

# REIT Alert

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

## In Search of Equity Capital: What Is the Best Manner of Sale in the Current Economic Environment?

In recent publications, we addressed ways in which U.S. REITs and other public real estate companies can preserve capital through the use of cash/stock dividends and raise equity capital through at the market offerings (*see*, Goodwin Procter REIT Alerts "[Cash Preservation Strategies for REITs](#)" and "[At the Market Offerings: Raising Equity Capital in Volatile Markets](#)," and BNA International's "[Cash Conservation Strategies for REITs](#)"). While these strategies can be successful in strengthening balance sheets on a small scale and conserving capital, the purpose of this alert is to discuss more meaningful ways to normalize a company's debt-to-total-capitalization ratio and to position a company for upcoming debt maturities by raising significant amounts of common equity capital (as opposed to preferred stock issuances, asset sales or joint ventures). As discussed below, there is no optimal approach, and each company will need to address whether, and how, to raise significant equity capital in order to delever and address pending debt maturities. What is clear, however, is that in the midst of the current credit crisis, thoughtful action is needed to re-equitize REIT balance sheets and properly address the industry's upcoming debt maturities. In the face of these maturities, many U.S. REITs will no longer be able to stand on the sidelines waiting for stock prices to climb before contemplating an equity issuance. Many REITs may be forced to take decisive action by issuing large blocks of common equity at discounts to their perceived underlying net asset values. Modestly dilutive issuances of common or preferred equity that only assist at the margin in addressing a REIT's debt maturities will likely not be sufficient to address the liabilities side of the balance sheet. Arguably, for an issuance of common equity to be well received in light of the discounted prices that the market may demand to clear the offering in the current environment, the offering will almost certainly need to be large enough to solve (or at a minimum go a long way towards solving) the inflated debt to total capitalization ratios and related pending debt maturities that plague the balance sheets of many domestic REITs.

### Background

The structural bear market has affected the REIT industry as much as any other industry. More than 45% of the NYSE-listed REITs currently trade at a per share value of \$10.00 or less. Relatively recently, a REIT with a \$1 billion equity market capitalization was considered a modest sized REIT. Today (as was the case earlier in the history of the REIT industry), that amount of equity capital would place the company in the top third of all publicly traded equity REITs as of the close of trading on March 20, 2009. Some REITs that only a year ago were some of the largest in the industry based on their equity market capitalization, including General

Growth Properties (NYSE: GGP) and Maguire Properties (NYSE: MPG), are now teetering on the verge of bankruptcy with per share prices below \$1.00 as they struggle with debt maturities and unfavorable debt to equity ratios.

How serious is the need for equity capital? Very serious, to put it mildly. According to current statistics, U.S. REITs need to refinance approximately \$20 billion of debt in 2009 and between \$33 billion and \$40 billion in *each* of 2010, 2011 and 2012. To put this into perspective, based on rough estimates as of the end of February 2009, the total capitalization of all publicly traded U.S. REITs is approximately \$369.8 billion, but the total *equity* capitalization of the same REITs is only approximately \$128.5 billion – resulting in an industry-wide leverage ratio of approximately 65.3%. The severity of this issue is, of course, company-specific. For example, the leverage metrics, and the resulting urgency, for GGP and Tanger Factory Outlet Centers (NYSE: SKT) stand at opposite ends of the spectrum. One of those companies, GGP, has approximately 40% of its total debt (approximately \$10 billion) maturing in 2009 and 2010, and the other company, SKT, has no significant debt maturing in 2009 or 2010. While the current market price of GGP's common stock is such that as a practical matter it probably could not obtain a meaningful amount of common equity capital in the market, SKT is not in a position where it *needs* to raise capital at discounted prices to meet maturing obligations. Most REITs, however, fall somewhere in the middle. With credit markets still in turmoil and new debt financing currently not a viable method for replacing all of the maturing debt, most public REITs should be in the process of evaluating their specific capital needs and weighing all of their alternatives, including the equity capitalization strategies described below.

### **Underwritten Offerings**

Traditional equity raising techniques for U.S. REITs and other public real estate companies most often involve some form of underwritten offering. For companies with an effective shelf registration statement available, the particular form of underwritten offering normally will depend on a combination of factors including speed and certainty of execution, stock price and cost. In the current environment, the underwriter's risk tolerance is often as much of a determining factor as the company's considerations. In addition, we believe that REITs raising significant amounts of equity to address upcoming debt maturities and to delever their balance sheets in this environment should carefully analyze the dilutive nature of their offering by reference to their per share net asset values and not necessarily by reference to their FFO or AFFO per share.

At the low end of the risk spectrum from an underwriter's perspective is a *firm commitment* underwritten offering in which the underwriter, and more often multiple underwriters, commits to buy a fixed number of shares at a fixed price only after it has completed its marketing efforts and is reasonably certain it can resell the shares at a profit. The book-building efforts can vary in length from several days to more than a week. Longer efforts expose the company's common stock to market arbitrage and increase the risk and uncertainty that its stock price may decrease before an agreement is reached, while shorter marketing efforts can hamper the underwriter's ability to find sufficient demand for all the shares the company wishes

to sell. The announcement of the proposed offering itself, particularly in the current market, often will cause the company's stock price to move significantly lower. In the current environment of low stock prices and high market volatility, REITs and public real estate companies seeking to raise significant amounts of equity capital quickly have found fully marketed *firm commitment* underwritten offerings unappealing.<sup>1</sup> Similarly, given current market conditions, underwriters seem to be disinclined to consider *firm commitment* offerings except for the largest and most well-established real estate companies, and even then only at a substantial discount to the market price.

A *bought deal*, in contrast to a *firm commitment* offering, is typically the most attractive offering for a company primarily because of the speed and certainty of execution, but the riskiest from an underwriter's standpoint. In a *bought deal* the underwriter purchases the shares for its own account (usually after the close of trading followed within minutes by a deal announcement) before beginning its marketing efforts and therefore assumes fully the risk of not being able to resell the shares at a profit, if at all. Moreover, historically the spreads on *bought deals* (when available) have tended to be relatively thin because companies frequently shop bids among several underwriters, often within only hours of the pricing deadline. We would be surprised to see significant (if any) *bought deals* for REIT common shares in this volatile equity market. A more likely approach would be discounted *overnight* or extremely short-term marketed underwritten offerings where the equity, as noted below, is purchased at a price discount of between 8% and 9% with gross spreads between 3.5% and 4.5%.

Recent underwritten offerings illustrate these points. For example, last week Simon Properties Group (NYSE: SPG) and Alexandria Real Estate Equities (NYSE: ARE) each completed significant issuances of common stock on an *overnight* basis to pay down existing debt. SPG issued 15 million shares of common stock at a price of \$31.50 per share (as compared to a pre-announcement closing price of \$34.38 per share), increasing its total shares by about 6.5%, raising approximately \$472 million.<sup>2</sup> ARE completed an offering that was more dilutive to its current shareholders by issuing 7 million shares at a net price of \$36.62 per share before offering expenses (as compared to a pre-announcement closing price of \$41.77 per share), increasing its total shares outstanding by approximately 22%, raising approximately \$256 million. In both of these offerings it appears that the underwriters took minimal risk by only entering into the underwriting agreement after they had received indications from purchasers following very short (possibly overnight) marketing efforts. The shares in these issuances were sold at a price discount of approximately 8.4% with gross spreads of approximately 4.25%.

### **Registered Direct Offerings and Block Sales**

An alternative to the traditional underwritten offering or a *bought deal* is a sale by the company of a block of common equity to a single or a limited number of third-party buyers. In some cases, the company will hire a broker-dealer that will facilitate a group of investors or "club" to come together and purchase the entire equity issuance. The terms of these transactions will vary and be specific to the objectives of the individual company and purchasers involved. These transactions

can offer a number of advantages to a company, including very short marketing periods with little or no associated market arbitrage risk. REITs will need to be sensitive in structuring these *registered direct offerings* in light of securities exchange rules and should typically protect against premature disclosure by entering into confidentiality agreements with prospective participants.

It is not clear that large block sales will require the price discounts and gross spreads required in an underwritten deal (*see* the discussion of the Developers Diversified Realty sale below, which was completed at prices above the trading price of its common stock at the time of the sale). In the current market, however, a U.S. REIT should be prepared to give concessions to any investor willing to purchase a large block of its common equity securities. Block trades may involve intense negotiations on any number of issues that could affect the timing of a sale and may involve components in addition to the purchase of the common stock (e.g., preferred stock or warrants). Negotiated block purchases have an advantage to issuers over underwritten offerings in that the buyer agrees to purchase the equity securities at a set price directly from the REIT, thus alleviating the need for underwriters and potential uncertainties in the marketing process. Additionally, despite the dilution that comes from the issuance of the additional shares, block purchases by a sophisticated investor can have a positive effect on the share price of a REIT's common stock. Investors are likely to see a major purchase of shares by a sophisticated buyer to some extent as a vote of confidence in the REIT, which is likely to lead to an immediate (although not always prolonged) uptick in the trading price of the issuer's stock. For instance, after the announcement of the sale of a large block of shares of common stock and warrants by Developers Diversified Realty (NYSE: DDR) to the Otto family on February 23, 2009, the price of DDR's common stock rose from a \$2.63 per share closing price on February 20, 2009 to an intraday price of \$4.02 per share on February 24, 2009. However, this sale was not enough to bring a sustained rally to DDR's share price and was viewed by many in the industry as too small an offering to address DDR's pending debt maturities. Subsequent to an announcement of an FFO loss for the fourth quarter of 2008, DDR's share price declined steadily with the broader market until it reached an intraday low of \$1.38 per share on March 9, 2009, well below the per share price prior to the announcement of the sale to the Otto family. Since that time, DDR's share price has rebounded with the broader market to close at \$2.72 per share on March 23, 2009.

In addition to the practical difficulties involved in finding an investor with capital willing to make a large investment in the current market, *registered direct offerings* and block purchases do contain uncertainties different from a typical underwritten offering. For example, unlike an underwritten offering that is exempt from the NYSE requirements of a shareholder vote as a "public offering for cash," a block purchase of more than 20% of a NYSE-listed REIT's shares by a third party will trigger a shareholder vote to approve the transaction,<sup>3</sup> which will create a delay between the announcement of a transaction and the receipt of the much needed capital from the sale of the shares. As a result of the timing necessary to obtain shareholder approval, the closing conditions for the transaction will need to be carefully considered to take into account the current volatility in the markets and potential fluctuations during the period between signing and closing of the sale.

With many REIT charters containing ownership limitations, depending on the precise terms of these limitations, a charter amendment may also need to be approved by shareholders. Finally, in negotiating large block purchases with one individual (or a small group of individuals), U.S. REITs will need to be mindful of the limitation that five or fewer individuals cannot own more than 50% of the value of the REIT's stock during the last half of its taxable year. In contrast, purchasers of excess shares above a REIT's ownership limitation would be prudent to negotiate the right to transfer the position in the future without the need for an additional waiver of the REIT's ownership limitation if the transfer would not otherwise cause the REIT to no longer qualify as a real estate investment trust. In addition, REITs should review other potential structural issues, such as antidilution provisions and change-of-control triggers, before proceeding with an offering.

### ***Developers Diversified Realty Sale***

As discussed above, DDR recently announced that the Otto family agreed to pay \$112.5 million to purchase 30 million new common shares and warrants to purchase an additional 10 million shares at a price of \$60 million. The shares will be sold in two tranches consisting of 15 million shares at a price of \$3.50 and the issuance of 5 million warrants at the first closing and 15 million shares at a price of \$4.00 and the issuance of an additional 5 million warrants at the second closing. The share purchase prices represent a premium of approximately 33% and 53% respectively to the closing price of DDR's common shares on February 20, 2009. The warrants are exercisable for a five-year period at a price of \$6.00 per share. If the Otto family acquires all of the shares subject to the share purchase, including the warrant shares, it will own approximately 27% of DDR's common stock, making it by far DDR's largest shareholder. The Otto family also will receive the right to nominate two members of DDR's board of directors so long as it continues to own at least 17.5% of DDR's outstanding common stock and the right to nominate one member of DDR's board of directors if the Otto family owns between 17.5% and 7.5% of DDR's outstanding common stock. In addition, a company owned by the Otto family agreed to make a \$60 million five-year mortgage loan as well as a bridge mortgage loan in the amount of \$60 million to provide DDR with capital prior to the closing of the share purchase. Prior to the sale, the Otto family already owned a substantial block of 6 million shares of DDR common stock, representing slightly less than 5% of the approximately 130 million outstanding shares.

Since the aggregate issuance of 40 million shares exceeds the 20% limit contained in NYSE rules (prior to the issuance of the new shares, DDR had approximately 130 million shares outstanding), the Otto sale is contingent on receipt of shareholder approval of the transaction and an amendment to the ownership limitations applicable to Otto in DDR's charter. DDR has scheduled a shareholder vote for April. Additionally, the Otto sale is subject to certain other closing conditions that provide a level of uncertainty and could derail the transaction. These conditions include a broad range of possible scenarios, including (i) an event that has or is reasonably likely to have material adverse effect on DDR's condition (financial or otherwise), results of operations, business, properties or assets, (ii) a change in certain executive officers, (iii) an announcement of an allegation of fraud or malfeasance on the part of one of DDR's executive officers by a governmental

body, (iv) the announcement of a covenant breach or receipt of a notice of default under certain unsecured debt, (v) a voluntary bankruptcy filing by one of DDR's five most significant tenants and (vi) a decrease of more than 50% of DDR's market capitalization over any three consecutive trading days compared to DDR's market capitalization at the close on February 19, 2009. The DDR transaction illustrates the potential structural complexity and non-economic costs of a single-purchaser equity raise.

While this transaction provided DDR with much needed equity, with debt maturities of approximately \$400 million in 2009, almost \$2 billion in 2010 and approximately \$1.6 billion in 2011, it is questionable whether this transaction will solve all of DDR's debt maturity issues over the coming years, which may be part of the explanation why DDR's share price has not sustained the levels the Otto family agreed to pay for its shares.

### **Rights Offerings**

As noted above, recent equity offerings by Simon Properties Group and Alexandria Real Estate Equities were done at a discount to the last traded price per share of approximately 8.4% with gross spreads of approximately 4.25%. Although the underwritten offerings raised an aggregate amount of equity for the two REITs of approximately \$740 million, the equity offerings significantly diluted the economic and voting ownership of existing shareholders. One alternative to raising capital in the market that may avoid or mitigate the dilution of current shareholders is a rights offering. Set forth below is a general overview of rights offerings in the U.S., including a discussion of certain of the peculiar issues raised in connection with these offerings. While it is important to understand rights offerings as a way to raise equity capital, the potential complexity and issues presented by these types of offerings in many cases will make rights offerings an inefficient means to delever a REIT's balance sheet.

### ***History***

Raising equity capital through a rights offering has been largely abandoned by publicly traded U.S. companies.<sup>4</sup> This may be explained in part by the perception that rights offerings are a last resort for distressed companies without access to more traditional underwritten offerings due to their poor financial health. This view is in contrast to issuers in Europe, much of Asia and Australia, where rights offerings have been relatively common.<sup>5</sup>

It should come as no surprise that current market conditions are forcing REITs to consider all options, including rights offerings, as viable and alternative methods to raising equity capital. A rights offering potentially avoids, or at least lessens, the significant ownership dilution that existing shareholders may face in volatile capital markets from a traditional large underwritten offering when the stock is trading at depressed prices. In addition, if the rights are transferable, they may provide value to shareholders that do not exercise their subscription rights to the extent that a trading market develops for unexercised subscription rights, thereby diminishing price dilution. Finally, rights offerings may be perceived by existing shareholders as

a more equitable means of raising capital by giving them, in effect, a “pre-emptive right” or “right of first refusal” before the shares are offered at a discount to market price to new investors, particularly in the face of a much needed large equity offering designed to delever the company’s balance sheet.

## ***The Offering***

### *General*

In a typical rights offering, the company distributes to existing shareholders, at no charge, subscription rights to purchase newly issued shares of common stock (or preferred stock<sup>6</sup>) on a *pro rata* basis at a discount to the current market price. The rights offering also may include an over-subscription right that provides existing shareholders (or their transferees, if such rights are transferable) with a right to subscribe for additional shares that remain unsubscribed, subject to *pro rata* adjustment if over-subscription requests exceed the number of offered shares. Generally, the length of a rights offering is longer than either an underwritten or a *registered direct offering* (about 15 to 30 days, although the offering period can be extended).<sup>7</sup> REITs should carefully consider how the various structural variables outlined below may affect the timing and certainty of success of a rights offering, as well as the exposure to market risk and the transaction costs associated with these various alternatives. Additionally, due to REIT ownership limitations, the rights offering will typically prohibit shareholders from subscribing for shares if such a purchase (including any purchase in an oversubscription round) would cause the shareholder to exceed the ownership limitations contained in the REIT’s charter.

### *Types of Rights Offerings*

- ***Rights Offering with Non-Transferable Rights.*** In this case, the rights distributed to shareholders are not transferable. If a shareholder does not exercise its subscription rights, the shareholder will lose all the value represented by the rights and will be diluted. This type of rights offering has been viewed as “coercive” in the sense that a shareholder must participate in the rights offering in order to avoid dilution and has no way to capture any portion of this lost value by transferring its rights. The offering may include an over-subscription privilege that allows shareholders to purchase additional shares not taken up by other shareholders. The company will often engage an information agent, and may also engage a dealer-manager to provide marketing assistance and advice to the company for a fee.
- ***Rights Offerings with Transferable Rights.*** On the other hand, rights offerings with transferable rights provide existing shareholders with the possibility of realizing value without participating in the rights offering, such that non-participating shareholders can be partially protected from dilution of their existing shares’ value (assuming such transferable rights are sold). If the rights are transferable, the rights typically will trade on the same securities exchange on which the company’s common stock is listed from the commencement of the rights offering until the close of business on the last day on which the rights offering expires. There is no guarantee that active trading in the rights will in

fact develop, though, and rights trading may in turn exert downward pressure on the price of the company's common stock. Where rights are transferrable, companies usually engage a dealer-manager to facilitate trading of the rights.

- ***Rights Offering with Underwriting or Other Standby Arrangements.*** A rights offering may include some form of standby underwriting (*firm commitment* or *best efforts*) or, more significantly, a “backstop” arrangement designed to provide assurances that the company will raise the full amount of the proceeds contemplated by the rights offering to effectively delever its balance sheet. In the case of a standby underwriting, one or more investment banks will enter into an agreement with the company pursuant to which they will agree to sell to the public in an underwritten offering any unsubscribed shares for a price generally no less than the subscription price associated with the rights offering. A company may also use a standby purchaser that has agreed in advance to buy any shares not taken up by the existing shareholders in the rights offering (or, where applicable, by purchasers in the underwritten offering). The use of standby purchasers that are related persons (i.e., directors, officers or 5% shareholders) raises certain issues under securities exchange requirements that are discussed below (*see*, “Securities Exchange Requirements” below). Underwriting and standby arrangements could also be viewed as “coercive” because they also force shareholders to exercise their rights to avoid significant dilution as they are aware in advance that the success of the rights offering is “guaranteed.” The potentially coercive effects need to be considered as part of an overall analysis by the board of directors and management of the specific needs of the company and the importance of minimizing the risk of a failed or inadequate equity raise in light of duties to various constituencies and upcoming debt maturities.

### ***Valuing a Rights Offering: Calculation of Theoretical Ex-Rights Price***

A REIT evaluating a potential rights offering will need to carefully consider the effect of the offering on its share price. In a rights offering, the price of the newly issued shares is fixed, and is usually below the current market price. To calculate the theoretical price at which the shares may trade immediately following a rights issue, analysts use a calculation known as the theoretical ex-rights price, or “TERP.” A company with a low equity capitalization may find that the relationship of its current equity capitalization to the amount of additional capital needed to address debt maturities is such that the size of the rights issuance necessary to raise the needed capital will have such a negative effect on the TERP that it will not be well received by investors.

The best way to illustrate the practical determination of the TERP for a share of common stock in a rights offering is by way of an example. Assume a hypothetical REIT has 100 million shares outstanding, with a trading price of \$5.50 per share before a rights offering. A rights offering to raise \$210 million is undertaken by issuing 70 million shares to existing investors at a price of \$3.00 per share for a total of \$210 million. The issue is a seven-for-ten rights issue, which means that for every ten shares held, a shareholder can purchase seven shares at a price of \$3.00 per share. This price is 45% less than the \$5.50 current market price. While the

discount on the newly issued shares is 45%, the share price will not remain static (as a result of dilution), changing as the rights expiration date approaches. To see if the rights issue does in fact give a material discount to its existing shareholders, the TERP should be calculated to determine how much the company's share price will be diluted.

This value is theoretical because other business and market factors will affect the share price. TERP is calculated by dividing the sum of the market capitalization plus the amount of capital raised in the rights offering by the number of shares outstanding following the completion of the rights offering. The formula to determine the TERP, assuming all of the rights are exercised and there are no interim dividends that need to be accounted for, is as follows:

$$\text{TERP} = [\text{pre-rights issue price} \times \text{pre-rights issue number of shares} / \text{total number of shares after rights issuance}] + [\text{rights issue price} \times \text{rights issue number of shares} / \text{total number of shares after rights issuance}]$$

Using the numbers in our previous example:

$$\text{TERP} = [\$5.50 \times 100 \text{ million} / 170 \text{ million}] + [\$3 \times 70 \text{ million} / 170 \text{ million}]$$
$$\$3.235 + \$1.235$$
$$\text{TERP} = \$4.47$$

So, in theory, as a result of the issuance of new shares at the discounted price, the value of a shareholder's existing shares (assuming full exercise of the rights) would decline from \$5.50 to \$4.47 or 18.73% of the \$5.50 trading value of the common shares prior to the offering. The loss is offset, however, by the gain in share value on the new rights: the new shares cost \$3.00 but have a theoretical market value of \$4.47.

### ***Securities Exchange Requirements***

Rights offerings are generally exempt from the shareholder approval requirements imposed by the NYSE on issuances of 20% or more of the issued and outstanding stock at a discount to book or market value since the NYSE views a rights offering as a "public offering for cash." Accordingly, even a substantial rights offering at a significant discount to market value will usually fit within this exemption. However, the analysis under securities exchange requirements is more complex in the case of rights offerings followed by an underwritten offering and/or a purchase of leftover shares by a standby (or "backstop") purchaser. In that case, each round of the offering (i.e., the rights offering, the underwritten offering and the purchase by the standby purchaser) must either (i) fall within an exemption under the securities exchange requirements or (ii) be approved by the company's shareholders if no exemption is available and the amount of shares sold is 20% or more of the issued and outstanding shares of the company prior to the rights offering. As noted above, there also will be constraints on the company if the standby purchaser is a "related

party” (e.g., director, officer or substantial shareholder or is affiliated with any of these).

As an example, below is a hypothetical transaction structure that the NYSE would likely view as not requiring shareholder approval. The standby purchaser in the following example is not a 5% shareholder and otherwise not a “related party,” and the example below is subject to the possibility of different results depending on the facts and circumstances of a specific transaction.

- **Round One-Rights Offering.** The company offers to its existing shareholders a right to purchase shares of common stock on a *pro rata* basis at a discount to the current market price. The NYSE generally views this as a public offering for cash and no shareholder approval is required.
- **Round Two-Subscription Rights.** Existing shareholders of the company are given the right to subscribe (subject to certain limitations and to allotment) for additional shares that remain unsubscribed. This round is viewed as part of the rights offering and therefore, a public offering for cash. No shareholder approval is required.
- **Round Three-Underwritten Offering.** The company enters into an underwritten agreement pursuant to which one or more underwriters have agreed to purchase any shares not taken up in the rights offering (including in the oversubscription) for resale to the public in an underwritten offering. The NYSE will view this round as a public offering for cash only if such offering is a true public offering for cash. In other words, as in a traditional underwritten offering, marketing efforts are made to a wide group of potential purchasers and shares are purchased by some or all of these potential buyers. If the shares are in fact purchased by 10 or more of these potential purchasers, the NYSE is likely to presume that this was a *bona fide* public offering for cash. If there are fewer purchasers despite adequate marketing efforts, the offer could still be a public offering for cash, but the analysis by the NYSE would be a subjective review of the facts and circumstances, which could put the availability of this exemption at risk.
- **Round Four-Standby Purchase.** In order not to trigger a shareholder vote, the standby purchaser(s) may purchase up to 19.9% in the aggregate of the issued and outstanding shares of common stock prior to the rights offering.<sup>8</sup> The standby purchaser (since it is not a related party in this hypothetical) may receive a fee by the underwriters for its agreement to standby.

If the standby purchaser is a related party under NYSE rules, there are important differences from the example above. First, assuming the related party wants to participate in other rounds of the offering (including, for example, the underwritten round), the related party must sit out one of the rounds. For example, the related person could participate in the rights offering, sit out the oversubscription round, participate in the underwritten offering and then take up the leftover shares, if any, in the standby purchase. Second, the related person can receive no fees as consideration for its agreement to standby. Third, the related person must buy the

shares in the standby purchase on the same terms offered to existing shareholders in the rights offering. As noted above, the aggregate purchase by the standby purchaser must be no greater than 19.9% of the issued and outstanding shares prior to the rights offering.

### **Conclusion**

With debt markets still in turmoil and the industry facing unprecedented debt maturities over the next few years, it is clear that a large number of REITs will need to undertake dilutive equity issuances at depressed share prices (and in all likelihood at a discount to these depressed prices) to raise equity capital that will allow them to strengthen their balance sheets and meet these liabilities. In order to maximize the appeal of an equity issuance to investors and existing shareholders in this market, an equity offering will need to demonstrate that the REIT has the ability to solve its balance sheet problems and position the REIT to address upcoming debt maturities. Dilutive issuances that only prolong the downward spiral of many REITs will likely not be well received by the market.

Additionally, it is unlikely that *bought deals* will be seen in the current market because the high volatility makes the risk to underwriters too great. Instead, equity issuances completed in the coming months will often take the form of discounted *overnight sales* (e.g., similar to the underwritten offerings undertaken by SPG and ARE). It is also likely that we will see a number of *registered direct offerings*, as well as additional block sales to a single investor similar to the DDR transaction. Although REITs that need to raise significant amounts of equity should consider rights offerings, they may not need to go through the uncertain process of conducting a rights offering with a “backstop” arrangement as discussed above, if they can be reasonably confident that an underwritten offering can be completed without an extensive marketing period or an excessive discount to the trading price of the company’s common stock.

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<sup>1</sup> To our knowledge, based on a review of SEC filings, there have been no fully marketed underwritten offerings by a U.S. REIT in the past six months. All of the offerings made by U.S. REITs during this period have either been *at the market offerings* or *overnight deals*, such as those most recently conducted by Simon Properties Group (NYSE: SPG) and Alexandria Real Estate Equities (NYSE: ARE). Please note that the reference to *overnight deals* simply implies a very limited marketing period and should not be taken literally.

<sup>2</sup> SPG also agreed to sell \$650 million of 10-year bonds at an interest rate of 10.75%.

<sup>3</sup> Section 312.03 of the NYSE Listed Company Manual provides that shareholder approval is required prior to the issuance of common stock, or of securities convertible into or exercisable for common stock, in any transaction or series of related transactions if: (i) the common stock to be issued has, or will have upon issuance, voting power equal to or in excess of 20% of the

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voting power outstanding before the issuance of such stock or of securities convertible into or exercisable for common stock; or (ii) the number of shares of common stock to be issued is, or will be upon issuance, equal to or in excess of 20% of the number of shares of common stock outstanding before the issuance of the common stock or of securities convertible into or exercisable for common stock. In addition, NYSE rules require shareholder approval in cases where a “related party” is acquiring more than 1% (in the case of directors, officers and affiliated purchasers) or 5% (in the case of a “substantial security holder”).

<sup>4</sup> Between 1935 and 1955, rights offerings were much more commonplace in the U.S. with more than one-half of domestic common stock issues with proceeds over \$1 million being the result of rights offerings.

<sup>5</sup> A number of publicly traded United Kingdom real estate companies, including, among others, Land Securities Group, The British Land Company, Hammerson and Segro, have engaged in rights offerings during the past few months.

<sup>6</sup> See, Form S-3/A filed by Brookfield Homes Corporation on March 6, 2009 registering rights to purchase convertible preferred stock and the shares of common stock issuable upon conversion of such preferred stock.

<sup>7</sup> Under Section 703.03(E) of the NYSE Listed Companies Manual, existing shareholders must be allowed at least 16 days after the rights have been mailed to subscribe to the offering, although this period may be shortened to 14 days if permission has been received from the NYSE.

<sup>8</sup> As noted above, REIT ownership limitations, antidilution provisions and change-of-control triggers will need to be considered in the case of a large commitment by the standby purchaser.

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