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REIT M&A in 2020

REITs on the whole had a strong year in 2019, with robust growth, stock performance and deal activity. That said, not all sectors moved in tandem, and tech-disruption and activism continued to present challenges and opportunities for many companies. We offer some specific observations below that might be helpful as we enter the new decade:

1. Board Best Practices. A well-functioning, collegial board that speaks with one voice is essential to navigating the complexity of the evolving REIT markets, particularly when activists come knocking or extraordinary transactions are considered. Board dysfunction or division was a clear factor in a number of sub-optimal situations last year. Our firm's recent [Some Thoughts for Boards of Directors in 2020](#) may be of interest in this regard.
2. Activism. Activists are increasingly part of the trigger for major REIT transactions or internal changes, more so than may be apparent from public reports. Managing proactively and reactively for activism is now a core part of the REIT landscape. Too often activists are attracted by the simplistic notion that a quick flip of the real estate at NAV will unlock value, without understanding the costs or complexity involved. Once in a while they shake things up with interesting ideas, but care should be taken not to allow activists to disrupt operations or long-term planning or dictate actions or results for the sake of short-term profits without regard to longer-term implications. Well-prepared boards have a variety of tools at their disposal for dealing with short-termist disruptors.
3. Shareholder Engagement. A handful of passive investors now own a third or more of the stock of many REITs. Understanding their perspective, and engaging with them, is an absolute necessity, and is best done well before a difficult vote. Activists know them well and visit them often; their voice should not be the only one heard. At the same time, actively managed funds are increasingly wielding their voting power and influence behind the scenes, and great care should be taken to maintain strong relationships and anticipate and resolve potential friction points with those investors who determine the trading price of the company's stock.
4. Proxy Contests. The rise of the "passive" investors, the influence of the proxy advisors, and evolving relationships among active managers, analysts and activists has given activists a relatively easy path to outright winning board seats – or influencing board composition and business strategy – even when they own a very small amount of stock. Boards should understand and plan for this, particularly where the activists seek just one or two board seats and various governance or other metrics show vulnerability.
5. 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 any particular situation.

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6. Realistic Price Expectations. 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. Unquestioning 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 theoretical NAV metrics.
7. 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.
8. 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 bumpitraging – while far from rare – should equally not discourage the well-advised and well-prepared board.
9. Executive Compensation and Retention. Executive compensation and termination protection issues should be considered – by both buyers and sellers – early in any process to ensure retention of employees critical to a successful transaction. Regular review of change-in-control protections on a clear day – with no activists or transactions in sight – is always prudent, but swiftly moving events often require boards to be nimble and creative in maintaining management team focus, ensuring successful completion of transactions, and protecting against the downside of a busted deal. Compensation committees should remain current on their executive team’s incentive and termination protections, as well as market practices, to be prepared for and be in a position to react quickly in the context of activist or transactional developments.
10. 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 2020, with interest rates and political disruption being key wild cards.

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