Harvard Law School Forum on
Corporate Governance and Financial Regulation

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REIT M&A in 2019

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As we enter the new year, we offer some thoughts based on hits and misses in 2018:

1. **Realistic Price Expectations are Key**. REITs interested in exploring strategic alternatives—and there are more of these than casual observers might suspect—should be careful to set (and ensure that their internal records are consistent with) realistic price expectations. Slavish belief in internal or third-party NAVs is often a recipe for confusion and disappointment—in the real world, many favorable transactions that are in the best interests of shareholders fall below artificial NAV metrics. As we have long pointed out, the NAVs bandied about with great authority are often nothing more than rough estimates based on limited data, are usually backward looking, fail to take frictional costs into account, and in many cases do not reflect fundamental value. As Green Street recently pointed out, "managers and boards with an NAV-or-bust mindset do a disservice to shareholders."

2. **Activism**. Activists are increasingly targeting REITs of all sizes and flavors, sometimes attracted by the simplistic idea of a quick flip of the real estate at NAV, without understanding the complexity involved. Once in a while they have interesting ideas which are worth considering, but care should be taken not to allow them to disrupt operations or long-term planning or to dictate actions or results for the sake of short-term profits. Well-prepared boards have a variety of tools at their disposal for dealing with short-termist disruptors.

3. **Sale Processes***.* As a number of recent deals have shown, there is no one-size-fits-all approach for running a process that achieves the best results for shareholders. Each situation is different, and different paths to maximizing value will be attractive depending on the assets, bidders, capital sources, frictional costs, third party consents, blocking positions and other facts and circumstances at play in the particular situation.

4. **Market Checks**. Post-deal market checks can be an attractive tool for maximizing value, providing the benefits of an "auction with a floor." A no-shop coupled with a two-tiered break fee (low for an initial period and then climbing to market) is sometimes a helpful compromise between go-shops and high-break-fee no-shops. Negotiating the right balance of deal protections while preserving the ability to fulfill fiduciary duties is especially important as topping bids are increasingly considered and made.

5. **Litigation**. Deal litigation continues to be largely inevitable, but should not be allowed to wag the dog. If a process is properly managed, the courts will afford boards wide latitude to determine how best to maximize shareholder value, with litigation/settlement costs and exposure controlled and kept to a minimum. The possibility of deal activism or bumpitrage—while far from rare—should equally not discourage the well-advised and well-prepared board.

6. **Executive Compensation**. Executive retention and termination protection issues should be considered early in the process, preferably on a clear day.

7. **Arbitrage Mismatches**. Perhaps not surprisingly, the sectors that are often of least interest to private investors have the largest number of REITs interested in exploring an exit from the public markets. At the moment, this mismatch is creating too large a valuation gap for transactions to pencil out, and only time will tell whether the valuation gap will close in 2019. In some cases, particularly where there is concern about property obsolescence, we are not optimistic.

8. **Shareholder Engagement**. Passive investors now own a third or more of the stock of many REITs. Understanding the perspectives of these new "passive" behemoths and all shareholders, and engaging with them, is an absolute necessity, and is best done well before a difficult vote.

9. **Deals**. We expect the current trend of public-to-private arbitrage plays and, particularly in tech-driven sectors, public-to-public consolidation plays, to continue into 2019, with interest rates and political disruption being key wild cards.

As ever, predictions are hard—especially about the future. We expect 2019 will be full of surprises. Whatever those developments may be, a thorough appreciation and understanding of today's environment and the seismic changes that REITs and their shareholders have experienced in recent years will serve boards and managements well in responding nimbly to M&A opportunities.