

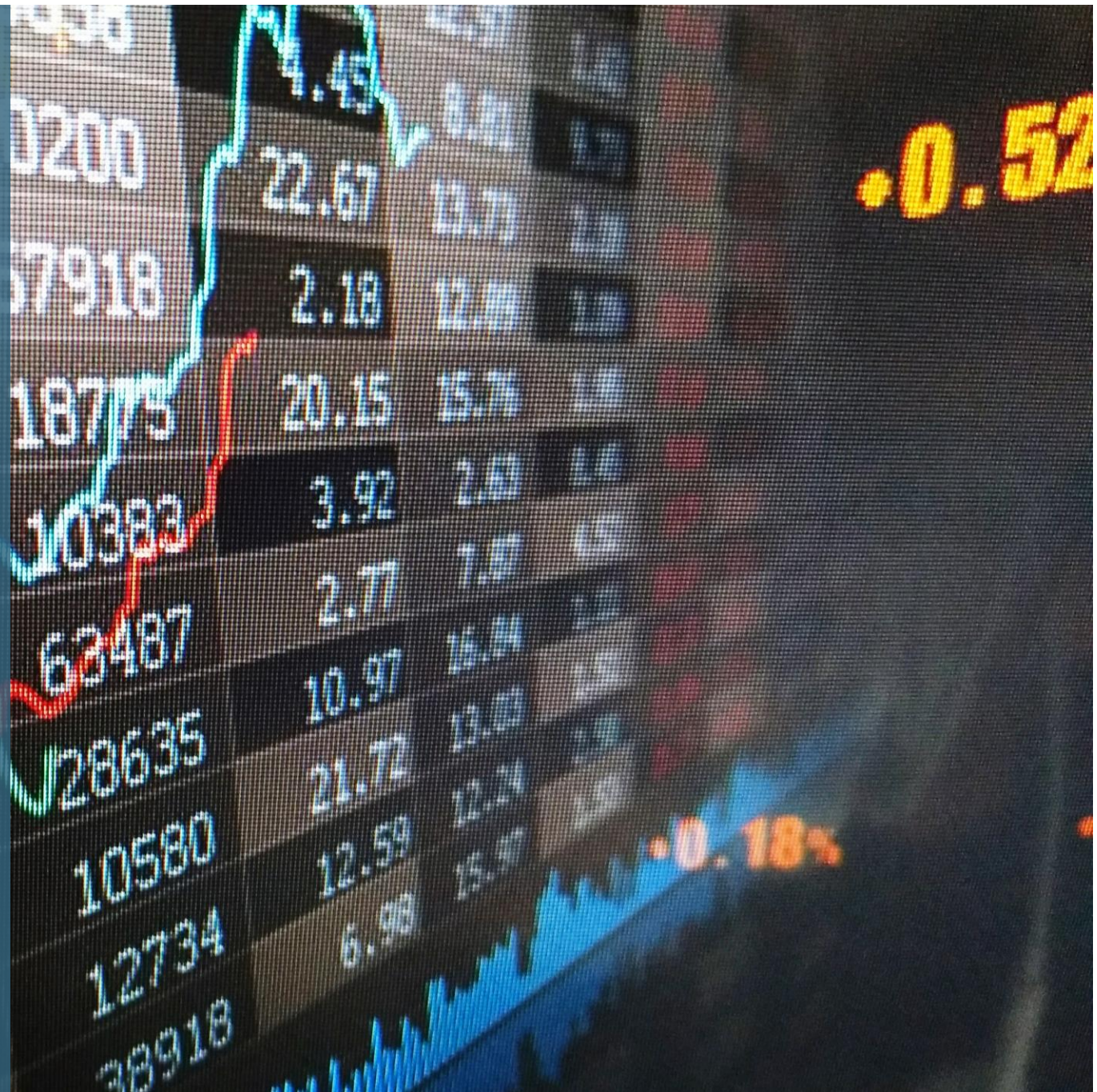
Vinson&Elkins

OCTOBER 30, 2019

# SPACS: AN ALTERNATIVE TO THE TRADITIONAL IPO FOR REITS AND OTHER REAL ESTATE COMPANIES

*V&E REIT Series*

velaw.com





## TODAY'S PANELISTS



**GREG COPE**  
PARTNER, CAPITAL MARKETS AND MERGERS & ACQUISITIONS

Washington

+1.202.639.6526  
[gcope@velaw.com](mailto:gcope@velaw.com)



**ZACH SWARTZ**  
SENIOR ASSOCIATE, CAPITAL MARKETS AND MERGERS & ACQUISITIONS

Richmond

+1.804.327.6324  
[zswartz@velaw.com](mailto:zswartz@velaw.com)

## DISCUSSION TOPICS

SPAC IPOs	04
SPAC M&A Considerations	14
Considerations for Real Estate/REIT De-SPACs	23
Precedent Real Estate/REIT De-SPACs	27

SPAC IPOs

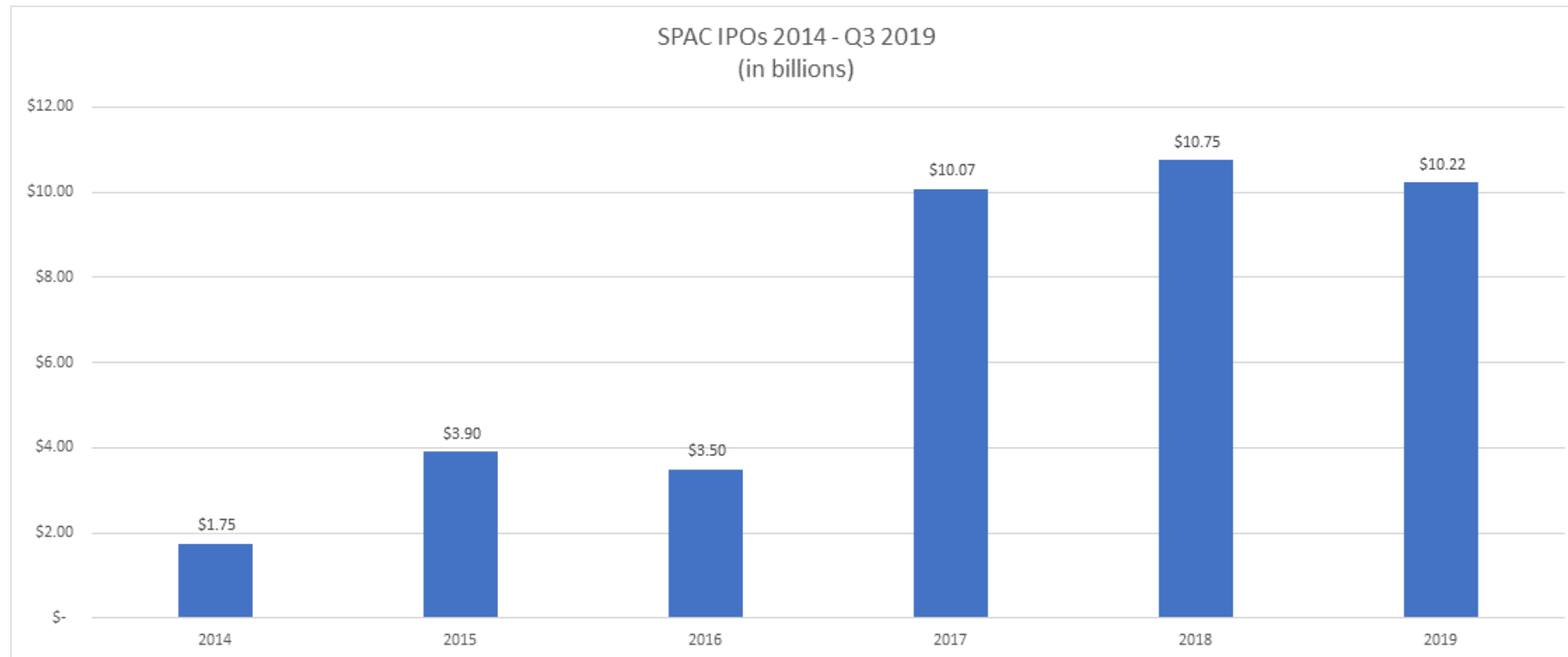


## WHAT IS A “SPAC”?

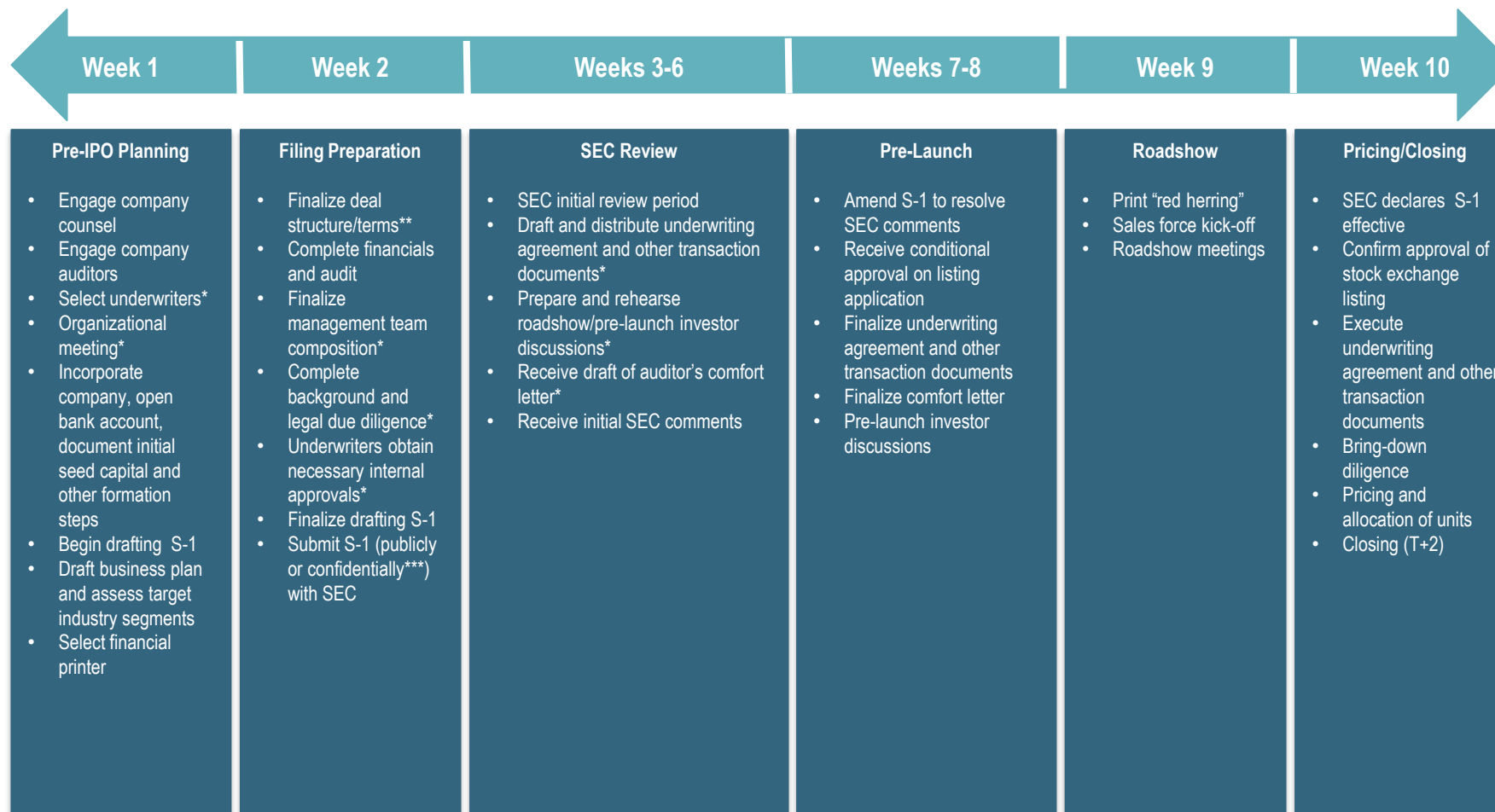
- **Special Purpose Acquisition Company**
  - Shell company
  - Formed and taken public with no/nominal assets
  - Intends to use the proceeds from the IPO to seek an unspecified acquisition target

## SPAC IPOs

JANUARY 1, 2014 – SEPTEMBER 30, 2019



# ILLUSTRATIVE SPAC IPO TIMELINE



\* Can be deferred to later in the process. Underwriters will need to be identified several weeks before road show launch in order to allow time for FINRA clearance. Management composition will need to be early enough for customary diligence (background checks) to be conducted by underwriters.

\*\* Need to determine initial filing size, jurisdiction of formation and listing exchange.

\*\*\* A public filing is required 15 days before the roadshow is launched.

## SPAC IPOs

### PRE-IPO PLANNING / FILING PREPARATION

- Need to form SPAC and capitalize the entity so that financial statements can be drafted and audited
- Typically formed as a Delaware corporation
  - Sometimes formed offshore (e.g., Cayman Islands) if the SPAC will target an offshore acquisition
- The sponsor of the SPAC purchases common equity in the SPAC (“founder shares”) for a nominal amount (usually \$25,000) at the time the SPAC is formed
  - This initial capital contribution is the only transaction/activity that will be reflected in the audited financial statements to be included in the IPO registration statement
  - The founder shares will ultimately represent 20% of the total outstanding shares of the SPAC after completion of the IPO



## SPAC IPOs

### CHOOSING A STOCK EXCHANGE

- Prior to 2017, the overwhelming majority of SPACs chose to list on Nasdaq
- In 2017, the NYSE revised its initial and continued listing requirements for SPACs to make them identical to Nasdaq's requirements
- Smaller SPACs (less than \$100 million in market cap) would likely list on the Nasdaq Capital Market
  - NYSE requires at least \$100 million in market cap
- Except as described above, the decision likely hinges on the SPAC's target focus

## SPAC IPOs

### SECURITIES SOLD IN THE IPO AND CONCURRENT PRIVATE PLACEMENT

- IPO involves a sale of a unit, comprised of one share of stock and a whole or fractional warrant
  - The number of warrants can be negotiated; often a function of investors' view of the sponsor/management team and their ability to complete a quality de-SPAC
- Warrants
  - Public warrants
    - Included in units sold in IPO; typically \$11.50 strike price
    - Split from common stock and can trade separately after the IPO
    - Typically become exercisable on the later of (i) 30 days after the SPAC completes an acquisition and (ii) the 12-month anniversary of the closing of the SPAC's IPO
  - Sponsor warrants
    - Sold to sponsor to cover IPO and pre-acquisition expenses
    - Purchase price = 2% “upfront” underwriting discount, plus estimated offering expenses and post-IPO working capital (often, offering expenses and working capital equal \$2 million)
  - \$18.00 typical forced exercise price for public warrants (styled as redemption right)
  - Cash exercise for public (unless registration is not effective); cashless for sponsor
  - Recent trend toward “redemption for shares” provisions – warrants redeemable for common stock if common stock closes at or above \$10.00
- Net IPO Proceeds plus portion of Sponsor Warrant proceeds deposited into Trust Account

## SPAC IPOs

### UNDERWRITING DISCOUNT AND TRUST ACCOUNT

- Underwriting Discount
  - Typically an aggregate discount of 5.5%
    - 2.0% “upfront” discount paid at closing of IPO
    - 3.5% “deferred” discount deposited in trust account and only paid upon the closing of a de-SPAC
- Trust Account
  - Amount deposited typically equals 100% (or more) of gross IPO proceeds
    - Underwriters wire directly to trust account and withhold their 2% upfront discount; Sponsor funds an amount equal to the 2% discount into the trust account as part of the purchase price for the Sponsor Warrants
  - Proceeds held in trust account can be invested in certain government securities or money market funds that meet certain conditions under the '40 Act
  - Proceeds generally may not be released from the trust account until the completion of a de-SPAC
    - Common to permit withdrawals of interest earned on funds held in trust to pay franchise/income taxes
    - Less common to be able to withdraw interest for working capital
  - If the SPAC fails to complete a de-SPAC prior to deadline, proceeds held in the trust account are distributed pro rata to holders of the public shares
    - Including both the 2% that the Sponsor funded into the trust account, as well as the 3.5% deferred discount



## SPAC IPOs

### FOUNDER SHARE AND SPONSOR WARRANT TERMS

- Founder Shares
  - Prior to the closing of the IPO, the SPAC will enter into a registration rights agreement with the sponsor and any other holders of founder shares (typically the SPAC's independent directors), giving the sponsor and such other holders broad registration rights for the founder shares
  - Locked up for 1 year post-de SPAC, subject to early expiration if shares trade above specified prices (e.g., \$12.00 starting 150 days post-business combination)
- Sponsor Warrants
  - The registration rights agreement described above will also cover the sponsor warrants and the shares issuable upon exercise of the sponsor warrants
  - Non-redeemable for cash so long as held by the sponsor or its permitted transferees
  - May be exercised by the sponsor and its permitted transferees for cash or on a cashless basis
  - Otherwise, terms and provisions are identical to those of the public warrants

## THE “SPECIAL PURPOSE”

- No identified target should be under consideration at the time of the IPO
  - Standard language: “We currently do not have any specific business combination under consideration. Our officers and directors have neither individually selected nor considered a target business for our initial business combination nor have they had any discussions regarding possible target businesses among themselves or with our underwriters or other advisors.”
- Unsolicited inquiries with respect to potential business combination targets should not be responded to during the registration statement and offering process
- Private equity affiliation introduces additional considerations
  - SEC comment letter: “In light of the ongoing nature of the involvement of the officers/directors with [private equity firms] and the company’s stated intent to focus on acquisition candidates in [x], please provide the following disclosure...(iii) in light of the fact that each officer/director is looking at the same companies with respect to both the company and those other entities in which each such individual is involved, it would appear that all contacts and discussions currently being conducted by each such individual are relevant to the company and its business operations (including potential acquisition targets) and should be fully disclosed and discussed in the prospectus.”
  - Resulting in standard language for private equity-sponsored SPACs: “[PE Fund] is continuously made aware of potential business opportunities, one or more of which we may desire to pursue for a business combination, but we have not (nor has anyone on our behalf) contacted any prospective target business or had any discussions, formal or otherwise, with respect to a business combination transaction. We ... will not consider a business combination with any company that has already been identified to [PE fund] as a suitable acquisition candidate for it.”



## SPAC M&A CONSIDERATIONS



## M&A CONSIDERATIONS

### OUTSIDE DATE AND TARGET SIZE

- Outside Date
  - Both NYSE and Nasdaq permit a maximum of 36 months to complete the de-SPAC
  - However, market practice typically provides for somewhere between 18 to 24 months (specified in SPAC's charter, adopted at IPO)
    - Some SPAC charters provide for a 3 month “accordion” feature, where the deadline to complete the de-SPAC is extended if an LOI is entered into prior to the deadline but the de-SPAC hasn't been completed
  - Extension would usually require vote and an obligation to provide redemption right for non-approving stockholders
- Minimum/Maximum Target Size
  - Target business/assets must exceed 80% of trust account (excluding deferred underwriter discount)
  - No maximum

## M&A CONSIDERATIONS

### REDEMPTION RIGHTS

- Stockholders must be provided with the opportunity to redeem their shares in connection with the de-SPAC
  - Redemption price = pro rata share of amount then in the trust account (less amounts released to pay franchise and income taxes and for working capital)
  - Opportunity to redeem may be provided (i) in connection with a stockholder meeting called to approve the de-SPAC or (ii) by means of a tender offer
    - Stockholder approval is often required in connection with the de-SPAC, so the stockholder meeting route is much more common
  - If stockholder approval is sought, the de-SPAC must be approved by a majority of the votes cast at the meeting
    - Most SPACs provide that stockholders can redeem their shares irrespective of whether they vote for or against the de-SPAC, so obtaining stockholder approval is typically not a concern – redemptions are the key focus

## M&A CONSIDERATIONS

### DISCLOSURE AND SEC REVIEW

- Disclosure Document
  - Proxy statement versus tender offer documents
  - Stock exchange rules require tender offer documents to contain “substantially the same financial and other information” about the de-SPAC and the redemption rights as would be required under the proxy rules
- Typically very light SEC review of merger proxy statement, including target-related disclosures
- At closing, Form 10 disclosures must be filed (Reg. S-K compliant business section, MD&A, etc.), together with audited financial statements
- M&A related disclosures should mirror anticipated Form 10 disclosures to the fullest extent practicable
- Having disclosure counsel involved is critical to smooth execution
- Shareholder base promotes high turnout, so extended solicitation period is unnecessary



## STRUCTURING THE DE-SPAC

### LIMITATIONS AND THRESHOLD CONSIDERATIONS

- Deposits/Break-Up Fees/Indemnities
  - Limited due to restrictions on use of escrowed cash
  - Possibility to use third-party backstop as alternative purchaser
  - Potential to use R&W insurance?
- PE Sponsor
  - Targets identified by PE sponsor as suitable targets for the PE fund(s) prior to the completion of the SPAC IPO are expressly prohibited
  - Allocation of investment opportunities
  - Forward purchase commitment
- Financial Statements Required for Target

## STRUCTURING THE DE-SPAC

### PROMOTING DEAL CERTAINTY

- Equity and/or debt financing commitments to backstop redemptions
  - Provide assurances if SPAC equity trades poorly upon announcement
  - Serves as a deterrent to SPAC investors seeking hold-up value
  - Precedent for both pre-signing vs. post-signing commitments, each with benefits and drawbacks
  - If sponsor has access to external capital, can also utilize backstop purchaser or staged sale
- Willingness of seller to roll over equity
  - Can be structured to be at option of seller, providing for deterrent effect
  - Impact of a seller rolling over increasing amount of equity can be negotiated pre-signing or in pre-closing amendments. May impact:
    - Governance rights
    - Registration rights
    - Sharing in sponsor economics

## USE M&A TRANSACTION AS OPPORTUNITY TO REVAMP GOVERNANCE

- The SPAC is temporary
  - Not necessary to spend a significant amount of time on governance at IPO – can tailor to the post-transaction company's peers in connection with the de-SPAC
- Can have the post-transaction public company look like any other company in the same industry immediately following IPO with respect to organizational and governance documents
- To the extent seller will become a large shareholder in the public company post-transaction, negotiate charter amendments and other key items as part of M&A transaction

## ANTICIPATE “RECUT” OF TRANSACTION

- Shareholder base is notorious for seeking arbitrage opportunities and hold-up value
- Pre-closing amendments are common in de-SPAC transactions
- Ensure seller has a seat at the table to participate and approve of any arrangements with new investors, or otherwise has appropriate safeguards on economics, governance and registration rights
  - Oftentimes redemptions and vote come in the last day or two
  - Utilize bankers and/or solicitors with touch points in shareholder base to monitor redemptions

## LIMITED SELLER PROTECTION IF DEAL FALLS THROUGH

- Typically limited rights against trust account
- Post-termination indemnification or reimbursement obligations are of little value, given SPAC's limited assets
- Seller may seek to require SPAC to pay transaction costs in the first instance, as opposed to reimbursing such costs
  - Costs may ultimately be borne by SPAC sponsor in such circumstances
- SPAC outside date can be used to align incentives





# CONSIDERATIONS FOR REAL ESTATE/REIT DE-SPACs

## REIT OWNERSHIP TESTS

- A REIT must:
  - Have 100 or more beneficial owners for at least 335 days of each taxable year or during a proportionate part of a shorter year. This test does not apply to the first year for which a REIT election is made.
  - Not be closely held (i.e., 5 or fewer individuals cannot own more than 50% (by value) of a REIT's outstanding stock at any time during the last half of its taxable year applying ownership attribution rules). This test does not apply to the first year for which a REIT election is made.
    - Many REITs have restrictions ("excess share provisions") in their governing documents prohibiting ownership of 9.8% or more of the REIT's stock unless an exception is approved by the board of directors.
- If a significant number of stockholders redeem their shares in connection with the de-SPAC, the REIT ownership tests may be implicated
- The Sponsor of a SPAC typically holds 20% of the SPAC's outstanding common stock at the closing of the IPO, with anti-dilution rights built into the SPAC's charter, as well as sponsor warrants that may become exercisable for additional common stock

## MULTIPLE PROPERTY/PORTFOLIO ACQUISITIONS

- A SPAC must complete “one or more business combinations having an aggregate fair market value” equal to or greater than 80% of the value of the trust account
- This requirement may make acquisitions of properties or portfolios from multiple, unaffiliated parties more difficult to accomplish in a SPAC

## FORMING THE SPAC AS A REIT IPO

- Customary form of SPACs presents challenges for organizing a SPAC as a REIT
  - SPAC will only hold cash/cash equivalents from closing of IPO until de-SPAC, which may not comply with REIT requirements under the Internal Revenue Code
  - REIT 75% gross income test may be difficult to satisfy once past the 1-year mark after the SPAC IPO
  - Distribution of substantially all taxable income requirement could implicate anti-dilution rights and limitations on trust account distributions
- Organize in form that SPAC investors are used to seeing (i.e., Delaware C-Corp) to preserve flexibility
  - Disclose in IPO prospectus that real estate/REIT will be the SPAC's industry focus
  - If it makes sense at de-SPAC, the post-closing company can be set up as a REIT
  - Retain flexibility to pursue targets outside of the stated industry focus



PRECEDENT REAL  
ESTATE/REIT DE-SPACs





## TWO HARBORS / ARMOUR

### OVERVIEW OF TRANSACTIONS

- Delaware incorporated SPAC
- New entities formed by Sponsors as Maryland corporations with no assets/operating business
- The SPAC merged with a wholly-owned merger sub of the new Maryland corporation
  - All outstanding common stock and warrants in the SPAC were converted on a one-for-one basis for common stock and warrants in the Maryland corporations
  - The SPACs were preserved as taxable REIT subsidiaries (“TRS”) of the Maryland corporations, which subsequently made REIT elections
- Mergers were conditioned on trust account containing no less than \$100 million after the closing after taking into account payment of transaction expenses
  - Sponsors agreed to cancel all of their founder shares upon completion of the merger
  - Significant number of public shares were redeemed
  - Additional public shares were purchased by the SPAC at the closing of the merger for a per share price equal to the redemption price
- The Sponsors kept their private placement warrants, but the warrants were amended to increase the exercise price from \$7.50 to \$11.00, extend the expiration date and limit the ability to exercise to comply with charter restrictions on ownership of common stock
- Because the Maryland corporations had no assets, the 80% acquisition rule wasn’t complied with
  - Proxy Statements/Prospectuses contained disclosure regarding SPAC IPO investors’ rescission rights

## TWO HARBORS / ARMOUR

### RATIONALE

- Both SPACs were nearing their completion deadlines
- Market opportunity
  - Dislocation in the U.S. mortgage market in 2008/2009 provided an opportunity for new mortgage REIT market entrants, but the IPO market was challenging
- Sub-Management
  - Affiliates of the sponsors of both SPACs entered into sub-management agreements with the external managers of the REITs entitling them to a percentage of the management fees earned by the external managers, as well as termination fees
  - Also provided that, if affiliates of the external managers managed certain other investment vehicles, the external manager would negotiate in good faith to provide the sub-managers with the right to enter into sub-management agreements with respect to those vehicles

## PLAYA HOTELS & RESORTS

- Cayman incorporated SPAC / Dutch target
- Series of transactions intended to “replicate the economics of a merger” of the SPAC and the target
- Common equity holders in the target rolled their equity
- Sponsor agreed to cancel 1/3 of its founder shares
- Sponsor agreed to cancel 1/3 of its warrants – new warrants of equivalent value were issued to the target’s shareholders
- \$30 million of earnout warrants – 1/3 issued to the target’s shareholders, 2/3 issued to the Sponsor
  - Warrants become exercisable upon stock trading at \$13 or higher for 20 out of any 30 consecutive days
- \$50 million of additional capital raised in concurrent PIPE transaction

## BROADMARK REALTY CAPITAL

- Delaware incorporated SPAC
- Pending – transaction announced in August 2019; stockholder meeting scheduled for November 12
- Forming an internally managed mortgage REIT through the acquisition of 4 Broadmark lending companies and internalization of Broadmark's management companies
- \$75 million of additional capital to be raised in concurrent PIPE transaction
- Sponsor agreed to forfeit 44% of its founder shares and 58% of its private placement warrants
- Amendments to Warrants
  - Many SPAC Warrant Agreements provide for an anti-dilution adjustment in the event that cash dividends are paid in an amount that, together with all other cash dividends paid in the preceding 365-day period, exceed \$0.50 per share
    - Good lesson for SPACs that may end up targeting a REIT (or any company that will pay dividends regularly) – address this provision of the warrant agreement at the IPO so that it doesn't have to be amended in connection with the de-SPAC
  - Each outstanding public warrant to be changed from being exercisable for 1 share with an \$11.50 strike price to ¼ of a share with a \$2.875 strike price
  - In exchange for the cash dividend anti-dilution adjustment, each holder of a public warrant will receive a cash payment of \$1.60

## V&E RESOURCES

### SPECIAL PURPOSE ACQUISITION COMPANIES: AN INTRODUCTION

Our primer provides an overview of SPACs, including a comparison to an operating company IPO, their capitalization and economic structure, governance considerations, and the post-IPO target acquisition and subsequent De-SPAC process.

Follow the link to request your copy!

<https://www.velaw.com/Insights/An-Introduction--Special-Purpose-Acquisition-Companies/>



# THANK YOU

---

Austin  
T +1.512.542.8400

Beijing  
T +86.10.6414.5500

Dallas  
T +1.214.220.7700

Dubai  
T +971.4.330.1800

Hong Kong  
T +852.3658.6400

Houston  
T +1.713.758.2222

London  
T +44.20.7065.6000

New York  
T +1.212.237.0000

Richmond  
T +1.804.327.6300

Riyadh  
T +966.11.250.0800

San Francisco  
T +1.415.979.6900

Tokyo  
T +81.3.3282.0450

Washington  
T +1.202.639.6500