

GIBSON DUNN



Real Estate Update

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## Three Transactions in One — Navigating Operational Real Estate Investments

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Interest in operational real estate transactions is growing fast. Investors are looking for exposure not only to real estate assets but also to the platforms that originate, manage and scale them. Managers, in turn, are seeking reliable capital to support growth, accelerate fundraising and — increasingly — provide liquidity or succession solutions for founders. Both sides see the appeal. The challenge is execution.

The result has been the continued growth of operational real estate transactions, arrangements that combine a capital commitment to a real estate strategy with some form of participation in the management platform itself. When structured effectively, these transactions can create significant value for both sides. Achieving that alignment, however, requires navigating considerable complexity.

***What distinguishes these arrangements is that they are effectively three transactions in one.***

A capital-raising transaction, through which an investor funds a particular investment strategy; a joint venture arrangement, governing the ongoing relationship between investor and management team; and, where the acquisition (or future acquisition) of a stake in the management business is involved, an M&A transaction. The complexity lies not in negotiating each workstream in isolation,

but in ensuring they operate cohesively, economics agreed in the fundraising documents may affect the value of the management business, and governance rights at the manager level may influence future fundraising flexibility.

The operational component of these transactions typically takes one of three forms.

### **Economic Participation**

The simplest structure gives the investor an economic interest in the real estate manager's success without conferring ownership. This may take the form of a share of management fees generated from future investors and/or participation in the manager's carried interest or performance fee, a seed or cornerstone investor negotiating entitlement to a portion of the economics as the platform grows.

These arrangements preserve the manager's ownership and operational independence while offering the investor enhanced alignment. They still require careful thought around tax treatment and the mechanics of calculating and distributing revenue streams.

***Illustrative scenario:*** A sovereign wealth fund commits €500m to a Pan-European logistics management platform and negotiates a 15% scrape of management fees and promote on future vehicles raised by the manager. The investor gains a meaningful economic stake in the platform's success and the manager retains full control.

### **Options and Warrants: A Pathway to Future Ownership**

A second approach gives the investor the right to acquire an ownership interest at a later date, typically through an option or warrant, deferring dilution and governance changes until the relationship has matured.

Deferring ownership does not eliminate complexity. The parties must agree how the manager will be valued at exercise, what protections the investor receives in the interim, and how future fundraising or equity issuances may affect the prospective stake. Pre-emption and anti-dilution protections are essential to prevent that stake being eroded before the option is exercised. Many of the issues present in a full M&A transaction arise from the outset.

***Illustrative scenario:*** An opportunistic institutional investor makes a cornerstone commitment to the investment vehicle of a build-to-rent asset manager. In consideration the investor is granted warrants with the option to convert into a 20% equity stake within five years at a strike price representing a material discount to the then prevailing valuation. During the option period, the investor benefits from anti-dilution protection, other pre-emptive rights and limited negative controls.

## **Day-One Equity: A Full M&A Transaction**

The most comprehensive structure involves the investor acquiring an ownership interest at closing, whether through a primary subscription, acquisition of an existing stake from founders or existing shareholders, or a combination. Increasingly, these transactions are used to facilitate founder liquidity and succession planning as much as platform growth.

The transaction takes on the characteristics of a private equity deal: comprehensive due diligence of the management business, negotiation of a purchase or subscription agreement, and, particularly on larger transactions, obtaining W&I insurance. The parties must also negotiate the joint venture agreement governing their future relationship, which may range from limited protective rights to board representation and consent rights over key decisions, the right balance depending on the size of the stake and the maturity of the management platform.

***Illustrative scenario:** A US pension fund establishes a material separate managed account with a London-headquartered real estate debt platform and acquires a significant minority interest from the existing management team. In addition to the establishment of the SMA, the transaction involves due diligence on the platform, negotiation of the acquisition documents, including W&I insurance and the renegotiation of shareholders' agreement in respect of the platform, including to recut governance rights and provide for greater certainty over liquidity.*

## **Key Considerations**

**Regulatory environment.** Real estate managers are typically regulated businesses. Depending on jurisdiction and stake size, an acquisition may trigger notification and/or approval requirements, which can materially affect timing and structure. Identify regulatory implications across every relevant jurisdiction early.

**Management incentivisation and retention.** Many of these transactions arise because founders are seeking liquidity or succession solutions. Ensuring management remains incentivised and committed to delivering the business plan is therefore central to the joint venture agreement negotiation. Key person provisions, non-compete and non-solicit covenants are important protections.

**Exit mechanics.** Exit provisions, drag and tag rights, put and call options, rights of first offer, or IPO provisions are highly bespoke and depend on stake size, investor profile and platform trajectory. They should be identified and agreed early.

**Dilution and pre-emption.** Investors will expect to maintain their proportionate interest over time, but this must be balanced with the capital requirements of the management platform. Pre-emption rights and anti-dilution protections are standard and any necessary exceptions or carve outs should be clearly documented.

**Balancing investor and LP interests.** Where an investor holds both an interest in the real estate manager and a “limited partner” position in its fund(s), conflicts of interest must be carefully managed. Existing LPs may have consent rights triggered by changes to the management structure, and the governance framework must accommodate ongoing fundraising without creating conflicts.

**Understanding the manager’s objectives.** Early alignment on objectives is essential. Understanding the real estate manager’s red lines, how much control they will cede, their growth ambitions and how this capital fits their plans is as important as understanding the investor’s requirements. Misalignment on these points, however attractive the economics, rarely produces a successful partnership.

**Cross-border complexity.** Real estate managers increasingly operate across multiple markets, and pan-European platforms are common. Investors need to understand the regulatory, tax and governance implications of investing in a multi-jurisdictional business.

### **An Integrated Approach**

In operational real estate transactions, the disciplines of real estate fund formation, joint ventures and M&A are deeply interconnected. A concession on the fund economics may require adjustment to governance rights. Ownership decisions affect fundraising flexibility. Getting the balance right across all three, simultaneously, is what makes these transactions genuinely complex to execute well.

**The following Gibson Dunn lawyers prepared this update: Sean Tierney, Hayden Cameron, and Chris Slack.**

Gibson Dunn advises across the full lifecycle of operational real estate transactions — from term sheet to closing and beyond. To discuss how best to navigate these transactions, or to explore how we can support your strategy, please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm’s Real Estate practice group, or the authors:

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