GOODWIN REIT ALERT

Trends in REIT M&A (2022–2023)

October 09, 2023

In our 2022 alert "REIT M&A Trends Through the Pandemic,"[1] we cataloged a total of 42 new REIT transactions announced between August 2020 and May 2022, a pace that rivaled or exceeded pre-pandemic levels. From May 2022 through August 2023, a further 15 new REIT M&A transactions have been announced, with an aggregate transaction value of approximately $71 billion. We are pleased to share in this article our findings with respect to the terms of the 15 most recent REIT M&A transactions announced to date, as well as our thoughts on the outlook for REITs and real estate sector M&A in 2023 and beyond. A full listing of the reviewed transactions is included at the end of this article.[2]

Overview

[1] 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, in 2021 and again in 2022.

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

Selected Data	
Of the 15 new REIT M&A transactions announced since May 2022:	
12 *(80%)*	were public-to-public transactions
3 *(20%)*	were go-private transactions
9 (60%)	provided for all-stock consideration
3 (20%)	provided for all-cash consideration
3 (20%)	provided for mixed cash and stock consideration
35.16%	was the average premium (and **31.80%** was the median premium) to unaffected share price for the transactions involving publicly traded targets, with a high of 59.2% and a low of 17.0%
5 (33%)	were transactions in the mortgage REIT sector
2 (13%)	involved proposed transactions between REITs with affiliated external managers
3 (20%)	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
3.48%	of target equity value was the average (and **3.50%** was the median) of final or single termination fees, with a high of 6.0% and low of 1.45%
9 (60%)	limited the target’s remedies to a “reverse breakup fee” if buyer failed to close
5 (50%)	of the equity REIT transactions required the target to facilitate the pre-closing (or simultaneous with closing) sale of select assets as designated by buyer

Key Takeaways

A Year Makes a Big Difference. The 13-month period between March 2021 and April 2022 saw new and substantial REIT M&A transactions announced at a blistering pace: more than 30 deals, with an average transaction value approaching $6 billion each. Nearly half of the deals were all-cash, and a significant number were go-private transactions. Blackstone and its affiliates were prolific and active buyers, accounting for almost $50 billion worth of transactions across seven different deals in the lodging, data centers, and residential subsectors. Fast-forward to Q3 2023, and the deal flow and transaction structures have changed dramatically. Of the approximately $71 billion in aggregate transaction values over the past year and a half, three large deals alone account for the lion's share of the overall total.[3] The historic surge in interest rates and corresponding higher borrowing costs have severely negatively affected the ability of private-sector buyers to fund public REIT acquisitions. Since May 2022, only three go-private transactions have been announced and only three all-cash deals. Blackstone and its affiliates have not participated as buyers in any announced deals since April 2022; indeed, Blackstone and affiliates have been active sellers of commercial real estate assets during this period.

Ongoing Distress. Commercial real estate as an asset class continues to face headwinds resulting from rising interest rates; longer-term impacts of the pandemic, including ongoing flexible working arrangements; and global economic uncertainties. While the immediate post-pandemic period demonstrated the resiliency of the public REIT sector as a whole, the share prices of most traded REITs have not recovered to pre-pandemic levels. Across all RMZ-constituent companies, share prices are down 28%, on average, from their late February 2020 levels — and in some subsectors, significantly lower. Valuation challenges persist even for highly attractive portfolios, and it is still too early to project a sector wide recovery with any certainty. And as interest rates remain high and go even higher, the significant cost of debt capital now facing REITs is likely to continue to pressure equity valuations. Higher relative G&A loads at many smaller REITs also contribute to persistent valuation pressures vis-à-vis their larger peers.

What we can say with certainty, however, is that public REITs currently trading at oversize discounts to historical NAV will remain vulnerable in the near and midterm to shareholder activism (see below), unsolicited offers (such as Public Storage's hostile bid for Life Storage that ultimately contributed to Life Storage's sale to Extra Space Storage), and general consolidation pressures.

Smaller, High-Quality Portfolios Still Attracting Buyers. Several of the deals announced in the 2022–2023 period represented the acquisition of a relatively small, high-quality portfolio of assets by a larger strategic consolidator. In light of the widespread share price declines noted above, discerning buyers see a disconnect in certain sectors between negative market sentiment and otherwise strong fundamentals.[4] When REITs are attractively priced, there are nearly always pockets of appetite that remain among discerning investors to acquire high-quality assets or portfolios. Recent dealmaking has demonstrated that debt capital from the major banks also remains available for the right sponsors or strategic players in acquisition transactions.[5] If REITs continue to underperform the rest of the market in spite of positive fundamentals and growth prospects, we would expect sophisticated buyers to continue trying to scoop up high-quality portfolios at attractive pricing.

Ongoing Impact of Shareholder Activism. As we have noted previously, shareholder activism continues to be a recurring theme in the REIT sector. Unsurprisingly, several of the targets in our most recent sample set of REIT M&A transactions had a recent history of activist investor campaigns. While active campaigns subsided during the heart of the 2020 economic shutdown, activism in the sector has since returned in full force. In 2022

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[3] Includes Duke Realty's merger with Prologis (announced June 2022), Store Capital's acquisition by Oak Street/GIC (announced September 2022), and Life Storage's merger with Extra Space Storage (announced April 2023).

[4] See, e.g., JLL M&A and Strategic Transactions Monitor, September 2023, noting that "negative sentiment around office and CRE debt defaults are a drag on the rest of the real estate sector, even though cash flows and occupancies are healthy".

[5] See, e.g., Green Street Advisors, "Hersha Heads for the Exits," August 28, 2023.

alone, 41 new activist campaigns were launched targeting publicly-traded REITs, a high water mark for the REIT sector. This year through Q3 2023, a further 36 new activist campaigns have been launched against 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 parts of the commercial real estate sector. We expect activism in the sector to continue in 2023-2024 and beyond, leading inevitably in some cases to sale or combination transactions as activists clamor for short-term value.

Uncertainty of Closing. In our March 2021 alert, we noted that in the wake of the economic crisis caused by the global COVID-19 pandemic, numerous previously announced REIT transactions were abandoned, terminated and litigated, or renegotiated. Several transactions in our most recent sample set also ran into determined resistance from shareholders and activist funds, with one pair of externally managed REITs recently calling off their merger entirely in the face of an opposition shareholder proxy battle. While “certainty of close” is the inviolable mantra of every public REIT target, these transactions have shown that even the most securely drafted deals are vulnerable to challenge, particularly in uncertain times.

Premiums Continue to Creep Higher. Among transactions involving publicly traded targets in our sample set, the average premium to unaffected share price was 35.2%, with a median of 31.8%. This is markedly higher than the historical average premium to unaffected share price of 22.5% (and median of 16.7%) we calculate using all publicly-traded transactions in our database going back to 2012. The higher premiums were found not only in cash deals — where the consideration to be received by target shareholders is intended to capture all future upside in the target business — but also in stock deals, including mixed consideration transactions, even though target shareholders retain the ability to capture future upside to the extent of the stock consideration.

Termination Fees Are Also Higher. The median termination fee payable by the target REITs in our sample — in the event they elected to terminate the agreement to pursue a competing proposal or otherwise — rose to 3.5% of transaction equity value, as compared to a historical median of 3.0% of transaction equity value going back to 2012. While the 2022–2023 group of transactions provides a relatively small sample size, six of the 15 deals surveyed included a termination fee of 4.0% of transaction equity value or higher, with an outlier as high as 6.0%. Among other reasons, the uptick in higher termination fees may be seen as a reaction of buyers to a more aggressive activist environment, as noted above, and increased insistence on deal certainty in more uncertain times.

Index of REIT M&A Transactions Announced Since May 2022

Date Announced	Target	Acquirer	Sector
May-22	CatchMark Timber Trust, Inc.	PotlatchDeltic Corporation	Specialty
Jun-22	Duke Realty Corporation	Prologis, Inc.	Industrial
Sep-22	Store Capital Corporation	Oak Street/GIC	Diversified
Feb-23	Indus Realty Trust, Inc.	Centerbridge/GIC	Industrial
Feb-23	Broadmark Realty Capital Inc.	Ready Capital Corporation	Mortgage
Apr-23	Life Storage, Inc.	Extra Space Storage Inc.	Storage
Apr-23	Diversified Healthcare Trust	Office Properties Income Trust	Healthcare
May-23	Urstadt Biddle Properties Inc.	Regency Centers Corporation	Retail
May-23	The Necessity Retail REIT, Inc.	Global Net Lease, Inc.	Retail
May-23	Arlington Asset Investment Corp.	Ellington Financial Inc.	Mortgage
Jun-23	Western Asset Mortgage Capital Corporation*	Terra Property Trust, Inc.	Mortgage
Jun-23	Great Ajax Corp.	Ellington Financial Inc.	Mortgage
Aug-23	Western Asset Mortgage Capital Corporation	AG Mortgage Investment Trust, Inc.	Mortgage
Aug-23	RPT Realty	Kimco Realty Corporation	Retail
Aug-23	Hersha Hospitality Trust	KSL Capital Partners, LLC	Lodging

* This transaction was not consummated due to the receipt of a topping bid deemed by the target board to constitute a “superior proposal.”

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