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Nontraded REITs Find Ample Options In Liquidity Search

By **Andrew McIntyre**

Law360, New York (July 08, 2014, 9:16 PM ET) -- Many of the nontraded real estate investment trusts that are embarking on the required searches for liquidity that come roughly five years after their formation have aggressively been buying up properties since the downturn, and lawyers are helping such REITs make sense of a welcomed set of attractive exit options that is broader than what their peers have seen in recent years.

When the real estate market hit bottom five years ago, many REITs — both public and nontraded — got aggressive in their property acquisition, and many companies also formed REITs around that time, with the view of cashing in on low property prices.

But since nontraded REITs are illiquid investment vehicles, such companies have built-in time frames — often as little as five years after the creation of the REIT — at which point, the management must look at options for liquidity. Those nontraded REITs formed at the bottom of the recession are now looking at liquidity options and finding many viable ones, lawyers say, thanks in part to the fact that they've made so many acquisitions.

“Those nontraded REITs have raised more capital. They are bigger entities,” said George C. Howell of Hunton & Williams LLP. “The IPO market is reasonably friendly these days.”

Latham & Watkins LLP’s William J. Cernius said he has seen an uptick in activity as many nontraded REITs reach the liquidity investigation point. American Realty Capital is among the most active of the so-called nontraded REIT “sponsors,” the companies that set up and manage nontraded REITs.

American Realty has set up numerous nontraded REITs, some of which have gone public. And in one of the latest blockbuster REIT deals, Ventas Inc. last month acquired American Realty Capital Healthcare Trust Inc. for $2.6 billion. American Realty Capital Healthcare had been a nontraded REIT until it went public in 2012 and thus has now gone both the IPO and mergers and acquisitions route.

“Sponsors now have multiple realistic options available to them when it comes time to provide an exit strategy,” Michael L. Hermsen of Mayer Brown wrote in an email. “The stock markets are great for REITs right now and the real estate market has heated up and is providing better values upon a sale of properties. So sponsors can take a good hard look in deciding upon the right exit strategy for them.”

The timing for companies to address the liquidity question is rarely set in stone, and given the market, many companies are addressing the liquidity question even earlier than required, lawyers say.

“The speed with which some of these entities have embarked [on the liquidity question] has been accelerated because of favorable market conditions,” said Sharon A. Kroupa at Venable LLP. ”These REITs have had the benefit of being able to acquire properties at fantastic prices.”

As nontraded REITs reach the liquidity discussion phase, lawyers and investment bankers help companies sort out the pros and cons of seeking IPOs versus sales. With acquirers sitting on piles of cash and an IPO market that has been favorable to real estate companies over the past couple of years, companies — armed with large property portfolios — are facing numerous strong prospects for exits. They can list with an initial public offering, list without an initial public offering and instead use a tender offer, be acquired, merge with an existing REIT or even execute a reverse merger, Kroupa said.

As nontraded REITs look for exit strategies, they, like other companies contemplating an IPO, are also taking advantage of the option to file confidentially with the U.S.Securities and Exchange Commission, said Laurence E. Crouch of Shearman & Sterling LLP. Such confidential filings give managements of nontraded REITs yet another avenue for determining how best to maximize shareholder value.

Part of the success of nontraded REITs, though, is a reflection of market conditions, and companies that did more acquisitions at the bottom of the market are finding it even easier to produce the results their shareholders want to see.

“There is a little bit of a Goldilocks situation because portfolios that are reaching the fourth, fifth, sixth year … they bought after the high point,” said Ettore A. Santucci of Goodwin Procter LLP. “In a way, if success is measured by liquidating or returning capital to shareholders at least at par or better compared to cost, it’s easier to do so if you bought low. In a way, if you want to use Lake Wobegon, everybody’s above average.”

--Editing by Elizabeth Bowen and Christine Chun.
