

## FOCUS ON REITs

### PUBLIC REAL ESTATE COMPANIES' ADVANTAGES WILL OVERPOWER THE REIT BEAR MARKET

by Robin Panovka



The current REIT-related news centers on the day-to-day performance of REIT stocks, the excessive restrictions imposed by the REIT rules, methods for retaining and compensating REIT executives, and predictions for when the REIT bear market will end. Often forgotten, however, as the REIT industry licks its bear market wounds, are the *long-term* advantages of publicly traded, corporate real estate operating companies, or REOCs. For all of their shortcomings and maturational problems, publicly-traded REITs represent a new breed of investment vehicles that have noteworthy virtues and fundamental advantages over many of the older methods of investing in real estate.

Take, for example, the perspective of the individual investor who bought interests in syndicated limited partnerships in the 1980's and whose plight is once again making news. There can be little doubt that the public REIT or REOC offers individual investors more liquidity, better governance and accountability of management, and better reporting and transparency than the syndicated limited partnership structure.

And the same is often true from the perspective of institutional investors. Take the admittedly crude example of an institutional investor based somewhere in the Midwest who would like to allocate some funds to office buildings in the Southeast. The investor now has a choice between investing in the publicly-traded stock of any number of REITs which focus on the sector or utilizing one of the various private market alternatives that has historically been available. Investing in the public stock will often prove advantageous for a number of reasons:

- Instant access to information required to make the investment decision — SEC filings on the REIT that provide detailed information, including audited financials, can be pulled off the internet in seconds.
- Speed of execution and liquidity — depending on the size of the investment, the stock can be purchased and sold almost instantly with a few clicks of a mouse.
- Assurance of getting future reports on a regular basis — public companies are required to file with the SEC publicly available quarterly reports, including financials, and to disclose all material events.
- Tried-and-true public company corporate governance structure — while certainly not perfect, the governance structure that has evolved in corporate America is relatively well-defined, gives the shareholders a clear voice, and provides mechanisms for aligning the interests of management with those of the shareholders.
- Comfort that the various Wall Street watchdogs (analysts, rating agencies, investment banks and the financial press) will be keeping an eye on the REIT.

- 
- Efficiency and lower transaction costs — when buying real estate through investment in publicly traded stock, there is no need to negotiate joint-venture agreements and other contracts; hire lawyers and ground-level consultants; perform costly ground-level due diligence; develop new business relationships; hire a staff; open offices; or incur frictional costs of entry and exit (transfer taxes, title insurance premiums, etc.), all potential aspects of direct investment in real estate. In addition, in the case of foreign investors, FIRPTA taxes typically can be avoided.

There will always be an active private real estate investment sector (as there is in non-real estate capital intensive industries that have long been public), and some investors will continue to shy away from investments in public REITs and REOCs because of the view that such investments do not provide the sought-after diversification from stock market investments historically provided by real estate investments (the jury will be out for some time as to this debate). But on balance, despite the recent setbacks, public REITs' and REOCs' roles as investment vehicles will continue to grow as their advantages to investors converge with the inescapable logic of providing the capital intensive real estate industry with access to the public capital markets.<sup>REI</sup>

#### ABOUT OUR FEATURED COLUMNIST

**Robin Panovka**, is a partner of Wachtell, Lipton, Rosen & Katz in New York, where he specializes in REIT and real estate mergers and acquisitions and other strategic and capital markets real estate transactions.