

RealFoundations

Bringing expert advice to real estate M&A



Jonathan A. Schein, senior vice president and managing director of global business development for Institutional Real Estate, Inc., recently spoke with **Barry Faulkner**, senior managing consultant for RealFoundations, about the complexity of M&As and how outside consultants can help ensure successful transaction outcomes. Following is an excerpt of that conversation.

We are in a merger-and-acquisition phase of the real estate cycle. What should a real estate company be aware of, at a high level, if it undertakes an M&A transaction?

A merger or acquisition is a transformational event for the companies involved, holding the promise of creating increased value in a way that other strategies can't, such as immediate scale, increased efficiencies or access to new markets. However, there are significant personnel, financial and operational challenges associated with achieving the expected results, and it's critical to manage those challenges effectively. Unfortunately, most companies struggle through the process unless they hire outside expertise to assist.

What are the key challenges?

Each firm needs to look hard at all details surrounding the transaction's execution and determine exactly how it will accomplish its goals. Everything surrounding the transaction must be done simultaneously and in a very compressed time frame, yet most leadership teams have never been through an M&A event, so they aren't experts in rapidly integrating two companies. Typically, the combined entity is under tremendous pressure to deliver on promised financial synergies by certain milestones, especially for a public company where the stock price will suffer. While delivering those benefits, management also needs to integrate operations across the two different companies. Even if they are in the same market space and appear similar externally, each company likely approaches its work differently from a systems, personnel and resourcing perspective. To deliver the anticipated benefits, management must build a platform that meshes the two legacy organizations into one. Finally, while all this planning and transitioning is going on, the company still needs to perform seamlessly for its tenants, vendors, investors and employees. It needs to coordinate across all these dimensions at once, which is the real challenge.

What should a firm do to ensure its success?

RealFoundations has identified five key priorities that firms involved in an M&A should focus on immediately leading up to the closing. First, establish an integration management office, which can coordinate the inventory of transaction-related projects across both companies. Second, identify and retain key resources from all levels of both companies, especially C-suite executives, to provide leadership and a sense of continuity. Third, implement a tactical plan designed to achieve all strategic goals and synergy targets. Fourth, determine the necessary resources that are required to do all the work to keep the business effectively running during the transition. Fifth, integrate or transition the two companies' technology platforms and systems.

All of that sounds like a huge undertaking. Is there one thing above all others the company should focus on in the near term?

Right out of the gate, post-merger or post-acquisition, the new company must be functional — able to pay bills, collect rents and make payroll. Operations need to be stabilized so the business runs effectively, even if not at 100 percent efficiency. Once everything is stabilized, executives can plan the next 30, 60 and 180 days with greater specificity to become more efficient and hit synergy targets.

You mention resources as a key priority. Please expand on that.

When we talk about resources, we're concerned with the human capital for the go-forward organization. To be successful, the new firm needs to have continuity of leadership. Given the complexity and change that happens in an M&A transaction, having the right leadership is crucial. You need executive sponsorship dedicated to the integration's success, as well as a supporting team fully committed to all the projects associated with moving from two legacy organizations to one. You also need line leaders of the different business units working through operational transitioning and subject-matter experts working on technical aspects. The combination of executive leadership and a detailed staffing plan, which includes incentives for a successful merger, can really help companies reach their targets.

You've also highlighted synergies and technology as key priorities. Can you provide a little more detail?

Typically, during the initial underwriting of an M&A transaction, executives and investment bankers determine synergy targets, based on industry benchmarks. The targets are generally high level, e.g., X percent savings from a reduction in software licenses, but eventually the financial target is set and must be met (or exceeded). Even if these targets are conservative, company leaders have to develop tactical plans to reach them without disrupting normal business operations. Regarding technology, executives need to do their research and make critical decisions as early as possible to stabilize the combined entity. Even in an acquisition where the acquirer will most likely impose its platform, executives need to thoroughly think through the design of the target state technology map, how scalable the current infrastructure is and best methods for systems integration and data conversion.

How should the new company approach accomplishing this work?

Companies need a systematic view of both companies' operating models and should start by creating a work map that allows them to completely understand how the two legacy enterprises have historically managed their operations. Next, they should look at sourcing, or who is doing the work. Two different organizations invariably accomplish the same tasks, but in different ways — for example, one might be vertically integrated, while the other outsources to multiple vendors. Developing a complete understanding of who does the work, in what time frame and under what metrics gives everyone a clear idea of scaling capabilities for the combined company. Finally, having a detailed technology map for both organizations is essential, as decisions will need to be made on systems and information will need to be transitioned between legacy companies. Without a detailed understanding of where both companies are currently positioned, your efforts will be compromised.

What role does communication play during a merger or acquisition?

Combining two companies can be traumatic for management, employees, vendors and investors alike. Change is difficult, especially when the organizations have different business cultures. However, it is easier if both legacy companies are transparent and open with their stakeholders about what is happening, timing, impacts, etc. Employees and vendors are much more likely to see the transaction as a personal opportunity, make an extra effort and/or be patient if they feel included in the process. Similarly, investors will appreciate receiving status updates against a high-level plan that provides milestones and targets.

Why is the topic of M&As especially important now?

There's been a notable spike during the past few years in real estate M&A activity. A few things have come together to drive this trend. Investors have a significant amount of dry powder (unallocated capital) because they are having trouble finding appropriate assets to buy, so some have decided to buy an operating company, including the real estate. Alternatively, the current interest-rate environment, which is still historically low, has supported aggressive acquisition programs. In addition, REIT pricing has been hovering below asset values, so these companies are particularly appealing as take-over targets. Finally, advancements in technology make managing and growing larger real estate portfolios more efficient than ever before.

What qualifications should firms look for when hiring outside consultants to help them navigate the M&A process?

Because real estate is a unique business, firms going through a merger or acquisition should retain experts with a proven track

record in both M&A and delivering these transactions within the industry. You don't want to have to explain your business to someone who might be an M&A expert in consumer products, but does not know much, if anything, about real estate. Your consultant needs to have a deep understanding of and appreciation for real estate operating models, outsourcing providers, and systems that are specific to this industry. They should also have experience across a broad spectrum of the industry, so they can bring ideas from different asset classes to the M&A transactions that they're supporting, such as multifamily to single-family rental. Additionally, a consultancy should possess detailed methodologies and tools that accelerate implementing projects like these.

Having an external M&A integration consultant should be just as important as having an M&A lawyer or investment banker during underwriting. An outside consultant can ensure that the transaction implementation meets all the goals, while allowing the company's C-suite to focus on managing the business.

How does RealFoundations fit into all of this?

A real estate company going through an M&A can't afford to be shortsighted by not retaining the right support for such a large investment. An M&A transaction will determine the company's direction for years to come. Having an external M&A integration consultant should be just as important as having an M&A lawyer or investment banker during underwriting. An outside consultant can ensure that the transaction implementation meets all the goals, while allowing the company's C-suite to focus on managing the business. Working with a consultancy like RealFoundations can provide a significant benefit to a company. Since 2017, RealFoundations has managed four of the largest mergers and acquisitions transactions in the industry. We have supported companies that now have a combined enterprise value of \$70 billion, and we have helped companies achieve over \$150 million of synergies, surpassing their original targets. A real estate company going through a transaction like this can rely on a company like RealFoundations to meet its M&A goals. Merging two companies with different cultures, different business structures and different systems is a significant challenge. It's not one that a company should take on without the type and caliber of expert advice that RealFoundations can provide.



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About RealFoundations

RealFoundations is a professional-services firm focused on helping real estate enterprises around the globe run better. We apply unmatched industry knowledge and insight to help companies that develop, own, operate, service, occupy or invest in real estate make better, more profitable decisions. Our passionate experts and proven solutions around business intelligence, process improvement, and systems planning and integration deliver lasting value and real bottom-line results.

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