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SPACopoly: SPACs and Commercial Real Estate

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2020 was the year of a global pandemic; it was also the year of the special purpose acquisition company (SPAC) or "blank check company." According to SPACInsider, in 2020, there were 248 SPAC initial public offerings (IPOs) that raised approximately $83.3 billion (USD), a significant increase from 59 IPOs in 2019 with gross proceeds of approximately $13.6 billion.

Despite the media attention, SPACs have been limited in the commercial real estate sector. While pros and cons for sponsors and targets exist, the SPAC structure may be useful for certain types of real estate investments.

Overview

A SPAC raises funds through an IPO to find and merge with a target private company. IPO investors typically receive "units" consisting of one public share and a fraction of a warrant to purchase one public share, which are almost always offered at $10 per unit. These funds are held by the SPAC sponsor in escrow. The SPAC sponsor typically has up to 24 months to identify a company to acquire. Once the target is selected, SPAC investors can decide not to participate in the acquisition. An investor who elects not to participate is redeemed in cash, with interest.

In return for setting up the SPAC, identifying the acquisition target, negotiating the deal, and providing ongoing oversight and expertise post-acquisition, the SPAC sponsors are issued "promote" for a nominal fee, $1 per share for example. These shares are convertible into 20% of the publicly traded shares of the acquired company. In addition to the funds held in the SPAC's escrow account, there is often a private investment round (PIPE) that occurs once the target is identified. PIPE investors, usually institutional investors, acquire common shares at the IPO price. The SPAC "acquires" the target company by merging into the private company. De-SPAC occurs when the company is merged with the SPAC and the shareholders of the private company receive shares of the SPAC.

Origins and Growth

David Nussbaum and David Miller invented the SPAC in 1993 to access everyday investors. The dot.com boom of the late 1990s made traditional IPOs more popular and blank check firms fell out of favor. SPACs were muted until early-stage, high-growth companies like Virgin Galactic Holdings, Inc. started merging with them in 2019. As of May 9, 2021, there have been 315 IPOs in 2021 raising $101.7 billion.[1] The Real Deal reports that about two-thirds of the IPOs were in five areas: space travel and exploration, electric vehicles, autonomous driving, online gaming (gambling), and e-sports.

Benefits and Concerns

SEC Commissioner Allison Herren Lee detailed benefits of SPACs in a recent speech:

- the ability to co-invest with sponsor management and possibly target management
- the liquidity of a publicly traded entity
- the protection of public company registration, reporting, information and auditing requirements
- potentially attractive risk-adjusted returns
- downside protection if a merger does not occur.

Several areas of concern have been identified with respect to the SPAC structure:

- There is a good deal of capital looking at too few opportunities thereby pressuring sponsors to get a deal done, rather than get the right deal done at the right price.
- SPAC targets are generally private companies that are not subject to the same financial reporting requirements as public companies. Sponsors may provide financial forecasts that would not be allowed in an IPO registration statement which relies on past performance.
- Sponsors may not work exclusively for a particular SPAC and may have fiduciary obligations with other entities. After the merger, the sponsor does not have a fiduciary duty to the investors in the acquired company.
- JPMorgan Chase reported that sponsors, on average, earned a 648% return on their money over the past two years. Buy-and-hold-investors who bought in after an acquisition was made earned 44%, which lags the return of a standard market index fund.

Recently, the SEC also has asked for more transparency from sponsors. This oversight, together with market pressures from potential target companies, may help lessen risks for targets and investors.

Real Estate Focus

The Real Deal is tracking 54 SPACs with real estate sponsors or targets. As of May 2021, funds raised in these IPOs total approximately $6.3 billion. Sponsors include Cushman & Wakefield, Starwood Capital, CBRE, Cantor Fitzgerald, Tishman Speyer, Equity Group Investments and Simon Property Group. Only five have de-SPACed to date. These business combinations include Social Capital Hedosophia II with Opendoor, Protech Acquisition Corp with Porch.com, OPES Acquisition Corp with BurgerFi, Gores Holdings IV with United Wholesale Mortgage and CF Acquisition with View.

For sponsors, SPACs are an alternative to raising a private fund, publicly traded REIT or a non-traded REIT. A business combination with a SPAC may allow a private real estate company target to obtain liquidity, secured by assets or unsecured, either for the entire company or through dispositions of specific assets.

SPACs are public form of venture capital, with potential for big rewards and real risks. Like most venture capital deals, many will fail. Nonetheless, the SPAC model has many applications in the CRE space. As the vehicle is used in real estate and a set of market norms is developed, some of the misalignments in the SPAC model will likely be corrected to the benefit of sponsors, targets and investors.

(1) SPACInsider