



Brokerage's Blank-Check Bet

May 1, 2006 12:00 PM, By Joe Gose

When Mark Rose took over as CEO of Grubb & Ellis in March 2005, it became clear to him that the large service provider based in Northbrook, Ill., needed to jump into the investment management business to grow and compete.

After months of exploring how to launch the strategy, Rose and other company executives created a shell company known as Grubb & Ellis Realty Advisors and raised \$144 million in an IPO in late February. Now, it intends to use most of those proceeds to buy office and industrial properties in secondary and tertiary markets within the next two years.

The IPO continues Rose's growing reputation as an innovator at Grubb & Ellis. Indeed, Realty Advisors is the first special purpose acquisition corporation, or SPAC, to focus on real estate. SPACs are management-intensive investment vehicles that, while novel in approach, are quickly gaining popularity.

Also known as "blank-check" companies, these special purpose entities raise money through IPOs and then search for private assets or operating companies to acquire.

Grubb & Ellis Realty Advisors will put the service provider on par with competitors such as CB Richard Ellis and Jones Lang LaSalle, Rose says, two peers that have long provided investment management to clients. Grubb & Ellis owns some 20% of the SPAC.

Under the microscope

The highly speculative SPAC structure is coming under scrutiny, however, particularly as it proliferates on Wall Street. The National Association of Securities Dealers is investigating SPAC share trading and has made inquiries into New York-based EarlyBirdCapital, an investment bank that specializes in blank-check IPOs. Plus, of the more than 40 SPACs going public over the last two years, only a handful have actually completed acquisitions.

Still, those worries have failed to quell interest in blank-check companies. Last year, 28 SPACs raised \$2.11 billion compared with 11 blank-check IPOs that raised about \$241 million in 2004, according to "The Reverse Merge Report", which tracks the SPAC industry. In fact, in October, Key Hospitality Acquisition Corp. raised \$48 million in its IPO, and the blank-check company is searching for a hotel operator to buy.

SPAC proponents contend that the blank-check structure perfectly aligns interests of investors and managers. Why? While investors give management up front financing to find worthwhile assets or companies to buy, each group makes money only if the acquisition succeeds after it begins trading on the public markets.

"The old phrase in real estate is 'location, location, location,'" says Mitchell Littman, a partner with the New York law firm of Littman Krooks, who specializes in securities. "But in a SPAC, it's 'management, management, management.' Investors are relying on the guys at the helm to go out and find a particular business that the SPAC has been created for."

Rose down plays Realty Advisors' connection to the broader SPAC movement, however. Generally, SPACs give private companies that are too small to pursue a conventional IPO an alternative route to the public capital markets. How? By buying private operating businesses via so-called "reverse mergers," SPACs provide the businesses with capital and instant admission to a stock market exchange. In turn, SPAC investors receive shares of the new publicly traded firm.

While Realty Advisors could combine with a single private property company, it could also buy several properties from different players, or one large property from one firm, Rose says. Realty Advisors will tap Grubb & Ellis' 107 offices to identify undervalued or distressed assets, he adds. Then it will use Grubb & Ellis' management, leasing and renovation services to improve the properties. The aim is to generate annualized internal rates of return of some 20% over average hold periods of three years.

SPAC rules, however, require that Realty Advisors' initial acquisition equal at least 80% of the roughly \$135 million in net proceeds that Realty Advisors has placed in trust. Realty Advisors also plans to pair its war chest with an average debt load of 75%, which creates potential purchasing power of \$540 million.

Blank-check comeback

While Realty Advisors is the first SPAC to ever target real estate, the overall financing structure is hardly new. Blank-check companies were common in the 1990s, though they were largely considered the used-car salesmen of the finance markets. The companies virtually dropped out of sight in the late 1990s as investment banks pursued every conceivable IPO in the heat of the tech boom.

But after the tech bust, companies with a market cap of less than \$200 million often lacked access to capital. They were too small to launch IPOs, and too large or mature to tap venture capital. In 2003, entrepreneurs retooled blank-check companies and reintroduced them as SPACs.

Those early SPACs typically raised \$20 to \$40 million. But now larger investment banks are pursuing such deals, and blank-check firms are frequently raising more than \$100 million. Deutsche Bank Securities underwrote Realty Advisors' IPO, which was one of the largest SPAC offerings on record.

"You're seeing a different class of managers, and investors are definitely seeing SPACs as a more legitimate alternative to conventional IPOs," says Floyd Wittlin, a partner in the New York office of the Bingham McCutchen law firm, who specializes in structuring SPACs.

In March, Bingham McCutchen was involved in the \$150 million IPO of Acquicor Technology, which is a SPAC led by former Apple Computer executive Steve Wozniak. Acquicor plans to purchase a technology, multimedia or networking business.

SPAC 101: A quick primer

So, you want to form a SPAC and raid real estate markets? Here are a few rules that all blank-check companies generally follow.

SPACs typically sell units for \$6 each, and a unit comprises one common share and two warrants, which give investors the right to buy two more shares for \$5 each. Shortly after the IPO, investors

have the option of separating warrants from shares, or keeping the units whole, and all three securities begin trading. Grubb & Ellis Realty Advisors' units, shares and warrants are listed on the American Stock Exchange under the tickers GAV-U, GAV and GAV-WT, respectively.

SPAC insiders get a sweeter deal. Grubb & Ellis provided the initial \$2.5 million in Realty Advisors' funding last year before the IPO, paying 43 cents a share for some 5.9 million shares. But those securities are typically locked up for three years from the date of the SPAC's IPO, and managers don't receive salaries while hunting for a deal.

After a blank-check company pays for the IPO and other expenses, the remaining proceeds are put into a trust to pay for an acquisition, which typically must occur within 24 months of the IPO. Not only must the first transaction equal at least 80% of the trust account's value, but the deal also must receive approval from 80% of the shareholders.

If shareholders reject a transaction, or one simply fails to materialize, the SPAC may hunt for another deal, depending on the timing, or it will return the trust proceeds to investors. In that case, the management team stands to lose its initial investment.

Generally, however, shareholder votes go either 100% for or against a merger, say SPAC experts. Why? Because if the market likes the proposed deal, it will bid up the SPAC's stock. Thus, shareholders who aren't in favor of the transaction can sell at a profit.

— **Joe Gose**