

FIRST ALBANY COMPANIES INC

Form PRER14A

June 12, 2007

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
SCHEDULE 14A INFORMATION  
(Rule 14a-101)  
INFORMATION REQUIRED IN PROXY STATEMENT  
SCHEDULE 14A INFORMATION  
Proxy Statement Pursuant to Section 14(a) of the Securities  
Exchange Act of 1934 (Amendment No. 1)**

Filed by the Registrant ☐

Filed by a Party other than the Registrant ☐

Check the appropriate box:

☐ Preliminary Proxy Statement

☐ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

☐ Definitive Proxy Statement

☐ Definitive Additional Materials

☐ Soliciting Material Pursuant to Section 240.14a-12

**First Albany Companies Inc.**

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than Registrant)

Payment of Filing Fee (Check the appropriate box):

☐ No fee required.

☐ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11  
(Set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

- Fee paid previously with preliminary materials.
- Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.
  - (1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

---

**Table of Contents**

June \_\_, 2007

Dear Fellow Shareholder:

Enclosed are the proxy materials for the 2007 annual meeting of First Albany Companies Inc. (the Company ).

**Please read those materials carefully.**

As you may know, on May 14, 2007, the Company announced that the Board of Directors unanimously approved an agreement to recapitalize and receive a \$50 million equity investment from an affiliate of MatlinPatterson Global Opportunities Partners II LP, which is a global private equity firm with approximately \$4 billion under management. **This capital investment will provide the Company with resources to grow our business, to seek to acquire other securities or advisory businesses, to focus on its core investment products and services strengths, to provide incentives to its employees and to better meet the needs of its clients.** This transaction will complete a year of restructuring and repositioning for the Company.

After experiencing recurring losses, in the spring of 2006 the Board of Directors retained Freeman & Co. Securities LLC as its financial advisor to evaluate and entertain alternatives for recapitalization of the Company. In addition, the Board of Directors of the Company (the Board ) formed a Special Committee to examine strategic alternatives, evaluate proposals from potential investors and to recommend to the Board the best course of action for the Company and its shareholders . Throughout 2006 and early 2007, the Company had active conversations with numerous potential investors, but ultimately received no offers. In the first quarter of 2007, MatlinPatterson FA Acquisition LLC ( MatlinPatterson ) expressed interest in a transaction. **Following intensive discussions and consultation with their financial advisors and legal counsels, the Special Committee unanimously recommended to the Board of Directors that the MatlinPatterson proposal was in the best interests of the Company and its shareholders, and the Board of Directors unanimously approved the transaction.**

This year's annual meeting is most important since you will be asked, among other things, to consider, act upon and approve five proposals, together authorizing the transaction to recapitalize the Company. In such recapitalization transaction, MatlinPatterson agreed to purchase 33,333,333 newly-issued shares of common stock of the Company (subject to upward adjustment) for an aggregate cash purchase price of \$50 million. Upon consummation of the transaction, MatlinPatterson would control approximately 69.5% of the voting power of the Company (59.5% on a fully diluted basis), based on the number of shares of common stock outstanding on May 8, 2007, and after giving effect to an increase in the number of Purchased Shares that is currently expected to result from the adjustment provisions of the Investment Agreement. **This transaction has important implications for your investment.**

**In connection with the recapitalization transaction:**

The Special Committee unanimously recommended, and the Board of Directors unanimously approved the transaction;

Freeman & Co. Securities LLC, the financial advisor of the Company, provided a fairness opinion that, from a financial point of view, the consideration for the newly-issued shares is fair to the Company;

Peter McNierney, the Company's President and Chief Executive Officer, following consummation of the transaction, will become President and Chief Operating Officer;

Lee Fensterstock will take over management of Company as Chairman and Chief Executive Officer; Mr. Fensterstock has over 20 years of experience in the securities industry, having served as President and Chief Operating Officer of Gruntal & Co., Chairman and Co- Chief Executive Officer of Bonds Direct Securities Inc. and Managing Director of Jefferies & Co.; and

26 of the Company's employees, comprising substantially all of the most senior management of the Company, have signed non-compete and non-solicit agreements conditioned on the closing of the recapitalization transaction which we believe is indicative of their commitment to the future of the Company if the recapitalization transaction is completed.

**In order for the transaction to proceed, it is important that you vote **FOR** the five recapitalization proposals (Proposals 2 through 6) in the attached proxy.**

---

**Table of Contents**

**Your vote is very important.** We hope that you are planning to attend the annual meeting personally and we look forward to seeing you. **Whether or not you are able to attend in person, it is very important that your shares be represented at the annual meeting. Accordingly, the return of the enclosed proxy as soon as possible will ensure that your shares are represented at the annual meeting. In addition to using the traditional proxy card, most shareholders also have the choice of voting over the Internet or by telephone.**

Since the approval of some of the recapitalization proposals requires the affirmative vote of holders of a majority of the outstanding shares of the Company's common stock, the **failure to vote your shares will have the same effect as voting against approval and adoption of such proposal.**

If you have any questions concerning these documents, please feel free to contact:

MacKenzie Partners, Inc.  
105 Madison Avenue  
New York, NY 10016  
Call Collect: (212) 929-5500  
or  
Toll Free: (800) 322-2885

On behalf of the Board of Directors and management of First Albany Companies Inc., I would like to thank you for your continued support and confidence.

Sincerely yours,  
George C. McNamee  
Chairman of the Board

---

**Table of Contents**

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS  
TO BE HELD  
— —, 2007**

NOTICE IS HEREBY GIVEN that the annual meeting of the shareholders of First Albany Companies Inc. (the Company ) will be held at the offices of the Company, 677 Broadway, Albany, New York, on — —, 2007 at 10:00 a.m. (EDT), for the following purposes:

- (1) To elect three (3) directors whose terms will expire at the 2010 annual meeting of shareholders;
- (2) To consider and act upon a proposal to approve the Company s issuance and sale of shares of common stock to certain qualified investors in a private placement;
- (3) To consider and act upon a proposal to amend the Company s Certificate of Incorporation to increase the authorized share capital of the Company from 50,000,000 shares of common stock to 100,000,000 shares of common stock with the same par value of \$0.01 per share;
- (4) To consider and act upon a proposal to amend the Company s Certificate of Incorporation to increase the authorized share capital of the Company from 500,000 shares of preferred stock to 1,500,000 shares of preferred stock with the same par value of \$1.00 per share;
- (5) To consider and act upon a proposal to amend the Company s Certificate of Incorporation to limit the liability of the directors of the Company to the extent permitted under Section 402(b) of the New York Business Corporation Law (the NYBCL );
- (6) To consider and act upon a proposal to approve the adoption of the First Albany Companies Inc. 2007 Incentive Compensation Plan;
- (7) To ratify the appointment of PricewaterhouseCoopers LLP as independent accountants of the Company for the fiscal year ending December 31, 2007; and
- (8) To transact such other business as may properly come before the meeting or any adjournment thereof.

We ask that you give it your careful attention.

**The First Albany Companies Inc. Board of Directors unanimously recommends that the shareholders vote (1) FOR the election of the three (3) persons named as nominees under Election of Directors; (2) FOR the proposal to approve the Company s issuance and sale of shares of common stock to certain qualified investors in a private placement; (3) FOR the proposal to amend the Company s Certificate of Incorporation to increase the authorized share capital of the Company from 50,000,000 shares of common stock to 100,000,000 shares of common stock with the same par value of \$0.01 per share, (4) FOR the proposal to amend the Company s Certificate of Incorporation to increase the authorized share capital of the Company from 500,000 shares of preferred stock to 1,500,000 shares of preferred stock with the same par value of \$1.00 per share; (5) FOR the proposal to amend the Company s Certificate of Incorporation to limit the liability of the directors of the Company to the extent permitted under Section 402(b) of the NYBCL; (6) FOR the proposal to adopt the First Albany Companies Inc. 2007 Incentive Compensation Plan; and (7) FOR the ratification of the appointment of PricewaterhouseCoopers LLP as independent accountants of the Company for the fiscal year ending December 31, 2007.**

As in the past, we will be reporting on your Company s activities and you will have an opportunity to ask questions about its operations.

Holders of common stock of record as of the close of business on — —, 2007 are entitled to receive notice of and vote at the annual meeting of the shareholders. A list of such shareholders may be examined at the annual meeting.

We hope that you are planning to attend the annual meeting personally and we look forward to seeing you. Whether or not you are able to attend in person, it is important that your shares be represented at the annual meeting. For that reason we ask that you

**Table of Contents**

promptly sign, date, and mail the enclosed proxy card in the return envelope provided. You may also have the option of voting over the Internet or by telephone. Please refer to your proxy materials or the information forwarded by your bank, broker or other holder of record to see which voting methods are available to you. Shareholders who attend the annual meeting may withdraw their proxies and vote in person.

By Order of the Board of Directors

Peter J. McNierney  
President and Chief Executive Officer  
Albany, New York  
— —, 2007

---



## Table of Contents

	<b>Page No.</b>
<u>Questions and Answers</u>	1
<u>Summary</u>	8
<u>Annual Meeting of Shareholders</u>	15
<u>Voting, Record Date and Quorum</u>	16
<u>Proposal No. 1 Election of Directors</u>	18
<u>Proposal No. 2 Approval of the Private Placement</u>	21
<u>Proposal No. 3 Amend Certificate of Incorporation to Increase Authorized Shares of Common Stock</u>	45
<u>Proposal No. 4 Amend Certificate of Incorporation to Increase Authorized Shares of Preferred Stock</u>	46
<u>Proposal No. 5 Amend Certificate of Incorporation to Limit Director Liability</u>	48
<u>Proposal No. 6 Adopt First Albany Companies Inc. 2007 Incentive Compensation Plan</u>	50
<u>Proposal No. 7 Ratification of Selection of Independent Accountants</u>	54
<u>Stock Ownership of Principal Owners and Management</u>	56
<u>Director Compensation for Fiscal Year 2006</u>	57
<u>Compensation of Executive Officers</u>	60
<u>Summary Compensation Table for Fiscal Year 2006</u>	63
<u>Grants of Plan-Based Awards During Fiscal Year 2006</u>	64
<u>Outstanding Equity Awards at End of Fiscal Year 2006</u>	65
<u>Option Exercises and Stock Vested During Fiscal Year 2006</u>	67
<u>Nonqualified Deferred Compensation During Fiscal Year 2006</u>	67
<u>Compensation Committee Interlocks and Insider Participation</u>	75
<u>Audit Committee Report</u>	76
<u>Financial and Other Information Incorporation by Reference</u>	77
<u>Other Matters</u>	77
<u>Appendix A Investment Agreement, form of Registration Rights Agreement, Voting Agreements and Amendment to Rights Agreement</u>	
<u>Appendix B Freeman &amp; Co. Securities LLC Fairness Opinion</u>	
<u>Appendix C Amendment to the Certificate of Incorporation</u>	

---

**Table of Contents**

**677 Broadway  
Albany, New York 12207-2990  
PROXY STATEMENT**

**QUESTIONS AND ANSWERS ABOUT THIS PROXY MATERIAL AND VOTING**

*The following are some questions that you, as a shareholder of First Albany Companies Inc., may have regarding the private placement and the other matters being considered at the annual meeting of shareholders and the answers to those questions. First Albany Companies Inc. urges you to read carefully the remainder of this document because the information in this section does not provide all the information that might be important to you with respect to the private placement and the other matters being considered at the annual meeting. Additional important information is also contained in the appendices to, and the documents incorporated by reference into, this document. The words we, our, and us as used in this proxy statement refer to First Albany Companies Inc. and its subsidiaries.*

**Why am I receiving these materials?**

We sent you this proxy statement and the enclosed proxy card because the Board of Directors (the Board or Board of Directors) of First Albany Companies Inc. (sometimes referred to as the Company or First Albany) is soliciting your proxy to vote at our annual meeting of the shareholders to be held on \_\_ \_\_, 2007. You are invited to attend the annual meeting to vote on the Proposals described in this proxy statement. However, you do not need to attend the meeting to vote your shares. Instead, you may simply complete, sign and return the enclosed proxy card.

We intend to mail this proxy statement and accompanying proxy card on or about \_\_ \_\_, 2007 to all shareholders of record entitled to vote at the annual meeting.

**What am I voting on?**

There are seven matters scheduled for a vote at the annual meeting:

- (1) To elect three (3) directors whose terms will expire at the 2010 annual meeting of shareholders;
- (2) To consider and act upon a proposal to approve the Company's issuance and sale of shares of common stock to certain qualified investors in a private placement;
- (3) To consider and act upon a proposal to amend the Company's Certificate of Incorporation to increase the authorized share capital of the Company from 50,000,000 shares of common stock to 100,000,000 shares of common stock with the same par value of \$0.01 per share;
- (4) To consider and act upon a proposal to amend the Company's Certificate of Incorporation to increase the authorized share capital of the Company from 500,000 shares of preferred stock to 1,500,000 shares of preferred stock with the same par value of \$1.00 per share;
- (5) To consider and act upon a proposal to amend the Company's Certificate of Incorporation to limit the liability of the directors of the Company to the extent permitted under Section 402(b) of the New York Business Corporation Law (the NYBCL);
- (6) To consider and act upon a proposal to approve the adoption of the First Albany Companies Inc. 2007 Incentive Compensation Plan (the 2007 Plan); and

## **Table of Contents**

(7) To ratify the appointment of PricewaterhouseCoopers LLP as independent accountants of the Company for the fiscal year ending December 31, 2007.

### **What is the Private Placement described in Proposal 2?**

On May 14, 2007, we entered into an investment agreement (the "Investment Agreement") pursuant to which we agreed to issue and sell to MatlinPatterson FA Acquisition LLC ("MatlinPatterson") 33,333,333 shares, subject to upward adjustment as described in the Investment Agreement, of the common stock, par value \$0.01 per share, of the Company (the "Purchased Shares") for an aggregate cash purchase price of \$50 million (the "Private Placement"). If Proposal 2, Proposal 3, Proposal 4, Proposal 5 and Proposal 6 (collectively, the "Investment Proposals") are approved by our shareholders and the Private Placement is completed, we will sell and issue the Purchased Shares representing, after the closing, approximately 69.5% of our outstanding common stock (59.5% on a fully-diluted basis), based on the number of shares outstanding on May 8, 2007, and after giving effect to an increase in the number of Purchased Shares that is currently expected to result from the adjustment provisions of the Investment Agreement.

### **Why is the Company selling the Purchased Shares?**

We have experienced recurring losses and as of March 31, 2007, had cash of approximately \$4.0 million and working capital of approximately \$26 million. Continuing losses will adversely impact the Company's liquidity and net capital. We need additional capital to pursue our strategic objectives. If the Investment Proposals are approved by our shareholders, we would be authorized to issue the Purchased Shares and upon satisfaction of the other conditions to closing the Private Placement, we would receive \$50 million of gross proceeds from the sale of Purchased Shares, less transaction fees and expenses. The net proceeds from the Private Placement would have a positive impact on our liquidity and net capital and we believe they would improve our ability to pursue our strategic objectives. The additional capital would provide us with additional resources to grow our businesses, to seek to acquire other securities or advisory businesses, to focus on our core investment products and service strengths, to provide incentives to employees and to better meet the needs of our clients.

We believe that the Private Placement, together with the new incentive compensation plan that is proposed to be adopted in connection with the Private Placement, will further and promote the interests of the Company and our shareholders by improving our ability to retain and motivate our current employees and to attract additional employees who can help us obtain our strategic objectives. In the past, we have lost a significant number of investment banking, brokerage, research and other professionals and, more recently, we lost several senior professionals. Continuing losses of professionals, particularly key senior professionals or groups of related professionals, could impair our ability to secure or successfully complete client engagements, materially and adversely affect our revenues and make it more difficult to return to profitability. Although we could still lose more employees in the future, we believe that completion of the Private Placement and adoption of the proposed new incentive compensation plan will significantly improve our ability to retain key employees. This belief is strengthened by the fact that 26 of our employees, comprising substantially all of the most senior management of the Company, have signed non-compete and non-solicit agreements conditioned on the closing of the recapitalization transaction.

We also believe that the Private Placement will strengthen our investor base with the addition of a new experienced investor who will have a significant stake in our long-term success and will be motivated to provide the support and assistance to protect and enhance its investment. We also believe we will strengthen our Board with the addition of new directors who have significant experience in advising comparable companies.

### **What will happen if Proposal 2 is not approved?**

Approval of each of the Investment Proposals is a condition to closing of the Private Placement or is otherwise contemplated thereby. In the event that Proposal 2 is not approved, we will not complete the Private Placement or receive any of the proceeds from the sale of the Purchased Shares as described in Proposal 2. We also will not amend our Certificate of Incorporation as described in Proposal 3 and Proposal 4 and we will not adopt the 2007 Plan as described in Proposal 6, even if one or more of such other Investment Proposals is approved by the shareholders. However, if Proposal 5 is approved by the shareholders, our Certificate of Incorporation will still be amended as provided in that Proposal.

### **To what extent will the issuance of the Purchased Shares dilute our existing shareholders' percentage ownership of the Company?**

Our shareholders will incur immediate and substantial dilution of their percentage ownership in the Company if the Investment Proposals are approved by the shareholders and the Purchased Shares are issued. Based on the number of shares outstanding on May 8, 2007, the aggregate ownership of all holders of our outstanding common stock immediately prior to the issuance of the Purchased Shares will be reduced to approximately 30.5% of the outstanding shares of common stock (37.2% on a fully-

- 2 -

---

## **Table of Contents**

diluted basis) based on the number of shares of common stock outstanding on May 8, 2007, and after giving effect to an increase in the number of Purchased Shares that is currently expected to result from the adjustment provisions of the Investment Agreement.

### **Why is the Company seeking shareholder approval for the Private Placement?**

We are subject to the rules of the NASDAQ Stock Market because our common stock is currently listed on the NASDAQ Global Market. These rules require us to obtain shareholder approval for any issuance or sale of common stock that is (i) equal to 20% or more of our outstanding common stock before such an issuance or sale and (ii) at a price per share below the greater of book value or market value of such issuance or sale. These rules also require shareholder approval of any issuance of voting stock that would result in a change of control of the issuer, which is defined as the ownership by any shareholder or group of affiliated shareholders of 20% or more of an issuer's voting stock immediately following the issuance. The rules apply to the sale and issuance of the Purchased Shares because (i) the price of the Purchased Shares to be issued pursuant to the Investment agreement is \$1.50 per share, compared to the \$1.60 per share closing price of our common stock on the NASDAQ Global Market on May 11, 2007, the last business day prior to entry into the agreement to sell the Purchased Shares and (ii) issuance of the Purchased Shares will constitute a change of control under the NASDAQ Marketplace Rules because MatlinPatterson will beneficially own more than 20% of our common stock following completion of the Private Placement. For these reasons, we are required under the NASDAQ Marketplace Rules to obtain shareholder approval prior to issuing the Purchased Shares.

In addition, under the Investment Agreement, we agreed to seek the approval of the Private Placement at a meeting of our shareholders to be held as soon as practicable after the execution of the Investment Agreement.

### **Why is the Company seeking to increase the authorized number of shares of common stock as described in Proposal 3?**

We do not currently have sufficient authorized shares to complete the Private Placement described in Proposal 2. To complete the Private Placement and issue the Purchased Shares, we need to substantially increase the number of shares of our common stock authorized for issuance under our Certificate of Incorporation. It is a condition to the completion of the Private Placement that our shareholders approve Proposal 3. Our current Certificate of Incorporation authorizes 50,000,000 shares of common stock for issuance. As of May 8, 2007, there were 16,082,117 shares of our common stock outstanding and an additional approximately 5,233,000 shares reserved for issuance upon exercise of outstanding options and warrants and reserved for future issuance under our equity compensation plans. As a result, as of May 8, 2007, there were only approximately 28,684,883 authorized shares of our common stock available for issuance. We have proposed increasing the authorized number of shares of common stock to 100,000,000 shares to permit completion of the Private Placement and to provide for additional authorized shares of common stock to issue in the future. The additional shares may be issued for various purposes without further shareholder approval, except to the extent required by applicable NASDAQ Marketplace Rules. The purposes may include raising capital, providing equity incentives to employees, officers, directors or consultants, establishing strategic relationships with other companies, expanding our business or product lines through the acquisition of other businesses or products, and other corporate purposes.

### **What will happen if Proposal 3 is not approved?**

If Proposal 3 is not approved, we will not amend our Certificate of Incorporation as provided in Proposal 3. As noted above, if our Certificate of Incorporation is not amended to increase the authorized number of shares of common stock, we will not be able to complete the Private Placement. If Proposal 3 is not approved, we will not complete the Private Placement or receive any of the proceeds from the sale of the Purchased Shares as described in Proposal 2, we will not amend our Certificate of Incorporation as described in Proposal 4 and we will not adopt the 2007 Plan as described in Proposal 6, even if one or more of such other Investment Proposals is approved by the shareholders. However, if Proposal 5 is approved by the shareholders, our Certificate of Incorporation will still be amended as provided in that Proposal.

### **Why is the Company seeking to increase the authorized number of shares of preferred stock as described in Proposal 4?**

Under the Investment Agreement, we agreed to seek the shareholders' approval of an amendment to our Certificate of Incorporation to increase the authorized number of shares of preferred stock from 500,000 to 1,500,000.

The additional shares of preferred stock also relate to the Rights Agreement we entered into on March 30, 1998 with our transfer agent, American Stock Transfer & Trust Company (the Rights Agreement ), designed to provide for fair and equal treatment for all shareholders in the event that an unsolicited attempt is made to acquire our Company. The Rights Agreement gives each holder of common stock the right to purchase 1/100<sup>th</sup> share of preferred stock upon certain triggering events. In connection with the authorization of 100,000,000 shares of common stock in accordance with Proposal 3, 1,000,000 shares of preferred stock will be needed to support these rights. The additional shares of authorized preferred stock may also be issued for various other purposes, including raising capital, providing equity incentives to employees, officers, directors or consultants, establishing strategic relationships with other companies, expanding our business or product lines through the acquisition of other businesses or products, and other corporate purposes.

- 3 -

---

## **Table of Contents**

### **What will happen if Proposal 4 is not approved?**

If Proposal 4 is not approved, we will not amend our Certificate of Incorporation as provided in Proposal 4. Approval of the amendment to our Certificate of Incorporation to increase the number of authorized shares of our preferred stock is a condition to the closing of the Private Placement. If the shareholders do not approve Proposal 4, unless MatlinPatterson waives the condition, we will not complete the Private Placement or receive any of the proceeds from the sale of the Purchased Shares as described in Proposal 2, we will not amend our Certificate of Incorporation as described in Proposal 3 and we will not adopt the 2007 Plan as described in Proposal 6, even if one or more of such other Proposals is approved by the shareholders. However, if Proposal 5 is approved by the shareholders, our Certificate of Incorporation will still be amended as provided in that Proposal.

### **Why is the Company seeking to limit the liability of the directors of the Company as described in Proposal 5?**

Under the Investment Agreement, we agreed to seek the shareholders' approval of an amendment to our Certificate of Incorporation limiting the liability of the directors of the Company to the extent permitted under Section 402(b) of the NYBCL at the annual meeting. The Board believes that limiting the directors' personal liability as permitted by the New York statute will enhance the ability of the Company to attract and retain highly qualified directors in the future. In addition, the threat of personal liability may have an adverse effect on the decision-making process of directors. The proposed amendment may also encourage directors to make entrepreneurial decisions that they believe to be in the best interest of the Company with less threat of personal liability for damages for breach of their duty of care.

### **What will happen if Proposal 5 is not approved?**

Approval of the amendment to our Certificate of Incorporation to limit the liability of the directors of the Company to the extent permitted under Section 402(b) of the NYBCL is a condition to the closing of the Private Placement. If the shareholders do not approve Proposal 5, unless MatlinPatterson waives the condition, we will not complete the Private Placement or receive any of the proceeds from the sale of the Purchased Shares as described in Proposal 2, we will not amend our Certificate of Incorporation as described in Proposal 3 and Proposal 4 and we will not adopt the 2007 Plan as described in Proposal 6, even if one or more of such other Proposals is approved by the shareholders. However, if Proposal 5 is approved by the shareholders, our Certificate of Incorporation will still be amended as provided in that Proposal.

### **Why is the Company seeking to put into effect the new First Albany Companies Inc. 2007 Incentive Compensation Plan as described in Proposal 6?**

The 2007 Plan is designed to advance the interests of the Company by providing a means through which incentive awards can be granted to officers, other employees and persons who provide services to the Company and its subsidiaries. By making grants of awards under this plan, the Company can attract, retain and reward such persons and, by linking compensation measures to performance, the Company can provide incentives for the creation of shareholder value. In addition, the interests of the Company's shareholders and the award recipients can be more closely aligned by giving the recipients an interest in the long-term success of the Company.

Furthermore, the obligation of MatlinPatterson to complete the Private Placement is conditioned on at least 22 of 27 designated key employees of the Company becoming bound by certain non-competition and non-solicitation covenants conditioned on the closing of the Private Placement and remaining employed by the Company at the closing of the Private Placement. Twenty-six of such 27 designated key employees have already entered into such agreements to become effective as of the closing. The terms on which such designated key employees entered into such non-competition and non-solicitation covenants require that the Company grant to such employees certain awards of restricted stock units under the 2007 Plan if the Private Placement closes. The Company expects to enter into an employment agreement with Mr. Lee Fensterstock that will become effective as of the closing of the Private Placement. The Company has also entered into an employment agreement with Mr. Peter McNierney and an amendment to the existing employment agreement of Mr. Brian Coad that will each become effective as of the closing of the Private Placement. Under the terms of these employment agreements, following the closing of the Private Placement, Mr. Fensterstock will serve as the new Chairman of the Board and Chief Executive Officer of the Company, Mr. McNierney will become the President and Chief Operating Officer and Mr. Coad will remain the Chief Financial Officer. If the Private Placement is completed, these employment agreements (or amendment in the case of

Mr. Coad) will also obligate the Company to award certain restricted stock units to such executives under the 2007 Plan. Accordingly, it is contemplated that, as of the closing of the Private Placement, awards of restricted stock units in respect of up to 6.75 million shares of common stock will be made or committed to be made under the 2007 Plan, representing approximately 10.9% of the shares of common stock expected to be outstanding immediately following the closing assuming the issuance of 33,333,333 Purchased Shares, on a fully diluted basis, after giving effect to an increase in the number of Purchased Shares that is currently expected to result from the adjustment provisions of the Investment Agreement. If the Private Placement is not consummated, we will not adopt the 2007 plan as proposed.

**What will happen if Proposal 6 is not approved?**

If Proposal 6 is not approved at the annual meeting, the 2007 Plan will not go into effect unless approved by our shareholders at a subsequent meeting. If Proposals 2, 3, 4 and 5 are approved, following the closing of the Private Placement, MatlinPatterson will beneficially own a majority of the then outstanding shares of our common stock. As a result, if Proposal 6 is not approved at the annual meeting, there is a likelihood that a proposal to adopt the 2007 Plan will be approved by a majority vote of the shareholders at a

- 4 -

---



## **Table of Contents**

meeting subsequent to the closing of the Private Placement. If we are required to hold a special meeting of the shareholders following the closing of the Private Placement in order to reconsider the approval of the 2007 Plan, we will incur additional expenses.

### **Who can vote at the annual meeting?**

Only shareholders of record at the close of business on \_\_\_\_\_, 2007 will be entitled to vote at the annual meeting. At the close of business on this record date, there were \_\_\_\_\_ shares of common stock outstanding and entitled to vote.

#### *Shareholder of Record: Shares Registered in Your Name*

If at the close of business on \_\_\_\_\_, 2007 your shares were registered directly in your name with our transfer agent, American Stock Transfer & Trust Company, then you are a shareholder of record. As a shareholder of record, you may vote in person at the meeting or vote by proxy. Whether or not you plan to attend the meeting, we urge you to complete and return the enclosed proxy card to ensure your vote is counted.

#### *Beneficial Owner: Shares Registered in the Name of a Broker or Bank*

If at the close of business on \_\_\_\_\_, 2007 your shares were held in an account at a brokerage firm, bank, dealer, or other similar organization, then you are the beneficial owner of shares held in street name, and these proxy materials are being forwarded to you by that organization. The organization holding your account is considered the shareholder of record for purposes of voting your shares at the annual meeting. As a beneficial owner, you have the right to direct your broker or other agent on how to vote the shares in your account. You are also invited to attend the annual meeting. However, since you are not the shareholder of record, you will not be able to vote your shares in person at the meeting unless you request and obtain a valid proxy from your broker or other agent.

### **How do I vote?**

For each of the matters to be voted on, you may vote For or Against or abstain from voting. The procedures for voting are fairly simple:

#### *Shareholder of Record: Shares Registered in Your Name*

If you are a shareholder of record, you may vote in person at the annual meeting or vote by proxy. Whether or not you plan to attend the meeting, we urge you to vote by proxy to ensure your vote is counted. You may still attend the meeting and vote in person if you have already voted by proxy.

To vote by proxy, most shareholders have a choice of voting over the Internet, using a toll-free telephone number or completing the proxy card in the form enclosed and mailing it in the envelope provided. Please refer to your proxy card or the information forwarded by your bank, broker or other nominee to see which options are available to you.

To vote in person, come to the annual meeting, and we will give you a ballot when you arrive.

#### *Beneficial Owner: Shares Registered in the Name of Broker or Bank*

If you are a beneficial owner of shares registered in the name of your broker, bank or other agent, you should have received a proxy card and voting instructions with these proxy materials from that organization rather than from us. Simply complete and mail the proxy card to ensure that your vote is counted.

To vote in person at the annual meeting, you must obtain a valid proxy from your broker, bank or other agent. Follow the instructions from your broker or bank included with these proxy materials or contact your broker or bank to request a proxy form.

IF YOU HAVE ANY QUESTIONS OR NEED ASSISTANCE WITH VOTING YOUR SHARES, PLEASE CALL MACKENZIE PARTNERS, INC., THE FIRM ASSISTING US IN THIS SOLICITATION, TOLL-FREE AT (800) 322-2885.

### **How many votes do I have?**

On each matter to be voted upon, you have one vote for each share of common stock you own as of \_\_\_\_\_, 2007.

### **What if I return a proxy card but do not make specific choices?**

If you return a signed and dated proxy card without marking any voting selections, your shares will be voted (1)

For the election of the three (3) persons named as nominees under Election of Directors; (2) For the proposal to

approve the Private Placement; (3) *For* the proposal to amend the Company's Certificate of Incorporation to increase the authorized share capital of the Company from 50,000,000 shares of common stock to 100,000,000 shares of common stock with the same par value of \$0.01 per share, (4) *For* the proposal to amend the Company's Certificate of Incorporation to increase the authorized share capital of the Company from 500,000 shares of preferred stock to 1,500,000 shares of preferred stock with the same par value of \$1.00 per share; (5)

- 5 -

---

## **Table of Contents**

*For* the proposal to amend the Company's Certificate of Incorporation to limit the liability of the directors of the Company to the extent permitted under Section 402(b) of the NYBCL; (6) *For* the proposal to adopt the 2007 Plan; and (7) *For* the ratification of the appointment of PricewaterhouseCoopers LLP as independent accountants of the Company for the fiscal year ending December 31, 2007.

### **What does it mean if I receive more than one proxy card?**

If you receive more than one proxy card, your shares are registered in more than one name or are registered in different accounts. Please complete, sign and return each proxy card to ensure that all of your shares are voted.

### **Can I change my vote after submitting my proxy?**

Yes. You can revoke your proxy at any time before the final vote at the meeting. You may revoke your proxy in any one of three ways:

You may submit another properly completed proxy card with a later date.

You may send a written notice that you are revoking your proxy to First Albany Companies Inc.'s Secretary at 677 Broadway, Albany, New York 12207-2990.

You may attend the annual meeting and vote in person. Simply attending the meeting will not, by itself, revoke your proxy.

### **How are votes counted?**

Votes will be counted by the inspector of election appointed for the meeting, who will separately count *For* and *Against* votes, abstentions and broker non-votes. Abstentions will be counted towards a quorum and the vote total for each Proposal and will have the same effect as *Against* votes. Broker non-votes will be counted towards a quorum and depending on the Proposal either will have the same effect as an *Against* vote on the Proposal or will have no effect. Please see the more detailed description of the effect of broker non-votes on specific Proposals in the answer to "How many votes are needed to approve each proposal?" below.

If your shares are held by your broker as your nominee (that is, in street name), you will need to obtain a proxy card from the institution that holds your shares and follow the instructions included on that proxy card regarding how to instruct your broker to vote your shares. If you do not give instructions to your broker, your broker can vote your shares with respect to discretionary items but not with respect to non-discretionary items. Discretionary items are proposals considered routine under the rules of the NASDAQ Stock Market and on which your broker may vote shares held in street name in the absence of your voting instructions. On non-discretionary items for which you do not give your broker instructions, the shares will be treated as broker non-votes. The Investment Proposals will all be considered non-discretionary items.

### **How many votes are needed to approve each proposal?**

For the election of directors, the three nominees receiving the most *For* votes from the shares present and entitled to vote at the annual meeting, either in person or by proxy, will be elected. Abstentions will not be treated as votes cast at the annual meeting for such purpose.

To be approved, Proposal 2 must receive *For* votes constituting a majority of the votes cast at the annual meeting with respect to shares entitled to vote thereon. If you abstain from voting, it will have the same effect as an *Against* vote. Broker non-votes will not be treated as votes cast at the annual meeting for such purpose.

To be approved, Proposal 3 must receive *For* votes from the holders of a majority of the shares outstanding as of the record date. If you abstain from voting, it will have the same effect as an *Against* vote. Broker non-votes will also have the same effect as an *Against* vote.

To be approved, Proposal 4 must receive *For* votes from the holders of a majority of the shares outstanding as of the record date. If you abstain from voting, it will have the same effect as an *Against* vote. Broker non-votes will also have the same effect as an *Against* vote.

To be approved, Proposal 5 must receive *For* votes from the holders of a majority of the shares outstanding as of the record date. If you abstain from voting, it will have the same effect as an *Against* vote. Broker non-votes will also have the same effect as an *Against* vote.

To be approved, Proposal 6 must receive *For* votes constituting a majority of the votes cast at the annual meeting with respect to shares entitled to vote thereon. If you abstain from voting, it will have the same effect as an *Against* vote. Broker non-votes will not be treated as votes cast at the annual meeting for such purpose.

- 6 -

---

## **Table of Contents**

To be approved, Proposal 7 must receive *For* votes constituting a majority of the votes cast at the annual meeting with respect to shares entitled to vote thereon. If you abstain from voting, it will have the same effect as an *Against* vote.

### **What is the quorum requirement?**

A quorum of shareholders is necessary to hold a valid meeting. A quorum will be present if at least a majority of the shares outstanding and entitled to vote as of the record date are represented by shareholders present at the meeting or by proxy. On \_\_\_\_\_, 2007, the record date, there were \_\_\_\_\_ shares outstanding and entitled to vote. As a result \_\_\_\_\_ of these shares must be represented by shareholders present at the meeting or by proxy to have a quorum.

Your shares will be counted towards the quorum if you submit a valid proxy vote or vote at the meeting. Abstentions and broker non-votes will also be counted towards the quorum requirement. If there is no quorum, a majority of the votes present at the meeting may adjourn the meeting to another date.

### **How can I find out the results of the voting at the annual meeting?**

Preliminary voting results will be announced at the annual meeting and announced promptly following the annual meeting in a press release and current report on Form 8-K. Final voting results will be published in our quarterly report on Form 10-Q for the third quarter of 2007 that we are required to file with the Securities and Exchange Commission (the SEC) by November 9, 2007.

### **Who is paying for this proxy solicitation?**

We will pay for the entire cost of soliciting proxies. In addition to these mailed proxy materials, our directors, officers and other employees may also solicit proxies in person, by telephone or by other means of communication. Directors, officers and other employees will not be paid any additional compensation for soliciting proxies. We may also reimburse brokerage firms, banks and other agents for the cost of forwarding proxy materials to beneficial owners. The solicitation of proxies will also be supplemented through the services of MacKenzie Partners, Inc., a proxy solicitation firm. MacKenzie Partners, Inc. will receive a customary fee which we estimate to be approximately \$15,000.

IF YOU HAVE ANY QUESTIONS OR NEED ASSISTANCE WITH VOTING YOUR SHARES, PLEASE CALL MACKENZIE PARTNERS, INC. TOLL-FREE AT (800) 322-2885.

### **When are shareholder proposals due for next year's annual meeting?**

The deadline for submitting a shareholder proposal for inclusion in our proxy statement and form of proxy for the 2008 annual meeting of shareholders is \_\_\_\_\_, 2008. If shareholders wish to submit proposals or director nominations that are not otherwise to be included in such proxy statement and proxy, the proposal must be received by the Company no earlier than \_\_\_\_\_, 2008 and no later than the close of business on \_\_\_\_\_, 2008. Shareholders are advised to review our Bylaws, which contain additional requirements with respect to advance notice of shareholder proposals and director nominations. Our current Bylaws are available at the SEC's website, [www.sec.gov](http://www.sec.gov), or upon written request to Investor Relations, First Albany Companies Inc., 677 Broadway, Albany, New York 12207-2990. The proposed Amendments to our Certificate of Incorporation referred to in Proposal 3, Proposal 4 and Proposal 5 are appended to this proxy statement as **Appendix C** and will also be available at [www.sec.gov](http://www.sec.gov) or upon written request to our Investor Relations department following adoption.

**Table of Contents**

**SUMMARY**

*This summary highlights information contained elsewhere in this document and may not contain all the information that is important to you. First Albany Companies Inc. urges you to read carefully the remainder of this document, including the attached appendices, and the other documents to which we have referred you to because this section does not provide all the information that might be important to you with respect to the Private Placement and the other matters being considered at the annual meeting of shareholders. We have included page references to direct you to a more complete description of the topics presented in this summary. Unless the context otherwise requires, references to we, our and us in this document refer to First Albany Companies Inc. and its subsidiaries.*

**The Companies**

**First Albany Companies Inc.**

677 Broadway  
Albany, New York 12207-2990  
(518) 447-8673

First Albany Companies Inc. is an independent investment bank that serves the qualified market, state and local governments and the growing corporate middle market by providing clients with strategic, research-based investment opportunities, as well as advisory and financing services. First Albany offers a diverse range of products through its Equities division and its Municipal Capital Markets division (which is under contract to be sold), as well as Descap Securities Inc., its mortgage-backed security/asset-backed security trading subsidiary, and FA Technology Ventures Inc., its venture capital division. First Albany maintains offices in major business and commercial markets.

First Albany, a New York corporation, is traded on the NASDAQ Global Market, which we refer to as NASDAQ, under the symbol FACT .

**MatlinPatterson FA Acquisition LLC**

c/o MatlinPatterson Global Advisers LLC  
520 Madison Avenue, 35th Floor  
New York, New York 10022  
(212) 651-9500

MatlinPatterson FA Acquisition LLC is a Delaware limited liability company formed by MatlinPatterson Global Opportunities Partners II L.P., an investment fund, and its parallel offshore vehicle (collectively, MatlinPatterson GOP II ), for the purpose of entering into the Investment Agreement and acquiring the Purchased Shares. MatlinPatterson GOP II is managed by MatlinPatterson Global Advisers LLC, a global investment firm that currently manages, in addition to MatlinPatterson GOP II, MatlinPatterson Global Opportunities Partners L.P. These partnerships have aggregate assets and commitments of approximately \$3.8 billion.

**The Annual Meeting**

**The Annual Meeting (See page 15)**

The First Albany annual meeting will be held at 677 Broadway, Albany, New York 12207-2990, at 10:00 a.m. (EDT), on \_\_\_\_\_, 2007. At the First Albany annual meeting, First Albany shareholders will be asked:

- (1) To elect three (3) directors whose terms will expire at the 2010 annual meeting of shareholders;
- (2) To consider and act upon a proposal to approve the Private Placement;
- (3) To consider and act upon a proposal to amend the Company's Certificate of Incorporation to increase the authorized share capital of the Company from 50,000,000 shares of common stock to 100,000,000 shares of common stock with the same par value of \$0.01 per share;
- (4) To consider and act upon a proposal to amend the Company's Certificate of Incorporation to increase the authorized share capital of the Company from 500,000 shares of preferred stock to 1,500,000 shares of preferred stock with the same par value of \$1.00 per share;

**Table of Contents**

- (5) To consider and act upon a proposal to amend the Company's Certificate of Incorporation to limit the liability of the directors of the Company to the extent permitted under Section 402(b) of the NYBCL;
- (6) To consider and act upon a proposal to approve the adoption of the 2007 Plan;
- (7) To ratify the appointment of PricewaterhouseCoopers LLP as independent accountants of the Company for the fiscal year ending December 31, 2007; and
- (8) To transact such other business as may properly come before the meeting or any adjournment thereof.

You may vote at the First Albany annual meeting if you owned shares of First Albany common stock at the close of business on \_\_\_\_\_, 2007. On that date, there were \_\_\_\_\_ shares of First Albany common stock outstanding, approximately 20% of which were owned and entitled to be voted by First Albany directors and executive officers and their affiliates. We currently expect that First Albany's directors and executive officers will vote their shares in favor of the Private Placement, and Messrs. George McNamee and Alan Goldberg, directors of the Company, and Mr. McNierney, a director and the President and CEO of the Company, have agreed with MatlinPatterson to vote the shares of common stock owned by them in favor of the transaction. These persons collectively own approximately 19% of the outstanding shares of common stock.

You can cast one vote for each share of First Albany common stock you own. The proposals require different percentages of votes in order to approve them:

For the election of directors, the three nominees receiving the most *For* votes from the shares present and entitled to vote at the annual meeting, either in person or by proxy, will be elected. Abstentions will not be treated as votes cast at the annual meeting for such purpose.

To be approved, Proposal 2 must receive *For* votes constituting a majority of the votes cast at the annual meeting with respect to shares entitled to vote thereon. If you abstain from voting, it will have the same effect as an *Against* vote. Broker non-votes will not be treated as votes cast at the annual meeting for such purpose.

To be approved, Proposal 3 must receive *For* votes from the holders of a majority of the shares outstanding as of the record date. If you abstain from voting, it will have the same effect as an *Against* vote. Broker non-votes will also have the same effect as an *Against* vote.

To be approved, Proposal 4 must receive *For* votes from the holders of a majority of the shares outstanding as of the record date. If you abstain from voting, it will have the same effect as an *Against* vote. Broker non-votes will also have the same effect as an *Against* vote.

To be approved, Proposal 5 must receive *For* votes from the holders of a majority of the shares outstanding as of the record date. If you abstain from voting, it will have the same effect as an *Against* vote. Broker non-votes will also have the same effect as an *Against* vote.

To be approved, Proposal 6 must receive *For* votes constituting a majority of the votes cast at the annual meeting with respect to shares entitled to vote thereon. If you abstain from voting, it will have the same effect as an *Against* vote. Broker non-votes will not be treated as votes cast at the annual meeting for such purpose.

To be approved, Proposal 7 must receive *For* votes constituting a majority of the votes cast at the annual meeting with respect to shares entitled to vote thereon. If you abstain from voting, it will have the same effect as an *Against* vote.

**Proposal No. 1: Election of Directors (See page 18)**

Three directors will be elected at the annual meeting to serve for a three-year term expiring at the annual meeting of shareholders in 2010. The Board has nominated three persons as directors. The Board recommends that shareholders vote FOR the election of these nominees.

**Proposal No. 2: Approval of the Private Placement (See page 21)**

**Background of the Private Placement (See page 22)**





## Table of Contents

The Company experienced losses in several of our key segments in 2005 and 2006, including equities sales and trading, equity investment banking and fixed income sales and trading. Recognizing these losses and the need to maintain liquidity requirements, in the spring of 2006 the Board retained Freeman & Co. Securities LLC ( Freeman ) as its financial advisor to establish a comprehensive process to entertain both a strategic sale of, or a strategic investment in, the Company.

Throughout 2006 and early 2007, the Company had conversations with numerous potential investors but ultimately received no offers. In the first quarter of 2007, MatlinPatterson expressed interest in investing in the Company. The Board formed a special committee of the Board (the Special Committee ) to assist in evaluating proposals from potential investors and to make recommendations to the Board regarding any issues requiring Board consideration with respect to any proposals received from such investors. Bingham McCutchen LLP was retained as legal counsel for the Special Committee.

The Board and Special Committee engaged in discussions and consulted with their financial advisors and legal counsel regarding the potential MatlinPatterson transaction. The Special Committee ultimately reported to the Board that it was satisfied with the process and felt that all reasonably possible scenarios and interested parties had been considered and that the efforts made were sufficient to indicate that the MatlinPatterson proposal was the best available for the Company and its shareholders.

The Special Committee also requested that Freeman deliver a fairness opinion regarding the consideration to be paid to the Company in connection with the Private Placement.

On May 14, 2007, the Company entered into the Investment Agreement with MatlinPatterson described below and attached hereto as **Appendix A** providing for the issuance and sale of Purchased Shares for gross proceeds of \$50 million. Please see the section Investment Agreement below for information on the Investment Agreement.

### **Reasons for the Private Placement (See page 25)**

We have experienced recurring losses and, as of March 31, 2007, had cash of approximately \$4.0 million and working capital of approximately \$26 million. Continuing losses will adversely impact the Company's liquidity and net capital. We need additional capital to pursue our strategic objectives. If the Investment Proposals are approved by our shareholders, we would be authorized to issue the Purchased Shares and, upon satisfaction of the other conditions to closing the Private Placement, we would receive \$50 million of gross proceeds from the sale of the Purchased Shares, less transaction fees and expenses. The additional capital would provide us with additional resources to grow our businesses, to seek to acquire other securities or advisory businesses, to focus on our core investment products and service strengths, to provide incentives to employees and to better meet the needs of our clients.

After considering numerous potential financing and strategic alternatives, the Board determined that the Private Placement was the best available alternative and would provide the greatest potential value for our shareholders, as well as provide the necessary capital to pursue our long-term strategic goals. The determination was the result of careful consideration by the Board of a number of factors, including (i) that the Private Placement will strengthen our financial condition and reduce our financial risk, (ii) that the Private Placement will strengthen our investor base with the addition of a new experienced investor who will have a significant stake in our long-term success and will be motivated to provide the support and assistance to protect and enhance its investment and (iii) that we believe we will strengthen our Board with the addition of new directors who have significant experience in advising comparable companies. In its review of the Private Placement, the Board also considered a number of potentially negative factors, including (i) that the Private Placement will have a highly dilutive effect on our current shareholders and option holders, (ii) that MatlinPatterson would control approximately 69.5% of the voting power of our capital stock immediately upon the closing of the Private Placement (59.5% on a fully diluted basis), after giving effect to an increase in the number of Purchased Shares that is currently expected to result from the adjustment provisions of the Investment Agreement and (iii) the Private Placement will result in restrictions on our ability to use our net operating loss carryforwards to offset future taxable income. The Board recognized that there can be no assurance that we would be able to achieve all or significantly all of each anticipated benefit or advantage or that it had identified and accurately assessed each risk and negative factor. However the Board concluded that the potential benefits and advantages of the Private Placement significantly outweigh the risks and negative factors that it had identified.

### **Recommendations of the Board of Directors (See page 44)**

After careful consideration and on the unanimous recommendation of the Special Committee, the Board unanimously approved the Investment Agreement on May 14, 2007. For the factors considered by the Board in reaching its decision to approve the Investment Agreement, see the section entitled "Proposal 2, Approval of the Private Placement - Reasons for the Private Placement" beginning on page 25. **The First Albany Board of Directors unanimously recommends that the First Albany shareholders vote *For* the proposal to approve the issuance of First Albany common stock in the Private Placement.**

**Opinion of our Independent Financial Advisor (See page 27)**

On May 14, 2007, First Albany's financial advisor, Freeman, delivered to the Board its opinion that, as of the date of the opinion and based upon the assumptions made, matters considered and limits of review set forth in its written opinion, the consideration to be paid to the Company was fair from a financial point of view. A copy of Freeman's written opinion is attached to this proxy statement as **Appendix B**.

First Albany encourages you to read carefully both the section entitled "Proposal 2, Approval of the Private Placement - Opinion of Our Financial Advisor" beginning on page 27 and Freeman's written opinion in its entirety for a description of the assumptions made, matters considered and limits on the scope of review undertaken by Freeman. Freeman's opinion was intended for the use and benefit of the Board of Directors, does not address the merits of the underlying decision by First Albany to enter into the

- 10 -

---

## **Table of Contents**

Investment Agreement or any of the transactions contemplated thereby, including the Private Placement, and does not constitute a recommendation as to how any holder of common stock should vote on, or take any action with respect to, the Private Placement or any related matter.

### **Terms of the Private Placement (See page 30)**

The following is a summary of the terms of the Private Placement and the provisions of the Investment Agreement, the Registration Rights Agreement, the Voting Agreements and the Amendment of the Rights Agreement referred to below. The sale of the Purchased Shares has not been registered under the Securities Act of 1933, as amended (the Securities Act). The Purchased Shares will be sold to MatlinPatterson FA Acquisition LLC, an accredited investor, and possibly additional co-investors who are accredited investors, in reliance upon exemptions from registration under Section 4(2) of the Securities Act and SEC Rule 506 of Regulation D. None of the Purchased Shares may be offered or sold in the United States absent registration under or exemption from the Securities Act and any applicable state security laws.

**THIS SUMMARY OF THE TERMS OF THE PRIVATE PLACEMENT IS INTENDED TO PROVIDE YOU WITH BASIC INFORMATION CONCERNING THE TRANSACTION. IT IS NOT A SUBSTITUTE FOR REVIEWING THE INVESTMENT AGREEMENT, THE FORM OF REGISTRATION RIGHTS AGREEMENT, THE VOTING AGREEMENTS AND THE AMENDMENT TO RIGHTS AGREEMENT APPENDED TO THIS PROXY STATEMENT AS APPENDIX A. YOU SHOULD READ THIS SUMMARY IN CONJUNCTION WITH THE AGREEMENTS APPENDED HERETO AS APPENDIX A.**

### ***Investment Agreement (See page 30)***

On May 14, 2007, the Company entered into the Investment Agreement with MatlinPatterson FA Acquisition LLC providing for the purchase by MatlinPatterson FA Acquisition LLC and certain co-investors which may be designated by it (collectively referred to herein as MatlinPatterson), upon the terms and subject to the conditions of the Investment Agreement, of 33,333,333 newly issued shares of the Company's common stock, par value \$0.01 per share, for an aggregate cash purchase price of \$50 million. The number of shares issuable to MatlinPatterson in consideration of the \$50 million purchase price (referred to herein as the Purchased Shares) is subject to an upward adjustment if the Company incurs certain incremental employment-related obligations as a result of the DEPFA Transaction (as defined below) not having closed prior to closing the Private Placement and if the Company's net tangible book value per share at closing is less than \$1.60. Upon the closing of the Private Placement, and after giving effect to the contemplated issuance to certain employees of restricted stock units as described herein, MatlinPatterson would own approximately 69.5% of the outstanding common stock (approximately 59.5% on a fully diluted basis), based on the number of shares outstanding on May 8, 2007, and after giving effect to an increase in the number of Purchased Shares that is currently expected to result from the adjustment provisions of the Investment Agreement. The proceeds to the Company from the sale of shares to MatlinPatterson would be invested in the Company's ongoing businesses, consistent with a strategic plan to be developed by the Company, and to retire short-term debt.

The Company previously announced its agreement to sell the Municipal Capital Markets Group of First Albany Capital Inc., the Company's wholly-owned subsidiary, to DEPFA BANK plc (sometimes referred to herein as the DEPFA Transaction). We currently expect that the DEPFA Transaction will not close prior to the closing of the Private Placement. As a result, certain employees of the Company, who will remain employed by the Company at the time of the closing of the Private Placement and who would have otherwise have become employed by DEPFA had the DEPFA Transaction closed prior to the Private Placement, are expected to become entitled to receive certain cash payments and accelerated vesting of certain equity awards triggered by MatlinPatterson gaining control of the Company that they would not have been entitled to if the DEPFA Transaction had closed first. In such an event, the Investment Agreement provides that the number of Purchased Shares will be increased to account for the cash bonuses or other amounts paid or payable by the Company to any employee of the Municipal Capital Markets Group that would not have been so paid had the DEPFA Transaction closed prior to the closing of the Private Placement, as well as the accelerated vesting of the restricted stock awards and stock options held by such employees that would not have occurred if the DEPFA Transaction had closed prior to the closing of the Private Placement. In the event that our employees entitled to receive such payments and to benefit from the accelerated vesting of such awards and options do not waive such rights, we expect the number of Purchased Shares to be increased from 33,333,333 to 36,690,705 at

the closing, without MatlinPatterson being required to contribute more than the \$50 million already contemplated by the Investment Agreement. If the number of Purchased Shares is increased in this manner, MatlinPatterson would own approximately 69.5% of the outstanding common stock (approximately 59.5% of the common stock, on a fully diluted basis). To the extent that the affected employees are willing to waive their rights to such payments and accelerated vesting, the number of additional Purchased Shares will be reduced accordingly.

The Investment Agreement also provides that the number of Purchased Shares will be further adjusted upwards, in addition to the adjustment described above, if our net tangible book value per share is less than \$1.60 as of the closing date. In such case, the number of Purchased Shares will be increased by a factor reflecting the percentage shortfall represented by the net tangible book value per share as of the closing date compared to a target of \$1.69 per share. If the DEPFA Transaction closes prior to the closing of the

- 11 -

---

## **Table of Contents**

Private Placement, there will first be a pro forma adjustment to eliminate the effects of the closing of the DEPFA Transaction on net tangible book value per share, including a pro forma elimination of the incremental cash payments and accelerated restricted stock awards and stock options referred to above.

In connection with entering into the Investment Agreement, the Company has agreed with MatlinPatterson to terminate the Company's previously announced plans to reprice outstanding employee stock options and to replace outstanding employee restricted stock awards with stock appreciation rights.

The Investment Agreement contains other covenants of the Company, including an agreement of the Company to operate its business in the ordinary course until the purchase is completed. The Company has also agreed not to solicit or initiate discussions with third parties regarding other competing proposals and to certain restrictions on its ability to respond to any unsolicited competing proposal. The Investment Agreement also includes customary representations and warranties of the Company and MatlinPatterson, indemnification provisions for MatlinPatterson and termination provisions for both the Company and MatlinPatterson.

The summary above of the Investment Agreement does not purport to be complete and is qualified in its entirety by the more detailed description contained herein as well as the full text of such agreement, a copy of which is attached in **Appendix A** hereto.

The Investment Agreement contains representations and warranties of the Company and MatlinPatterson made to each other as of specific dates. The assertions embodied in those representations and warranties were made solely for purposes of the contract between the Company and MatlinPatterson and may be subject to important qualifications and limitations agreed to by the Company and MatlinPatterson in connection with negotiating the terms of the Investment Agreement. Moreover, some of those representations and warranties may not be accurate or complete as of any specified date, may be subject to a contractual standard of materiality different from those generally applicable to shareholders or may have been used for purposes of allocating risk among the Company and MatlinPatterson rather than establishing matters as facts.

### ***Registration Rights Agreement (See page 36)***

We agreed to enter into a Registration Rights Agreement with MatlinPatterson (the "Registration Rights Agreement"), pursuant to which we would be required upon the demand of MatlinPatterson on up to three occasions to file with the SEC a registration statement for the resale of Purchased Shares. The Registration Rights Agreement would obligate us to use our best efforts to have the registration statement declared effective as soon as practicable after it is filed. The Registration Rights Agreement also provides MatlinPatterson with piggyback registration rights exercisable if we file certain registration statements on our own initiative or upon the request of another shareholder. We would bear all of the costs of any demand or piggyback registration other than underwriting discounts and commissions and certain other expenses.

The summary above of the Registration Rights Agreement does not purport to be complete and is qualified in its entirety by the more detailed description contained herein as well as the full text of such agreement, a copy of which is attached in **Appendix A** hereto.

### ***Voting Agreements (See page 37)***

MatlinPatterson has entered into certain voting agreements with Messrs. Alan Goldberg, George McNamee and Peter McNierney, individually (the "Voting Agreements"), pursuant to which each such shareholder has agreed to vote the shares of common stock beneficially owned by him in favor of approval of each of the Investment Proposals. Messrs. Goldberg, McNamee and McNierney have agreed, among other things (i) to vote their shares of common stock in favor of the Private Placement and the other Investment Proposals, (ii) not to solicit, encourage or recommend to other shareholders of the Company that they vote their shares of common stock in any contrary manner, that they refrain from voting their shares, that they tender, exchange or otherwise dispose of their shares of common stock pursuant to a "Competing Transaction" (as defined in the Voting Agreements), or that they attempt to exercise any statutory appraisal or other similar rights they may have, (iii) unless otherwise instructed in writing by MatlinPatterson, to vote their shares against any Competing Transaction and (iv) not to, and not to permit any of their employees, attorneys, accountants, investment bankers or other agents or representatives to, initiate, solicit, negotiate, encourage, or provide confidential information in order to facilitate any Competing Transaction. These persons collectively own approximately 19% of the outstanding shares of our common stock.

The summary above of the Voting Agreements does not purport to be complete and is qualified in its entirety by the more detailed description contained herein as well as the full text of each such agreement, a copy of which is attached in **Appendix A** hereto.

*Amendment of the Rights Agreement (See page 37)*

- 12 -

---

## **Table of Contents**

On March 30, 1998, we entered into the Rights Agreement with our transfer agent, American Stock Transfer & Trust Company, designed to provide for a fair and equal treatment for all shareholders in the event that an unsolicited attempt is made to acquire our Company. The effect of the Rights Agreement is to discourage acquisitions of more than 15% of our common stock without negotiations with the Board. As required under the Investment Agreement, we entered into an amendment to the Rights Agreement (the "Amendment to the Rights Agreement") to provide that entry into the Investment Agreement and the Private Placement will be exempt from the Rights Agreement and that MatlinPatterson and certain related persons would not be deemed to be "Acquiring Persons" thereunder.

### **No Appraisal Rights (See page 41)**

The shareholders are not entitled to appraisal rights with respect to the Private Placement, and we will not independently provide the shareholders with any such rights.

### **Proposal No. 3: Amend the Certificate of Incorporation to Increase the Company's Authorized Common Stock from 50,000,000 shares to 100,000,000 shares (See page 45)**

We do not currently have sufficient authorized shares to complete the Private Placement described in Proposal 2. To complete the Private Placement and issue the Purchased Shares, we need to substantially increase the number of shares of our common stock authorized for issuance under our Certificate of Incorporation. It is a condition to the completion of the Private Placement that our shareholders approve Proposal 3. Our current Certificate of Incorporation authorizes 50,000,000 shares of common stock for issuance. As of May 8, 2007, there were 16,082,117 shares of our common stock outstanding and an additional approximately 5,233,000 shares reserved for issuance upon exercise of outstanding options and warrants and reserved for future issuance under our equity compensation plans. As a result, as of May 8, 2007, there were only approximately 28,684,883 authorized shares of our common stock available for issuance. We have proposed increasing the authorized number of shares of common stock to 100,000,000 shares to permit completion of the Private Placement, for the Company to reserve 25% of our shares of common stock outstanding from time to time for issuance under the 2007 Plan and our existing long-term incentive plans and to provide additional authorized shares of common stock available to issue in the future. The additional authorized shares may be issued for various purposes without further shareholder approval, except to the extent required by applicable NASDAQ Marketplace Rules. The purposes may include raising capital, providing equity incentives to employees, officers, directors or consultants, establishing strategic relationships with other companies, expanding our business or product lines through the acquisition of other businesses or products, and other corporate purposes.

If our shareholders do not approve the amendment to our Certificate of Incorporation to increase the authorized number of shares of common stock, we will not be able to complete the Private Placement and we will not receive any of the proceeds from the sale of the Purchased Shares. In such event, we will also not amend our Certificate of Incorporation as described in Proposal 4 and we will not adopt the 2007 Plan as described in Proposal 6, even if one or more of such other Proposals is approved by the shareholders. However, if Proposal 5 is approved by the shareholders, our Certificate of Incorporation will still be amended as provided in that Proposal.

### **Proposal No. 4: Amend the Certificate of Incorporation to Increase the Company's Authorized Preferred Stock from 500,000 shares to 1,500,000 shares (See page 46)**

Under the Investment Agreement, we agreed to seek the shareholders' approval of an amendment to our Certificate of Incorporation to increase the authorized number of shares of preferred stock from 500,000 to 1,500,000. The additional shares of preferred stock also relate to the Rights Agreement we entered into on March 30, 1998 with our transfer agent, American Stock Transfer & Trust Company (the "Rights Agreement"), designed to provide for fair and equal treatment for all shareholders in the event that an unsolicited attempt is made to acquire our Company. The Rights Agreement gives each holder of common stock the right to purchase 1/100<sup>th</sup> share of preferred stock upon certain triggering events. In connection with the authorization of 100,000,000 shares of common stock in accordance with Proposal 3, 1,000,000 shares of preferred stock will be needed to support these rights. The additional shares of authorized preferred stock may also be issued for various other purposes, including raising capital, providing equity incentives to employees, officers, directors or consultants, establishing strategic relationships with other companies, expanding our business or product lines through the acquisition of other businesses or products, and other corporate purposes.

Approval of the amendment to our Certificate of Incorporation to increase the number of authorized shares of our preferred stock is a condition to the closing of the Private Placement and if the shareholders do not approve Proposal 4, we will not be able to complete the Private Placement and we will not receive any proceeds from the sale of the Purchased Shares, unless MatlinPatterson waives the condition. In such event, we also will not amend our Certificate of Incorporation as described in Proposal 3 and we will not adopt the 2007 Plan as described in Proposal 6, even if one or more of such other Proposals is approved by the shareholders. However, if Proposal 5 is approved by the shareholders, our Certificate of Incorporation will still be amended as provided in that Proposal.

- 13 -

---



**Table of Contents**

**Proposal No. 5: Amend the Certificate of Incorporation to Limit the Liability of the Directors of the Company to the Extent Permitted under Section 402(b) of the New York Business Corporation Law (See page 48)**

Under the Investment Agreement, we agreed to seek the shareholders' approval of an amendment to our Certificate of Incorporation limiting the liability of the directors of the Company to the extent permitted under Section 402(b) of the NYBCL. The Board believes that limiting the directors' personal liability as permitted by the New York statute will enhance the ability of the Company to attract and retain highly qualified directors in the future. In addition, the threat of personal liability may have an adverse effect on the decision-making process of directors. The proposed amendment may also encourage directors to make entrepreneurial decisions which they believe to be in the best interest of the shareholders with less threat of personal liability for damages for breach of their duty of care.

Approval of the amendment to our Certificate of Incorporation to limit the liability of the directors and officers of the Company is a condition to the closing of the Private Placement and if the shareholders do not approve Proposal 5, we will not be able to complete the Private Placement and we will not receive any proceeds from the sale of the Purchased Shares, unless MatlinPatterson waives the condition. In such event, we also will not amend our Certificate of Incorporation as described in Proposal 3 and Proposal 4 and we will not adopt the 2007 Plan as described in Proposal 6, even if one or more of such other Proposals is approved by the shareholders. If Proposal 5 is approved by the shareholders, we intend to amend our Certificate of Incorporation as contemplated by Proposal 5, even if none of the other Proposals are approved.

**Proposal No. 6: Adopt the First Albany Companies Inc. 2007 Incentive Compensation Plan (See page 50)**

The 2007 Plan is designed to advance the interests of the Company by providing a means through which incentive awards can be granted to officers, other employees and persons who provide services to the Company and its subsidiaries. By making grants of awards under this plan, the Company can attract, retain and reward such persons and, by linking compensation measures to performance, the Company can provide incentives for the creation of shareholder value. In addition, the interests of the Company's shareholders and the award recipients can be more closely aligned by giving the recipients an interest in the long-term success of the Company. The 2007 Plan provides that the number of shares of common stock available for outstanding awards under that plan and our existing long-term incentive plans will be equal to 25% of the total number of shares of common stock outstanding from time to time.

Furthermore, the obligation of MatlinPatterson to complete the Private Placement is conditioned on at least 22 of 27 designated key employees of the Company becoming bound by certain non-competition and non-solicitation covenants conditioned on the closing of the Private Placement and remaining employed by the Company at the closing of the Private Placement. Twenty-six of such 27 designated key employees have entered into such agreements to become effective as of the closing. The terms on which such designated key employees entered into such non-competition and non-solicitation covenants require that the Company grant to such employees certain awards of restricted stock units under the 2007 Plan if the Private Placement closes. The Company also expects to enter into an employment agreement with Mr. Fensterstock that will become effective at the closing of the Private Placement. The Company has also entered into an employment agreement with Mr. Nierney and an amendment to the existing employment agreement of Mr. Coad that will each become effective as of the closing of the Private Placement. If the Private Placement is completed, these employment agreements (or amendment in the case of Mr. Coad) will also obligate the Company to award certain restricted stock units to such executives under the 2007 Plan. Accordingly, it is contemplated that, as of the closing of the Private Placement, awards of restricted stock units in respect of up to 6.75 million shares of common stock will be made or committed to be made under the 2007 Plan, representing approximately 10.9% of the shares of common stock expected to be outstanding immediately following the closing assuming the issuance of 33,333,333 Purchased Shares, on a fully diluted basis, and after giving effect to an increase in the number of Purchased Shares that is currently expected to result from the adjustment provisions of the Investment Agreement. If the Private Placement is not consummated, we will not adopt the 2007 plan as proposed.

If Proposal 6 is not approved at the annual meeting, the 2007 Plan will not go into effect unless approved by our shareholders at a subsequent meeting. If Proposals 2, 3, 4 and 5 are approved, following the closing of the Private Placement, MatlinPatterson will beneficially own a majority of the then outstanding shares of our common stock. As a

result, if Proposal 6 is not approved at the annual meeting, there is a likelihood that a proposal to adopt the 2007 Plan will be approved by a majority vote of the shareholders at a meeting subsequent to the closing of the Private Placement. If we are required to hold a special meeting of the shareholders following the closing of the Private Placement in order to reconsider the approval of the 2007 Plan, we will incur additional expenses.

**Proposal No. 7: Ratification of Selection of Independent Accountants (See page 54)**

The Audit Committee of the Board of Directors has selected PricewaterhouseCoopers LLP as the Company's independent accountants for fiscal year ending December 31, 2007. We are submitting the selection of independent accountants for shareholder ratification at the annual meeting.

- 14 -

---

**Table of Contents**

**ANNUAL MEETING OF SHAREHOLDERS**

\_\_\_\_\_, 2007

This proxy statement is being furnished to the shareholders of First Albany in connection with the solicitation by the Board of Directors of proxies for use at the annual meeting to be held at the offices of the Company, 677 Broadway, Albany, New York on \_\_\_\_\_, 2007 at 10:00 a.m. (EDT), and any postponements or adjournments thereof. The mailing address of the principal office of the Company is 677 Broadway, Albany, New York 12207-2990 and its telephone number is (518) 447-8500.

At the annual meeting, the shareholders of the Company will be asked (1) to elect the three (3) persons named as nominees under Election of Directors; (2) to consider and act upon a proposal to approve the Private Placement; (3) to consider and act upon a proposal to amend the Company's Certificate of Incorporation to increase the authorized share capital of the Company from 50,000,000 shares of common stock to 100,000,000 shares of common stock with the same par value of \$0.01 per share; (4) to consider and act upon a proposal to amend the Company's Certificate of Incorporation to increase the authorized share capital of the Company from 500,000 shares of preferred stock to 1,500,000 shares of preferred stock with the same par value of \$1.00 per share; (5) to consider and act upon a proposal to amend the Company's Certificate of Incorporation to limit the liability of the directors of the Company to the extent permitted under Section 402(b) of the NYBCL; (6) to consider and act upon a proposal to approve the adoption of the 2007 Plan; and (7) to ratify the appointment of PricewaterhouseCoopers LLP as independent accountants of the Company for the fiscal year ending December 31, 2007.

**Proxy Solicitation**

This proxy statement and the enclosed form of proxy are expected to be mailed on or about \_\_\_\_\_, 2007. All expenses of the Company in connection with this solicitation of proxies will be borne by the Company. Proxies may be solicited by directors, officers and other employees of the Company in person or by mail, telephone, facsimile or e-mail, without additional compensation. Representatives of MatlinPatterson may also contact shareholders in connection with the solicitation of proxies. The Company has also retained MacKenzie Partners, Inc. to aid in the solicitation of proxies with respect to shares held by broker-dealers, financial institutions, and other custodians, fiduciaries and nominees for a fee of approximately \$15,000, plus certain other fees for related services and reasonable out-of-pocket expenses. The Company will also request brokerage firms, nominees, custodians and fiduciaries to forward proxy materials to the beneficial owners of shares held of record by such persons and will reimburse such persons and the Company's transfer agent for their reasonable out-of-pocket expenses in forwarding such materials but these individuals will receive no additional compensation for these solicitation services.

**Voting by Mail, Internet or Telephone**

Shareholders who cannot attend the annual meeting in person can be represented by proxy. Most shareholders have a choice of voting over the Internet, using a toll-free telephone number or completing the proxy card in the form enclosed and mailing it in the envelope provided. Please refer to your proxy card or the information forwarded by your bank, broker or other nominee to see which options are available to you.

A proxy may be revoked at any time before it is exercised by giving notice of revocation to the Secretary of the Company, by executing a later-dated proxy (including an Internet or telephone vote) or by attending and voting in person at the annual meeting. The execution of a proxy will not affect a shareholder's right to attend the annual meeting and vote in person, but attendance at the annual meeting will not, by itself, revoke a proxy. Proxies properly completed and received prior to the annual meeting and not revoked will be voted at the annual meeting.

- 15 -

**Table of Contents**

**VOTING, RECORD DATE AND QUORUM**

Proxies will be voted as specified or, if no direction is indicated on a proxy, will be voted (1) *For* the election of the three (3) persons named as nominees under Election of Directors; (2) *For* the proposal to approve the Private Placement; (3) *For* the proposal to amend the Company's Certificate of Incorporation to increase the authorized share capital of the Company from 50,000,000 shares of common stock to 100,000,000 shares of common stock with the same par value of \$0.01 per share; (4) *For* the proposal to amend the Company's Certificate of Incorporation to increase the authorized share capital of the Company from 500,000 shares of preferred stock to 1,500,000 shares of preferred stock with the same par value of \$1.00 per share; (5) *For* the proposal to amend the Company's Certificate of Incorporation to limit the liability of the directors of the Company to the extent permitted under Section 402(b) of the NYBCL; (6) *For* the proposal to adopt the 2007 Plan; and (7) *For* the ratification of the appointment of PricewaterhouseCoopers LLP as independent accountants of the Company for the fiscal year ending December 31, 2007.

The persons named in the proxy also may vote in favor of a proposal to adjourn the annual meeting to a subsequent date or dates without further notice in order to solicit and obtain sufficient votes to approve the matters being considered at the annual meeting. If a proxy is returned which specifies a vote against a proposal, such discretionary authority will not be used to adjourn the annual meeting in order to solicit additional votes in favor of such proposal. As to any other matter or business which may be brought before the annual meeting, including any adjournment(s) or postponement(s) thereof, a vote may be cast pursuant to the proxy in accordance with the judgment of the person or persons voting the same. As of the date hereof, the Board does not know of any such other matter or business.

The close of business on \_\_\_\_\_, 2007 has been fixed as the record date for the determination of shareholders entitled to vote at the annual meeting. \_\_\_\_\_ shares of common stock were outstanding as of the record date. Each shareholder will be entitled to cast one vote, in person or by proxy, for each share of common stock held. There are no other shares of voting stock of the Company outstanding. The presence, in person or by proxy, of the holders of at least a majority of the shares of common stock entitled to vote at the annual meeting is necessary to constitute a quorum at the annual meeting. Abstentions and broker non-votes (as described below) and votes to withhold authority are counted in determining whether a quorum has been reached on a particular matter. Votes to withhold authority are treated the same as abstentions for purposes of the voting requirements described below.

If you hold your shares in street name through a broker or other nominee, your broker or nominee may not be permitted to exercise voting discretion with respect to certain matters. Thus, if you do not give your broker or nominee specific instructions, your shares may not be voted on those matters and will not be counted in determining the number of shares necessary for approval. Your broker **will** be permitted to exercise voting discretion with respect to Proposal 1 and Proposal 7. Your broker **will not** be permitted to exercise voting discretion with respect to any of the Investment Proposals.

You can cast one vote for each share of First Albany common stock you own. The proposals require different percentages of votes in order to approve them:

For the election of directors, the three nominees receiving the most *For* votes from the shares present and entitled to vote at the annual meeting, either in person or by proxy, will be elected. Abstentions will not be treated as votes cast at the annual meeting for such purpose.

To be approved, Proposal 2 must receive *For* votes constituting a majority of the votes cast at the annual meeting with respect to shares entitled to vote thereon. If you abstain from voting, it will have the same effect as an *Against* vote. Broker non-votes will not be treated as votes cast at the annual meeting for such purpose.

To be approved, Proposal 3 must receive *For* votes from the holders of a majority of the shares outstanding as of the record date. If you abstain from voting, it will have the same effect as an *Against* vote. Broker non-votes will also have the same effect as an *Against* vote.

Edgar Filing: FIRST ALBANY COMPANIES INC - Form PRER14A

To be approved, Proposal 4 must receive *For* votes from the holders of a majority of the shares outstanding as of the record date. If you abstain from voting, it will have the same effect as an *Against* vote. Broker non-votes will also have the same effect as an *Against* vote.

To be approved, Proposal 5 must receive *For* votes from the holders of a majority of the shares outstanding as of the record date. If you abstain from voting, it will have the same effect as an *Against* vote. Broker non-votes will also have the same effect as an *Against* vote.

To be approved, Proposal 6 must receive *For* votes constituting a majority of the votes cast at the annual meeting with respect to shares entitled to vote thereon. If you abstain from voting, it will have the same effect as an *Against* vote. Broker non-votes will not be treated as votes cast at the annual meeting for such purpose.

- 16 -

---

**Table of Contents**

To be approved, Proposal 7 must receive *For* votes constituting a majority of the votes cast at the annual meeting with respect to shares entitled to vote thereon. If you abstain from voting, it will have the same effect as an *Against* vote.

**The Board unanimously recommends that the shareholders vote FOR (1) the election of the three (3) persons named as nominees under Election of Directors; (2) the proposal to approve the Company's issuance and sale of shares of common stock to certain qualified investors in a private placement; (3) the proposal to amend the Company's Certificate of Incorporation to increase the authorized share capital of the Company from 50,000,000 shares of common stock to 100,000,000 shares of common stock with the same par value of \$0.01 per share, (4) the proposal to amend the Company's Certificate of Incorporation to increase the authorized share capital of the Company from 500,000 shares of preferred stock to 1,500,000 shares of preferred stock with the same par value of \$1.00 per share; (5) the proposal to amend the Company's Certificate of Incorporation to limit the liability of the directors of the Company to the extent permitted under Section 402(b) of the NYBCL; (6) the proposal to adopt the First Albany Companies Inc. 2007 Incentive Compensation Plan; and (7) the ratification of the appointment of PricewaterhouseCoopers LLP as independent accountants of the Company for the fiscal year ending December 31, 2007.**

- 17 -

---

**Table of Contents**

**PROPOSAL NO. 1  
ELECTION OF DIRECTORS**

The Bylaws of the Company provide that effective as of the annual meeting the Board shall consist of seven directors elected in three classes. Three directors will be elected at the annual meeting to serve for a three-year term expiring at the annual meeting of shareholders in 2010. The Board has nominated three persons as directors. The Board recommends that shareholders vote FOR the election of these nominees.

If the enclosed proxy card is duly executed and received in time for the annual meeting, and if no contrary specification is made as provided therein, it will be voted in favor of the election of persons nominated as directors by the Board.

Each of the nominees has consented to serve as a director if elected. Should any nominee for director become unable or unwilling to accept election, proxies will be voted for a nominee selected by the Board, or the size of the Board may be reduced accordingly. The Board has no reason to believe that any of the nominees will be unable or unwilling to serve if elected to office. Any vacancy occurring during the term of office of any director may be filled by the remaining directors for a term expiring at the next meeting of shareholders at which the election of directors is in the regular order of business. Each of the nominees is presently a director of the Company. The annual meeting shall constitute a special meeting for the election of directors as may be required by the provisions of Section 603 of the New York Business Corporation Law.

As discussed more fully below with respect to Proposal No. 2 Approval of the Private Placement, the Company has agreed that on or prior to the closing date of the Private Placement, the Company will cause the size of its Board of Directors to be increased from seven to nine and to cause certain of its current directors designated by MatlinPatterson to resign. The remaining directors would appoint directors designated by MatlinPatterson to fill the resulting vacancies. The Company has been advised that MatlinPatterson currently intends to nominate to the Board three representatives of MatlinPatterson and its affiliates, as well as Mr. Fensterstock. Mr. McNamee and Mr. McNierney will continue as members of the Board. It is currently expected that \_\_\_\_\_, \_\_\_\_\_ and \_\_\_\_\_ will also continue as members of the Board following the closing of the Private Placement until asked to resign in accordance with the Investment Agreement, at which time the remaining directors will fill the resulting vacancies with directors designated by MatlinPatterson.

Set forth below is certain information furnished to the Company by the director nominees and by each of the incumbent directors whose terms will continue following the Meeting.

**Directors of the Company**

The directors nominated for election whose terms will expire in 2010 are as follows:

PETER J. MCNIERNEY, age 41, joined First Albany in 2002 as the Director of Investment Banking, and was appointed as President and Chief Executive Officer in June 2006. Prior to joining First Albany, Mr. McNierney was a Managing Director and the Head of the Healthcare and Communications Services groups at Robertson Stephens. Prior to that, Mr. McNierney was a Vice President in the Healthcare Group at Smith Barney. Mr. McNierney received a BA and a JD/MBA from the University of Texas at Austin. Mr. McNierney has been a director of the Company since June 2006.

ALAN P. GOLDBERG, age 61, joined First Albany in 1980. Mr. Goldberg became Vice Chairman of the Company in June 2006. Mr. Goldberg served as the Company's President from 1989 to June 2006, as Chief Executive Officer from 2003 to June 2006 and as Co-Chief Executive Officer from 1993 until 2002. Mr. Goldberg is a Director of MVP Health Care (a private company that provides health benefit plans). He is active in industry and civic organizations and serves on the board of several nonprofit institutions. Mr. Goldberg has been a director of the Company since its incorporation in 1985.

CARL P. CARLUCCI, Ph.D., age 58, has been Executive Vice President and Chief Financial Officer of the University of South Florida since 2001. Prior to joining the University of South Florida he was appointed First Deputy Comptroller, Office of the State Comptroller, State of New York from 1999 to 2001. From 1993 to 1999, Dr. Carlucci was Executive Vice President of the University at Albany, State University of New York. Dr. Carlucci's public service has included the positions of Secretary to the New York State Assembly Ways & Means Committee and Director of the New York Assembly Higher Education Committee. His prior experience in higher education has also included the

position of Vice President for Administration at Brooklyn College and serving on the faculty of the Public Administration Departments of Baruch College of City University of New York and the University at Albany's Rockefeller College. Dr. Carlucci is Chair of the Audit Committee and is a member of the Executive Compensation Committee; he has served as a director of the Company since 2003.

**The Board recommends a vote FOR each of the three Director nominees.**

The following directors' terms will expire at the annual meeting of shareholders in 2008:

- 18 -

---



## **Table of Contents**

GEORGE C. McNAMEE, age 60, joined First Albany in 1969. Mr. McNamee has been Chairman of the Company since its inception and also serves as Managing Partner and Managing Director of FA Technology Ventures. Mr. McNamee was Co-Chief Executive Officer of the Company from 1993 to 2002. In addition, Mr. McNamee is Chairman of Plug Power Inc. (a leading fuel cell developer) and a director of iRobot Corporation (a designer and manufacturer of robots). Additionally, he is a director of several private companies including Autotask Corporation, CORESense Inc., MetaCarta Inc., and StreetEasy. He also serves on the Board of Directors of the New York Conservation Education Fund and is a Trustee of the Albany Academy for Girls. He received his Bachelor of Arts degree from Yale University. Mr. McNamee has been a director of the Company since its incorporation in 1985.

SHANNON P. O BRIEN, age 48, is Chief Executive Officer of the Girl Scouts, Patriot's Trail Council, Inc. since February 2005. Ms. O'Brien was the State Treasurer and Receiver General for the Commonwealth of Massachusetts from 1999 to January 2003. The 2002 Democratic Nominee for Governor of Massachusetts, Ms. O'Brien also served previously for eight years in the Massachusetts Legislature. She was Vice President for External Affairs for Community Care Systems, a behavioral healthcare network and taught at Boston University School of Communications. A graduate of Yale University and Boston University School of Law, she practiced law with the firm of Morrison Mahoney and Miller before entering the legislature. Ms. O'Brien is Chair of the Committee on Directors and Corporate Governance, a member of the Audit Committee and has been a director of the Company since 2003.

The following directors' terms will expire at the annual meeting of shareholders in 2009:

NICHOLAS A. GRAVANTE, JR., age 46, has been a partner at the law firm of Boies Schiller & Flexner LLP since July 1, 2000. Prior to that time he was a partner at Barrett, Gravante, Carpinello & Stern, LLP in New York City since 1992. Mr. Gravante practices law in the areas of corporate litigation and white-collar criminal defense. He is also a Trustee of the Community Service Society of New York, the Brooklyn Public Library, the Columbia Law School Association, a member of the Board of Governors at the Lords Valley Country Club in Lords Valley, Pennsylvania and a member of the Alumni Board of Governors at Poly Prep Country Day School. Mr. Gravante is Chair of the Executive Compensation Committee, a member of the Committee on Directors and Corporate Governance and has been a director of the Company since 2003.

DALE KUTNICK, age 57, is Senior Vice President of Research at Gartner, Inc., and has been there since April 2005 when Gartner acquired his previous employer, Meta Group. He was co-founder, Chairman and a director of Meta Group, Inc., a research and consulting firm focusing on information technology and business transformation. Mr. Kutnick served as Chief Executive Officer and Research Director of Meta Group, Inc. since its inception in January 1989 until 2002. Prior to co-founding Meta Group, Inc., Mr. Kutnick was Executive Vice President of Research at Gartner Group, Inc. and an Executive Vice President at Gartner Securities. Prior to his experience at Gartner Group, Inc., he served as an Executive Director, Research Director and Principal at Yankee Group and as a Principal at Battery Ventures, a venture capital firm. Mr. Kutnick is a graduate of Yale University. Mr. Kutnick is a member of the Committee on Directors and Corporate Governance, a member of the Audit Committee and has been a director of the Company since 2003.

## **GOVERNANCE OF THE COMPANY**

The Board of Directors held nineteen (19) meetings during the Company's fiscal year ended December 31, 2006. The committees of the Board each held the number of meetings noted below in "Committees of the Board". During 2006, each Director attended at least 86 % of the total number of meetings of the Board (while he or she was a member) and at least 82 % of the total number of meetings of committees of the Board on which he or she served. Directors are encouraged to attend the annual meeting of shareholders, and all directors attended last year's meeting. Walter Fiederowicz served as the Board's lead director until he resigned effective September 28, 2006, and the position previously held by him is currently vacant. The Board determined that each of Messrs. Carlucci, Gravante, Fiederowicz, Arthur J. Roth, and Kutnick and Ms. O'Brien qualify as an independent director as defined in the NASDAQ Stock Market listing standards. Messrs. Fiederowicz and Roth ceased to be directors on September 28, 2006.

The Company has a Code of Business Conduct and Ethics applicable to all employees of the Company and members of the Board of Directors. The Code, as well as the current charters of each of the Committees listed below,

are available on the Company's website ([www.firstalbany.com](http://www.firstalbany.com)). The Company intends to post amendments to or waivers from its Code at this location on its website.

The Company has also adopted a procedure by which shareholders may send communications as defined within Item 407(f) of Regulation S-K under the Securities Exchange Act of 1934, as amended (the Exchange Act), to one or more members of the Board of Directors by writing to such director(s) or to the whole Board of Directors in care of the Company's Corporate Secretary at the following address: First Albany Companies Inc., 677 Broadway, Albany, New York 12207-2990, Attn: Corporate Secretary. Any such communications will be promptly distributed by the Corporate Secretary to such individual director(s) or to all directors if addressed to the whole Board of Directors.

- 19 -

---

## Table of Contents

### **Committees of the Board**

The Board of Directors has three standing committees: the Audit Committee, the Executive Compensation Committee and the Committee on Directors and Corporate Governance.

**The Audit Committee.** The Audit Committee, responsible for reviewing the Company's financial statements, met eleven (11) times during 2006. The Audit Committee operates pursuant to a written charter that the Committee and the Board reviews each year to assess its adequacy. Among the primary purposes of the Audit Committee are assisting the Board of Directors in its oversight of the integrity of the Company's financial reporting process; its compliance with legal and regulatory requirements; the qualifications, independence and performance of its independent auditors; and the performance of the Company's internal accounting controls. In addition, the Audit Committee decides whether to appoint, retain or terminate the Company's independent auditors and pre-approves all audit, audit-related, tax and other services, if any, to be provided by the independent auditors. The Audit Committee also prepares the Audit Committee report required by the rules of the Securities and Exchange Commission (SEC) for inclusion in the Company's annual proxy statement. Until September 28, 2006, this committee was comprised of Mr. Roth, who served as chair, Ms. O'Brien and Mr. Fiederowicz. Messrs. Roth and Fiederowicz ceased to be directors on September 28, 2006. Currently, this committee is comprised of Mr. Carlucci, who serves as Chair, Ms. O'Brien and Mr. Kutnick. Each member of the Audit Committee is an independent director as defined in the NASDAQ Stock Market listing standards, and is independent within the meaning of Rule 10A-3 under the Exchange Act and the Company's Corporate Governance Guidelines. Each of Mr. Carlucci and Mr. Kutnick are qualified as an audit committee financial expert within the meaning of Item 401(h) of Regulation S-K under the Exchange Act, and the Board has determined that they have accounting and related financial management expertise within the meaning of the NASDAQ Stock Market listing standards.

We have adopted policies on reporting of concerns regarding accounting, internal accounting controls or auditing matters (Accounting Matters). Any employees who have concerns about Accounting Matters may report their concerns to any of the following: (i) the employee's supervisor, (ii) an attorney in the Legal Department of First Albany, (iii) the Company's toll free anonymous voice mailbox at 1-866-480-6132, or (iv) the Company's anonymous drop-box, which may be accessed through the Company's website ([www.firstalbany.com](http://www.firstalbany.com)). The full text of the Complaint Procedures for Accounting and Auditing Matters is available on our website.

The Audit Committee's procedures for the pre-approval of the audit and permitted non-audit services are described in Audit Committee Report and Audit Committee Pre-Approval Policy.

**The Executive Compensation Committee.** Under its charter, the primary purposes of the Executive Compensation Committee are to determine and approve the compensation of the Company's Chief Executive Officer and make recommendations to the Board of Directors with respect to executive compensation (including compensation of executive officers other than the Chief Executive Officer) and the Company's incentive-based compensation and equity-based plans that are subject to Board approval. Based on recommendations from the Chief Executive Officer, the Executive Compensation Committee reviews and approves the compensation of all executive officers of the Company other than the Chief Executive Officer. The Committee also administers the Company's 1999 Long-Term Incentive Plan, 2001 Long-Term Incentive Plan and the 2003 Senior Management Bonus Plan and will administer the 2007 Plan, if approved by the shareholders. The Committee assists the Board of Directors in its oversight of the development, implementation and effectiveness of the Company's policies and strategies relating to its human capital management function, including but not limited to those policies and strategies regarding recruiting, retention, career development and progression, management succession (other than that within the purview of the Committee on Directors and Corporate Governance), diversity and employment practices. In addition, the Executive Compensation Committee also prepares its report regarding the Compensation Discussion and Analysis as required by the rules and regulations of the SEC.

The Executive Compensation Committee is composed of two independent directors and operates under a written charter adopted by the Board, which was amended January 2004. Until September 28, 2006, it was comprised of Messrs. Carlucci and Fiederowicz. Currently, it is comprised of Mr. Gravante, who serves as Chair, and Mr. Carlucci. The Board annually reviews the NASDAQ Stock Market listing standards definition of independence and has determined that each member of the Committee is independent. During the year 2006, the Committee met

seven ( 7 ) times.

**The Committee on Directors and Corporate Governance.** The Board established the Committee on Directors and Corporate Governance in fiscal year 2002. The Committee held two (2) meetings during 2006. Among its specific duties, the Committee determines criteria for service as director, reviews candidates and considers appropriate governance practices. The Committee also oversees the evaluation of the performance of the Board of Directors and Chief Executive Officer and annually reviews the Corporate Governance Guidelines, reporting to the Board any recommended changes. The Committee considers nominees for directors proposed by shareholders. To recommend a prospective nominee for the Committee's consideration, shareholders should submit the candidate's name and qualifications to the Company's Corporate Secretary in writing to the following address: First Albany Companies Inc., 677 Broadway, Albany, New York 12207-2990, Attn: Corporate Secretary. The Committee on Directors and Corporate Governance is comprised of Ms. O'Brien, who serves as Chair, and Messrs. Gravante and Kutnick. In identifying and recommending nominees for positions on the Board of Directors, the Committee on Directors and Corporate Governance places primary emphasis on the criteria set forth in our Corporate Governance Guidelines which include diversity, age and skills, all in the context of an assessment of the perceived needs of the Board. Recommendations by shareholders that are made in accordance with these procedures will receive the same consideration.

- 20 -

---

**Table of Contents**

**PROPOSAL NO. 2  
APPROVAL OF THE PRIVATE PLACEMENT**

On May 14, 2007, the Company entered into an Investment Agreement with MatlinPatterson providing for the issuance to MatlinPatterson and certain co-investors which may be designated by it, upon the terms and subject to the conditions of the Investment Agreement, of 33,333,333 newly issued shares of the Company's common stock, par value \$0.01 per share, for an aggregate cash purchase price of \$50 million. The number of shares issuable to MatlinPatterson in consideration of the \$50 million purchase price (the "Purchased Shares") is subject to upward adjustment (i) if the Company incurs certain incremental employment-related obligations as a result of the DEPFA Transaction not having closed prior to the closing of the Private Placement and (ii) if the Company's consolidated net tangible book value per share at closing is less than \$1.60, as more fully described below.

We currently expect that the DEPFA Transaction will not close prior to the closing of the Private Placement. As a result, certain employees of the Company, who will remain employed by the Company at the time of the closing of the Private Placement and who would have otherwise have become employed by DEPFA had the DEPFA Transaction closed prior to the Private Placement, are expected to become entitled to receive certain cash payments and accelerated vesting of certain equity awards triggered by MatlinPatterson gaining control of the Company that they would not have been entitled to if the DEPFA Transaction had closed first. In such an event, the Investment Agreement provides that the number of Purchased Shares will be increased to account for the cash bonuses or other amounts paid or payable by the Company to any employee of the Municipal Capital Markets Group ("MCMG") that would not have been so paid had the DEPFA Transaction closed prior to the closing of the Private Placement, as well as the accelerated vesting of the restricted stock awards and stock options held by such employees that would not have occurred if the DEPFA Transaction had closed prior to the closing of the Private Placement. In the event that our employees entitled to receive such payments and to benefit from the accelerated vesting of such awards and options do not waive such rights, we expect the number of Purchased Shares to be increased from 33,333,333 to 36,690,705 at the closing, without MatlinPatterson being required to contribute more than the \$50 million already contemplated by the Investment Agreement. If the number of Purchased Shares is increased in this manner, MatlinPatterson would own approximately 69.5% of the outstanding common stock (approximately 59.5% on a fully diluted basis). To the extent that the affected employees are willing to waive their rights to such payments and accelerated vesting, the number of additional Purchased Shares will be reduced accordingly.

The Investment Agreement also provides that the number of Purchased Shares will be further adjusted upwards, in addition to the adjustment set forth above, if the net tangible book value per share is less than \$1.60 as of the closing date. In such case, the number of Purchased Shares will be increased by a factor reflecting the percentage shortfall represented by the net tangible book value per share as of the closing date compared to a target of \$1.69 per share. There will first be a pro forma adjustment to eliminate the effects of the closing of the DEPFA Transaction on net tangible book value per share, including a pro forma elimination of the incremental cash payments and accelerated restricted stock awards and stock options referred to above. As of March 31, 2007, the Company's net tangible book value per share is approximately \$1.86 and if the Company incurs losses, such an adjustment could be required.

The proceeds to the Company from the sale of the shares to MatlinPatterson would be invested in the Company's ongoing businesses, consistent with a strategic plan to be developed by the Company and MatlinPatterson, and to retire certain short-term debt. The Private Placement is expected to close in the third quarter of 2007. The terms of the Investment Agreement and the related Registration Rights Agreement and Voting Agreements are more fully described below under "Summary of Terms of the Private Placement," and copies of the Investment Agreement, the form of the Registration Rights Agreement and the Voting Agreements are appended to this proxy statement as **Appendix A**.

It is expected that, if the Private Placement is completed, the Company will hire Mr. Lee Fensterstock, a securities industry veteran, to act as the Company's Chief Executive Officer. Mr. Fensterstock would also be elected to the Company's Board of Directors and serve as its Chairman. Mr. Peter J. McNierney, currently the Company's President and Chief Executive Officer, would become the Company's President and Chief Operating Officer.

In connection with the Private Placement, the Company would issue or commit to issue under the 2007 Plan restricted stock units in respect of up to 6,750,000 shares of common stock to key employees who enter into

non-compete and non-solicit agreements with the Company and pursuant to the employment agreement that the Company expects to enter into with Mr. Fensterstock and has entered into with Mr. McNierney. The restricted stock units would vest over a three-year period following issuance.

The Company has agreed that on or prior to the closing date of the Private Placement, the Company will cause the size of its Board of Directors to be increased from seven to nine and to cause certain of its current directors designated by MatlinPatterson to resign. The remaining directors would appoint directors designated by MatlinPatterson to fill the resulting vacancies. The Company has been advised that MatlinPatterson currently intends to nominate to the Board three representatives of MatlinPatterson and its affiliates, as well as Mr. Fensterstock. Mr. McNamee and Mr. McNierney will continue as members of the Board. It is currently expected that \_\_\_, \_\_\_ and \_\_\_ will also continue as members of the Board following the closing of the Private Placement until asked to resign in accordance with the Investment Agreement, at which time the remaining directors will fill the resulting vacancies with directors designated by MatlinPatterson. As

- 21 -

---

## **Table of Contents**

the holder of a majority of the outstanding shares of common stock following the closing of the Private Placement, MatlinPatterson will have the power to replace any or all of such directors in the future and has indicated its intention to seek other qualified individuals with experience in the securities industry or other relevant skills or knowledge to become directors of the Company after the closing.

In connection with the Investment Agreement, the Company has agreed with MatlinPatterson to terminate the Company's previously announced plans to reprice outstanding employee stock options and to replace outstanding employee restricted stock awards with stock appreciation rights.

The Company has agreed to reimburse MatlinPatterson for certain reasonably incurred, documented expenses incurred in connection with the negotiation and execution of the Investment Agreement and the completion of the transactions contemplated thereby, subject to certain limits. The Investment Agreement contains other covenants of the Company, including an agreement of the Company to operate its business in the ordinary course until the purchase is completed. The Company has also agreed not to solicit or initiate discussions with third parties regarding other competing proposals and to certain restrictions on its ability to respond to any unsolicited competing proposal. The Investment Agreement also includes customary representations and warranties of the Company and MatlinPatterson, indemnification provisions for MatlinPatterson and termination provisions for both the Company and MatlinPatterson.

Under applicable NASDAQ Marketplace Rules, the Private Placement is subject to approval by a majority of the Company's shareholders. Messrs. George McNamee and Alan Goldberg, directors of the Company, and Mr. McNierney have agreed with MatlinPatterson to vote the shares of common stock owned by them in favor of the transaction. These persons collectively own approximately 19% of the outstanding shares of common stock. The completion of the Private Placement is also subject to the satisfaction or waiver of a variety of other closing conditions.

The Purchased Shares would be sold by the Company in the Private Placement in reliance on an exemption from the registration requirements of the Securities Act. MatlinPatterson and the Company would, at the closing of the Private Placement, enter into a Registration Rights Agreement pursuant to which MatlinPatterson would acquire rights to cause the Company to register, under specified circumstances, the subsequent offer and resale of the Purchased Shares.

The Investment Agreement contains representations and warranties the Company and MatlinPatterson made to each other as of specific dates. The assertions embodied in those representations and warranties were made solely for purposes of the contract between the Company and MatlinPatterson and may be subject to important qualifications and limitations agreed to by the Company and MatlinPatterson in connection with negotiating the terms of the Investment Agreement. Moreover, some of those representations and warranties may not be accurate or complete as of any specified date, may be subject to a contractual standard of materiality different from those generally applicable to shareholders or may have been used for purposes of allocating risk among the Company and MatlinPatterson rather than establishing matters as facts.

### **Background of the Private Placement**

The Company experienced losses in several of our key segments in 2005 and 2006, including equities sales and trading, equity investment banking and fixed income sales and trading.

Recognizing these losses and the need to maintain liquidity requirements, in the spring of 2006 the Board retained Freeman & Co. Securities LLC ( Freeman ) as its financial advisor to establish a comprehensive process to entertain both a strategic sale of, or a strategic investment in, the Company. We began to work immediately on preparing materials for potential investors, and in the spring and summer of 2006 a broad target list of over thirty names was developed, which led to focused discussions with twenty-two parties. After discussions and preliminary due diligence, three potential investors emerged. The first of these formally withdrew without providing a letter of intent or a term sheet and while both the second and third gave verbal indications of interest at a valuation of approximately tangible book value, neither provided a written letter of intent or term sheet, and the process concluded unsuccessfully.

The Board's conclusions from the formal process were that (1) there was apparent potential market interest to buy the entire Company for tangible book value, but no written offers were received, (2) the process was beginning to have a negative effect upon employee retention and (3) the Company should focus on its strategy to repair the

financials of the Company that was begun in June 2006 and suspend the formal process while still selectively entertaining or soliciting interest in a sale or investment.

During the December 22, 2006 meeting of the Board of Directors, Peter McNierney provided the Board with an update on the financial performance of the Company. He noted that the results were below budget projections by \$3-4 million and stated that although the Company could continue to survive as a stand-alone entity, this would not be the preferred course of action. Mr. McNierney then presented an analysis and comparison of potential transactions the Company might undertake through a merger, an acquisition or by a third party investment.

- 22 -

---



## **Table of Contents**

In the first quarter of 2007, the Company had active conversations with seven potential investors. The first contacted Peter McNierney to make an employment offer, and after a formal decline, took a concentrated look at purchasing the Company as a whole. Ultimately, it formally withdrew due to uncertainty of integration of the Company into its existing platform. Two additional firms took an active look at the Municipal Capital Markets Group ( MCMG ), one of which took a second active look at MCMG and the Descap division, but ultimately, both companies also withdrew. DEPFA BANK plc ( DEPFA ) also expressed a strong interest in MCMG. The conversations with DEPFA resulted in the sale of MCMG to DEPFA for a cash purchase price equal to \$12 million plus the value of the municipal bond inventory used in the business, which is expected to range between \$150-\$200 million at closing. Following entry into the MCMG transaction with DEPFA, two investors took an active look at the remaining divisions of the Company. One investor decided not to submit a proposal at the time based on employee turnover and the continued losses of the Company. The second investor, composed of two parties, was unable to get comfortable with the key employee turnover and viewed the fixed income business as non-productive, whose only value was from capital, less the closing costs. MatlinPatterson then indicated its interest in the Company.

On March 20, 2007, MatlinPatterson executed a confidentiality agreement with the Company pursuant to which the Company was to provide confidential information to MatlinPatterson in connection with a potential transaction. Following initial due diligence and discussions with senior management at the Company, MatlinPatterson indicated interest in pursuing a direct investment in the Company.

During the January 3, 2007 meeting of the Board, a special committee of the Board (the Special Committee ), comprised of Nicholas A. Gravante, Jr., Carl P. Carlucci, Dale Kutnick and Shannon P. O'Brien, was formed to assist in evaluating proposals from potential investors and to make recommendations to the Board regarding any issues requiring Board consideration with respect to any proposals received from such investors. Bingham McCutchen LLP was then retained as legal counsel for the Special Committee.

At the Board meeting on April 5, 2007, Mr. McNierney gave an update on the operating results for the quarter. He stated that the Company expected to report a significant loss for the quarter. Mr. McNierney then lead the Board in a discussion of potential transactions, including a potential transaction with MatlinPatterson. The duties of the outside directors and the role of the Special Committee was also discussed. The Board appointed Ms. O'Brien and Mr. Kutnick co-chairs of the Special Committee.

On April 25, 2007, MatlinPatterson delivered a draft letter of intent and term sheet (the Letter of Intent ) to the Board for its review and approval. It contemplated a \$40 million capital infusion into the Company at \$1.50 per share, thereby obtaining an approximate 52.9% ownership position in the Company on a fully diluted basis after grants of restricted stock based awards by the Company for employee retention. In addition, the Letter of Intent included an exclusivity period until May 9, 2007 during which the Company would not negotiate with or solicit competing proposals from other bidders.

On April 26, 2007, at a meeting of the Board, members of the Company's management reviewed with the Board the draft Letter of Intent submitted by MatlinPatterson. The Company's financial and legal advisors participated in the meeting, as did counsel for the Special Committee. Mr. Gravante reported on the Special Committee's efforts to confirm the level of interest of other interested parties, including the Special Committee's direct communications with such other interest parties without management present, and the Special Committee's discussions with Freeman, which anticipated the delivery of a fairness opinion to the Board prior to authorization of a definitive agreement in light of the potential for MatlinPatterson to exercise voting control following completion of the proposed investment. The Special Committee reported that it was satisfied with the process and felt that all reasonably possible scenarios and interested parties had been considered and that the efforts made were sufficient to indicate that the MatlinPatterson proposal was the best available for the Company and its shareholders. At this meeting, the Company's Board discussed their fiduciary duties with respect to the proposed Letter of Intent presented. The Board resolved to authorize members of the Company's senior management to execute the Letter of Intent with certain revisions proposed by the Board.

On April 27, 2007, MatlinPatterson delivered a revised Letter of Intent, which was executed by MatlinPatterson and the Company.

At a meeting of the Special Committee on May 1, 2007, Mr. McNierney provided a status report regarding the negotiations with, and the due diligence conducted by, MatlinPatterson to date. He explained that MatlinPatterson planned to have Mr. Fensterstock serve as the new Chairman of the Board and Chief Executive Officer of the Company following the closing of the Private Placement, with Mr. McNierney becoming the President and Chief Operating Officer and Mr. Coad remaining the Chief Financial Officer. MatlinPatterson also required execution of the definitive Investment Agreement to be contingent upon certain designated Company employees entering into non-compete and non-solicit agreements that would become effective upon the closing of the Private Placement, and with such closing being conditioned on a certain number of additional employees entering into such agreements and remaining employed by the Company at the closing of the proposed investment. The Special Committee set a tentative agenda for its upcoming meetings and discussed the timeline for receiving certain reports from its officers, legal counsel and financial advisor regarding the Company's financial performance, including receipt of a written fairness opinion from the Company's financial advisor, as well as the possible consequences of the investment by MatlinPatterson. Please see the section entitled "Opinion of our Independent Financial Advisor" below for information on Freeman and the fairness opinion. The Special Committee then

- 23 -

---

## **Table of Contents**

discussed whether there existed any potential conflicts of interest among its members that might impact its impartiality. The Special Committee determined that no member had any potential conflicts of interest in addressing the issues presented and noted that the Special Committee was well positioned to act impartially in the best interests of the shareholders, particularly with respect to equity awards and employment matters.

The Special Committee met again on May 4, 2007 without management present and during which it reviewed its duties under the Company's Certificate of Incorporation and relevant fiduciary law. After management was asked to join the meeting, Mr. McNierney provided a status report regarding the transaction structure, due diligence and process. First and second rounds of due diligence had been completed by MatlinPatterson and no significant issues had arisen. The Special Committee considered certain specific regulatory matters raised as part of legal and regulatory due diligence.

During the Special Committee meeting on May 6, 2007, Freeman presented an overview of its market survey on behalf of the Company. Mr. McNierney provided a status report on the Company's efforts to secure key employees continued employment as part of the transaction, including MatlinPatterson's indication that it would require Messrs. McNierney and Coad to amend their employment agreements prior to the execution of the Investment Agreement, that it would similarly require certain other key employees to execute non-compete and non-solicit agreements that would be conditioned on the closing of the proposed investment and that it would require certain additional key employees to execute such non-compete and non-solicit agreements between the signing of the Investment Agreement and closing and remaining employed by the Company at the closing of the proposed investment. The Special Committee engaged in a lengthy discussion of specific provisions contained in the draft Investment Agreement received from MatlinPatterson's counsel. The Special Committee also discussed the challenges and logistics of the resignation of current directors and the appointment of new directors as required by the Investment Agreement. Ms. O'Brien also reported separately to the Special Committee the conversation she and Mr. Kutnick had with Mr. Fensterstock regarding MatlinPatterson's plans for the future financial success of the Company and its intentions with respect to employee compensation. The Special Committee resolved that it would not seek compensation for performance of their duties on the Committee, other than the usual per-meeting fees.

During a telephonic discussion between members of the Special Committee and its financial advisors and management on May 8, 2007, Dewey Ballantine LLP, outside counsel to the Company, provided an update on the status of negotiations with counsel for MatlinPatterson. There were several key provisions of the Investment Agreement that the parties were continuing to negotiate. Dewey Ballantine LLP also reported that MatlinPatterson would be seeking voting agreements from Messrs. McNierney, McNamee and Goldberg. Freeman reviewed its draft presentation to the Board, which covered an overview of the situational analysis, the process leading up to the MatlinPatterson offer and the financial analysis of the proposed investment, to be presented to the full Board.

Freeman's presentation characterized the Company as being in a critical survival situation due to continued financial losses and key employee losses. Freeman was concerned that continued losses could be funded only by sales of inventory to free-up capital and this would continue to erode the tangible book value at an accelerated pace. The Special Committee discussed additional concerns that this could threaten the DEPFA Transaction as the purchase agreement entered into with DEPFA contained conditions to closing that set forth minimum net capital requirements on a pro-forma stand alone basis. Therefore, Freeman recommended that the Company accept the formal, fully vetted and diligenced offer by MatlinPatterson instead of risking the deal by postponing it and pursuing another offer.

During that meeting, Mr. McNierney reported that MatlinPatterson was considering increasing its investment in the Company from \$40 million to \$50 million. The Special Committee asked that, in the event such a proposal materialized, it receive analysis from its financial advisor with respect to the merits of such an increased investment. Mr. McNierney also reported on the status of discussions with a group of employees from another middle-market institutional investment bank considering joining the Company.

The Board met on May 9, 2007 and Mr. McNierney updated the Board on the MatlinPatterson deal discussions. He summarized the outstanding issues as the following: a per share purchase price adjustment in the event that the DEPFA Transaction has not closed prior to the closing of the MatlinPatterson investment; a per share purchase price adjustment based on a significant drop in net tangible book value; the retention of key employees; the indemnification language; reimbursable expenses upon breakup of the transaction; the drop dead date; and the material adverse change

definition. Representatives of Dewey Ballantine LLP led the Board through a discussion of the significance of each of the above issues, as well as other terms of the deal, including a discussion of the Registration Rights Agreement and the Voting Agreements. Mr. McNierney then described MatlinPatterson's proposal to increase its investment in the Company. The Board then considered MatlinPatterson's proposal to (a) extend the exclusivity period from May 9 to May 14, 2007, and (b) increase the proposed capitalization to \$50 million. The Board resolved to authorize extension of the exclusivity period under the Letter of Intent to May 14, 2007, and decided to discuss the proposed increase in capitalization further. In that regard, the Board asked counsel to review whether an increase in ownership could impact any supermajority thresholds in the constituent documents of the Company, and asked Freeman to analyze the financial impact of an increase in the size of the proposed investment to \$50 million.

At a meeting of the Special Committee on May 11, 2007, Freeman provided its analysis of the proposed \$10 million additional capitalization. Freeman stated that the additional capitalization would provide MatlinPatterson with a voting interest of

- 24 -

---

## Table of Contents

59.9% on an undiluted basis and 58.4% on a fully-diluted basis. This compares with MatlinPatterson's voting interest of 54.4% undiluted and 52.9% fully diluted if the investment were limited to \$40 million. These percentages were calculated taking into account approximately 6.0 million restricted stock units to be issued to certain key employees in connection with the proposed investment, as was contemplated at the May 11, 2007 Special Committee meeting. The number of restricted stock units was later increased to 6.75 million. Please see the section entitled "Proposal No. 2 Approval of the Private Placement" above for a discussion of MatlinPatterson's undiluted and fully-diluted voting interest taking into account the additional 750,000 restricted stock units. Freeman's analysis also found that the additional \$10 million would increase the Company's pro forma tangible book value per share. The Special Committee discussed MatlinPatterson's intention to earmark the additional \$10 million investment for FA Technology Ventures Corporation ( "FATV" ), the Company's investment fund manager. Freeman reported that it strongly supported the increased investment by MatlinPatterson, noting that it would increase tangible book value per share and achieve a more favorable tangible book value to cash ratio. Mr. Coad further stated that the additional \$10 million would benefit the Company from an operational perspective. Freeman also reported that it would be very comfortable that the price at which the increased investment would be made (\$1.50 per share) would be fair to the Company from a financial perspective.

At that meeting, the Special Committee questioned management regarding the likelihood that a potential pricing adjustment in the Investment Agreement may be triggered if the net tangible book value targets are not met as of the closing date. Management provided an analysis, based on past results and current management projections, to support their belief that the pricing adjustment trigger was not expected to be met.

At a meeting of the Board and the Special Committee on May 13, 2007, management presented an analysis on the MatlinPatterson transaction from legal, operational, and financial perspectives. Representatives of Dewey Ballantine LLP reviewed in detail the terms of the proposed Investment Agreement, form of Registration Rights Agreement and Voting Agreements. The Board discussed various contingencies with respect to the closing of the transaction, including the need for additional non-compete and non-solicit agreements to be secured from key employees, the risk of a potential price adjustment in the event the net tangible book value target were not met, and the ability of competing bidders to initiate a potential alternative transaction.

Freeman then provided a financial analysis of the transaction and its valuation of the Company. Freeman described the Company's current financial status, including fifteen consecutive quarterly operating losses leading to a reduced tangible book value and stock price, and a negative impact on employee retention. Freeman described the process by which the Company had undertaken an attempt to find potential buyers or strategic investors, as described above, concluding with its belief that there were no other bidders besides MatlinPatterson. Freeman further stated its belief that a price adjustment based on the net tangible book value trigger was unlikely. Freeman further concluded that the consideration to be paid by MatlinPatterson in the Private Placement was fair, from a financial point of view, to the Company and described the procedures and basis for that opinion.

Management discussed the operational and financial impacts of the transaction, and recommended approval of the transaction. The Special Committee also reviewed the numerous meetings and substantial process undertaken by the Special Committee in its evaluation of the transaction, confirmed the independence of its members and the process undertaken, and offered its unanimous recommendation that the Board approve the transaction. Following discussion of the fairness opinion and the terms of the various agreements, the Board unanimously approved the Private Placement and authorized the officers to enter into the Investment Agreement and related documents substantially as presented at the meeting.

On May 14, 2007, the Company entered into the Investment Agreement with MatlinPatterson described below and attached hereto as **Appendix A** providing for the issuance and sale of Purchased Shares for gross proceeds of \$50 million. Please see the section "Investment Agreement" below for information on the Investment Agreement.

### **Reasons for the Private Placement**

We believe that we need additional capital to more effectively pursue our strategic objectives. After considering numerous potential financing and strategic alternatives, including alternate financing structures, seeking to sell the Company, seeking a merger of the Company with another entity, and the liquidation of the Company, the Board determined that the Private Placement was the best available alternative and would provide the greatest potential value

for the shareholders, as well as provide the necessary capital to pursue our long-term strategic goals.

In making its determination to approve the Private Placement, the Board formed an independent Special Committee to assist management in evaluating various aspects of the transaction, and to make recommendations to the Board regarding any issues requiring Board consideration with respect to the transaction. As part of that process, the Board and the Special Committee consulted with our officers with respect to strategic and operational matters. The Board and the Special Committee also consulted with Freeman regarding financial matters and Dewey Ballantine LLP and Bingham McCutchen LLP regarding legal matters, including the Investment Agreement and related documents. The determination was the result of careful consideration by the Board and the Special Committee of a number of factors, including the following positive factors:

- 25 -

---

**Table of Contents**

The Private Placement will provide significant additional funding, which is important because the continued operation of our business is costly and capital intensive and our current capital resources are limited.

If the Private Placement is not completed, we may be forced to preserve our cash position through a combination of additional cost reduction measures and sales of assets at values that may be significantly below their potential worth or augment our cash through additional dilutive financings, and there can be no assurance that we could obtain funds on terms that are as favorable to us as the terms of the Private Placement.

The Company will have reduced cash compensation expenses by reducing the amount of cash bonuses compared to past practices in light of the issuance of restricted stock units to key employees and is expected to have savings resulting from reductions in back office personnel and related costs. Immediately following the closing of the Private Placement, the Company will have no long-term debt and approximately \$38 million of cash on the balance sheet.

The current market process has led to no other investors and/or acquirers after the initial due diligence process. Please see a more detailed description of the current market process in the sections entitled *Background of the Private Placement* on page 22 and *Opinion of Our Independent Financial Advisor* on page 27.

Our prior market check process only led to verbal indications of interest for transactions that we believe are less favorable to our shareholders than the Private Placement and the Board believes that, with the severe risks of further key employee turnover combined with the absence of any written or formal current offers at this previous market check level, the MatlinPatterson deal is financially attractive. Please see a more detailed description of the previous market check in the sections entitled *Background of the Private Placement* on page 22 and *Opinion of Our Independent Financial Advisor* on page 27.

The Private Placement will strengthen our financial condition and reduce our financial risk, which the Board believes will:

- reassure our employees of our continued viability and long-term prospects as a place to work;

- improve our ability to raise additional funding through debt or equity financings on favorable terms; and

- make our common stock more attractive to prospective investors for purchase on the open market and for use as an acquisition currency.

The Board believes the 2007 Plan will further and promote the interests of the Company and its shareholders by enabling the Company and its subsidiaries to attract, retain and motivate employees and officers or those who will become employees or officers of the Company, to link compensation to measures of the Company's performance in order to provide additional incentives and to align the interests of those individuals and the Company's shareholders.

The Board believes the Private Placement will strengthen our investor base with the addition of a new experienced investor who will have a significant stake in our long-term success and will be motivated to provide the support and assistance to protect and enhance its investment.

We believe we will strengthen our Board with the addition of new directors who have significant experience in advising comparable companies.

The Private Placement will assist us in our efforts to maintain our listing on the NASDAQ Global Market by augmenting our shareholders' equity.

The securities issued in the Private Placement will be shares of common stock rather than debt or preferred stock, which will place the new investors at the same rank as the existing shareholders and allow us to maintain a less complicated capital structure.

We received the opinion of Freeman that the consideration to be received by us in the Private Placement is fair to us from a financial point of view. Please see the section entitled *Opinion of Our Independent Financial Advisor* on page 27 for further information.

- 26 -

---



## **Table of Contents**

In contrast to a sale of the Company, the Private Placement will permit the existing shareholders to continue to own shares of our common stock thereby giving them the opportunity to share in any increase in value that we are able to create following the infusion of new capital.

In its review of the Private Placement, the Board also considered a number of potentially negative factors, including the following factors:

the risks and uncertainties of our ability to execute our strategic plan and to enhance shareholder value;

the Private Placement will have a highly dilutive effect on our current shareholders and option holders;

the interests of MatlinPatterson as a controlling shareholder may conflict with your interests. MatlinPatterson will control approximately >In providing financing to us, a lender may impose restrictions on us that would affect our ability to incur additional debt, make certain investments, reduce liquidity below certain levels, make distributions to our stockholders and otherwise affect our distribution and operating policies. In general, we expect that our loan agreements will restrict our ability to encumber or otherwise transfer our interest in the respective property without the prior consent of the lender. Such loan documents may contain other negative covenants that may limit our ability to discontinue insurance coverage, replace our Advisor or impose other limitations. Any such restriction or limitation may limit our ability to make distributions to you. Further, such restrictions could make it difficult for us to satisfy the requirements necessary to qualify as a REIT.

### **We may engage in hedging transactions, which can limit our gains and increase exposure to losses.**

Subject to qualifying as a REIT, we may enter into hedging transactions to protect us from the effects of interest rate fluctuations on floating rate debt. Our hedging transactions may include entering into interest rate swap agreements or interest rate cap or floor agreements, or other interest rate exchange contracts. Hedging activities may not have the desired beneficial impact on our results of operations or financial condition. No hedging activity can completely insulate us from the risks associated with changes in interest rates. Moreover, interest rate hedging could fail to protect us or adversely affect us because, among other things:

- available interest rate hedging may not correspond directly with the interest rate risk for which we seek protection;
- the duration of the hedge may not match the duration of the related liability;
- the party owing money in the hedging transaction may default on its obligation to pay;
- the credit quality of the party owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the value of derivatives used for hedging may be adjusted from time to time in accordance with accounting rules to reflect changes in fair value, such downward adjustments, or mark-to-market losses, which would reduce our stockholders' equity.

Hedging involves risk and typically involves costs, including transaction costs, that may reduce our overall returns on our investments. These costs increase as the period covered by the hedging increases and during periods of rising and volatile interest rates. These costs will also limit the amount of cash available for distribution to stockholders. We

generally intend to hedge as much of the interest rate risk as our Advisor determines is in our best interests given the cost of such hedging transactions. The REIT tax rules may limit our ability to enter into hedging transactions by requiring us to limit our income from non-qualifying hedges. If we are unable to hedge effectively because of the REIT tax rules, we will face greater interest rate exposure than may be commercially prudent.

**Economic conditions may adversely affect the real estate market and our income.**

Continued concerns regarding the uncertainty over whether the U.S. economy will be adversely affected by inflation, deflation or stagflation, and the systemic impact of increased unemployment and underemployment, volatile energy costs, geopolitical issues, the availability and cost of credit, the mortgage market in the United States and a distressed real estate market have contributed to increased market volatility and weakened business and consumer confidence. This difficult operating environment could adversely affect our ability to generate revenues, thereby reducing our operating income and earnings.

In addition, local real estate conditions such as an oversupply of properties or a reduction in demand for properties, competition from other similar properties, our ability to provide or arrange for adequate maintenance, insurance and management and advisory services, increased operating costs (including real estate taxes), the attractiveness and location of

## **Table of Contents**

the property and changes in market rental rates may adversely affect a property's income and value. A rise in energy costs could result in higher operating costs, which may affect our results of operations. In addition, local conditions in the markets in which we own or intend to own properties may significantly affect occupancy or rental rates at such properties. Events that could prevent us from raising or maintaining rents or cause us to reduce rents include layoffs, plant closings, relocations of significant local employers and other events reducing local employment rates, an oversupply of or a lack of demand for office space, a decline in household formation and the inability or unwillingness of tenants to pay rent increases.

**We may incur significant costs complying with various federal, state and local laws, regulations and covenants that are applicable to our properties, which could have an adverse impact on our financial conditions, results of operations, cash flows and market price of our common stock.**

The properties in our initial portfolio are subject to various covenants and federal, state and local laws and regulatory requirements, including permitting and licensing requirements. Local regulations, including municipal or local ordinances, zoning restrictions and restrictive covenants imposed by community developers may restrict our use of our properties and may require us to obtain approval or waivers from local officials or restrict our use of our properties and may require us to obtain approval from local officials of community standards organizations at any time with respect to our properties, including prior to acquiring a property or when undertaking renovations of any of our existing properties. Among other things, these restrictions may relate to fire and safety, seismic or hazardous material abatement requirements. There can be no assurance that existing laws and regulatory policies will not adversely affect us or the timing or cost of any future acquisitions or renovations, or that additional regulations will not be adopted that could increase such delays or result in additional costs. Our growth strategy may be affected by our ability to obtain permits, licenses and zoning relief. Our failure to obtain such permits, licenses and zoning relief or to comply with applicable laws could have an adverse effect on our financial condition, results of operations, cash flow and per share market price of our common stock.

**We could incur significant costs related to government regulation and private litigation over environmental matters involving the presence, discharge or threat of discharge of hazardous or toxic substances, which could adversely affect our operations, the value of our properties, and our ability to make distributions to our stockholders.**

Our properties may be subject to environmental liabilities. Under various federal, state and local laws, a current or previous owner, operator or tenant of real estate can face liability for environmental contamination created by the presence, discharge or threat of discharge of hazardous or toxic substances. Liabilities can include the cost to investigate, clean up and monitor the actual or threatened contamination and damages caused by the contamination or threatened contamination.

The liability under such laws may be strict, joint and several, meaning that we may be liable regardless of whether we knew of, or were responsible for, the presence of the contaminants, and the government entity or private party may seek recovery of the entire amount from us even if there are other responsible parties. Liabilities associated with environmental conditions may be significant and can sometimes exceed the value of the affected property. The presence of hazardous substances on a property may adversely affect our ability to sell or rent that property or to borrow using that property as collateral.

Environmental laws also:

- may require the removal or upgrade of underground storage tanks;
- regulate the discharge of storm water, wastewater and other pollutants;
- regulate air pollutant emissions;
- regulate hazardous materials generation, management and disposal; and
- regulate workplace health and safety.

**Existing conditions at some of our properties may expose us to liability related to environmental matters.**

Independent environmental consultants have conducted Phase I or similar environmental site assessments on all of our initial properties. Site assessments are intended to discover and evaluate information regarding the environmental

## **Table of Contents**

condition of the surveyed property and surrounding properties. These assessments do not generally include subsurface investigations or mold or asbestos surveys. None of the recent site assessments revealed any past or present environmental liability that we believe would have a material adverse effect on our business, financial condition, cash flows or results of operations. However, the assessments may have failed to reveal all environmental conditions, liabilities or compliance concerns. Material environmental conditions, liabilities or compliance concerns may have arisen after the review was completed or may arise in the future; and future laws, ordinances or regulations may impose material additional environmental liability.

Costs of future environmental compliance could negatively affect our ability to make distributions to our stockholders, and remedial measures required to address such conditions could have a material adverse effect on our business, financial condition, cash flows or results of operations.

### **Our properties may contain asbestos or develop harmful mold, which could lead to liability for adverse health effects and costs of remediating the problem, which could adversely affect the value of the affected property and our ability to make distributions to our stockholders.**

We are required by federal regulations with respect to our properties to identify and warn, via signs and labels, of potential hazards posed by workplace exposure to installed asbestos-containing materials (ACMs) and potential ACMs. We may be subject to an increased risk of personal injury lawsuits by workers and others exposed to ACMs and potential ACMs at our properties as a result of these regulations. The regulations may affect the value of any of our properties containing ACMs and potential ACMs. Federal, state and local laws and regulations also govern the removal, encapsulation, disturbance, handling and/or disposal of ACMs and potential ACMs when such materials are in poor condition or in the event of construction, remodeling, renovation or demolition of a property.

When excessive moisture accumulates in buildings or on building materials, mold growth may occur, particularly if the moisture problem remains undiscovered or is not addressed over a period of time. Some molds may produce airborne toxins or irritants. Concern about indoor exposure to mold has been increasing because exposure to mold may cause a variety of adverse health effects and symptoms, including allergic or other reactions.

The presence of ACMs or significant mold at any of our properties could require us to undertake a costly remediation program to contain or remove the ACMs or mold from the affected property. In addition, the presence of ACMs or significant mold could expose us to claims of liability to our tenants, their or our employees, and others if property damage or health concerns arise.

### **Potential losses, including from adverse weather conditions, natural disasters and title claims, may not be covered by insurance.**

Certain of our initial properties are located in Florida, Idaho and Oregon, where natural disasters such as hurricanes and earthquakes are more common than in other states. Given recent extreme weather events across other parts of the United States, it is also possible that our other properties could incur significant damage due to other natural disasters. While we carry insurance to cover a substantial portion of the cost of such events, our insurance includes deductible amounts and certain items may not be covered by insurance. Future natural disasters may significantly affect our operations and properties and, more specifically, may cause us to experience reduced rental revenue (including from increased vacancy), incur clean-up costs or otherwise incur costs in connection with such events. Any of these events may have a material adverse effect on our business, cash flows, financial condition, results of operations and ability to make distributions to our stockholders.

Furthermore, we do not carry insurance for certain losses, including, but not limited to, losses caused by certain environmental conditions, such as mold or asbestos, riots or war. In addition, our title insurance policies may not insure for the current aggregate market value of our portfolio, and we do not intend to increase our title insurance coverage as the market value of our portfolio increases. As a result, we may not have sufficient coverage against all losses that we may experience, including from adverse title claims.

If we experience a loss that is uninsured or exceeds policy limits, we could incur significant costs and lose the capital invested in the damaged properties as well as the anticipated future cash flows from those properties. In addition, if the damaged properties are subject to recourse indebtedness, we would continue to be liable for the indebtedness, even if these properties were irreparably damaged.

## **Table of Contents**

Moreover, we carry several different lines of insurance, placed with several large insurance carriers. If any one of these large insurance carriers were to become insolvent, we would be forced to replace the existing insurance coverage with another suitable carrier and any outstanding claims would be at risk for collection. In such an event, we cannot be certain that we would be able to replace the coverage at similar or otherwise favorable terms. Replacing insurance coverage at unfavorable rates and the potential of uncollectible claims due to carrier insolvency could adversely affect our results of operations and cash flows.

### **We have no operating history and no employees and may not be able to successfully operate our business or generate sufficient cash flow to make or sustain distributions to our stockholders.**

We are newly formed and have no operating history or employees. We are dependent on our Advisor to manage the business risks and uncertainties associated with any new business, including the risk that we will not achieve our investment objectives as described in this prospectus and that the value of your investment could decline substantially. We may not be able to generate sufficient cash flow over time to pay our operating expenses and make or sustain distributions to our stockholders.

### **We may be limited in our ability to diversify our investments making us more vulnerable economically than if our investments were diversified.**

Our ability to diversify our portfolio may be limited both as to the number of investments owned and the geographic regions in which our investments are located. While we will seek to diversify our portfolio by geographic location, we expect to focus on our specified target markets that we believe offer the opportunity for attractive returns and, accordingly, our actual investments may result in concentrations in a limited number of geographic regions. As a result, there is an increased likelihood that the performance of any single property, or the economic performance of a particular region in which our properties are located, could materially affect our operating results.

### **We may acquire properties with lock-out provisions, or agree to such provisions in connection with obtaining financing, which may prohibit us from selling or refinancing a property during the lock-out period.**

We may acquire properties in exchange for common units and agree to restrictions on sales or refinancing, called lock-out provisions, which are intended to preserve favorable tax treatment for the owners of such properties who sell them to us. In addition, we may agree to lock-out provisions in connection with obtaining financing for the acquisition of properties. Lock-out provisions could materially restrict us from selling, otherwise disposing of or refinancing properties. These restrictions could affect our ability to turn our investments into cash and thus affect cash available for distributions to our stockholders. Lock-out provisions could impair our ability to take actions during the lock-out period that would otherwise be in the best interests of our stockholders and, therefore, could adversely impact the market value of our common stock. In particular, lock-out provisions could preclude us from participating in major transactions that could result in a disposition of our assets or a change in control even though that disposition or change in control might be in the best interests of our stockholders.

### **Illiquidity of real estate investments could significantly impede our ability to respond to adverse changes in the performance of our properties and harm our financial condition.**

The real estate investments made, and to be made, by us are relatively difficult to sell quickly. As a result, our ability to promptly sell one or more properties in our initial portfolio in response to changing economic, financial and investment conditions is limited. Return of capital and realization of gains, if any, from an investment generally will occur upon disposition or refinancing of the underlying property. We may be unable to realize our investment objectives by sale, other disposition or refinancing at attractive prices within any given period of time or may

otherwise be unable to complete any exit strategy. In particular, our ability to dispose of one or more properties is subject to weakness in or even the lack of an established market for a property, changes in the financial condition or prospects of prospective purchasers, changes in national or international economic conditions, such as the recent economic downturn, and changes in laws, regulations or fiscal policies of jurisdictions in which the property is located. Furthermore, our ability to dispose of our initial properties within the four years immediately following the completion of the formation transactions is subject to certain limitations imposed by our tax protection agreements.



## **Table of Contents**

In addition, the Code imposes restrictions on a REIT's ability to dispose of properties that are not applicable to other types of real estate companies. In particular, the tax laws applicable to REITs effectively require that we hold our properties for investment, rather than primarily for sale in the ordinary course of business, which may cause us to forego or defer sales of properties that otherwise would be in our best interest. Therefore, we may not be able to adjust our initial portfolio in response to economic or other conditions promptly or on favorable terms, which may adversely affect our financial condition, results of operations, cash flow and per share market price of our common stock.

### **If we sell properties by providing financing to purchasers, we will bear the risk of default by the purchaser.**

If we decide to sell any of our properties, we intend to use commercially reasonable efforts to sell them for cash. However, in some instances we may sell our properties by providing financing to purchasers. If we provide financing to purchasers, we will bear the risk of default by the purchaser which would reduce the value of our assets, impair our ability to make distributions to our stockholders and reduce the price of our common stock.

### **We may be unable to collect balances due on our leases from any tenants in bankruptcy, which could adversely affect our cash flow and the amount of cash available for distribution to our stockholders.**

The bankruptcy or insolvency of one or more of our tenants may adversely affect the income produced by our properties. We cannot assure you that any tenant that files for bankruptcy protection will continue to pay us rent. If a tenant files for bankruptcy, any or all of the tenant's or a guarantor of a tenant's lease obligations could be subject to a bankruptcy proceeding pursuant to Chapter 11 or Chapter 7 of the U.S. Bankruptcy Code. Such a bankruptcy filing would bar all efforts by us to collect pre-bankruptcy rents from these entities or their properties, unless we receive an order from the bankruptcy court permitting us to do so. A tenant or lease guarantor bankruptcy could delay our efforts to collect past due balances under the relevant leases and could ultimately preclude collection of these sums. If a lease is rejected by a tenant in bankruptcy, we would only have a general unsecured claim for damages. This claim could be paid only in the event funds were available and then only in the same percentage as that realized on other unsecured claims. Our claim would be capped at the rent reserved under the lease, without acceleration, for the greater of one year or 15% of the remaining term of the lease, but not greater than three years, plus rent already due but unpaid. Therefore, if a lease is rejected, it is unlikely we would receive any payments from the tenant or we would receive substantially less than the full value of any unsecured claims we hold, which would result in a reduction in our rental income, cash flow and the amount of cash available for distribution to our stockholders.

### **We may face additional risks and costs associated with owning properties occupied by government tenants, which could negatively impact our cash flows and results of operations.**

Upon completion of the formation transactions, we will own six properties in which some or all of the tenants are federal government agencies. We intend to pursue the acquisition of office properties in which substantial space is leased to governmental agencies. As such, lease agreements with these federal government agencies contain certain provisions required by federal law, which require, among other things, that the contractor (which is the lessor or the owner of the property), agree to comply with certain rules and regulations, including but not limited to, rules and regulations related to anti-kickback procedures, examination of records, audits and records, equal opportunity provisions, prohibition against segregated facilities, certain executive orders, subcontractor cost or pricing data, certain provisions intending to assist small businesses and contractual rights of termination by the tenants. We may be subject to requirements of the Employment Standards Administration's Office of Federal Contract Compliance Programs and requirements to prepare affirmative action plans pursuant to the applicable executive order may be determined to be applicable to us.

In addition, some of our leases with government tenants may be subject to statutory or contractual rights of termination by the tenants, which will allow them to vacate the leased premises before the stated terms of the leases expire with little or no liability. For fiscal policy reasons, security concerns or other reasons, some or all of our government tenants may decide to vacate our properties. If a significant number of such vacancies occur, our rental income may materially decline, our cash flow and results of operations could be adversely affected and our ability to pay regular distributions to you may be jeopardized.

## **Table of Contents**

**Some of the leases at our properties contain early termination provisions which, if triggered, may allow tenants to terminate their leases without further payment to us, which could adversely affect our financial condition and results of operations and/or the value of the applicable property.**

Certain tenants have a right to terminate their leases upon payment of a penalty but others are not required to pay any penalty associated with an early termination. Most of our tenants that are federal or state governmental agencies, which account for approximately 33.2% of the base rental revenue from our initial properties as of December 31, 2013, may, under certain circumstances, vacate the leased premises before the stated terms of the leases expire with little or no liability to us. There can be no assurance that tenants will continue their activities and continue occupancy of the premises. Any cessation of occupancy by tenants may have an adverse effect on our operations.

**The federal government's green lease policies may adversely affect us.**

In recent years the federal government has instituted green lease policies which allow a government tenant to require leadership in energy and environmental design for commercial interiors, or LEED®-CI, certification in selecting new premises or renewing leases at existing premises. In addition, the Energy Independence and Security Act of 2007 allows the General Services Administration to prefer buildings for lease that have received an Energy Star label. Obtaining such certifications and labels may be costly and time consuming, but our failure to do so may result in our competitive disadvantage in acquiring new or retaining existing government tenants.

**We may be unable to complete acquisitions and, even if acquisitions are completed, we may fail to successfully operate acquired properties.**

Our business plan includes, among other things, growth through identifying suitable acquisition opportunities, consummating acquisitions and leasing such properties. We will evaluate the market of available properties and may acquire properties when we believe strategic opportunities exist. Our ability to acquire properties on favorable terms and successfully develop or operate them is subject to the following risks:

- we may be unable to acquire a desired property because of competition from other real estate investors with substantial capital, including from other REITs and institutional investment funds;
- even if we are able to acquire a desired property, competition from other potential acquirers may significantly increase the purchase price;
- even if we enter into agreements for the acquisition of properties, these agreements are subject to customary conditions to closing, including completion of due diligence investigations to our satisfaction;
- we may incur significant costs in connection with evaluation and negotiation of potential acquisitions, including acquisitions that we are subsequently unable to complete;
- we may acquire properties that are not initially accretive to our results upon acquisition, and we may not successfully lease those properties to meet our expectations;

- we may be unable to finance the acquisition on favorable terms in the time period we desire, or at all;
- even if we are able to finance the acquisition, our cash flows may be insufficient to meet our required principal and interest payments;
- we may spend more than budgeted to make necessary improvements or renovations to acquired properties;
- we may be unable to quickly and efficiently integrate new acquisitions, particularly the acquisition of portfolios of properties, into our existing operations;
- market conditions may result in higher than expected vacancy rates and lower than expected rental rates; and

## **Table of Contents**

- we may acquire properties subject to liabilities and without any recourse, or with only limited recourse, with respect to unknown liabilities for clean-up of undisclosed environmental contamination, claims by tenants or other persons dealing with former owners of the properties and claims for indemnification by general partners, directors, officers and others indemnified by the former owners of the properties.

### **Acquired properties may be located in new markets where we may face risks associated with investing in an unfamiliar market.**

We may acquire properties in markets that are new to us. When we acquire properties located in new markets, we may face risks associated with a lack of market knowledge or understanding of the local economy, forging new business relationships in the area and unfamiliarity with local government and permitting procedures. We work to mitigate such risks through extensive diligence and research and associations with experienced service providers. However, there can be no guarantee that all such risks will be eliminated.

### **Adverse market and economic conditions could cause us to recognize impairment charges or otherwise impact our performance.**

We intend to review the carrying value of our properties when circumstances, such as adverse market conditions (including conditions resulting from the recent economic downturn), indicate a potential impairment may exist. We intend to base our review on an estimate of the future cash flows (excluding interest charges) expected to result from the property's use and eventual disposition on an undiscounted basis. We intend to consider factors such as future operating income, trends and prospects, as well as the effects of leasing demand, competition and other factors. If our evaluation indicates that we may be unable to recover the carrying value of a real estate investment, an impairment loss will be recorded to the extent that the carrying value exceeds the estimated fair value of the property.

Impairment losses would have a direct impact on our operating results because recording an impairment loss results in an immediate negative adjustment to our operating results. The evaluation of anticipated cash flows is highly subjective and is based in part on assumptions regarding future occupancy, rental rates and capital requirements that could differ materially from actual results in future periods. If the real estate market deteriorates, we may reevaluate the assumptions used in our impairment analysis. Impairment charges could materially adversely affect our financial condition, results of operations, cash flows and ability to pay distributions on, and the per share market price of, our common stock.

### **Litigation may result in unfavorable outcomes.**

Like many real estate operators, we may be involved in lawsuits involving premises liability claims and alleged violations of landlord-tenant laws, which may give rise to class action litigation or governmental investigations. Any material litigation not covered by insurance, such as a class action, could result in us incurring substantial costs and harm our financial condition, results of operations, cash flows and ability to pay distributions to you.

### **We may invest in properties with other entities, and our lack of sole decision-making authority or reliance on a joint-venturer's financial condition could make these joint venture investments risky and expose us to losses or impact our ability to qualify or maintain our qualification as a REIT.**

We may co-invest in the future with third parties through partnerships, joint ventures or other entities. We may acquire noncontrolling interests or share responsibility for managing the affairs of a property, partnership, joint venture or other entity. In such events, we would not be in a position to exercise sole decision-making authority regarding the property or entity. Investments in entities may, under certain circumstances, involve risks not present were a third party not involved. These risks include the possibility that partners or joint-venturers:

- might become bankrupt or fail to fund their share of required capital contributions;
- may have economic or other business interests or goals that are inconsistent with our business interests or goals; and

## **Table of Contents**

- may be in a position to take actions contrary to our policies or objectives or exercise rights to buy or sell at an inopportune time for us.

Such investments may also have the potential risk of impasses on decisions, such as a sale or refinancing of the property, because neither we nor the partner or joint-venturer would have full control over the partnership or joint venture. Disputes between us and partners or joint-venturers may result in litigation or arbitration that would increase our expenses and prevent our officers and/or directors from focusing their time and effort on our business or result in costs to terminate the relationship. Actions of partners or joint-venturers may cause losses to our investments and adversely affect our ability to qualify as a REIT. In addition, we may in certain circumstances be liable for the actions of our third-party partners or joint-venturers if:

- we structure a joint venture or conduct business in a manner that is deemed to be a general partnership with a third party;
- third-party managers incur debt or other liabilities on behalf of a joint venture which the joint venture is unable to pay, and the joint venture agreement provides for capital calls, in which case we could be liable to make contributions as set forth in any such joint venture agreement or suffer adverse consequences for a failure to contribute; or
- we agree to cross default provisions or to cross-collateralize our properties with the properties in a joint venture, in which case we could face liability if there is a default relating to those properties in the joint venture or the obligations relating to those properties.

### **Compliance with the Americans with Disabilities Act and similar laws may require us to make significant unanticipated expenditures.**

All of our initial properties and any future properties that we acquire are and will be required to comply with the ADA. The ADA requires that all public accommodations must meet federal requirements related to access and use by disabled persons. For those projects receiving federal funds, the Rehabilitation Act of 1973 (the RA ) also has requirements regarding disabled access. Although we believe that our initial properties are substantially in compliance with the present requirements, we may incur unanticipated expenses to comply with the ADA, the RA and other applicable legislation in connection with the ongoing operation or redevelopment of our properties. These and other federal, state and local laws may require modifications to our properties, or affect renovations of our properties. Non-compliance with these laws could result in the imposition of fines or an award of damages to private litigants and also could result in an order to correct any non-complying feature, which could result in substantial capital expenditures.

### **Our property taxes could increase due to property tax rate changes or reassessment, which may adversely impact our cash flows.**

Even if we qualify as a REIT, we will be required to pay some state and local taxes on our properties. The real property taxes on our properties may increase as property tax rates change or as our properties are assessed or reassessed by taxing authorities. Therefore, the amount of property taxes that we pay in the future may increase substantially. In addition, the real property taxes on Cherry Creek are reduced due to having a government user as its largest tenant and loss of such tenant would increase the amount of property taxes. If the property taxes that we pay increase, our cash flow could be impacted, and our ability to pay expected distributions to our stockholders may be

adversely affected.

**It may be difficult to enforce civil liabilities against members of our board of directors, our officers or officers of our Advisor.**

Some of the members of our board of directors, our officers and the principals of our Advisor reside in Canada, our Advisor is incorporated in British Columbia, Canada and substantially all of the assets of such persons are located in Canada. As a result, it may be difficult for you to effect service of process within the United States or in any other jurisdiction outside of Canada upon these persons or to enforce against them in any jurisdiction outside of Canada judgments predicated upon the laws of any such jurisdiction, including any judgment predicated upon the federal and state securities laws of the United States.



---

**Table of Contents**

**Risks Related to Our Status As a REIT**

**Our failure to qualify as a REIT would result in significant adverse tax consequences to us and would adversely affect our business and the value of our stock.**

We intend to operate in a manner that will allow us to qualify as a REIT. Qualification as a REIT involves the application of highly technical and complex tax rules, for which there are only limited judicial and administrative interpretations. The fact that we hold substantially all of our assets through a partnership further complicates the application of the REIT requirements. Even a seemingly minor technical or inadvertent mistake could jeopardize our REIT status. Our REIT status depends upon various factual matters and circumstances that may not be entirely within our control. For example, in order to qualify as a REIT, at least 95% of our gross income in any year must be derived from qualifying sources, such as rents from real property, and we must satisfy a number of requirements regarding the composition of our assets. Also, we must make distributions to stockholders aggregating annually at least 90% of our REIT taxable income, excluding net capital gains. In addition, new legislation, regulations, administrative interpretations or court decisions, each of which could have retroactive effect, may make it more difficult or impossible for us to qualify as a REIT, or could reduce the desirability of an investment in a REIT relative to other investments. We have not requested and do not plan to request a ruling from the Internal Revenue Service (the "IRS") that we qualify as a REIT, and the statements in this prospectus are not binding on the IRS or any court. Accordingly, we cannot be certain that we will be successful in qualifying as a REIT.

If we fail to qualify as a REIT in any taxable year, we will face serious adverse U.S. federal income tax consequences that would substantially reduce the funds available to distribute to you. If we fail to qualify as a REIT:

- we would not be allowed to deduct distributions to stockholders in computing our taxable income and would be subject to U.S. federal income tax at regular corporate rates;
- we could also be subject to the U.S. federal alternative minimum tax and possibly increased state and local taxes; and
- unless we are entitled to relief under applicable statutory provisions, we could not elect to be taxed as a REIT for four taxable years following the year in which we were disqualified.

In addition, if we fail to qualify as a REIT, we will not be required to make distributions to stockholders. As a result of all these factors, our failure to qualify as a REIT could impair our ability to expand our business and raise capital and would adversely affect the value of our common stock.

Even if we qualify as a REIT, we may be subject to some U.S. federal, state and local income, property and excise taxes on our income or property and, in certain cases, a 100% penalty tax, in the event we sell property as a dealer. In addition, any taxable REIT subsidiary will be subject to tax as a regular corporation in the jurisdictions in which it operates.

**To qualify as a REIT, we may be forced to borrow funds during unfavorable market conditions to make distributions to our stockholders.**

To qualify as a REIT, we generally must distribute to our stockholders at least 90% of our REIT taxable income each year, excluding any net capital gain, and we will be subject to regular corporate income taxes to the extent that we distribute less than 100% of our REIT taxable income each year. In addition, we will be subject to a 4% nondeductible excise tax on the amount, if any, by which distributions paid by us in any calendar year are less than the sum of 85% of our ordinary income, 95% of our capital gain net income and 100% of our undistributed income from prior years. To qualify as a REIT and avoid the payment of income and excise taxes, we may need to borrow funds to meet the REIT distribution requirements. These borrowing needs could result from:

- differences in timing between the actual receipt of cash and inclusion of income for U.S. federal income tax purposes,
- the effect of nondeductible capital expenditures,

## **Table of Contents**

- the creation of reserves, or
- required debt or amortization payments.

We may need to borrow funds at times when the then-prevailing market conditions are not favorable for borrowing. These borrowings could increase our costs or reduce our equity and adversely affect the value of our common stock.

### **If our operating partnership failed to qualify as a partnership for U.S. federal income tax purposes, we would cease to qualify as a REIT and suffer other adverse consequences.**

We believe that our operating partnership will be treated as a partnership for U.S. federal income tax purposes. As a partnership, our operating partnership will not be subject to U.S. federal income tax on its income. Instead, each of its partners, including us, will be required to pay tax on its allocable share of the operating partnership's income. We cannot assure you, however, that the IRS will not challenge the status of the operating partnership or any other subsidiary partnership in which we own an interest as a partnership for U.S. federal income tax purposes, or that a court would not sustain such a challenge. If the IRS were successful in treating our operating partnership or any such other subsidiary partnership as an entity taxable as a corporation for U.S. federal income tax purposes, we would fail to meet the gross income tests and certain of the asset tests applicable to REITs and, accordingly, we would likely cease to qualify as a REIT. Also, the failure of our operating partnership or any subsidiary partnerships to qualify as a partnership could cause it to become subject to U.S. federal and state corporate income tax, which would reduce significantly the amount of cash available for debt service and for distribution to its partners, including us.

### **Dividends payable by REITs do not qualify for the reduced tax rates available for some dividends.**

The maximum income tax rate applicable to qualified dividends payable to non-corporate U.S. stockholders, including individuals, trusts and estates, is 20%. Dividends payable by REITs, however, generally are not eligible for the reduced rate. Although these rules do not adversely affect the taxation of REITs or dividends payable by REITs, the more favorable rates applicable to regular corporate qualified dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the shares of REITs, including the market price of our common stock.

### **The tax imposed on REITs engaging in prohibited transactions may limit our ability to engage in transactions which would be treated as sales for U.S. federal income tax purposes.**

A REIT's net income from prohibited transactions is subject to a 100% penalty tax. In general, prohibited transactions are sales or other dispositions of property, other than foreclosure property held in inventory primarily for sale to customers in the ordinary course of business. Although we do not intend to hold any properties that would be characterized as inventory held for sale to customers in the ordinary course of our business, such characterization is a factual determination and no guarantee can be given that the IRS would agree with our characterization of our properties or that we will always be able to make use of the available safe-harbors.

### **To qualify as a REIT, we may be forced to forego otherwise attractive opportunities.**

To qualify as a REIT, we must satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts that we distribute to our stockholders and the ownership of our stock. We may be required to make distributions to stockholders at times when it would be more advantageous to reinvest cash in our business or when we do not have funds readily available for distribution. Thus, compliance with the REIT

requirements may hinder our ability to operate solely on the basis of maximizing profits.

In particular, we must ensure that at the end of each calendar quarter, at least 75% of the value of our assets consists of cash, cash items, government securities and qualified real estate assets. The remainder of our investment in securities (other than government securities, securities of any qualified REIT subsidiary of ours and securities that are qualified real estate assets) generally may not include more than 10% of the outstanding voting securities of any one issuer or

## **Table of Contents**

more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our assets (other than government securities, securities of any qualified REIT subsidiary of ours and securities that are qualified real estate assets) may consist of the securities of any one issuer. If we fail to comply with these requirements at the end of any calendar quarter, we must remedy the failure within 30 days or qualify for certain limited statutory relief provisions to avoid losing status as a REIT. As a result, we may be required to liquidate otherwise attractive investments. These actions could have the effect of reducing our income and amounts available for distribution to our stockholders.

### **We may be subject to adverse legislative or regulatory tax changes that could increase our tax liability, reduce our operating flexibility and reduce the market price of our common shares.**

At any time, the U.S. federal income tax laws governing REITs may be amended or the administrative and judicial interpretations of those laws may be changed. We cannot predict when or if any new U.S. federal income tax law, regulation, or administrative and judicial interpretation, or any amendment to any existing U.S. federal income tax law, regulation or administrative or judicial interpretation, will be adopted, promulgated or become effective, and any such law, regulation, or interpretation may be effective retroactively. We and our stockholders could be adversely affected by any such change in, or any new, U.S. federal income tax law, regulation or administrative and judicial interpretation.

### **Risks Associated With Our Advisor and the Advisory Agreement**

#### **Our Advisor and certain of its affiliates may have interests that diverge from the interests of our common stockholders.**

We are subject to conflicts of interest arising out of our relationship with our Advisor and its affiliates. Our Advisor and its affiliates, including the executive officers and employees of our Advisor on whom we rely, could make substantial profits as a result of pursuing transactions that may not be in our best interest, which could have a material adverse effect on our operations and your investment. Examples of these potential conflicts of interests include:

- competition for the time and services of personnel that work for us and our affiliates;
- compensation and fees payable by us to our Advisor, none of which were the result of arm's length negotiations and may not be on market terms and are payable, in some cases, whether or not our stockholders receive distributions;
- enforcement of the terms of contribution and other agreements relating to the contributions of direct and indirect interests in certain properties from affiliates of our Advisor;
- the possibility that our Advisor and its affiliates may make investment or disposition recommendations to us in order to increase their own compensation even though the investments or dispositions may not be in the best interests of our stockholders; and

- the possibility that we may acquire or merge with our Advisor, resulting in an internalization of our management functions.

**We will depend upon our Advisor to conduct our operations and, therefore, any adverse changes in the financial health of our Advisor or personnel, or our relationship with our Advisor, could hinder our operating performance and adversely affect the market price of our common stock.**

We have no employees. Personnel and services that we require are provided to us under contracts with our Advisor. We will depend on our Advisor to manage our operations and acquire and manage our portfolio of real estate assets. Our Advisor will make all decisions with respect to the management of our company, subject to the supervision of, and any guidelines established by, our board of directors. Our Advisor will depend upon the fees and other compensation that it will receive from us in connection with the management of our business and sale of our properties to conduct its operations. Any adverse changes in the financial condition of, or our relationship with, our Advisor could hinder its ability to successfully manage our operations and our portfolio of investments.

## **Table of Contents**

### **Our Advisor has no operating history and the prior performance of programs sponsored by or affiliated with Second City may not be an indication of our future results.**

Our Advisor was formed in July 2013 and has never acted as an advisor or external manager to a prior public company. Although the Second City Group has previously invested in office properties, you should not rely upon the past performance of other programs sponsored by or affiliated with the Second City Group to predict our future results. This is particularly true as none of the Second City Group's prior investment programs intended to qualify as a REIT. There can be no assurance that we will be able to find suitable investments or generate sufficient cash flows to pay our operating expenses and make distributions to our stockholders.

### **The nature of our Advisor's business, and our dependence on our Advisor, makes us subject to certain risks to which we would not ordinarily be subject based on our targeted investments.**

While the directors have oversight responsibility with respect to the services provided by our Advisor pursuant to the Advisory Agreement, the services provided by our Advisor under such agreements will not be performed by employees of our company or its subsidiaries, but by our Advisor directly. Personnel and services that we require are provided to us under contracts with our Advisor. As a result, our Advisor will have the ability to influence many matters affecting our company and the performance of its properties now and in the foreseeable future.

The Advisory Agreement has an initial four-year term and will automatically be renewed for additional one-year terms unless terminated by either us or our Advisor upon prior notice. Accordingly, there can be no assurance that our company will continue to have the benefit of our Advisor's Advisory Services, including its executive officers, or that our Advisor will continue to be our manager. If our Advisor should cease for whatever reason to provide Advisory Services or be our manager, the cost of obtaining substitute services may be greater than the fees that we pay to our Advisor under the Advisory Agreement, and this may adversely impact our ability to meet our objectives and execute our strategy which could materially and adversely affect our cash flows, results of operations and financial condition.

### **If our Advisor loses or is unable to retain or obtain key personnel, our ability to implement our investment strategies could be hindered, which could adversely affect our cash flow and our ability to make cash distributions to our stockholders.**

Our success depends to a significant degree upon the contributions of certain of the officers and other key personnel of our Advisor. We cannot guarantee that all, or any, will remain affiliated with our Advisor. If any of our key personnel were to cease their affiliation with our Advisor, our results of operations could suffer.

We believe our future success depends upon our Advisor's ability to hire and retain highly skilled managerial, operational and marketing personnel. Competition for such personnel is intense, and we cannot assure you that our Advisor will be successful in retaining and attracting such skilled personnel. If our Advisor loses or is unable to obtain the services of key personnel, our ability to implement our investment strategies could be delayed or hindered, and the market price of our common stock may be adversely affected.

### **Termination of the Advisory Agreement, even for poor performance, could be difficult and costly, including as a result of termination fees, and may cause us to be unable to execute our business plan.**

Termination of the Advisory Agreement without cause, even for poor performance, could be difficult and costly. Our agreement provides that we may terminate the Advisory Agreement only (i) for cause upon the affirmative vote of two-thirds of our independent directors or a majority of our outstanding common stock or (ii) a change of control of our Advisor upon the affirmative vote of our independent directors. If we terminate the agreement without cause or if

our Advisor terminates the agreement because of a material breach of the agreement by us or as a result of a change of control of our company, we must pay our Advisor a termination fee payable in cash, shares of our common stock or any combination thereof at the election of our Advisor. The termination fee, if any, will be equal to three times the amount of the acquisition and advisory fees earned by the Advisor for the 12 months preceding the termination. These provisions may substantially restrict our ability to terminate the Advisory Agreement without cause and would cause us to incur substantial costs in connection with such a termination. Furthermore, in the event that the Advisory Agreement is terminated and we are unable to identify a suitable replacement to manage us, our ability to execute our business plan could be adversely affected.



## **Table of Contents**

### **Our management structure and agreements and relationships with our Advisor may restrict our investment activities and may create conflicts of interest or the perception of such conflicts.**

Our Advisor is authorized to follow broad operating and investment guidelines and, therefore, has discretion in determining the types of properties that will be appropriate investments for us, as well as our individual operating and investment decisions. Our board of directors periodically reviews our operating and investment guidelines and our operating activities and investments, but it does not review or approve each decision made by our Advisor on our behalf. In addition, in conducting periodic reviews, our board of directors relies primarily on information provided to it by our Advisor.

### **The potential for conflicts of interest as a result of our management structure may provoke dissident stockholder activities that result in significant costs.**

In the past, in particular following periods of volatility in the overall market or declines in the market price of a company's securities, stockholder litigation, dissident stockholder director nominations and dissident stockholder proposals have often been instituted against companies alleging conflicts of interest in business dealings with affiliated and related persons and entities. Our relationships with our Advisor and its affiliates may precipitate such activities. These activities, if instituted against us, could result in substantial costs and a diversion of our management's attention.

## **Risks Related to This Offering**

### **There is currently no public market for our common stock. An active trading market for our common stock may not develop following this offering.**

There has not been any public market for our common stock prior to this offering. Our company, Second City and the underwriters have determined the initial public offering price of our common stock, considering such factors as our record of operations, our management, our estimated net income, our estimated funds from operations ( FFO ), our estimated cash available for distribution to you, our anticipated dividend yield, our growth prospects, the current market valuations, financial performance and dividend yields of publicly traded companies considered by us and the underwriters to be comparable to us and the current state of the commercial real estate industry and the economy as a whole. A publicly traded real estate investment trust will not necessarily trade at values determined solely by reference to the underlying value of its real estate assets. The price at which shares of our common stock trade after the completion of this offering may be lower than the price at which the underwriters sell them in this offering.

### **The market price and trading volume of our common stock may be volatile following this offering, and you could experience a loss if you sell your shares.**

Even if an active trading market develops for our common stock, the market price of our common stock may be volatile. In addition, the trading volume in our common stock may fluctuate and cause significant price variations to occur. If the market price of our common stock declines significantly, you may be unable to resell your shares at or above the public offering price. We cannot assure you that the market price of our common stock will not fluctuate or decline significantly in the future.

Some of the factors that could negatively affect our share price or result in fluctuations in the price or trading volume of our common stock include:

- actual or anticipated variations in our quarterly results of operations or distributions;
- changes in our FFO or earnings estimates;
- the extent of investor interest;
- publication of research reports about us or the real estate industry;
- increases in market interest rates that lead purchasers of our shares to demand a higher yield;
- changes in market valuations of similar companies;

**Table of Contents**

- strategic decisions by us or our competitors, such as acquisitions, divestments, spin-offs, joint ventures, strategic investments or changes in business strategy;
- the reputation of REITs generally and the reputation of REITs with portfolios similar to ours;
- the attractiveness of the securities of REITs in comparison to securities issued by other entities (including securities issued by other real estate companies);
- adverse market reaction to any additional debt that we incur or acquisitions that we make in the future;
- additions or departures of key management personnel;
- future issuances by us of our common stock;
- actions by institutional stockholders;
- speculation in the press or investment community;
- the realization of any of the other risk factors presented in this prospectus; and
- general market and economic conditions.

**Market interest rates may have an adverse effect on the market price of our securities.**

One of the factors that will influence the price of our common stock will be the dividend yield on our common stock (as a percentage of the price of the stock) relative to market interest rates. An increase in market interest rates may lead prospective purchasers of our common stock to expect a higher dividend yield, and higher interest rates would likely increase our borrowing costs and potentially decrease funds available for distribution. Thus, higher market interest rates could cause the market price of our common stock to fall.

**Broad market fluctuations could negatively impact the market price of our common stock.**

The stock market has recently experienced extreme price and volume fluctuations that have affected the market price of many companies in industries similar or related to ours and that have been unrelated to these companies' operating performance. These broad market fluctuations could reduce the market price of our common stock. Furthermore, our results of operations and prospects may be below the expectations of public market analysts and investors or may be lower than those of companies with comparable market capitalizations. Either of these factors could lead to a material decline in the market price of our common stock.

**The market price of our common stock could be adversely affected by our level of cash distributions.**

The market's perception of our growth potential and our current and potential future cash distributions, whether from operations, sales or refinancings, as well as the real estate market value of the underlying assets, may cause our common stock to trade at prices that differ from our net asset value per share. If we retain operating cash flow for investment purposes, working capital reserves or other purposes, these retained funds, while increasing the value of our underlying assets, may not correspondingly increase the market price of our common stock. Our failure to meet the market's expectations with regard to future earnings and cash distributions likely would adversely affect the market price of our common stock.

**The historical performance of the City Office Predecessor will not, and the pro forma financial statements included in this prospectus may not, be indicative of our future results or an investment in our common stock.**

We have presented in this prospectus under "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Prospectus Summary," "Summary Financial Data" and "Selected Financial Data" certain information relating to the summary consolidated pro forma financial data for our company and the historical performance of the City Office Predecessor and our initial properties. When considering this information, you should bear in mind that the combined

## **Table of Contents**

historical results of the City Office Predecessor and the properties that we will acquire in the formation transactions are not indicative of the future results that you should expect from us or any investment in our common stock. Furthermore, you should also not rely upon the pro forma financial statements included in this prospectus as being indicative of our future results.

**Future offerings of debt, which would be senior to our common stock upon liquidation, and/or preferred equity securities that may be senior to our common stock for purposes of dividend payments or upon liquidation, may adversely affect the market price of our common stock.**

In the future, we may attempt to increase our capital resources by making additional offerings of debt or preferred equity securities, including medium-term notes, senior or subordinated notes and preferred stock. Upon liquidation, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings will receive distributions of our available assets prior to the holders of our common stock. Our preferred stock, if issued, could have a preference on liquidating distributions or a preference on dividend payments that could limit our ability to pay a dividend or make another distribution to the holders of our common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, our stockholders bear the risk of our future offerings reducing the market price of our common stock and diluting their stock holdings in us.

**The requirements of being a public company may strain our resources and divert management's attention and our lack of public company operating experience may impact our business and stock price.**

As a public company, we will be subject to the reporting requirements of the Securities Exchange Act of 1934, as amended (the Exchange Act), the Sarbanes-Oxley Act (other than the auditor attestation requirement of Section 404 while we continue to qualify as an emerging growth company), the Dodd-Frank Wall Street Reform and Consumer Protection Act, the listing requirements of the NYSE and other applicable securities rules and regulations. Compliance with these rules and regulations will increase our legal and financial compliance costs, make some activities more difficult, time consuming or costly and increase demand on our systems and resources, particularly after we are no longer an emerging growth company. The Exchange Act requires, among other things, that we file annual, quarterly and current reports with the Securities and Exchange Commission (the SEC).

As a result of disclosure of information in this prospectus and in filings required of a public company, our business and financial condition will become more visible, which we believe may result in threatened or actual litigation, including by competitors and other third parties. If such claims are successful, our business and operating results could be harmed, and even if the claims do not result in litigation or are resolved in our favor, these claims, and the time and resources necessary to resolve them, could divert the resources of our management and adversely affect our business and results of operations.

We also expect that being a public company and these new rules and regulations will make it expensive for us to obtain director and officer liability insurance, and we may be required to incur substantial costs to obtain coverage. Potential liability associated with serving on a public company's board could make it difficult for us to attract and retain qualified members of our board of directors, particularly to serve on our audit committee and compensation committee, and qualified executive officers.

Our lack of public company operating experience may make it difficult to forecast and evaluate our future prospects. If we are unable to execute our business strategy, our financial condition and results of operations may be harmed and the market price of our common stock may be adversely affected.

**Our internal controls over financial reporting may not be effective and our independent registered public accounting firm may not be able to certify as to their effectiveness, which could have a significant and adverse effect on our business and reputation.**

Upon becoming a public company, we will be required to comply with the SEC's rules implementing Sections 302 and 404 of the Sarbanes-Oxley Act, which will require management to certify financial and other information in our quarterly

---

**Table of Contents**

and annual reports and provide an annual management report on the effectiveness of controls over financial reporting. Though we will be required to disclose changes made in our internal controls and procedures on a quarterly basis, we will not be required to make our first annual assessment of our internal controls over financial reporting pursuant to Section 404 until the year following our first annual report required to be filed with the SEC. Additionally, as an emerging growth company, as defined in the JOBS Act, our independent registered public accounting firm will not be required to formally attest to the effectiveness of our internal controls over financial reporting pursuant to Section 404 until the later of the year following our first annual report required to be filed with the SEC or the date we are no longer an emerging growth company. At such time, our independent registered public accounting firm may issue a report that is adverse in the event that it is not satisfied with the level at which our controls are documented, designed or operating.

To comply with the requirements of being a public company, we may need to undertake various actions, such as implementing new internal controls and procedures and hiring accounting or internal audit staff. Testing and maintaining internal controls can divert our management's attention from other matters that are important to the operation of our business. In addition, when evaluating our internal controls over financial reporting, we may identify material weaknesses that we may not be able to remediate in time to meet the applicable deadline imposed upon us for compliance with the requirements of Section 404 of the Sarbanes-Oxley Act. If we identify material weaknesses in our internal controls over financial reporting or are unable to comply with the requirements of Section 404 of the Sarbanes-Oxley Act in a timely manner or assert that our internal controls over financial reporting are effective, or if our independent registered public accounting firm is unable to express an opinion as to the effectiveness of our internal controls over financial reporting, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock could be negatively affected, and we could become subject to investigations by the NYSE, the SEC or other regulatory authorities, which could require additional financial and management resources.

**We are an emerging growth company and we cannot be certain if the reduced disclosure requirements applicable to emerging growth companies will make our common stock less attractive to investors.**

We are an emerging growth company, as defined in the JOBS Act, and we intend to take advantage of certain exemptions from various reporting requirements that are applicable to other public companies but not to emerging growth companies, including, but not limited to, an exemption from the auditor attestation requirement of Section 404 of the Sarbanes-Oxley Act, which may increase the risk that weaknesses or deficiencies in our internal control over financial reporting go undetected, and reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, which may make it more difficult for investors and securities analysts to evaluate us.

We cannot predict if investors will find our common stock less attractive as a result of our taking advantage of these exemptions. If some investors find our common stock less attractive as a result of our choices, there may be a less active trading market for our common stock and our stock price may be more volatile. We may take advantage of these reporting exemptions until we are no longer an emerging growth company. We could be an emerging growth company until the last day of the fiscal year following the fifth anniversary of the completion of this offering, although a variety of circumstances could cause us to lose that status earlier.

**Differences between the book value of contributed properties and the price paid for shares of common stock in this offering will result in an immediate and material dilution of the book value per share of our common stock.**

As of December 31, 2013, the aggregate historical combined net tangible book value of the interests and assets to be transferred to us and our operating partnership, after adjusting for our acquisition of a controlling interest in the

Cherry Chreek property, which occurred on January 2, 2014, was approximately \$740,060, or \$0.13 per share of our common stock held by continuing investors, assuming the exchange of units into shares of our common stock on a one-for-one basis. As a result, the pro forma net tangible book value per share of our common stock after the completion of this offering and the formation transactions will be less than the initial public offering price. The purchasers of shares of our common stock offered hereby will experience immediate and substantial dilution of \$10.43 per share in the pro forma net tangible book value per share of our common stock due to the effects, among other things, of the grants of awards covering shares of our common stock to our directors and executive officers and our Advisor.



## **Table of Contents**

**Our operating partnership may issue additional common units to third parties without the consent of our stockholders, which would reduce our ownership percentage in our operating partnership and could have a dilutive effect on the amount of distributions made to us by our operating partnership and, therefore, the amount of distributions we can make to our stockholders.**

After giving effect to this offering, we will own 69.6% of the outstanding common units and we may, in connection with our acquisition of properties or otherwise, cause our operating partnership to issue additional common units to third parties. Such issuances would reduce our ownership percentage in our operating partnership and could affect the amount of distributions made to us by our operating partnership and, therefore, the amount of distributions we can make to our stockholders. Because you will not directly own common units, you will not have any voting rights with respect to any such issuances or other partnership level activities of our operating partnership.

## **Risks Related to Our Organizational Structure and Our Formation Transactions**

**Conflicts of interest exist or could arise in the future between the interests of our stockholders and the interests of holders of units in our operating partnership, which may impede business decisions that could benefit our stockholders.**

Conflicts of interest exist or could arise in the future as a result of the relationships between us, on the one hand, and our operating partnership or any partner thereof, on the other. Our directors and officers have duties to our company under applicable Maryland law in connection with their management of our company. At the same time, we, as the general partner of our operating partnership, have fiduciary duties and obligations to our operating partnership and its limited partners under Maryland law and the partnership agreement of our operating partnership in connection with the management of our operating partnership. Our fiduciary duties and obligations as general partner to our operating partnership and its partners may come into conflict with the duties of our directors and officers to our company.

Additionally, the partnership agreement provides that we and our officers, directors and employees, will not be liable or accountable to our operating partnership for losses sustained, liabilities incurred or benefits not derived if we, or such officer, director or employee acted in good faith. The partnership agreement also provides that we will not be liable to the operating partnership or any partner for monetary damages for losses sustained, liabilities incurred or benefits not derived by the operating partnership or any limited partner, except for liability for our intentional harm or gross negligence. Moreover, the partnership agreement provides that our operating partnership is required to indemnify us and our officers, directors, employees, agents and designees from and against any and all claims that relate to the operations of our operating partnership, except (1) if the act or omission of the person was material to the matter giving rise to the action and either was committed in bad faith or was the result of active and deliberate dishonesty, (2) for any transaction for which the indemnified party received an improper personal benefit, in money, property or services or otherwise in violation or breach of any provision of the partnership agreement or (3) in the case of a criminal proceeding, if the indemnified person had reasonable cause to believe that the act or omission was unlawful. No reported decision of a Maryland appellate court has interpreted provisions similar to the provisions of the partnership agreement of our operating partnership that modify and reduce our fiduciary duties or obligations as the general partner or reduce or eliminate our liability for money damages to the operating partnership and its partners, and we have not obtained an opinion of counsel as to the enforceability of the provisions set forth in the partnership agreement that purport to modify or reduce the fiduciary duties that would be in effect were it not for the partnership agreement.

**The consideration that we will pay for the properties and assets to be acquired by us in the formation transactions may exceed their aggregate fair market value.**

The amount of consideration that we will pay is based on management's estimate of fair market value, including an analysis of market sales comparables, market capitalization rates for other properties and assets and general market conditions for such properties and assets. In certain instances, the amount of consideration that we will pay was not negotiated on an arm's length basis and management's estimate of fair market value may exceed the fair market value of these properties and assets.

## **Table of Contents**

The value of the common units that we will issue as consideration for the properties and assets that we will acquire will increase or decrease if the per share market price of our common stock increases or decreases. The initial public offering price of our common stock will be determined in consultation with the underwriters. The initial public offering price does not necessarily bear a direct relationship to our book value of our properties and assets. As a result, the consideration to be given in exchange by us for the contribution of properties and other assets in the formation transactions may exceed the fair market value of these properties and assets.

**Upon completion of this offering and the formation transactions, the Second City Group, CIO REIT and CIO OP in particular, will own a substantial indirect beneficial interest in our company on a fully diluted basis and will have the ability to exercise significant influence on our company and our operating partnership, including the approval of significant corporate transactions.**

Upon completion of this offering and the formation transactions, the Second City Group will own approximately 5,969,142 common units and shares of our common stock, representing a 47.2% beneficial interest in our company on a fully diluted basis. In addition, our amended and restated bylaws have the effect of granting to the Second City Group the right to designate up to two nominees for election to our board of directors in accordance with, or as provided pursuant to, the partnership agreement, and the partnership agreement will limit any actions in contravention of an express provision of the partnership agreement, limit any transfers of our general partner interest in our operating partnership and prevent our voluntary withdrawal as the general partner based on the Second City Group's ownership of common units. See Description of the Partnership Agreement of City Office REIT Operating Partnership, L.P. Purpose, Business and Management and Description of the Partnership Agreement of City Office REIT Operating Partnership, L.P. Restrictions on General Partner's Authority. For so long as the Second City Group maintains a significant interest in our company, they will have substantial influence on us and could exercise this influence in a manner that conflicts with the interest of other stockholders.

At the end of its contractual lock-up period (see Underwriting No Sales of Similar Securities), the Second City Group may seek to redeem its common units and sell any common stock received in exchange therefor or in the formation transactions. No prediction can be made as to the effect, if any, a future sale of common stock by the Second City Group will have on the market price of the common stock prevailing from time to time. However, the future sale of a substantial number of our common shares by the Second City Group, or the perception that such sale could occur, could adversely affect prevailing market prices for our common stock.

**We are a holding company with no direct operations and, as such, we will rely on funds received from our operating partnership to pay liabilities, and the interests of our stockholders will be structurally subordinated to all liabilities and obligations of our operating partnership and its subsidiaries.**

We are a holding company and will conduct substantially all of our operations through our operating partnership. We do not have, apart from an interest in our operating partnership, any independent operations. As a result, we will rely on distributions from our operating partnership to pay any dividends that we may declare on shares of our common stock. We will also rely on distributions from our operating partnership to meet any of our obligations, including any tax liability on taxable income allocated to us from our operating partnership. In addition, because we are a holding company, your claims as stockholders will be structurally subordinated to all existing and future liabilities and obligations (whether or not for borrowed money) of our operating partnership and its subsidiaries. Therefore, in the event of our bankruptcy, liquidation or reorganization, our assets and those of our operating partnership and its subsidiaries will be available to satisfy the claims of our stockholders only after all of our operating partnership's and its subsidiaries' liabilities and obligations have been paid in full.

**We may assume unknown liabilities in connection with the formation transactions.**

As part of the formation transactions, we will acquire entities and assets that are subject to existing liabilities, some of which may be unknown or unquantifiable at the time this offering is completed. These assumed liabilities might include liabilities for cleanup or remediation of undisclosed environmental conditions, claims by tenants, vendors or other persons dealing with our predecessor entities (that had not been asserted or threatened prior to this offering), tax liabilities and accrued but unpaid liabilities incurred in the ordinary course of business. While in some instances we may have the right to

---

**Table of Contents**

seek reimbursement against an insurer, any recourse against third parties, including the contributors of our assets, for these liabilities will be limited. There can be no assurance that we will be entitled to any such reimbursement or that ultimately we will be able to recover in respect of such rights for any of these historical liabilities.

Our contribution agreements include certain representations and warranties by the contributors regarding the conditions of the properties. The contributors provide an indemnification to us for breaches of their representations and warranties under the contribution agreements. However, we are entitled to indemnification under the contribution agreements to the extent our damages exceed 1% of the consideration paid to the contributors. In addition, the indemnification in the contribution agreements is capped at 10% of the value of the consideration paid to the contributors. Therefore, it is possible that our liabilities will exceed our indemnification payments.

In addition, we have not obtained and do not intend to obtain new or additional title insurance in connection with this offering and the formation transactions, including any so-called date down endorsements or other modifications to our existing title insurance policies. As a result, we may acquire properties from the Second City Group with unknown material title defects or developments and our title insurance policies may not provide coverage against such defects or developments or insure for the current aggregate market value of our portfolio. There can be no assurance that our current title insurance policies will adequately protect us against any losses resulting from such title defects or adverse developments.

**Our tax protection agreements could limit our ability to sell or otherwise dispose of certain properties.**

In connection with the formation transactions, our operating partnership will enter into tax protection agreements that provide that if we dispose of any interest in our initial properties in a taxable transaction prior to the fourth anniversary of the completion of the formation transactions, subject to certain exceptions, we will indemnify Gibralt, GCC Amberglen, Daniel Rapaport and CIO OP for their tax liabilities attributable to the built-in gain that exists with respect to our initial properties as of the time of this offering and their tax liabilities incurred as a result of such tax protection payment. Therefore, although it may be in our stockholders' best interests that we sell one of these properties, it may be economically prohibitive for us to do so because of these obligations. Moreover, as a result of these potential tax liabilities, the Second City Group and its affiliates and certain of our officers may have a conflict of interest with respect to our determination as to these properties.

**Our tax protection agreements may require our operating partnership to maintain certain debt levels that otherwise would not be required to operate our business.**

Under our tax protection agreements, our operating partnership will be required to maintain a minimum level of indebtedness throughout the four years immediately following the completion of the formation transactions, regardless of whether such debt levels are otherwise required to operate our business. Moreover, our operating partnership may be required to provide Gibralt, GCC Amberglen, Daniel Rapaport and CIO OP with the opportunity to guarantee debt at the completion of the formation transactions and this offering (if needed) and upon a future repayment, retirement, refinancing or other reduction of currently outstanding debt prior to the fourth anniversary of the completion of the formation transactions. After such fourth anniversary, our operating partnership will be required to use commercially reasonable efforts to provide the Protected Parties (as defined below) with an opportunity to guarantee its debt, provided that it will not be required to incur any debt that it otherwise would not have incurred. If we fail to make such opportunities available, we will be required to make a cash payment intended to approximate the sum of the tax liabilities resulting from our failure to make such opportunities available or to maintain the minimum level of indebtedness and the tax liabilities incurred as a result of such tax protection payment. See Certain Relationships and Related Person Transactions Tax Protection Agreements. We agreed to these provisions in order to assist the contributors and their owners in deferring the recognition of taxable gain as a result of and after the formation

transactions. These obligations may require us to maintain more or different indebtedness than we would otherwise require for our business.

**Our charter, our amended and restated bylaws and Maryland law contain provisions that may delay, defer or prevent a change of control transaction and may prevent our stockholders from receiving a premium for their shares.**

*Our charter contains ownership limits that may delay, defer or prevent a change of control transaction.* Our charter, with certain exceptions, authorizes our directors to take such actions as are necessary and desirable to qualify as a REIT. Unless exempted by our board of directors, our charter provides that no person may own more than 9.8% of the value

## **Table of Contents**

of our outstanding shares of capital stock or more than 9.8% in value or number (whichever is more restrictive) of the outstanding shares of our common stock. The board may not grant such an exemption to any proposed transferee whose ownership in excess of 9.8% of the foregoing ownership limits would result in the termination of our status as a REIT. These restrictions on transferability and ownership will not apply if our board of directors determines that it is no longer in our best interests to attempt to qualify as a REIT. The ownership limit may delay or impede a transaction or a change of control that might involve a premium price for our common stock or otherwise be in the best interests of our stockholders.

***We could authorize and issue stock without stockholder approval that may delay, defer or prevent a change of control transaction.*** Our charter authorizes us to issue additional authorized but unissued shares of our common stock or preferred stock. In addition, our board of directors may classify or reclassify any unissued shares of our common stock or preferred stock and may set the preferences, rights and other terms of the classified or reclassified shares. Our board of directors may also, without stockholder approval, amend our charter to increase the authorized number of shares of our common stock or our preferred stock that we may issue. The board of directors could establish a class or series of common stock or preferred stock that could, depending on the terms of such class or series, delay, defer or prevent a transaction or a change of control that might involve a premium price for our common stock or otherwise be in the best interests of our stockholders.

***Certain provisions of Maryland law could delay, defer or prevent a change of control transaction.*** Certain provisions of the Maryland General Corporation Law ( MGCL ) may have the effect of inhibiting a third party from making a proposal to acquire us or of impeding a change of control. In some cases, such an acquisition or change of control could provide you with the opportunity to realize a premium over the then-prevailing market price of your shares. These MGCL provisions include:

- business combination provisions that, subject to limitations, prohibit certain business combinations between us and an interested stockholder for certain periods. An interested stockholder is generally any person who beneficially owns 10% or more of the voting power of our shares or an affiliate or associate of ours who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of the voting power of our then outstanding voting stock. A person is not an interested stockholder under the statute if our board of directors approved in advance the transaction by which he otherwise would have become an interested stockholder. Business combinations with an interested stockholder are prohibited for five years after the most recent date on which the stockholder becomes an interested stockholder. After that period, the MGCL imposes two super-majority voting requirements on such combinations; and
- control share provisions that provide that holders of control shares of our company acquired in a control share acquisition have no voting rights with respect to the control shares unless holders of two-thirds of our voting stock (excluding interested shares) consent. Control shares are shares that, when aggregated with other shares controlled by the stockholder, entitle the stockholder to exercise one of three increasing ranges of voting power in electing directors. A control share acquisition is the direct or indirect acquisition of ownership or control of control shares from a party other than the issuer.

In the case of the business combination provisions of the MGCL, we opted out by resolution of our board of directors. In the case of the control share provisions of the MGCL, we opted out pursuant to a provision in our amended and restated bylaws. However, our board of directors may by resolution elect to opt in to the business combination provisions of the MGCL. Further, we may opt in to the control share provisions of the MGCL in the future by

amending our bylaws, which our board of directors can do without stockholder approval.

Maryland law, and our charter and amended and restated bylaws, also contain other provisions that may delay, defer or prevent a transaction or a change of control that might involve a premium price for our common stock or otherwise be in the best interest of our stockholders. See [Description of Stock](#) and [Certain Provisions of Maryland Law and of Our Charter and Bylaws](#).



---

**Table of Contents**

**The ability of our board of directors to revoke our REIT status without stockholder approval may cause adverse consequences to our stockholders.**

Our charter provides that our board of directors may revoke or otherwise terminate our REIT election, without the approval of our stockholders, if it determines that it is no longer in our best interest to continue to qualify as a REIT. If we cease to be a REIT, we would become subject to U.S. federal income tax on our taxable income and would no longer be required to distribute most of our taxable income to our stockholders, which may have adverse consequences on our total return to our stockholders.

**Our board of directors may amend our investing and financing guidelines without stockholder approval, and, accordingly, you would have limited control over changes in our policies that could increase the risk that we default under our debt obligations or that could harm our business, results of operations and share price.**

Although we are not required to maintain any particular leverage ratio, we intend, when appropriate, to employ prudent amounts of leverage and to use debt as a means of providing additional funds for the acquisition of our target assets and the diversification of our portfolio. Although our board of directors has not adopted a policy limiting the total amount of debt that we may incur, our Advisor intends to target a ratio of debt to total assets of 50% on future acquisitions. Our Advisor also intends to target a limit on our floating rate debt that we may incur of no more than 20% of outstanding debt after giving effect to any interest rate hedges into which we may enter. However, our organizational documents do not limit the amount or percentage of debt that we may incur, nor do they limit the types of properties we may acquire or develop. The amount of leverage we will deploy for particular investments in our target assets will depend upon our management team's assessment of a variety of factors, which may include the anticipated liquidity and price volatility of the target assets in our investment portfolio, the potential for losses, the availability and cost of financing the assets, our opinion of the creditworthiness of our financing counterparties, the health of the U.S. economy and commercial mortgage markets, our outlook for the level, slope and volatility of interest rates, the credit quality of our target assets and the collateral underlying our target assets. Our board of directors may alter or eliminate our current guidelines on investing and financing at any time without stockholder approval. Changes in our strategy or in our investing and financing guidelines could expose us to greater credit risk and interest rate risk and could also result in a more leveraged balance sheet. These factors could result in an increase in our debt service and could adversely affect our cash flow and our ability to make expected distributions to you. Higher leverage also increases the risk that we would default on our debt.

**Our rights and the rights of our stockholders to take action against our directors and officers are limited.**

Maryland law provides that a director or officer generally has no liability in that capacity if he or she performs his or her duties in good faith, in a manner he or she reasonably believes to be in our best interests and with the care that an ordinarily prudent person in a like position would use under similar circumstances. Upon completion of this offering, as permitted by the MGCL, our charter will limit the liability of our directors and officers to us and our stockholders for money damages, except for liability resulting from:

- actual receipt of an improper benefit or profit in money, property or services; or
- active and deliberate dishonesty established by a final judgment and which is material to the cause of action.

In addition, our charter will authorize us to obligate our company, and our amended and restated bylaws will require us, to indemnify and pay or reimburse our present and former directors and officers for actions taken by them in those capacities to the maximum extent permitted by Maryland law. As a result, we and our stockholders may have more limited rights against our directors and officers than might otherwise exist under common law. Accordingly, in the event that actions taken in good faith by any of our directors or officers impede the performance of our company, your ability to recover damages from such director or officer will be limited.

**Table of Contents**

**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

This prospectus contains forward-looking statements within the meaning of the federal securities laws. These forward-looking statements are included throughout this prospectus, including in the sections entitled Prospectus Summary, Risk Factors, Use of Proceeds, Management's Discussion and Analysis of Financial Condition and Results of Operations, Business and Certain Relationships and Related Person Transactions, and relate to matters such as our industry, business strategy, goals and expectations concerning our market position, future operations, margins, profitability, capital expenditures, financial condition, liquidity, capital resources, cash flows, results of operations and other financial and operating information. We have used the words approximately, anticipate, assume, believe, but, contemplate, continue, could, estimate, expect, future, intend, may, outlook, plan, potential, possibly, should, target, will and similar terms and phrases to identify forward-looking statements in this prospectus. All of our forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from those that we are expecting, including:

- adverse economic or real estate developments in the office sector or the markets in which we operate;
- changes in local, regional and national economic conditions;
- our inability to compete effectively;
- our inability to collect rent from tenants or renew tenants' leases;
- our reliance on, and actual or potential conflicts of interest with, our Advisor;
- defaults on or non-renewal of leases by tenants;
- increased interest rates and operating costs;
- decreased rental rates or increased vacancy rates;
- our failure to obtain necessary outside financing on favorable terms or at all;
- changes in the availability of additional acquisition opportunities;
- availability of qualified personnel;

- our inability to successfully complete real estate acquisitions;
- our failure to successfully operate acquired properties and operations;
- changes in our business strategy;
- our failure to generate sufficient cash flows to service our outstanding indebtedness;
- environmental uncertainties and risks related to adverse weather conditions and natural disasters;
- our failure to qualify and maintain our status as a REIT;
- government approvals, actions and initiatives, including the need for compliance with environmental requirements;
- financial market fluctuations;
- changes in real estate and zoning laws and increases in real property tax rates; and
- additional factors discussed under the sections captioned Risk Factors, Management's Discussion and Analysis of Financial Condition and Results of Operations and Business.

The forward-looking statements contained in this prospectus are based on historical performance and management's current plans, estimates and expectations in light of information currently available to us and are subject to

**Table of Contents**

uncertainty and changes in circumstances. There can be no assurance that future developments affecting us will be those that we have anticipated. Actual results may differ materially from these expectations due to the factors, risks and uncertainties described above, changes in global, regional or local political, economic, business, competitive, market, regulatory and other factors described in Risk Factors, many of which are beyond our control. We believe that these factors include those described in Risk Factors. Should one or more of these risks or uncertainties materialize, or should any of our assumptions prove to be incorrect, our actual results may vary in material respects from what we may have expressed or implied by these forward-looking statements. We caution that you should not place undue reliance on any of our forward-looking statements. Any forward-looking statement made by us in this prospectus speaks only as of the date on which we make it. Factors or events that could cause our actual results to differ may emerge from time to time, and it is not possible for us to predict all of them. We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by applicable securities laws.

**Table of Contents**

**STRUCTURE AND FORMATION OF OUR COMPANY**

**Formation Transactions**

We were formed in November 2013 specifically for the purpose of consummating this offering. Second City currently owns 100% of our outstanding common stock. We have not commenced operations and currently do not own any property.

Following the completion of this offering and the formation transactions, our operating partnership will, directly or indirectly, hold substantially all of our assets and conduct substantially all of our operations. Subject to other classes or series of units that our operating partnership may issue in the future, our interest in our operating partnership will entitle us to share in cash distributions from our operating partnership in proportion to our percentage ownership of common units. As the sole general partner of our operating partnership, we generally will have the exclusive power under the partnership agreement to manage and conduct its business, subject to limited approval and voting rights of the limited partners described more fully in Description of the Partnership Agreement of City Office REIT Operating Partnership, L.P.

All of the initial property interests that we will acquire in the formation transactions currently are owned by the Property Ownership Entities. Prior to or concurrently with the completion of this offering, we will engage in the formation transactions described below, which are designed to consolidate the ownership of our initial properties into our operating partnership; facilitate this offering; enable us to raise necessary capital to repay existing and future indebtedness related to certain properties in our portfolio; enable us to qualify as a REIT commencing with our taxable year ending December 31, 2014; and preserve the tax position of certain continuing investors.

The following formation transactions have occurred or will occur prior to, or concurrently with, the completion of this offering. All monetary amounts are based on the midpoint of the initial public offering price range set forth on the cover page of this prospectus:

- City Office REIT, Inc. was formed as a Maryland corporation on November 26, 2013. We intend to elect to be taxed and to operate in a manner that will allow us to qualify as a REIT commencing with our taxable year ending December 31, 2014.
- Our operating partnership was formed as a Maryland limited partnership on December 12, 2013.
- We intend to enter into an advisory agreement with our Advisor pursuant to which our Advisor will provide management and advisory services to us. See Our Advisor and the Advisory Agreement Advisory Agreement.
- We will sell 6,666,667 shares of our common stock in this offering (1,000,000 additional shares if the underwriters exercise their over-allotment option in full) and we will contribute the net proceeds to our operating partnership in exchange for 6,666,667 common units. If the underwriters elect to exercise all or any part of their over-allotment option, we will use all of the additional net proceeds from such exercise to redeem from the Second City Group, for cash, a portion of the common stock and common units

issued to them in the formation transactions at a redemption price per common unit or share of common stock equal to the public offering price per share in this offering.

- Pursuant to separate contribution agreements, the Second City Group will contribute to us and our operating partnership their entire interests in the Property Ownership Entities in exchange for (i) 5,590,068 common units and shares of our common stock with an aggregate value of approximately \$83,851,020, representing 44.2% of the total number of shares of our common stock outstanding on a fully diluted basis upon completion of this offering and (ii) \$19,380,050 of cash, subject to certain adjustments. We will contribute any interests in the Property Ownership Entities that we acquire to our operating partnership in exchange for common units. Second City will use \$7,705,050 of the cash received to buy out minority interests in the initial properties prior to contributing their initial interest in the Property Ownership Entities to our operating partnership as further detailed below.

## **Table of Contents**

- As a result of the formation transactions, we will acquire a 100% interest in each of the Washington Group Plaza, Cherry Creek and Corporate Parkway properties and we will acquire an approximately 76% interest in the AmberGlen property, 90% interest in the Central Fairwinds property and 95% interest in the City Center property. The parties retaining the remaining interests in the AmberGlen, Central Fairwinds and City Center properties at the conclusion of the formation transactions will not receive any common units, common stock or cash from us. The value of the consideration to be paid to each of the entities in the Second City Group in the formation transactions will be determined according to the terms of the respective contribution agreements. The contributions will be effected concurrently with the completion of this offering. Set forth in greater detail below is the consideration that the Second City Group will receive in connection with the formation transactions:
  
- Second City will receive as consideration for its contribution approximately \$7,705,050 in cash in accordance with the terms of its contribution agreement with us and our operating partnership. Second City will use the cash to acquire various noncontrolling interests and eliminate economic incentives in the initial properties as follows: \$4,311,717 for the City Center property, \$445,000 for the Central Fairwinds property, \$250,000 for the Corporate Parkway property and \$2,698,333 for the Washington Group Plaza property.
  
- Second City GP will receive as consideration for its contribution an aggregate of 5,473 common units with an aggregate value of approximately \$82,095, which represents 0.045% of the total number of shares of our common stock outstanding on a fully diluted basis upon completion of this offering, in accordance with the terms of its contribution agreement with us and our operating partnership.
  
- Gibralt and GCC Amberglen will receive as consideration for their contribution an aggregate of 123,518 common units with an aggregate value of approximately \$1,852,760, which represents 1.0% of the total number of shares of our common stock outstanding on a fully diluted basis upon completion of this offering, and approximately \$11,675,000 in cash in accordance with the terms of their contribution agreement with us and our operating partnership. Of the total, Gibralt will receive 123 common units with an aggregate value of approximately \$1,845, which represents 0.001% of the total number of shares of our common stock outstanding on a fully diluted basis upon the completion of this offering, and GCC Amberglen will receive the balance.
  
- CIO OP will receive as consideration for its contribution an aggregate of 3,477,453 common units with an aggregate value of approximately \$52,161,795, which represents 27.5% of the total number of shares of our common stock outstanding on a fully diluted basis upon completion of this offering, in accordance with the terms of its contribution agreement with us and our operating partnership.
  
- CIO REIT will receive as consideration for its contribution an aggregate of 1,866,958 shares of our common stock with an aggregate value of approximately \$28,004,370, which represents 14.8% of the total number of shares of our common stock outstanding on a fully diluted basis upon completion of this offering, in accordance with the terms of its contribution agreement with us and our operating partnership.



- Daniel Rapaport will receive as consideration for his contribution an aggregate of 116,667 common units with an aggregate value of approximately \$1,750,000, which represents 0.9 % of the total number of shares of our common stock outstanding on a fully diluted basis upon completion of this offering, in accordance with the terms of his contribution agreement with us and our operating partnership.
- At December 31, 2013, \$8,411,836 has been reserved by Second City to fund existing commitments for capital expenditures, tenant improvements and free rent. This amount will be reduced to the extent that these costs are paid prior to the date of the formation transactions.
- Prior to, or concurrently with, the closing of this offering, we expect to enter into the New Mortgage Loan. Following the formation transactions, the Washington Group Plaza property will remain subject to the Washington Mortgage Loan and the AmberGlen property will remain subject to the AmberGlen Mortgage Loan

**Table of Contents**

unless the AmberGlen Refinancing has occurred prior to the closing of this offering. In addition, we expect to enter into the Revolving Credit Facility, which we expect will have an accordion feature that will permit us to borrow up to \$150 million, subject to additional collateral availability and lender approval.

- In connection with this offering and the formation transactions, we expect to adopt a cash and equity-based incentive award plan for our directors and officers and our Advisor. See Executive and Director Compensation Equity Incentive Plan.

For each of our initial properties, the table below shows the equity interests that we and our operating partnership will acquire from the Second City Group in the Property Ownership Entities in exchange for the consideration described herein, any interest to be disposed by the Second City Group and any economic participation interests that will be eliminated by the Property Ownership Entities with respect to each property.

<b>Property</b>	<b>Equity Interest Acquired by the Company/Operating Partnership</b>	<b>Economic Interest Disposed by Second City Group</b>	<b>Economic Participation Interests Eliminated by Property Ownership Entity</b>
Amberglen <sup>(1)</sup>	<ul style="list-style-type: none"> <li>· 0.001% from Gibralt US, Inc.</li> <li>· 88.58% from GCC Amberglen Investments LP</li> </ul>	<ul style="list-style-type: none"> <li>· GCC Amberglen Investments LP will dispose 9% of its economic interest to a noncontrolling third party</li> </ul>	<ul style="list-style-type: none"> <li>· All minority interests owners economic participation incentives</li> </ul>
Central Fairwinds	<ul style="list-style-type: none"> <li>· 3.81% from Daniel Rapaport</li> <li>· 31.44% from CIO REIT Stock Limited Partnership</li> <li>· 58.56% from CIO OP Limited Partnership</li> <li>· 0.001% from Second City Capital Partners</li> </ul>	N/A	<ul style="list-style-type: none"> <li>· All minority interests owners economic participation incentives</li> </ul>

Cherry Creek	II, General Partnership		
	· 34.93% from CIO REIT Stock Limited Partnership	N/A	N/A
	· 65.07% from CIO OP Limited Partnership		
City Center	· 0.001% from Second City Capital Partners II, General Partnership		
	· 31.44% from CIO REIT Stock Limited Partnership	N/A	· All minority interests owners economic participation incentives
	· 58.56% from CIO OP Limited Partnership		
	· 5.00% from Second City Capital Partners II, Limited Partnership		
	· 0.001% from Second City Capital Partners II, General Partnership		

**Table of Contents**

<b>Property</b>	<b>Equity Interest Acquired by the Company/Operating Partnership</b>	<b>Economic Interest Disposed by Second City Group</b>	<b>Economic Participation Interests Eliminated by Property Ownership Entity</b>
Corporate Parkway	<ul style="list-style-type: none"> <li>· 34.93% from CIO REIT Stock Limited Partnership</li> <li>· 65.07% from CIO OP Limited Partnership</li> </ul>	N/A	<ul style="list-style-type: none"> <li>· All minority interests owners economic participation incentives</li> </ul>
Washington Group Plaza	<ul style="list-style-type: none"> <li>· 0.001% from Second City Capital Partners II, General Partnership</li> <li>· 31.40% from CIO REIT Stock Limited Partnership</li> <li>· 58.49% from CIO OP Limited Partnership</li> <li>· 10.11% from Second City Capital Partners II, Limited Partnership after being acquired from minority interest holder</li> <li>· 0.001% from Second City Capital Partners II, General Partnership</li> </ul>	N/A	N/A

*(1) In connection with the formation transactions, our operating partnership will acquire a 88.58% limited partnership interest from GCC Amberglen, a 3.81% limited partnership interest from Daniel Rapaport and a 0.001% limited partnership interest from Gibralt in the AmberGlen property. GCC Amberglen will transfer a 9% economic participation interest in the AmberGlen property to a noncontrolling interest owner of the AmberGlen property (who previously had a majority position in a prior 15% economic participation interest in the AmberGlen property) to eliminate any additional incremental economic participation rights held by the noncontrolling interest owner. After giving effect to these transactions, our operating partnership will own a 92.39% limited partnership interest, which equals a 76% economic interest, in the property.*

In addition, with respect to the Central Fairwinds property (which is currently approximately 62.6% leased, including committed tenants), we will be obligated to make Earn-Out Payments following the closing of this offering, which payments are contingent on the Central Fairwinds property achieving increased occupancy levels from qualified tenants within five years following the closing of this offering (the Earn-Out Term ). Second City will be entitled to receive an Earn-Out Payment (net of the associated leasing costs and inclusive of leasing commissions and tenant improvements/allowances and free rent) as and when the occupancy of Central Fairwinds reaches each of 70%, 80% and 90% (each, an Earn-Out Threshold ) based on the incremental cash flow generated by new leases and a 7.75% stabilized capitalization rate. We will make any additional Earn-Out Payment within 30 days of the end of the Earn-Out Term based on new qualified leases entered into since the achievement of the last Earn-Out Threshold. If a qualified tenant under a new lease used in the calculation of any Earn-Out Payment defaults in the payment of rent for a period of 60 consecutive days or more and is not replaced with a new qualified tenant, the amount equal to the Earn-Out Payment on such lease shall be deducted from the next available Earn-Out Payment (the Claw-back Amount ); provided that if the nonpaying tenant is replaced prior to the later of the next applicable Earn-Out Payment determination or the first anniversary of the termination of such non-paying tenant, then the deducted amount, subject to certain adjustments will be included in the next Earn-Out Payment. If any Claw-back Amount remains unpaid at the expiration of the Earn-Out Term, Second City shall repay the deficit to us. Additionally, payment of any Earn-Out Payment otherwise earned hereunder shall be deferred if the trailing 12 month net operating income to the owner of the Central Fairwinds property for the most recent quarter ended prior

## **Table of Contents**

to the applicable determination date is less than a certain base net operating income threshold, which grows annually, established by the parties and increased based on incremental cash flow attributable to qualified tenants. We can pay any Earn-Out Payment in cash or common units at the election of our board of directors.

### **Benefits of the Formation Transactions to Related Parties**

In connection with this offering and the formation transactions, certain of our directors, executive officers and their affiliates will receive material financial and other benefits as shown below. Amounts below are based on the midpoint of the initial public offering price range set forth on the cover page of this prospectus. For a more detailed discussion of these benefits, see Management and Certain Relationships and Related Person Transactions.

As a result of the Second City Group's contribution of its interest in the Property Ownership Entities to us and our operating partnership in the formation transactions:

- James Farrar, our chief executive officer and one of our directors, and his immediate family member will beneficially own, through their ownership interests in CIO REIT and a one-time grant of restricted stock under the Equity Incentive Plan (see Our Advisor and the Advisory Agreement Grants of Equity Compensation to Employees of Our Advisor ), 149,795 shares of our common stock with a total value of approximately \$2,246,925, which will represent 1.2% of the total number of shares of our common stock outstanding on a fully diluted basis upon completion of this offering and the formation transactions;
- Gregory Tylee, our chief operating officer and president, and his immediate family member will beneficially own, through their ownership interests in CIO REIT and a one-time grant of restricted stock under the Equity Incentive Plan (see Our Advisor and the Advisory Agreement Grants of Equity Compensation to Employees of Our Advisor ), 135,877 shares of our common stock with a total value of approximately \$2,038,155, which will represent 1.1% of the total number of shares of our common stock outstanding on a fully diluted basis upon completion of this offering and the formation transactions;
- Anthony Maretic, our chief financial officer, secretary and treasurer, will beneficially own through a one-time grant of restricted stock under the Equity Incentive Plan (see Our Advisor and the Advisory Agreement Grants of Equity Compensation to Employees of Our Advisor ), 18,954 shares of our common stock with a value of approximately \$284,310, which will represent 0.2% of the total number of shares of our common stock outstanding on a fully diluted basis upon completion of this offering and the formation transactions;
- Samuel Belzberg, president of our Advisor and one of our director nominees, and his immediate family members and associated holding companies, will beneficially own, through their ownership interests in GCC Amberglen, Gibralt, Second City GP, and CIO OP and a one-time grant of restricted stock under the Equity Incentive Plan (see Our Advisor and the Advisory Agreement Grants of Equity Compensation to Employees of Our Advisor ), 2,162,282 common units and shares of our common stock with a total value of approximately \$32,434,230 , which will

represent 17.1% of the total number of shares of our common stock outstanding on a fully diluted basis upon completion of this offering and the formation transactions. Mr. Belzberg will also receive \$10 million of cash through his ownership of Gibralt and GCC Amberglen when Gibralt and GCC Amberglen contribute their interests in the Amberglen property to our operating partnership; and

- Stephen Shraiberg, one of our director nominees, will beneficially own 92,784 common units with a total value of approximately \$ 1,391,760, which will represent 0.7% of the total number of shares of our common stock outstanding on a fully diluted basis upon completion of this offering and the formation transactions.

If the underwriters elect to exercise all or any part of their over-allotment option, we will use all of the additional net proceeds from such exercise to redeem from the Second City Group, for cash, a portion of the common stock and common units issued to them in the formation transactions at a redemption price per common unit or share of common stock equal to the public offering price per share in this offering. In such event, the number of shares of common stock and common units held by the persons named above will decrease and the amount of cash paid to such persons will increase.

## **Table of Contents**

Also, for so long as the Second City Group and its affiliates collectively own at least 10% or more of our outstanding common stock on a fully-diluted basis (assuming all outstanding common units not owned by us or our subsidiaries are tendered for redemption and exchanged for shares of our common stock, regardless of whether such common units are then eligible for redemption), the Second City Group will have the right from time to time to designate individuals for nomination for election by our stockholders to our board of directors as follows:

- For so long as the Second City Group and its affiliates own 30% or more of our fully diluted outstanding common stock, (i) if the number of directors comprising our entire board of directors is six or more, the Second City Group will have the right to designate two nominees and (ii) if the number of directors comprising our entire board of directors is five or fewer, the Second City Group will have the right to designate one nominee.
- For so long as the Second City Group and its affiliates own less than 30% but at least 10% of our fully diluted outstanding common stock, regardless of the number of directors comprising our entire board of directors, the Second City Group will have the right to designate one nominee.
- If the Second City Group and its affiliates own less than 10% of our fully diluted outstanding common stock, the Second City Group will have no right to designate for nomination any individual to serve on our board of directors. If, subsequent to the time that Second City Group and its affiliates ownership of our fully diluted outstanding common stock falls below 10%, the Second City Group and entities controlled by the Second City Group again own 10% or more of the outstanding shares of our common stock as determined in the same manner as described above, then the Second City Group shall once again be entitled to exercise any designation or other applicable rights of the Second City Group set forth in the partnership agreement.
- During any period in which the Second City Group and its affiliates own at least 5% of our fully diluted outstanding shares of our common stock as determined in the same manner as described above, the Second City Group will be entitled to identify an individual to attend and observe meetings of our board of directors.
- Notwithstanding the foregoing, if the Second City Group and its affiliates own none of our common stock for a period of one year or more, the Second City Group's designation or other applicable rights under the partnership agreement shall terminate.

### *Tax Protection Agreements*

Pursuant to tax protection agreements, we have agreed to make certain tax indemnity payments to certain of the contributors of our initial properties and their owners (including parties related to us) if we dispose of any interest with respect to our initial properties in a taxable transaction or fail to maintain a minimum level of indebtedness during the four years immediately following the completion of the formation transactions. See Certain Relationships and Related Person Transactions.

### *Indemnification Agreements*



We also expect to enter into indemnification agreements with our directors and executive officers at the closing of this offering, providing for procedures for indemnification by us to the fullest extent permitted by law and advancements by us of certain expenses and costs relating to claims, suits or proceedings arising from their service to us as directors or officers. See Certain Relationships and Related Person Transactions Indemnification and Limitation of Directors and Officers Liability. Our contribution agreements contain certain indemnification obligations with respect to the Second City Group. See Certain Relationships and Related Person Transactions Contribution Agreements.

*Registration Rights Agreement*

We expect to enter into a registration rights agreement with the various persons receiving shares of our common stock or common units in the formation transactions, including the Second City Group and certain of our executive officers. See Certain Relationships and Related Person Transactions Registration Rights Agreement.

**Table of Contents****Consequences of this Offering and the Formation Transactions**

The completion of this offering and the formation transactions will have the following consequences. All amounts are based on the midpoint of the initial public offering price range set forth on the cover page of this prospectus:

- Through our ownership of common units, we will indirectly own a fee simple interest in and operate all of our initial properties (or our interest therein).
- We will be the sole general partner of our operating partnership and will own 69.6% of the common units therein, equal in number to the number of shares of our common stock outstanding. If the underwriters over-allotment option is exercised in full and we redeem from Second City common units issued to it in the formation transactions, we will own 74.9% of the outstanding common units.
- Purchasers of our common stock in this offering will own 78.1% of our outstanding common stock, or 74.8% on a fully diluted basis, assuming the redemption of all common units for shares of our common stock 54.4% of our outstanding common stock, or 52.8% on a fully diluted basis, if the underwriters over-allotment option is exercised in full and we redeem from the Second City Group, for cash, a portion of the common stock and common units issued to them in the formation transactions at a redemption price per common unit or share of common stock equal to the public offering price per share in this offering.

The following table presents the interest to be acquired by us and our operating partnership and the debt secured by each of our initial properties:

<b>Property</b>	<b>Interest to be Acquired by Us and Our Operating Partnership</b>	<b>Debt Secured by Property</b>
Washington Group Plaza	100.0%	Washington Mortgage Loan
Cherry Creek	100.0	New Mortgage Loan
AmberGlen	76.0	AmberGlen Mortgage Loan
City Center	95.0	New Mortgage Loan
Corporate Parkway	100.0	New Mortgage Loan
Central Fairwinds	90.0	Revolving Credit Facility <sup>(1)</sup>

*(1) We do not expect to draw on the Revolving Credit Facility at the closing of this offering.*



## Table of Contents

### **Our Structure**

The following diagram depicts our expected ownership structure and the expected ownership structure of our operating partnership upon completion of this offering and the formation transactions (assuming no exercise by the underwriters of their over-allotment option and excluding restricted stock to be granted to our directors and executive officers under the Equity Incentive Plan):

- (1) City Office will be the sole general partner of our operating partnership and will own a 69.6% ownership interest in our operating partnership upon the completion of the offering and the formation transactions.*
- (2) Our operating partnership will own interests in each of the Property Ownership Entities as follows: Amberglen Properties Limited Partnership (OR) (76%), Core Cherry Limited Partnership (DE) (100%), Central Fairwinds Limited Partnership (FL) (90%), City Center STF, LP (FL) (95%), SCCP Boise Limited Partnership (DE) (100%), SCCP Boise Outlot Limited Partnership (DE) (100%) and SCCP Central Valley Limited Partnership (DE) (100%).*
- (3) The general partner of each of the Property Ownership Entities is a separate entity established for the purpose of holding such interests: Gibralt Amberglen LLC (DE), Core Cherry GP Corp. (DE), Central Fairwinds GP Corporation (FL), City Center STF GP Corp. (FL), SCCP Boise GP, Inc. (DE), SCCP Boise Outlot GP, Inc. (DE) and SCCP Central Valley GP Corp. (DE), each of which will elect to be a taxable REIT subsidiary of ours (other than Gibralt Amberglen LLC (DE)).*
- (4) In connection with the formation transactions, Gibralt will receive 123 common units with an aggregate value of approximately \$1,845, which represents 0.001% of the total number of shares of our common stock outstanding on a fully diluted basis upon the completion of this offering.*

## **Table of Contents**

### **Determination of Consideration Payable for Our Properties**

As a result of the formation transactions, we and our operating partnership will acquire interests in the Property Ownership Entities. The consideration paid to each of the sellers or contributors in the formation transactions will be based on the terms of the applicable contribution agreements. Under these agreements, each contributor will receive either (i) a fixed number of common units or common stock, subject to adjustment for pre-closing unit splits or similar structural changes to our pre-closing unit capitalization, (ii) a fixed amount of cash or (iii) a combination of the foregoing. In all cases, the number or value of common units or common stock will be subject to working capital adjustments and changes in indebtedness encumbering the properties, among other things. The value of common units or common stock issued will be equal to (i) the initial public offering price of our common stock in this offering, multiplied by (ii) such number of common units or common stock. We will contribute any interests in the Property Ownership Entities that we acquire to our operating partnership in exchange for common units equal to the number of shares of our common stock issued in the formation transactions.

### **Determination of Offering Price**

Prior to this offering, there has been no public market for our common stock. The initial public offering price will be negotiated between the representatives of the underwriters and us. In determining the initial public offering price of our common stock, we and the representatives of the underwriters will consider, among other things, our record of operations, our management, our estimated net income, our estimated funds from operations, our estimated cash available for distribution, our anticipated dividend yield, our growth prospects, the financial performance and dividend yields of publicly traded companies considered by us and the underwriters to be comparable to us and the current state of the commercial real estate industry and the economy as a whole. The initial public offering price does not necessarily bear a direct relationship to the book value of the properties and assets to be acquired in the formation transactions, our financial condition or any other established criteria of value and may not be indicative of the market price for our common stock after this offering.

**Table of Contents**

**USE OF PROCEEDS**

After deducting the estimated underwriting discounts and expenses of this offering and the formation transactions payable by us, we estimate that the net proceeds that we will receive from this offering will be approximately \$89.4 million, or approximately \$103.4 million if the underwriters' over-allotment option is exercised in full, in each case, assuming an initial public offering price of \$15.00 per share (which is the midpoint of the initial public offering price range set forth on the cover page of this prospectus). A \$1.00 increase (decrease) in the assumed initial public offering price of \$15.00 per share would increase (decrease) net proceeds to us from this offering by approximately \$6,666,667, assuming the number of shares offered by us as set forth on the cover page of this prospectus remains the same. We will contribute the net proceeds of this offering to our operating partnership in exchange for common units, and we expect that our operating partnership will use the proceeds as described below:

- approximately \$19.4 million to acquire interests in our initial properties, including the payment of transaction expenses in connection with the contribution of our initial properties in the formation transactions;
- approximately \$6.5 million to repay portions of certain mortgage loans <sup>(1)</sup> as the proceeds from our new mortgage loans will be less than the amount of mortgage loans we will repay in connection with this offering; and
- the remaining approximately \$63.5 million for general working capital purposes, including payment of expenses associated with our formation transactions, future acquisitions and creating reserves for capital expenditures, tenant improvements and leasing commissions.

If the underwriters elect to exercise all or any part of their over-allotment option, we will use all of the additional net proceeds from such exercise to redeem from the Second City Group, for cash, a portion of the common stock and common units issued to them in the formation transactions at a redemption price per common unit or share of common stock equal to the public offering price per share in this offering.

Pending application of the net proceeds, our Advisor will invest the net proceeds from this offering for our benefit in interest-bearing accounts and short-term, interest-bearing securities in a manner that is consistent with our intention to qualify for taxation as a REIT. These investments are expected to provide a lower net return than we will seek to achieve from our investment in office properties.

*(1) The \$6.5 million will be used to repay portions of certain mortgage loans secured by our initial properties, including a \$50 million mortgage loan secured by the Cherry Creek property, which bears interest at 5% and matures in January 2016, a \$20.9 million mortgage loan secured by the City Center property, which bears interest at 6.00% and matures in June 2014, a \$10 million mortgage loan secured by the Central Fairwinds property, which bears interest at 6.25% and matures in October 2015, and a \$19.5 million mortgage loan secured by the Corporate Parkway property, which bears interest at 7.25% and matures in April 2016.*



**Table of Contents**

**DISTRIBUTION POLICY**

We intend to elect and qualify to be treated as a REIT commencing with our taxable year ending December 31, 2014. U.S. federal income tax law requires that a REIT distribute annually at least 90% of its net taxable income, excluding net capital gains, and that it pay tax at regular corporate rates to the extent that it annually distributes less than 100% of its net taxable income, including net capital gains. In addition, a REIT is required to pay a 4% nondeductible excise tax on the amount, if any, by which the distributions that it makes in a calendar year are less than the sum of 85% of its ordinary income, 95% of its capital gain net income and 100% of its undistributed income from prior years. For more information, please see U.S. Federal Income Tax Considerations. To satisfy the requirements to qualify as a REIT and generally not be subject to U.S. federal income and excise tax, we generally intend to make regular quarterly distributions to holders of our common stock, beginning at such time as our board of directors determines that we have sufficient cash flow to do so, over time in an amount equal to our taxable income, which would be reduced by, among other things, the amount of the annual advisory fee and any acquisition fees payable, and offering expenses reimbursable, to our Advisor pursuant to the Advisory Agreement. Although we anticipate making quarterly distributions to our stockholders over time, our board of directors has the sole discretion to determine the timing, form (including cash and shares of our common stock at the election of each of our stockholders) and amount of any distributions to our stockholders. Although not currently anticipated, in the event that our board of directors determines to make distributions in excess of the income or cash flow generated from our portfolio of assets, we may make such distributions from the proceeds of this or future offerings of equity or debt securities or other forms of debt financing or the sale of assets.

If we pay a taxable stock distribution, our stockholders would be sent a form that would allow each stockholder to elect to receive its proportionate share of such distribution in all cash or in all stock and the distribution will be made in accordance with such elections, provided that if the stockholders' elections, in the aggregate, would result in the payment of cash in excess of the maximum amount of cash to be distributed, then cash payments to stockholders who elected to receive cash will be prorated and the excess of each such stockholder's entitlement in the distribution, less such prorated cash payment, would be paid to such stockholder in shares of our common stock.

To the extent that in respect of any calendar year, cash available for distribution is less than our taxable income, we could be required to fund distributions from working capital, sell assets or borrow funds to make cash distributions or make a portion of the required distribution in the form of a taxable stock distribution or distribution of debt securities. In addition, we could be required to utilize the net proceeds of this offering to fund our quarterly distributions, which would reduce the amount of cash that we have available for investing and other purposes. For more information, see U.S. Federal Income Tax Considerations Annual Distribution Requirements.

Our charter allows us to issue preferred stock that could have a preference over our common stock with respect to distributions. We currently have no intention to issue any preferred stock, but if we do, the distribution preference on the preferred stock could limit our ability to make distributions to the holders of our common stock.

Dividends and other distributions made by us will be authorized and determined by our board of directors in its sole discretion out of funds legally available therefor and will be dependent upon a number of factors, including restrictions under applicable law and other factors described below. We cannot assure you that our distributions will be made or sustained or that our board of directors will not change our distribution policy in the future. Any dividends or other distributions that we pay in the future will depend upon our actual results of operations, economic conditions, debt service requirements, capital expenditures and other factors that could differ materially from our current expectations. Our actual results of operations will be affected by a number of factors, including our revenue, operating expenses, interest expense and unanticipated expenditures. For more information regarding risk factors that could materially adversely affect our actual results of operations, see Risk Factors.





Table of Contents**CAPITALIZATION**

The following table sets forth the historical combined cash and cash equivalents and capitalization of the City Office Predecessor as of December 31, 2013 on an actual basis, as adjusted to give effect to the formation transactions but before giving effect to this offering and as further adjusted to give effect to this offering and the intended use of the net proceeds from this offering as described in Use of Proceeds. You should read this table in conjunction with Structure and Formation of Our Company, Use of Proceeds, Selected Financial Data, Management's Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and related notes appearing elsewhere in this prospectus.

	<b>As of December 31, 2013</b>		
	<b>Historical</b>	<b>Pro Forma Formation Transactions</b>	<b>Pro Forma Adjusted (1)(2)(3)</b>
Cash and cash equivalents	\$ 7,127,764	\$ 8,195,289	\$ 67,471,766
Debt:			
Total debt <sup>(4)</sup>	\$ 109,916,430	\$ 159,916,430	\$ 153,449,159
Equity:			
Common stock, \$0.01 par value per share; 100,000 shares authorized, actual; 1,000 shares issued and outstanding, actual; 100,000,000 shares authorized, as adjusted; 8,912,699 shares issued and outstanding, as adjusted <sup>(2)(3)</sup>		10	89,127
Preferred stock, \$0.01 par value per share; no shares authorized, actual; no shares issued and outstanding, actual; 100,000,000 shares authorized, as adjusted; no shares issued and outstanding, as adjusted			
Additional paid-in capital		990	89,516,081
City Office Predecessor equity	26,624,375	23,684,365	
Total stockholders' equity			
Noncontrolling interests in Our Operating Partnership			395,199
Noncontrolling interests in properties	1,083,740	815,092	(1,870,484)
Total equity	27,708,115	24,500,457	88,129,923
<b>Total Capitalization <sup>(5)</sup></b>	<b>\$ 137,624,545</b>	<b>\$ 184,416,887</b>	<b>\$ 241,579,082</b>

(1) Does not include the exercise of the underwriters' option to purchase up to 1,000,000 additional shares of our common stock.

(2) The common stock outstanding as shown includes 379,074 shares of our common stock to be issued upon vesting and settlement of equity compensation grants to our executive officers. Does not include 1,000 shares of common

*stock initially issued to Second City and which will be repurchased by us at cost upon the completion of this offering or 884,506 shares of our common stock or LTIP units available for future issuance under the Equity Incentive Plan. See Executive and Director Compensation Equity Incentive Plan.*

- (3) Assumes 6,666,667 shares of common stock will be sold in this offering at an initial public offering price of \$15 per share for net proceeds of approximately \$87.6 million after deducting the underwriting discounts and estimated expenses of this offering and the formation transactions of approximately \$12.4 million. See Use of Proceeds.*
- (4) We expect to enter into the New Mortgage Loan and the Revolving Credit Facility prior to, or concurrently with, the closing of this offering. Following the formation transactions, the Washington Group Plaza property will remain subject to the Washington Mortgage Loan and the AmberGlen property will remain subject to the AmberGlen Mortgage Loan unless the AmberGlen Refinancing has occurred prior to the closing of this offering.*
- (5) Each \$1.00 increase (decrease) in the initial public offering price per share would increase (decrease) each of pro forma as adjusted cash and cash equivalents, additional paid-in capital, stockholders' equity and total capitalization by approximately \$6,200,000, assuming that the number of shares that we are offering, as set forth on the cover page of this prospectus, remains the same and that the underwriters do not exercise their over-allotment option. An increase (decrease) of 1,000,000 shares that we are offering would increase (decrease) each of pro forma as adjusted cash and cash equivalents, additional paid in capital, stockholders' equity and total capitalization by approximately \$13,950,000, assuming the initial public offering price per share remains the same. If the underwriters elect to exercise all or any part of their over-allotment option, we will use all of the additional net proceeds from such exercise to redeem from the Second City Group, for cash, a portion of the common stock and common units issued to them in the formation transactions at a redemption price per common unit or share of common stock equal to the public offering price per share in this offering.*

**Table of Contents****DILUTION**

Purchasers of shares of our common stock offered in this prospectus will experience an immediate and substantial dilution in the net tangible book value per share of our common stock from the initial public offering price. As of December 31, 2013, after adjusting for our acquisition of a controlling interest in the Cherry Creek property which occurred on January 2, 2014, we had a pro forma combined net tangible book value of \$740,060, or \$0.13 per share of our common stock, assuming the exchange of all outstanding common units into shares of our common stock on a one-for-one basis. After giving effect to the sale of the shares of our common stock offered hereby, including the use of proceeds as described under Use of Proceeds, the formation transactions, the deduction of underwriting discounts and the estimated offering and formation transactions expenses payable by us, the pro forma net tangible book value as of December 31, 2013 attributable to common stockholders, including the effects of the grants of awards covering shares of our common stock to our directors and executive officers and our Advisor, would have been \$57,776,899, or \$4.57 per share of our common stock. This amount represents an immediate increase in net tangible book value of \$4.44 per share to prior investors and an immediate dilution in pro forma net tangible book value of \$10.43 per share from the assumed public offering price of \$15.00 per share of our common stock to new public investors. The following table illustrates this per share dilution:

Assumed initial public offering price per share	\$ 15.00
Net tangible book value per share before the formation transactions and this offering <sup>(1)</sup>	0.13
Net increase/decrease in pro forma net tangible book value per share attributable to the formation transactions	(1.23)
Net increase/decrease in pro forma net tangible book value per share attributable to this offering	5.67
Pro forma net tangible book value per share after the formation transactions and this offering <sup>(2)</sup>	4.57
Dilution in pro forma net tangible book value per share to new investors <sup>(3)</sup>	\$ 10.43

(1) Net tangible book value per share of our common stock before the formation transactions and this offering is determined by dividing net tangible book value based on December 31, 2013, after adjusting for our acquisition of a controlling interest in the Cherry Creek property which occurred on January 2, 2014, net book value of the tangible assets (consisting of total assets less intangible assets, which are comprised of goodwill (if applicable), deferred financing and leasing costs, acquired above-market leases and acquired in place lease value, net of liabilities to be assumed, excluding acquired below market leases) by us by the number of shares of our common stock held by prior investors after this offering, assuming the exchange for shares of our common stock on a one-for-one basis of the common units to be issued in connection with the formation transactions.

(2) Based on pro forma net tangible book value of approximately \$57,776,899 after completion of the formation transactions and this offering divided by the sum of 12,635,809 shares of our common stock and common units to be outstanding after this offering and the formation transactions, not including 1,000,000 shares of our common stock issuable upon exercise of the underwriters' over-allotment option.

(3) Dilution is determined by subtracting pro forma net tangible book value per share of our common stock after giving effect to the formation transactions and this offering from the initial public offering price paid by a new investor for a share of our common stock.



**Table of Contents**

The following table summarizes, as of December 31, 2013, after adjusting for our acquisition of a controlling interest in the Cherry Creek property which occurred on January 2, 2014, on the same pro forma basis after giving effect to this offering and the formation transactions, the differences between the number of shares of our common stock and common units to be received by the prior investors in the formation transactions, the number of shares of our common stock or restricted stock units covering shares of our common stock issuable to our directors and executive officers and our Advisor and the number of shares of our common stock purchased by the new investors in this offering, and between the total consideration paid and the average price per share or common unit paid by the prior investors in the formation transactions (based on the net tangible book value of the assets and properties being acquired by us and our operating partnership in the formation transactions) and the total consideration paid and the average price per share paid by our directors and executive officers and our Advisor and by the new investors purchasing shares of our common stock in this offering.

	Common Units/Shares Issued		Net Tangible Book Value of Contribution <sup>(1)</sup> /Cash		Average Price
	Number	Percentage	Amount	Percentage	Per Share/ Common Unit
	(in thousands)		(in thousands)		
Prior Investors	5,590	44.2%	\$ 740	0.7%	\$ 0.13
Management Awards <sup>(2)</sup>	379	3.0			
New Investors	6,667	52.8	100,000	99.3	15.00
<b>Total</b>	<b>12,636</b>	<b>100.0%</b>	<b>\$ 100,740</b>	<b>100.0%</b>	

(1) Represents pro forma net tangible book value as of December 31, 2013, of the assets contributed to us in the formation transactions after adjusting for our acquisition of a controlling interest in Cherry Creek which occurred on January 2, 2014.

(2) Represents restricted stock units to be granted to our directors and executive officers and our Advisor under the Equity Incentive Plan upon completion of the offering.

**Table of Contents**

**SELECTED FINANCIAL DATA**

*The following financial data should be read in conjunction with the audited and unaudited financial statements and the related notes, and our unaudited pro forma financial information and the related notes, included elsewhere in this prospectus.*

The following table sets forth selected financial and operating data on (i) a consolidated pro forma basis for our company after giving effect to (a) the formation transactions, including our acquisition of interests in our initial properties, and required purchase accounting adjustments, (b) the estimated net proceeds, including the use thereof, from this offering as if each occurred on December 31, 2013 and (c) the continuance of the Washington Mortgage Loan and the AmberGlen Mortgage Loan, the incurrence, including the use thereof, of indebtedness under the New Mortgage Loan and our entry into the Revolving Credit Facility, and (ii) a combined historical basis for the real estate activity and holdings of the entities that own the historical interests in the AmberGlen, Central Fairwinds, City Center, Cherry Creek, Corporate Parkway and Washington Group Plaza properties, which are the initial properties being contributed to us in the formation transactions. We have not presented historical information for City Office because we have not had any corporate activity since our formation other than the issuance of 1,000 shares of common stock to Second City in connection with our initial capitalization, and activity in connection with the formation transactions and this offering, and because we believe that a discussion of the results of City Office would not be meaningful.

The historical combined balance sheet information as of December 31, 2013 and December 31, 2012 of the City Office Predecessor and the combined statements of operations information for the years ended December 31, 2013 and December 31, 2012 of the City Office Predecessor have been derived from the historical audited combined financial statements included elsewhere in this prospectus.

Our unaudited pro forma consolidated financial statements and operating information as of and for the year ended December 31, 2013 assume completion of this offering and the formation transactions as of the beginning of the periods presented for the operating data and as of the stated date for the balance sheet data. Our pro forma financial information is not necessarily indicative of what our actual financial position and results of operations would have been as of the date and for the periods indicated, nor does it purport to represent our future financial position or results of operations.

The information presented below should be read in conjunction with Capitalization, Management's Discussion and Analysis of Financial Condition and Results of Operations, Certain Relationships and Related Person Transactions and our audited and unaudited financial statements and related notes, which are included elsewhere in this prospectus.

**Table of Contents****City Office REIT, Inc. (Pro Forma) and the City Office Predecessor (Historical)**

	<b>Year Ended December 31,</b>		
	<b>Pro Forma Consolidated 2013 (Unaudited)</b>	<b>Historical Combined 2013</b>	<b>2012</b>
<b>Statement of Operations Data:</b>			
<b>Revenues</b>			
Rental income	\$ 29,598,376	\$ 18,427,794	\$ 9,991,712
Expense reimbursement	2,185,817	1,316,068	1,053,466
Other	785,162	746,716	471,280
<b>Total Revenues</b>	<b>\$ 32,569,355</b>	<b>\$ 20,490,578</b>	<b>\$ 11,516,458</b>
<b>Operating Expenses</b>			
Property operating expenses	\$ 8,873,869	\$ 6,021,287	\$ 4,109,993
Insurance	610,906	518,361	398,083
Property taxes	1,805,440	1,385,954	969,564
Property acquisition costs	1,479,292	1,479,292	212,765
Base management fee	1,283,128		
General and administrative	1,477,000		
Property management fees	665,325	539,460	571,420
Stock based compensation	1,895,371		
Depreciation and amortization	13,065,765	7,775,219	3,956,204
<b>Total Operating Expenses</b>	<b>\$ 31,156,096</b>	<b>\$ 17,719,573</b>	<b>\$ 10,218,029</b>
<b>Operating Income</b>	<b>\$ 1,413,259</b>	<b>\$ 2,771,005</b>	<b>\$ 1,298,429</b>
<b>Other Expense (income)</b>			
Canadian offerings costs	\$ 1,983,195	\$ 1,983,195	\$
Interest expense, net	7,197,139	5,368,016	3,685,881
Equity in income of unconsolidated entity		(402,913)	(505,877)
<b>Net Loss</b>	<b>\$ (7,767,075)</b>	<b>\$ (4,177,293)</b>	<b>\$ (1,881,575)</b>
Net Loss Attributable to Noncontrolling Interests in the Properties	\$ (190,624)	\$ 44,368	\$ 286,481
	(7,957,699)	(4,132,925)	(1,595,094)
Net Loss Attributable to Noncontrolling Interests in Operating Partnership	2,415,991		
<b>Net Loss Attributable to City Office REIT, Inc./City Office Predecessor</b>	<b>(5,541,708)</b>	<b>(4,132,925)</b>	<b>(1,595,094)</b>



**Balance Sheet Data (at year end):**

Real estate properties, net of accumulated depreciation	\$ 146,015,624	\$ 100,126,486	\$ 42,171,832
Investments in unconsolidated entity		4,337,899	4,882,753
<b>Total Assets</b>	<b>254,658,665</b>	<b>143,639,341</b>	<b>61,016,126</b>
Mortgage loans payable	153,449,159	109,916,430	53,256,600
<b>Total Liabilities</b>	<b>166,528,742</b>	<b>115,931,226</b>	<b>55,006,264</b>
Stockholder/Owners Equity	89,605,208	26,624,375	6,149,404
Noncontrolling interests in operating partnership	395,199		
Noncontrolling interests in properties	(1,870,484)	1,083,740	(139,542)
<b>Total Equity</b>	<b>\$ 88,129,923</b>	<b>\$ 27,708,115</b>	<b>\$ 6,009,862</b>

**Other Data:**

Cash flows from / (to):			
Operating activities		\$ 1,459,782	\$ 3,891,017
Investing activities		(75,105,500)	(17,109,811)
Financing activities		77,666,866	14,858,006

---

**Table of Contents**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion and analysis is based on, and should be read in conjunction with, the selected financial data, the audited combined financial statements and the related notes thereto of the City Office Predecessor as of December 31, 2013 and December 31, 2012 and for the periods then ended appearing elsewhere in this prospectus.*

*Where appropriate, the following discussion includes analysis of the formation transactions, certain other transactions and this offering. These effects are reflected in the pro forma consolidated financial statements located elsewhere in this prospectus.*

*As used in this section, unless the context otherwise requires, references to we, us, our and our company are to City Office REIT, Inc. and City Office REIT Operating Partnership, L.P. References to the City Office Predecessor are to the real estate activity and holdings of the entities that own the historical interests in the AmberGlen, Central Fairwinds, City Center, Cherry Creek, Corporate Parkway and Washington Group Plaza properties.*

*This management's discussion and analysis of financial condition and results of operations contains forward-looking statements that involve risks, uncertainties and assumptions. See Cautionary Statement Regarding Forward-Looking Statements for a discussion of the risks, uncertainties and assumptions associated with those statements. Our actual results may differ materially from those expressed or implied in the forward-looking statements as a result of various factors, including but not limited to those in Risk Factors and included in other portions of this prospectus.*

**Overview**

*Company*

We are a newly organized Maryland corporation formed on November 26, 2013 to acquire, own and operate high-quality office properties located within our specified markets in the United States. We have not had any corporate activity since our formation, other than the issuance of 1,000 shares of our common stock to Second City in connection with our initial capitalization and activities in preparation for this offering and the formation transactions. Accordingly, a discussion of our results would not be meaningful, and therefore, set forth below is a discussion regarding the historical operations of the City Office Predecessor only.

Following the completion of this offering, we and our operating partnership will acquire substantially all of our assets and our operating partnership will conduct substantially all of our operations. All of the initial property interests that we will acquire in the formation transactions currently are owned by the Property Ownership Entities. Pursuant to the formation transactions, (i) we intend to enter into the Advisory Agreement with our Advisor pursuant to which our Advisor will provide management and advisory services to us; (ii) we will sell 6,666,667 shares of our common stock in this offering (1,000,000 additional shares if the underwriters exercise their over-allotment option in full) and we will contribute the net proceeds to our operating partnership in exchange for 6,666,667 common units; and (iii) pursuant to separate contribution agreements, we and our operating partnership will acquire interests in the Property Ownership Entities in exchange for shares of common stock, common units and cash. We will contribute any interests in the Property Ownership Entities that we acquire to our operating partnership in exchange for common units.

As a result of the formation transactions, we will acquire a 100% interest in each of the Washington Group Plaza, Cherry Creek and Corporate Parkway properties and we will acquire an approximately 76% interest in the AmberGlen

property, 90% interest in the Central Fairwinds property and 95% interest in the City Center property. The parties retaining the remaining interests in the AmberGlen, Central Fairwinds and City Center properties at the conclusion of the formation transactions will not receive any common units, common stock or cash from us for their property interests. The value of the consideration to be paid to each of the entities in the Second City Group in the formation transactions will be determined according to the terms of the respective contribution agreements. The contributions will be effected concurrently with the completion of this offering.

Upon consummation of this offering and the formation transactions, we intend to elect and to qualify to be taxed as a REIT, commencing with our taxable year ending December 31, 2014, and generally will not be subject to U.S. federal taxes on our income that we currently distribute to our stockholders. We are structured as an UPREIT and will own substantially all

---

**Table of Contents**

of our assets and conduct substantially all of our business through our operating partnership, which was formed on December 12, 2013. We will serve as the sole general partner and expect to own an approximately 69.6% interest in our operating partnership upon consummation of this offering. Consummation of the formation transactions will enable us to consolidate ownership of our initial properties into our operating partnership; facilitate this offering; enable us to raise necessary capital to repay existing and future indebtedness related to certain properties in our portfolio; enable us to qualify as a REIT for U.S. federal income tax purposes commencing with our taxable year ending December 31, 2014; and preserve the tax position of certain continuing investors.

*Indebtedness*

We expect to enter into the New Mortgage Loan prior to, or concurrently with, the closing of this offering. Following the formation transactions, the Washington Group Plaza property will remain subject to the Washington Mortgage Loan and the AmberGlen property will remain subject to the AmberGlen Mortgage Loan unless the AmberGlen Refinancing has occurred prior to the closing of this offering. In addition, we expect to enter into the Revolving Credit Facility, which we expect will have an accordion feature that will permit us to borrow up to \$150 million, subject to additional collateral availability and lender approval.

For additional information regarding the New Mortgage Loan, the AmberGlen Mortgage Loan, the Washington Mortgage Loan and the Revolving Credit Facility, please refer to [Liquidity and Capital Resources](#) below.

*Revenue Base*

Upon consummation of this offering and the formation transactions, we will own six office complexes comprised of 16 office buildings with a total of approximately 1.85 million square feet of net rentable area. As of December 31, 2013, our initial properties were approximately 89% leased (or 91% after giving effect to committed leases, the terms of which have not yet commenced).

*Office Leases.* Historically, most leases for our initial properties were on a full-service gross or net lease basis, and we expect to continue to use such leases in the future. A full-service gross lease has a base year expense stop whereby we pay a stated amount of expenses as part of the rent payment while future increases (above the base year stop) in property operating expenses are billed to the tenant based on such tenant's proportionate square footage in the property. The property operating expenses are reflected in operating expenses, but only the increased property operating expenses above the base year stop recovered from tenants are reflected as tenant recoveries in the statements of income. In a net lease, the tenant is typically responsible for all property taxes and operating expenses. As such, the base rent payment does not include any operating expenses but rather all such expenses are billed to or paid by the tenant. The full amount of the expenses for this lease type is reflected in operating expenses, and the reimbursement is reflected in tenant recoveries. The tenant in the Corporate Parkway property has a net lease. We are also a lessor for a fee simple ground lease at the AmberGlen property. All of our remaining leases are full-service gross leases.

*Interest Rate Contracts.* As of December 31, 2013, the City Office Predecessor had an interest rate cap at the City Center property with a notional value of \$15 million, maturing in May 2014 with an effective fixed interest rate of 6%. This interest rate cap is expected to be canceled upon consummation of this offering. The interest rate cap had no value as of December 31, 2013.

**Factors That May Influence Our Operating Results and Financial Condition**

*Business and Strategy*

We will focus on acquiring office properties in our target markets that exhibit favorable economic growth trends, growing populations with above average employment growth forecasts, a large number of government offices, large international, national and regional employers across diversified industries, low-cost centers for business operations, proximity to large universities and increasing office occupancy rates. We expect to use our Advisor's market specific knowledge as well as the expertise of local real estate operators and our investment partners to identify acquisition opportunities that we believe will offer cash flow stability and long-term value appreciation. Our target markets are attractive, among other reasons, because we believe that ownership is often concentrated among local real estate operators that typically do not benefit from the same access to capital as public REITs and there is a relatively low level of participation of large institutional investors, which can result in attractive pricing levels and risk-adjusted returns.

**Table of Contents***Rental Revenue and Tenant Recoveries*

The amount of net rental revenue generated by our initial properties will depend principally on our ability to maintain the occupancy rates of currently leased space and to lease currently available space and space that becomes available from lease terminations. As of December 31, 2013, the percent leased for our initial properties was approximately 89% (or 91% when giving effect to committed leases, the terms of which have not yet commenced). The amount of rental revenue generated also will depend on our ability to maintain or increase rental rates at our initial properties. We believe that the average rental rates for our initial properties generally are equal to or slightly above the current average quoted market rates. Negative trends in one or more of these factors could adversely affect our rental revenue in future periods. Future economic downturns or regional downturns affecting our markets or submarkets or downturns in our tenants' industries that impair our ability to renew or re-let space and the ability of our tenants to fulfill their lease commitments, as in the case of tenant bankruptcies, could adversely affect our ability to maintain or increase rental rates at our properties. In addition, growth in rental revenue will also partially depend on our ability to acquire additional properties that meet our investment criteria.

*Scheduled Lease Expirations*

Year of Lease Expiration	Number of Leases Expiring	NRA of Expiring Leases	Percentage of Initial Properties NRA	Annualized Base Rent <sup>(1)</sup>	Percentage of Initial Properties Annualized Base Rent <sup>(1)</sup>	Annualized Base Rent per Leased Square Foot Expiring <sup>(2)</sup>
Vacant and Contracted <sup>(3)</sup>		196,543	10.6%	\$	0.0%	\$
2014	16	64,684	3.5	1,392,816	4.7	21.53
2015	12	238,136	12.9	4,061,949	13.7	17.06
2016	19	410,380	22.1	7,446,412	25.0	18.15
2017	20	256,392	13.8	4,122,227	13.9	16.08
2018	19	210,814	11.4	3,955,397	13.3	18.76
2019	10	89,824	4.8	1,875,614	6.3	20.88
2020	2	18,721	1.0	365,242	1.2	19.51
2021	2	13,158	0.7	253,445	0.8	19.26
2022	2	17,746	1.0	409,908	1.4	23.10
2023	1	2,022	0.1	15,600	0.1	7.72
Thereafter	3	334,806	18.1	5,838,206	19.6	17.44
<b>Total / Weighted Average:</b>	<b>106</b>	<b>1,853,226</b>	<b>100.0%</b>	<b>\$ 29,736,816</b>	<b>100.0%</b>	<b>\$ 17.95</b>

(1) Annualized base rent is calculated by multiplying (i) rental payments (defined as cash rents before abatements) for the month ended December 31, 2013, by (ii) 12.

(2) Annualized base rent per leased square foot expiring reflects annualized base rent (as defined above), divided by NRA of expiring leases in the period.

*(3) As of December 31, 2013, our initial properties had 35,461 square feet of contracted net rentable area related to seven leases collectively at the City Center, AmberGlen and Central Fairwinds properties.*

*Operating Expenses*

Our operating expenses generally consist of utilities, property and ad valorem taxes, insurance and site maintenance costs. Increases in these expenses over tenants' base years are generally passed on to tenants in our full-service gross leased properties and are generally paid in full by tenants in our net leased properties. As a public company, we estimate that our annual general and administrative expenses will increase due to increased legal, insurance, accounting and other expenses related to corporate governance, SEC reporting and other compliance matters, compared to the period prior to the initial public offering. In addition, we expect that our initial properties may be reassessed for local real estate tax purposes after the consummation of the formation transactions.

*Conditions in Our Markets*

Positive or negative changes in economic or other conditions in the markets we operate in, including state budgetary shortfalls, employment rates, natural hazards and other factors, may impact our overall performance.

---

**Table of Contents**

**Summary of Significant Accounting Policies**

*Basis of Preparation*

The City Office Predecessor represents a combination of certain entities holding interests in real estate that are commonly controlled. Due to their common control, the financial statements of the separate entities which own our initial properties are presented on a combined basis.

The accompanying combined financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ). All significant intercompany balances and transactions have been eliminated in combination.

Variable interest entities ( VIE ) are accounted for within the scope of Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) 810, Consolidation and are required to be consolidated by their primary beneficiary. The primary beneficiary of a variable interest entity is the enterprise that has the power to direct the activities that most significantly impact the variable interest entity s economic performance and the obligation to absorb losses or the right to receive benefits of the variable interest entity that could be significant to the variable interest entity. We have evaluated the applicability of ASC Topic 810 to our investments in ROC-SCCP Cherry Creek I, LP and determined that this entity is not a variable interest entity or that the City Office Predecessor is not the primary beneficiary and, therefore, consolidation of this investment is not required. The investments are accounted for using the equity method of accounting.

*Use of Estimates*

We have made a number of significant estimates and assumptions relating to the reporting of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses to prepare these combined financial statements in conformity with GAAP. These estimates and assumptions are based on our best estimates and judgment. We evaluate our estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment. The current economic environment has increased the degree of uncertainty inherent in these estimates and assumptions. Management adjusts such estimates when facts and circumstances dictate. The most significant estimates made include the recoverability of accounts receivable, allocation of property purchase price to tangible and intangible assets acquired and liabilities assumed, the determination of VIEs and which entities should be consolidated, the determination of impairment of long-lived assets, loans receivable and equity method investments, valuation of derivative financial instruments and the useful lives of long-lived assets. Actual results could differ materially from those estimates.

*Business Combinations*

The fair value of the real estate acquired, which includes the impact of fair value adjustments for assumed mortgage debt related to property acquisitions, is allocated to the acquired tangible assets, consisting of land, building and improvements and identified intangible assets and liabilities, consisting of the value of above-market and below-market leases, other value of in place leases and value of tenant relationships, based in each case on their fair values. Acquisition costs are expensed as incurred in the accompanying combined statement of income. Also, noncontrolling interests acquired are recorded at estimated fair market value.

The fair value of the tangible assets of an acquired property (which includes land, building and improvements and fixtures and equipment) is determined by valuing the property as if it were vacant. The as-if-vacant value is then allocated to land and building and improvements based on our determination of relative fair values of these assets.



Factors considered by us in performing these analyses include an estimate of carrying costs during the expected lease-up periods considering current market conditions and costs to execute similar leases. In estimating carrying costs, we include real estate taxes, insurance and other operating expenses and estimates of lost rental revenue during the expected lease-up periods based on current market demand. We also estimate costs to execute similar leases including leasing commissions.

The fair value of above-market and below-market lease values are recorded based on the difference between the current in place lease rent and our estimate of current market rents. Below-market lease intangibles are recorded as part

## **Table of Contents**

lease intangibles liability and amortized into rental revenue over the non-cancelable periods and bargain renewal periods of the respective leases. Above-market leases are recorded as part of intangible assets and amortized as a direct charge against rental revenue over the non-cancelable portion of the respective leases.

The fair value of acquired in place leases are recorded based on the costs we estimate we would have incurred to lease the property to the occupancy level of the property at the date of acquisition. Such estimates include the fair value of leasing commissions and legal costs that would be incurred to lease the property to this occupancy level. Additionally, we evaluate the time period over such occupancy level would be achieved and include an estimate of the net operating costs incurred during the lease-up period.

### *Revenue Recognition*

We recognize lease revenue on a straight-line basis over the term of the lease. Certain leases allow for the tenant to terminate the lease, but the tenant must make a termination payment as stipulated in the lease. If the termination payment is in such an amount that continuation of the lease appears, at the time of lease inception, to be reasonably assured, then we recognize revenue over the term of the lease. We have determined that for these leases, the termination payment is in such an amount that continuation of the lease appears, at the time of inception, to be reasonably assured. We recognize lease termination fees as other revenue in the period received and write off unamortized lease-related intangible and other lease-related account balances, provided there are no further obligations by us under the lease. Otherwise, such fees and balances are recognized on a straight-line basis over the remaining obligation period with the termination payments being recorded as a component of rent receivable-deferred or deferred revenue on the combined balance sheets.

If we fund tenant improvements and the improvements are deemed to be owned by us, revenue recognition will commence when the improvements are substantially completed and possession or control of the space is turned over to the tenant. If we determine that the tenant allowances are lease incentives, we commence revenue recognition when possession or control of the space is turned over to the tenant for tenant work to begin. The lease incentive is recorded as a deferred expense and amortized as a reduction of revenue on a straight-line basis over the respective lease term.

Recoveries from tenants for real estate taxes, insurance and other operating expenses are recognized as revenues in the period that the applicable costs are incurred. We recognize differences between estimated recoveries and the final billed amounts in the subsequent year. Final billings to tenants for real estate taxes, insurance and other operating expenses did not vary significantly as compared to the estimated receivable balances.

Expenditures for maintenance and repairs are charged to operations as incurred.

### *Impairment of Real Estate Properties*

Long-lived assets currently in use are reviewed periodically for possible impairment and will be written down to fair value if considered impaired. Long-lived assets to be disposed of are written down to the lower of cost or fair value less the estimated cost to sell. We review our real estate properties for impairment when there is an event or a change in circumstances that indicates that the carrying amount may not be recoverable. We measure and record impairment losses and reduce the carrying value of properties when indicators of impairment are present and the expected undiscounted cash flows related to those properties are less than their carrying amounts. In cases in which we do not expect to recover our carrying costs on properties held for use, we reduce our carrying costs to fair value. We do not believe that the values of our initial properties are impaired as of December 31, 2013 and December 31, 2012.

### *Derivative Instruments and Hedging Activities*

We record all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on whether we have elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. We have not elected to designate any instruments as a hedge under ASC 815-10.

**Table of Contents**

As of December 31, 2013 and December 31, 2012, we had interest rate caps that are not designated as hedges. These derivatives are not speculative and were used to manage the City Office Predecessor's exposure to interest rate movements and other identified risks, but we have elected not to designate these instruments in hedging relationships based on the provisions in ASC 815-10. The changes in fair value of derivatives not designated in hedging relationships have been recognized in earnings. Summarized below are the interest rate derivatives that were not designated as cash flow hedges and the fair value of all derivative assets and liabilities as of December 31, 2013 and December 31, 2012:

Property	Type of Instrument	Notional Amount	Maturity Date	Effective Rate	Fair Value as of	
					December 31, 2013	December 31, 2012
City Center	Interest Rate Swap	\$ 15,000,000	June 2014	6.0%	\$	\$ 3,000

*Fair Value of Financial Instruments*

ASC 820-10, Fair Value Measurements and Disclosures ( ASC 820-10 ) defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. ASC 820-10 applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements; accordingly, the standard does not require any new fair value measurements of reported balances.

ASC 820-10 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, ASC 820-10 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, which is typically based on an entity's own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

*Cash Equivalents, Restricted Cash, Accounts Receivable and Accounts Payable and Accrued Liabilities*

We estimate that the fair value approximates carrying value due to the relatively short-term nature of these instruments.

*Interest Rate Swap*

The majority of the inputs used to value our interest rate swap liability fall within Level 2 of the fair value hierarchy, such as observable market interest rate curves; however, the credit valuation associated with the interest rate swap liability utilizes Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by us and our counterparties. As of December 31, 2013 and December 31, 2012, we determined that the credit valuation adjustment relative to the overall interest rate swap liability is not significant. As a result, the entire interest rate swap liability has been classified in Level 2 of the fair value hierarchy.

**Table of Contents***Mortgage Loans Payable*

We determine the fair value of the City Office Predecessor's fixed rate debt based on a discounted cash flow analysis using a discount rate that approximates the current borrowing rates for instruments of similar maturities. Based on this, we have determined that the fair value of these instruments was \$88.5 million and \$35.7 million as of December 31, 2013 and December 31, 2012, respectively. Loans with variable rate interest are excluded from the amount noted as the carrying value approximates the fair value. Although we have determined that the majority of the inputs used to value fixed rate debt fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with our fixed rate debt utilize Level 3 inputs, such as estimates of current credit spreads. However, as of December 31, 2013 and December 31, 2012, we assessed the significance of the impact of the credit valuation adjustments on the overall valuation of the City Office Predecessor's fixed rate debt and determined that the credit valuation adjustments are not significant to the overall valuation of the City Office Predecessor's fixed rate debt. Accordingly, mortgage loans payable have been classified as Level 2 fair value measurements.

**New Accounting Pronouncements**

During February 2013, the FASB issued Accounting Standards Update (ASU) No. 2013-02, Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income. ASU 2013-02 requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. ASU is effective prospectively for reporting periods beginning after December 15, 2012. The adoption of ASU 2013-02 is not expected to have a material impact on our financial condition or results of operations.

**JOBS Act**

In April 2012, the JOBS Act was enacted. Section 107 of the JOBS Act provides that an emerging growth company can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act of 1933, as amended (the Securities Act), for complying with new or revised financial accounting standards. An emerging growth company can therefore delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. However, we have determined to opt out of such extended transition period and, as a result, we will comply with new or revised financial accounting standards on the relevant dates on which adoption of such standards is required for non-emerging growth companies.

**Results of Operations***Overview*

The following table identifies the date of acquisition for those properties that were acquired during the reporting period.

<b>Acquired Properties</b>	<b>Acquisition Date</b>	<b>NRA (000s SF)</b>
Central Fairwinds	May 2012	169

Corporate Parkway	May 2013	178
Washington Group Plaza	June 2013	558
<b>Total</b>		<b>905</b>

All amounts and percentages used in this discussion of our results of operations are calculated using the numbers presented in the financial statements contained in this report rather than the rounded numbers appearing in this discussion.

**Table of Contents***Comparison of Year Ended December 31, 2013 to Year Ended December 31, 2012**Revenue*

*Total Revenue.* Revenue includes net rental income, including parking, signage and other income, as well as the recovery of operating costs and property taxes from tenants. Total revenues increased \$9.0 million, or 78%, to \$20.5 million for the year ended December 31, 2013 compared to \$11.5 million in the corresponding period in 2012. Approximately \$0.3 million of the increase resulted from the acquisition of the Central Fairwinds property in May 2012 as the year ended December 31, 2013 includes a full period of rental and other income from this property. Revenue also increased by \$2.0 million from the acquisition of the Corporate Parkway property in May 2013 and \$5.1 million from the acquisition of the Washington Group Plaza property in June 2013. The remaining increase of \$1.6 million in revenues is driven by increased occupancy at the City Center and AmberGlen properties, both of which were owned throughout both periods.

*Rental Income.* Rental income includes net rental income, income from the City Office Predecessor's ground lease and lease termination income. Total rental income increased \$8.4 million, or 84%, to \$18.4 million for the year ended December 31, 2013 compared to \$10.0 million for the year ended December 31, 2012. The increase in rental income was primarily due to the acquisitions described above and an increase in average occupancy year-over-year at the City Center and AmberGlen properties. The increase in rental income contributed by a full year of operating results at the Central Fairwinds property was a total of \$0.2 million. The acquisition of the Corporate Parkway and Washington Group Plaza properties contributed an additional \$2.0 million and \$4.8 million in additional rental income, respectively. The remaining increase of \$1.4 million was due to an increase in average occupancy year-over-year for the City Center and AmberGlen properties.

*Expense Reimbursement.* Total expense reimbursement increased \$0.3 million, or 25%, to \$1.3 million for the year ended December 31, 2013 compared to \$1.0 million for the year ended December 31, 2012, primarily due to the acquisition of the Central Fairwinds and Washington Group Plaza properties described above. The Corporate Parkway property, which was acquired in May 2013, is a net lease and does not have any expense reimbursements. Increase in expense reimbursement was also driven by overall increase in occupancy at AmberGlen for the year ended December 31, 2013 when compared with December 31, 2012. Expense reimbursement increased \$0.3 million as a result of the Washington Group Plaza property acquisition. The Central Fairwinds and City Center expense reimbursements remained consistent year over year.

*Other.* Other revenues includes parking, signage and other miscellaneous income. Total other revenues increased \$0.2 million, or 58%, to \$0.7 million for the year ended December 31, 2013 compared to \$0.5 million for the year ended December 31, 2012, primarily due to increased parking income at City Center and Central Fairwinds. The Corporate Parkway property, which was acquired in May 2013, is a net lease and does not have any other income.

*Operating Expenses*

*Total Operating Expenses.* Total operating expenses consist of property operating expenses, as well as insurance, property taxes, property acquisition costs, management fees and depreciation and amortization. Total operating expenses increased by \$7.5 million, or 73%, to \$17.7 million for the year ended December 31, 2013, from \$10.2 million for the same period in 2012. This increase in total operating expenses is attributable primarily to the factors discussed below.

*Property Operating Expenses.* Property operating expenses are comprised mainly of building common area and maintenance expenses, as well as certain expenses that are not recoverable from tenants, the majority of which are



related to costs necessary to maintain the appearance and marketability of vacant space. In the normal course of business, property expenses fluctuate and are impacted by various factors including, but not limited to, occupancy levels, weather, utility costs, repairs, maintenance and re-leasing costs. Property operating expenses increased \$1.9 million, or 47%, to \$6.0 million for the year ended December 31, 2013 compared to \$4.1 million for the year ended December 31, 2012. The increase in property operating expenses was due to an increase of \$0.4 million for the year ended December 31, 2013, which includes a full period of operating expense from the Central Fairwinds property and an increase of \$1.7 million due to the acquisition of the Washington Group Plaza property. This increase was offset by a decrease of \$0.2 million in operating expenses due to cost savings initiatives implemented at the City Center and AmberGlen properties.

## **Table of Contents**

*Insurance.* Insurance costs increased \$0.1 million, or 30%, to \$0.5 million for the year ended December 31, 2013 compared to \$0.4 million for the year ended December 31, 2012 primarily due to the acquisition of the Central Fairwinds and Washington Group Plaza properties.

*Property Taxes.* Property taxes increased \$0.4 million, or 43%, to \$1.4 million for the year ended December 31, 2013 compared to \$1.0 million for the year ended December 31, 2012, primarily due to the acquisition of the Central Fairwinds and Washington Group Plaza properties.

*Property Acquisition Costs.* Property acquisition costs increased \$1.3 million to \$1.5 million for the year ended December 31, 2013 as a result of the Corporate Parkway and Washington Group Plaza acquisitions during the period compared to \$0.2 million for the year ended December 31, 2012 when the Central Fairwinds property was acquired.

*Property Management Fees.* Property management fees were relatively unchanged for the year ended December 31, 2013 compared to the year ended December 31, 2012. Property management fees increased \$0.1 million related to the acquisition of the Central Fairwinds and Washington Group Plaza properties during the 2013 period which was offset by a \$0.1 million decrease at the AmberGlen property related to non-recurring management fees incurred in 2012.

*Depreciation and Amortization.* Depreciation and amortization increased \$3.8 million, or 97%, to \$7.8 million for the year ended December 31, 2013 compared to \$4.0 million for the year ended December 31, 2012, primarily due to the acquisition of the Central Fairwinds and Washington Group Plaza properties.

### *Other Expense (Income)*

*Canadian Offering Costs.* \$2.0 million of transaction costs for the year ended December 31, 2013 was incurred in connection with the potential Canadian public offering, which we decided not to file with the Toronto Stock Exchange.

*Interest Expense, Net.* Interest expense increased \$1.7 million, or 46%, to \$5.4 million for the year ended December 31, 2013, compared to \$3.7 million for the corresponding period in 2012. Interest expense increased \$0.2 million due to a full year of interest expense on the Central Fairwinds property debt, \$0.9 million and \$0.8 million from debt used by Second City to acquire the Corporate Parkway and Washington Group Plaza properties, respectively, in 2013 and \$0.1 million from additional debt incurred at City Center to fund capital expenditures, tenant improvements and leasing commissions related to increased leasing activity. This increase was offset by a \$0.3 million decrease in interest expense at the AmberGlen property resulting from a write-off of deferred financing costs related to debt refinancing in 2012.

*Equity in Income of Unconsolidated Entity.* Equity in income of unconsolidated entity is related to an office property located in Denver, Colorado, known as the Cherry Creek property in which the City Office Predecessor owned 42% as of December 31, 2013. Equity income decreased \$0.1 million, or 20%, to \$0.4 million for the year ended December 31, 2013 compared to \$0.5 million for the year ended December 31, 2012 primarily due to an increase in non-recoverable operating expenses and a decrease in other income.

## **Liquidity and Capital Resources**

### *Analysis of Liquidity and Capital Resources*

The City Office Predecessor had approximately \$7.1 million of cash and cash equivalents at December 31, 2013. In addition, we expect to enter into the Revolving Credit Facility, which will allow borrowings of up to \$150 million, of which approximately \$11 million will be available at the close of the offering. We intend to use the Revolving Credit Facility, among other things, to finance the acquisition of other properties, to provide funds for tenant improvements and capital expenditures and to provide for working capital and other corporate purposes.

Our short-term liquidity requirements primarily consist of operating expenses and other expenditures associated with our properties, distributions to our limited partners and distributions to our stockholders required to qualify for REIT

**Table of Contents**

status, capital expenditures and, potentially, acquisitions. We expect to meet our short-term liquidity requirements through net cash provided by operations, reserves established from existing cash, the proceeds from this offering and borrowings under our secured revolving credit facility.

Our long-term liquidity needs consist primarily of funds necessary for the repayment of debt at maturity, property acquisitions and non-recurring capital improvements. We expect to meet our long-term liquidity requirements with net cash from operations, long-term secured and unsecured indebtedness and the issuance of equity and debt securities. We also may fund property acquisitions and non-recurring capital improvements using our secured revolving credit facility pending permanent financing.

We believe we have access to multiple sources of capital to fund our long-term liquidity requirements, including the incurrence of additional debt and the issuance of additional equity securities. However, we cannot assure you that this is or will continue to be the case. Our ability to incur additional debt is dependent on a number of factors, including our degree of leverage, the value of our unencumbered assets and borrowing restrictions that may be imposed by lenders. Our ability to access the equity capital markets is dependent on a number of factors as well, including general market conditions for REITs and market perceptions about our company.

*Consolidated Indebtedness as of December 31, 2013*

As of December 31, 2013, the City Office Predecessor had approximately \$109.9 million of outstanding consolidated indebtedness, of which approximately \$22.3 million, or 20%, is variable rate debt, subject to an interest rate swap option on the LIBOR portion of the interest rate for a notional amount of \$15 million to a fixed rate of 6%, expiring in June 2014.

The following table sets forth information as of December 31, 2013 with respect to the City Office Predecessor's outstanding indebtedness.

	Indebtedness Outstanding as of		Interest	
Property Securing Debt		December 31, 2013	Rate	Maturity Date
City Center <sup>(1)</sup>	\$	22,333,938	6.00% <sup>(2)</sup>	June 2014 <sup>(3)</sup>
Central Fairwinds <sup>(4)</sup>		10,000,000	6.25	October 2015
AmberGlen <sup>(5)</sup>		23,500,000	6.25	July 2017
Corporate Parkway <sup>(6)</sup>		19,133,333	7.25	April 2016
Washington Group Plaza <sup>(7)</sup>		34,949,159	3.85	July 2018
<b>Total</b>	<b>\$</b>	<b>109,916,430</b>		

(1) The City Center property is subject to senior mortgage debt in a principal amount of \$22.5 million. The loan may be voluntarily prepaid without penalty in full or in part with the payment of an exit fee of \$291,313.

(2) Based on annualized 30 day LIBOR of 2.00% + 4%.

(3)

*In November 2013, the City Office Predecessor exercised its option to extend the maturity date of the loan for a six month period, to June 2014. The City Office Predecessor has an option to extend the maturity date of the loan an additional one and a half years, to December 2015.*

- (4) The Central Fairwinds property is subject to senior mortgage debt in a principal amount of \$10.0 million. The loan may be voluntarily prepaid without penalty in full or in part after the second anniversary of the loan advance date of May 9, 2012.*
- (5) The AmberGlen property is subject to the AmberGlen Mortgage Loan, which may be voluntarily prepaid without penalty in full after December 12, 2013 with the payment of an exit fee equal to 1% of the outstanding loan amount.*
- (6) The Corporate Parkway property is subject to senior mortgage debt in a principal amount of \$20.0 million. The loan may be voluntarily prepaid in full or in part subject to certain conditions. If the prepayments are made during fixed interest period, a payment equal to the interest that would have been earned by the lender related to the prepayment amount is required plus actual expenses incurred by the lender.*
- (7) The Washington Group Plaza property is subject to the Washington Mortgage Loan.*

**Table of Contents***Consolidated Indebtedness to be Outstanding After this Offering*

<b>Debt</b>	<b>Pro Forma Amount Outstanding</b>	<b>Interest Rate</b>	<b>Maturity Date</b>
New Mortgage Loan <sup>(1)</sup>	\$ 95,000,000	4.34%	February 2021
Washington Mortgage Loan <sup>(2)</sup>	34,949,159	3.85%	July 2018
Revolving Credit Facility <sup>(3)</sup>		LIBOR +2.75% <sup>(4)</sup>	February 2016
AmberGlen Mortgage Loan <sup>(5)</sup>	23,500,000	6.25%	July 2017
<b>Total</b>	<b>\$ 153,449,159</b>		

(1) Prior to, or concurrently with, the closing of this offering, we expect to enter into the New Mortgage Loan.

(2) Following the formation transactions, the Washington Group Plaza property will remain subject to the Washington Mortgage Loan.

(3) Following the formation transactions, we expect to enter into the Revolving Credit Facility, which we expect will have an accordion feature that will permit us to borrow up to \$150 million, subject to additional collateral availability and lender approval.

(4) As of March 5, 2014, the 3 Month LIBOR rate was 0.23%.

(5) Following the formation transactions, the AmberGlen property will remain subject to the AmberGlen Mortgage Loan unless the AmberGlen Refinancing has occurred prior to the closing of this offering. Upon the completion of the AmberGlen Refinancing, a pre-payment fee of 1.0% of the outstanding loan amount will be paid.

**Contractual Obligations and Other Long-Term Liabilities**

The following table provides information with respect to the City Office Predecessor's commitments as of December 31, 2013, including any guaranteed or minimum commitments under contractual obligations. The table does not reflect available debt extension options.

<b>Contractual Obligation</b>	<b>Total</b>	<b>Payments Due by Period</b>			<b>More than 5 years</b>
		<b>2014</b>	<b>2015-2016</b>	<b>2017-2018</b>	
Principal payments on mortgage loans <sup>(1)</sup>	\$ 109,916,430	\$ 22,961,366	\$ 53,960,248	\$ 32,994,816	\$
Interest payments <sup>(2)</sup>	17,082,518	5,732,209	8,330,613	3,019,696	
Tenant-related commitments	6,286,805	5,286,805			1,000,000
<b>Total</b>	<b>\$ 133,285,753</b>	<b>\$ 33,980,380</b>	<b>\$ 62,290,861</b>	<b>\$ 36,014,512</b>	<b>\$ 1,000,000</b>

(1)

*City Center debt is based on 30 day LIBOR plus 4%. Interest payment is estimated based on debt outstanding at the beginning of the period multiplied by the effective interest rate as of December 31, 2013 of 6.00%.*

*(2) On January 2, 2014, the City Office Predecessor entered into a \$50 million loan to finance the acquisition of its interest in the Cherry Creek property. This loan will be repaid with a portion of the New Mortgage Loan.*

The following table provides information with respect to the City Office Predecessor's commitments as of December 31, 2013 on a pro forma basis, after giving effect to the formation transactions and application of the net proceeds from the offering as described under Use of Proceeds, including any guaranteed or minimum commitments under contractual obligations. The table does not reflect available debt extension options.

Contractual Obligation	Total	Pro Forma Payments Due by Period			More than 5 years
		2014	2015-2016	2017-2018	
Principal payments on mortgage loans	\$ 153,449,159	\$ 627,428	\$ 3,308,271	\$ 59,896,851	\$ 89,616,609
Interest payments <sup>(1)</sup>	38,742,736	7,093,441	14,003,784	10,954,346	6,691,165
Operating leases					
Tenant-related commitments <sup>(2)</sup>	6,286,805	5,286,805			1,000,000
Ground Leases					
<b>Total</b>	<b>\$ 198,478,700</b>	<b>\$ 13,007,674</b>	<b>\$ 17,312,055</b>	<b>\$ 70,851,197</b>	<b>\$ 97,307,774</b>

*(1) On January 2, 2014, the City Office Predecessor entered into a \$50 million loan to finance the acquisition of its interest in the Cherry Creek property. This loan will be repaid with a portion of the New Mortgage Loan.*

*(2) Tenant related commitments related to the State of Colorado lease totalling approximately \$1.9 million will be prefunded by the Second City Group upon closing of the offering to the extent the amounts have not already been incurred.*

## **Table of Contents**

### **Off-Balance Sheet Arrangements**

As of December 31, 2013, the City Office Predecessor did not have any off-balance sheet arrangements.

### **Cash Flows**

#### ***Comparison of Year Ended December 31, 2013 to Year Ended December 31, 2012***

Cash and cash equivalents were \$7.1 million and \$3.1 million as of December 31, 2013 and 2012, respectively.

Net cash provided by operating activities decreased by \$2.4 million to \$1.5 million for the year ended December 31, 2013 compared to \$3.9 million for the same period in 2012. The decrease was primarily due to an increase in straight line rent receivable and restricted cash.

Net cash used in investing activities increased by \$58.0 million to \$75.1 million for the year ended December 31, 2013 compared to \$17.1 million for the same period in 2012. The net cash used in investing activities in 2013 was used to acquire the Corporate Parkway and Washington Group Plaza properties, complete tenant improvements and associated costs, acquire equipment and enhance capital assets.

Net cash provided by financing activities increased by \$62.8 million to \$77.7 million for the year ended December 31, 2013 compared to \$14.9 million for the year ended December 31, 2012. Cash flow from financing activities is primarily derived from re-financing and mortgage proceeds on new financing offset by mortgage payments. The increase was primarily due to the new mortgage and equity financing associated with the Corporate Parkway and Washington Group Plaza property acquisitions in 2013 as compared to the Central Fairwinds property acquisition in 2012 and scheduled mortgage payments during the year ended December 31 2013.

### **Inflation**

Substantially all of our office leases provide for separate real estate tax and operating expense escalations. In addition, most of the leases provide for fixed rent increases. We believe that inflationary increases may be at least partially offset by the contractual rent increases and expense escalations described above.

### **Quantitative and Qualitative Disclosures about Market Risk**

Our future income, cash flows and fair values relevant to financial instruments are dependent upon prevalent market interest rates. Market risk refers to the risk of loss from adverse changes in market prices and interest rates. As more fully described in the interest rate risk section, the City Office Predecessor has used, and we will use, derivative financial instruments to manage or hedge interest rate risks related to borrowings. The City Office Predecessor has entered, and we will only enter into, contracts with major financial institutions based on their credit rating and other factors.

As of December 31, 2013 and December 31, 2012, the City Office Predecessor had interest rate caps that are not designated as hedges. These derivatives are not speculative and are used to manage the Company's exposure to interest rate movements and other identified risks, but we have elected not to designate these instruments in hedging relationships based on the provisions in ASC 815-10. The changes in fair value of derivatives not designated in hedging relationships have been recognized in earnings.





**Table of Contents**

**INDUSTRY OVERVIEW**

**U.S. National Office Market Overview**

The U.S. economy has been growing at a moderate pace since the end of the 2008 recession with gross domestic product increasing at an annualized rate of 2.4% between the end of the recession and the end of 2013. Total office employment in the United States increased from 26.9 million in September 2009, its post-recession low, to 29.4 million in December 2013 according to the U.S Bureau of Labor Statistics.

**Quarterly Change in Total Office Employment**

*Source: U.S. Bureau of Labor Statistics*

Reis, Inc. projects that the recovering economy and improved job growth will lead to lower vacancy rates and higher rental rates in office buildings in the United States through 2018 as shown in the chart below.

**U.S. Office Rental and Vacancy Rates**

*Source: Reis, Inc.*

**Table of Contents**

**Our Target Markets**

Our target markets are located in metropolitan areas in the Southern and Western United States. We believe that our target markets possess a number of the following characteristics: favorable economic growth trends, growing populations with above average employment growth forecasts, a large number of government offices, large international, national and regional employers across diversified industries, low-cost centers for business operations, proximity to large universities and increasing office occupancy rates. We also believe that there is a relatively low level of participation of large institutional investors in our target markets because they generally have concentrated on Gateway markets. In addition, we believe that our target markets offer the opportunity for attractive risk-adjusted returns because these markets exhibit positive economic and demographic trends and ownership is often concentrated among local real estate operators that typically do not benefit from the same access to capital as public REITs. Within our target markets, we expect to primarily focus on acquiring properties with a purchase price between \$20 million and \$50 million as we believe that large institutional investors and public REITs are focused on larger acquisition opportunities. According to data compiled by SNL Financial, in 2013, only 25% of office property acquisitions by public U.S. REITs had a purchase price of less than \$56 million. Additionally, we believe that it is challenging for many local buyers in our target markets to raise the debt and equity capital necessary to complete real estate transactions in excess of \$20 million. We are currently targeting 12 specified markets in the United States and own properties in five of these markets. Though we do not currently own a property in seven of our target markets, the Second City Group, from which we will be acquiring our initial properties, has existing properties and relationships in the target markets that we expect to be able to leverage.

**Table of Contents**

The growth in jobs since the recession has not been spread evenly across the country. We believe that metropolitan areas outside of Gateway markets have exposure to growing segments of the economy such as technology and energy and are creating jobs at a faster rate than the nation as a whole. We also believe that as companies continue to look for ways to reduce costs in the wake of the recession, more jobs are shifting to metropolitan areas with lower costs of living, real estate and doing business generally. These areas include our target markets.

**Job Growth from 2009 to 2012 in Target and Current Markets**

*Source: U.S. Bureau of Labor Statistics*

**Projected Population Growth in Target and Current Markets**

*Source: SNL Financial LC*

**Table of Contents**

**Unemployment Rate in September 2009 and December 2013 in Target and Current Markets**

*Source: U.S. Bureau of Labor Statistics*

*Note: The September 2009 unemployment rate is the higher number in all markets.*

***Limited New Supply***

Despite rising office employment in the United States, we believe that the construction of new office buildings has been low by historical standards since the 2008 recession. While a limited number of build-to-suit projects have been completed, we believe that there has been limited speculative office development over the last several years because current rental rates do not generally support new development. We believe that the combination of job growth and limited new construction is likely to decrease vacancy and increase rental rates in our target markets.

***Lower Concentration of Institutional Competitors***

We believe that there is a relatively low level of participation of large institutional investors in our target markets because they have generally concentrated on Gateway markets. For example, public REITs own no office properties in Salt Lake City (UT), five office properties in Portland (OR) and 10 office properties in San Antonio (TX) as of September 30, 2013 according to data compiled by SNL Financial. We believe that the relatively low level of participation by public REITs and other institutional investors in our target markets has caused acquisition prices to be lower and cap rates to be higher than in the Gateway markets. According to Colliers International, as shown in the table below, while prices for office properties in the Central Business Districts ( CBD ) of Gateway markets have recovered 89.8% of the value that they lost during the recent recession as of May 2013, CBD office properties and suburban office properties in non-Gateway markets recovered only 38.8% and 4.2% of the value they lost, respectively.

---

**Table of Contents**

**Peak-to-Trough Valuation Loss Recovered Following the Recession**

*Source: Colliers International. Data as of May 2013.*

***Attractive Debt Financing for Well-Capitalized Sponsors***

We believe that although there is limited institutional equity available for office buildings in many of our target markets, debt financing is now available on attractive terms for well-known and well-capitalized owners. An important source of debt financing in our target markets is the CMBS market. While the new issuance of CMBS in the United States was approximately \$3 billion in 2009, the total new issuance in 2013 was \$80 billion according to the CRE Finance Council. Additionally, we believe that both commercial banks and life insurance companies are now making loans secured by office properties outside the Gateway markets at attractive rates to well-capitalized sponsors. We believe that the combination of acquisition opportunities at relatively high cap rates and attractive debt financing provides well-known and well-capitalized sponsors an opportunity to realize attractive levered returns on equity by investing in office properties outside the Gateway markets.

**Our Initial Markets**

***Boise Economy***

Metropolitan Boise, Idaho ( Boise ) ranks seventh in the United States for long-term job growth according to the U.S. Chamber of Commerce. Boise is home to more than 700 businesses, ranging from major employers to entrepreneurial businesses. Technology is among Idaho's rapidly growing industries and has been prevalent for over 40 years in Boise. According to the Idaho Department of Labor, Boise is home to hundreds of high-tech businesses spanning a diverse range of sectors, including Hewlett-Packard Company's laser jet division and Micron Technology, a computer memory manufacturer. More patents are generated per capita in Boise than any other city in the country and Boise has emerged as one of the leading business incubators in the United States. According to the Boise Valley Economic Partnership, Boise is also home to numerous higher education institutions, with nearly a dozen colleges and universities offering undergraduate and graduate-level programs. Boise State University, Idaho's flagship university, is located across the Boise River from the Washington Group Plaza property. Boise State University has over 20,000 students. Approximately 75% of graduates continue to work and live in Boise. The region today is home to a skilled workforce of 308,000 individuals, almost 110,000 of whom possess college degrees.

**Table of Contents**

Set forth below are the historical and projected office asking rental rates and vacancy rates for Boise for the periods indicated.

**Metro Boise Office Asking Rental Rates and Vacancy Rates**

*Source: Reis, Inc.*

***Denver Economy***

Metropolitan Denver, Colorado ( Denver ) has a diversified economy and is the third-most highly educated workforce among metropolitan areas in the United States. According to the U.S. Census Bureau, 44.1% of Denver's population has a college degree, compared to 34.1% nationally. Colorado has the third largest aerospace economy in the United States and is home to four military commands, eight major space contractors and more than 400 aerospace companies and suppliers. Ten local higher education institutions with bioscience programs and numerous bioscience research assets support the region's burgeoning bioscience industry. Alternative and traditional energy industries are also prominent growth areas.

Set forth below are the historical and projected office asking rental rates and vacancy rates for Denver for the periods indicated.

**Metro Denver Office Asking Rental Rates and Vacancy Rates**

*Source: Reis, Inc.*

---

**Table of Contents**

***Portland Economy***

Metropolitan Portland, Oregon ( Portland ) is located along a major navigable waterway near the Pacific coast, benefiting numerous employment sectors, with a particular impact on trade and transportation-related industries. The region benefits from relatively low energy costs, accessible natural resources, north-south and east-west interstate highways, international air terminals, large marine shipping facilities and intercontinental railroads. These geographic and economic advantages have led to relatively diverse business development. Portland is noted for sustainable policies, progressive land-use planning and investment in transit-oriented development. We believe that a strong regional economy and healthy demographic trends will lead to above average job growth in Portland and gradually shrinking unemployment levels.

Set forth below are the historical and projected office asking rental rates and vacancy rates for Portland for the periods indicated.

**Metro Portland Office Asking Rental Rates and Vacancy Rates**

*Source: Reis, Inc.*

***Tampa Economy***

Metropolitan Tampa, Florida ( Tampa ), which includes St. Petersburg and Clearwater, has seen its population grow by more than 14% in the past ten years. It is anticipated that this trend will continue, with an average of 38,700 new residents expected per year between 2013 and 2017. The region's growing labor force has been largely fueled by migration and graduating students. According to October 2013 statistics from the Bureau of Labor Statistics, the Tampa-St. Petersburg-Clearwater metropolitan area ranked first in Florida in percentage growth of employment over the preceding 12 months. The University of South Florida is a major university located in Tampa with approximately 47,000 undergraduate and post-graduate students. The healthcare sector is also becoming one of the region's reliable growth drivers.



**Table of Contents**

Set forth below are the historical and projected office asking rental rates and vacancy rates for Tampa for the periods indicated.

**Metro Tampa Office Asking Rental Rates and Vacancy Rates**

*Source: Reis, Inc.*

***Allentown Economy***

Located approximately 60 miles north of Philadelphia, the metropolitan area of Allentown, Pennsylvania, is known locally as Lehigh Valley and comprises the third most populous region in Pennsylvania after Philadelphia and Pittsburgh. Lehigh Valley is home to a variety of large and international companies such as Crayola, Mack Trucks and D&B. Because of the area's geographic location, Allentown is known as a leading center on the East coast for warehouses and distribution centers. Companies that own and operate warehouses and distribution centers include global brands such as Amazon.com, BMW, Estee Lauder and Home Depot.

Set forth below are the historical office asking rental rates and vacancy rates for Allentown for the periods indicated.

**Metro Allentown Office Asking Rental Rates and Vacancy Rates**

*Source: Reis, Inc.*

**Table of Contents**

***Orlando Economy***

Metropolitan Orlando, Florida ( Orlando ) enjoys worldwide recognition for its entertainment and tourism industry. Local businesses do a large amount of work for Walt Disney World and Universal Studios. Other companies, including Fortune 500 companies such as Home Depot and Darden Restaurants, have also established a presence in Orlando, particularly in its CBD where the city has invested heavily. Orlando 's professional services sector has matured recently, partly in reaction to population and job growth. According to the Orlando Economic Development Commission, Orlando is one of the fastest growing local economies in the United States and the hospitality, defense contracting and technology industries are expected to bring more people and jobs to the city.

Set forth below are the office asking rental rates and vacancy rates for Orlando.

**Metro Orlando Office Asking Rental Rates and Vacancy Rates**

*Source: Reis, Inc.*

---

**Table of Contents****BUSINESS****Overview**

We are a newly organized, externally managed Maryland corporation formed to acquire, own and operate high-quality (Class A and B) office properties located within our specified target markets in the United States. We have currently identified 12 target markets, each of which is located in a metropolitan area in the Southern and Western United States. We believe that our target markets possess a number of the following characteristics: favorable economic growth trends, growing populations with above average employment growth forecasts, a large number of government offices, large international, national and regional employers across diversified industries, low-cost centers for business operations, proximity to large universities and increasing office occupancy rates. We also believe that there is a relatively low level of participation of large institutional investors in our target markets because they generally have concentrated on Gateway markets, which are commonly defined as New York, Los Angeles, Washington, D.C., Boston, Chicago and San Francisco. In addition, we believe that our target markets offer the opportunity for attractive risk-adjusted returns because these markets exhibit positive economic and demographic trends and ownership is often concentrated among local real estate operators that typically do not benefit from the same access to capital as public REITs. We also believe that our target markets have experienced limited new construction of office properties since 2008 because rental rates in these markets have generally not supported new development. We anticipate identifying additional target markets with the foregoing characteristics in the future. Within our target markets, we expect to primarily focus on acquiring properties with a purchase price between \$20 million and \$50 million as we believe that large institutional investors and public REITs are focused on larger acquisition opportunities. According to data compiled by SNL Financial, in 2013, only 25% of office property acquisitions by public U.S. REITs had a purchase price of less than \$56 million. Additionally, we believe that it is challenging for many local buyers in our target markets to raise the debt and equity capital necessary to complete real estate transactions in excess of \$20 million.

Our management team is being provided by our Advisor. The principals of our Advisor, who have extensive experience in U.S. real estate markets, are James Farrar, our chief executive officer with over 10 years of U.S. experience, Gregory Tylee, our president and chief operating officer with over 12 years of U.S. experience, Anthony Maretic, our chief financial officer with over 16 years of U.S. experience and Samuel Belzberg, the president of our Advisor and one of our director nominees with over 48 years of U.S. experience. The Second City Group has existing relationships with the brokerage community and local operators in our target markets. We will use local partners to manage and lease our geographically diversified portfolio so that we can benefit from their market knowledge, efficient operations and existing infrastructure without incurring the overhead associated with creating a real estate operation function in each of our markets.

Upon completion of this offering and the formation transactions, we will own six office complexes comprised of 16 office buildings with a total of approximately 1.85 million square feet of net rentable area in the metropolitan areas of Boise (ID), Denver (CO), Portland (OR), Tampa (FL), Allentown (PA) and Orlando (FL). We believe that our initial properties are high quality assets that provide excellent access to transportation options, are located near affluent neighborhoods, contain extensive amenities and are well maintained. We also believe that our initial properties have a stable and diverse tenant base, including federal and state governmental agencies and national and regional businesses. As of December 31, 2013, approximately 61.4% of the base rental revenue from our initial properties was derived from tenants in these markets that are federal or state government agencies or investment grade tenants. Our largest tenant is the Colorado Department of Public Health and Environment, whose lease at the Cherry Creek property represents approximately 16.9% of the aggregate net rentable area of our initial properties and expires in 2026. Our initial properties also have a stable, long-term tenancy profile and our occupied and committed leases have staggered expirations and a weighted average remaining lease term to maturity of 5.2 years (10 years taking into account tenant renewal options). The majority of our leases are modified gross leases pursuant to which our tenants reimburse us for

operating expenses, property taxes and insurance in excess of a base amount. The base rent amount of the majority of our leases is equal to annualized operating expenses, property taxes and insurance at the time the lease is signed. This structure helps insulate us from increases in certain operating expenses and provides a more predictable cash flow. Our leases typically include rent escalation provisions designed to provide annual growth in our rental income.

Most of the buildings included in our initial properties have undergone recent investment programs since being acquired with approximately \$7.2 million of capital improvements and \$14.2 million for tenant improvements and leasing commissions having been spent in the aggregate. As a result of these investments, occupancies throughout our initial properties have increased substantially. As of December 31, 2013, the weighted average in place and committed occupancy

## **Table of Contents**

rate of our initial properties was 91.3%. Due to recent leasing activity, there are a number of tenants that have signed leases but had not taken occupancy of their space as of December 31, 2013. There are also several tenants that have taken occupancy but are still in their free rent period. As of December 31, 2013, there were seven executed leases for 35,461 square feet with annualized base rents of approximately \$688,208 in which the tenant has not begun to pay rent.

### **Our Advisor**

We will be externally managed by our Advisor. In connection with this offering, we will enter into the Advisory Agreement. The principals of our Advisor control the general partner of Second City. Second City began its investment activities in the spring of 2010 and was founded by James Farrar, Gregory Tylee and Gibralt, a corporation indirectly owned by Samuel Belzberg. Mr. Belzberg founded First City Financial in the 1970s, built the company into a multi-billion dollar financial services organization with offices located across North America and Europe and founded a real estate company in the 1990s which at its peak operated 26 real estate projects throughout the United States and was ultimately sold to the Blackstone Group. In addition, Mr. Belzberg has been active in various real estate markets in the United States. Since its launch, Second City has obtained commitments for equity capital of over \$100 million from institutional investors and high net worth individuals and has acquired real estate assets with a cost of approximately \$400 million across a variety of asset classes in the United States. Second City owns three other office complexes totaling approximately 1.1 million square feet in Arizona, Florida and Texas. In addition, in 2014, the principals of Second City acquired an interest in a 181,341 square foot office tower in Austin, Texas and 123 apartment units in San Antonio, Texas. These properties are not being contributed to us as part of our initial properties due to the relatively low cash flow associated with these non-stabilized, value-add properties. Second City also owns approximately 1,700 apartment units in Texas and New York and 330 acres of land held for future development in California and Texas, which are also not being contributed to us. We believe Second City's acquisition and investment activities in many of our target markets will provide us with ready access to local operators and acquisition opportunities.

We may not acquire any additional properties from the Second City Group or its affiliates after the completion of this offering without stockholder approval. See Our Advisor and the Advisory Agreement.

After completion of this offering, the principals of our Advisor, through the ownership of our common units, will beneficially own an approximately 19.5% interest in our company on a fully diluted basis, which we believe aligns their interests with those of our stockholders.

### **Property and Target Market Summary**

## Table of Contents

### **Our Competitive Strengths**

We believe that the following competitive strengths distinguish us from other owners and operators of office properties in our target markets and will enable us to successfully operate and expand our portfolio.

***Experienced Management Team:*** Our senior management team, led by Mr. Farrar, our chief executive officer, Mr. Tylee, our president and chief operating officer, and Mr. Maretic, our chief financial officer, has an intimate knowledge and understanding of each of our initial properties as well as a strong familiarity with the local markets in which the properties are located. Mr. Farrar has over 15 years of experience in real estate acquisitions, management and finance and has completed acquisitions and divestitures with a combined enterprise value in excess of \$1 billion and has completed over \$500 million of financings. Mr. Tylee has over 20 years of experience negotiating and structuring complex real estate transactions and developments and has been involved in real estate transactions with a combined enterprise value of approximately \$1.5 billion over the course of his career. Mr. Maretic has acted as chief financial officer and chief operating officer of Earls Restaurants Ltd. and has over 20 years of experience in financing, public company reporting requirements and internal controls. Upon completion of this offering and the formation transactions, the principals of our Advisor and their affiliates will own approximately 19.5% of the equity interests of our company on a fully diluted basis, which we believe helps to align their interests with those of our stockholders.

***Alignment of Interests with Established Local Operators:*** One component of Second City's strategy has been to invest in properties in markets where it has relationships with well-established local real estate operators that provide property management services and, in some cases, hold minority interests in the properties that they manage. We believe that this strategy of permitting local real estate operators to invest in our properties helps to align their interests with ours. Consistent with this strategy, five of our six initial properties are managed by well-established local real estate operators, all of which have invested equity with management in the past and three of which will continue to hold a minority interest in our initial properties after completion of the formation transactions, furthering the alignment of their interests with ours. The Corporate Parkway property in Allentown, Pennsylvania, is self-managed by the sole tenant, D&B. Our strategy of utilizing local real estate operators also eliminates the need for us to incur the overhead costs associated with creating a real estate operation function in each of our markets. We intend to continue this strategy of offering ownership interests and other incentives to local real estate operators, which we believe can enhance the operating performance of our properties and strengthen our relationships with them.

***Initial Properties with Attractive Real Estate Fundamentals:*** Our initial properties consist of 16 office buildings comprised of six office complexes with a total of approximately 1.85 million square feet of net rentable area in the metropolitan areas of Boise (ID), Denver (CO), Portland (OR), Tampa (FL), Allentown (PA) and Orlando (FL). We believe that our target markets have a number of the following characteristics: favorable economic growth trends, growing populations with above average employment growth forecasts, a large number of governmental offices, large international, national and regional employers across diversified industries, low-cost centers for business operations, proximity to large universities and increasing office occupancy rates. Most of the buildings included in our initial properties have undergone recent investment programs since being acquired with approximately \$7.2 million of capital improvements and \$14.2 million for tenant improvements and leasing commissions having been spent in the aggregate.

***Investment Grade Tenants and Well-Staggered Lease Maturities:*** As of December 31, 2013, approximately 61.4% of the base rental revenue of our initial properties was derived from tenants that are federal or state government agencies or investment grade tenants. Five of our top ten tenants are investment grade tenants, representing approximately 45.8% of the base rental revenue of our initial properties as of December 31, 2013. Our largest tenant is the Colorado Department of Public Health and Environment, whose lease at the Cherry Creek property represents approximately 16.9% of the aggregate net rentable area of our initial properties and expires in 2026. Our initial

properties also have a stable, long-term tenancy profile and our occupied and committed leases have staggered expirations and a weighted average remaining lease term to maturity of 5.2 years (10 years taking into account tenant renewal options).

***Experienced Board of Directors:*** Our board of directors has extensive experience in the real estate industry, in real estate capital markets and as public company directors. We expect to have six directors at the completion of this offering, four of whom are expected to be independent under the standards of the NYSE. Our independent directors include William Flatt, former chief financial officer as well as secretary and later chief operating officer of Parkway Properties, Inc., a NYSE

## **Table of Contents**

listed REIT specializing in office properties in top-tier Sunbelt markets, John McLernon, formerly the chairman and chief executive officer of Colliers Macaulay Nicolls Group, a global commercial real estate service company, Mark Murski, a managing partner with Brookfield Financial Corp., a global investment bank, and Stephen Shraiberg, the president of Urban Property Management, Inc., a Denver-based real estate development and management company. Our chief executive officer, James Farrar, and the president of our Advisor, Samuel Belzberg, will also serve as members of our board of directors.

***Clearly-Defined Acquisition Strategy:*** We will focus on acquiring office properties in our target markets that we believe possess the attractive economic and demographic characteristics described above. We expect to use our Advisor's market specific knowledge as well as the expertise of local real estate operators and our investment partners to identify acquisition opportunities that we believe will offer cash flow stability and long-term value appreciation. Our target markets are attractive, among other reasons, because we believe that ownership is often concentrated among local real estate operators that typically do not benefit from the same access to capital as public REITs and there is a relatively low level of participation of large institutional investors, which can result in attractive pricing levels and risk-adjusted returns. Within our target markets, we expect to focus on acquiring properties with a purchase price between \$20 million and \$50 million as we believe that large institutional investors and public REITs prefer to target larger assets. In 2013, only 25% of office property acquisitions by public U.S. REITs had a purchase price of less than \$56 million. Additionally, we believe that many local real estate operators in our target markets have difficulty raising the debt and equity capital to complete acquisitions of more than \$20 million.

***Strong Lender Relationships:*** Our management has strong lending relationships with various banks, insurance companies and CMBS platforms. We expect to complete a refinancing of three of our initial properties (Cherry Creek, City Center and Corporate Parkway) with the New Mortgage Loan. Following the formation transactions, the Washington Group Plaza property will remain subject to the Washington Mortgage Loan and the AmberGlen property will remain subject to the AmberGlen Mortgage Loan unless the AmberGlen Refinancing has occurred prior to the closing of this offering. The offering hereby and formation transactions are not subject to completion of the AmberGlen Refinancing. We also expect to enter into the Revolving Credit Facility, which we expect will have an accordion feature that will permit us to borrow up to \$150 million, subject to additional collateral availability and lender approval.

## **Business Objectives and Growth Strategies**

Our principal business objective is to provide attractive risk adjusted returns to our investors over the long-term through a combination of dividends and capital appreciation. Specifically, we intend to pursue the following strategies to achieve these objectives:

### ***Internal Growth***

We will seek to manage our properties in a manner to increase their value by improving cash flow over time through our Advisor's hands on approach to real estate management alongside local real estate operators. We will focus on maintaining strong relationships with existing tenants, which we believe can help reduce marketing, leasing and tenant improvement costs required for new tenancies and minimize interruptions in rental revenue resulting from periods of vacancy and tenant renovations. Our internal growth strategy will include the following:

***Seeking Contractual Rent Escalations:*** With respect to our initial properties as of December 31, 2013, the leases provide for contractual increases in base rental rates per square foot averaging approximately 2% per annum over the next three years. These rental escalations are expected to result in predictable increases in rental revenues for us over time. We will continue to seek to include contractual rent escalators in future leases to further facilitate predictable



growth in rental income.

***Expanding Our Properties:*** We will seek to enhance our asset base through select expansion and improvement of our properties. We believe that there are several expansion opportunities within our initial properties. As an example, management has identified an attractive 1.8 acre pad site at the Washington Group Plaza property that would be suitable for a potential future retail development either by us or through a sale to a developer. We have identified an additional 75,000 square feet of net rentable area at the Washington Group Plaza property that had been under-reported by the previous owner due to the use of out-of-date measurement standards. When new tenants take occupancy where the rentable square feet was under-reported, we intend to have the leases reflect the updated measurement standards, which will generate additional rental income for us over time.

---

**Table of Contents**

***Leasing Currently Vacant Space:*** As of December 31, 2013, the weighted average in place and committed occupancy rate of our initial properties was 91.3% and we believe that there is potential to generate additional rental income by leasing up space in these properties that is currently unoccupied. In addition, we have identified certain common areas that can be converted to leasable space. We believe that our initial properties compete for tenants with other landlords that are capital constrained and may not be able to enhance their buildings' appeal through capital investments or offer tenants attractive tenant improvement packages.

***Implementing Improvements and Preventive Maintenance Programs:*** We will seek to operate our portfolio as efficiently as possible. Site visits, property inspections and preventive maintenance programs will be performed to ensure that our properties are well maintained so that we will minimize long-term capital expenditures. In addition, we intend to actively pursue cost reduction initiatives, such as eliminating redundant or unnecessary expenses and engaging property tax appeal specialists to lower property tax costs, and make an ongoing effort to increase expense recoveries from tenants on new and renewed leases. We believe that there are opportunities for continued cost reductions at our initial properties. We will also seek to acquire properties within close geographic proximity to one another in order to benefit from economies of scale in the operation of the properties by sharing property management among properties and having greater negotiating leverage with vendors.

***External Growth***

Our external growth strategy will include the following:

***Focusing on Acquisitions in Our Specified Target Markets:*** We will seek to expand our portfolio through acquisitions of office properties primarily located in our target markets. We believe that current economic conditions and relatively low levels of competition from institutional buyers have created attractive investment opportunities for the acquisition of office properties in our target markets as compared to Gateway markets. We expect to use our management team's market specific knowledge as well as the expertise of our local real estate operators and our investment partners to identify acquisitions that we believe will offer cash flow stability and price appreciation.

We are currently in discussions regarding a number of properties that meet our investment criteria. In particular, we have engaged in dialogue or submitted non-binding indications of interest with respect to four properties within three of our target markets. Collectively, these four properties outlined below represent approximately 790,000 square feet of NRA and, on a combined basis, are available for an estimated purchase price of approximately \$112 million.

- Denver, Colorado multi-tenant property with approximately 220,000 square feet of NRA available at an estimated purchase price of approximately \$23 million;
- Denver, Colorado multi-tenant property with approximately 200,000 square feet of NRA available at an estimated purchase price of approximately \$25 million;
- Tampa, Florida multi-building property that is located in a desirable submarket that is fully leased to a long-term credit tenant. The property is approximately 190,000 square feet of NRA available at an estimated purchase price of approximately \$31 million; and

- Phoenix, Arizona multi-tenant property that is well located in what we believe is a highly desirable submarket with approximately 180,000 square feet of NRA available at an estimated purchase price of approximately \$33 million.

In addition to these four potential acquisition prospects, we are also in preliminary discussions relating to a number of other potential acquisition prospects located within our target markets. We have not completed our due diligence process and have not entered into exclusivity agreements with the sellers of any of these properties. Furthermore, in the event that we were to be exclusively selected to negotiate definitive documentation, not only would we have to reach agreement as to the terms of such definitive documentation, but we would also need to satisfy a number of additional conditions and approvals in addition to completing the full scope of our due diligence process. As a result, we do not deem any of these potential acquisition prospects probable as of the date of this prospectus.

## **Table of Contents**

***Leveraging Opportunities From Our Advisor:*** We expect to benefit from the strong existing industry relationships of our management team, which has completed approximately \$230 million in acquisitions since April 2013. Historically, our management team has proactively sourced acquisition opportunities through a number of channels, including targeting properties owned by our local property managers and through management's relationships with local owners, investment brokers, mortgage brokers and lenders. We believe that through the activities of the Second City Group, our Advisor will be able to maintain relationships in our target markets that may result in acquisition opportunities for us. During the term of the Advisory Agreement (as defined in Our Advisor and the Advisory Agreement), we will have an exclusive right of first opportunity to purchase any office property or property interest that the Second City Group (including any future funds created by the principals of Second City) or our Advisor identifies, provided that the property has greater than 85% occupancy and an average remaining lease term of more than three years.

### **Our Local Real Estate Operators**

Five of our six initial properties are managed by well-established local third party real estate operators, all of which have invested equity with management in the past and three of which will continue to hold a minority equity interest in the property after completion of the formation transactions, furthering the alignment of their interests with ours. The Corporate Parkway property in Allentown, Pennsylvania, is self-managed by the sole tenant, D&B, which is a subsidiary of The Dun & Bradstreet Corporation. These real estate operators typically manage or lease a large number of properties in the submarkets and markets where our initial properties are located.

#### **Idaho**

The Washington Group Plaza property in Boise (ID) is managed by Thornton Oliver Keller (TOK), which provides real estate advisory services to property owners and is one of the largest commercial real estate firms in Idaho as measured by square footage under management. Established in 1991, TOK manages and lists nearly 500 properties for a wide range of clients. Because TOK is independent, it has relationships with brokers, lenders and appraisers around the country.

#### **Colorado**

The Cherry Creek property in Denver (CO) is managed by DPC Development Company (DPC), a privately held, Colorado-based owner and developer of over 2.5 million square feet of commercial properties, comprised of office, retail and industrial buildings. DPC provides management services to over 25 properties with 1.9 million square feet of space on behalf of its portfolio and third-party owners. DPC's real estate operation division is fully integrated with on-site building engineers, experienced in-house management personnel and sophisticated accounting and budgeting. DPC, through its affiliates, is an active investor and developer in the Colorado commercial real estate market.

#### **Oregon**

The AmberGlen property in Portland (OR) is managed by Felton Properties Inc. (Felton), a full-service real estate company that focuses on the acquisition, operation and management of commercial property. Felton was formed in 1997 and is based in Portland (OR), with offices located in downtown Portland, Bellevue (WA) and Westport (CT). Felton currently owns and manages over 2.5 million square feet of commercial real estate in Oregon, Washington and Colorado. Through institutional and private partnerships, Felton Properties Inc. and Felton Management Corp. have closed more than 25 acquisitions over the past 10 years representing over \$500 million in acquisitions. After giving effect to this offering, Felton will own a 24% economic interest in the AmberGlen property, which we believe will help to align the incentives of Felton with those of our stockholders.

## Florida

Both the City Center property in St. Petersburg, Florida, which is part of the Tampa metropolitan area, and the Central Fairwinds property in Orlando, Florida, are managed by Tower Realty Partners ( Tower ), a commercial real estate investment firm formed in 1987 and focused on value-add opportunities throughout Florida. Since its inception, Tower has executed over \$1 billion in transactions. In 1997, Tower s portfolio became the cornerstone of an initial public offering for Tower Realty Trust. In 1999, Tower s senior management team purchased properties in Florida and Arizona from Tower Realty Trust and reestablished Tower Realty Partners. Currently, Tower s assets represent over three million square feet of office and retail properties throughout Florida. Tower also provides a full spectrum of real estate services to complement its

