

WHITEPAPER

3 Steps to a Well-Structured Transaction Data Room

The quality of a data room has a direct impact on the purchase price in M&A and real estate transactions. This white paper shows how markdowns can be avoided.

Background

According to studies conducted by REAG (Real Estate Advisory Group) and Drooms during 2012, transactions executed through poorly organised data rooms result in damages amounting to billions of euros each year. These transactions do not always fail because of poor quality data, in fact, the quality of the data itself is normally very good, but the result of being badly laid out in a poorly organised data room leads directly to a price reduction of anything up to and beyond 20%.

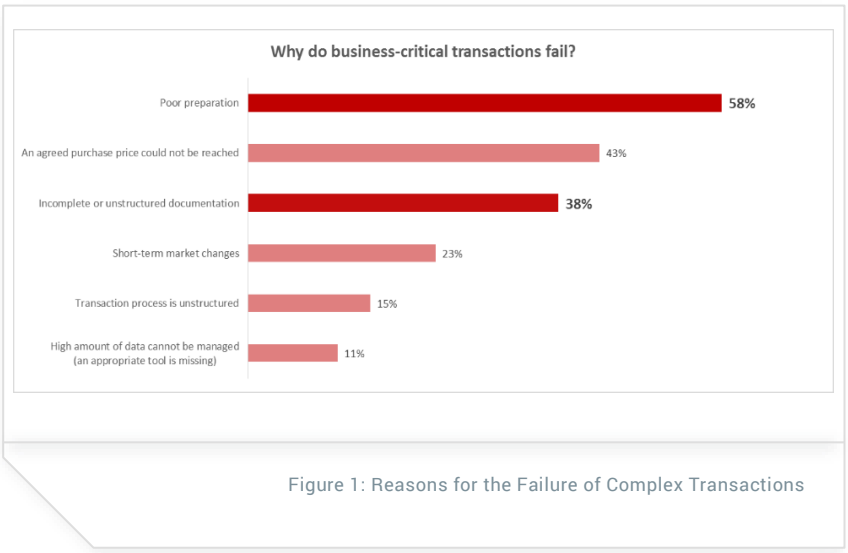


Figure 1: Reasons for the Failure of Complex Transactions

The causes of poorly organised data rooms are varied. However it is often due to the seller's project manager being trapped in a vicious cycle involving multiple factors, such as: a) limited "time-to-market", b) poorly defined roles and c) lack of support from specific departments. In many instances, regulatory hurdles also enter into the equation.

In order to avoid markdowns in transactions, it is therefore essential to set up a process which includes a professionally structured data room. This requires that:

- Documents are complete and up-to-date.
- Documents have been reviewed and are consistent.
- Vendor due diligence has been completed before bidders enter the data room.
- Subsequent delivery of missing materials during the due diligence phase can be reduced to a minimum.

Description of the Process

The ideal process necessary to prepare for effective sell side due diligence can be broken down into three steps:

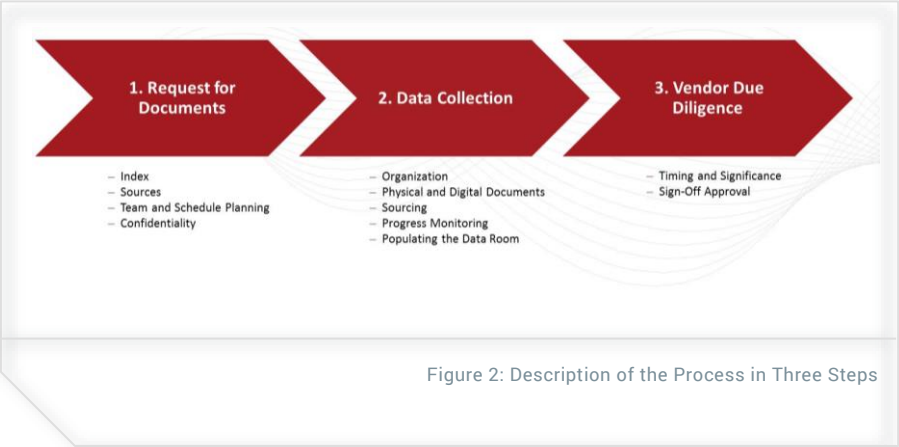


Figure 2: Description of the Process in Three Steps

Step 1: Request for Documents

INDEX

The index is the heart of a data room and is anything but trivial. A company should allow its legal and financial advisors to take care of selecting the appropriate documents in the right numbers. Typically, there is a model index for each type of transaction that serves as a general blueprint. In most cases, however, this index will need to be modified in order to fit the specific circumstances, since no two assets are alike.

How far back the documentary history should go is a particularly interesting question. Here, too, there's no set answer. It will depend on the strategy applied by the seller and the state of affairs of the company or condition of the object.

An equally widespread approach to structuring documents employs transactional phases. This applies to both "green" (general) and "red" (confidential) documents shown during the various phases of the due diligence process and to blacked-out documents shown (if at all) un-redacted versions only shortly prior to signing.

Document requests to public authorities, such as trade licensing offices or property registries, often prove especially time-critical. These documents should be requested at the start of the process so that the overall project schedule is not made captive to their availability.

SOURCES

Once the index has been defined, the sources of the documents must be identified. Under ideal circumstances, all documents will be centrally located and provided by a single person.

Normally, however, documents are stored in a decentralised fashion, resulting in data needing to be collected from a variety of sources/people depending on the transaction. Often these people are spread all over the globe, work for different companies, and should not even be aware of the transaction.

TEAM AND SCHEDULE PLANNING

The make up of a team is based primarily on the sources, and can easily involve 20 people, even for a small transaction. If this is the case then it may make sense to appoint a team leader, who is responsible for coordinating team members and assigning them specific topics, such as finance.

Regardless, it is important that team members are informed well in advance, and that they are kept appraised of developments. Each member of the team should receive the excerpt from the index which is relevant to them.

It is necessary to prepare a feasible and sustainable schedule, so that the documents can be delivered on time by the individual team members. Any deviations from the schedule should be reported as soon as they are detected, since delays in data collection will delay the process as a whole.

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CONFIDENTIALITY – THE OBLIGATION TO NON-DISCLOSURE

Not every member of the team needs to know the reason why data is being collected. Team members who are aware of the reasons for data collection should be (directly or indirectly) bound by a NDA (non-disclosure agreement).

Step 2: Data Collection

ORGANISATION

The way data collection is structured depends to a great extent on the nature of a given transaction. Essentially, it is possible to either assemble all of the data centrally in the data room, or to have individual team members manage and directly populate specific elements in a data room, effectively serving as content administrators. Depending on the complexity involved, consultants may be called on to coordinate the document flow.

PHYSICAL AND DIGITAL DOCUMENTS

Data collection normally consists of both digital and physical data. When processing physical documents, it is advisable to make use of barcode sheets or barcode tabs. These are printed out beforehand (according to the index), distributed to team members and placed in front of the appropriate document. This allows the scanner to identify each document and establish where it belongs in the data room.
With digital documents it is recommended naming documents in the data room according to target index points. This allows the documents to be directly located in the data room.

Use of so-called “negative statements” may also be helpful. These are inserted where no document (yet) exists or where the question does apply, owing to the nature of the property, but nevertheless needs to be retained as a recurring index point. If, for example, a current annual financial statement is available for each company, but one does not exist for a particular investment, a negative notation can be used to refer to this fact, thereby preventing gaps in documentation.

SOURCING – SUPPORT DURING DATA COLLECTION

Consultants are often used during the data collection process – primarily M&A consultants and lawyers. It is incumbent upon them to define the index, and to monitor the data room to verify that it makes a positive contribution to the transactional outcome.

Often the task of conducting data collection is assigned to advisory groups. The current trend, however, is to employ specialised service providers for this purpose. Their job is less focused on providing a professional evaluation of the data room and more so on ensuring that the process is executed efficiently and effectively. They ensure that the data room is compiled in a timely manner according to the index, in order to provide for vendor/bidder due diligence.

This involves a number of different variants:

- The service provider assists the project manager with coordination and indexing.



- The service provider directly coordinates information flow with the respective departments.



- The service provider works in the relevant departments to coordinate the actual collection (e.g., in the archives).



Index 2	Index 3	Index 4	Index 5	Index 6	Document	Unit 1	Unit 2	Unit 3	Unit 4	Unit 5	Unit 6	Unit 7	Unit 8	Unit 9	Unit 10	Unit 11	Unit 12	Unit 13
						Address	Address	Address	Address	Address	Address	Address	Address	Address	Address	Address	Address	Address
2					Other Documents													
2	1				Service agreements - commercial													
2	1	1			Supply contract	E	E	E	E	K	O	E	E	E	O	K	O	K
2	2				Authorities													
2	2	1			Real estate tax answer	K	E	E	E	E	E	E	E	E	E	E	O	E
2	2	2			Notices of assessment	E	E	K	E	E	K	E	E	E	K	E	K	E
2	3				Characteristics	E	E	N2	K	N2	E	E	O	O	O	O	O	E
3					Building situation													
3	1				Building permit and belated building permits	E	K	E	E	E	E	E	E	K	E	E	K	K
3	2				Current work	E	N3	N1	N1	N1	N1	E	E	E	E	N1	E	E
3	3				Official test certificates	K	K	K	E	K	E	E	E	E	E	E	E	E
3	4				Construction descriptions	E	E	E	E	E	O	O	O	O	O	O	K	E
3	5				Building plans (relevant floor plans, sections, views)	E	E	E	E	E	E	E	E	O	E	E	K	E
3	6				Surface calculation	K	K	K	K	E	E	N1	O	E	E	K	K	K
3	7				building certificates (e.g. harmful substances, facade faults)	E	O	O	O	O	E	N1	E	O	E		K	E
3	8				Period testing according state building code (test reports)	E	E	E	E	E	E	O	O	O	O	O	O	O
3	9				Open official regulations	E	E	E	O	E	E	O	E	E	E	E	E	E
3	10				Technical object report (current status)	E	O	E	E	E	E	O	O	O	N1	N1	N1	E
3	11				Settlements for parking spaces	E	K	K	K	K	K	E	E	E	N2	N1	K	K
3	12				Information about improvement contributions	E	E	E	E	E	E	E	E	O	N2	N1	E	O
3	13				Urban development contracts, agreements with cities and local districts	E	E	K	E	E	E	O	E	E	N2	N1	N1	E
3	14				Disclosure monument protection service	E	O	E	E	E	O	E	E	E	N1	N3	N1	N1
3	15				Essential property information	E	E	E	O	E	E	E	E	E	E	K	K	O
3	16				Current disputes/ current administrative procedures	E	N1	N3	N3	N3	N1	O	E	E	N3	O	N3	O
3	17				Service and maintaenance contracts	E	E	E	E	K	E	E	E	E	O	E	E	E
3	18				Other relevant documents	E	O	O	E	K	E	E	E	E	K	K	K	K

Figure 3: Sample Progress Reporting

PROGRESS MONITORING

Data collection is essentially a linear process, the progress of which must be closely monitored in order to provide a punctual delivery. Progress reporting can be organised and presented in a variety of ways. The following example shows how a colour-coded table can be used to indicate the progress in data collection relating to a real estate portfolio. It shows that the same documents are being collected for each asset, with current status indicated by different colours.

POPULATING THE DATA ROOM

The goal of data collection is to populate the data room with documentation. In order to allow the vendor to begin the due diligence process as early as possible, it is recommended that documents be fed directly into the data room, and that specialised staff be given access to conduct vendor due diligence. Populating the data room should be accomplished as efficiently as possible. In certain circumstances, it may be advisable to first assemble all the documents and then upload them en masse (e.g. using “batch upload“).

Step 3: Vendor Due Diligence

TIMING AND SIGNIFICANCE

Vendor due diligence (for the purpose of reviewing data room documentation) should be completed prior to bidder due diligence. It may begin as soon as documents have been uploaded to the data room. Financial vendor due diligence is not initially affected by this, since it extends beyond the original documents in the data room.

SIGN-OFF APPROVAL

The approach taken in releasing data room documents differs widely and is frequently not taken into consideration at all. Depending on the size of the data room and the underlying platform, release may occur in a variety of ways. A dual-control principle is recommended in which a specialist in charge (e.g. for accounting) uploads the materials and the project manager approves their release.

Conducting Bidder Due Diligence

Proper vendor due diligence is essential to the success of negotiations. When a bidder is better informed about an asset than the seller at the end of the due diligence process, the conditions of the negotiation are not ideal.

Once the documents have been assembled, organised and released, the bidders may then be invited into the data room. It is recommended that opening the data room does not deviate from the predetermined schedule, since the seller must always remain aware of the effect their actions are having on the bidder. If the opening date for the data room is rescheduled because the data room is not ready, or it is opened despite not being ready – the bidder will be aware that no other party is ahead in the process.
An incomplete data room should also not be made available to bidders. If entire sections are missing, these should not be made accessible at the start of the due diligence process.
The structure of the initial collection process should also be applied to updates. Figures based on experience show that up to 10% of additional documents will be added subsequently, in response to questions.

Conclusion

Taking the steps to properly prepare for a transaction is both time and labour intensive, but is nevertheless essential, as it has a direct effect on the value of an asset. Using an efficiently structured data room makes it possible to avoid markdowns of up to 20% so that investing in the pre-transaction phase quickly prove to be cost effective.

That's why many institutional investors, such as real estate and private equity funds, now employ permanent life-cycle data rooms. These are set up immediately after an asset has been acquired – or, alternatively, transferred to the bidder after the sale is complete – then updated regularly by the asset manager/target company. This not only avoids the effort and expense involved in re-compiling, but also generates the following benefits:

- The fund is always ready for potential transactions.
- The target company initially has no knowledge of the sale (since it is not involved).
- The data base is available for refinancing and appraisals.
- Provides for more efficient fulfilment of regulatory requirements (e.g. AIFMD).

The outcome of either method is the same: proper preparation saves time and reduces expenses – for both the seller and the buyer.

Please contact www.drooms.com/en/contact for a consultation at no obligation.