

Strategic Transactions Around REIT Conversions

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October 20, 2021

Abstract

This paper examines the conversion-related M&A activity and post-conversion performance of 80 international Real Estate Operating Companies (REOCs) that adopted Real Estate Investment Trust (REIT) status. In the years prior to the conversion, we document an increased M&A deal activity that is in part driven to fulfill regulatory REIT requirements. We find that REOCs are willing to pay a premium above the market valuation to acquire desired portfolios. Moreover, we document that the REIT status enhances equity inflows, driving increased M&A transaction activities and deal volume. While converted REITs outperform their peers over the long run, we find that a lower (higher) level of restructuring activity is associated with even higher (risk-adjusted) performance.

Keywords: Mergers and Acquisitions, REITs, REIT Conversions

JEL: G34, R30

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1 Introduction

Real Estate Operating Companies (REOCs) and Real Estate Investment Trusts (REITs) regularly engage in strategic transactions in the form of mergers and acquisitions (M&A).¹ We note a remarkably high degree of M&A activity around REIT conversions (Figure 1). In particular, we observe an increase in the number of M&A transactions conducted during the conversion period that appears dissociated from the general M&A environment in the economy and industry. Moreover, we observe a sharp increase in post-conversion M&A activity as well as in equity inflows into converted REITs.

However, existing M&A research in the REIT sector focuses on established REITs and, so far, lacks an explicit in-depth analysis of the deal environment that accompanies the (REOC-to-) REIT conversion process. Moreover, despite increasing research interest in REIT conversions (Wagner et al., 2021, Ling et al., 2020) and the market entry of REITs (Chan et al., 2019), the related restructuring process has not yet been explored from a scientific perspective.

This study aims to fill a gap in the literature concerning the motives and consequences of M&A activities around REOC-to-REIT conversions. By focusing on established REOCs that opted to convert, we can characterize the realignments of those companies more precisely. We can also track their evolution in terms of both, assets and capital structures, as caused by the increased attractiveness to equity investors (e.g. Ling et al., 2020, Damodaran et al., 2005, Damodaran et al., 1997).

Our empirical analysis is based on a unique, partially hand-collected dataset to examine the M&A environment of REIT conversions at an international level. The global setting allows us to observe and explore differences and commonalities in post-conversion performance across countries. Our dataset comprises conversions of listed real estate companies across nine large markets for the 1999-2018 period. All firms are index constituents of the FTSE EPRA/NAREIT Global Real Estate Index. We carefully categorize deal types and the role of each respective REIT in the observed deals and provide a distinct view of the internal and external reorganization activities.

¹See Glascock et al. (2018) for a comprehensive review. Following Mulherin and Womack (2015), we use the terms “mergers”, “acquisitions” and “takeovers”, as well as “target” and “seller”, interchangeably throughout this article.

In the first part of our analysis, we seek to better understand the strategic decision-making phase prior to the conversion: preparing for the REIT market. In doing so, we first identify the determinants that drive the pursued transactions. The corporate finance literature shows that regulatory shocks, usually in the form of changes in prevailing antitrust regimes, tend to cause waves of acquisitions (e.g., Harford, 2005; Martynova and Renneboog, 2008). In turn, market concentration adversely impacts REIT market participants (Zhang and Hansz, 2019). Since many REIT conversions occur close to the introduction of a REIT regime, we discover and examine an M&A-inducing regulatory shock that is both unique to the real estate sector and new to the literature.

Based on the outlined observation, we analyze whether consummated transactions are subject to a strategic rationale. Therefore, we address the question of whether converters' deals are conducted to fulfill the REIT asset test criterion – a regulatory requirement regarding the fraction of qualifying real estate assets to total assets (e.g. 75% in the U.S.). Our panel regression results indicate that the distance to the asset-test threshold increases deals activity along two key dimensions (i.e., the number of deals conducted and their relative sizes), which characterize the first strategic dimension behind the observed conversions.

In the context of the pre-conversion M&A activity, we also examine whether converting REOCs pay substantial premiums for their M&A targets to fulfill the REIT requirements. We compute cumulative abnormal returns (CARs) of conversion-related deals to identify if converters exhibit excess valuations. Our results indicate a relatively high willingness to pay by converters, compared to the cross-section of results of existing REIT M&A studies, and based on the underlying subsample of observed deals with publicly listed targets.

The third part of our analysis addresses the relation between converting REITs' long-term performance and their degree of M&A activity. In particular, we seek to answer the question of whether the conducted deals are value-enhancing. We construct portfolios of converters with high and low levels of M&A activity and calculate their buy-and-hold abnormal returns (BHARs) over different time-horizons of the post-conversion period. We find that restructuring activity interacts with long-

term performance. Converted REITs in the two largest REIT markets are achieving significantly positive post-conversion returns. Accounting for the level of M&A activity around conversions, we find that firms with the lowest levels of deal activity achieve higher BHARs. Higher levels of transaction activity, in turn, lead to beneficial risk-adjusted returns, revealing another strategic dimension that can be perceived as advantageous portfolio reshaping in preparation for the REIT market

Our research contributes to a growing interest in REIT conversions (Wagner et al., 2021, Ling et al., 2020) and the market entry of REITs (Chan et al., 2019). In particular, we analyze the conversion related-restructuring activities for the first time. These novel insights into the M&A environment of REIT conversions will be of interest to several market participants. REIT investors and executives will be interested to fully understand how restructuring relates to conversions and how restructuring around conversions impacts post-conversion performance. Governments and tax authorities, who create and enforce the respective legal frameworks, will be interested in insights about the firm-level process of adopting the REIT format and about the market consolidation effects of REIT regimes.

The remainder of this article is organized as follows. Chapter 2 provides a brief review of the related literature and develops our research hypotheses. Chapter 3 introduces the data, while Chapter 4 focuses on conversion-related M&A activity. Post-conversion performance is discussed in Chapter 5. Chapter 6 concludes.

2 Related Literature and Hypotheses

The testable implications of M&A activity along REIT conversions build on the general finance and real estate literature. Research on strategic transactions in the property sector predominantly focuses on established REITs but lacks an analysis of the deal environment accompanying the conversion processes. In particular, the entire restructuring process and its interactions with post-conversion performance have not yet been the subject of any scientific inquiries.

We note that M&A deals in the property sector are more homogeneous than those in other branches (Mulherin and Womack, 2015, Eichholtz and Kok, 2008). The underlying rationale for the decision-making may not be evident for every transaction. However, in the context of REIT conversions, REOCs pursue an organizational form change into REITs that implies a defined goal. Given the companies' geographic domiciles, the respective legislation demands the fulfillment of certain criteria regarding the attainment of REIT status. For our analysis, the most relevant criterion is that REITs must hold a specific level of qualifying real estate assets.² If a firm is closer to this legal requirement, its related restructuring expenses should be *ceteris paribus* lower. Therefore, REOCs are subject to potential restructuring on a company level that may affect asset allocation.

Freybote and Qian (2015) document that REIT mergers tend to be strongly incentivized by acquiring strategically relevant properties for managers. Similar to evidence for IPOs in Malmendier and Tate (2008), REOCs may use the opportunity of a REIT conversion to signal their ability to form higher-quality portfolios. In general, the M&A deals of REITs involve deal premiums (cumulative abnormal returns) of lower than 10%. For example, Sahin (2005) and Womack (2012) report premiums of about 5%, Ling and Petrova (2011) find about 7%, and Campbell et al. (2001) find between 1% and 3%. In the case of regulatory incentivized transactions or strategic restructuring, converting REOCs are likely willing to purchase a certain portfolio at a higher amount above market value. Taking those aspects together, we formulate our first pair of hypotheses as follows:

²This refers to the criterion Asset Test, which is defined as the proportion of qualifying real estate to overall assets. The ratio must exceed a nationally defined threshold, for example, 75% in the U.K. EPRA (2021) lists the most recent regime requirements for REITs. Note that those criteria may change over time.

M&A Rationale

Hypothesis 1a: *Deals are conducted to meet the REIT criterion, Asset Test.*

and

Hypothesis 1b: *Converting REOCs are willing to pay a premium to acquire the desired portfolio allocation.*

Gyourko and Sinai (1999) describe the net benefits (tax savings over capital raising costs) of the U.S. REIT structure. To date, over 30 countries have introduced REIT regimes to facilitate capital flows to the real estate sector (Eichholtz and Kok, 2007). In addition, REITs are increasingly used by investors who seek real estate exposure (Downs et al., 2019). Adopting the status is regularly rewarded by a positive market valuation. For example, Damodaran et al. (2005), Piao et al. (2017), and Ling et al. (2020) find positive announcement effects result from signaling a REIT conversion.

The prevailing literary evidence suggests that REIT frameworks are also associated with higher inflows, which may in turn lead to higher levels of M&A activity and larger relative deal sizes, i.e., relative to the companies' average deal sizes.³ Putting those aspects together, we formulate our second hypothesis as follows:

Hypothesis 2: *Conversion-induced increases in inflows lead to higher numbers of deals and an increase in excess deal size.*

Numerous studies have analyzed mergers and acquisitions of real estate firms. However, they tend to focus on returns around takeover events and the pre- and post-merger performance of targets and acquirers in the (U.S.) REIT sector. Studies on the long-run post-acquisition performance of REIT acquirers by Sahin (2005) and Ratcliffe et al. (2018) find no persistent evidence of positive effects on REIT performance. They find even negative impact of acquisitions on acquirers' returns in the years following an acquisition, as described in Campbell et al. (2009). Thus, if an increased number of acquisitions accompanies the conversion process, and if long-lasting adverse performance of acquirers accompanies REIT takeovers, we presume that, on average:

³*Average Deal Size* $_{i,t} = \text{Aggregate Deal Size}_{i,t} / \text{Number of Deals}_{i,t}$. See Appendix 6 for detailed variable definitions.

Performance Implications

Hypothesis 3a: *Converted REITs will exhibit relatively high performance in the post-conversion period.*

and

Hypothesis 3b: *Higher M&A activity implies lower long-term performance for converting REITs.*

3 Data and Descriptive Statistics

Our empirical analysis is based on the FTSE EPRA/NAREIT Global Real Estate Index constituents, which comprises listed firms with relevant real estate activities.⁴ The observation period ranges from the index’s introduction in 1999 through 2018. The constituent list is updated every month and is not subject to survivorship bias. Moreover, by focusing on index firms, we ensure a high degree of data quality and comparability at the multinational level.

For REOCs, we identify conversion events by tracking the year of listing and the year of REIT election. Those dates are collected partially via the S&P Global Intelligence database, using CRSP share code changes for U.S. firms, and hand-collected from company reports. We include firms with at least 24 months of listings to exclude entities that pursued conversion from inception.⁵ For our analysis, we exclude countries that had no REIT conversions during our sample period, which leaves us with 90 conversion events.

We obtain data on the existence and the nature of the deals for a total of 80 converted REITs from nine countries from the Securities Data Company (SDC) Mergers and Acquisitions database. Table 1 provides an overview.⁶ Using the entire observation period, ± 5 years around the event, we can track M&A activities in common business cycles during restructuring times (two years prior to

⁴The index provider defines relevant real estate activities as the ownership, trading, and development of income-producing real estate (Russell, 2019).

⁵Our sample companies remain stable from 12 months onward. In line with Ooi et al. (2007), we require 24 months of listings to analyze the conversion process of sample REITs from an initial equilibrium position.

⁶The extensive review of Glascock et al., 2018 shows that prior REIT M&A studies involve a median sample size of 95 deals, with similar sizes for national and international samples. Studying 80 converters and up to 1,093 associated deals may thus allow us to draw sufficiently robust inference from a sample size perspective. Moreover, observed companies exhibit relative homogeneity since the individuals are all about to prepare for the REIT market and are close to adopting the REIT format while complying with the corresponding criteria. Cross-country divergence and the fact that conversions take place at different points in time will be encountered by fixed effects models, respectively.

conversion date), and during the post-conversion era.⁷ We observe asset deals, for which parts of the assets, the majority of assets, or the entire assets of the respective party change hands and share deals i.e., the acquisitions of partial and remaining interest, of 100% of stocks and mergers. This yields a total amount of 1,093 transactions in which a sample REIT is involved on the acquirer- or target side.⁸

Over the time span of eleven years, we observe a substantial increase in deal activity for the years in which the REIT conversion occurs. The average number of deals settled by the observed entities in the years of their conversions is about two times as large as during the preceding years. On the average level per firm per year, this implies an increase in deal activity by 47%. This is accompanied by an increase in total deal volume. The average deal volume reaches its high point four years after a conversion has taken place (Figure 1), which is disassociated from the evolution of the overall M&A market in the respective economies.

Table 2 reports the number of deals in each period by deal type and role of the sample REIT in the respective deal. The acquisition of shares is predominant (56% of deals). In 55% of the observed transactions, a sample REIT directly acquires the assets or shares of another entity. Only a small fraction of deals (3.7%) conducted by 25 sample firms can be characterized as internal restructuring activities, i.e., the sample REIT is simultaneously engaged on the acquirer and target side of a deal. This can happen reciprocally or as the parent of the respective deal party. Highest prevalence among internal deals exhibit acquisitions from immediate subsidiaries (Table 3).

⁷The average time span from REIT election announcement to actual conversion is two years, as documented in Carlock and Wilkin (2018).

⁸Beside the acquirer role, the role of the target parent is important since this involves deals in which converting REOCs sell parts of their portfolios.

4 M&A Activity Around REOC-to-REIT Conversions

4.1 Strategic Restructurings by REOCs

To control for potential structural differences between more (less) active sample firms, we build portfolios and characterize them along with the quartile levels of restructuring activity, i.e., number of conducted deals (Table 4). As shown in Table 5, a comparison of typical M&A-related firm-level variables for high and low restructuring entities two years prior to conversion does not show substantial ex-ante divergence, based on descriptive statistics.⁹ Following the regulatory perspective, i.e., the demands of the asset test criterion, 49 firms already hold adequate qualified real estate portfolios two years before the respective conversion takes place. The remainder of the sample firms are, on average, close to meeting the necessary national benchmark ratio (on average, 0.2% below it).

We use a multivariate panel regression framework to examine whether regulatory requirements drive M&A deal activity. In particular, we analyze whether the asset test impacts the decision to reallocate the property portfolio in advance and close to the conversion (-5 to 1 year(s) around the conversion event). Detailed variable definitions dependent and explanatory variables used throughout the analyses are provided in Appendix 6. Our analysis is geared in two directions. We use Poisson regression to explain how the asset test explains the number of conducted deals and other firm-level variables and a linear panel regression to examine the determinants of the relative deal sizes that we observe accordingly.

The results are presented in Table 6. Controlling for firm-level characteristics, we find a statistically significant impact on asset test requirements once we include year fixed effects.¹⁰ If large relative deal sizes are associated with the extent to which companies undercut their formal asset requirements, this could support the notion of increasing M&A activity through the regulation-

⁹Since numerical differences between the incorporated variables are sizable, we control for relevant REIT characteristics throughout the following analyses.

¹⁰Model *ii* uses country fixed effects, respectively, to account for heterogeneity between systems. We use robust standard errors clustered at the company level throughout the paper. We observe firms in relative time and employ year fixed effects, which, together with the usage of firm fixed and country fixed effects (specification *ii*), mitigates the possible impact of market conditions.

driven necessity to comply with the asset test requirement.

This result is based on a subsample of converting REOCs domiciled in countries with strict asset test requirements. Moreover, the point estimates translate to an under-proportional relationship: based on the results of model *ii* on *Relative Deal Size*, given a one percentage point divergence below the requirement, a company engages on average *ceteris paribus* in 0.5% larger deals. Together with the fact that companies are on average 0.2% below the benchmark ratio, and in line with Hypothesis 1a, we can conclude that the asset test partially, but not sufficiently, explains the observed M&A activity.¹¹ We presume that the usage of proceeds from beneficial market valuation to reshape property portfolios when entering the REIT market may be a second strategic motive and important driver of M&A activity. This is investigated further below.

But what is the instantaneous return on those deals and what does it convey regarding a converter's willingness to pay? To answer this question, we follow an event study approach to obtain information on the deal premium. A fraction of 37 deals of 26 sample firms from 8 countries qualify for this part of our analysis since the analysis can only be conducted using stock market data of publicly traded targets with sufficiently high market liquidity.¹²

For this subsample of M&A deals, we derive cumulative abnormal returns (CARs) using an estimation period of 120 days to 20 days prior to the deal announcement ($t = 0$), and a symmetric event window of ± 5 days. Based on the mean evolution of the countries' market indices and the respective target's stock price in the estimation window, expected returns for each day of the event window are predicted using the market model.¹³ Deviations between actual and predicted returns are computed and added up along the event window to provide the cumulative abnormal return as the aggregate of differences of actual and predicted returns within this period. Hence, the cumula-

¹¹The proximity to the fulfillment of the asset test criterion might impact the decision to convert at all. This study only addresses converters such that the potential endogeneity does not impair the results.

¹²As surveyed by Glascock et al., 2018, sample sizes of relevant prior REIT M&A studies range between 27 and 161 observed deals. Here, the special focus of deals around the conversion event limits the amount of relevant deals. We offer the caveat that due to the relatively small size of our subsample, albeit an international sample, the results at this part of the analysis may be interpreted with some caution.

¹³For the use of the market model in M&A studies, see e.g., Harford (1999) or, for the case of REITs, Campbell et al. (2001) and Sahin (2005). We use the S&P500, EuroStoxx600, FTSE100, and the S&P South Africa Index as a market index, respectively.

tive abnormal return associated with the acquisition of target j is:

$$CAR_j = \sum_{t=-5}^5 \hat{e}_{jt} \quad (1)$$

where \hat{e}_{it} is the difference between actual and expected stock return of the observed target firm at day t of the event window.

Compared to prior results in the REIT literature, we find a high average premium of approximately 9.1% (surveyed by Glascock et al., 2018).¹⁴ This indicates a relatively high willingness to pay for the REITs from the excerpt of our converted REITs M&A sample. Internal differentiation between pre- and post-REIT-conversion deals reveals that the premiums tend to be larger on average for pre-conversion deals (10.3% versus 8.1%). Based on these findings, one can conclude that the restructuring process involves relatively expensive deals. Consistent with Hypothesis 1b, we find that REITs pay higher prices to achieve this goal, which means that converting REOCs accept short-term return compression. Section 5 shows how this pays off in the long run.

4.2 Equity Flows and Post-Conversion M&A Activity

The observation of a remarkable increase in absolute and average deal size over the four subsequent years after conversions motivates an in-depth analysis of those deals. Figure 2 shows the average number of outstanding shares in the five-year horizon around REIT conversion dates. It illustrates how the level of equity rises simultaneously during this period. The persistently increasing number of outstanding shares reflects the possibility to issue and place shares as REIT more easily.¹⁵ Be-

¹⁴Average premium refers to the arithmetic mean of CARs over the 37 observed deals. If we vary the event window, we find 8.3% for ± 2 days.

¹⁵One may conclude that the new REIT status forces the converting company to finance through the capital markets since, on an international level, the distribution test ranges between 70-100% of taxable income. The payout rate in our sample period is 90% of taxable income for the U.S., a relatively high requirement for REITs in the international comparison. For example, Soyeh and Wiley (2019) and Beracha et al. (2019) show that the payout obligation for U.S. REITs is not a binding constraint for discretionary income. Bradley et al. (1998) argue that REITs can pay, on average, twice the amount of taxable income, although U.S. REITs were obliged to distribute even 95% in their sample period. Given this empirical evidence, we assess REITs have the capability to draw from a higher and lasting internal free cash flow than the payout obligation may suggest. Furthermore, we conclude that converted REOCs use the positive market appreciation to source equity via offerings at lowered capital costs, given the new REIT status, to engage in a higher amount of M&A activity on both dimensions, number and size.

cause we observe deals in relative time around the conversion dates in nine countries, we conclude that equity issuance is not driven by market dynamics. The observation of increases in deal activity and the relationship with inflows is consistent with the literature on cash flow sensitivity of investment (see, e.g., Hovakimian and Hovakimian, 2009 and Riddiough and Wu, 2009). However, the observation of increasing then decreasing average deal size (and deal number) in the post-conversion period is an important distinct feature to analyze here.

The subsequent part of our inferential analysis tests the effect of increasing inflows on M&A activity and deal size for the set of acquirers (acquirer subsample in Table 4). We proxy for inflows by changes in the number of shares (corrected for stock splits), as a count variable, to capture the full picture of all equity-affecting issues such as SEOs, ATMs, and stock repurchases (following Harrison et al., 2011). We perform a Poisson regression to test the influence of inflows on the higher number of transactions and then employ two-step estimation techniques to disentangle the possible effect of REIT status on inflows. We, therefore, use REIT status and firm-specific characteristics to estimate inflows in the first stage. We define an indicator variable taking the value 1 if the company operates as a REIT in period t , and 0 otherwise. The change in these linearly predicted inflows serves as a key explanatory variable for the number of transactions. Equation 2 represents the second stage of our model.

$$\begin{aligned}
 \text{Number of Deals}_{i,t} = & \alpha \\
 & + \beta_1 \text{Inflows}_{i,t} + \beta_2 \text{Inflows}_{i,t-1} \\
 & + \sum_{k=1}^K \gamma_k \text{Firm-level control}_{k,i,t} \\
 & + \sum_{c=1}^{C-1} \delta_c D_{c,i} + \epsilon_{i,t}
 \end{aligned} \tag{2}$$

$\text{Number of Deals}_{i,t}$ is the number of completed transactions of company i in period t . $\text{Inflows}_{i,t}$ reflects the difference in each company's logarithmized number of shares between period t and $t-1$.

Firm-level controls are explanatory variables that are homogeneously and frequently documented in general and REIT M&A literature. We control for country-specific effects (country-dummy $D_{c,i}$) to account for time-invariant heterogeneity in different REIT markets (e.g., Dogan et al., 2019). In addition, we estimate the effect of inflows on excess deal size, which is defined as the percentage deviation from the average deal size of each company by linear panel regression.

Next, we describe how the number of M&A deals relates to the inflows triggered by REIT conversions. Table 7 shows the results of our corresponding set of estimations. The first column refers to the first stage, which identifies REIT status as a highly statistically significant contributor to inflows, besides certain firm characteristics. On average, REIT status induces *ceteris paribus* approximately 12.3% higher annual inflows. The second stage estimation results reveal a significant positive influence of predicted inflows on deal activity, at a 5% level for both contemporaneous and one-period lagged inflows. Because our observations are on an annual basis, we note that the contemporaneous inflows are as reasonable as those in the preceding year. Accounting for lagged inflows also strengthens the causal inference on the direction of the effects. The results in Table 8, with a statistically significant combined effect of inflows, corroborate our findings. Increased inflows also explain the observed increase in excess (above average) deal size, which is characteristic for the post-conversion period (graphically illustrated in Figure 1).

As shown in the last column of Table 7, the increase in REITs' equity levels leads them to conduct larger deals. On average, excess deal size increases by 0.57 percentage points for each percentage point increase in net inflows. Overall, the results are consistent with Hypothesis 2.

5 Post-Conversion Performance

Lastly, we investigate long-term post-conversion performance for REITs with different levels of conversion-related restructuring activities via a buy-and-hold abnormal return (BHAR) approach. We form portfolios from the lowest to the highest M&A activity quartile according to the number of deals conducted during the two years prior to the conversion date (Table 4). We track the

performance of converted REITs up to five years post-conversion. In addition, we compute the Sharpe (1966) ratios for these periods to capture risk-adjusted performance with respect to individual trading activity.

We calculate BHARs in accordance with Barber and Lyon (1997) and Lyon et al. (1999), where the BHAR of REIT i is:

$$BHAR_i = \prod_{t=1}^T (1 + r_{i,t}) - \prod_{t=1}^T (1 + r_{PF,t}) \quad (3)$$

$r_{i,t}$ is the individual daily total return of company i at day t , and $r_{PF,t}$ represents the total return of each country's EPRA real estate index. Similarly to previous BHAR analyses of REITs by Sahin (2005), Campbell et al. (2009), Ratcliffe et al. (2018) and Downs et al. (2019), the benchmark portfolio reflects an eligible peer group of the respective REIT market.

The results of the BHAR analysis in Table 9 show significantly positive abnormal returns for converting REOCs in the three countries with the largest numbers of conversions – the U.K., the U.S., and South Africa. This indicates they have realized the advantage of changing the legal, organizational form. The results are supportive of Hypothesis 3a. The findings on positive BHARs are in line with evidence on positive conversion effects in Damodaran et al. (2005) and Piao et al. (2017), but in contrast to Sahin (2005), Campbell et al. (2009), and Ratcliffe et al. (2018), who do not find positive excess returns in M&As of established REITs.

Building on the overall positive BHARs for converters, we form three converted REIT portfolios for the two largest developed - thus sufficiently homogeneous - REIT markets in our sample, the U.K. and the U.S. According to EPRA (2021), the legal frameworks are similar with respect to the Asset-, Income-, Distribution- and Ownership Test. The aim is to determine whether converters with different levels of M&A-activity around the conversion event perform differently in the years following the conversion, as hypothesized in Hypotheses 3a and 3a. Portfolios are formed according

to trading activity i.e., the number of conducted deals. Table 4 reports that 26 firms from the lower quartile conduct up to five deals during the observation window; the 18 most active conduct up to 78 deals over that time span. The high (low) portfolio comprises the firms in the upper (lower) quartile of deal activity, while the medium group captures the 50% of firms with moderate pre-conversion M&A activity.

As shown in Table 10, despite their overall positive post-conversion performance, the entities with the highest levels of restructuring tend to underperform relative to converted REITs with low M&A engagement in terms of BHARs.¹⁶ The underperformance is persistent over the five-time horizons that are analyzed here. This may imply that the benefit from the conversion is offset in part by the costs of conducting the strategic transactions i.e., the high premiums paid and the expenses arising through the restructuring efforts. This is in line with the neutral or negative post-acquisition performance to (serial) acquirers documented in the REIT and general finance literature (e.g., Glascock et al., 2018; Bond and Xue, 2017; Betton et al., 2008), and it corroborates Hypothesis 3b.

However, computing excess portfolio returns over a market index or a portfolio of firms entails comparing the returns of single assets with those of a set of assets. Holding the latter is generally less risky for investors. Thus, some of the excess returns may simply be due to the related risk premium. A key strategic benefit of M&A activity might be the composition of an adequately diversified property portfolio in advance of the REOC-to-REIT conversion and in preparation for the REIT market.¹⁷ Therefore, in the next step, we derive long-run excess returns using the Sharpe (1966) ratio, which accounts for the return volatility of the asset and the benchmark portfolios. Table 10 shows the results for risk-adjusted returns.

We conclude that, as opposed to the simple buy-and-hold strategy, the considerable difference between high and low restructuring entities is no longer apparent. This implies that investors who

¹⁶Despite the detected long-term effects documented here, positive short-term performance is recently reported by Ling et al. (2020).

¹⁷For established U.S. REITs, Huerta-Sanchez et al. (2020) find no significant difference in market returns for the type of acquisition (asset vs. share deals).

benefit from the advantageous performance of low restructuring firms must accept higher risk. Simultaneously, the results show that only high restructuring REITs generate positive risk-adjusted abnormal post-conversion performance. Due to lower raw BHARs, this indicates there is reduced risk associated with investments in those firms. Together, it reveals a strategic advantage of high restructuring REITs, which explains the decision to conduct numerous M&A transactions preceding the adoption of REIT status.¹⁸

6 Conclusion

This article examines M&A activity related to REOC-to-REIT conversions on a multinational level. Drawing on a unique dataset of internationally listed FTSE EPRA/NAREIT property companies over the 1999-2018 period, we analyze 80 companies that elect the REIT status. We find several interesting key insights:

First, REIT conversions generate an increased amount of M&A activity. This, in turn, leads to a high amount of restructuring deals that are tied closely to the conversion date and to a high share of large-volume deals in the four years post-conversion. We find that REOCs are willing to pay a premium of approximately 9.2% above-market valuation to acquire desired portfolios for strategic realignment. Second, adopting REIT status enhances equity inflows, which drive post-conversion M&A transaction activities, regarding the number of conducted deals and deal volumes. Third, REIT converters in the two analyzed established REIT markets outperform their peers over the long run. Converters with lower restructuring activity exhibit even higher performance, and REOCs that undergo high restructuring show beneficial risk-adjusted returns.

Taken together, our results indicate that converting REITs tend to conduct substantial restructuring efforts during the pre-conversion period to prepare for the REIT market. Their strategic rationale involves the facilitation of the conversions as well as the goal to achieve beneficial long-

¹⁸In a robustness test, we match firms of high and low M&A activity along firm size. We find that the M&A activity drives the outperformance as opposed to firm size. The results are assessed as qualitatively similar. In addition, we computed simple BHARs for the U.K. and the U.S. separately. The return pattern remains as reported. Both results are available from the authors upon request.

term performance. Subsequent to converting, strategic restructuring is aligned with a rapid path of growth through large-scale reinvestment of the inflows attracted by the REIT status and closely associated with excess returns compared to the market.

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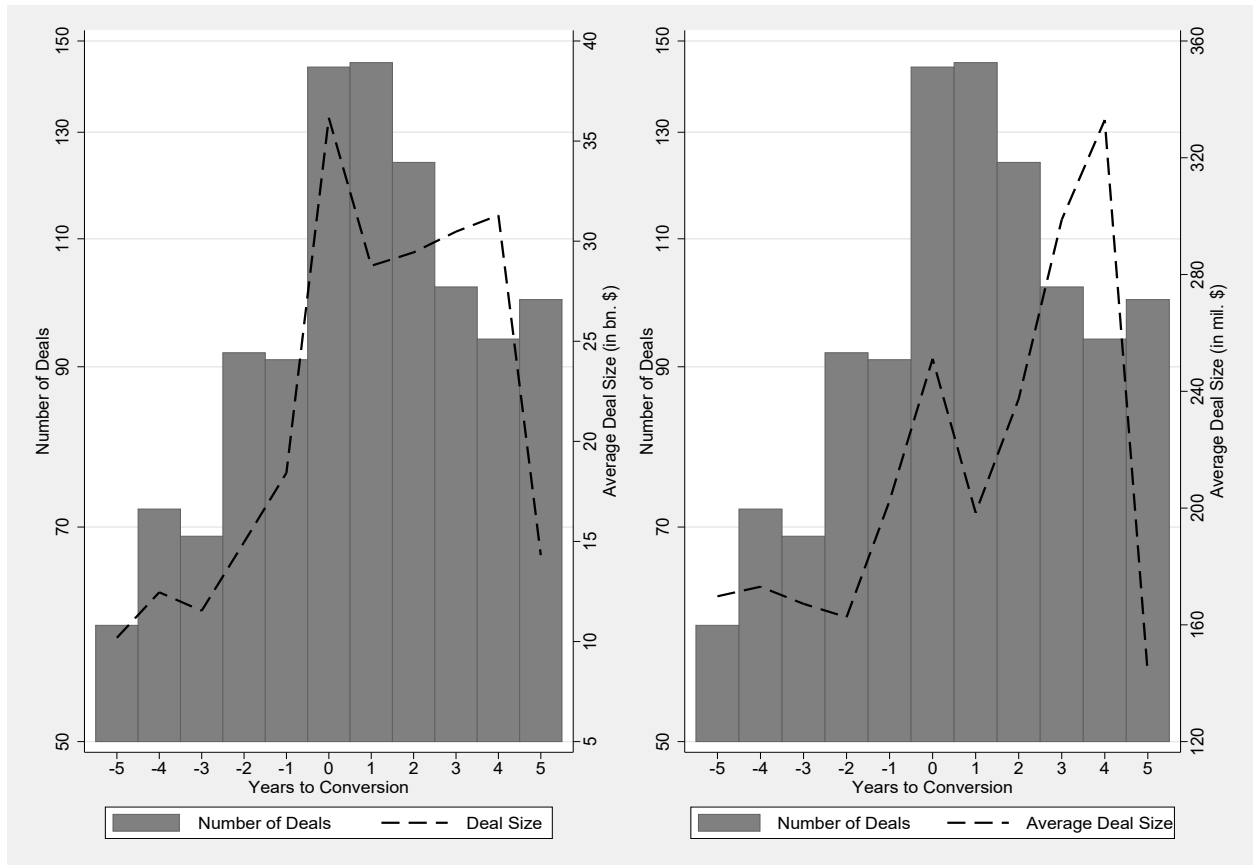
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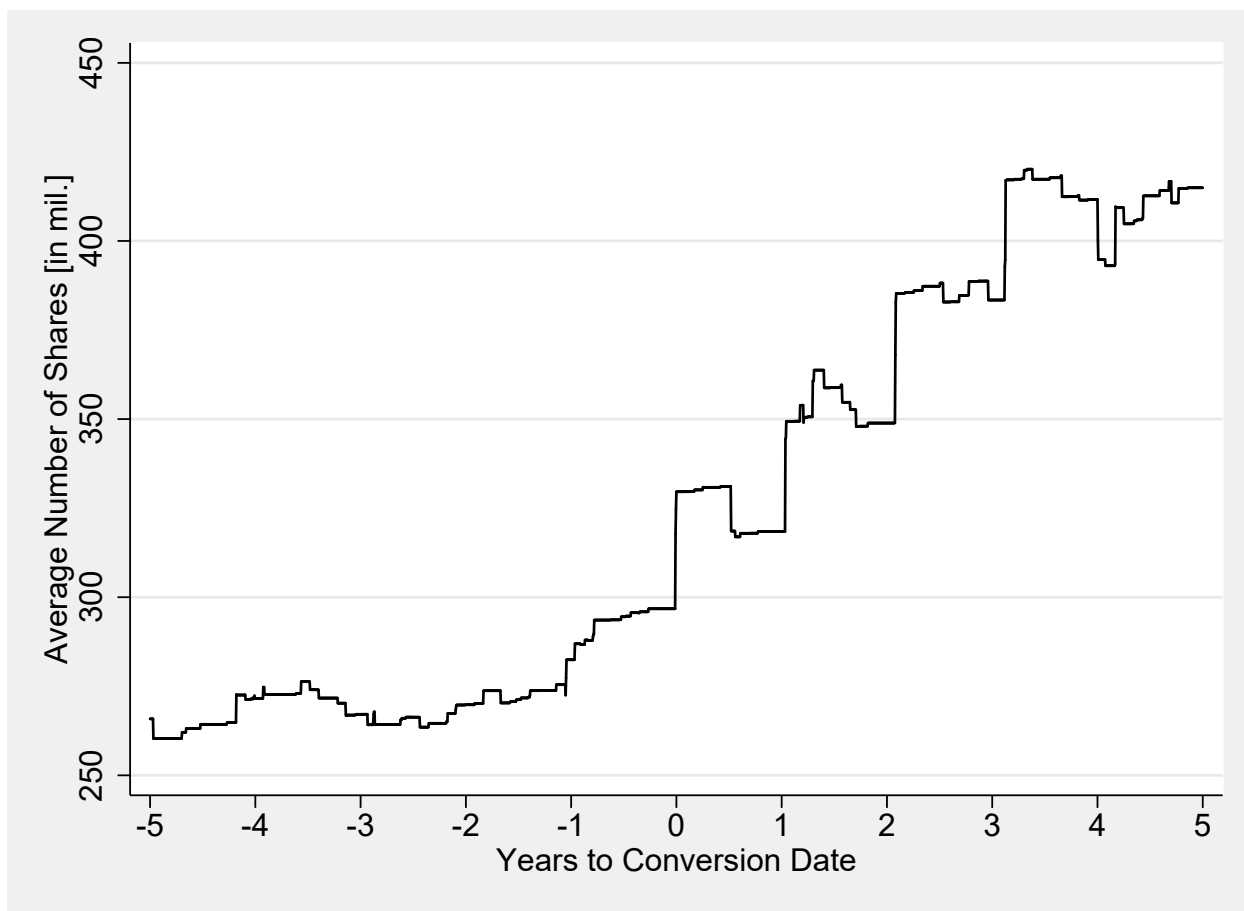
Figures & Tables

Figure 1: Number of Sample Deals and (Average) Deal Size Around Conversion Dates



Note: This figure shows the aggregate number of deals (bars) and corresponding deal values (lines) within the window of -5 to 5 years around the conversion date. The left-hand (right-hand) graph shows total (average) deal value.

Figure 2: Inflows around REIT Conversions



Note: This figure shows the average number of outstanding shares for all sample companies within the window of -5 to 5 years around the conversion date.

Table 1: Number of (Converted) REITs Across Countries

Country	All REITs	Converted REITs	Sample
Belgium	9	3	3
Canada	37	10	10
France	16	12	11
Germany	3	1	0
Italy	3	3	3
Netherlands	8	3	2
S. Africa	20	14	13
Spain	4	2	2
U.K.	39	24	21
U.S.	222	18	15
Total	361	90	80

Note: This table illustrates the multinational REIT conversion sample. The second column shows the overall number of historical and actual REIT constituents of the FTSE EPRA/NAREIT Global Real Estate Index. Of those, the third column reports the identified converted REITs. The last column gives the number of converted REITs that have available M&A data.

Table 2: Number of Sample Deals per Deal Type

Years to Conversion	Deal Type		Role of the REIT			
	Asset Deals	Share Deals	Acquirer	Acquirer Parent	Target	Target Parent
-5	27	33	40	2	4	10
-4	32	40	50	2	2	13
-3	29	40	44	5	2	11
-2	35	57	41	15	5	24
-1	39	52	42	16	3	22
0	57	87	78	16	3	35
1	62	83	75	16	6	40
2	56	68	69	13	7	28
3	44	58	58	4	4	22
4	47	47	53	11	1	23
5	55	45	49	11	2	27
Total	483	610	599	111	39	255

Note: This table reports the number of deals within the window of -5 to 5 years around the conversion date. Deals are classified as asset deals, for which parts of the assets, the majority of assets or the entire assets of the respective party change hands and share deals i.e., the acquisitions of partial and remaining interest, of 100% of stocks and mergers (second and third columns). The fourth through seventh columns show the role of the sample REIT (acquirer, acquirer parent, target, or target parent).

Table 3: Number of Internal Sample Deals

Deal Description	Number of Firms
REIT buys from subsidiary	34
REIT buys from parent	2
REIT sells to parent	1
REIT buys from subsidiary of subsidiary	3
Total	40

Note: This table shows deals within concerns. The first column refers to the role of the sample REIT in the deal; the second lists the aggregate number of deals.

Table 4: Distribution of Sample Deals and Firms across Quartiles

Quartile	Full Sample		Acquirer Subsample	
	# Deals	# Firms	# Deals	# Firms
1	5	26	2	25
2-3	29	36	10	36
4	78	18	31	19

Note: This table shows the overall number of deals and the number of deals in which the sample REIT appears as an acquirer. Sample REITs are grouped into pre-conversion (two-year) M&A activity quartiles. The number of deals reflect the thresholds of each quartile, e.g., the first line (25% quartile) displays 26 firms conducting 5 or fewer deals in the full sample. The two middle quartiles are given in aggregate.

Table 5: Two-Sample t-Test for High and Low Restructuring Quartiles

	Low	High	High-Low
Leverage	0.497	0.395	-0.102
M/B Ratio	1.683	1.938	0.255
Asset Test	11.905	-0.195	-12.100
Age	13.738	20.629	6.891
Market Cap	601.092	1695.208	1094.117
Total Debt	608.785	1615.682	1006.897
Total Assets	1189.059	3650.925	2461.866

Note: This table displays the arithmetic means of typical M&A-related firm characteristics according to the upper and lower trading activity quartiles for the U.K. and the U.S. for the two years pre-conversion. The last column reports the difference between the quartiles. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively.

Table 6: Regression Results for the Impact of the Asset Criterion

	Deal Number		Relative Deal Size	
	i	ii	i	ii
<i>Key Variable</i>				
Asset Test Criterion	-0.014 (0.009)	-0.016** (0.007)	-0.005*** (0.002)	-0.003* (0.002)
<i>Control Variables</i>				
Cash	5.190*** (1.194)	5.336*** (1.290)	1.080** (0.427)	0.492 (0.381)
Leverage	0.076** (0.035)	0.078** (0.038)	0.016** (0.007)	0.008 (0.007)
Leverage Squared	-0.001** (0.000)	-0.001** (0.000)	-0.000** (0.000)	-0.000 (0.000)
Return on Assets	-4.261 (4.311)	-3.396 (5.276)	2.588 (1.993)	0.542 (1.654)
M/B Ratio	0.010** (0.004)	0.015*** (0.006)	0.001 (0.001)	0.001 (0.001)
Dividend Yield	0.016 (0.041)	0.032 (0.052)	0.006 (0.015)	0.022 (0.016)
Size	-0.022 (0.126)	0.182 (0.165)	-0.043* (0.023)	-0.017 (0.033)
Age	0.020* (0.011)	0.012 (0.016)	-0.001 (0.003)	-0.004 (0.004)
Constant	-1.783 (2.185)	-3.597 (2.627)	0.086 (0.405)	-0.278 (0.557)
Year FE	Yes	Yes	Yes	Yes
Country FE	No	Yes	No	Yes
Observations	235	235	120	120
Adj. / Pseudo R ²	0.1603	0.1974	0.2666	0.3252

Note: This table shows the Poisson and linear panel regression results on the Number of Deals and Relative Deal Sizes within the window of -5 to 1 year around the conversion date. The unit of observation is Deal Number (first and second columns) and Relative Deal Size (third and fourth columns). Models *i* lag all explanatory variables by one period; Models *ii* also use country fixed effects. We use robust standard errors clustered on company-level, which are given in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively.

Table 7: Regression Results for Inflows, Number of Deals, and Excess Deal Size

	Inflow	Deal Number	Excess Deal Size
<i>Key Variables</i>			
REIT Status	0.123*** (0.032)		
Inflows		0.660** (0.328)	0.573* (0.290)
L1 Inflows		0.880** (0.353)	-0.224 (0.216)
<i>Control Variables</i>			
Cash	-0.297* (0.178)	2.562** (1.295)	-0.941 (0.951)
Leverage	-0.003* (0.002)	0.032* (0.017)	0.026 (0.038)
Leverage squared	0.000* (0.000)	-0.000*** (0.000)	-0.000 (0.000)
Return on Assets	0.616 (0.563)	-7.503** (3.016)	-1.117 (7.989)
M/B-Ratio	-0.001 (0.001)	-0.005 (0.004)	-0.028 (0.037)
Dividend Yield	0.010** (0.005)	0.027 (0.023)	-0.048 (0.040)
Size	0.452*** (0.028)	0.393*** (0.101)	0.210 (0.292)
Age	0.004 (0.013)	-0.019 (0.013)	- -
Constant	4.970*** (0.465)	-23.555*** (1.637)	-2.671 (3.612)
Year FE	Yes	Yes	Yes
Country FE	Yes	Yes	Yes
Firm FE	No	No	Yes
Observations	659	495	225
Adj. / Pseudo R ²	0.4827	0.2169	0.1353

Note: This table gives the results of the two-stage Poisson and linear panel regressions within the window of -5 to 5 years around the conversion date. Model *i* represents the first stage, which explains inflows (by REIT status). Model *ii* represents the second stage, which explains number of deals. Model *iii* reports the linear panel (FE) regression results, which explain excess deal size. We use robust standard errors clustered on company-level, which are given in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively.

Table 8: Combined Effect of Inflows

Coef.	Std. Err.	z	p-value	[95% Conf.	Interval]
1.541	.591	2.61	0.009	0.382	2.699

Note: This table shows the combined effect of the contemporaneous and one-year lagged inflows on the number of M&A deals around REIT conversions estimated in Model *ii*.

Table 9: Post-Conversion Performance across Countries

	U.K.	U.S.	SA	FR	CA
1y	0.004 (0.171)	0.054 (0.309)	0.121*** (0.108)	-0.032 (0.335)	0.014 (0.226)
2y	-0.058 (0.303)	0.307** (0.519)	0.285*** (0.202)	-0.193 (0.357)	-0.020 (0.493)
3y	0.073 (0.347)	0.351* (0.669)	0.564*** (0.405)	-0.111 (0.861)	-0.158 (0.507)
4y	0.177* (0.427)	0.644** (0.797)	0.927*** (0.808)	-0.587 (1.261)	-0.145 (0.570)
5y	0.263** (0.446)	0.764*** (0.786)	0.872*** (0.784)	-0.533 (1.889)	-0.120 (0.652)

Note: This table shows abnormal buy-and-hold returns (BHAR) for the five countries with the largest number of conversions. Beginning from the conversion date, we observe post-conversion windows of 1 – 5 years. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively. Standard errors are in parentheses.

Table 10: Post-Conversion (Risk-Adjusted) Performance by M&A Activity Quartile

	Simple BHAR				Risk-Adjusted BHAR			
	Low	Medium	High	High-Low	Low	Medium	High	High-Low
1y	0.114 (0.182)	-0.104 (0.258)	0.052 (0.233)	-0.062 (0.085)	0.175 (0.256)	0.089 (0.176)	0.119* (0.309)	-0.056 (0.117)
2y	0.372** (0.351)	0.024 (0.473)	0.056 (0.431)	-0.315* (0.161)	0.174 (0.239)	0.139 (0.233)	0.105* (0.247)	-0.069 (0.104)
3y	0.487*** (0.231)	0.120 (0.663)	0.138 (0.506)	-0.349** (0.141)	0.187 (0.267)	0.162 (0.220)	0.102** (0.216)	-0.084 (0.111)
4y	0.848*** (0.457)	0.525* (0.523)	0.201 (0.633)	-0.647*** (0.234)	0.224 (0.302)	0.164 (0.176)	0.092** (0.182)	-0.132 (0.130)
5y	0.926** (0.591)	0.611* (0.494)	0.281* (0.612)	-0.645** (0.279)	0.230 (0.315)	0.145 (0.164)	0.103** (0.182)	-0.127 (0.135)

Note: This table shows simple and risk-adjusted abnormal buy-and-hold returns (BHARs) over five relative time horizons for the U.K. and the U.S.. We calculate the risk-adjusted returns from the Sharpe (1966) ratio. The first through third columns for both return types show the results according to M&A activity quantiles. The respective fourth column for each states the difference between the upper and lower quartiles. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively. Standard errors are in parentheses.

Appendix

- Dependent Variables

- *Number of Deals* $_{i,t}$ = *Number of Deals of firm i in period t*
- *Average Deal Size* $_{i,t}$ = *Aggregate Deal Size* $_{i,t}$ / *Number of Deals* $_{i,t}$
- *Relative Deal Size* $_{i,t}$ = *Aggregate Deal Size* $_{i,t}$ / *Total Assets* $_{i,t}$
- *Excess Deal Size* $_{i,t}$ = $\log(\text{Aggregate Deal Size}_{i,t} / \text{Average Deal Size}_{i,t})$

- Explanatory Variables

- *Cash* $_{i,t}$ = *Cash* $_{i,t}$ / *Total Assets* $_{i,t}$
- *Return on Assets* $_{i,t}$ = *EBITDA* $_{i,t}$ / *Total Assets* $_{i,t-1}$
- *M/B-Ratio* $_{i,t}$ = *Market Value of Equity* $_{i,t}$ / *Book Value of Equity* $_{i,t}$
- *Dividend Yield* $_{i,t}$ = *Dividends per Share* $_{i,t}$ / *Earnings per Share* $_{i,t}$
- *Size* $_{i,t}$ = $\log(\text{Total Assets}_{i,t})$
- *Age* $_{i,t}$ = *Years since IPO* $_{i,t}$
- *Leverage* $_{i,t}$ = *Total Debt* $_{i,t}$ / *Total Assets* $_{i,t}$
- *Leverage Squared* $_{i,t}$ = *Leverage* $_{i,t}^2$
- *Asset Test* $_{i,t}$ = $\frac{\text{Qualifying Assets Ratio}_{i,t} - \text{National Regulation Ratio}_{j,t}}{\text{National Regulation Ratio}_{j,t}}$; *country index j*