Goodwin Insights: REIT Alert

REIT M&A Trends Through the Pandemic (2020-2022)

Yoel Kranz, John Haggerty, Blake Liggio, Mark Opper, Ettore Santucci
June 06, 2022

As in most other market sectors, REIT M&A activity came to a screeching halt in March 2020 as the COVID-19 pandemic took hold in the United States and globally. In the face of significant uncertainty surrounding the ability of tenants to make rent payments, REITs in many sectors (but not all) effectively went into survival mode during the second and third quarters of 2020 and new deal activity virtually ceased from March 1, 2020 through August 1, 2020. Through late 2020 and early 2021, as the pandemic was perceived to be easing, M&A activity in the REIT sector began to show signs of life, with a trickle of new deals announced primarily in the non-traded REIT space. In March 2021, the first significant new transaction

[1] Through August 1, 2020, the last transactions to be completed in the ordinary course between unrelated parties involving a public equity REIT target were those first announced in Fall 2019. Simon's acquisition of Taubman, announced in February 2020, was litigated in a high-profile dispute and ultimately renegotiated (see below), and Front Yard Residential's sale to Amherst Residential, also announced in February 2020, was terminated before Front Yard Residential was ultimately sold to funds controlled by Pretium and Ares in early 2021.

involving the acquisition of a publicly-traded REIT since the start of the pandemic was announced, followed closely by several others in April and May 2021. In the full year that has followed, one or more new REIT M&A transactions have been announced in every month other than October 2021, and transaction volume over the last 12 months has rivaled or outpaced pre-pandemic levels.

In total, 42 new REIT transactions were announced between August 1, 2020 and May 30, 2022, with an aggregate transaction value of approximately $158 billion. In 2018 we released our advisory alert "Trends in Public REIT M&A: 2012–2017," chronicling select metrics across the 50+ REIT M&A transactions announced during the 2012-2017 period. We updated the sample set and findings in our 2019 update alert and again in 2021. We are pleased to share in this article our findings with respect to the terms of REIT M&A transactions through the pandemic, in addition to our thoughts on the outlook for REIT and Real Estate sector M&A in 2022 and beyond.

A full listing of the reviewed transactions is included at the end of this article.[2]

Selected Data of the 42 new REIT M&A transactions announced since August 1, 2020

31 (*74%*)	were public-to-public transactions
11 (*26%*)	were go-private transactions
17 (40%)	involved the acquisition of non-exchange traded public REITs
11 (26%)	were related-party transactions, involving the acquisition of a non-exchange traded REIT by its sponsor or other affiliated entity
12 (48%)	of all targets of transactions involving publicly-traded REITs had a history of recent activist investor campaigns
26.95%	was the average premium (and **22.50%** the median premium) to unaffected share price for the transactions involving publicly-traded targets, with a high of 70.6% and a low of 7.9%
16 (38%)	provided for all-cash consideration
22 (52%)	provided for all-stock consideration
4 (10%)	provided for mixed cash and stock consideration
28 (74%)	generally permitted continued payment by target of regular periodic dividends to stockholders (24 of which were stock, or partly stock, deals)
10 (26%)	restricted payment of ongoing dividends by target (nine of which were all-cash deals)
8 (19%)	included an affirmative "go-shop" provision (typically between 30-45 days)
14 (33%)	included either "go-shop" or "window-shop" two-tiered termination fee provisions, whereby a substantially lower fee was payable during the go-shop or window-shop periods
1.6%	of target equity value was the average (and **1.5%** was the median) first-tier termination fee to be applicable during any go-shop or window shop period, with a high of 3.5% and a low of 1.0%
3.0%	of target equity value was the average (and **3.29%** was the median) of final or single termination fees, with a high of 5.4% and low of 1.0%
20 (48%)	limited target's remedies to a "reverse breakup fee" if buyer failed to close, typically from 7-10% of equity value for cash deals

[2] Goodwin Procter LLP played a role in a number of the surveyed transactions. No nonpublic information about any of these transactions has been used in writing this alert.

Key Takeaways

- ***Ongoing Effects of COVID-19.*** COVID-19's impact on REIT M&A activity took several different forms, including:

  - One immediate effect of the global economic shutdown and prolonged stay-at-home orders was the devastating effect on valuations in most commercial real estate sectors. With the worst of the pandemic hopefully now behind us, traditional buyers and sellers of assets can, at least in theory, more reliably consider recent dealmaking, historical precedent and reasonable assumptions in reaching agreement on post-pandemic valuations.
  - The COVID-19 pandemic accelerated pre-existing secular trends in the REIT sector. For example, the retail and CBD office sectors were experiencing adverse changes in demand fundamentals pre-pandemic, which were only exacerbated by the global economic shutdown. Conversely, sectors tied to growing areas such as e-commerce and the technology-based economy, such as logistics/industrial, data center and tower REITs, were strong performers pre-COVID-19 and this continued through the pandemic.[3]
  - While 2021 demonstrated the resiliency of the public REIT sector as a whole, the share prices of many REITs in the most-directly impacted subsectors have not yet recovered to pre-pandemic levels and are currently facing headwinds resulting from rising interest rates, global uncertainties and inflation. These companies remain more vulnerable to activism, unsolicited offers and general consolidation pressures. In addition, as valuation challenges persist even for highly attractive portfolios (with the exception of selected bright spots, such as for example logistics and datacenter assets), the universe of possible buyers who have the ability to write the equity check in a transaction increases.

- ***Blackstone is Back.*** Blackstone began the post-pandemic public markets activity with its acquisition of Extended Stay America, announced in March 2021. Indeed, 50% of all cash transactions announced in the post pandemic period involved a Blackstone entity as the buyer, for a total of $44 billion in aggregate transaction value. Notably, four of these transactions involved BREIT, Blackstone's $100+ billion non-traded REIT vehicle. In 2022 to date alone, Blackstone has announced four material transactions in the residential space. In our 2019 update, we observed the "big two" effect of Blackstone and Brookfield on REIT M&A, noting their uniqueness in terms of ability deploy capital nimbly, and in size. Through BREIT, a retail-focused vehicle, as well as in its traditional institutional private real estate funds, Blackstone continues to raise amounts of capital unmatched in the industry (perhaps in the history of equity REITs) that can largely be deployed on a moment's notice in just about any geography across any property segment. Moreover, the BREIT platform provides Blackstone with a perpetual ownership structure that does not require recycling acquired assets back into the public markets via IPO, as Blackstone has done historically with REIT portfolios acquired in its institutional real estate funds. This allows Blackstone to avoid the risk of downturns in the REIT capital markets generally, and IPO market specifically, while providing BREIT with permanent capital and growth portfolios that can generate higher recurring earnings.

  We are aware of a number of large, credentialed asset management platforms seeking to challenge BREIT's pre-eminence, particularly with the creation of large non-traded REIT vehicles that would offer state-of-the-art structures and economics to investors of all types. We would expect to see further significant transactions in 2022 and beyond involving Blackstone-affiliated entities and new entrants into the non-traded REIT quadrant of the industry.

[3] See, e.g., www.wsj.com/articles/reits-romped-in-2021-as-property-values-soared-11640696407

- ***Ongoing Impact of Shareholder Activism.*** As we noted in our 2019 and 2021 update articles, shareholder activism continues to be a recurring theme in the REIT sector. Of the 25 new transactions announced in the post-pandemic period involving publicly-traded targets, nearly half (48%) of these targets had a history of recent activist investor campaigns.

  Pre-pandemic, we noted a sharp increase in the number of activist campaigns in the sector, due in part to shares in some sub-sectors trading at persistent discounts to NAV. While active campaigns subsided during the heart of the 2020 economic shutdown, activism in the sector has since returned in full force. In 2021 and in 2022 to date, a total of 34 new activist campaigns were launched targeting publicly-traded REITs. Indeed, continued economic dislocation in the commercial real estate space has made underperformers more conspicuous — and more vulnerable — than ever to activist campaigns. In certain sectors, activists will argue that market fundamentals have irreversibly changed and that the "same old" is no longer viable in the commercial real estate sector. We expect activism in the sector to continue in 2022 and beyond, leading inevitably in some cases to sale or combination transactions as activists clamor for short-term value.

- ***Alternative Structuring.*** A growing number of transactions in the pandemic period included non-traditional elements in terms of structure. Where a traditional REIT M&A transaction structure typically includes a corporate consolidation, whereby target company shares are exchanged for a fixed amount of cash, stock or both, some recent deals have included some more atypical features, including:

  — Pre-closing spin-off of discrete business segment to target shareholders;

  — Reverse merger, in which target nominally acquires buyer, accompanied by pre-closing cash dividend to target shareholders;

  — Whole portfolio asset sale, followed by liquidation;

  — Asset sales of core portfolio, followed by merger for balance of target; and

  — Contingent consideration component tied to outcome of regulatory matter.

To be certain, every M&A transaction is different and there are any number of unique factors and contingencies that might drive a particular structure over another. Nevertheless, a contributing factor in the increased number of transactions with novel features is the allocation of risk and uncertain values among parties in the post-pandemic environment. Target companies and their boards may be reluctant to transact at flat values that reflect pandemic-era discounts to NAV and are increasingly open to novel structures and contingent payment opportunities in an effort to maximize shareholder value in a market where fundamentals may have moved significantly against them.

- ***Consolidation among NTRs.*** Partially continuing a trend we noted in our previous alerts, of the 42 REIT transactions announced since August 1, 2020, 10 (24%) involved the combination of companies externally managed by the same sponsor/advisor. Strategically, combinations of similarly-focused companies in the non-traded REIT space under the same management team can streamline operations and rationalize advisory fees ahead of significant financing transactions and possible liquidity events. Practically, the G&A cost of running multiple "sister" platforms in a largely retail investor market may no longer be tenable in many circumstances, particularly in light of the fact that capital raising in the NTR space for companies not named Blackstone has slowed significantly in recent years. From a process standpoint and in order to cleanse the potential application of a heightened fiduciary standard of review, we reiterate that proposed business combination transactions among related parties present conflicts of interest concerns and that each party would do well to establish its own special committee of independent directors, advised by its own independent counsel and financial adviser(s), to negotiate and approve all material transaction terms.

Notable in the post-pandemic period, however, is that over 40% of the transactions involving NTR targets were between unrelated parties. In some transactions, a higher-bidding interloper even jumped the initial deal,[4] a phenomenon that has traditionally been rare in the NTR space.

- ***Higher Premiums to Unaffected Share Price.*** Among transactions involving publicly-traded targets in our sample set, the average premium to unaffected share price was 26.95%, with a median of 22.50%. This is markedly higher than the historical average of 22.5%, and median of 16.7%, premium to unaffected share price we calculate using all publicly-traded transactions in our database going back to 2012.[5] A factor likely at play here is the pronounced disparity in recent years between NAV and share prices across many sectors, which, as noted above, has been only exacerbated by the lingering effects of the pandemic. Even while share prices are down, target boards and management teams have not entirely discarded pre-COVID-19 views of intrinsic value — meaning that the market-clearing price for capital transactions is increasingly at a higher premium to current share price.

- ***Go-Shops and Window-Shops.*** Eight of the 42 deals in our post-pandemic sample included a go-shop provision and a further 6 transactions included a two-tiered termination fee without a go-shop (a so-called "window-shop" provision). Altogether, approximately 33% of the sampled transactions featured two-tiered termination fee provisions, pursuant to which a substantially lower fee is payable by target if it terminated the agreement to pursue a competing offer received during the go-shop or window-shop period. As noted above, the median first-tier termination fee in our sample was 1.5%, rising to a median 3.0% for the second-tier/final termination fee.

As we have noted in our past alerts, parties to REIT M&A transactions are increasingly leaving the door open, sometimes fairly wide open, to possible competing bids that might maximize shareholder value. The current rate of inclusion of go-shop and window-shop provisions is markedly higher than the overall incidence of go-shops and window-shops when considering all public REIT transactions going back to 2012, which was only 26%. Part of this is attributable to the higher incidence of related-party transactions in recent years, as noted above. Likewise, in transactions where the target board or special committee has not been able to conduct a sufficiently thorough pre-market check, it may choose to include a go-shop or window-shop provision in an effort to ensure it has sufficient information on potential bidders and maximized pricing in the marketplace. In a handful of recent cases, however, target boards simply insisted on having a two-tiered termination fee structure, whether strictly necessary or not.

Ironically, as discussed in our 2021 alert, market studies have found that while the incidence of go-shop and similar provisions may be increasing in M&A agreements, their ultimate effectiveness at getting a better price for target shareholders is decreasing.[6] The persistence of the trend should nonetheless caution transaction participants when considering the optimal structure for balancing to more favorable opportunities should they arise post-announcement of a transaction.

[4] E.g., the $1.2 billion acquisition of Cole Office & Industrial REIT II by Griffin Capital Essential Asset REIT, which trumped an earlier announced acquisition by CIM Real Estate Finance Trust, Inc. Another Cole NTR party to the same multi-company deal with CIM also received a post-signing topping bid, which was not ultimately accepted.

[5] See, also, Green Street Advisors, "Twenty Years of U.S. REIT M&A", February 24, 2020, reporting a median premium to unaffected share price of approximately 15% in their review of 70 publicly-traded REIT transactions going back to 2000.

[6] See, e.g., 133 Harv. L. Rev. 1215 (https://harvardlawreview.org/2020/02/go-shops-revisited/).

Index of REIT M&A Transactions Announced Since April 2020

Announced	Target	Acquirer	Sector
Aug-20	Jernigan Capital	NexPoint Advisors	Storage
Aug-20	Cole Credit Property Trust V Cole Office & Industrial REIT III Cole Office & Industrial REIT II	CIM Real Estate Finance Trust, Inc	Retail Office/Industrial
Sep-20	Resource Real Estate Opportunity REIT Resource Real Estate Opportunity REIT III	Resource Real Estate Opportunity REIT II	Residential
Oct-20	Front Yard Residential Corp	Pretium/Ares	Residential
Nov-20	Cole Office & Industrial REIT II	Griffin Capital Essential Asset REIT	Office/Industrial
Nov-20	Strategic Storage Trust IV, Inc.	SmartStop Self Storage REIT	Storage
Dec-20	Anworth Mortgage Asset Corp	Ready Capital Corporation	Mortgage
Jan-21	Cottonwood Residential I Cottonwood Multifamily I Cottonwood Multifamily II	Cottonwood Communities Inc.	Residential
Mar-21	Extended Stay America, Inc.	Blackstone/Starwood Capital	Lodging
Apr-21	VEREIT	Realty Income Corp.	Office/Diversified
Apr-21	Weingarten Realty	Kimco Realty	Retail
Apr-21	Tremont Mortgage Trust	RMR Mortgage Trust	Mortgage
May-21	Monmouth Real Estate Investment Cor	Equity Commonwealth	Industrial
Jun-21	QTS Realty Corp	Blackstone	Data Centers
Jun-21	Griffin-American Healthcare REIT III	Griffin-American Healthcare REIT IV	Healthcare
Jun-21	New Senior Investment Group	Ventas	Healthcare
Jul-21	Capstead Mortgage Corp	Benefit Street Partners Realty Trust	Mortgage
Jul-21	Steadfast Aparment REIT, Inc.	Independence Realty Trust, Inc.	Residential
Jul-21	Retail Properties of America	Kite Realty Group	Retail
Aug-21	MGM Growth Properties LLC	VICI Properties, Inc.	Specialty
Sep-21	CIM Income NAV, Inc.	CIM Real Estate Finance Trust, Inc.	Mortgage
Sep-21	Columbia Property Trust	PIMCO	Office
Sep-21	Condor Hospitality Trust, Inc.	Blackstone Real Estate Partners	Lodging
Nov-21	Monmouth Real Estate Investment Corp	Industrial Logistics Properties Trust	Industrial
Nov-21	Corepoint Lodging Inc.	Highgate/Cerberus Capital Management	Lodging

Announced	Target	Acquirer	Sector
Nov-21	CyrusOne Inc.	KKR/Global Infrastructure Partners	Data Centers
Nov-21	Coresite Realty Corporation	American Tower Corporation	Data Centers
Dec-21	BlueRock Residential Growth REIT	Blackstone Real Estate Partners	Residential
Jan-22	Resource REIT	Blackstone Real Estate Income Trust, Inc.	Residential
Feb-22	Preferred Apartment Communities Inc.	Blackstone Real Estate Income Trust, Inc.	Residential
Feb-22	Strategic Storage Growth Trust II, Inc.	Smartstop Self Storage REIT, Inc.	Storage
Feb-22	CPA 18 Global, Inc.	W.P. Carey Inc.	Diversified
Feb-22	Healthcare Trust of America	Healthcare Realty Trust Inc.	Healthcare
Mar-22	Cedar Realty Trust, Inc.	DRA Advisors/Wheeler Real Estate Investment Trust	Retail
Apr-22	American Campus Communities Inc.	Blackstone Real Estate Income Trust, Inc.	Residential
Apr-22	PS Business Parks, Inc.	Blackstone Real Estate Partners	Diversified
May-22	Terra Income Fund 6	Terra Property Trust	Mortgage

Want to learn more about REITs or M&A in real estate?

Connect with one of our REIT and Real Estate M&A professionals to discuss how market activity impacts your business, goals, and legal needs.
Visit goodwinlaw.com/reits to get started.