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Houlihan Lokey

Options for Monetizing mREIT Managers

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David Freed
Partner, Mayer Brown LLP
+1 212 506 2498
DFreed@mayerbrown.com

Jennifer Fuller
Managing Director, Houlihan Lokey
+1 212 497 7836
Jennifer.Fuller@hl.com

Brian Hirshberg
Partner, Mayer Brown LLP
+1 212 506 2176
BHirshberg@mayerbrown.com

James Page
Managing Director, Houlihan Lokey
+1 212 497 7810
JPage@hl.com

Remmelt Reigersman
Partner, Mayer Brown LLP
+1 415 874 4259
RReigersman@mayerbrown.com

Agenda

- Internalizations
- Manager sales
- Manager terminations coupled with mortgage real estate investment trust (“mREIT”) sales
- Current market considerations
- Tax implications
- Best practices and the role of the board/special committee

Drivers of Mortgage REIT Manager Value

Obligations and Objectives	• Maximizing value • Meeting fiduciary obligations • Managing conflicts of interest
Monetization Transactions	• Internalization • Manager sale, externalization or similar transaction • Merge REIT with unaffiliated buyer • Alternative: merge REIT with affiliate
Establishing Value Prior to Monetization	• Establishing and maintaining a fee structure appropriate for the business • Sharing fees with institutional anchors • Successfully raising capital

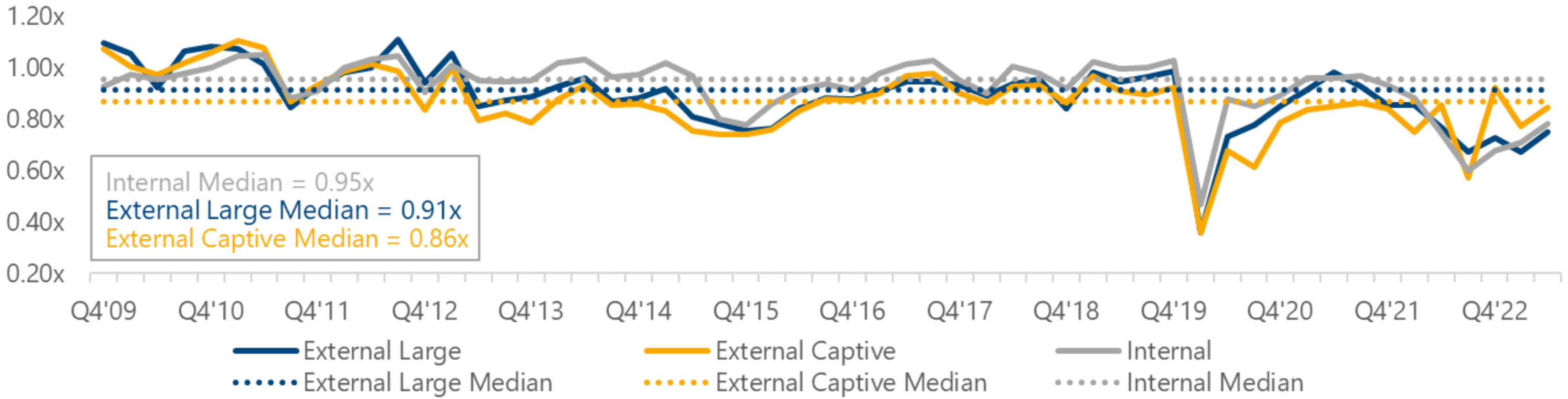
Internalization Transactions: Management Structure and Market Perception

	"Captive" Managers	Broad Manager Platform	Hybrid Management Structure
Structure	• External manager either only manages the REIT, or does not have complementary capabilities on its platform	• External manager is part of a broad asset management platform with both complementary capabilities and corporate support infrastructure	• REIT is externally managed, but has a subsidiary / subsidiaries whose employees are employees of the REIT • Subsidiary businesses are typically operationally intensive and involve significant overhead, which does not fit well within a "market" mREIT fee structure
Rationale for External Management	• Mitigates expense load to REIT investors at small scale • Helpful in attracting anchor investors who can share in fees of growing manager	• Platform resources, deal flow and talent cannot be achieved as an internally-managed REIT • Initially mitigates expense load	• Allows REIT investors to "own" platform value while benefitting from top level management by a large platform with significant resources
Likely Investor Reaction	• Pressure to internalize as platform the grows (What is the reason for external management? How does it impact the expense ratio?)	• Acceptance of structure if manager platform is truly strategic	• Structure is uncommon; perception of fee "redundancies" may be questioned

Internalization Transactions: How does the market value external management?

- While there are many factors influencing market valuation, internally managed mortgage REITs generally trade at a premium to externally managed mortgage REITs, with captive mortgage REITs, which are smaller on average than other externally managed REITs, faring worst

Mortgage REIT Price / Book Value



Sources: S&P Capital IQ. Data points for each period represent the median quarter end price / book value for the group, which includes both currently publicly traded and formerly publicly traded companies.

Internalization Transactions: Financial and Shareholder Considerations

Benefits	Considerations
• Shareholders "own" platform value	• Creation of goodwill
• Likely lower expense ratio	• Quantum of cost savings
• Fewer conflicts of interest	• Compensation for executives
• Potentially broader group of investors	• Required transition services
• Board can better influence strategic direction	• Manager capabilities "lost"
• Ability for the Board to better tailor executive compensation to be aligned with performance	

Internalization Transactions: Precedent Mortgage REIT Internalizations*

Company	Ticker	Announce Date	Consid-eration ($mm)	Consideration / Cost Savings[3]	Consideration / LTM Fees	Consideration / Market Cap at Announce	Consideration / MRQ Common Eq.
Rithm Capital Corp. (f/k/a New Residential Investment Corp.)	RITM	6/17/22	$ 400 [2]	6.4x	4.0x	10.4%	6.9%
Brightspire Capital (f/k/a Colony Credit Real Estate, Inc.)	BRSP	4/5/21	102	6.8	3.5	9.2	6.6
Granite Point Mortgage	GPMT	10/12/20	45	N/D	2.8	11.4	4.8
AGNC Investment Corp. (f/k/a American Capital Agency Corp.)	AGNC[1]	5/23/16	562	7.0	4.3	8.1	7.3

Sources: S&P Capital IQ, SEC-filed documents.

* For material consideration. There have been four mortgage REIT internalizations completed in the last 20 years for no or negligible consideration. Mortgage REITs merging with managers that have significant "outside" business have been excluded.

(1) AGNC's manager also managed MTGE, a smaller mortgage REIT. The numerator and denominator incorporate both AGNC and MTGE.

(2) RITM's consideration included $200mm paid on 6/17/22, $100mm paid on 9/15/22, and $100mm paid on 12/15/22.

(3) Refers to expected cost savings stated by the companies. If a range is given, the multiple is based on the midpoint of the range. GPMT announced estimated 2021 operating expense ($30-$35 million, which was expected to be a meaningful reduction) instead of cost savings.

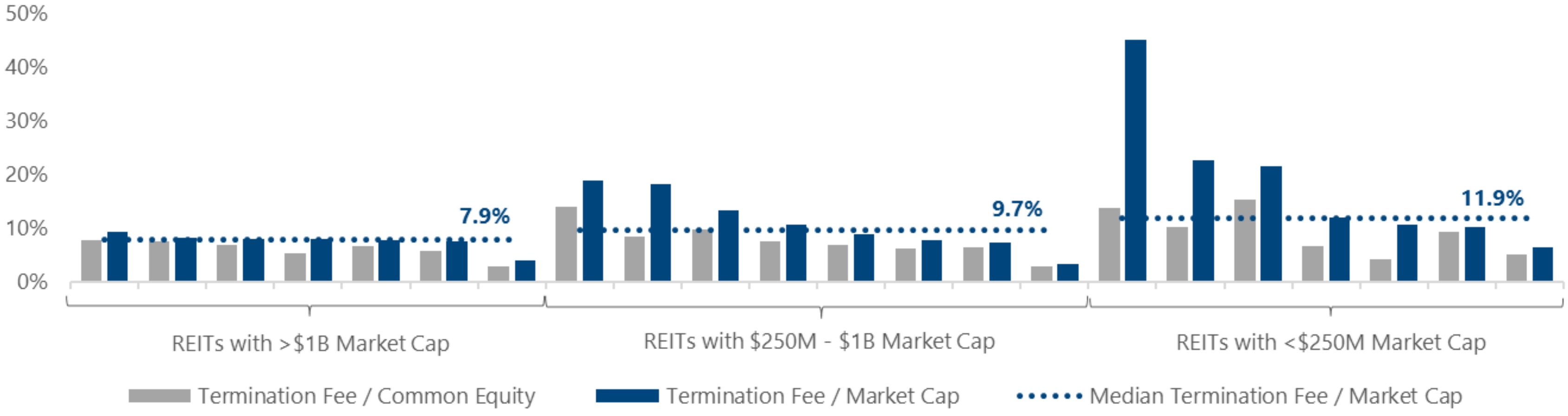
Mortgage REIT M&A: Transaction Alternatives

	Description	Benefits	Considerations
Sale of REIT to Unaffiliated Buyer	• Typically stock-for-stock deals designed to increase buyer's capital • Results in buyer or its manager, paying for the seller's management contract	• Payment to the manager may be negotiated or equal to termination fee • Target shareholders typically receive a more liquid stock • Interest in the current environment for third party "take private" acquisitions for cash	• Ability to offer a premium in stock-for-stock deals relies on "arb" between buyer and seller price / book • Large management termination fees can impede transaction economics • Ability to reallocate target's capital is key in stock-for-stock transactions
Sale of REIT to Affiliated Buyer	• Manager or REIT under common management with seller is the buyer • Typically done to "arbitrage" transaction multiples, provide a quick solution, or add float to an affiliated company	• Affiliates are often most competitive given termination fees are typically waived. Manager maintains AUM • Often have significant cash component • Less execution risk • Precedent for tenders / second step mergers (avoids shareholder vote)	• Heightened scrutiny, given inherent conflicts • If there has been no process to engage with third party buyers, a "go shop" period can ensure other alternatives are fully considered
Sale of Manager to Third Party, Externalization or Similar Transaction	• Manager is sold to a third party • May come with an investment in the REIT – equity at a premium to market, or debt/structured security • May involve initial contribution of assets from an affiliate of the new manager	• Avoids locking in discount to book value in a sale of the REIT • New manager may provide additional resources that are accretive to the REIT	• Does not provide full resolution to REIT shareholders, if there are challenges to scale or similar issues • If the REIT is subscale, must consider future implications • Future strategy and resources of the new manager must be considered

Mortgage REIT M&A: Challenges in the Current Environment

- Termination fees are typically earned on an "Equity" definition that exceeds GAAP equity in the current environment
- Due to book value losses and trading discounts to book, contractual fees are currently sizeable

Estimated Contractual Termination Fee Size for Externally Managed Mortgage REITs



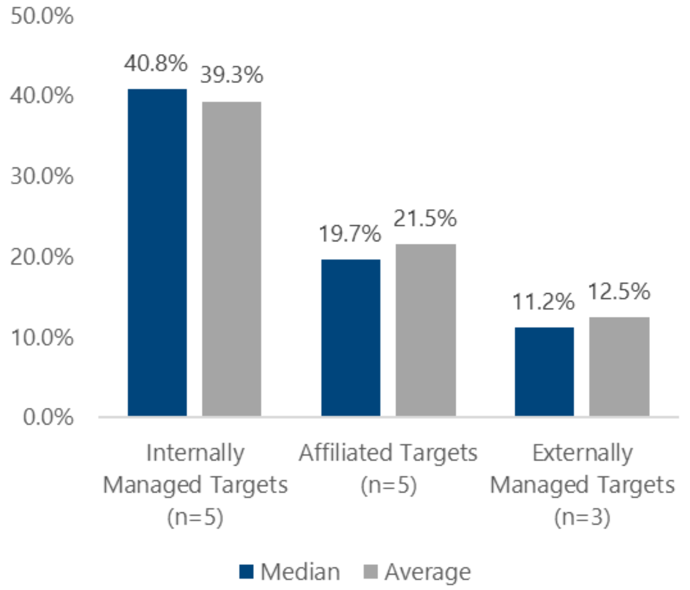
Source: Houlihan Lokey estimates based on termination fee structure and trailing quarterly management fees disclosed in SEC-filed documents. Market cap is as of 11/3/23.

Mortgage REIT M&A: Structure Impact on Valuation

- Management termination fees challenge transaction economics, as a transaction must accommodate the manager's termination fee (generally effectively "paid" by one or both REITs, but potentially paid in part by the buyer's manager), offer a premium to market, and avoid meaningful dilution to book value
- Internally managed targets enable the most shareholder-friendly M&A economics, followed by affiliated targets and externally managed targets

1-Day Price Premium at Announcement

Mortgage REIT M&A Targets Since 2008



Source: S&P Capital IQ and SEC-filed documents. Excludes reverse mergers and non-traded targets.

Manager Sales, Externalizations & Similar Transactions: Precedents

CAPITAL TRUST Externalization and Asset Management Sale	• On 12/19/12, Blackstone purchased the asset management business and associated co-investments of Capital Trust, a publicly traded REIT • Blackstone also became the external manager of Capital Trust and purchased a 17% stake in the company at $2.00 per share, valuing the company, considering a special dividend to be paid to shareholders prior to closing of $2, at $4 per share, a 31% premium to the 60-day trailing average price • In May 2013, the company, which was then newly managed by Blackstone, raised $660 million at a reverse split-adjusted price of $2.55
NorthStar REALTY FINANCE Externalization and Spin of Asset Management Operations	• On 6/30/14, NorthStar Realty Finance Corp. (“NRF”), an NYSE-traded REIT, spun off its asset management operations into a separate publicly traded company, NorthStar Asset Management Group Inc. (“NSAM”). Both companies initially had a post-spin market cap of ~$3 billion • Post-spin, NSAM managed NRF as well as NRF’s three non-traded REITs, and housed NRF’s captive SEC-registered broker-dealer platform • On a combined basis, NRF shareholders recognized price appreciation of 20%, 33% and 35% in the day following announcement, announcement through the completion of the spin, and announcement to the three month anniversary of the spin, respectively
Five Oaks Investment Corp. New Manager and Concurrent Investment	• In January 2018, Five Oaks Investment Corp., a publicly traded residential mortgage REIT, announced it had entered into a management agreement with an affiliate of Hunt Companies, a holding company focused on the real estate and infrastructure sectors • The transaction was to allow Hunt to reallocate capital into the commercial mortgage sector and access Hunt’s pipeline of mortgage opportunities • In connection with the transaction, an affiliate of Hunt purchased shares equal to 9.5% ownership of the company at a 57% premium to the most recent market price, representing both primary shares and shares purchased from the REIT’s largest shareholder, who agreed to terminate its warrants
EXANTAS Externalization and Concurrent Committed Capital	• In August 2020, Exantas Capital Corp., a publicly traded commercial mortgage REIT, announced that ACRES Capital Corp., a private commercial real estate lender, had purchased Exantas’ management agreement from an affiliate of C-III Capital Partners, and that the company had entered into agreements with MassMutual and Oaktree, who partnered with ACRES in the transaction, for new capital commitments of up to $375 million

Preemptive Considerations: Pre-Transaction Value Creation

- Establish a proper fee structure for the business
  - Occasionally, REITs' business models change and revisions to the management fee structure are appropriate. Any such changes should be carefully considered and messaged to investors
- When raising initial capital, weigh ability to get "anchor" investors on board and prospective capital growth against negotiating termination fee terms or giving "anchor" investors a share of management fees
- Prudent capital growth strategies
  - Active consideration of ATMs and underwritten offerings, as well as stock-for-stock acquisitions
  - Market and investor reaction should be carefully considered prior to any dilutive equity raise

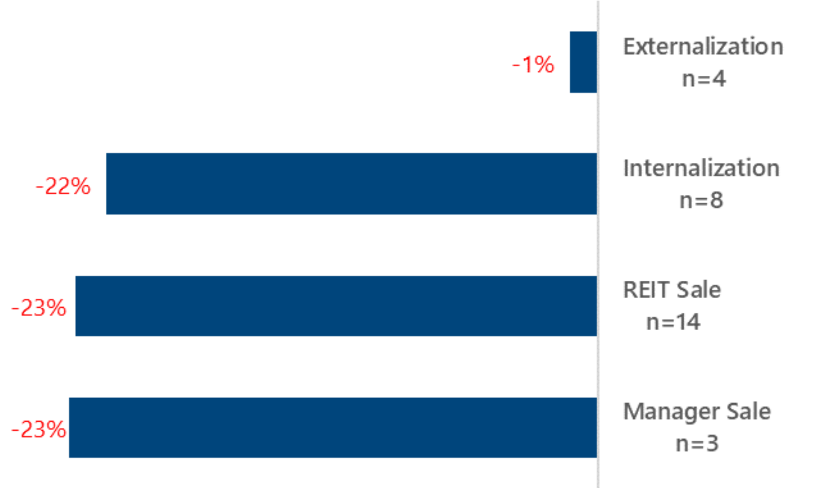
Transaction Considerations: Typical Catalysts for Platform Monetization

- Sale of manager's parent
- REIT liquidity or capital structure challenges forcing a sale process
- Pressure from REIT investors, including activists
- Sustained challenges to REIT scale, access to capital and valuation parity to peers
- Management transition or succession planning
- Unsolicited interest in REIT at an attractive valuation
- Manager's desire to "arbitrage" valuation through take-private or affiliate transaction (preservation - not monetization - of value)
- Manager-specific internal initiatives or social considerations

Transaction Considerations: Timing

- Precedent transactions have generally occurred after a period of declining prices coupled with little access to new capital
- While declining value may drive the need to undertake a transaction, many teams wait to explore a transaction in a challenging environment in order to see if conditions improve
- Proactive management of timing and process allows managers to better drive a process, and better create value for both shareholders and the external manager

Median Change in Market Cap in 12 Months Prior to Monetization Transaction(1)



Source: S&P Capital IQ and SEC-filed documents.
(1) Represents the year-over-year change in market capitalization the 12 months ending on the last calendar quarter prior to the transaction's announcement.

Tax Implications

Tax Implications

- Sale of REIT
  - Typically structured as a tax-free transaction
    - Merger with stock consideration
- Sale or internalization of manager
  - Consideration?
    - Cash and/or REIT equity
    - Partnership units
  - Timing and Character

Best Practices and the Role of the Board/Special Committee

Best Practices for mREIT Directors

- Due to actual or potential conflicts, disinterested directors should control the process and negotiate the terms
- Retain qualified advisors capable of rendering independent financial advice
- Devote appropriate time and energy to the process
- Document the process

Duties of mREIT Directors Under the MGCL

- Most mREITs are incorporated in Maryland
  - The Maryland General Corporation Law (MGCL) has a specific statutory standard of conduct that applies individually, director by director, and not collectively to the board
- Satisfying the statutory standard of conduct requires a director to act:
  - in *good faith*;
  - with a *reasonable belief* that his or her action is in the *best interests of the corporation*; and
  - with the care of an *ordinarily prudent person* in a like position under similar circumstances
- A director may rely on information, opinions, reports and financial statements prepared or presented by certain third parties if reliance is reasonable

Practical Takeaways for Satisfying the Statutory Standard of Conduct

- Obtain as much information as possible, including the advice and opinions of experts, and weigh it carefully
- Question information provided by management or advisors if the director feels, based on his or her individual knowledge and experience, that such information may be inaccurate or incomplete
- Consider all reasonable alternatives
- Deliberate carefully as a board, ask questions, express his or her views and listen to the views of others
- Take whatever time, including additional meetings, that the director feels he or she reasonably needs to deliberate and reach a decision
- Satisfy himself or herself that the board's action is in the best interests of the company
- Ask for more information or for more time if needed

Interested Director Transactions Under the MGCL

- Under Section 2-419 of the MGCL, a contract or transaction in which one or more directors have an interest is not void or voidable solely because of the common directorship or interest if:
  - the fact of the common directorship or interest is disclosed or known to the board or a board committee; and
  - the board or a board committee approves the contract or transaction by the affirmative vote of a majority of disinterested directors, even if the disinterested directors constitute less than a quorum.
- A director is "disinterested" in a contract or transaction if neither the director nor any entity in which the director has a material financial interest is a party to or has a material financial interest in the contract or transaction

Interested Director Transactions Under the MGCL

- If certain members of the board have a direct or indirect interest in a manager transaction that differs from the interests of the REIT's stockholders, a special committee of disinterested directors should negotiate the transaction on behalf of the REIT
  - A special committee should exclude anyone with a direct or indirect interest in the transaction
  - A special committee should engage its own unconflicted legal and financial advisors
  - A special committee should have full negotiating power, including the power to reject any transaction and consider alternative transactions
  - A special committee should be formed early in the process, before any material transaction terms are agreed, and have access to all relevant material information regarding the proposed transaction

Practical Takeaways for MREIT Directors

- In any manager transaction, the possibility of litigation against the REIT and its directors is not insignificant
- Directors and officers have substantial protection against personal liability for money damages under the MGCL and most REIT charters
- However, if directors do not satisfy the statutory standard of conduct under the MGCL, a manger transaction may be enjoined or rescinded
- A director should be prepared for the possibility of being deposed and testifying under oath
- In the context of a manager transaction, a director should be able to explain why they were reasonable in believing that their actions are in the best interests of the company

Other Legal Considerations

- NYSE and Nasdaq 20% rules may require shareholder approval of issuance of securities
- Stockholder meeting, if required, necessitates filing of proxy statement with SEC
  - Historical and/or pro forma financial statements of the REIT and the Manager
  - Proxy solicitation process similar to public company M&A process
  - May need to obtain stockholder approval of equity plan – CD&A required in proxy statement

Additional Resources

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