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Management Alert

SEC Issues Comprehensive Guidance on REIT Disclosure

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On July, 16, 2013, the Securities Exchange Commission (the "SEC") published updates to the Division of Corporation Finance Financial Reporting Manual (the "Manual") and Disclosure Guidance Topic No. 6 ("Topic 6"). The updates to the Manual address certain financial reporting requirements under Rules 3-05 and 3-14 of Regulation S-X in respect of real estate acquisitions. The updates to Topic 6 provide guidance on disclosure topics intended for Real Estate Investment Trusts ("REITs") that are public, non-listed REITs ("PNLRs") that also may apply generally to publicly traded REITs as well.

Financial Reporting Manual

The updates to the Manual address disclosure requirements in connection with real estate acquisitions and specifically the disclosures required under Rule 3-14 and Rule 3-05 of Regulation S-X. The updated Manual includes highly technical interpretative guidance for all REITs as well as guidance applicable to only those REITs that are conducting blind pool offerings.

The updated guidance applicable to all REITs is as follows:

- **For an acquisition that requires disclosure under Item 2.01 of Form 8-K and financial statements under Rule 3-14, the REIT may assess significance based on its pro forma financial information included with the Form 8-K and not the historical financial statements of the acquired property.**
- **The filing of a registration statement, amendments to registration statements (other than those disclosing a fundamental change) and shelf takedown offerings will not trigger Rule 3-14 financial statement reporting requirements.**
- **Significance for individually insignificant property acquisition should be calculated as follows:**
    1. **If Rule 3-14 financial statements are required for individually insignificant properties and such financial statements have been provided for properties over 50% of the aggregate purchase price of the insignificant properties, no additional financial statements are required, and related party acquisitions are no longer excluded from this exception.**
    2. **Individually insignificant properties acquired after the end of the most recently complete fiscal year should be combined with probable acquisitions; and**
    3. **Property acquisitions that do not require Rule 3-14 financial statements (e.g., newly constructed properties) should be excluded from the calculation.**

- **In connection with the acquisition of an equity interest in a pre-existing entity:**
    1. **If the acquired entity only holds property under lease (including related debt), Rule 3-14 financial statements are permissible in lieu of Rule 3-05 financial statements under the prior guidance; and**
    2. **If the acquired entity conducts other activities (e.g., development or management services), Rule 3-05 financial statements are required.**
- **For an acquisition of a property with an operating history less than nine months:**
    1. **No financial statements are required if the operating history is less than three months; and**
    2. **Unaudited financial statements may be presented for all other historical periods less than nine months.**
- **For triple net lease acquisitions with a rental history, Rule 3-14 financial statements should be provided now in circumstances where there is not a significant asset concentration.**

The guidance that applies only to blind pool offerings consists of the following:

- **Acquisitions from related parties will no longer be considered significant solely because they are transactions with a related party.**
- **Estimated offering proceeds should take into account comparable offerings by peer companies, the sponsor's historical track record raising capital and the funds raised as of the measurement date.**
- **A uniform test under Industry Guide 5 now applies to all property acquisitions, and there is no longer a separate test for triple net lease properties. The new test compares the REIT's total assets plus expected net proceeds of the offering over the next twelve months plus any debt secured by the property that is assumed by the acquirer.**

Topic 6

Topic 6 provides guidance in response to the Division of Corporation Finance's review of filings by PNLRs. Similar to the recent guidance provided by FINRA,[1] the SEC clarified its views on disclosure of dividend coverage, dilution, limitations on redemption programs and NAV estimates, prior performance and prospectus readability. The key issues addressed by Topic 6 are:

- **Distributions - PNLRs should disclose the source of cash used to pay distributions, the relationship of distributions actually paid out and those reinvested, any estimated distribution yield along with a reasonable basis and should provide supporting documentation to back up historical distributions.**
- **Dilution - PNLRs should update dilution disclosure annually if it had net losses for the three preceding fiscal years or if it commenced operations within the three preceding three fiscal years.**
- **Redemption Programs - PNLRs should provide the number of redemption requests received, the number honored, the number rejected and the source of funds used to honor such requests.**
- **Estimated NAV Per Share Values - PNLRs should disclose the valuation methodology, the value assigned to each asset type, key assumptions, the relationship of the purchase price to the value ascribed to such assets, and the value of such estimates for prior periods.**
- **Prior Performance - the SEC provided in-depth guidance to the completion of the prior performance tables required by Disclosure Guidance Topic No. 5 which should be carefully reviewed if applicable to the PNLR's disclosure.**
- **Prospectus Readability - PNLRs should not only update their prospectuses but consolidate their supplements quarterly into one or two supplements to enhance readability.**

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[1] See Client Alert dated June 6, 2013, available at http://www.seyfarth.com/publications/OMMRE060613.

The information provided above is merely a summary of the comprehensive guidance provided by the SEC, and all REITs should consult with legal counsel in order to understand the scope and effect of this new guidance with respect to their disclosure and ensure their compliance with the rules and regulations of the SEC.

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