

A photograph of three business professionals in a meeting. On the left, a woman with short blonde hair is looking towards the center. In the middle, a man with glasses and a beard is looking towards the right. On the right, a woman with dark curly hair is smiling and gesturing with her hands. They are all dressed in business attire.

CAPITAL RAISING TECHNIQUES BEYOND THE ROUTINE EQUITY OFFERING

Introduction

Within the last few years, alternative capital raising techniques have gained momentum. Companies are choosing to form or obtain growth capital by structuring investment offerings that provide the right type of capital for their needs while offering features and benefits that attract retail investors. Among the alternative or “hybrid” channels are the increasingly popular continuous, non-traded preferred offerings.

This white paper will share the collective input from leaders of three unique companies in an effort to offer real-world insights to business finance leaders who may be looking for new and creative channels for raising capital.

Preferred stock offerings have long existed in the open securities market and most investors are familiar with traded preferred stock. As of late, Non-Traded Preferred Stock has garnered interest within both the investment community and those organizations seeking new methods of capital raising. Although non-traded preferred stock can be a capital raising channel for any publicly or privately traded company, this paper will include specific examples from the REIT and BDC industries. Readers will learn distinctions of non-traded preferred securities that will help them determine if non-traded, preferred stock is right for them.

Section 1: What are preferred securities?

By the most basic definition, preferred stock is generally an equity investment that sits on the balance sheet above common stock and below debt. These investments have some attributes of a common stock investment, but also attributes of debt. Investors are attracted to Preferred Stock due to the consistent dividend, which is similar to debt interest payments, but there is some potential upside akin to common stock. Preferred stocks have been around for more than 100 years, and while they haven't necessarily been as popular among investors or issuers raising capital, they can play a very important and strategic role.

Retail investors mainly invest in preferred stock for the dividend benefit, but there are many features that can be used to craft a particular preferred stock. A company considering a preferred stock offering needs to look at various things as they structure the security. Likewise, investors need to look at those same things as they select a preferred stock to invest in.

Dividend

The payment from an equity investment can be quarterly, but these types of offerings are generally monthly. Will the rate stay consistent or increase based upon time, inflation, interest rates or some other company metric?

Cumulative

The right to receive dividend payments in arrears, if a company has suspended its dividend, before the common equity distribution can be resumed. Cumulative rights are typically a protection for preferred equity holders.

Callable

The right for an issuer to purchase back the preferred equity at par value after a set date. If interest rates fall, the issuer may call or redeem existing preferred equity and reissue new preferred equity at a lower dividend rate. An additional consideration is how long will the security stay outstanding before it is callable by the company.

Section 1: What are preferred securities?

Convertible

The right to exchange preferred equity shares for a set number of common shares under certain circumstances, which can vary significantly by the preferred equity issue.

Redemption Rights

This is more common in non-traded preferred stock offerings where the investor has the right of redemption at their option. A right of redemption can provide liquidity for investors in an otherwise non-listed investment. Redemptions typically have a redemption fee that decreases over time until preferred equity shares can be redeemed at the stated value, usually after three to five years. Redemptions can be met by paying cash or by issuing freely tradable common shares.

Voting Rights

This feature varies between offering and the traded versus non-traded structure. Listed preferred equity usually does not carry corporate voting rights like common equity shares. However, some non-traded preferred equity shares are being granted voting rights, especially if the vote impacts the preferred security.

TRADED VS. NON-TRADED – WHAT'S THE DIFFERENCE?



Traded stock offerings

Has volatility and will fluctuate with market movements.

Capital Source: Typically issued and underwritten through Wall Street investment banks and their institutional syndicates.



Non-traded stock offerings

Has a stable value and is commonly considered a non-correlated asset.

Capital Source: Generally Issued through "Main Street" via Independent Broker Dealers and Registered Investment Advisors; not listed on public exchanges but directly available to investors.

Section 2: Why continuous, non-traded preferred stock may be right for you as an issuer

Companies are actively managing their balance sheets through various market cycles, to meet expiring debt, and to become more conservative through deleveraging or to obtain new growth capital. The point of this white paper is not only to have companies consider the use of preferred stock but also the source of their capital. Most firms understand the sources of common stock capital and interest in their firms as well as the various sources of debt. Yet companies are tapping directly into the retail investor through their financial advisors, and now billions of dollars of capital are flowing onto firms' balance sheets mainly as growth capital. Companies are generally seeking to diversify their sources of capital and their capital stack.

As a company, when choosing the path of the continuous, non-traded preferred stock offering, you need to look at several decision points. First, look at this particular product offering from an investor demand standpoint. Presently, there is strong retail demand!

Second, you should look at the offering from your own company's perspective. Non-traded preferred stock affords issuers flexibility when it comes to raising capital. For years, public companies like publicly traded REITS and BDCs have utilized the non-traded preferred stock for specific funding purposes, such as making strategic investments or acquiring additional assets or real estate. Non-traded preferred stock provides a similar use of equity raised with common stock, but with the advantage of not diluting an issuer's common stock base.

Third, with a non-traded preferred stock offering, there is an element of predictability or management control to capital flows coming in. Compared to other capital raising techniques this is unique. For any CFO interested in raising capital, the total offering needs to be at the right cost point or price for the issuing company, which may include the ability to call the investments. This is important and gives issuers the opportunity to calibrate their capital stack based on their individual needs.

Section 2: Why continuous, non-traded preferred stock may be right for you as an issuer

After a ramp up period the flow of capital from a continuously offered non-traded preferred stock can be steady and stable for an extended multiyear period. Many of the offerings deliver fresh capital every two weeks or on monthly basis. This could match up nicely with capital funding needs or the acquisition pipeline of the company. This type of offering is not ideal for those companies seeking a large, one-time injection of capital; rather institutional offerings are the right decision for that need.

Implications to Your Balance Sheet

There are structural components or variables to your deal terms that will determine how a preferred stock offering is structured – as equity or debt – or perhaps somewhere in the middle, or “mezzanine,” on the balance sheet. There is no right or wrong approach on how you may choose to classify the investment. It can be considered more of an equity part of a company's balance sheet. Here are the factors and influences:

1. Accounting standards for your industry, structure or sector
2. The terms of the preferred offering
3. The auditors
4. Credit rating agencies for those that are rated

Investors and Customers in One

In certain industries, such as in REITs and BDCs, issuers can actually gain brand recognition and loyalty from their investor base. Since dividends are paid from profits back to investors, some investors will become so-called “Investomers”, individuals who patronizes the company in which he or she is also a shareholder. This is a unique benefit to the issuer that also plays to the retail investors' interest in seeing the parent company perform well. It may also draw attention to your common offering, extending a company's reach and interaction with Main Street investors.



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Proven Public Performance and Street Credibility

If you are a public company contemplating issuing non-traded preferred stock to raise capital, you as the issuer already have pre-existing proof points that may make your offering more attractive to potential investors. In the case of retail investors, they can go to EDGAR® or to your investor relations site, and they can see your regular filings with the SEC, your quarterly and annual results as well as any of your press releases, including any material you are required to publicly disclose. Your transparency builds confidence in the mind of your potential investors.

As a public company, investors can research these proof points and answer their own questions such as, “Are you legitimate? Do you have a positive reputation on Wall Street? Do you have a consistent track record of paying dividends?” Between a positive reputation and existing operations, publicly listed companies have a significant advantage of raising capital through financial advisors over the many “startup” companies that have little operating history or few assets to validate their strategy. This is key for the investor; these investments are not blind pools.

Here’s what’s encouraging: the market has proven this as a viable capital raising technique and a win-win for the issuer as well as the investor. Over the most recent decades a tremendous amount of capital has been raised by non-traded, common stock offerings of REITs and BDCs. One might refer to this category as first-generation. Preferred stock offerings, while not offering as much potential upside for investors, fixed many of the concerns for first-generation offerings. Additionally, these companies take the next step and list on an exchange, opening the door for issuing the latest generation of preferred stock investment to continue the company’s growth and evolution.

Section 2: Why continuous, non-traded preferred stock may be right for you as an issuer

Here are some industry sectors where non-traded preferred stock could be a good fit:

- > **Utilities:** Electricity, water, and natural gas (suppliers, not producers)
- > **Energy:** Oil, natural gas (producers, not suppliers), and master limited partnerships (MLPs)
- > **Telecommunications:** Carriers (U.S. and international) and wireless services
- > **Consumer staples:** Food/beverages, prescription drugs, household products, tobacco, and alcohol
- > **Real estate:** Commercial, residential, or office buildings inside real estate investment trusts (REITS)
- > **Financials:** Banks, Business Development Companies (BDCs), Mortgage companies.

CASE STUDY:

Preferred Apartment Communities (APTS) began their first offering of non-traded preferred stock in 2012. Since then they have methodically raised over \$2 billion in capital from over 50,000 investors that were recommended the offering by their financial advisor. The investors were educated about the existence, strategy of the company and preferred offering through the investment process. Between the financial advisors who analyze the offering and the investors, the firm's brand recognition has experienced significant growth with benefits of residents in their apartments and interest in the common stock side as well.

Section 2: Why continuous, non-traded preferred stock may be right for you as an issuer

Covered Security: A view of standards state-by-state

The term “covered security” applies to securities exempt from state registration because of their oversight by Federal authorities and national-level regulatory bodies pursuant to Section 18 of the Securities Act. Generally, securities listed on national exchanges are the most common type of covered security exempt from state registration. A non-traded security can also be a covered security if it has a seniority greater than or equal to other securities from the same issuer that are listed on a national exchange, such as the NYSE. The preferred stock is a covered security because it is senior to common stock and is therefore exempt from state registration.

There are several advantages to both issuers and investors of a security being deemed a covered security. These include:

- › **More Investors** – Covered securities can be purchased by a broader range of investors than non-covered securities. Non-covered securities are subject to suitability requirements that vary from state to state. These so-called “Blue Sky” regulations often prohibit the sale of securities to certain investors and may prohibit the sale of securities altogether until a specific volume of sales have been achieved in other states.
- › **Issuance Costs** – Covered securities may have lower issuance costs since they avoid the expense of dealing with the various regulations of each of the 50 states and Washington, D.C. This could save time and money and allows issuers of covered securities the flexibility to enter the real estate markets at a time of their choosing. All investors of the issuer would benefit from any lower issuance costs that may be achieved.

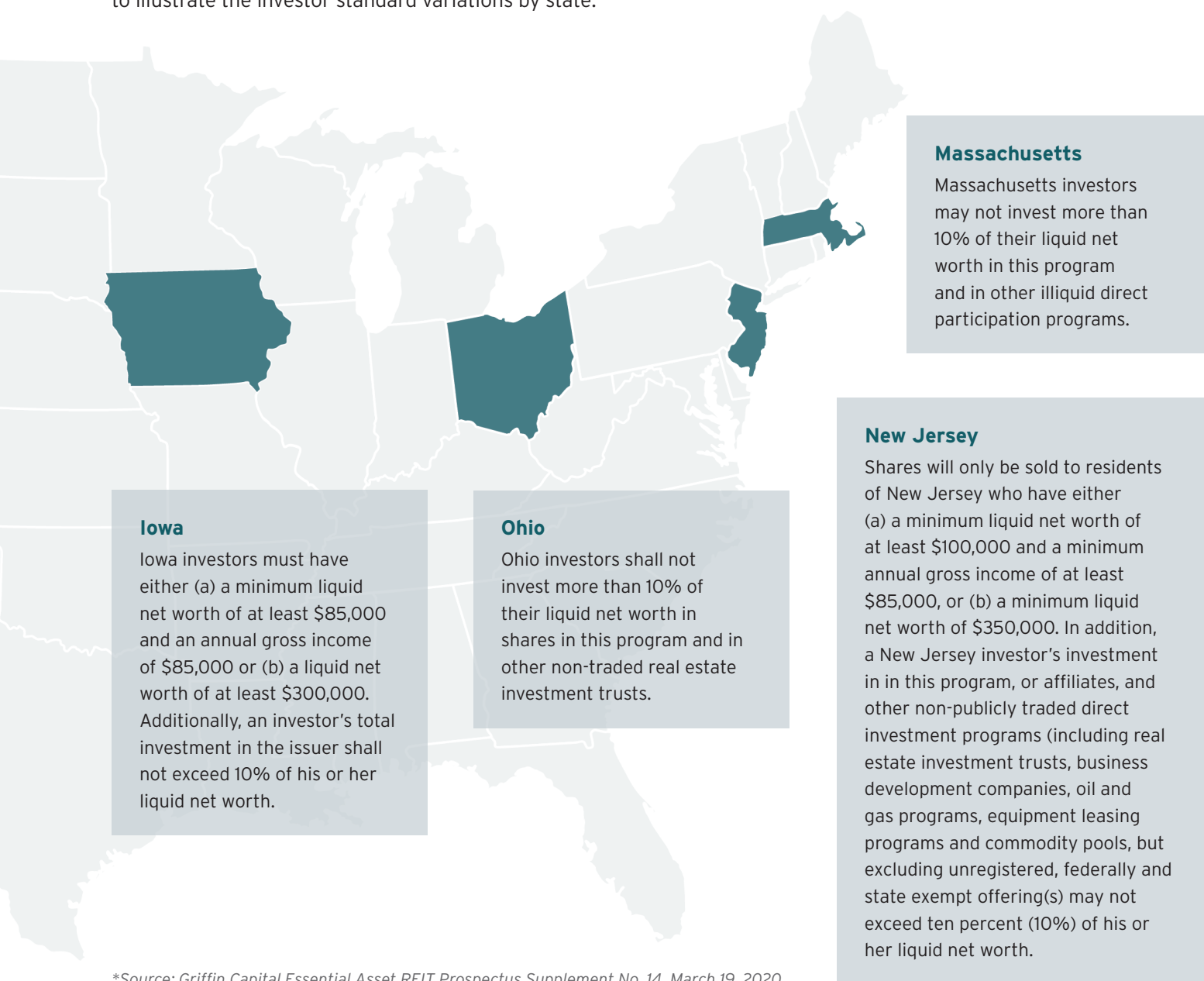
There are several disadvantages to investors of a security being deemed a covered security. These include:

- › **Lack of State Suitability Standards** – Since there are no state investor eligibility requirements, there is no prohibition on the sale of the securities to certain investors, including investors that may not be suitable to purchase the securities.
- › **No State Review** – Investors will not receive an additional level of review and possible protection afforded by the various state regulators.

Section 2: Why continuous, non-traded preferred stock may be right for you as an issuer

A State by State Comparison

Here is a random sampling of State Suitability Standards (in no particular order) from a REIT Prospectus* to illustrate the investor standard variations by state:



*Source: Griffin Capital Essential Asset REIT Prospectus Supplement No. 14. March 19, 2020

Section 2: Why continuous, non-traded preferred stock may be right for you as an issuer

Transaction and Custody of Non-traded Preferred Stock

Also, these preferred securities have a unique CUSIP with each new offering by the company. And, so like any other publicly preferred stock program, these can be purchased through a brokerage account with a unique CUSIP, and they're electronically traded through the depository trust and clearing corporation or DTCC. These securities can also be held directly with the issuer's transfer agent or at third party custodians and finally inside of self-directed IRAs. If structured properly, non-traded preferred stock are very flexible in their transaction methods and custody options allowing them to be acquired by large institutions and Main Street investors.

So, why preferred stock as an alternative avenue to capital raising?

These companies and America's most famous investor have made it work. Warren Buffet has long used the preferred stock strategy when making investments, including with headline names like:

- > **2019** - \$10 billion investment into Occidental Petroleum
- > **2011** - \$5 billion investment into Bank of America
- > **2009** - \$3 billion investment into Dow Chemical
- > **2008** - \$3 billion investment into General Electric
- > **2008** - \$5 billion investment into Goldman Sachs

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The Main Street Investor

The Main Street investor controls more wealth than even before. There are many factors that contribute to this including but not limited to:

- › The sheer volume of retail investors
- › The amount and value of investor dollars
- › The trend away from defined benefit plans (Pension funds) to defined benefits plans (401Ks). When an employee leaves an employer or retire, most commonly the 401K is rolled into an Individual Retirement Account (IRA) and then is managed with the assistance of some form of a financial advisor.

Generally speaking, financial advice for these retirement accounts come from one of six sources:

1. Wall Street Wire Houses / Regional firms - Merrill Lynch, Morgan Stanley, Raymond James
2. Banks - Wells Fargo, Chase, Truist etc.
3. Insurance Companies - Prudential, Allstate, etc.
4. Independent Broker Dealers / Financial Advisors - LPL, Advisor Group, Cetera
5. Registered Investment Advisors (RIAs) - Cornerstone Wealth Management
6. Direct Investment Firms - Charles Schwab, Fidelity, Vanguard

While the large firms have well-known brands and manage large portions of capital, the independent broker dealers and RIAs have a significant number of affiliated advisors who cover large and small cities across the United States. Investors can find non-traded securities of various types offered in most of these channels. The non-traded preferred stocks have gained initial traction among independent broker dealers and RIAs, however, interest is quickly growing in all segments. All of these are sources to access the Main Street investor. Finding the right investment bank or managing broker dealer to help the issuer to structure and distribute the preferred stock offering is critical to the success of reaching the Main Street investor with your offering and raising the desired level of capital.



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Investor Benefits

Why are all types of investors making allocations into non-listed preferred stocks? What is the attraction for retail investors?

The short answer is: A consistent, high-yield income that can often times be more favorable than that of the common stock. From the investor perspective, this particular security is becoming increasingly more interesting for those looking for a higher and more stable yield.

Preferred stocks are designed to provide a steady income stream through regular dividend payments. These dividends tend to be higher than some of the traditional fixed income securities – a preferred security that is offered includes the principal protection as these securities sit in the preferred part of the capital stack, ahead of common stock. Additionally, price stability of the security comes into view.

Offering investors what they really want

Stability: These securities are sold at a stated value generally \$1,000 or \$25. If the business operates according to plan and there is sufficient common equity, the state value is stable. Low interest rates of debt and fluctuating common stock volatility do attribute to the attractiveness of the non-traded, fixed price preferred stock. Financial advisors call this a non-correlated asset which is sought after in portfolio construction. Advisors and investors think of these securities as a fixed income alternative.

Almost 10,000 baby boomers turn 65 every day. The famed generation, defined as those born between 1946 and 1964, is causing something of a stir as they reach retirement age in droves. In 2031, the U.S. population over the age of 65 will number 75 million, almost double what it was just 23 years prior in 2008.

Section 2: Why continuous, non-traded preferred stock may be right for you as an issuer

Income: One of the most distinctive attributes of non-traded, preferred stock is consistent income. Many of these non-traded preferred offerings are cumulative. That's what investors are looking for. Especially if you look at demographics, and how aging baby boomers are looking for income to replace their employment, so they can cover all their bills and maintain a quality lifestyle. That's where cumulative income comes into play here, specifically on the non-traded preferred stock offering. So that's another way to add stability to the investor's portfolio.

FACT: Social Security payments only replace about 40% of the average American's pre-retirement income. This percentage is even lower for people who earned higher-than-average income during their careers.

Source: Social Security Administration

FACT: According to a recent study by the Employee Benefits Research Institute (EBRI), at least half of retirees restrict their spending to match their regular income (income that does not include sales of retirement plan assets).

Takeaway: Retirees are looking for consistent sources of income (and it's a real need, not just a want).



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Taxes

There is a tax benefit for preferred stock investors, since dividends are often taxed at qualified dividend rates. A qualified dividend is a dividend that falls under capital gains tax rates that are lower than the income tax rates on unqualified or ordinary dividends. An investor's interest income from bonds or common stock dividends will be taxed as ordinary income. The dividends from REITs and BDCs are not qualified dividends mainly because those entity structures do not pay any corporate level tax, but rather, pass along gains and losses directly to the investors. Depending on the types of assets held, depreciation schedules, financial performance and other factors, there may be significant tax advantages with REITs and BDCs as well.

Capital Preservation - Two Advantages

Seniority in the Capital Stack: First, these are a senior security, which means not only are the dividends paid first, but also in the return of capital upon any time of liquidation of the company. After debt obligation, the preferred stock holders receive their principal investment before any value can be allocated to the common shareholders.

Not Interest Rate Sensitive like Comparable Securities: Non-traded preferred stocks are not interest rate sensitive, in the same sense that traded preferred like bonds or your exchange traded note funds may be. Those securities are constantly moving up and down with changes in interest rates or the forward-looking projections of where interest rates are going to be.

Section 2: Why continuous, non-traded preferred stock may be right for you as an issuer

Think about it. If you own a bond or a bond fund right now in 2021, if interest rates begin to rise (since they cannot go much lower!), the value of your bond funds is going to decrease because people are constantly looking to sell their old interest rate investments and buy new interest rate investments. So that turns your stable, fixed income investment into something that has volatility.

Therein is the appeal of the non-traded preferred stock offering. It doesn't move with interest rates. It stays flat on the investor account at a fixed price per share. This offers significant protection to the investor as interest rates move.



Section 3: The hallmarks of a strong non-traded preferred stock offering

So you've decided to pursue a continuous, non-traded preferred stock offering. Congratulations! First thing you should know is, you'll have some foundational groundwork to establish.

By contrast, traditional common offered deals and underwritten deals are fairly straight forward in the sense you can turn to an investment bank to issue an overnight or secondary offering. The process to structure a product, grow a selling group of advisors and establish a base of investors in a non-traded preferred stock is a little bit more elongated.

Establishing your partner network

There are three Tier 1 partners that can work together to launch a successful offering.



Managing Broker / Investment Bank



Legal Counsel



Transfer Agent

The combination of these three firms can help advise and create a competitive offering. Selecting the right initial firms are key and they should have specific experience in transactions of non-traded preferred stock. For the offering to be successful, the firm can provide a layout of the current landscape of the offering and what features and benefits would be attractive to investors.

Once the structure is in place, the managing broker dealer's role is to help identify the right financial intermediaries to market the offering to. This process is a real "boots on the ground" effort.

For starters, you need to identify target advisors, broker dealers and registered investment advisor that use these types of securities. You will need to have them sign a selling agreement and, to get to that point, you typically need to go through their investment committee. That then involves them doing due diligence on your offering and reviewing all your public filings and so forth. Once the selling agreement is in place the managing broker's wholesaler will begin to educate the firm's financial advisors about the offering and where it would fit into investor portfolio allocation.

Section 3: The hallmarks of a strong non-traded preferred stock offering

Likewise, it is critically important that you have a seasoned and knowledgeable transfer agent, like Computershare, who is able to support both traded and non-traded securities. This is important simply for the purpose of managing the relationships with all your firms and managing your cost of capital inflows to your firm. Building a strong network of partners and providers is in your best interest here, your Tier 1 on partners can assist you in the coordination of Tier 2 partners that will include firms like:

- > Escrow Agent
- > DTCC
- > Custodians
- > Clearing Firms
- > CUSIP Bureau
- > Security Data Providers
- > Valuation Experts
- > Third Party Due Diligence

With many intermediaries involved, every time you do a capital closing, you have to coordinate with all of the entities listed to get the proper sign-offs to make sure the security – as you issue it – is properly accounted for on the books and records of DTCC and to ensure that the new issuance is made DRS eligible and is properly priced.

You need to ensure that it all flows seamlessly, from the closing and escrow process into the investor accounts. It is a process that will require you to take initiative to orchestrate, and you need knowledgeable partners – from the transfer agent through the distribution side – so that it can be a good experience for, not only the issuer, but also for all the financial advisors and investors who are involved.

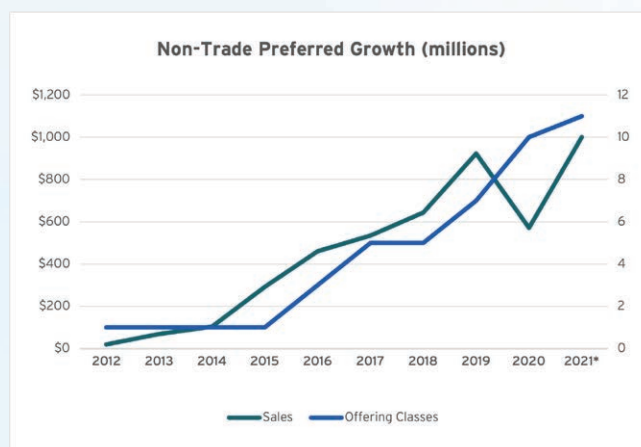


Section 3: The hallmarks of a strong non-traded preferred stock offering

A good foundational process cannot be overemphasized

Prepare yourself for laying the foundation of your initial offering. While there is a little bit of a process to get these broker dealers up and running and to be able to sell your product, the initial effort will benefit you in the long run. To set your expectations: Your first continuous, non-traded preferred stock offering will not happen overnight. However, you can start to make it more efficient as you get into product two and product three. Keep in mind, it takes time for the channel to get to know who your company is and to know what your underlying product is.

You will need to establish a commitment to your channels, and that means spending money on due diligence reports and so forth. So, while this may not be a channel for the faint of heart, it is a channel that can be very effective for you in raising capital. Keep your end capital raising goal in mind as you lay that foundation.



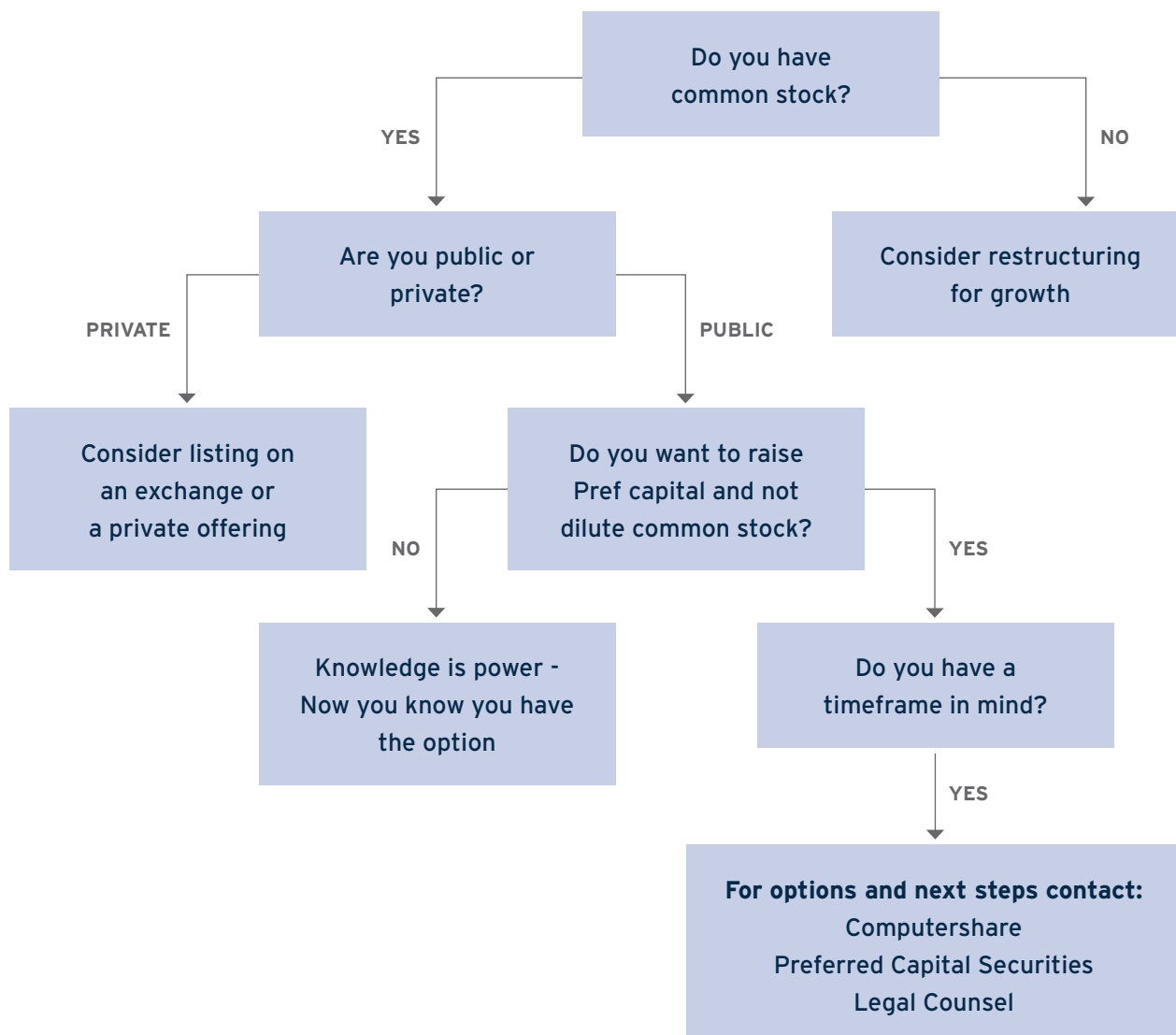
**2021 estimated. Historical Data provided by Robert A. Stanger & Company, Inc.*

There is room for optimism here. It is not all an uphill climb. Non-traded preferred stock offering products already have a lot of acceptance among the major broker dealers and sophisticated RIAs and family offices. However, do not go into this thinking that if you have a few wholesalers scattered between the coasts that you will hit your goal. You need to think about your partners and your wholesaler strategy. You will want to come to the table with substantial financial resources to put into your capital markets team from both a wholesale standpoint and a national accounts standpoint and, of course, an operations and client services standpoint.

Section 4: How does it work and what do I need?

Perhaps after reading this white paper and giving it some thought, continuous non-traded preferred stock sounds like something you would like to investigate and possibly even pursue. Where do you start? The below workflow provides a simple decision tree to help you parse the basic questions and steps you should consider.

To get started, work through the following questions:



Conclusion

In any economic climate, business and finance leaders need to keep an eye on growth as well as planning for potential downside events or risks. This requires a strategic and tactical approach to balancing equity on the balance sheet, including raising capital. Alternate capital raising techniques have gained popularity recently with both issuers and retail investors. In the case of this white paper, issuing non-traded, preferred stock has been the primary focus and, as we have come to see, it is a step-by-step process with advantages to both parties.

Decision makers and business leaders should first evaluate their capital raising goals and, secondly, determine what an attractive offer would look like to the end shareholders. As a fixed income security, non-traded preferred stock offers investors potential advantages such as yield, dividend frequency, tax advantages, dividend coverage, dividend sustainability, and principal protection.

To be successful, a strong non-traded preferred stock offering will require careful planning and resource budgeting. While the start-up requirements can be rigorous from an administrative and due diligence perspective, building a skilled team of collaborative partners to bring your offering to market has valuable long-term capital raising advantages to both the issuers (potentially even from a brand perspective), as well as the Main Street advisors to the shareholders with whom they maintain relationships.





Considering issuing non-traded preferred stock? Computershare can help.

Watch our webinar: computershare.com/capital-raising-webinar

Contact Computershare for guidance on how you can work with an experienced transfer agent for your non-traded, preferred stock offering.

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