

REIT Financial Modeling

– Certification Quiz Questions

Module 5 – 2.5-Hour REIT Leveraged Buyout and LBO Model Case Study (Blackstone / Pure Industrial Real Estate Trust)

- You are working on a REIT LBO model for Blackstone’s leveraged buyout of Pure Industrial Real Estate Trust [PIRET], a Canadian industrial REIT with an Acquisition focus. The deal was done for a purchase EV / EBITDA of 23.7x, with a Purchase Equity Value of \$2.5 billion and a Purchase Enterprise Value of \$3.6 billion.

The screenshot below shows the Project-Level Returns in the Base Case with a Year 5 Exit:

Returns Calculations:	Units:	Historical:			Projected:				
		FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22
LTM EV / EBITDA Implied by Portfolio Cap Rate:	x	15.5 x	14.8 x	16.0 x	16.1 x	16.4 x	16.7 x	16.7 x	16.7 x
LTM EV / EBITDA at Year End:	x	17.3 x	18.8 x	20.9 x	22.6 x	23.0 x	23.3 x	23.3 x	23.3 x
Trading Multiple Premium:	%	11.3%	26.8%	31.0%	40.0%	40.0%	40.0%	40.0%	40.0%
EBITDA:	\$ M				183.0	206.8	229.7	254.9	280.3
(x) Exit Multiple:	x				22.6 x	23.0 x	23.3 x	23.3 x	23.3 x
Exit Enterprise Value:	\$ M				4,132.0	4,746.8	5,359.8	5,948.1	6,540.7
(-) Net Debt:	\$ M				(1,782.9)	(2,105.0)	(2,424.0)	(2,747.3)	(3,076.0)
Exit Equity Value:	\$ M				2,349.1	2,641.9	2,935.8	3,200.8	3,464.7
Dividends:	\$ M				87.8	89.4	91.0	93.5	99.7
Total Cash Flows to Equity Investors:	\$ M				87.8	89.4	91.0	93.5	3,564.4
Project-Level Returns:									
Multiple:	x								1.8 x
IRR:	%								13.0%
Returns Attribution Analysis:									
EBITDA Growth:									
Dividends:									
Multiple Expansion:									
Debt Paydown and Cash Generation:									
Total Return to Equity Investors:									

Your Managing Director has asked you to fill in the blank areas for a Returns Attribution Analysis that shows the percentages of returns from different sources.

Based on this screenshot and your knowledge of REIT LBOs, which of the following results is LEAST likely in this model and models for similar deals in this sector?

- EBITDA Growth – 175%; Dividends – 25%; Multiple Expansion – (5%); Debt Paydown and Cash Generation – (95%)

- b. EBITDA Growth – 110%; Dividends – 40%; Multiple Expansion – 40%; Debt Paydown and Cash Generation – (90%)
- c. EBITDA Growth – 30%; Dividends – 20%; Multiple Expansion – 25%; Debt Paydown and Cash Generation – 25%
- d. EBITDA Growth – 100%; Dividends – 15%; Multiple Expansion – (20%); Debt Paydown and Cash Generation – 5%
- e. EBITDA Growth – 150%; Dividends – 5%; Multiple Expansion – 20%; Debt Paydown and Cash Generation – (75%)

2. Why is it arguably pointless to build a traditional Debt Schedule into a REIT LBO model?

- a. Because Optional Debt Repayments are highly unlikely.
- b. Because you can simply track the Debt balances over time on the Balance Sheet, show maturities on the Cash Flow Statement, and then record Interest Expense on the Income Statement based on the rate for each tranche.
- c. Because the REIT will almost always issue additional Debt each year to fund its operations and pay for maturities, so neither Mandatory not Optional Debt Repayments make a significant net impact.
- d. Because you do not need a full Debt Schedule to calculate the credit stats and ratios and determine covenant compliance.
- e. All of the above.

3. Why does it tend to be extremely difficult to achieve a 20%+ IRR in REIT leveraged buyouts?

- a. It is extremely difficult to realize any Multiple Expansion because the real estate industry is cyclical.

- b. The Net Debt balance tends to grow each year, and there is a trade-off between the Exit Multiple and the Yields from Acquisitions and Developments.
- c. If a REIT wanted to boost its Dividend Yield to support a higher IRR, it would also have to accept lower EBITDA Growth or a lower Exit Multiple.
- d. If there is no Debt Paydown at all, it is almost impossible to realize an acceptable IRR – even in leveraged buyouts of normal companies.
- e. All of the above.

4. You are leaning toward a NEGATIVE recommendation for this deal, i.e., you do not think it is likely that Blackstone can achieve its targeted 20%+ IRR.

The sensitivity tables are shown below:

Sensitivity Tables - Sponsor Returns:

		FY22 Exit EV / EBITDA Multiple (Base Scenario):										
		20.8 x	21.3 x	21.8 x	22.3 x	22.8 x	23.3 x	23.8 x	24.3 x	24.8 x	25.3 x	25.8 x
Purchase Premium:	20.5%	8.4%	9.4%	10.3%	11.2%	12.1%	12.9%	13.7%	14.5%	15.3%	15.9%	16.4%
	18.0%	9.0%	9.9%	10.9%	11.8%	12.6%	13.5%	14.3%	15.1%	15.8%	16.3%	16.8%
	15.5%	9.5%	10.5%	11.4%	12.4%	13.2%	14.1%	14.9%	15.7%	16.2%	16.7%	17.2%
	13.0%	10.1%	11.1%	12.0%	13.0%	13.8%	14.7%	15.5%	16.1%	16.6%	17.1%	17.7%
	10.5%	10.7%	11.7%	12.7%	13.6%	14.5%	15.3%	16.0%	16.5%	17.1%	17.6%	18.1%
	8.0%	11.4%	12.3%	13.3%	14.2%	15.1%	15.9%	16.4%	17.0%	17.5%	18.1%	18.6%
	5.5%	12.0%	13.0%	13.9%	14.9%	15.8%	16.3%	16.9%	17.5%	18.0%	18.5%	19.1%
	3.0%	12.7%	13.7%	14.6%	15.6%	16.2%	16.8%	17.4%	18.0%	18.5%	19.0%	19.6%
	0.5%	13.4%	14.4%	15.3%	16.1%	16.7%	17.3%	17.9%	18.5%	19.0%	19.6%	20.1%

		Exit EV / EBITDA Multiple Premium to Multiple Implied by Cap Rate (Base Scenario):										
		27.5%	30.0%	32.5%	35.0%	37.5%	40.0%	42.5%	45.0%	47.5%	50.0%	52.5%
Exit Year:	FY18	(6.0%)	(2.6%)	0.7%	4.1%	7.4%	10.7%	14.1%	17.4%	20.7%	24.0%	27.4%
	FY19	4.4%	6.3%	8.1%	9.9%	11.6%	13.4%	15.1%	16.7%	18.4%	20.0%	21.6%
	FY20	7.7%	8.9%	10.2%	11.4%	12.6%	13.7%	14.9%	16.0%	17.1%	18.1%	19.2%
	FY21	8.8%	9.7%	10.7%	11.6%	12.5%	13.4%	14.2%	15.0%	15.9%	16.7%	17.4%
	FY22	9.3%	10.1%	10.8%	11.5%	12.3%	13.0%	13.6%	14.3%	15.0%	15.6%	16.0%

		Exit EV / EBITDA Multiple Premium to Multiple Implied by Cap Rate (FY22 Exit)										
		27.5%	30.0%	32.5%	35.0%	37.5%	40.0%	42.5%	45.0%	47.5%	50.0%	52.5%
Operational Scenario:	Upside	12.6%	13.4%	14.1%	14.9%	15.6%	16.1%	16.6%	17.1%	17.5%	18.0%	18.4%
	Base	9.3%	10.1%	10.8%	11.5%	12.3%	13.0%	13.6%	14.3%	15.0%	15.6%	16.0%
	Downside	7.0%	7.7%	8.4%	9.1%	9.8%	10.4%	11.1%	11.7%	12.3%	12.9%	13.5%

		Exit EV / EBITDA Multiple Premium to Multiple Implied by Cap Rate (FY22 Exit, Base Scenario)										
		27.5%	30.0%	32.5%	35.0%	37.5%	40.0%	42.5%	45.0%	47.5%	50.0%	52.5%
Subordinated Notes - Multiple of LTM Purchase EBITDA:	0.0 x	9.0%	9.7%	10.4%	11.0%	11.7%	12.3%	12.9%	13.5%	14.1%	14.7%	15.3%
	1.0 x	9.1%	9.9%	10.6%	11.3%	12.0%	12.6%	13.3%	13.9%	14.5%	15.1%	15.7%
	2.0 x	9.3%	10.1%	10.8%	11.5%	12.3%	13.0%	13.6%	14.3%	15.0%	15.6%	16.0%
	3.0 x	9.4%	10.3%	11.1%	11.9%	12.6%	13.4%	14.1%	14.8%	15.5%	15.9%	16.4%
	4.0 x	9.6%	10.5%	11.4%	12.2%	13.0%	13.8%	14.6%	15.3%	15.9%	16.3%	16.8%

Which of the following is the most REALISTIC way to improve the returns in this deal and change your opinion of it?

- a. If we used more leverage, such as 4-5x EBITDA for the Subordinated Notes rather than the current 2x.
- b. If we negotiated a lower purchase price for the company, such as a 5-10% premium rather than the 20% one assumed here.
- c. If we simply waited for higher Cap Rates (and lower corresponding EBITDA multiples) and acquired the company at a lower point in the real estate cycle.
- d. If we executed a series of high-yielding add-on acquisitions, all funded by additional Debt issuances.
- e. If we realized higher returns in the Base and Upside Cases by removing any incentive fees to other investor groups and removing the management options pool (if applicable).