Lakewood Capital Issues Letter to Select Income REIT Board of Trustees

PRNewswire Lakewood Capital Management, LP
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NEW YORK, June 11, 2014 /PRNewswire/ -- Lakewood Capital Management, LP sent the following letter to the Board of Trustees of Select Income REIT (SIR) on June 11, 2014:

https://lakewood.box.com/shared/static/wj4nt0gp5751g4duz7mn.pdf (PDF File)

June 11, 2014

Board of Trustees
Select Income REIT
Two Newton Place
255 Washington Street, Suite 300
Newton, Massachusetts 02458

Ladies and Gentlemen:

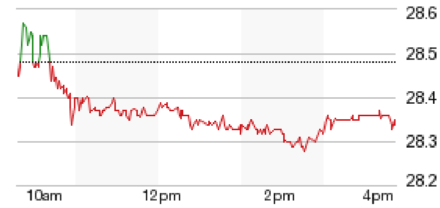
Funds managed by Lakewood Capital Management, LP ("Lakewood") hold a 5.8% economic interest in Select Income REIT ("SIR" or the "Company") through ownership of common stock and cash-settled total return swaps. Prior to the dilution we suffered in last month's common equity offering, these holdings represented a 6.8% economic interest in the Company. We have been SIR shareholders since the days immediately following the Company's initial public offering in March 2012.

In our seven years in business, we have never been pushed to the point of publicly expressing opposition to the governance of any company in which we have invested, so we do not take the contents of this letter lightly. During the past five weeks, we have witnessed a sickening series of events unfold whereby the SIR Trustees have deliberately taken multiple steps to protect their own interests at the expense of shareholders in clear breach of their fiduciary duties. We have spoken with several other significant SIR shareholders and they share our outrage. We believe SIR's shares are substantially undervalued (please see the attached Exhibit A: SIR's Undervaluation), and we urge the Board to start minding the interests of the shareholders they were elected to represent and immediately cease any activities that further entrench the Board and management including, but not limited to, (1) diluting existing shareholders through any further equity offerings at prices below the fair value of the Company's underlying assets, (2) expanding the size of SIR's Board and (3) offering to repurchase shares directly from SIR's largest shareholder, CommonWealth REIT ("CommonWealth"), thereby reducing its ability to exercise influence over SIR, without making such offer available to all shareholders on equal terms.

Background

As you are certainly aware, there is a long, established history of shareholder concerns related to entities affiliated with SIR's external manager, Reit Management & Research ("RMR"), a privately-held company controlled by SIR Trustees Barry and Adam Portnoy (please see the attached Exhibit B: RMR – A Track Record of Governance Abuses). As you are also aware, SIR's largest shareholder, CommonWealth, an RMR-managed publicly-traded company, was recently the subject of a consent solicitation to remove its Board of Trustees, resulting from shareholder frustration with RMR and corporate governance. Prior to last month's SIR common equity offering, CommonWealth owned a 44.1% interest in SIR, which has since been diluted down to 37.4%.

In September 2013, SIR announced it was taking steps to improve its own corporate governance, ostensibly in response to the mounting pressures to replace the CommonWealth Board. These steps included tying a portion of RMR's management fees to share price performance and proposing an amendment to SIR's Declaration of Trust that would eliminate the current three-year staggered terms and permit the annual election of all Trustees. The SIR Independent Trustees stated in a press release that the Board was "considering additional governance enhancements which may be announced during the next several months."[1] The preliminary shareholder proxy filed in March 2014 highlighted that "these changes reflect our commitment to our shareholders' interests and best practices." The proxy went on to assure shareholders that the Board will "continue to work hard to make meaningful changes to incorporate our shareholders'



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feedback."[2],[3] Like many shareholders, we viewed these changes positively and were hopeful the Board's interest in improved governance was genuine.

On March 25, 2014, CommonWealth announced that its shareholders had voted to remove its entire Board of Trustees (including SIR Trustees Barry Portnoy, Adam Portnoy and William Lamkin, who together hold 60% of the seats on the SIR Board) and that a new CommonWealth Board would be selected in late May 2014.[4] At this point, it was clear that RMR's days were numbered as the manager of CommonWealth. As CommonWealth held 44.1% of SIR shares, these changes had clear implications for SIR's future governance.

On April 3, 2014, the week following the CommonWealth shareholder vote, we met with SIR's President David Blackman, Chief Financial Officer John Popeo and Investor Relations Director Jason Fredette (all three are RMR employees) at Morgan Stanley's "Triple Net REIT Day" conference in New York City. At that meeting, we expressed concern that SIR might schedule its shareholders' meeting before the selection of the new CommonWealth Board, thereby disenfranchising CommonWealth with respect to the shareholder vote on the amendment proposal permitting annual election of the Trustees. We recognized such a maneuver would be viewed negatively by shareholders and would be a major step backward from the governance enhancements to which the Board appeared committed. Mr. Blackman explained to us that they would "not be caught in a limbo period" because CommonWealth management (i.e., RMR) could vote those shares at the SIR shareholders' meeting prior to the election of the new CommonWealth Board. Furthermore, Mr. Blackman reasoned that if there were any issues with RMR voting those shares then the Company "would probably be forced to delay the meeting because of quorum." Mr. Blackman further assured us that RMR was in favor of the proposed amendment. This struck us as plausible at the time as Barry and Adam Portnoy had already approved the amendment proposal in their capacity as SIR Trustees.

After we gained comfort that CommonWealth would be entitled to exercise its vote on this important governance matter, we raised our other major concern, a common equity offering. We outlined our view that SIR's stock was trading significantly below the fair value of the Company's assets, largely due to concerns around corporate governance. Given the stock's discounted valuation and underleveraged balance sheet, we expressed our stark opposition to issuing equity at or near the levels where the stock was trading. We further expressed our view that diluting shareholders (specifically, CommonWealth) would only exacerbate shareholder concerns about corporate governance and undermine the governance enhancements that appeared to be underway. Both Mr. Blackman and Mr. Popeo agreed that the shares were undervalued, and Mr. Blackman specifically stated that "the team is pretty focused on narrowing the gap of where we trade and NAV [Net Asset Value]." Mr. Popeo noted that "[SIR] might want to go to the rating agencies at some point" to get an investment grade rating, but stressed that the Company had "$450 million to $600 million in firepower" for acquisitions before an equity deal was necessary due to the Company's low leverage levels. Mr. Blackman added that he "was not a big fan of where pricing is for acquisitions" and the Company "was passing on a lot of deals right now." Both Mr. Blackman and Mr. Popeo expressed agreement with our point of view that issuing equity in the near- or intermediate-term made no sense in light of these facts.

During the subsequent five weeks, as RMR and the SIR Board of Trustees felt the looming threat from the removal and replacement of the CommonWealth Board, SIR shareholders were subjected to some of the most brazen corporate governance transgressions that we have ever seen. It sadly was about to become abundantly clear that the supposed governance enhancements were nothing more than a ruse designed to persuade shareholders to have a more favorable view of RMR in a desperate last plea to salvage its lucrative management agreements with CommonWealth. When RMR lost the battle with CommonWealth shareholders, the SIR Trustees abruptly lost their commitment to their fiduciary duties and their focus swiftly turned to entrenching their positions at SIR.

The SIR Annual Meeting of Shareholders (May 2, 2014)

On April 7, 2014, four days after our meeting with SIR management, SIR set its annual meeting date for May 2, 2014, less than three weeks before the new CommonWealth Board was to be selected.[5] On May 2, 2014, the Company issued a press release announcing that the vote on the amendment to de-stagger the Board did not pass.[6] On May 7, 2014, we held a conference call with SIR management to try to understand what had just happened.   We were told that CommonWealth's management, represented by SIR Trustee and RMR President Adam Portnoy, chose to vote only on so-called "routine" matters but not on special items such as the amendment. The fears we expressed to SIR management in the April 3, 2014 meeting were being realized. Because the approval of two-thirds of shares outstanding was required for the amendment to pass, the amendment never had a chance without CommonWealth's 44.1% participation. Shareholders who did vote cast 18,788,329 votes "for" the amendment and only 317,084 votes "against" (98% "for" and 2% "against").[7]

When we asked why the meeting was not simply delayed a few weeks to allow the Company's largest shareholder to participate in this critical vote, Mr. Blackman told us that "SIR had a quorum and conducted business" because CommonWealth was technically represented at the meeting by Adam Portnoy as evidenced by his vote on CommonWealth's behalf to ratify the appointment of the Company's auditor. So, Adam Portnoy elected


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to vote CommonWealth's shares on one matter to ensure a quorum at the meeting, but he somehow did not see it fit to vote on a separate matter that was specifically intended to protect SIR shareholders from the oppression of his own company, RMR. Simply put, the SIR Board of Trustees and RMR knowingly held a banana republic-style election to ensure the proposal to de-stagger the Board did not pass to protect their own interests rather than take simple and obvious steps to allow a proper vote on a proposal that the voting SIR shareholders nearly unanimously supported (again, 98% in favor).

We would also like to point out that during our May 7, 2014 conference call we asked Mr. Blackman if the proposal to de-stagger the Board would be on the agenda for next year's shareholders' meeting, to which he replied, "If there are no changes, the annual election of directors should be on the agenda next year." We urge the Board to be mindful of its fiduciary duties and put the proposal for the annual election of Trustees on the agenda for the 2015 shareholders' meeting.

Finally, after expressing our displeasure with these developments to SIR management on the conference call, we reiterated our view that we saw no reason for SIR to issue common equity given the discounted stock price and SIR's low leverage levels. Mr. Blackman responded, "We understand your perspective."

The RMR Termination Payment (May 9, 2014)

On May 12, 2014, less than two weeks before the new CommonWealth Board was to be selected and just five days after our conference call with SIR management, the Company filed a Form 8-K disclosing that on May 9, 2014, it amended its management agreements with RMR to obligate the Company to pay a termination fee to RMR if the Company terminated or failed to renew the management agreements.[8] We calculate that this fee payable to RMR would end up amounting to more than $30 million.[9] The only mentioned consideration given by RMR in return for the right to this egregious payment was a meaningless 60 day increase to the advance notice period in the highly improbable event that RMR elects to terminate the management agreements.

On May 30, 2014, we held another conference call with SIR management to try to understand what had happened. Mr. Blackman attempted to explain to us that following the changes at CommonWealth, the Independent Trustees were "concerned that RMR could potentially be disincentivized to invest in technologies to allow us to efficiently manage the business or that RMR would have a difficult time hiring and retaining the best and brightest employees."[10]

Let us be clear – this is complete nonsense. If SIR's Independent Trustees genuinely believe that RMR would dare refuse to fully invest in the proper technologies or put the right people on the job to fulfill its obligations under its management agreements, then the Independent Trustees should simply fire RMR. RMR is well paid for its services, and there is not a shred of doubt in anyone's mind that RMR would in fact go to extraordinary lengths to maintain its grip on this fee stream (again, please see attached Exhibit B: RMR – A Track Record of Governance Abuses). Given the Independent Trustees are actually the only ones with the power to terminate RMR, their concerns for RMR are not credible; in fact, introducing this obstacle to removing RMR makes it clear that the Independent Trustees are fearful that one day *they* are the ones who will be terminated by frustrated shareholders. Sadly, this outrageous termination provision was nothing more than another blatant step to entrench RMR and the Board.

The Common Equity Offering (May 14, 2014)

On May 14, 2014, less than two weeks before the new CommonWealth Board was to be selected and just one week after our conference call with SIR management where we reiterated our opposition to a common equity offering, the Company announced a public offering of 8,000,000 common shares.[11] SIR completed the offering within a matter of hours at a discount to SIR's market price. After SIR upsized the deal to 9,000,000 shares, the offering amounted to an astounding 18% of the outstanding common shares.[12] Furthermore, this offering amounted to a staggering 32% of the freely-tradable outstanding shares not held by CommonWealth and represented 53 times the trailing 20-day average daily trading volume in SIR shares at the time.[13] By any measure, the scale of this deal was enormous. Following the deal, SIR had diluted CommonWealth's stake from 44.1% down to 37.4% and Lakewood's stake from 6.8% down to 5.8%.

On our May 30, 2014 conference call with SIR management, Mr. Blackman stated, "We presented financing alternatives to the Board… and based upon the timing to execute those strategies as well as the effect on our long-term cost of capital and the Company's desire to have an investment grade rating, the Board elected that raising common equity would be the best alternative to achieve the Company's goals and so that's what we did." When we inquired why the Board was in a hurry to do such a substantial equity offering, Mr. Popeo pointed to the Company's rising leverage levels which stood at 37% debt-to-total capitalization following an increase in the revolving credit facility during the first quarter, presumably to fund $208 million of acquisitions announced in April 2014. Recall just weeks earlier in our April 3, 2014 meeting with SIR management, Mr. Popeo agreed the Company had a low degree of leverage and specifically stated that the Company had "$450 million to $600 million in firepower" for acquisitions before an equity deal was necessary.

Mr. Popeo's statements in our April 3, 2014 meeting were consistent with public statements he had made up until that point on the Company's quarterly earnings calls. On the October 31, 2013 third quarter 2013 earnings call, Mr. Popeo stated, "We are running at, I would say, an atypical debt to total capitalization or leverage ratio right now. If you assume now, and this is back of the envelope, that we acquire enough property to get ourselves back up to 40%, 40% to 45% [debt-to-total capitalization], I think is what we discussed in prior calls as sort of the sweet spot before we may feel the need to go back to the capital markets."[14] On the February 20, 2014 fourth quarter 2013 earnings call, Mr. Popeo stated, "As of today, our $750 million revolving credit facility has $170 million outstanding, leaving $580 million available to support our acquisition activity and other working capital needs… We plan to begin exploring various options to add longer-term fixed-rate debt to the balance sheet, a capital stack strategy more in line with our longer-term business plans. We may also consider moving corporate leverage higher than in prior quarters in order to capitalize on today's attractive borrowing rates and to minimize shareholder equity dilution."[15]

After emphasizing to shareholders that SIR would look to increase corporate leverage and minimize shareholder dilution on that February 20, 2014 earnings call, SIR's management suddenly changed its tone after RMR lost its battle with the CommonWealth shareholders on March 25, 2014. In his prepared remarks on the April 25, 2014 first quarter 2014 earnings call, Mr. Popeo stated, "Moving on, our total debt-to-book capitalization ratio at March 31 was 37.3% and our fixed charge coverage ratio was 12 times… As of the end of the first quarter, we have $345 million drawn on our revolving credit facility. Considering our revolver was approximately 50% drawn, we will likely explore various options to reduce amounts outstanding on our revolver with fixed rate debt, equity or a mix of both in order to free-up capacity for future investment opportunities."[16] The Company drew on its revolving credit facility by the end of the first quarter 2014 and saw its cash balance increase by $184 million as a result.[17] In hindsight, management's choice to draw on its revolving credit facility appears to have been introduced as a justification for an equity offering in stark contrast to prior statements regarding increasing leverage and minimizing shareholder dilution.

Simply, after the Board felt threatened by the removal of the CommonWealth Board, the common equity offering was just another tool to further entrench RMR and the Board.

Finally, after expressing our complete objection to this series of developments to SIR management on our May 30, 2014 conference call, we raised a new concern, the prospect that SIR might attempt to directly repurchase shares from CommonWealth, thereby reducing its stake and further entrenching RMR and the Board. We noted the SIR prospectus for the May 14, 2014 common equity offering ominously stated, "We are not prohibited from voluntarily negotiating with [CommonWealth] with respect to any potential resale of all or a portion of our common shares that it owns."[18] When we highlighted our concern to Mr. Blackman, he responded that while there was no "specific agreement" or "direct path at this point… it is certainly something that makes sense to get those shares out of the hands of CommonWealth if in fact they don't have a long-term interest in being an owner but at this point we don't have a specific view."

Let us once again be clear – this is preposterous. After SIR management went to great lengths to justify to us an illogical and corrupted equity *issuance*, in nearly the same breath, they entertained the logic of actually doing the opposite: a *repurchase* of what would likely amount to an extraordinary number of shares. It is wholly apparent to us that the Company is contemplating making an offer to CommonWealth for a portion of its shareholdings without making that offer available to other shareholders. Such an act would be yet one more egregious step to further entrench RMR and the Board. There is little doubt that SIR shareholders are better off with a large shareholder like CommonWealth to keep RMR and the SIR Board in check, and we again urge the Trustees to be mindful of their fiduciary duties and cease any consideration of repurchasing any of CommonWealth's shares without making such offer available to all shareholders on equal terms.

In closing, we greatly regret the actions that the Board has taken over the past five weeks. We hope this letter will encourage other shareholders to also express their concerns to the Board. There is a substantial amount of value in SIR's assets, and you have an obligation to maximize that value (again, please see the attached Exhibit A: SIR's Undervaluation). Any further actions to entrench RMR and the Board will not be viewed favorably. We are committed to protecting our investment and ensuring that SIR shareholders are treated fairly, and we are committed to holding each of you personally responsible for any failure to fully live up to your fiduciary duties.[19]

Sincerely,

/S/ Anthony T. Bozza

Anthony T. Bozza
Managing Partner
Lakewood Capital Management, LP

Exhibit A: SIR's Undervaluation

Shares of Select Income REIT ("SIR") trade at a deep discount to their reasonable fair value by any measure. We believe SIR has an extremely valuable asset in its Hawaiian properties, where periodic rent resets provide for substantial organic growth in rental income and therefore net operating income (NOI). For example, over the past five quarters rental resets in Hawaii have been between 29.4% and 57.0% above the prior rents.[20] We believe SIR's stock is worth over $40 per share or more than 40% above the current trading price. This undervaluation is particularly notable in light of SIR's low leverage levels of just 24% Net Debt / Gross Real Estate Value (roughly half of its peer group), providing it with ample capacity to increase financial returns to shareholders above our estimates.

I. Based on peer FFO trading multiples, we think SIR's stock could be worth over $40 per share (more than 40% above the current share price) even after adjusting SIR's FFO to reflect normalized interest expense from an eventual higher mix of longer-term, fixed-rate debt. This undervaluation is particularly striking since SIR has considerably lower leverage than its peers. Prior to the dilutive May 2014 equity offering, our estimate of fair value was even higher.

	Pre-Equity Offering[21]	May 201 Equity Offering
(A) SIR 2014 Projected EBITDA (Street Consensus)	$167	
(B) Q1 2014 Pro Forma Net Debt	$723	($250)
(C) Current Weighted Average Cost of Debt[23]	1.69%	1.69
(D) Annual Interest Expense at Current Cost of Debt (B x C)	$12	($4)
(E) Estimated SIR Normalized Cost of Debt[24]	4.50%	4.50
(F) Incremental Interest at Normalized Cost of Debt ((B x E) - D)	$20	($7)
(G) Normalized FFO (A - D - F)	$134	$11
(H) SIR Share Count (millions of shares)	50	9
(I) FFO per share with Normalized Interest Expense (G / H)	$2.69	($0.22)
(J) Target SIR FFO Trading Multiple (Peer 2014 Median)[25]	16.5x	
Implied SIR Share Price (I x J)	**$44.55**	**($3.66)**
% Upside vs. Current Share Price	***56%***	
Memo: SIR Net Debt/Gross Real Estate Assets	*36.3%*	*(12.5*
Memo: Peer Median Leverage	*46.0%*	

II. The shares of SIR also trade at a significant discount to a conservative estimate of fair value based on net operating income (NOI) capitalization rates. Applying a reasonable range of capitalization rates to the highly valuable Hawaiian assets and conservatively valuing the mainland assets at a substantial discount to SIR's peer group, SIR's stock price would be worth approximately $36 to $42 per share (25% to 50% above the current share price).

	NOI Capitalization Rate Scenarios		
	Low	Middle	High
(A) LTM Hawaii GAAP NOI	$65	$65	$65
(B) Capitalization Rate[26]	6.0%	5.5%	5.0%

(C) Implied Hawaii Asset Value (A / B)	$1,084	$1,182	$1,299
(D) Q1 2014 Mainland GAAP NOI (Annualized)	$102	$102	$102
(E) Capitalization Rate	8.0%	7.5%	7.0%
(F) Implied Mainland Asset Value (D / E)	$1,277	$1,362	$1,459
Memo: Mainland Valuation Discount to Peer Median[27]	*180bps*	*130bps*	*80bps*
(G) Hawaii + Mainland Asset Value (C + F)	$2,361	$2,544	$2,758
(H) April 2014 Acquisitions at Cost	208	208	208
(I) Total Real Estate Asset Value (G + H)	$2,569	$2,752	$2,966
(J) Q1 2014 Pro Forma Net Debt[28]	473	473	473
(K) Implied Equity Value (I - J)	$2,095	$2,278	$2,493
(L) Shares Outstanding	59	59	59
Implied SIR Share Price (K / L)	**$35.61**	**$38.72**	**$42.37**
% Upside vs. Current Share Price	***25%***	***36%***	***49%***

III. SIR's stock trades at a discount of approximately 30% compared to its peer group.[29]

Ticker	Company	Price on 6/10/14	Equity Market Cap	Enterprise Value (EV)	Current Dividend Yield	Cap Rate	E
EPR	EPR Properties	$54.50	$2,873	$4,682	6.3%	7.1%	
NNN	National Retail	36.01	4,388	6,573	4.5	6.1	
O	Realty Income Corp	43.25	9,577	14,991	5.1	5.6	
SRC	Spirit Realty Capital	11.30	4,174	8,018	5.9	6.7	
ARCP	American Realty	12.10	9,888	21,196	8.3	6.4	
STAG	STAG Industrial	24.19	1,340	1,997	5.5	6.4	
LXP	Lexington Realty	11.38	2,591	4,733	5.8	8.0	
EGP	EastGroup Properties	64.68	1,998	2,894	3.3	5.2	
DCT	DCT Industrial Trust	8.10	2,791	4,210	3.5	5.5	
TRNO	Terreno Realty Corp	19.56	486	749	2.9	5.9	
FR	First Industrial Realty	18.70	2,136	3,551	2.2	6.2	
Peer Median					**5.1%**	**6.2%**	
Peer Average					**4.8**	**6.3**	
SIR[32]		**$28.48**	**$1,676**	**$2,149**	**6.7%**	**8.8%**	
% Discount vs. Peer Median					***(25%)***	***(29%)***	

IV. After the May 2014 equity offering, SIR's Net Debt / Gross Real Estate Value is just 24%, significantly below its peer group median of 46%. Even prior to the May 2014 equity offering, SIR's Net Debt / Gross Real Estate Value was well below the levels of its peer group.

	Q1 2014	April 2014 Acquisitions[33]	Pro Forma Acquisitic
(A) Price (6/10/14)	$28.48		$28
(B) Shares Outstanding	50		
(C) Market Cap (A x B)	$1,419		$1,
(D) Cash	204	(184)	

(E) Debt	714	29	7
(F) Enterprise Value (C - D + E)	$1,929	$213	$2,1
(G) Book Value	$1,202		$1,2
(H) Net Debt (E - D)	510		7
(I) Capitalization (G + H)	$1,712		$1,9
(J) Net Debt/Capitalization (H / I)	29.8%		37
Memo: Debt/Gross Capitalization (E / (E + G))	*37.3%*		*38*
(K) Gross Book Value of Real Estate	$1,782	$208	$1,9
(L) Net Debt/Gross Real Estate Value (H / K)	**28.6%**		**36**
Peer Median Net Debt/Gross Real Estate Value	46.0%		46

Exhibit B: RMR – A Track Record of Governance Abuses

Reit Management & Research ("RMR"), a privately-held company controlled by Select Income REIT ("SIR") Trustees Barry and Adam Portnoy, has built a track record of shameful governance abuses and total disregard for shareholders of the companies with which it is affiliated. Below is a brief summary of some of RMR's tactics used with three separate publicly-traded companies.

TravelCenters of America ("TA"): "This Board has no shame"

TA is an RMR-managed publicly-traded company that was spun off in 2007 by Hospitality Properties Trust, another RMR-managed company. TA operates and franchises travel centers along the U.S. highway system. TA leases the majority of its travel centers from Hospitality Properties Trust. TA's Chief Executive Officer and Chief Financial Officer are RMR employees, and Barry Portnoy, RMR's Chairman, sits on TA's Board.

In 2008, Locksmith Capital announced its intention to nominate two members to the TA Board and introduce stockholder proposals to "eliminate the significant and material conflicts of interest."[34] In response, TA filed a lawsuit arguing that the notice provided was invalid and therefore the nominees and other matters proposed by Locksmith were not properly presented for consideration at the TA annual meeting.[35] Based on these procedural items, TA prevented the proposals from being considered at TA's 2008 annual meeting.[36]

In reaction, Locksmith Capital stated that they "continue to be amazed that the [TA Board members] have spent a significant amount of shareholder money in order to disenfranchise its shareholders… Instead of allowing shareholders an opportunity to vote for our nominees and shareholder proposals, they invoked meaningless technicalities in order to create a Soviet style election and entrench the current Board of directors. This Board has no shame."[37]

Hospitality Properties Trust ("HPT"): Total Disregard for the Will of Shareholders

HPT is an RMR-managed publicly-traded real estate investment trust that owns hotels and travel centers. In 2010, the Florida State Board of Administration urged HPT to remove onerous governance requirements, including the two-thirds vote requirement for removal of Trustees and the 75% supermajority vote required to amend sections of HPT's certificate of incorporation and bylaws. This proposal won support of more than 91% of shares voted, yet HPT's Board, which included three members of the current SIR Board (Barry Portnoy, Adam Portnoy and William Lamkin), disregarded this overwhelming recommendation of shareholders in order to maintain RMR's stranglehold on HPT.[38]

Further, every year from 2009 through 2013, the California Public Employees' Retirement System (CalPERS) has made a shareholder proposal that HPT declassify its Board to allow for the annual election of all Trustees.[39],[40],[41],[42],[43] The HPT Board consistently ignored these proposals.

In an April 26, 2012 press release, five other major pension funds joined CalPERS in urging HPT to declassify its Board.[44] This group included CalPERS, California State Teachers' Retirement System, Public Employees' Retirement Association of Colorado, Florida State Board of Administration, North Carolina Retirement Systems and Ohio Public Employees Retirement System. As stated in the press release, "For the past three consecutive years, shareowner proposals to declassify the board won overwhelming support from shareowners, receiving in each year a supermajority of the votes cast and a majority of outstanding shares. The proposal received support from over 73 percent of voting shares in 2009, over 90 percent in 2010 and over 88 percent in 2011. The company has yet to adopt the reform."[45]

At its 2012 annual meeting, HPT Trustee Bruce Gans received affirmative votes from the holders of just 42% of the shares voted and therefore resigned from the Board. But amazingly, the Board reappointed Dr. Gans to the vacancy created by his resignation.[46] HPT attempted to justify the decision with an announcement explaining that the Board of Trustees had "determined that the insufficient vote for Dr. Gans appeared not to be directed at any personal failings of Dr. Gans, but rather to be the result of a policy position taken by the Board of Trustees in opposition to the shareholder proposal by the California Public Employee Pension Plan, or CalPERS."[47]

Similarly, at HPT's 2013 annual meeting, William Lamkin, a current SIR trustee, received affirmative votes from the holders of just 43% of shares voted and therefore resigned.[48] As with Dr. Gans, the Board immediately reappointed Mr. Lamkin to the HPT Board.[49]

CommonWealth REIT ("CWH"): A Campaign of Shareholder Disenfranchisement

CWH is an RMR-managed publicly-traded REIT that primarily owns office buildings. In 2013, after two shareholders, Corvex Management ("Corvex") and Related Companies ("Related"), announced an ownership stake in CWH, the CWH Board spent more than one year and a significant amount of shareholder money in a series of actions to keep themselves in control of CWH.

On February 25, 2013, CWH announced a proposed equity offering.[50] The following day, Corvex and Related reported an ownership interest of 9.8% in CWH and wrote a letter to the Board calling on the company to cease its dilutive equity offering and stating a willingness to acquire the company at a significant premium.[51] After the Board's decision to continue its pursuit of the large equity offering and debt repurchase, Corvex and Related filed a lawsuit to halt the deal.[52],[53] The Delaware County Employees Retirement Fund also filed a lawsuit alleging breach of fiduciary duties.[54] CWH completed an upsized equity offering despite the lawsuits.[55],[56]

Rather than engage shareholders, on March 1, 2013, the CWH Board attempted to amend the company's bylaws, requiring shareholders to have continuously owned at least 3% of CWH's shares for at least three years in order to initiate an action to remove CWH's Trustees, a significant hurdle to real change at the Company.[57]

On March 13, 2013, Corvex and Related filed a consent solicitation statement to remove all five members of the CWH Board by written consent of two-thirds of shareholders.[58] CWH subsequently filed a revocation statement and issued a press release disputing the validity of the Corvex and Related consent solicitation under Maryland law.[59],[60] CWH argued that the consent solicitation was not valid since Corvex and Related did not hold 3% of the outstanding stock for at least three years, the provision based on the bylaw amendments CWH's Board had added solely in response to Corvex and Related.[61]

CWH then filed a registration statement for the possible sale of its entire ownership position in SIR on March 25, 2013.[62] In response to this action, Corvex and Related wrote a letter urging CWH not to sell the then-controlling interest in SIR in an underwritten offering.[63] In a subsequent letter, Corvex and Related offered to "buy such controlling stake in SIR at a premium to market value if the current SIR trustees resign and SIR's management agreement with RMR is terminated."[64]

The CWH Board further appeared to lobby for a change to Maryland state laws, which would have prevented shareholders from removing the CWH Board without cause. As stated by Corvex and Related in a filing with the SEC, "On April 4, 2013, it first came to our attention that Barry Portnoy and RMR had hired a lobbying firm in Annapolis, and had secretly been lobbying selected members of the Maryland General Assembly to introduce a last minute change to a pending Senate Bill to amend various provisions of the Maryland corporate code. The proposed amendment, if approved, would have enabled Barry Portnoy and his beholden Trustees to unilaterally remove the 'without cause' removal provision from the charter, eliminating the right of CommonWealth shareholders to remove the Board with an affirmative 2/3 vote."[65]

At its 2013 annual meeting, CWH Trustee Joseph Morea received affirmative votes from the holders of just 21% of votes cast and just 16% of shares outstanding, a powerful demonstration of shareholder frustration with RMR and its hand-picked Board. Despite this clear message from shareholders, the other Trustees reappointed Mr. Morea to his old seat on the CWH Board.[66]

On June 21, 2013, Corvex and Related announced that holders of over 70% of the outstanding shares of CWH voted for the removal of the entire Board.[67] Despite this overwhelming message from its shareholders, CWH refused to recognize the results, claiming that the consent solicitation was not valid and that an arbitration panel that was convened to resolve the disputes with Corvex and Related had not yet ruled.[68]

In an interim ruling in August 2013, the arbitration panel determined that the CWH Board's bylaw amendment to require 3% ownership for three years to initiate shareholder actions was invalid.[69] In November 2013, the arbitration panel issued a ruling allowing Corvex and Related to conduct a new consent solicitation and outlining the procedures for such a process.[70] On November 25, 2013, Corvex and Related delivered a formal notice to proceed with a new consent solicitation.[71] In February 2014, real estate executives Sam Zell and David Helfand joined Corvex and Related and agreed to serve as Chairman and CEO, respectively, of a new CWH Board and management team.[72]

On March 25, 2014, CWH announced that its shareholders voted to remove its entire Board of Trustees, with holders of approximately 81% of CWH's shares supporting Corvex Management and Related Companies in ousting the existing CWH Board.[73]

[1] http://investor.shareholder.com/sireit/releasedetail.cfm?releaseid=792364.

[2] http://www.sec.gov/Archives/edgar/data/1537667/000104746914003
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[3] The SIR definitive proxy (filed in April 2014) included identical

language regarding governance improvements.

[4] http://investor.shareholder.com/HRPReit/releasedetail.cfm?releaseid=835221.

[5] http://www.sec.gov/Archives/edgar/data/1537667/000104746914003
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[6] http://investor.shareholder.com/sireit/releasedetail.cfm?releaseid=845041.

[7] http://www.sec.gov/Archives/edgar/data/1537667/000110465914036 11923_18k.htm.

[8] http://www.sec.gov/Archives/edgar/data/1537667/000110465914037 12348_18k.htm.

[9] Even without any further acquisitions in 2014, we estimate the termination payment would be $32.7 million by year-end 2014 based on 2.75x the estimated two-year average annual base management fee and audit services expense of $9.6 million plus 12x the estimated six-month average monthly property management fee of $0.5 million. By year-end 2015, we calculate the termination payment will have increased to $35.3 million without any further acquisitions. If, instead, the Company were to complete $350 million in acquisitions in each of 2014 and 2015, the estimated termination payment would be $33.3 million and $39.2 million at year-end 2014 and 2015, respectively.

[10] One of the three supposedly "Independent" SIR Trustees, William Lamkin, is or has been on the Board of at least three RMR-managed publicly-traded companies. If Mr. Lamkin is not truly independent, as we suspect, a majority of the SIR Board is conflicted.

[11] http://investor.shareholder.com/sireit/releasedetail.cfm?releaseid=848015.

[12] http://investor.shareholder.com/sireit/releasedetail.cfm?releaseid=848107.

[13] Source: Bloomberg.

[14] Select Income REIT Third Quarter 2013 Earnings Conference Call on October 31, 2013.

[15] Select Income REIT Fourth Quarter 2013 Earnings Conference Call on February 20, 2014.

[16] Select Income REIT First Quarter 2014 Earnings Conference Call on April 25, 2014.

[17] http://www.sec.gov/Archives/edgar/data/1537667/000110465914031 9734_110q.htm.

[18] http://www.sec.gov/Archives/edgar/data/1537667/0001047469
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[19] We understand that Maryland law gives the Board latitude to make rational business decisions, but that latitude does not include disloyal acts or irrational decision-making. In this regard, we remind all of the SIR Trustees, especially the supposedly "Independent" ones, that (1) Trustee indemnification is not available for actions taken in bad faith, (2) the exculpation

provisions of SIR's declaration of trust do not apply to actions where the Trustee received an improper benefit or that are the result of active and deliberate dishonesty and (3) the Company's D&O insurance almost certainly excludes coverage for actions by Trustees or officers found to be a willful violation of the law or in which they received an improper benefit.

[20] As disclosed in SIR's Q1 2014 supplemental operating and financial data, page 28.

[21] "Pre-Equity Offering" scenario incorporates $208 million in April 2014 acquisitions.

[22] Note that the recent equity offering lowered the Implied SIR Share Price by approximately 8%.

[23] Weighted average coupon per SIR Q1 2014 supplemental presentation.

[24] Based on median peer Interest Expense / Gross Debt as outlined in the comparable companies table below.

[25] Please see peer FFO trading multiples in comparable companies table below.

[26] Middle Scenario based on 5.25% capitalization rate for the Damon Estate (estimated 81% of NOI) and 6.75% for the Campbell Estate (estimated 19% of NOI).

[27] Please see peer median cap rates in comparable companies table below.

[28] Q1 2014 pro forma debt balance adjusted for both April 2014 acquisitions and the May 2014 equity offering.

[29] Peer group consists of all non-RMR managed companies listed as peers in April 2012 initiating coverage reports from RBC, Morgan Stanley, Bank of America and Wells Fargo, but excludes CapLease (acquired during 2013) and Prologis, which trades at a significant premium valuation given its large size and scale. We have also added Spirit Realty (which completed an IPO in September 2012) and American Realty Capital Properties (which has since become the largest triple net REIT through a series of transactions) to the peer group.

[30] Source: Analyst consensus estimates per Bloomberg.

[31] Includes Preferred Stock.

[32] SIR market cap and enterprise value are pro forma for the April 2014 acquisitions and May 2014 equity offering.

[33] Based on $208 million in base acquisitions plus $5 million in estimated transaction costs.

[34] http://www.sec.gov/Archives/edgar/data/1378453/00011442040
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[35]
http://www.sec.gov/Archives/edgar/data/1378453/000110465908006
4621_1defa14a.htm.

[36]
http://www.sec.gov/Archives/edgar/data/1378453/000110465908023
10269_18k.htm.

[37] http://www.sec.gov/Archives/edgar/data/1378453/00011442040
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[38]
http://www.sec.gov/Archives/edgar/data/945394/0001104659100207

8364_18k.htm.
[39] http://www.sec.gov/Archives/edgar/data/945394/00010474690
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[44] http://www.sec.gov/Archives/edgar/data/945394/00011715201
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[45] http://www.sec.gov/Archives/edgar/data/945394/00011715201
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[46] http://investor.shareholder.com/hptreit/releasedetail.cfm?releaseid=672051.
[47] http://www.sec.gov/Archives/edgar/data/945394/0001104659120369
12145_18k.htm.
[48] http://www.sec.gov/Archives/edgar/data/945394/0001104659130436
12824_18k.htm.
[49] http://investor.shareholder.com/hptreit/releasedetail.cfm?releaseid=765454.
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[51] http://www.sec.gov/Archives/edgar/data/803649/00011931251
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[52] http://investor.shareholder.com/HRPReit/releasedetail.cfm?releaseid=743540.
[53] http://www.sec.gov/Archives/edgar/data/803649/0001104659130169
5944_11ex99d1.pdf.
[54] http://www.sec.gov/Archives/edgar/data/803649/0001104659130168
5944_10ex99d3.pdf.
[55] http://investor.shareholder.com/HRPReit/releasedetail.cfm?releaseid=745069.
[56] http://investor.shareholder.com/HRPReit/releasedetail.cfm?releaseid=745249.
[57] http://www.sec.gov/Archives/edgar/data/803649/0001104659130168
5944_10ex3d2.htm.
[58] http://www.sec.gov/Archives/edgar/data/803649/00011931251
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[59] http://www.sec.gov/Archives/edgar/data/803649/00010474691
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[60] http://investor.shareholder.com/HRPReit/releasedetail.cfm?releaseid=750647.
[61] http://www.sec.gov/Archives/edgar/data/803649/00010474691

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[62] http://investor.shareholder.com/HRPReit/releasedetail.cfm?releaseid=750557.
[63] http://www.sec.gov/Archives/edgar/data/803649/00011931251
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[64] http://www.sec.gov/Archives/edgar/data/803649/00011931251
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[65] http://www.sec.gov/Archives/edgar/data/803649/00011931251
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[66] http://www.sec.gov/Archives/edgar/data/803649/0001104659130429 7724_288k.htm.
[67] http://www.sec.gov/Archives/edgar/data/803649/00011931251
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[68] http://investor.shareholder.com/HRPReit/releasedetail.cfm?releaseid=773173.
[69] http://www.sec.gov/Archives/edgar/data/803649/00011931251
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[70] http://www.sec.gov/Archives/edgar/data/803649/00011931251
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[71] http://www.sec.gov/Archives/edgar/data/803649/00011931251
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[72] http://www.sec.gov/Archives/edgar/data/803649/00011931251
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[73] http://www.sec.gov/Archives/edgar/data/803649/0001104659140219 6421_268k.htm.

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Lakewood Capital Management, LP is an SEC-registered investment adviser based in New York. Founded in 2007, Lakewood manages over $2.5 billion in assets and employs a long-term fundamental approach to investing.

CLX $91.23 -0.50%

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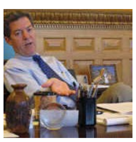

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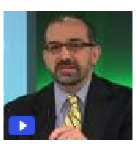

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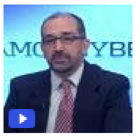

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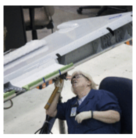

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