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FAIR GAME; An Agitator Speaks Up, And It Pays Off
By GRETCHEN MORGENSON

RATIONAL, constructive shareholder activism doesn't always make directors more accountable -- and it rarely gives investors immediate payoffs. But miracles can happen, as shown last week when a shareholder and a board squared off in a proxy fight at two closed-end real estate stock funds.

Almost since they were issued to the public in 2003, shares in the Neuberger Berman Real Estate Securities Income fund and the Neuberger Berman Realty Income fund have traded at discounts to their net asset values. (Neuberger Berman is a unit of Lehman Brothers.) Last year, for example, the two funds' shares traded at discounts of 15 percent to the value of the securities they own, largely reflecting the funds' lagging yield.

This is not unusual among closed-end stock funds that big brokerage firms offer. These investments carry onerous fees when bought in initial public offerings, and firms typically peddle them to investors when the industry in which the funds invest is near or already at the top of its cycle. (That fact alone should give investors pause.) More troubling, it's usually individual investors -- persuaded by their brokers -- who buy closed-end funds.

Total returns at the two Neuberger realty funds (if dividends were reinvested in the securities) have handily surpassed the return of the Standard & Poor's 500 since the funds were issued. That's nice, but completely eliminating the discount to asset value at both funds would push those returns even higher. And that's exactly what one Neuberger investor wanted to do.

Since 2003, Western Investment LLC, a Salt Lake City investment fund run by Art Lipson, has successfully agitated for change at a half-dozen closed-end funds, including the First Trust Value Line Dividend Index fund and the Tri-Continental Corporation. Western recently took aim at Neuberger, filing a dissident slate of five directors to run for election to the realty funds' boards at their combined annual meeting in New York, to be held on Wednesday.

Mr. Lipson said he acted because he wanted to narrow the discounts at which the funds trade to less than 5 percent. Recently, they carried discounts of 9 percent to 10 percent. Western has owned a significant stake in the funds since 2005.

He said he did not want to liquidate or control the funds, which have a combined market capitalization of around $1.3 billion. His slate of directors, if elected, would make the funds more accountable to shareholders, he said.

Late last week, however, it became clear that the dissident directors didn't need to win election to achieve their stated goal.

On Friday morning, five days before the annual meeting, and a day after this reporter asked Neuberger officials to comment on the coming proxy contest, the funds' directors announced that they would increase the monthly distributions to shareholders to the equivalent annual rate of 9 percent. The previous distribution rate at the funds was 5 percent to 6 percent.

Shareholders will start receiving their new-and-improved payments in May, Neuberger said. Shares of both funds jumped on the news. The Real Estate Securities Income fund rose 4.4 percent, to close at $19.52; the Realty Income fund rose 3.4 percent, to close at $25.80.

Peter E. Sundman, chairman and chief executive of the Neuberger funds, said in a statement that the boards had pondered how to narrow the shares' discounts for some time. Among the considerations were tax implications, investor interests and the long-term health of the funds, Mr. Sundman said.

"The boards determined, after significant analysis, to increase monthly distributions," he said, "which the boards believe should not impact the manner in which the funds are managed." Mr. Sundman also said the change might make the funds more attractive to investors and more competitive with similar funds.

Even before the announcement of the increased dividend, however, Western's arrival on the scene had buoyed the funds' shares and reduced the discounts at which they had traded. In talks with Neuberger officials over two months ago, Mr. Lipson asked them to move to reduce the discount. He suggested increasing the dividend or buying back shares to capitalize on the discounted price, he said.

He also argued for consolidation of the two funds to cut costs. Both funds have the same philosophy and manager -- Steven R. Brown, who also manages a related fund that is not part of the proxy fight, the Neuberger Berman Real Estate Income fund.

But Neuberger officials declined to act and so Mr. Lipson mounted a proxy battle with his alternate slate of directors. (Directors at these three Neuberger real estate funds are the same.)

"Management was happy to sell three funds to the public back in 2003 and 2004 and raise the assets, but they haven't been responsive to shareholders since," Mr. Lipson said in an interview last Thursday. The next day, the board increased the funds' payouts.

BEFORE that move, the Neuberger funds' directors had not shown themselves to be too shareholder-friendly.

In 2004, for example, when another investor made a tender offer for shares of the Neuberger Berman Real Estate Income Fund, directors instituted a poison pill, an extreme rarity in the fund world. Poison pills act to entrench directors by preventing the possibility of a takeover. That fund has not held an annual meeting for two years as it has been embroiled in litigation challenging the poison pill.

And pay attention to this: Directors have allowed the Neuberger funds to spend $800,000 of shareholders' money to defend the poison pill.

There is also the fact that only one of the funds' 13 independent directors owns a stake in the two real estate funds in the proxy battle, according to the most recent regulatory filings. The sole, stockholding director owns just 100 shares in the two funds, filings show.

Neuberger policy recommends that its directors own at least one year's worth of director fees in any of the funds they oversee. Regulatory filings show that the same 13 independent fund directors oversee 62 portfolios; the choice of which ones to invest in is theirs alone.

Still, the fact that only one of 13 directors owns any of these real estate funds -- and that her stake is so small -- does not inspire confidence that their board's interests are aligned with those of the shareholders they serve.

Directors at certain closed-end funds seem more attuned to their shareholders' desires, Mr. Lipson said. No surprise that the stocks of these funds perform well and carry modest discounts, if any. Funds that invest in fixed-income securities -- such as those issued by John Nuveen -- are often fine vehicles for investors seeking high yields and relative safety. And stock funds that pay generous dividends -- such as the Blue Chip Value fund -- often trade at a premium to their asset values.

But with so many closed-end funds trading at discounts to their net asset values, activists like Western can make a real difference for small shareholders.

Late Friday, Mr. Lipson said Western plans to withdraw its dissident slate on Monday and to vote for the funds' current directors at the meeting. "The board has taken significant, proactive steps to resolve shareholder concerns," he said, adding that the new dividend will result in an increased value to shareholders of over $250 million.

It is not clear what ultimately caused the Neuberger board to change its view on increased payouts to the funds' shareholders. But it is certainly a pleasing outcome to what promised to be a nasty fight, especially for investors.