Real Estate M&A

Contributing editor
Steven L Wilner

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GETTING THE DEAL THROUGH

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United States

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1 What is the typical structure of a real-estate-related business combination?

Generally, business combinations of real-estate-related businesses occur through the merger or acquisition of a publicly traded real estate company. These 'public real estate M&A deals' are structured to take into account tax, regulatory and operational considerations. Typically, such transactions are structured as 'triangular mergers' in which a wholly owned subsidiary of the acquirer is merged with the target. Triangular mergers take one of two forms: 'forward' or 'reverse'. In a forward triangular merger, the acquirer's merger subsidiary, not the target, survives the merger. In the reverse triangular merger, the target survives, resulting in the target becoming a wholly owned subsidiary of the acquirer. Reverse triangular mergers frequently provide the benefit of avoiding third-party consent rights resulting from changes of control or assignment. Public M&A deals (other than where underlying assets are few in number) are rarely, if ever, structured as asset sales due to the time and expense required to evaluate direct transfer restrictions and to prepare title transfer documents for each property individually.

The structuring of public transactions involving one or more real estate investment trusts (REITs) depends on the corporate structure of each REIT. REITs are often structured as umbrella partnership REITs, or UPREITs, that hold and operate properties through a wholly owned or partially owned operating partnership in which the REIT is the general partner. In this scenario, in addition to a merger of the publicly traded entity operating as a REIT (which is typically a corporation), the operating partnership of the target may be merged with the acquirer or survive the merger as subsidiary. The structuring analysis is influenced by limitations in the governing documents of the entities, tax treatment of the transaction and the most efficient tax treatment of the post-closing company.

2 Describe the process by which real-estate-related business combinations are typically initiated, negotiated and completed.

Transactions follow many different paths including as a result of conversations between a potential acquirer and a target due to perceived synergies including cost savings, geographic or asset type diversification, an auction sale process initiated by the target to create value for its shareholders or an 'activist investor' commencing a campaign to change management or sell the company. Recently, activists have taken an increasing role in triggering M&A transactions by targeting REITs perceived to be undervalued or ripe for a strategic combination. Activists have also targeted REIT-intensive operating companies (eg, Sears, Macy's, Target) in an effort to foment sales or spin-offs of real estate assets that are undervalued.

3 What are some of the primary laws and regulations governing or implicated in real-estate-related business combinations? Are commercial, residential or agricultural real estate assets subject to specific regulation that would be material in a typical transaction?

Foremost among the multiple laws governing public real estate combinations are the corporate laws of the target's state of organisation and federal securities laws applicable to M&A transactions involving publicly traded companies generally. In addition, each US state and local jurisdiction has a separate regime of real property law that could potentially impact an M&A deal. For instance, the imposition of transfer taxes and mortgage recording taxes is governed by local law. In addition, there are some jurisdictions that require reassessments of real property in the event of certain changes in control. As a result, local counsel should be consulted in states where material components of a target's portfolio are located to advise on matters of local law.

4 Are there any specific regulations relating to cross-border combinations or foreign investors or acquirers that are material to real-estate-related business combinations and related structures?

The Foreign Investment in Real Property Tax Act of 1980 (FIRPTA), can subject foreign owners of US real estate, or of shares in domestic US real property holding corporations, to taxes on gains in value upon the sale of such real estate, including assets held in a REIT. However, FIRPTA does not apply to shares of REITs that are domestically controlled (ie, with a majority of shares held directly and indirectly by domestic owners), or to portfolio interests (5 per cent or less) in publicly traded US real property holding corporations. Certain types of shareholders (eg, qualified foreign pensions or sovereigns) also may be exempt from taxation under FIRPTA.

Foreign investors should be aware that the Committee on Foreign Investment in the United States (CFIUS) may review the acquisition of real estate that is proximate to or is itself critical infrastructure or otherwise poses a sensitive security risk. Examples have included assets that adjoin sensitive US military installations or US government tenants. Submitting to CFIUS review is initially voluntary on the part of parties to a transaction, but CFIUS (or an individual agency member of CFIUS) can initiate a review on its own, and CFIUS has subpoena power to compel the production of information. Over the past few years, foreign investment in real estate has received increased attention from US authorities that focus on national security, which has included CFIUS reviews of high-profile real estate transactions such as the 2014 acquisition of the Waldorf Astoria by the Anbang Insurance Group Co.

5 What territory's law typically governs the definitive agreements in the context of real-estate-related business combinations? Which courts typically have subject-matter jurisdiction over a real-estate-related business combination?

Each US state has a separate corporate law regime that governs entities organised in the state. Because many entities in the US are organised in the state of Delaware, and because there is generally a high degree of comfort with the application of Delaware law, Delaware law is often selected to govern corporate and M&A purchase agreements. REITs are frequently organised under Maryland law and are typically corporations. When Maryland law governs the REIT, Maryland law is typically chosen to govern the definitive agreements.

Parties can also agree to submit to the exclusive jurisdiction of courts in a particular state and often a particular city. Courts in the state of New York, and specifically Manhattan, are often chosen. The Delaware Chancery Court is often chosen for public company deals involving Delaware companies, and Maryland courts may be chosen for deals involving public Maryland REITs. Note that in certain circumstances the state whose courts are selected may be different from the state whose law applies to the documents. Relevant factors in

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determining the combination of law or jurisdiction relate to the selection of a neutral venue, convenience of the parties and sophistication of the judiciary.

US securities laws and the rules of the Securities and Exchange Commission (SEC) also apply to acquisitions of a publicly traded company.

6 What information must be publicly disclosed in a public-company real-estate-related business combination?

Under the applicable proxy rules (in a one-step merger) or tender offer rules (in a tender offer), all agreements with the target and any of its shareholders or executive officers must be publicly filed and summarised for shareholders. The bidder's sources of funds are also disclosed, and any financing agreements are summarised and, for a tender offer, are publicly filed. A fairly detailed description of negotiations and other transaction background (including other bidders' proposals) is also required. Any other information that would be material to a target shareholder must also be disclosed.

If the acquisition consideration offered to shareholders includes securities, the buyer must register the offered securities under the Securities Act of 1933, requiring among other things two or three years of SEC-compliant financial statements, with a management discussion and analysis (MD&A) and, usually, pro forma financial statements, and a full business description. If the buyer is already an SEC-reporting company, much of this can be done through incorporation by reference to already publicly filed materials; if not, this is a major undertaking, akin to a US initial public offering.

7 Give an overview of the material duties, if any, of the directors and officers of a company towards company stakeholders in connection with a real-estate-related business combination. Do controlling shareholders have any similar duties?

Directors' duties depend on the entity type and state of organisation. Most publicly traded real-estate-related companies are either Delaware corporations or Maryland REITs.

In an acquisition of a Delaware corporation, entirely or significantly for cash, directors have a duty to use reasonable efforts to obtain the highest value reasonably obtainable ('Revlon' duties). This does not always require an auction or even a confidential solicitation of bids, but until the shareholders vote to approve (or a tender offer is consummated) the board must retain the ability to respond to bona fide indications of interest; provide information to and negotiate with another bidder; change its recommendation of the initial deal to shareholders; and usually will have the right to terminate the acquisition agreement to accept a superior proposal (subject to paying an agreed termination fee).

A controlling shareholder does not have a duty to agree to sell, even if that prevents other shareholders from receiving an attractive offer. If the acquirer already controls a Delaware corporation, see question 14.

While Revlon does not apply to publicly traded Maryland REITs, directors have duties to act in good faith and what they reasonably believe is in the REIT's best interest and act with due care. Generally, acquisition agreements for these types of REIT's are very similar to agreements for acquisitions of Delaware corporations as to these types of provisions.

8 What rights do shareholders have in a public-company real-estate-related business combinations? How do acquirers address and structure around the risks associated with shareholder dissent in the context of real-estate-related business combinations?

If the acquisition is structured as a tender offer, shareholders have the right, after receiving full and accurate disclosure, to decide whether to tender.

In most situations, if a majority of the outstanding shares are tendered and acquired, the acquirer may (and will likely by contract be required to) immediately thereafter be able to 'squeeze out' the remaining shareholders in exchange for the same consideration (or, if appraisal rights are available, in exchange for the appraised value payable in cash as noted below).

If the acquisition is instead structured as a 'one-step merger', the merger must be approved by holders of a majority of outstanding shares (or a higher threshold specified in the certificate of incorporation) in the case of a Delaware corporation or by holders of two-thirds of outstanding shares (or a higher or lower threshold specified in the declaration of trust, but not less than a majority) in the case of a Maryland REIT.

In Delaware, if shareholders of a listed company are required to accept anything other than listed shares (or American depository receipts) of the acquirer, shareholders who do not tender their shares or do not vote in favour of the merger can exercise 'appraisal rights' and receive the court-determined fair value of their shares in cash, excluding value arising from the completion or expectation of the merger. For a publicly traded Maryland REIT, there are generally no appraisal rights available unless the REIT is organised as a corporation, shareholders are required to receive cash as consideration and the REIT's directors and executive officers beneficially own in the aggregate more than 5 per cent of the REIT's outstanding shares and any of them have the right to roll over their shares for shares of the acquirer, which right is not made available to all shareholders.

9 Which kinds of termination fees are permissible, and what is their magnitude?

A Delaware corporation can agree to pay a 'reasonable' termination fee if its board terminates the transaction to accept (or changes its recommendation in light of) what it concludes is a superior proposal. Such fee is also commonly payable if the shareholders reject the tender offer or merger following a third party's competing proposal, and if the target is acquired within a specified period following the termination. While there is no precise definition of a 'reasonable' termination fee, fees of 2.5 per cent to 3.5 per cent (or for small deals 4 per cent) of the equity value of the deal are common and regularly upheld (often inclusive of expense reimbursement, but sometimes in addition to reimbursement up to a cap). Similar fees are generally included in acquisition agreements for Maryland REITs.

If the acquirer is relying on external financing, there may be a 'reverse termination fee' (generally as large as the termination fee or substantially larger) payable if the deal does not close because financing falls through even though the bidder complied with its obligations (see question 31).

10 How much advance notice must a public target give its shareholders in connection with approving a real-estate-related business combination, and what factors inform this analysis? How is shareholder approval typically sought in this context?

In a one-step merger, the target must generally mail the 'proxy statement' at least 20 business days before the shareholder meeting at which the vote takes place. In a merger, the target must file the proxy statement in 'preliminary form' with the SEC, which may be reviewed by the SEC staff, and must respond to comments (often multiple rounds) before mailing the proxy statement.

In a tender offer, the bidder must mail offer documents to the target shareholders at least 20 business days before the offer's scheduled expiration. In a tender offer, there is no prior filing with the SEC, though SEC staff may review the tender offer during the pendency of the offer and can require supplemental disclosure, which on rare occasions requires an extension of the offer period.

11 What are some of the typical tax issues involved in real-estate-related business combinations and to what extent do these typically drive structuring considerations? Are there certain considerations that stem from the tax status of a target?

Tax issues may be relevant for selling shareholders, acquirers or the target company. Many of the issues are the same as those relevant for M&A transactions generally. For selling shareholders, one major question is whether the transaction is a taxable transaction (eg, a cash acquisition) or is tax-free (eg, a corporate reorganisation or a contribution to a partnership). Acquirers often want a step-up in tax basis (available in a taxable asset acquisition) rather than a carryover basis. Where REITs are acquired, it may be possible to liquidate the REIT and obtain an asset basis step-up. Transactions may also trigger real property transfer taxes, mortgage recording taxes or reassessment of the real property. In private M&A transactions there are generally negotiations over the allocation of taxes pre- and post-closing and over contingent tax risks (eg, whether a REIT election was properly in effect).

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Because of the widely different characteristics and requirements of different types of entities, differing tax considerations may apply if the target is a US corporation, REIT or partnership.

12 What measures are normally taken to mitigate typical tax risks in a real-estate-related business combination? How important are tax issues in evaluating structuring alternatives in the context of a real-estate-related business combination?

As with any M&A transaction, before entering a definitive agreement acquirers generally engage in due diligence to obtain a better understanding of the corporate and tax structure of a target and any tax and other contingent exposures of the target. In public company transactions, due diligence is typically conducted prior to signing the purchase agreement. After signing, very few matters rise to the level of allowing the acquirer to refuse to close based upon its findings.

Tax issues often drive M&A transaction structuring: whether the acquisition is a stock acquisition or an asset acquisition, whether consideration is stock or cash, which company survives a merger and how financing is structured. This is true in all M&A transactions, although often more stark in a real estate M&A transaction because of FIRPTA and the special tax characteristics of partnerships and REITs.

13 What form of acquisition vehicle is typically used in connection with a real-estate-related business combination, and does the form vary depending on structuring alternatives or structure of the target company?

The acquisition vehicle form varies and can include one or more corporations, limited liability companies and limited partnerships. The selection of the acquisition vehicle, and whether additional newly formed entities that participate in the acquisition are necessary, depends on a variety of factors, including the current corporate structure of the parties, tax considerations, financing requirements and the intended structure of the company following closing. For example, if the target is an UPREIT (as discussed in question 1), the acquirer may want to keep the structure in place following closing, which may require a merger of the REIT with an acquiring corporation and the merger of the operating limited partnership with an acquiring limited partnership.

14 What issues typically face boards of real-estate-related public companies considering a take-private transaction? Do these considerations vary according to the structure of the target?

A traditional take-private transaction involves a controlling shareholder acquiring the company it controls. If a controlling shareholder of a Delaware corporation tries to take the corporation private, the transaction will generally be subject to 'entire fairness' judicial review. 'Entire fairness' includes fairness of price and process, and to help establish the fair process aspect, the target board normally establishes a special committee of independent directors (ie, non-management directors unaffiliated with the controlling shareholder) that can retain advisers, negotiate and reject any offer. The court will not apply 'entire fairness' review if the controlling shareholder makes the transaction irrevocably subject to approval by both a special committee and holders of a majority of unaffiliated shareholders, in both cases with full disclosure.

Normally, a special committee process will also be followed in connection with any take-private of a Maryland REIT.

In any acquisition by a controlling shareholder (or other target affiliate), in addition to tender offer rules or proxy rules described in question 6, additional SEC disclosure will be required under Rule 13e-3 unless an exemption is available.

15 How long do going-private transactions typically take in the context of a public real-estate-related business combination? What are the major milestones in this process? What factors could expedite or extend the process?

As discussed above, going-private transactions typically involve the establishment of a special committee of independent directors, which retains advisers and subsequently negotiates. This post-agreement process generally takes one to three months to reach agreement but can take longer.

In one-step mergers, proxy statements (including additional information required by Rule 13e-3) are prepared and filed with the SEC, subject to SEC review, and mailed to shareholders prior to the shareholder meeting. This post-agreement process generally takes another three to four months.

If, instead, the bidder commenced a tender offer before, or in connection with, making its offer to the board, the special committee review or negotiation process can run concurrently with the tender offer. In that event, once an agreement with the special committee and board is revealed, it may be possible for the tender offer's 'offer to purchase' (containing additional information required by Rule 13e-3) and other filings to be amended (likely requiring about one week), and the tender offer may be completed 10 business days after amended filings reflecting such agreement are made.

16 Are non-binding preliminary agreements before the execution of a definitive agreement typical in real-estate-related business combinations, and does this depend on the ownership structure of the target? Can such non-binding agreements be judicially enforced?

Letters of intent (also called memorandums of understanding) are rarely utilised in acquisitions of public real estate companies but are quite common for private companies. While such agreements are typically non-binding, there are a number of provisions that parties typically include as binding obligations including confidentiality, non-circumvention, choice of law, exclusivity and expense provisions.

Provisions contained in letters of intent that are intended to be enforceable are, as a general matter, respected by courts. So long as the terms of the letter are clearly and unambiguously non-binding, courts will respect the agreement of the parties. If, however, a party challenges the non-binding nature of the letter of intent and the letter of intent is ambiguous, courts will review and may find aspects of the letter to be enforceable so long as they contain all relevant material terms. For these reasons, it is a good practice to clearly state in the letter of intent that it is non-binding except with respect to the specified provisions in order to avoid ambiguity and potentially damages. Notwithstanding the terms of a letter of intent, most jurisdictions in the US recognise a general obligation of all parties to a transaction to negotiate in good faith.

Although public real estate companies rarely enter into a letter of intent to avoid being required to publicly disclose its content, they will require the target to enter into a non-disclosure agreement and in some cases will agree to enter into an exclusivity agreement for a short period of time to give the target time to formulate a proposal.

17 Describe some of the provisions contained in a purchase agreement that are specific to real-estate-related business combinations? Describe any standard provisions that are contained in such agreements.

Real estate M&A purchase agreements are substantially similar to purchase agreements for other business combinations. However, real estate M&A agreements often include additional property-specific representations and warranties, including with respect to the status of the target's ownership rights to the real property, existing liens on real properties, existing leases and insurance affecting the real property. These representations and warranties force the target to disclose diligence materials prior to signing. Qualifications to these representations are based upon target's knowledge and the level of materiality necessary to cause a breach of the agreement are common.

Purchase agreements also include closing conditions. In general, closing conditions fall into the following four categories: (i) regulatory related matters (eg, antitrust clearance and CFIUS), (ii) required shareholder approval, (iii) required deliverables (eg, in some REIT acquisitions, delivery of tax opinions) and (iv) the absence of a 'material adverse change' of the target. These closing conditions are typically significantly negotiated and, in particular with respect to the determination of a 'material adverse change,' are the subject of the negotiated exceptions.

The target typically covenants to continue operating its business in the ordinary course between signing and closing, which typically prohibits incurring debt, selling or acquiring properties or undertaking major capital projects. In real estate M&A deals involving REITs, the seller may also covenant to not take actions that would compromise its REIT status.

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18 Are there any limitations on a buyer's ability to gradually acquire an interest in a public target in the context of a real-estate-related business combination? Are these limitations typically built into organisational documents or inherent in applicable state or regulatory related regimes?

Publicly listed Maryland REITs typically have provisions in their organisational documents prohibiting any investor from acquiring more than 9.8 per cent (as a result of the need to maintain the REIT's preferential tax status) without prior board approval.

In both Delaware and Maryland, a corporation can adopt a 'poison pill' shareholder rights plan, pursuant to which if any entity or group acquires more than a specified percentage of shares, its ownership will be subject to possibly massive dilution.

In any event, if the target has more than a minimal amount of any non-real property assets before acquiring more than US$80.8 million of stock (subject to a cost-of-living based adjustment annually) the acquirer must obtain prior clearance by one of the US antitrust authorities pursuant to the Hart-Scott-Rodino Act. Also, if 5 per cent or more of the stock is acquired, the buyer will need to make a public filing with the SEC on Schedule 13D within 10 days containing specified information.

19 Describe some of the key issues that typically arise between a seller and a buyer when negotiating the purchase agreement, with an emphasis on building in certainty of closing? How are these issues typically resolved?

Public real estate M&A transactions typically include an array of deal protections and closing conditions that are heavily negotiated. 'No-shop' covenants are often included, which prevent the target from soliciting bids from other potential acquirers, but such provisions are uniformly subject to 'fiduciary out' provisions allowing the board to provide information to, and negotiate with, another bidder. Sometimes, particularly in private equity deals, the parties agree to 'go-shop' provisions that allow the target to affirmatively solicit competing bids for a limited period of time and, if that process leads to a superior deal during that period (or sometimes even later, if with a bidder who had surfaced during that period) then the size of the termination fee is significantly reduced. Under a no-shop or a go-shop, if a superior proposal surfaces, the bidder normally has 'matching rights' for several days before the target board is permitted to exercise its rights to withdraw its recommendation of the original deal and, if it has actual termination rights, before it can exercise such rights. Termination or break-up fees payable by the target (see question 9) somewhat reduce the bidder's risk of a competing bid and provide some compensation if it is outbid.

Also heavily negotiated are the target's rights if the acquirer fails to close – whether because of breach or a failure of its lenders to fund even though the acquirer did not breach (see question 26). Another heavily negotiated provision in real estate M&A purchase agreements, is the exact scope of the ubiquitous closing condition that the target not have suffered a material adverse effect that is continuing as of the closing.

20 Who typically bears responsibility for environmental remediation following the closing of a real-estate-related business combination? What contractual provisions regarding environmental liability do parties usually agree?

In public company sales, including public REITs, the acquired company continues to have the pre-closing liabilities and the selling shareholders retain no liability post-closing. The acquirer typically has the right to inspect the properties to gauge the scope of its potential liability and may require the target to perform environmental testing of the properties to assess liability. In some cases, the parties may negotiate environmental insurance coverage for known clean-up issues.

21 What other liability issues are typically major points of negotiation in the context of a real-estate-related business combination?

As described in question 20, in a public company real estate acquisition the selling shareholders do not retain any liability or risk of liability post-closing. Conversely, in the context of a private M&A deal, the sellers will often retain some risk of pre-closing liabilities. The scope of the liability risk the sellers agree to keep post-closing is the subject of significant negotiation. Issues include the threshold of damages giving rise to a claim, the cap on overall damages and the way in which the seller gives the acquirer comfort that it will be able to perform its obligation (eg, establishing an escrow arrangement, a holdback by the target or by delivering a guaranty from a creditworthy entity).

22 In the context of a real-estate-related business combination, what are the typical representations and covenants made by a seller regarding existing and new leases?

Common lease-related representations and warranties include those relating to whether there are any defaults under leases in place, any outstanding amounts owed to tenants under the leases and whether the leases contain any right for the tenant to purchase an individual property. Typically, there will be a covenant in the purchase agreement preventing the target from entering into any new lease or leases above certain thresholds between signing and closing and restrictions on terminating existing leases.

23 Describe the legal due diligence required in the context of a real-estate-related business combination. What specialists are typically involved and at what point in the transaction are the various teams typically brought in?

The scope and degree of due diligence depends on the target's portfolio of real estate assets. In a public real estate M&A deal, if the target's portfolio consists of a limited number of material properties, or includes a few material properties among many immaterial properties, the acquirer may focus only on those material properties. Otherwise, the acquirer may perform diligence on a representative sample of properties or forego property level diligence entirely. Property-level diligence may include reviewing the status of the target's legal title to some or all of the property (eg, whether a clear chain of conveyance documents evidences ownership, whether there are liens on the property, and whether other parties have rights to the property, such as easements) and reviewing change of control provisions, anti-assignment clauses, third-party consent rights, termination rights or economic terms under material contracts. In any real estate M&A transaction, research may also be conducted on the target's owners or major shareholders to determine whether the acquirer should expect resistance to the transaction.

In addition to the above, a review of tax, employment and environmental diligence will be typically be undertaken. Litigation-related diligence may also be necessary if the target is the subject of a material litigation.

24 How are title, lien, bankruptcy, litigation and tax searches typically conducted? On what levels are these searches typically run? What protection from bad title is available to buyers, and does this depend on the nature of the underlying asset?

As described above, the scope and degree of due diligence is a function of the target's portfolio and the acquirer's risk analysis. Bankruptcy, tax and litigation searches are typically run by third-party service providers that search multiple local and national databases to determine any issues.

With respect to title to the property, the acquirer may engage a title insurance company to perform title searches. These searches check land records and other sources to determine the current owner's state of title (eg, ownership and any encumbrances, conditions, covenants or restrictions to which such ownership is subject) and any issues of which the acquirer should be aware. If the target does not currently have title insurance policies, the acquirer may purchase the policies, which provide coverage against claims by third parties against an owner's title to real property.

25 What are some of the primary lease issues and other agreements that the legal teams customarily review in the context of a real-estate-related business combination, and does the scope vary with the structure of the transaction?

The primary concern regarding material contracts and leases is whether the target's counterparty has a termination or consent right that will be triggered by a change of control or assignment resulting from the transaction. Depending on the transaction, each material agreement or a specified selection of agreements will receive individual analysis. An acquirer may also review individual leases and agreements for their

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economic terms, which may be fundamental to the underlying M&A transaction.

26 What are the typical remedies for breach of a contract in the context of a real-estate-related business combination, and do they vary with the ownership of target or the structure of the transaction?

In real estate M&A deals involving a publicly traded REIT or other company, the acquirer does not have the benefit of post-closing breach of contract remedies, such as surviving representations and warranties and indemnities. The target's remedies only protect against the risk of the acquirer breaching the purchase agreement or being unable to close.

Prior to termination of the purchase agreement, the target may have the right to specific performance to enforce the acquirer's obligations under the purchase agreement. In deals that are strategic combinations (eg, the merger of two REITs), specific performance may entail forcing the acquirer to close the transaction regardless of the availability of funding for the deal. In deals involving the acquisition of a REIT by a private fund, specific performance may be limited by the availability of the acquirer's funding source.

After termination of the purchase agreement, the target may pursue damages for the acquirer's breach or, for certain breaches or certain failures to close not involving a breach, may be entitled to a reverse break-up fee. In strategic combinations, the target's claims may not be capped, whereas in acquisitions by private funds such claims may be capped at a reverse break-up fee amount with all claims released upon payment of such fee. The parties negotiate which breaches survive termination and which do not. Damages may be defined to clarify that damages are not limited to the target's own damages (largely just expenses) but include shareholders' expectations of the deal premium.

27 How does a buyer typically finance real-estate-related business combinations?

Transactions may be financed by real estate-secured debt, corporate debt, such as syndicated bank debt or corporate bonds, or a combination of both. The financing arrangement for a transaction depends on, among other considerations, the size of the transaction, interest rate environment, the terms of existing financing at target and whether the acquirer is required or permitted to assume the target's current debt. Procurement of financing is almost never a closing condition, but the target and acquirer typically require a commitment letter from a lender or other evidence of availability of funds before signing the purchase agreement.

28 What are the typical obligations of the seller in the financing?

The target (or seller, in a private transaction) usually insists that the acquirer has a firm financing commitment, which is often not the financing that is ultimately incurred at closing. The target typically agrees to cooperate with the acquirer's efforts to obtain better financing and the lenders' syndication efforts. The parties may negotiate that upon provision of certain required information by the target and the satisfaction of other conditions, a marketing period commences in which the acquirer must complete financing and be able to close. The required information varies depending on whether a deep level of property information is required, and often such cooperation is limited to reasonable requests, customary requirements or commercially reasonable efforts. Some items that may be included in financing cooperation provisions include:

- providing historical financial statements;
- assisting in the preparation of pro forma financial statements;
- assisting in obtaining title insurance and surveys;
- permitting field examinations for third-party reports and appraisals;
- providing information in connection with 'know your customer' and anti-money laundering rules;
- senior officers reasonably participating in meetings, calls, presentations and other activities;
- providing information for rating agency presentations;
- participating in the preparation of pledge and collateral documents;
- obtaining third-party consents, as required (eg, consents from joint venture partners); and
- obtaining customary pay-off letters.

29 What repayment guarantees do lenders typically require in the context of a real-estate-related business combination? For what purposes are reserves usually required?

If the transaction is financed with a loan secured by the real property, lenders typically require that cash flow from the properties be used to fund debt service and reserves for the operation of the property (eg, taxes, insurance, capital improvements). Cash flows are either immediately or upon the occurrence of certain events, including events of default and failure to meet negotiated financial thresholds (eg, debt yield and debt service coverage ratio), held in a lender controlled account. These property-level loans are typically non-recourse, meaning the borrower's liability is generally limited to its interest in the collateral property, but there are some notable exceptions. Lenders typically require that a creditworthy and liquid guarantor execute an indemnity for all losses related to environmental matters and a guaranty for losses arising from certain acts by the borrower (eg, fraud, intentional misrepresentation) and the entire debt under very limited circumstances (eg, bankruptcy of the borrower or an impermissible transfer of the property).

Corporate-style loans are typically recourse to the target and its subsidiaries (through the use of guarantees) and, if secured, often require the target to provide mortgages on its properties.

30 What covenants do lenders usually insist on in the context of a real-estate-related business combination? Does this vary with the overall financing of the transaction?

In the context of real-estate-secured debt, the borrower (usually a special-purpose subsidiary of the target) typically undertakes covenants to operate the properties in the ordinary course, maintain existing contracts, permits and leases, and not take any action to impair the assets.

In the context of corporate-style debt, the lender typically requires far fewer covenants concerning the property but relies on significantly more financial covenants and restrictions on the overall business of the target, including formation of new subsidiaries, acquisition of new properties, financial covenants including leverage tests and limitations on additional liens being placed on the collateral.

31 What equity financing provisions are common in a going-private real-estate-related transaction? Does it depend on the structure of the buyer?

The need for debt financing to facilitate going-private real-estate-related transactions adds risks that must be addressed and allocated between the parties. Given their structures and investment theses, private equity funds want to ensure that they are only obligated to close if the debt financing materializes. In the US, the customary market practice is to allocate this risk by including no express financing closing condition and allowing the target to force the private equity fund to draw on its equity to close the deal only if debt financing has or will be funded. The target is given the right to terminate the purchase agreement if the acquirer fails to close the deal when required. If the target terminates, the acquirer pays a reverse break-up fee and sometimes reimburses the target's expenses (often capped). Typically, payment of a reverse break-up fee caps the acquirer's liability for its failure to close. This provides the private equity fund with comfort that it is not liable beyond the reverse break-up fee and target's expenses, while allowing the target to look to a capitalised counterparty in the event of termination.

32 Are there particular legal considerations that shape the formation and activities of REITs?

REITs are tax-advantaged, in that they are corporations that can eliminate (or substantially eliminate) their corporate taxation so long as they pay dividends equal to their taxable income. Domestically controlled REITs are not treated as US real property for the purposes of FIRPTA. Where appropriate, therefore, REITs are often desirable.

Qualifying for REIT status imposes a number of limitations, however, on the ownership and governance of the REIT, the assets it can hold, the income it can receive and the activities it performs. As a result, there can be significant compliance burdens incident to REIT status and substantial limitations on its assets and activities, so REITs should only be used where it is also appropriate from a business perspective.

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33 Are there particular legal considerations that shape the formation and activities of real-estate-focused private equity funds? Does this vary depending on the target assets or investors?

Private equity funds often have investors with widely varying characteristics, including foreign sovereigns, other foreign investors, US tax-exempt investors or US taxable investors. Each type of investor has its own considerations. For example, foreign sovereigns are often sensitive to whether they will be treated as engaged in 'commercial activities', foreign investors are sensitive to whether they will be treated as engaged in a US trade or business, US tax-exempt investors are sensitive to whether they will receive 'unrelated business taxable income' and US taxable investors are sensitive to the timing and character of the income and losses they are allocated. Private equity funds therefore are often structured using parallel partnerships (or 'sleeves'), using 'blocker' corporations as appropriate, or organizing REITs to hold assets. The appropriate structure is driven by the characteristics and concerns of the investors and the types of assets being invested in and their expected return profiles.

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