multiple separate real estate holding entities. The SEC has extensive guidance on the disclosure and accounting requirements for these formation transactions.

Primary and Secondary Offerings

An IPO may consist of the sale of newly issued shares by the company (a "primary" offering), or a sale of already issued shares owned by shareholders (a "secondary" offering), or a combination of these.

Taxing Thoughts

In general, a REIT is able to offer publicly traded equity interests 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 the asset and income tests and the distribution requirements and will not engage in any prohibited transactions. The issuer will also be required to satisfy a number of technical requirements such as having at least 100 shareholders. If the issuer qualifies as a REIT, its income generally will not be subject to tax in the hands of the REIT but instead each of its shareholders will be taxed on amounts distributed by the REIT.

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), cash, cash items, and government securities. No more than 25% 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 securities of any one issuer, other than a TRS, and a REIT may not hold more than 10% of the voting power of any one issuer or more than 10% of the total value of the outstanding 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.

Underwriters may prefer a primary offering because the company will retain all of the proceeds to advance its business. However, many IPOs include secondary shares, either in the initial part of the offering or as part of the 15% overallotment option granted to underwriters. Venture capital and private equity shareholders view a secondary offering as their principal realization event. An issuer must consider whether any of its shareholders have registration rights that could require the issuer to register shareholder shares for sale in the IPO.

Taxing Thoughts – Cont'd

In general, a REIT must make qualifying distributions equal to 95% of its taxable income in order to maintain its REIT qualification. A REIT can elect to retain its capital gains and pay tax on the gains, then treat the gains as if distributed to its shareholders, with the shareholders receiving a credit against their taxes for the tax paid by the REIT. Many REITs offer dividend reinvestment programs to their shareholders.

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

In addition, although preferred interests can be issued, tax issues could arise for a REIT if holders of one class of stock receive dividends before or in a different amount or form of consideration than dividends received by the other stock holder in such class. Further consideration would be required to determine whether such a structure might violate the REIT prohibition against "preferential dividends." Violating the prohibition against "preferential dividends" would disqualify the REIT, in which case it would be treated like a C Corporation. Disqualification generally requires a five-year wait before REIT status can be reelected.

In the process of converting from a partnership or corporation to a REIT, built-in gains with respect to assets transferred from the partnership or corporation to the REIT may be subject to tax. The direct or indirect transfer of property by a partnership or C Corporation to a REIT will cause the REIT to be taxable as a C Corporation on any net built-in gain of the property transferred to the REIT if such property is sold during the 10-year period following the date of transfer. However, the contributing partnership or the C Corporation may make a deemed sale election pursuant to which it would be required to recognize its distributive share of the built-in gain on the date the property is transferred by the partnership of the C Corporation to the REIT as if the property were sold for its fair market value.

Careful tax planning is required to address these concerns.

Cheap Stock

"Cheap stock" describes options granted to employees of a pre-IPO company during the 18–24 months prior to the IPO where the exercise price is deemed (in hindsight) to be considerably lower than the fair market value of the shares at grant date. If the SEC determines (during the comment process) that the company has issued cheap stock, the company must incur a compensation expense that will have a negative impact on earnings. The earnings impact may result in a significant one-time charge at the time of the IPO, as well as going-forward expenses incurred over the option vesting period. In addition, absent certain limitations on exercisability, an option granted with an exercise price that is less than 100% of the fair market value of the underlying stock on the grant date will subject the option holder to an additional 20% tax pursuant to Section 409A of the Code.

The dilemma that a private company faces is that it is unable to predict with certainty the eventual IPO price. A good-faith pre-IPO fair market value analysis can yield different conclusions when compared to a fair market value analysis conducted by the SEC in hindsight based on a known IPO price. There is some industry confusion as to the acceptable method for calculating the fair market value of non-publicly traded shares and how much deviation from this value is permitted by the SEC. Companies often address this "cheap stock" concern by retaining an independent appraiser to value their stock options. However, it now appears that most companies are using one of the safe-harbor methods for valuing shares prescribed in the Section 409A regulations.

Governance and Board Members

A company must comply with significant corporate governance requirements imposed by the federal securities laws and regulations and the regulations of the applicable 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 regulations and exchange regulations. 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 after the IPO is completed. The company can turn to its large investors as well as its counsel and underwriters for references regarding potential directors.

THE OFFERING PROCESS

The public offering process is divided into three periods:

- **The pre-filing period** between determining to proceed with a public offering and the actual SEC filing of the registration statement; the company is in the "quiet period" and subject to potential limits on public disclosure relating to the offering.
- **The waiting or pre-effective period** between the SEC filing date and the effective date of the registration statement; during this period, the company may make oral offers, but may not enter into binding agreements to sell the offered security.
- **The post-effective period** between effectiveness and completion of the offering.

The Registration Statement

A registration statement contains the prospectus, which is the primary selling document, as well as other required information, written undertakings of the issuer, and the signatures of the issuer and the majority of the issuer's directors. It also contains exhibits, including basic corporate documents and material contracts. For REITs and certain other issuers whose business is primarily that of acquiring and holding real estate or interests in real estate, the SEC requires that the issuers use Form S-11 for IPOs. Note, issuers that operate a real estate-related business, such as a resort, are considered to be providing a service rather than holding real estate and must file on Form S-1. Foreign private issuers may also use Form S-11 although they are permitted to comply with certain provisions of Form 20-F, the general registration form for foreign private issuers, for certain non-real-estate-related disclosure rather than the more detailed requirements of Form S-11.

Dress Rehearsal

Well before its IPO, an issuer should begin to approach executive compensation as a public company would. 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 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.

Issuers contemplating an IPO should consider:

Systematizing compensation practices. Compensation decisions should be made more systematically—doing so may require:

- establishing an independent compensation committee of the board of directors.
- using formal market information to set compensation.
- establishing a regular compensation grant cycle.

Confirming accounting and tax treatment. The issuer should be sure that the Internal Revenue Code Section 409A valuation used to establish stock value for stock option purposes is consistent with that used for financial accounting purposes. The issuer also should consider whether to limit option grants as the IPO effective date approaches. Option grants close to an IPO may raise "cheap stock" issues.

Securities law compliance. The issuer should confirm that equity grants were made in compliance with federal and state securities rules, including Rule 701 limits, to avoid rescission or other compliance concerns.

Adopting plans. An issuer will have greater flexibility to adopt compensation plans prior to its IPO. Accordingly, planning ahead is essential. An issuer should adopt the plans it thinks it may need during its first few years of life as a public company (including an equity plan, employee stock purchase plans, and Code Section 162(m) "grandfathered" bonus plans), and reserve sufficient shares for future grants. Public companies are required to obtain shareholder approval for new compensation plans and material amendments.

Establishing a DRIP. Since REITs typically must pay dividends, in order to recapture a portion of such amounts and raise additional capital, many REITS adopt Dividend Re-Investment or Stock Repurchase Plans, or DRIPs.

The Prospectus

The prospectus describes the offering terms, the anticipated use of proceeds, the company, its industry, business, management and ownership, and its results of operations and financial condition. Although it is principally a disclosure document, the prospectus also is crucial to the selling process. A good prospectus sets forth the 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 that the company faces, and has no material misstatements or omissions, investors will not be able 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 and operating and financial trends that may affect its results of operations and prospects.

SEC rules generally require a substantial number of specific disclosures to be made in the prospectus. Further and in contrast to the general requirements of Form S-1, Form S-11 together with Guide 5 contain detailed requirements regarding the issuer's real estate ownership and investment policies, operating data, and descriptions of the real estate, as well as disclosure about the prior experience of sponsors and their affiliates. Depending on the nature of the specific REIT—UPREIT, DownREIT, equity, mortgage, externally managed, self-managed or self-administered blind pool, etc. —there will be additional necessary disclosures. If the transaction also meets the SEC definition of a "roll-up transaction," there are additional disclosure obligations (*see* "Roll-ups and UPREITs").

In addition, federal securities laws, particularly Rule 10b-5 under the Securities Exchange Act of 1934, require that documents used to sell a security contain all 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 in making an investment decision. That simple statement is often difficult to apply in practice.

Roll-ups and UPREITs

One common IPO approach is the "roll-up," in which one or more partnerships owning interests in real estate combine or reorganize and some or all of the investors in such partnerships receive new securities or securities in another entity. While the investors can receive securities of the to-be-public REIT, typically, in order to defer the recognition of gain, the transaction is structured as an UPREIT. In the typical UPREIT, the partners of the partnerships and the new REIT become partners in a new partnership termed the Operating Partnership. For their respective interests in the Operating Partnership ("Units"), the partners contribute the properties from the partnership and the REIT contributes the cash proceeds from its public offering. The REIT typically is the general partner and the majority owner of the Operating Partnership Units. The allocation of the Units based on the properties being contributed can involve significant analysis and negotiation. The UPREIT structure allows tax deferral while providing a kind of "on demand" liquidity.

After a period of time (often one year), the partners may enjoy the same liquidity as the REIT shareholders by tendering their Units for either cash or REIT shares (at the option of the REIT or Operating Partnership). This conversion may result in the partners incurring the tax deferred at the UPREIT's formation. The Unitholders may tender their Units over a period of time, thereby spreading out such tax. In addition, when a partner holds the Units until death, the estate tax rules usually permit the beneficiaries to tender the Units for cash or REIT shares without paying income taxes.

In the late 1980s and early 1990s, in response to concerns about sponsor abuses in structuring public real estate roll-ups, the U.S. Congress and California passed specific roll-up legislation, the SEC issued targeted roll-up disclosure requirements, and the NASD (now FINRA) issued roll-up guidelines, all of which were designed both to give investors necessary information about the transaction and to lessen the coercive effects of the offering. The SEC definition of a "roll-up transaction" has specific exclusions that often now are relevant. But if the exclusions are not applicable, in addition to the requirements of Form S-11 and Guide 5, the SEC will require significant additional disclosure, including about the properties being contributed (including separate supplements for each partnership), additional risk factors and disclosures regarding conflicts of interest, statements as to the fairness of the transaction to the investors in the partnerships, including whether there are fairness opinions, explanation of the allocation of the roll-up consideration and pro forma financial information.

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.

An issuer should be prepared for the time-consuming drafting process, during which the issuer, investment bankers, and their respective counsel work together to craft the prospectus disclosure.

The Pre-Filing Period

The pre-filing period begins when the company and the underwriters agree to proceed with a public offering. During this period, key management personnel will generally make a series of presentations covering the company's business and industry, market opportunities, and financial matters. The underwriters will use these presentations as an opportunity to ask questions and establish a basis for their "due diligence" defense.

From the first all-hands meeting forward, all statements concerning the company should be reviewed by the company's counsel to ensure compliance with applicable rules. Communications by an issuer more than 30 days prior to filing a registration statement 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 pre-sell the public offering may be considered an illegal prospectus, creating a "gun-jumping" violation. This might result in the SEC's delaying the public offering or requiring prospectus disclosures of these potential securities law violations. Press interviews, participation in investment banker-sponsored conferences, and new advertising campaigns are generally discouraged during this period.

In general, at least four to six weeks will pass between the distribution of a first draft of the registration statement and its filing with the SEC. To a large extent, the length of the pre-filing period will be determined by the amount of time required to obtain the required financial statements.

The Waiting Period

Responding to SEC Comments on the Registration Statement

The SEC targets 30 calendar days from the registration statement filing date to respond with comments. It is not unusual for the first SEC comment letter to contain a significant number of comments that the issuer must respond to both in a letter and by amending the registration statement. After the SEC has provided its initial set of comments, it is much easier to determine when the registration process is likely to be completed and the offering can be made. In most cases, the underwriters prefer to delay the offering process and to avoid distributing a preliminary prospectus until the SEC has reviewed at least the first filing and all material changes suggested by the SEC staff have been addressed.

Preparing the Underwriting Agreement, the Comfort Letter, and Other Documents; FINRA Filings

During the waiting period, the company, the underwriters and their 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 company agrees to sell, and the underwriters agree to buy, the shares and then sell them to the public; until this agreement is signed, the underwriters do not have an enforceable obligation to acquire the offered shares. The underwriting agreement is not

D&O Insurance

Directors' and officers' (D&O) insurance protects directors and officers from losses resulting from their service to a company. Typically, a D&O insurance policy maintained by a private company will not provide coverage for securities offerings, such as an IPO, and will not contain the coverage or provisions applicable to public companies.

A company that is going public should review its existing D&O coverage and seek additional coverage. A public company's D&O insurance program generally contains three types of coverage in one policy:

Side A covers D&Os' costs and expenses for defense and due to payouts under settlements and judgments, where indemnification may not otherwise be available, such as due to state law limitations.

Side B provides reimbursement to the company if it has indemnified D&Os in connection with a claim. Side B coverage is the most commonly invoked portion of a D&O policy.

Side C, known as "entity coverage," covers the company itself. For public companies, coverage usually includes only claims resulting from alleged securities law violations.

Most D&O insurance policies have complicated applications and impose compliance obligations upon the company. False statements in the application or failure to comply with these obligations can result in the loss of coverage if any substantial liabilities arise. As a result, a company will want to be certain that it has one or more employees who have appropriate experience preparing the application, and who will assume compliance responsibilities once the policy is effective.

signed until the offering is priced. In the typical IPO, the underwriters will have a "firm commitment" to buy the shares once they sign the underwriting agreement.

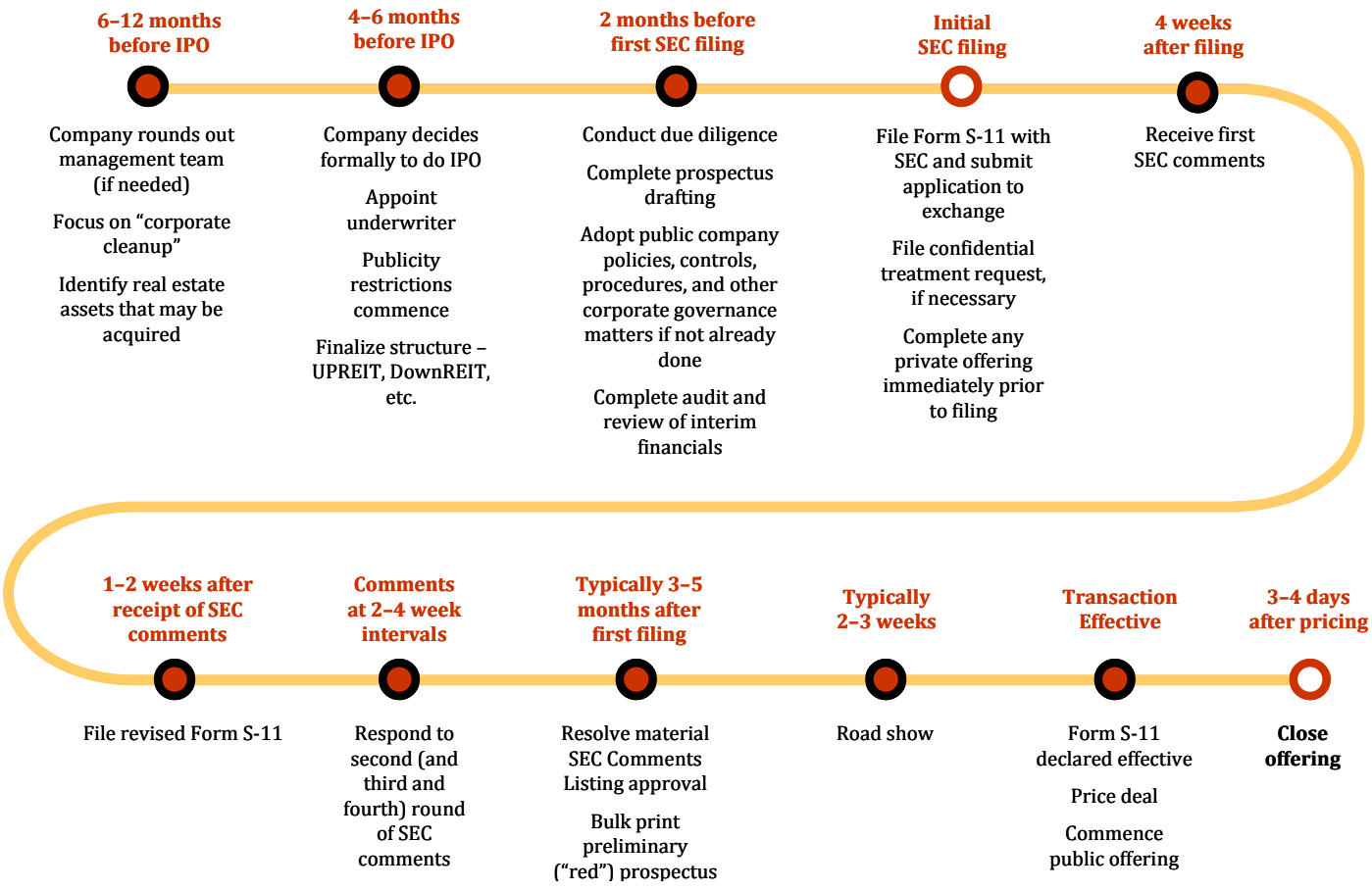
Underwriters' counsel will submit the underwriting agreement, the registration statement, and other offering documents for review to the Financial Industry Regulatory Authority (FINRA), which is responsible for reviewing the terms of the offering to ensure that they comply with FINRA requirements. In addition to compliance with the general FINRA corporate financing rule for IPOs, FINRA also imposes specific disclosure and organization and offering expense limitations on REIT offerings, which for some purposes, are treated as "direct participation programs." An IPO cannot proceed until the underwriting arrangement terms have been approved by FINRA.

In the "comfort letter," the auditor affirms (1) its independence from the issuer, and (2) the compliance of the financial statements with applicable accounting requirements and SEC regulations. The auditor also will note period-to-period changes in certain financial items. These statements follow prescribed forms and are usually not the subject of significant negotiation. The underwriters will also usually require that the auditor undertake certain "agreed-upon" procedures in which it compares financial information in the prospectus (outside of the financial statements) to the issuer's accounting records to confirm its accuracy.

Marketing the Offering

During the waiting period, marketing begins. The only written sales materials that may be distributed during this period are the preliminary prospectus and additional materials known as "free writing prospectuses," which must satisfy specified SEC requirements.

Sequencing Key Events



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 list on the NYSE.

Selected Listing Requirement	NYSE	Nasdaq Global Market*
Minimum Number of Shareholders	**400 round lot holders**	**Same**
Minimum Number of Publicly Held Shares	**1,100,000****	**Same,** with similar exclusions.
Minimum Aggregate Market Value of Publicly Held Shares	**Generally $40 million****	*Any of:* • **Income Standard:** $8 million • **Equity Standard:** $18 million • **Market Value Standard:** $20 million • **Total Assets/Total Revenue Standard:** $20 million
Minimum Price Per Share	**At least $4.00 at initial listing**	**Same**
Minimum Number of Market Makers	**N/A**	**Four,** unless company qualifies for listing under the Income or Equity Standards, which each require three.
Minimum Financial Standards	One of the following: • **Earnings Test:** Pre-tax earnings from continuing operations, subject to adjustments, must total (1) $10 million for the last three fiscal years, including a minimum of $2 million in each of the two most recent fiscal years and positive amounts in all three years, or (2) $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. • **Valuation/Revenue with Cash Flow Test:** (1) $500 million in global market cap, (2) $100 million in revenues during the most recent 12-month period, and (3) $25 million aggregate cash flows for the last three fiscal years with positive amounts in all three years, subject to adjustment. • **Pure Valuation/Revenue Test:** (1) $750 million in global market cap, and (2) $75 million in revenues during the most recent fiscal year. • **Affiliated Company Test:** (1) $500 million in global market capitalization, (2) parent or affiliated company is a listed company in good standing, and (3) parent or affiliated company retains control of, or is under common control with, the entity. • **Assets and Equity Test:** (1) $150 million in global market cap, and (2) $75 million in total assets, including $50 million in stockholders' equity, subject to adjustment.	One of the following: • **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. • **Equity Standard:** stockholders' equity of $30 million. • **Market Value Standard:** N/A for IPO. • **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.

* The other tiers (Nasdaq Global Select Market and Nasdaq Capital Market) have similar requirements.
** Shares held by directors, officers, or immediate families and other concentrated holdings of 10% or more are excluded.

While binding commitments cannot be made during this period, the underwriters will receive indications of interest from potential purchasers, indicating the price they would be willing to pay and the number of shares they would purchase. Once SEC comments are resolved, or it is clear that there are no material open issues, the issuer and underwriters will undertake a two- to three-week "road show," during which company management will meet with prospective investors.

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 and the offering has been priced, the issuer and the managing underwriters execute the underwriting agreement and the auditor delivers the final comfort letter. This occurs after pricing and before the opening of trading on the following day. The company then files a final prospectus with the SEC that contains the final offering information.

On the third or fourth business day following pricing, the closing occurs, the shares are issued, and the issuer receives the proceeds. The closing completes the offering process. Then, for the following 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.

THE UNDERWRITER'S ROLE

A company will identify one or more lead underwriters that will be responsible for the IPO. A company chooses an underwriter based on its industry expertise, including the knowledge and following of its research analysts, the breadth of its distribution capacity, and its overall reputation. A company should consider the underwriter's commitment to the sector and its distribution strengths. For example, does the investment bank have a particularly strong research distribution network, or is it focused on institutional distribution? Is its strength domestic, or does it have foreign distribution capacity? The company may want to include a number of co-managers in order to balance the underwriters' respective strengths and weaknesses.

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 a 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 are likely to spend a substantial amount of time performing business, financial, and legal due diligence in connection with the IPO, visiting the properties, and making sure that the prospectus and any other offering materials are consistent with the

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 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.

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.
- 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.
- Required "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 exchanges' listing requirements contain related substantive corporate governance requirements regarding independent directors; audit, nomination, and compensation committees; and other matters.

information provided. The underwriters will market the IPO shares, set the price (in consultation with the company) at which the shares will be offered to the public, and, in a "firm commitment" underwriting, purchase the shares from the company and then re-sell them to investors. 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.

FINANCIAL REPORTING AND ACCOUNTING

The IPO registration statement must include audited financial statements for the last three fiscal years; financial statements for the most recent fiscal interim period, comparative with interim financial information for the corresponding prior fiscal period (may or may not be audited depending on the circumstances); and income statement and condensed balance sheet information for the last five years (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 real estate operations to be acquired. In those circumstances, the SEC may allow an issuer to include more limited financial information.

Early on, the issuer should identify any problems associated with providing the required financial statements in order to seek necessary accommodation from the SEC. These statements must be prepared in accordance with U.S. GAAP, as they will be the source of information for "Management's Discussion and Analysis of Financial Condition and Results of Operations" (MD&A). The SEC will review and comment on the financial statements and the MD&A. The SEC's areas of particular concern are:

- revenue recognition
- business combinations
- segment reporting
- financial instruments
- impairments of all kinds
- deferred tax valuation allowances
- compliance with debt covenants, fair value, and loan losses

2009 – Nine REIT IPOs raised $3 billion of gross proceeds

First Half 2010 – Six REIT IPOs raised $1.2 billion of gross proceeds

Source: SNL Financial, NAREIT®.

FFO

The real estate industry discloses a unique operating metric that the SEC traditionally has allowed even when it was more hostile to non-GAAP financial measures. FFO, or "Funds from Operations," is neither operating income nor cash flow from operations. NAREIT has taken the lead in establishing a base definition of FFO since at least 1991, although many REITs disclose various forms of adjusted FFO. A typical FFO disclosure (from Vornado Realty Trust) reflecting the SEC focus on the purpose of the metric and comparability follows: "*FFO is computed in accordance with the definition adopted by the Board of Governors of the National Association of Real Estate Investment Trusts ("NAREIT"). NAREIT defines FFO as GAAP net income or loss adjusted to exclude net gains from sales of depreciated real estate assets and GAAP extraordinary items, and to include depreciation and amortization expense from real estate assets and other specified non-cash items, including the pro rata share of such adjustments of unconsolidated subsidiaries. FFO and FFO per diluted share are used by management, investors and analysts*

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

The recent adoption of the Dodd-Frank Act will lead to additional corporate governance changes for public companies, including:

- Requiring stock exchanges to establish additional listing standards relating to
  - a board's compensation committee practices and related disclosure;
  - issuer adoption of a policy providing for a "clawback" of incentive compensation from current and former executive officers if it is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws.
- Shareholder approval of certain transactions, including "say-on-pay" votes on executive compensation and certain golden parachute compensation arrangements.

to facilitate meaningful comparisons of operating performance between periods and among our peers because it excludes the effect of real estate depreciation and amortization and net gains on sales, which are based on historical costs and implicitly assume that the value of real estate diminishes predictably over time, rather than fluctuating based on existing market conditions. FFO does not represent cash generated from operating activities and is not necessarily indicative of cash available to fund cash requirements and should not be considered as an alternative to net income as a performance measure or cash flows as a liquidity measure. FFO may not be comparable to similarly titled measures employed by other companies."

Internal Control over Financial Reporting

An issuer will not be required to include either a management's report on its internal control over financial reporting or an auditor's report on such internal control until the second annual report following its IPO.

SEC COMMENTS

An integral part of the IPO process is the SEC's review of the registration statement. Once the registration statement is filed, 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 objective is to assess the company's compliance with its registration and disclosure rules. The SEC review process should not be viewed as a "black box" where filings go in and comments come out—rather, as with much of the IPO process, the relationship with the SEC is a collaborative process.

The Process

The SEC's principal focus during the review process is on disclosure. In addition to assessing compliance with applicable requirements, the SEC considers the 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 staff will closely review websites, databases, and magazine and newspaper articles, looking in particular for information that the staff thinks should be in the prospectus or that contradicts information included in the prospectus.

The review process is time-consuming. While there was a time when the review process could be completed in roughly a couple of months, now, given the length of the prospectus and the complexity of the disclosure, it can take three to five months. 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 provided in about 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 typically runs about 50 to 75 comments, with a majority of the comments addressing accounting issues. The company and counsel will prepare a complete and thorough response. In some instances, the company may not agree with the SEC staff's comment,

Controlling Your Shares

In connection with an IPO, the issuer may want the option to "direct" shares to directors, officers, employees and their relatives, or specific other designated people, such as vendors or strategic partners.

Directed share (or "family and friends") programs, or DSPs, set aside stock for this purpose, usually 5% to 10% of the total shares offered in the IPO. Participants pay the initial public offering price. Shares not sold pursuant to the DSP are sold by the underwriters.

Generally, directed shares are freely tradable securities and are not subject to the underwriter's lock-up agreement, although the shares may be locked up for some shorter period. Each underwriter has its own program format. There are, however, guidelines that must be followed. The DSP is not a separate offering by the company but is part of the plan of distribution of the IPO shares and must be sold pursuant to the IPO prospectus.

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

Note that in an UPREIT structure, the Unitholders may also be locked up but they may also be subject to a longer holding period before they can tender Units for the securities of the public REIT.

and may choose to schedule calls to discuss the matter with the staff. The company will file an amendment revising the prospectus, and provide the response letter along with any additional information. The SEC staff generally tries to address response letters and amendments within 10 days, but timing varies considerably.

Frequent Areas of Comment

It is easy to anticipate many of the matters that the SEC will raise in the comment process. The SEC makes the comment letters and responses from prior reviews available on its website, so it is possible to determine the most typical comments raised during the IPO process.

Overall, the SEC staff looks for a balanced, clear presentation of the information required in the registration statement. 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, products, or customers?
- **Prospectus summary:** Is the presentation balanced?
- **Risk factors:** Are the risks specific to the company and devoid of mitigating language?
- **Use of proceeds:** Is there a specific allocation of the proceeds among identified uses, and if funding acquisitions is a designated use, are acquisition plans identified?
- **Selected financial data and other financial information:** Does the presentation of non-GAAP financial measures comply with SEC rules?
- **Management's discussion & analysis:** Does the discussion address known 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, particularly the compensation discussion and analysis, clear? Does it include discussion of performance targets, benchmarking, and individual performance?
- **Prior performance information**: Is the description of prior performance by related real estate entities complete, responsive to disclosure requirements, and balanced?
- **Underwriting:** Is there sufficient disclosure about stabilization activities (including naked short selling), as well as factors considered in early termination of lock-ups and any material relationships with the underwriters?
- **Exhibits:** Do any other contracts need to be filed based on disclosure in the prospectus?

How Much Does An IPO Cost?

IPO expenses can add up quickly, as company personnel and professionals scramble to meet substantial demands in short timeframes. The table presents approximate costs for a $200 million IPO.

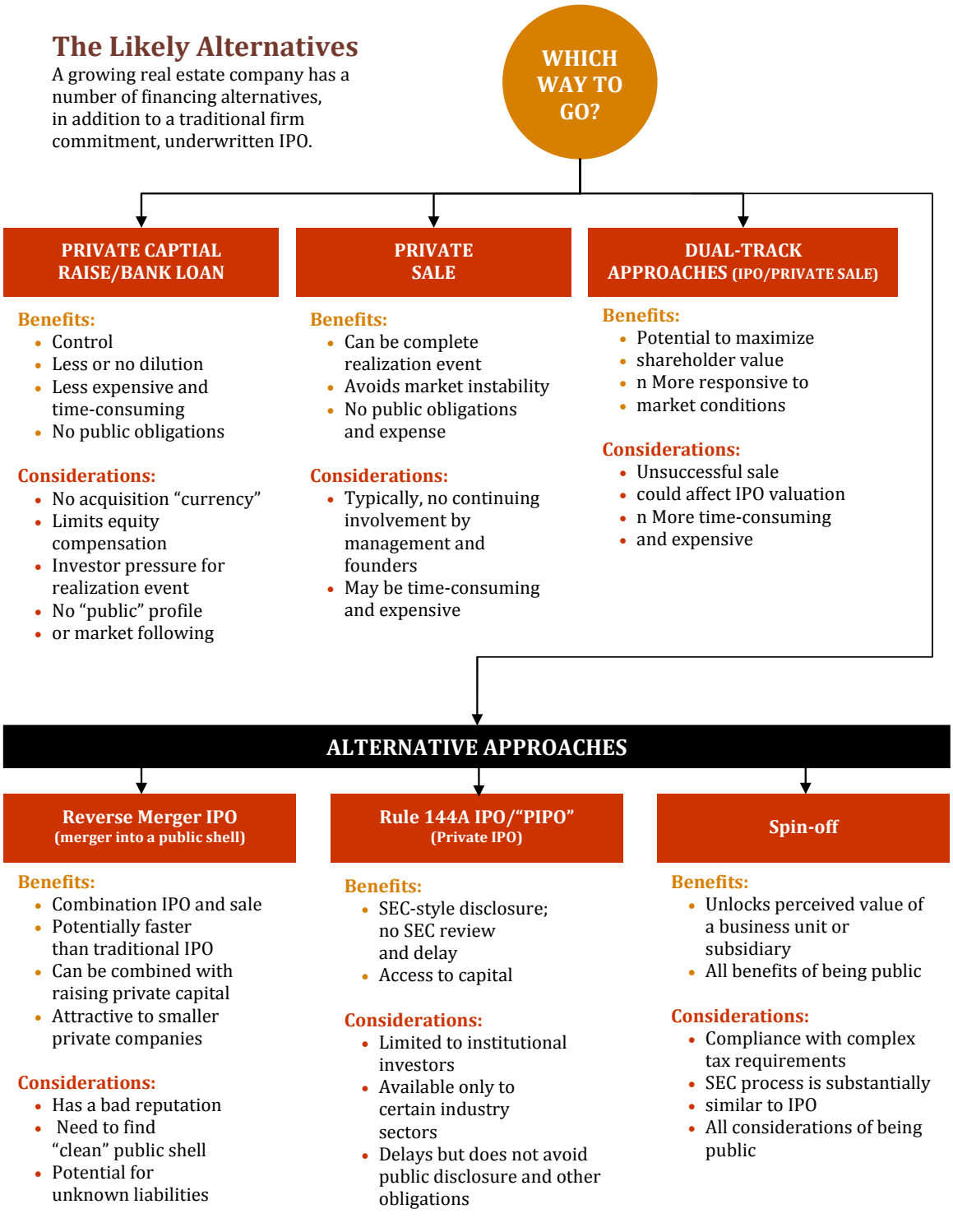
from the IPO	
Gross proceeds	**$200,000,000**
Underwriting discount (7% of gross proceeds)	14,000,000
Regulatory filing fees (SEC and FINRA)	34,760
NYSE listing fee (assuming $10 per share price)	114,000
Legal fees and expenses	800,000
Accounting fees and expenses	1,000,000
Transfer Agent fees and expenses	15,000
Road show expenses	200,000
Printing expenses	400,000
Net proceeds	**$183,436,240**

A FINAL THOUGHT

While 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 above. Much of this preparatory work is neither time-consuming nor expensive. Yet it will enhance greatly the opportunity to get into the market quickly, when the market is there. 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 acquisition by an existing public company.

The Likely Alternatives

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



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Morrison & Foerster's REIT practice is a collaborative, integrated, multi-office practice involving corporate, finance, M&A, investment management, real estate, tax, and other attorneys throughout the domestic and international offices of the firm. Attorneys in the REIT practice area are actively involved, as both general and special counsel, in advising REITs, and REIT sponsors, contributors, investors, investment advisers, underwriters, and institutional lenders on all aspects of REIT activity. They have been active and influential in NAREIT and other industry organizations, and in legislative affairs affecting the REIT industry. For more information on our REIT practice, refer to http://www.mofo.com/reits-services.

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

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