

REIT Alert

An informational newsletter from Goodwin Procter's Real Estate Capital Markets Group

Recent Developments in SEC Form 10-K Reviews

At the NAREIT Law and Accounting Conference on March 20, 2008, Karen Garnett, Assistant Director in the SEC's Division of Corporate Finance, announced that the staff at the SEC (the "Staff") has begun to issue comments requiring real estate companies to provide detailed descriptions of material properties and disclose property operating data in their Form 10-Ks. Although Item 102 of Regulation S-K currently requires some material property disclosure in Form 10-K, this announcement may come as a surprise since property operating data is not a technical Form 10-K requirement. The additional disclosures are similar to the type of information called for by Items 14 and 15 of Form S-11 for material properties, including a general description of such properties, the amount of any mortgages or other encumbrances on such properties, the principal terms of any lease of such properties and schedules of occupancy rates, lease expirations and average effective annual rents per square foot. These comments may require the reporting companies to file an amended Form 10-K to include the additional disclosures, depending on the materiality of the deficiency, as opposed to "futures comments," or those that do not require an immediate amendment but only apply to future filings.

Ms. Garnett noted that the Staff does not necessarily expect to see all of the disclosures required by Items 14 and 15, but does expect a good faith effort on the part of reporting companies to provide property descriptions and operating data disclosures that are relevant to investors. Item 14 type disclosures would only be required for individually material properties. While Item 15 on its face only applies to material properties, which the Staff has historically interpreted as a property whose value is 10% or more of total assets, Ms. Garnett stated that the Staff would expect disclosure of property operating data on a portfolio basis. Given that generating this information may be time consuming for those companies not already doing so in connection with their Form 10-K filing, companies should begin to take the necessary steps to include this disclosure in their next Form 10-K and be prepared for a potential Staff comment on this issue.

These comments appear to be a result of the recent participation by Staff legal examiners in Form 10-K reviews. As part of the Sarbanes-Oxley Act, Congress mandated that the SEC review the Form 10-Ks of each listed company at least once every three years. The SEC has gone above and beyond this mandate and has reviewed the largest issuers' Form 10-Ks, based on market capitalization, on an even more frequent basis. Historically, only accountants on the Staff

conducted these reviews. During 2007, however, legal examiners were also added to the Staff's review teams. Now, a typical Staff review of a Form 10-K may be conducted by a team consisting of an accounting and legal examiner and an accounting and legal reviewer. As a result of the added legal reviewers, issuers should expect to receive more lengthy Staff comment letters issued in conjunction with Form 10-K reviews. Specifically, in addition to the property description and operating data comments, Ms. Garnett noted that the Staff has recently issued comments requiring inclusion of reconciliations, on a portfolio basis, where net operating income per property information is disclosed and requiring the source of funds to be identified for any distributions made that are in excess of historical funds from operations, or FFO.

Ms. Garnett's comments came as part of the NAREIT conference's "SEC Hot Topics" panel which featured Goodwin Procter partner Eric Graham as a speaker.

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