On point.

Real Estate Investment Trusts

Real estate investment trusts ("**REITs**") are professionally managed companies that invest in real estate, mortgages and real estate-related assets on behalf of their investors. Established in 1960, REITs were designed to democratize real estate investing by providing retail investors with the opportunity to obtain passive gains from large-scale, income-producing real estate and mortgage portfolios. REITs typically receive preferential tax treatment in the form of no entity-level tax and are required to distribute at least 90% of their taxable income as dividends each year.

Due to the preferential tax treatment under Subchapter M of Chapter 1 of the Internal Revenue Code of 1986, as amended (the "**Code**"), REITs must comply with detailed requirements relating to their ownership structures, distributions and operations, all of which require careful planning. REITs must also comply with strict income, asset and ownership tests as detailed below. Further, REITs seeking to raise capital must ensure compliance with the Securities Exchange Act of 1934, as amended (the "**Exchange Act**"), Securities Act of 1933, as amended (the "**Securities Act**"), Investment Company Act of 1940, as amended (the "**Investment Company Act**"), Securities and Exchange Commission ("**SEC**") and Financial Industry Regulatory Authority ("**FINRA**") rules as well. Therefore, REITs must establish procedures, typically in coordination with its outside auditors, tax preparers, investment bankers and legal counsel, to ensure that they are investing in the correct types and proportions of assets, earning the right types and amounts of income and complying with ownership restrictions.

Types of REITs

The common stock of most REITs trade on a national securities exchange (referred to as publicly-traded REITs). However, there are also publicly registered but non-traded REITs (i.e., registered with the SEC but the securities of which are not traded on a national securities exchange), and private REITs, the securities of which are sold only in offerings that are exempt from the registration requirements of the Securities Act.

The industry and asset focus of REITs is diverse. REITs are broadly categorized as: equity REITs, which invest in real estate properties, and mortgage REITs, which invest in mortgages, real estate loans and other real-estate related assets.

Equity REITs typically lease their properties to tenants and concentrate their ownership on a specific market segment, such as office, retail, commercial or industrial properties, and may further differentiate between specific industry segments such as healthcare, malls or lodging. Recently, REITs investing in data center, healthcare, infrastructure and cell tower assets have been popular due in part to the COVID-19 pandemic, as the shift from in-person communication and commerce to the electronic platform helps those sectors at the expense of the traditional office, hotel and retail sectors.

Mortgage REITs generally have one of three investment strategies: arbitrage, operating and distressed. Arbitrage mortgage REITs acquire government-backed mortgage securities and other high quality mortgage securities with leverage to earn an arbitrage spread. Operating mortgage REITs originate and/or acquire residential or commercial loans. Distressed mortgage REITs invest in distressed mortgages and must comply with specific foreclosure property rules and restrictions.

Hybrid REITs, which own a combination of real estate properties and loans, are rare. At December 31, 2019, there were 179 equity REITs with an equity market capitalization of $1.245 trillion, 40 mortgage REITs with an equity market capitalization of $82.927 billion and no hybrid REITs (Source: NAREIT®).

REIT Formation Process

The REIT formation process is relatively simple and flexible. An entity eligible to be taxed as a corporation for U.S. federal income tax purposes is organized under the laws of any state (or the District of Columbia). Under the REIT regulations, an entity formed as a trust, partnership, limited liability company or corporation can be a REIT, provided any such entity is treated as a corporation for federal income tax purposes. Then, the entity elects to be treated as a REIT by computing taxable income as a REIT on its tax return (generally on Form 1120-REIT). Even if the entity could have qualified as a REIT for a prior year, an entity must affirmatively make this election for REIT tax treatment to apply. Once made, the election generally remains in effect until it is terminated or revoked under Code Section 856(g).

Unlike publicly-traded corporations (that are not intended to be REITs), which are typically incorporated or formed under Delaware law, most publicly traded REITs (approximately 75%) are formed as trusts under the Maryland REIT law or as corporations under Maryland law. There are a number of reasons why REITs prefer Maryland: Maryland has a specific statute for REITs; Maryland has developed an expertise in REIT law; and Maryland REIT law has distinct advantages over the relevant Delaware law. For example, Maryland REIT law not only provides that a REIT may issue shares of beneficial interest without consideration for the purpose of qualifying it as a REIT under the Code, but it also allows a majority of the REIT's board of trustees to amend the REIT's declaration of trust without shareholder action unless the trust's declaration specifically prohibits the board from doing so.

REITs may be formed for a finite life or in perpetuity. Unlike a REIT formed in perpetuity, a finite-life REIT does not reinvest the proceeds from the sale, financing or refinancing of assets or cash from operations in new real estate assets (subject to the REIT requirements). Instead, a finite-life entity distributes those proceeds to its partners or shareholders. At the end of the finite-life REIT's time period, the entity is dissolved and the partners or shareholders receive final distributions in accordance with the terms of the organizational documents.

Ownership and Holder Requirements

REITs must be beneficially owned by 100 or more persons and must not be "closely held." A REIT is "closely held" if five or fewer individuals directly or indirectly own more than 50% in value of its outstanding stock during the last half of the taxable year. Tax-exempt pension, profit-sharing, and bonus plans (i.e., "qualified trusts") described in Code Section 401(a), supplemental unemployment benefit trusts described in Code section 501(c)(17), private foundations described in Code Section 509(a) or the portion of a trust set aside for charitable purposes described in Code Section 642(c), are normally treated as single individuals.

There are certain exceptions to the REIT ownership and holder requirements. First, the entity must be beneficially owned by 100 or more persons only on at least 335 days of a taxable year of 12 months in which it wishes to qualify as a REIT, or during a proportionate part of a taxable year of less than 12 months. Second, the requirements that a REIT have at least 100 beneficial owners and that it not be "closely held" do not apply to the first taxable year for which a REIT election is made.

Although the Code does not require REITs to adopt ownership and transfer restrictions in their articles of incorporation or other organizational documents, REITs often do so. These restrictions generally prevent a person from not only beneficially or constructively owning more than 9.8% or 9.9% in value of the REIT's outstanding shares, but they also nullify and void attempted transfers of shares that result in a violation of the 9.8%-9.9% ownership limit. Further, these provisions may have the effect of functioning as an anti-takeover device for publicly traded REITs. Because sponsors or founders of a REIT typically own more than 9.9%, REITs with large shareholders usually have "grandfather" clauses and related decreases in ownership thresholds for other persons or may issue ownership waivers.

Income and Asset Tests

REITs are subject to two income tests. First, at least 75% of a REIT's gross income during a taxable year must derive from real estate sources, such as rents from real property or interest from real estate loans. Second, at least 95% of a REIT's gross income for the taxable year must be derived from items that meet the 75% income test above, other dividends, other interest and gain from the sale or other disposition of stock or securities that are not "dealer property" described in Code Section 1221(a)(1), i.e., inventory.

In addition to the two income tests, REITs must also satisfy certain assets tests. First, at least 75% of a REIT's assets by value must consist of real estate assets, cash and cash items (including receivables) and Government securities. Second, a REIT can invest a maximum of 20% of its assets by value in the securities of one (or more) taxable REIT subsidiary ("**TRS**"). Third, a REIT can invest a maximum of 25% of its assets by value in non-Government securities that are not otherwise treated as real estate assets (including securities of any TRS). Fourth, for those non-Government securities that are not otherwise treated as real estate assets, there are two specific restrictions: first, a maximum of 5% of the REIT's total assets by value may be represented by securities of any one issuer and second, the REIT may not hold securities possessing more than 10% of the total voting power, or having a value of more than 10% of the total value of, the outstanding securities of any one issuer. Each of the four assets tests described above are measured at the close of each calendar quarter.

A REIT may fail its income and asset tests but still qualify for relief under Code Sections 856(c)(6) and 856(c)(7). In the case of the income test, if the REIT files a schedule describing each item of its gross income and if such failure is due to reasonable cause, then it will still qualify as a REIT but is subject to a special tax approximately equal to a portion of the shortfall in qualifying income. With

respect to the asset test, if the REIT files a schedule describing each asset causing it to fail the asset test, if such failure is due to reasonable cause, and if the REIT disposes of the disqualifying asset within six months of disclosure, the REIT will still qualify as a REIT but may be subject to a potential penalty of at least $50,000.

Distribution Requirements

In general, a REIT must distribute at least 90% of its taxable income as dividends. Importantly, a REIT's taxable income does not include any capital gain and under Rev. Proc. 2017-45, a publicly traded REIT is allowed to pay 80% of its required dividend in stock (due to the COVID-19 pandemic, this percentage is increased from 80% to 90% for dividends declared on or after April 1, 2020, and on or before December 31, 2020). Provided that a REIT meets this 90% taxable income distribution requirement, a REIT is allowed to deduct these dividends from its taxable income as a dividends paid deduction under Code Section 562 and is taxed on any remaining taxable income at the entity level. Therefore, even though they are not required to do so (and even though a REIT is not required to distribute any capital gain), most REITs typically make distributions at least equal to their taxable income (including capital gains) to avoid being taxed at the REIT level. Publicly offered REITs often distribute amounts well in excess of REIT taxable income. Publicly offered REITs are also exempt from the preferential dividend rule, which prevents issuers from claiming a dividends paid deduction with respect to a distribution that gives preference to any share of stock over another stock in its class.

TRS Advantages and Drawbacks

Although REITs may own real property or mortgages and derive income therefrom, they are generally prohibited from earning income from more active management functions. For example, apart from charges for services customarily furnished or rendered in connection with the rental of real property, equity REITs are not allowed to derive income from providing hotel operations, health club operations or landscaping services, while mortgage REITs are not allowed to service third-party mortgage loans, modify loans, deal with foreclosures, create and hold mortgage loans for sale or engage in securitization. If a REIT engages in a "prohibited transaction," the REIT will be subject to a 100% tax on any net income derived from such a transaction.

However, as mentioned above, a REIT is allowed to hold a maximum of 20% of its assets by value in one more or TRSs. In general, a TRS is a corporation (other than a REIT or a qualified REIT subsidiary) in which the REIT directly or indirectly owns stock and for which the REIT and the corporation jointly elect treatment as a TRS. Notwithstanding certain restrictions, a TRS is generally able to engage in prohibited REIT transactions. For example, a laundry service operation should be conducted in a TRS and any income would be subject to corporate income tax in the hands of the TRS.

Nevertheless, there are certain TRS drawbacks. First, a TRS is taxable as a regular corporation, which is subject to an entity level tax. Therefore, REITs should ensure that income from real estate sources, as well as any income that may qualify under the 95% test described above, is, to the extent possible, flowing directly to a REIT and not to a TRS. Second, certain entities, such as corporations that operate or manage lodging or healthcare facilities, cannot be a TRS.

REIT Structures

Although there are a variety of possible REIT structures, publicly traded equity REITs are usually structured as umbrella partnership REITs ("**UPREITs**") because they provide tax advantages and liquidity. In a typical UPREIT structure, the REIT directly owns a majority of an operating partnership ("**OP**") that holds the real estate assets with minority limited partners ("**OP Unit Holders**"). After a lock-up period, the limited partnership interests in the OP ("**OP Units**") become redeemable for cash or, at the REIT's discretion, for shares of the REIT on a 1:1 basis.

The tax advantage exists because transferring real estate assets to an OP for OP Units, instead of transferring those same assets directly to a REIT for REIT shares, may qualify as a tax-deferred transaction under Code Section 721. The liquidity advantage exists because redemption of the OP Units not only results in cash or publicly traded stock, but it also allows OP Unit Holders to use the fair market value of their OP Units as collateral for loans and avoid being taxed upon redemption. Because redemption is a fully taxable transaction, OP Unit Holders usually do not redeem their OP Units unless they plan on immediately selling their REIT shares. If an OP Unit Holder is an individual and does not need to sell REIT shares, the OP Unit Holder may prefer to hold onto his or her OP Units until death, allowing his or her estate or beneficiaries to receive a "stepped-up" tax basis, and as a result, a chance to redeem or convert the OP Units on a tax-free basis.

A REIT can become an UPREIT either upon formation or upon acquiring particular assets. A newly formed REIT would contribute cash from an initial public offering ("**IPO**") to the OP, while an existing REIT would contribute its existing real estate assets. Simultaneously, other owners of real estate assets would contribute those assets to the OP, all in exchange for OP Units. Once the UPREIT is established, the UPREIT would use its OP to acquire additional assets in exchange for OP Units.

Despite their principal advantages of liquidity and tax deferrals, UPREITs introduce structural complexity and may also create conflicts of interest. For example, because the disposition of property by an UPREIT may result in gain recognition for the property's contributing partner, contributing partners often negotiate mandatory holding periods and other provisions to protect their tax deferral benefits.

DownREITs are extremely similar to UPREITs. The main difference is that instead of holding all of their assets in one OP, DownREITs typically hold their assets through multiple OPs. In addition to raising tax issues regarding tax-free contributions, the multiple OPs also reduce liquidity. Although the limited partnership units of each OP are also redeemable for cash or for a DownREIT share, the value of a DownREIT share is based on the assets in all of the OPs. Therefore, it is more difficult to determine whether a limited partnership unit for each OP is redeemable for a DownREIT share, and to prevent any uncertainty, most if not all DownREIT agreements tie redemption ratios at 1:1.

Externally and Internally Managed REITs

REITs are managed either internally or externally. In other words, either the REIT's own officers and employees manage the REIT's assets, or an external management company oversees the REIT's assets on the REIT's behalf. Under an external management system, the REIT compensates the manager through a private equity style arrangement: a flat fee based on assets under management and an incentive fee based on REIT performance. Some argue externally managed REITs create inherent conflicts of interest between managers and investors. For example, because the external manager's flat fee is based on the asset value under management, this may incentivize external managers to purchase additional assets even if those assets are unlikely to generate high returns.

Nevertheless, many private REITs are externally managed, and external management structures are more common in mortgage REITs than equity REITs. This is because mortgage REITs often invest in the same real estate loans, which enables external managers to operate more efficiently.

Financial Metrics Used to Measure REIT Performance

Funds from Operations ("**FFO**") is a non-GAAP measure of REIT operating performance. It has gained wide acceptance in the REIT industry primarily because FFO excludes historical cost depreciation and amortization, which REITs and investors believe artificially distorts GAAP net income. After a recent update to FFO's definition in 2018, Nareit defines FFO as: net income (calculated in accordance with GAAP), excluding (1) depreciation and amortization related to real estate; (2) gains and losses from the sale of certain real estate assets; (3) gains and losses from change in control; and (4) impairment write-downs of certain real estate assets and investments in entities when the impairment is directly attributable to decreases in the value of depreciable real estate held by the entity. While some REITs measure FFO strictly in accordance with Nareit's definition, most REITs disclose a modified or adjusted FFO. REITs also commonly use net asset value, adjusted funds from operations and net operating income to measure performance.

The SEC allows REITs to disclose FFO, adjusted FFO and even a per share FFO as a non-GAAP financial measure. However, Regulation G and Item 10(e) of Regulation S-K specify that if REITs disclose FFO, they must also present, with equal or greater prominence, the most directly comparable GAAP measure and to reconcile the two. Further, the SEC's 2016 Non-GAAP Compliance and Disclosure Interpretations clarify that if an adjusted FFO is intended to be a liquidity measure, it may not exclude charges or liabilities that required, or will require, cash settlement. The Compliance and Disclosure Interpretations also clarify that REITs may disclose a per share FFO, provided that it is used as a performance and not a liquidity measure.

Commodity Pool Exemption for REITs

Commodity pools are shared private pools of money from multiple participants to speculate in futures, swaps or options markets and are subject to the Commodities Exchange Act. According to the U.S. Commodity Futures Trading Commission (the "**CFTC**"), an equity REIT is not a commodity pool if it only uses derivatives for mitigating exposure to interest rate or currency risk, complies with all other REIT requirements under the Code and has identified itself as an equity REIT in Item G of its last U.S. income tax return or

intends to do so. Although the CFTC considers mortgage REITs as commodity pools, the CFTC will not take enforcement action if the mortgage REIT complies with certain detailed restrictions (*e.g.*, limits the initial margin and premiums required to establish its commodity interest positions to no more than 5% of the fair market value of the REIT's total assets) and files a claim of relief.

Financing Activities

Although investors benefit from REITs distributing at least 90% of their taxable income each year, this distribution requirement diminishes available capital necessary to fund future growth. Therefore, REITs often turn to capital markets to acquire additional assets and finance their operations. REITs also supplement their diverse equity and debt offerings with bank and non-bank financing arrangements, such as credit agreements, term loans, revolving loan facilities and warehouse lines of credit, as well as securitizing mortgage loans and incurring mortgage debt on real estate properties.

IPOs are a viable option for REITs seeking large amounts of capital, liquidity and reputational enhancement. The IPO process for REITs is the same as the IPO process for non-REITs (*e.g.*, filing a registration statement; roadshow), with a few caveats: REITs are subject to additional disclosure requirements under Form S-11, SEC Industry Guide 5 of the Securities Act, FINRA Rules 5110 and 2310, and potentially Section 14(h) of the Exchange Act. However, REITs may still qualify for significant IPO benefits provided to "emerging growth companies" ("**EGCs**"). Under Section 2(a)(19) of the Securities Act, a company qualifies as an EGC if it has total annual gross revenues of less than $1.07 billion during its most recently completed fiscal year and has not sold common equity securities under a registration statement. Given that most REITs considering an IPO will meet these requirements, they would enjoy advantages such as less extensive narrative compensation disclosure and filing audited financial statements for two instead of three fiscal years.

REITs are also eligible to confidentially submit draft registration statements and certain follow-on registration statements to the SEC. In general, if a REIT is pursuing an IPO or registration of a class of securities under Section 12(b) of the Exchange Act, the SEC will confidentially review the draft registration statement and related revisions in response to SEC staff comments; if a REIT conducts a follow-on offering within 12 months of the IPO or Section 12(b) registration, the REIT will still be allowed to confidentially submit its registration statement for SEC review, but the REIT must respond to any SEC comments with a public filing.

Most publicly registered and exchanged-traded REITs are listed on the New York Stock Exchange ("**NYSE**"). Therefore, the same NYSE rules that apply to non-REITs generally apply to REITs with one notable exception: for REITS with less than three years of operating history, the NYSE allows listing if the REIT has at least $60 million in stockholders' equity. The $60 million threshold includes funds raised in any IPO related to the listing.

The SEC requires REITs to file an initial registration statement using Form S-11 instead of Form S-1, which is the standard IPO registration statement form. Compared with Form S-1, Form S-11 mandates additional disclosures from REITs, such as investment policies and procedures regarding investments in real estate properties and securities; the location and description of all materially important properties; and operating data (e.g., occupancy rates; number of tenants) of each improved property.

Further, pursuant to FINRA Rule 5110, otherwise known as the "Corporate Financing Rule," FINRA does not allow members or persons associated with FINRA members to participate in any public offering of REIT securities unless the REIT timely files certain documents with FINRA. Such documents include, but are not limited to, the registration statement, the proposed underwriting agreement and an estimate of the maximum offering price.

Blind pool REITs

Blind pool REITs raise capital prior to acquiring any real estate assets and during the capital raising process; they do not inform investors of potential specific targets. Therefore, investors cannot evaluate the REIT's prior performance and must instead base their investment decision on the skills and reputation of the sponsor or general partner, who will then use the investment proceeds to acquire assets based on an investment strategy. Most publicly registered but non-trading REITs begin as blind pool REITs.

The SEC requires blind pool REITs to comply with SEC Industry Guide 5, which specifies additional disclosure requirements for registration statements. Such requirements include, but are not limited to, disclosing compensation and fees to the general partner; disclosing potential conflicts of interest that may arise between the general partner and investors; and disclosing risk factors relating to management's lack of experience, insufficient sources of capital and high leverage.

FINRA has also warned investors of higher risk associated with blind pool REITs, particularly because of the difficulties in evaluating prior performance and the uncertainty regarding future targets. Accordingly, some blind pool REITs may choose to reveal the

sponsor's or general partner's past performance when pursuing a similar investment strategy to increase investor confidence.

Limited Partnership Rollup Transactions

Traditionally, "rollup" transactions refer to when multiple finite life REITs are combined or "rolled-up" into one publicly traded perpetual life REIT, typically in an UPREIT structure. They were extremely popular in the late 1980s and remain a method for multiple limited partnerships, each holding real estate assets to consolidate and undergo an IPO today. The only difference is, the Exchange Act, the SEC and FINRA rules and regulations have made "rollup" transactions more onerous compared to the past. Further, if a "rollup transaction" does not fall under any allowed exemption, REITs are subject to even more disclosure obligations during an IPO.

Under Section 14(h)(4) of the Exchange Act and Item 901 of Regulation S-K, a limited partnership generally means a direct or indirect combination or reorganization of one or more limited partnerships through which some or all investors receive new securities or securities in another entity. Although roll-up transactions usually involve the partners of each limited partnership contributing their partnership interests into the new entity in exchange for shares in the new entity (i.e., creating a single operating partnership and thus, an UPREIT structure), roll-up transactions may be structured as an acquisition, a merger, a tender (exchange) offer or in some other fashion.

Some transactions are excluded from the definition of "limited partnership rollup transaction" under Section 14(h)(5) of the Exchange Act and Item 901 of Regulation S-K. Such excluded transactions include a transaction only involving a limited partnership or partnerships retaining cash for distribution and reinvesting the proceeds in accordance with SEC criteria; a transaction only involving the redemption of limited partnership interests for a securities of an operating company specifically identified at the formation of the original limited partnership; a transaction in which the securities to be issued or exchanged are not required to be and are not registered under the Securities Act; a transaction that only involves issuers that are not required to register or report under the Exchange Act both before and after the transaction; unless otherwise provided in the Exchange Act, the transaction is approved by a minimum of two thirds of the outstanding shares of each of the participating limited partnerships and the existing general partners will receive only compensation set forth in the preexisting limited partnership agreements; and unless otherwise provided in the Exchange Act, the securities of the new entity were reported and regularly traded for more than 12 months before the securities were offered to investors and the securities issued to investors do not exceed 20% of the total outstanding securities of the limited partnership.

Although qualifying for exclusion from a "limited partnership rollup transaction" requires considerable and proactive planning, failing to do so subjects the REIT and each limited partnership to significant additional disclosure under Section 14(h) of the Exchange Act, Items 902 through 915 of Regulation S-K and FINRA Rule 2310. For example, such disclosure includes a description of each material risk and effect of the roll-up transaction; a statement concerning whether the general partner reasonably believes that the roll-up transaction is fair or unfair to the partnership; a narrative description of the method of calculating the value of the partnership; and revealing the amounts of compensation and cash distributions made to the general partner and its affiliates during the last three fiscal years.

In addition, limited partnership rollup transactions also subject REITs to heightened listing requirements for both the NYSE and Nasdaq. NYSE Rule 105 prevents the listing of a security issued in a limited partnership rollup transaction unless the rollup transaction was conducted in accordance with procedures designed to protect the rights of limited partners, a broker-dealer registered with the SEC participates in the roll-up transaction and NYSE receives an opinion of outside counsel stating that the broker dealer's participation in the transaction was conducted in accordance with a national securities association designed to protect the rights of limited partners (*e.g.*, FINRA). Nasdaq also has similar listing requirements for limited partnership rollup transactions under Nasdaq Rule 5210(h).

Investment Company Act Considerations

REITs rely on Section 3(c)(5)(C) of the Investment Company Act to qualify for exemption from regulation as "investment companies." Exemption from the Investment Company Act is considered critical for REITs because the operations of most if not all mortgage REITs are incompatible with the Investment Company Act's rules and regulations.

Mortgage REITs usually rely on Section 3(c)(5)(C) of the Investment Company Act to qualify for exemption. The exclusion provided by Section 3(c)(5)(C) of the Investment Company Act is also used by issuers of mortgage-backed securities through SEC Rule 3a-7. Under Section 3(c)(5)(C) of the Investment Company Act, REITs are exempt from regulation if they are primarily engaged in "purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." The SEC has generally interpreted this phrase to mean

that at least 55% of the REIT's assets must consist of mortgages and other liens on and interests in real estate, otherwise known as "qualifying interests," and at least 80% of its assets are comprised of qualifying assets and real estate-related assets.

In 2011, the SEC issued a Concept Release asking commenters for their views regarding mortgage-related pools and whether they should be exempt from registration as "investment companies." Even though the Concept Release did not propose any new rules, it raised significant regulatory uncertainty and created a significant negative reaction. The SEC Staff issued the first guidance following the Concept Release with the publication of the Great Ajax Funding LLC No-Action Letter dated February 12, 2018. In that No-Action Letter, the SEC expanded the application of Section 3(c)(5)(C) of the Investment Company Act to include a sponsor of securitization trusts that held whole mortgage loans, which should provide greater investor confidence that REITs should continue to be exempt from the Investment Company Act.

Non-Traded REITs

Non-traded REITs are registered with the SEC and must make regular SEC disclosures such as annual reports (i.e., Form 10-K), but their shares are not traded on a national securities exchange. Instead, their shares are sold directly and have high-up front fees of approximately 9-10% of the investment. Therefore, non-traded REITs have limited secondary markets and are much less liquid compared to publicly registered and exchange-traded REITs. Although some "Daily Net Asset Value REITs" offer periodic redemption options at net asset value, non-traded REITs traditionally provide liquidity through eventually listing on an exchange, selling their real estate assets, or entering into a merger or business combination. In the past, it was also standard to set the initial price at $10 per share and to maintain this price regardless of the REIT's operating performance.

The SEC and FINRA have both issued investor alerts regarding non-traded REITs due to their complexities and risks. While non-traded REITs may offer higher dividend yields than publicly traded and exchange-listed REITs, investors should be wary of certain non-REIT features, such as a lack of liquidity and share value transparency; distributions in excess of their FFO; uncertain and expensive early redemption; unspecified properties; limited diversification; and high front-end fees. Further, as non-traded REITs typically employ external managers, there may be additional conflicts of interest between management and investors.

FINRA Rule 2310 requires that non-traded REITs provide a per share estimated value to investors. Specifically, FINRA Notice 15-02 mandates broker-dealers involved in the sale of non-traded REITs to provide a per share estimated value using one of two methodologies: a net investment methodology, which is based on the "amount available for investment" percentage in the "Estimated Use of Proceeds" section of the offering prospectus and can be used until 150 days following the second anniversary of breaking escrow; and an appraised value methodology, which can be used at any time and consists of the appraised valuation disclosed in the REIT's most recent report filed with the SEC.

Private REITs

Private REITs are neither registered with the SEC nor traded on a national securities exchange. REITs may issue equity securities without registering with the SEC if there is an available exemption, such as the exemption under Regulation D permitting an issuer to sell securities to "accredited investors," or the exemption under Rule 144A, which permits securities issued to qualified institutional buyers.

In addition to the Code requirements of having at least 100 beneficial owners and the prohibition against being "closely held," private REITs are subject to ownership ceilings. If a company has at least 2,000 shareholders of record, 500 shareholders who are not accredited investors (i.e., individuals with a net worth of at least $1 million or with income exceeding $200,000 over two prior years), or 100 holders who are not qualified purchasers, companies must register under the Exchange Act and the Investment Company Act.

Therefore, private REITs are often structured to have one or a few shareholders owning all the common stock while having at least 100 holders owning a special class of preferred shares. For most private REITs, satisfying the "not closely held" rule is not problematic; the private REIT shareholders will often be corporations and partnerships and unless those entities are tax-exempt, the rule is generally applied by looking through those entities to their many investors.

Capital Raising Alternatives

Although REITs often turn to the public markets to raise capital, the IPO market for REITs has been inconsistent and uncertain during the past few years. Similarly to the non-REIT market, late stage private capital raises have become preferred methods of financing in lieu of IPOs for privately held REITs. Late stage private placements with institutional investors, cross-over investors, and strategic investors also eliminate a number of issues associated with an IPO and often provide more capital to the REIT than an earlier stage financing. Privately held REITs can also set up or sponsor liquidity programs for their early investors, employees and consultants to address concerns resulting from the lack of a public trading market.

Regulation A offerings have also became increasingly important for REITs seeking capital. Regulation A is an exemption from registration for public offerings with two offering tiers: Tier 1, for offerings of up to $20 million in a 12-month period; and Tier 2, for offerings of up to $50 million in a 12-month period. For the three years from effectiveness of the amendments to Regulation A in 2015 through September 30, 2018, 257 offerings were qualified and nearly $1.3 billion was raised in Regulation A offerings, with REIT offerings accounting for the largest percentage of those transactions.

Forward sale arrangements also provide REITs with an avenue to raise capital. Forward sales allow REITs to sell their shares in the future at a specified price, less a discount, by entering into a forward sale agreement with a forward purchaser as part of the REIT's follow-on offering. The forward purchaser borrows shares from the market in order to allow the affiliated underwriter to sell the REIT's shares in the follow-on offering. The number of REIT forward sale issuances increased substantially in 2018, with nine REIT forward sale issuances raising $5.2 billion with a median forward term of 12 months.

Contacts

Christian Choi	**Brian D. Hirshberg**	**Anna T. Pinedo**	**Remmelt A. Reigersman**
New York	New York	New York	San Francisco
T: (212) 506-2505	T: (212) 506-2176	T: (212) 506-2275	T: (650) 331-2059
mchoi@mayerbrown.com	bhirshberg@mayerbrown.com	apinedo@mayerbrown.com	rreigersman@mayerbrown.com

The Free Writings & Perspectives, or FW&Ps, blog provides news and views on securities regulation and capital formation. The blog provides up to the minute information regarding securities law developments, particularly those related to capital formation. FW&Ps also offers commentary regarding developments affecting private placements, mezzanine or "late stage" private placements, PIPE transactions, IPOs and the IPO market, new financial products and any other securities related topics that pique our and our readers' interest. Our blog is available at: www.freewritings.law.

Mayer Brown is a global legal services provider advising many of the world's largest companies, including a significant portion of Fortune 100, FTSE 100, CAC 40, DAX, Hang Seng and Nikkei index companies and more than half of the world's largest banks. Our legal services include banking and finance; corporate and securities; litigation and dispute resolution; antitrust and competition; US Supreme Court and appellate matters; employment and benefits; environmental; financial services regulatory and enforcement; government and global trade; intellectual property; real estate; tax; restructuring, bankruptcy and insolvency; and private clients, trusts and estates.

Please visit www.mayerbrown.com for comprehensive contact information for all Mayer Brown offices.

Mayer Brown is a global services provider comprising legal practices that are separate entities, including Tauil & Chequer Advogados, a Brazilian law partnership with which Mayer Brown is associated (collectively the "Mayer Brown Practices"), and affiliated non-legal service providers, which provide consultancy services (the "Mayer Brown Consultancies"). The Mayer Brown Practices and Mayer Brown Consultancies are established in various jurisdictions and may be a legal person or a partnership. Details of the individual Mayer Brown Practices and Mayer Brown Consultancies can be found in the Legal Notices section of our website. "Mayer Brown" and the Mayer Brown logo are the trademarks of Mayer Brown. © 2020 The Mayer Brown Practices. All rights reserved. Attorney advertising. Prior results do not guarantee a similar outcome.