

# REIT Alert

An informational newsletter prepared by Goodwin Procter's Real Estate, REITs & RE Capital Markets Practice

## At The Market Offerings: Raising Equity Capital in Volatile Markets

Many public companies, including REITs, are facing unprecedented liquidity and capital resource constraints. The continuing market turmoil has resulted in substantially increased market volatility, which in turn has nearly shut down traditional methods of raising capital. The equity capital markets, for instance, are perceived to be effectively “closed” to many REITs at the moment and, indeed, the last traditional underwritten public offering by a REIT occurred in early October. Moreover, many of the offerings that were completed in the third quarter and early fourth quarter suffered a “file-to-offer” discount at pricing. As the current crisis continues, REITs are increasingly seeking alternative sources of economic capital.

### General

An “at the market”, or ATM, offering program<sup>1</sup> provides a potentially efficient means of raising measured amounts of equity capital over time by allowing a company to tap into the existing secondary market for its shares on an as-and-when-needed basis. Under an ATM offering program, an exchange-listed company incrementally sells newly issued shares into the trading market through a designated broker-dealer at prevailing market prices, rather than via a traditional underwritten offering of a fixed number of shares at a fixed price all at once. While some versions of these programs have been available for many years, their use and attractiveness have increased significantly over the past 2-3 years as a result of the Securities Act Reform regulations adopted by the SEC in December 2005, which streamlined the procedural hurdles for conducting an ATM offering.<sup>2</sup>

Indeed, over 25 publicly traded REITs have implemented an ATM offering program in recent years, and over a dozen in the last 12 months alone. REITs, in fact, have accounted for over 30% of all ATM offerings marketwide. The benefits to a public REIT of putting in place an ATM offering program include many of the traditional benefits associated with equity capital financing, such as funding acquisitions and development projects, adjusting overall leverage ratios or satisfying general working capital needs. The ability of a public REIT to effectively manage its balance sheet in difficult market conditions is often essential to continued execution of its strategic plan, in addition to retaining or enhancing credit ratings.

## Basic Elements

The basic elements of setting up and conducting an ATM offering are as follows:

**Registration Statement.** The company files a shelf registration statement on Form S-3 with the SEC and works to have it declared effective. The base prospectus included in the registration statement includes disclosure to the effect that sales of common stock (or common shares of beneficial interest) may be made from time to time at prevailing market prices by the issuer directly or through a designated agent. If the company already has an existing shelf registration statement on file containing such disclosure, and that registration statement is effective and has sufficient capacity, the ATM offering can be conducted utilizing the existing shelf and no further registration statement or post-effective amendment need be filed. If the issuer is a “well-known seasoned issuer” under SEC rules (generally, an issuer with a market capitalization held by non-affiliates greater than \$700 million), an automatically effective registration statement on Form S-3ASR may be filed simultaneously with the program prospectus described below. (See notes below for steps to be taken when an existing Form S-3 expires mid-program or if movements in share price during the term of a program make the company ineligible for use of Form S-3 or Form S-3ASR.)

**Sales Agreement.** The company enters into a sales agreement with a broker-dealer that has agreed to serve as placement agent for the shares to be sold under the ATM offering program. Because the placement agent may be deemed an “underwriter” under the Securities Act, the placement agent will typically have conducted pre-offering due diligence substantially similar to that performed by underwriters in firm commitment public offerings. Therefore, the sales agreement will usually include extensive representations and warranties of the company similar to those included in traditional underwriting agreements. Customary deliveries from company counsel, including a corporate and REIT qualification opinion and negative assurances letter, in addition to a customary accountant’s comfort letter, will also typically be required to assist the placement agent in establishing an effective due diligence defense under the Securities Act. The sales agreement is normally filed under cover of a Form 8 K with the SEC as a material agreement.

**Program Prospectus.** The company files a prospectus supplement with the SEC that describes the general terms of the proposed ATM offering program, including the plan of distribution and the maximum number of shares to be sold, and names the designated placement agent as required by SEC guidance.

**Sales Orders.** Once all required documentation has been executed, filed and delivered, the company may send sales orders to the placement agent based on volume or other relevant trading information available to the company to assess likely demand and/or the placement agent may bring to the attention of the company instances where demand may exist in the market. The timing, frequency and terms of sales orders (such as minimum required pricing, volume limitations, etc.) are entirely at the discretion of the company and can be altered (or sales orders revoked before they are executed) by the company at any time. The placement agent will generally execute orders over an ECN, or electronic communications network, to

preserve anonymity, but some sales agreements can also permit the placement agent to sell in block trades, private sales and otherwise.

**Settlement.** The placement agent will submit a trade blotter to the company, often daily, reflecting all trades made during the preceding period and specifying gross proceeds. The placement agent will be entitled to retain the agreed-upon sales commission (typically in a range of 1-3%) and will remit net proceeds to the company on or prior to settlement against electronic delivery of the requisite number of shares by the company to the placement agent's designated account. Some sales agreements provide the option for a single settlement at the end of a designated selling period rather than on a rolling T+3 basis.

**Program Maintenance.** So long as the program is effective, which can be for as long as 36 months, the placement agent will require periodic "bring downs" of its business and legal due diligence, including bring-down legal opinions, REIT qualification opinions, negative assurances letters and comfort letters. The frequency of required bring downs varies from annually to quarterly and even more frequently upon the occurrence of specified material developments, depending among other things on the specifics of the company's business strategy, operations and financial condition as well as the placement agent's internal policies.

**Disclosure.** The company typically will disclose aggregate sales and commission amounts paid on a quarterly basis. Disclosure can take the form of a 1-2 page prospectus supplement filed under Rule 424B to update the base prospectus and/or disclosure as part of the company's quarterly report on Form 10-Q. In some cases, the volume of sales or the terms may be individually material and therefore require prompt disclosure following such sales.

### **Benefits of an ATM Offering Program**

Raising equity capital through an ATM offering program can provide a number of benefits to REITs as compared to traditional methods of capital raising, particularly during periods of high market volatility like the current one, including:

- the company has flexibility to control the timing of sales, amount of sales and minimum acceptable price;
- the company can raise equity opportunistically, as-and-when needed, and can precisely match the sources and uses of funds;
- efficient sales management can mitigate volatility by selling more during periods of stock price strength and slowing/halting sales during periods of stock price weakness;
- the incremental nature of sales means that the company stands to benefit from a rising stock price;<sup>3</sup>
- instructions to the placement agent can be reassessed or revoked at any time, even intraday;
- sales are typically discreet/anonymous over an ECN, or electronic communications network;

- the placement agent provides continuous market feedback and can compare actual sales prices to VWAP over the same period;
- overall cost of issuance is generally significantly less than that of a traditional underwritten offering;
- program can be put in place relatively quickly (3-4 weeks), with no road-show or other sales efforts required; and
- no lock-up is usually required from directors, officers or significant shareholders.

### **Establishing and Maintaining an ATM Offering Program: Mechanics, Costs and Legal Considerations**

***Shelf Registration Maintenance.*** While ATM offering programs can generally be implemented in a relatively short period of time, generally 3-4 weeks, a number of required elements must be in place at the outset. For one, as indicated above, an ATM offering program can generally only be implemented by an issuer that is eligible to use the short-form S-3 registration statement (or F-3, as applicable) and has an effective shelf registration statement on file with adequate remaining availability. As described in our Public Company Advisories “[Shelf Registration Statements Begin Expiring in December](#)” (July 14, 2008) and “[Last Call Before S-3s Begin Expiring](#)” (November 14, 2008), some Form S-3 registration statements began to expire at the end of November 2008 under SEC Rule 415(a)(5), which limits the “shelf life” of some shelf registration statements to three years. As a related issue, the share prices of most REITs have fallen significantly over the past few quarters. As a result, some REITs that previously qualified as “well-known seasoned issuers” (or “WKSIs”) may no longer qualify and have become, or will become, ineligible to use the automatically effective Form S-3ASR. Other REITs that were previously eligible for unrestricted use of Form S-3 for primary offerings may soon fail to be eligible for such use.

As a result, a REIT contemplating an ATM offering program, should (1) review the status of, and remaining availability under, its currently effective Form S-3 registration statements, (2) assess the continued availability of those registration statements over the proposed term of the ATM offering program based on a variety of possible scenarios and (3), to the extent necessary, file post-effective amendments or replacement registration statements after considering its likely future eligibility to use Form S-3ASR or Form S-3.<sup>4</sup>

Ideally, the base prospectus included in the shelf registration statement under which an ATM offering program is proposed to be conducted will have specified, if broadly, that sales may be made through a placement agent at prevailing market prices. Note, however, that if adequate disclosure in this regard was not included in the base prospectus, the SEC has stated<sup>5</sup> that the disclosure may be added by way of prospectus supplement and does not necessitate a post-effective amendment to the registration statement.

Because an ATM offering program has a far longer duration than a traditional underwritten offering or private placement, it is important for the issuer to formulate

a strategy to minimize the risk that access to the capital markets through shelf registration will be interrupted. Specifically, the issuer must be aware of upcoming expiration dates for its existing shelf registration statements and plan – and file new registration statements – accordingly, allowing sufficient time to incorporate scheduling for third parties such as the company’s independent accountants, counsel and other offering participants, as well as for the possibility of SEC staff review and other events that may delay effectiveness of the new registration statement.

***Other Offerings.*** An ATM offering program will not typically restrict the issuer’s ability to conduct other sales of equity securities during the life of the program. Thus, for example, once the program is in place, an issuer may take advantage of favorable market conditions and elect to raise equity capital in a traditional underwritten public offering. Likewise, the terms of an ATM offering program will not generally restrict an issuer’s ability to issue equity securities in private transactions or in PIPE sales. Nevertheless, the issuer, the placement agent and any relevant underwriters and other agents may need to carefully structure the timing of anticipated offerings so as to ensure a minimal impact on prevailing stock prices. For example, all other things being equal, launching an ATM offering program and a traditional underwritten offering at the same time might result in some downward pressure on the issuer’s stock price as investors factor in the total amount of new stock that may be coming to market. There is likely to be less pressure on the stock price where an underwritten offering is announced well after an ATM offering program has been established, even if there is still availability under the program. Conversely, issuers should note that a typical underwritten offering will include lock-up provisions that restrict the issuer’s ability to sell stock for a specified period following the offering. Unless otherwise agreed, these lock-up provisions will also restrict sales under an ATM offering program, irrespective of the fact that the program may have already been established.

***Antifraud Provisions.*** While sales of shares by way of an ATM offering program may be unaccompanied by selling or marketing efforts, participants must be mindful that antifraud provisions of the securities laws apply to all ATM program sales in equal measure. Thus, similar to the restrictions applicable to share repurchase plans (if the inverse), no sale orders can be delivered to the broker/dealer nor any sales of common stock completed while the company is in possession of material nonpublic information. Likewise, sales orders should generally not be delivered and sales should not be made at a time when insiders would not be permitted to trade in the company’s securities under the company’s insider trading policy (for example, in and around the end of fiscal quarters and when other blackout periods are in effect).

***Managing Costs and Expenses.*** The cost of establishing and maintaining an ATM offering program, while generally considerably less than an underwritten offering, is not insignificant. Start-up costs for an ATM offering program will generally include negotiating a sales agreement, preparing, filing and printing one or more prospectus supplements, due diligence, and delivery of comfort letters by auditors and legal opinions, including REIT qualification opinions and negative assurances letters, by counsel at signing. Once the sales agreement has been signed and the program implemented, ongoing maintenance during the life of the program will

create additional costs, irrespective of actual or expected volume of sales. Nearly all programs are structured such that comfort letters, legal opinions (including REIT qualification opinions and negative assurances letters) are updated at least annually (typically with the filing of the 10-K), and often on a quarterly basis as well. These updates require a bring down of business due diligence by the placement agent and the refreshing of legal due diligence by counsel for both the issuer and the placement agent. Practice varies over whether the issuer will be responsible for just its own cost and expenses or whether it will bear some of the placement agent's costs and expenses as well, including the fees of its counsel. Even where the issuer agrees to bear some of the placement agent's costs, these can often be capped at a fixed amount, both for initial costs and for ongoing maintenance costs. Nevertheless, a REIT contemplating an ATM offering program will need to weigh its anticipated utilization of the program against the costs and expenses associated with required periodic updates of due diligence, comfort letters and legal opinions.<sup>6</sup> These considerations should be based on realistic expectations as to the likely amount of equity capital that can be raised under the ATM offering program, based, among other things, on the issuer's average trading volume.

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<sup>1</sup> These programs are also sometimes referred to as "equity distribution" or "dribble out" facilities. Likewise, different broker-dealers use different marketing names for ATM offering programs, such as "controlled" or "dynamic" equity offerings. As discussed in further detail above, the principal features of the majority of these programs are substantially similar.

<sup>2</sup> For example, prior to December 2005, SEC rules required the relevant broker-dealer to be named in the initial registration statement and imposed certain volume limitations. With the effectiveness of the Securities Act Reform, the volume limitations were lifted and the relevant broker-dealer can be named in the relevant prospectus supplement filed at the time the program is implemented.

<sup>3</sup> While, conversely, this "dollar cost averaging" structure of sales means that a particular day's favorable price cannot be locked in for all shares to be sold under the program as large numbers of shares cannot be issued/sold efficiently over short periods.

<sup>4</sup> For example, in some circumstances, a REIT that is presently qualified as a WKSI might choose to file a traditional "universal shelf" Form S-3 in order to avoid the delays that could result from the need to convert a Form S-3ASR to a traditional Form S-3 if the company subsequently falls below the minimum required market capitalization and becomes ineligible to use Form S-3ASR. (See our Public Company Advisory "[Last Call Before S-3s Begin Expiring](#)" (November 14, 2008) for a more detailed discussion of this scenario.)

Likewise, if an ATM offering program is first established pursuant to an automatic shelf registration statement at a time that the issuer is a WKSI and, at sometime during the life of the program, the issuer ceases to be a WKSI and thus becomes ineligible for use of the automatic shelf registration statement, it may be necessary to convert the existing Form S-3ASR registration statement into a traditional Form S-3 by way of post-effective amendment. Issuers facing these types of mid-program changes of status should consult with counsel to assess how best to manage the transition. For example, when transitioning from a Form S-3ASR to a traditional Form S-3, it might sometimes be more efficient to make the conversion by way of two post-effective amendments to the automatic shelf registration statement: one (before WKSI

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status is lost) to pay filing fees to cover securities expected to be sold under the converted registration statement in the future, and then a second to effect the actual conversion to a traditional Form S-3. See generally the SEC's FAQ on this topic, "Filing Guidance for Companies Replacing Expiring Shelf Registration Statements in Accordance with Securities Act Rules 415(a)(5) and (6)," available [here](#).

<sup>5</sup> See Question 11 in the SEC's FAQ, "Securities Offering Reform Transition Questions and Answers," available [here](#).

<sup>6</sup> Some REITs have experienced similar cost/benefit analyses in connection with medium term note (MTN) programs, which in many respects are analogous to ATM offerings in terms of the upfront costs necessary to establish them and the ongoing costs necessary to maintain them.

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