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Industry Observers Have Mixed Outlook on REIT M&A

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Robin Panovka

A complex market filled with a combination of opportunity and uncertainty is shaping the outlook for mergers and acquisitions activity in 2013, according to industry observers.

Robin Panovka, co-head of real estate and REIT M&A at the law firm of Wachtell, Lipton, Rosen and Katz, said low interest rates and easy access to capital could fuel more deals. In addition, the velocity of deals gained momentum in late 2012, which may carry over into '13, according to Panovka.

"I don't have a sense that we'll have a massive increase in deal volumes this year, but there should be a healthy volume similar to 2012, perhaps better," he said. "Activity picked up quite a bit in the last quarter of 2012, and it shows every sign of continuing."

Jonathan Litt, managing principal of Land and Buildings Investment Management LLC, said he thinks 2012 ended up being an extraordinary year because of the Archstone transaction. Multifamily REITs AvalonBay Communities Inc. (NYSE: AVB) and Equity Residential (NYSE: EQR) joined forces to purchase Archstone Inc. from Lehman Brothers Holdings Inc. for $6.5 billion in cash and stock. With no major deals like Archstone or the 2011 merger of industrial REITs Prologis (NYSE: PLD) and AMB, Litt speculated that '13 would have a tough time living up to recent years.

"Absent [the Archstone deal, 2012] would have been more of an average year. So, I think the ability to top 2012 might prove difficult in terms of straight acquisitions," he said.

Panovka pointed to lingering uncertainty as a possible obstacle to REIT M&A deals in 2013, especially when it comes to major public-to-public transactions.

"There's still a sense that things are uncertain, so it's difficult to pull the trigger on transformative deals, even though many boards are beginning to understand that it might be a mistake to pass up the significant opportunities some REITs are seeing" he said.

Panovka said he expects public-private arbitrage plays to remain appealing to some companies: "As long as REITs are trading north of the private market valuations, they will be in a good position to continue to acquire privately owned assets and portfolios in accretive transactions. REITs are uniquely positioned to offer sellers both tax deferral and liquidity and have a number of other competitive advantages."

The best course for REITs with strong balance sheets and access to low-cost capital may be to take advantage of opportunities to buy private portfolios or weaker public peers, according to Panovka. At the same time, he said REITs face “unprecedented levels of pressure and engagement from activist and institutional shareholders” which in some cases can promote short-term thinking and stifle entrepreneurial instincts and long-term value creation.

“There’s too much focus from the activists on short-term results and not enough on the long-term best interest of the shareholders,” he said. “The pendulum has swung too far in that direction and hopefully will now swing back to the point where boards can really focus on long-term value creation and running their companies well.”

Litt advised investors to be on the lookout for potentially hostile takeovers. REITs with underperforming stocks could become targets for acquisition, he said. Litt and Panovka both encouraged REITs that don’t want to be acquired to prepare their defenses ahead of time.

“When you have great assets in great markets with a good management team and are trading a big discount, the management team should do something about it,” Litt said. “And if they don’t, they are going to see people chase them.”