The Real Estate M&A and Private Equity Review

Eighth Edition

Editors
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The Law Reviews

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PREFACE

Real estate investment trusts (REITs) have emerged from covid-19 to face a new reality. Covid's acceleration of a number of key technological trends has changed the way in which we interact with real estate, ushering in an era of increased remote working and online shopping and the adoption of prop-tech into virtually every aspect of real estate. In general, companies with assets that service the digital economy – cell towers, logistics and industrial properties, and data centres – benefited from the pandemic's acceleration of the digital economy, while traditional sectors have had to adapt to the new realities. And the rapid advancement of artificial intelligence promises further change. Additionally, the recent tremors and disruption in the banking industry and the rise in interest rates and inflation, combined with upcoming debt maturities, may portend a volatile period. As always, strategic planning and risk management will be critical to adjust to changing times.

Covid-19 aside, the world is facing a number of macro headwinds that began to rear their heads in 2022, including persistent inflation, a higher interest rate environment, the ongoing war in Ukraine, and considerable turmoil in the banking sector. While there remain opportunities to make strategic acquisitions and investments within real estate, the continued volatility in the near term, and the complex and challenging macroeconomic backdrop will likely continue to have disparate impacts on different subsectors and different geographies within the industry.

Stepping back from recent global events and market dislocations, publicly traded real estate companies and REITs, with help from real estate private equity, have steadily transformed the global real estate markets over the past 25 years. Their principal innovation, and 'secret sauce', has been 'liquid' real estate. Unlike traditional property ownership, equity in publicly traded real estate vehicles is highly liquid, and can be bought and sold in large volumes, literally in minutes, on numerous global exchanges. Indeed, during the pandemic, REITs issued more than US$10 billion in public equity, taking advantage of the massive amounts of liquidity washing over financial markets beginning in the spring of 2020. In 2021, public REITs raised approximately US$27 billion in follow-on equity offerings, declining to approximately US$18 billion during the volatility of 2022.

Publicly traded real estate vehicles now have an aggregate market capitalisation of over US$1.3 trillion globally, including nearly US$1 trillion in the United States and approximately US$130 to US$170 billion in both Europe and Asia. As public REITs and other vehicles have aggregated these properties and grown in scale and sophistication, so too have real estate-focused private equity funds, playing an important role in catalysing hundreds of billions of dollars of REIT and real estate merger and acquisition (M&A) transactions and initial public offerings.

However, despite that massive growth and despite the pandemic, potential growth is far larger both in long-standing REIT markets and in newer REIT jurisdictions, where the trend is more nascent. With increasing development and urbanisation, the world is producing more and more institutional-grade properties, and a growing percentage of this expanding pool – an estimated US$5 trillion and counting – will inevitably seek the advantages of liquidity by migrating to the publicly traded markets. The growth is expected to be both local and cross-border, with nearly 40 countries already boasting REIT regimes. Despite this potential for growth, it remains to be seen whether the ongoing conflict in Ukraine and the associated energy and supply chain disruptions, as well as the rise of populist movements around the globe, will spur a wider backlash against globalisation and cross-border investment.

REITs and other publicly traded vehicles for liquid real estate have grown because they are often a superior vehicle for stabilised assets. Greater liquidity and transparency – and often superior governance – are attractive to investors, resulting in a lower cost of capital and superior access to vast amounts and varieties of capital in the public markets. In addition to cheaper capital, REITs and other public vehicles benefit from efficiencies of scale, sophisticated management and efficient deal structures, to name just a few advantages. With these advantages, the global march of real estate to the public markets seems unstoppable.

This publication is a multinational guide for understanding and navigating the increasingly complex and dynamic world of liquid real estate and the transactions that mostly produce it. The sea change in the markets, sometimes called the REIT revolution, has meant that major real estate transactions have migrated from Main Street to Wall Street. They now often take the form of mergers, acquisitions, takeovers, spin-offs and other corporate transactions conducted in the public markets for both equity and debt. They have grown exponentially in complexity and sophistication, and increasingly represent cross-border multinational transactions fuelled by the now-global real estate capital markets and M&A deal professionals. And they are often intermediated by international investment banks rather than local brokers and financed with unsecured bonds or commercial mortgage-backed securities. In a fair number of cases, they are catalysed by private equity firms or similar actors, sometimes building portfolios to be taken public or sold to public real estate companies, and sometimes through buyouts of public real estate companies for repositioning or sale.

To create this publication, we have invited leading practitioners from around the globe to offer practical insights into what is going on around the conference tables and in the markets in their jurisdiction, with an eye to cross-border trends and transactions. As will quickly become evident, the process of liquefying real estate and transactions involving public real estate companies requires a melding of the legal principles, deal structures, cultures and financial models of traditional real estate, public company M&A and private equity. None of this, of course, happens in a vacuum, and transactions often require expertise in tax, corporate and real estate law, not to mention securities laws and global capital markets. Each of our distinguished authors touches on these disciplines.

We hope this compilation of insight from our remarkable multinational authors produces clarity and transparency in this exciting world of liquid real estate and helps to further fuel the growth of the sector.

Adam Emmerich and Robin Panovka
Wachtell, Lipton, Rosen & Katz
New York
July 2023

Chapter 4

CANADA

Brenda Gosselin and Stephen Pincus[1]

I OVERVIEW OF THE MARKET

i The economic backdrop

Following a steady 2021, many expected activity in the Canadian real estate sector to return to pre-pandemic levels. Although valuation and equity issuance trends were strong in the first quarter of 2022, the rate of inflation reached concerning levels and the resulting interest rate hikes, together with geopolitical uncertainty, had an immediate impact on the real estate sector.

Canadian inflation hit a peak rate of 8.1 per cent in June 2022, the highest reading since January 1983, and the Bank of Canada introduced eight consecutive interest rate hikes starting in March 2022, increasing the benchmark rate from 0.25 per cent in January 2022 to 4.50 per cent in January 2023. Investment activity across all sub-classes of the sector declined rapidly as issuers tried to adapt to the impact of rising borrowing costs.

In January 2023, the Bank of Canada indicated it would hold its key lending rate as long as inflation was on track to return to recent historical norms of 2 per cent. Following the corrective measures introduced in 2022, the inflation rate in Canada gradually declined from its June 2022 peak, reaching 6.3 per cent in December. The first part of 2023 continued this trend, with inflation reaching 4.3 per cent in March 2023. Nevertheless, recent economic growth has been stronger than expected and Q1 2023 reports indicate that activity level was steady.[2] The unemployment rate remains low, labour markets are tight and inflation remains stubborn. There was a slight uptick in inflation in April 2023 (4.4 per cent as compared to 4.3 per cent in March) and the Bank of Canada reacted on 7 June 2023 by announcing a further increase of 0.25 basis points in the policy interest rate. With this latest increase, the

1 Brenda Gosselin and Stephen Pincus are partners at Goodmans LLP.

2 CBRE Report, 'Canadian Cap Rates and Investment Insights, Q1 2023'.

Bank of Canada has signalled that it will continue to implement its restrictive monetary policies when necessary, although it has stated that it continues to expect inflation to come down significantly this year.[3]

ii Public market real estate activity

Against this economic backdrop, performance levels of publicly traded issuers throughout the real estate sector suffered during 2022. The S&P/TSX Capped REIT Index (REIT Index) delivered an overall -17 per cent total return[4] in 2022 as compared to the S&P/TSX Composite Index which posted a negative return of -8.5 per cent.[5] This was a change from 2021 when the REIT Index significantly outperformed the broader S&P/TSX Composite Index's total return. Retail issuers were the strongest performing for the year with an overall total return of -3.2 per cent. The industrial, seniors housing and Canadian multifamily real estate investment trusts (REITs) experienced greater challenges, resulting in between -19.9 per cent and -22.3 per cent total return. Office REITs, together with non-Canadian multifamily issuers, were the hardest hit, seeing a total return of its issuers in the -31.8 per cent range.[6]

From a capital markets perspective, overall issuance activity was the lowest level of issuances in the past 10 years and a dramatic 63 per cent drop from the levels in 2021.[7] Equity issuances for the year totalled approximately C$1.7 billion[8] (well below the 10-year average) as issuers faced unit prices that were trading below net asset value (NAV) and investor sentiment reached new lows. There were a total of 15 equity offerings, almost all of which were completed in the first five months of the year. Most of the activity originated from issuers in the industrial, multifamily and office subsectors. The largest equity offerings were made by Summit Industrial Income Fund and Dream Industrial REIT for C$230 million each. The REIT initial public offering (IPO) market in 2022 remained at record lows, with only one IPO that launched during the year: Dream Residential REIT's C$125 million IPO, which closed in May 2022.

The higher interest rate environment also had a significant impact on the volume of senior unsecured debt offerings as REIT issuers started to look to lower-cost forms of funding. For 2022, there was a total of C$2.3 billion (excluding pension funds and real estate operating companies (REOCs)) of senior unsecured debt issued across seven transactions, which was the lowest level of issuances in the past 10 years and a dramatic 63 per cent drop from the levels in 2021.[9] One notable issuance was the inaugural debenture offering by Primaris REIT for an aggregate of C$350 million in the first quarter of 2022. The largest debt issuances in 2022 were made by Prologis LP and Choice Properties REIT, each for C$500 million deal value. Although there were depressed levels of capital markets activity in 2022, a number of mature issuers have approximately C$3.6 billion of senior unsecured debt expected to come due in 2023,[10] which may create opportunities for some additional activity in 2023.

3 Bank of Canada news release, 'Bank of Canada increases policy interest rate by 25 basis points, continues quantitative tightening', 25 January 2023 (www.bankofcanada.ca).
4 CIBC 'Canadian Real Estate Investment Banking – 2022 Year in Review' (CIBC 2022 Report).
5 BBM Bloomberg, 'TSX in 2022: A look back at how it performed', 30 December 2022.
6 CIBC 2022 Report.
7 ibid.
8 ibid.
9 ibid.
10 ibid.

The tighter credit space and wavering buyer interest created a nearly non-existent public M&A environment with only one transaction valued at approximately C$5.9 billion – the acquisition by GIC and Dream Industrial REIT of Summit Industrial Income REIT, which closed in February 2023. This was a modest decrease from the three deals launched in 2021 and more consistent with the lower volume seen at the height of the pandemic in 2020. It will be interesting to see whether public M&A transactions will also gradually return to an increased level if the market steadies in 2023 as anticipated.

iii Real estate transaction activity

Despite the challenging and uncertain economic environment, Canadian commercial real estate transaction volume (transactions greater than C$40 million) reached a new high of C$24.5 billion in 2022.[11] Private equity continued to take the lead on driving the transaction volume, a majority of which focused on industrial and multifamily assets, at approximately C$6.5 billion and C$3.9 billion of volume, respectively.[12] Industrial assets continued to be the preferred sub-class for investors due to its strong fundamentals and ability to withstand turbulent economic environments. Industrial represented C$8.7 billion of total acquisition volume for 2022, an increase from the four-year average ending 2021 of C$2.7 billion.[13] Private equity was the most acquisitive buyer in the industrial space, representing 75 per cent of total volume for this sub-class, with Pure Industrial REIT (owned by Blackstone) alone accounting for 26 per cent of all industrial transactions, including acquisitions of Cominar REIT's industrial portfolio for C$1.5 billion in March and a six-property portfolio from TD Asset Management for C$428 million in December. KingSett Capital was also an active participant in the industrial space, acquiring a 21-property portfolio in Mississauga, Ontario for C$461 million, a four-property portfolio in Quebec for C$80.1 million and a six-property portfolio in Cambridge Ontario for C$58.2 million. Skyline Industrial REIT's acquisition of a 16-building portfolio in Ontario for C$309.3 million was also among the top transactions based on deal size.[14]

Multifamily and seniors housing also continued to show strength as the second most active sector for transaction volume, representing C$8.4 billion of transaction volume,[15] as immigration levels remained high and a continued aging population result in demand outpacing supply. Centurion Apartment REIT was the most active buyer acquiring an aggregate of 4,734 units for C$1.4 billion for the year. There were 14 transactions for the year priced in the higher C$100 million to C$1 billion dollar range,[16] including Cogir Real Estate and Welltower's acquisition of the 1,165-bed Regency Retirement portfolio located in Okanagan, British Columbia for C$593 million and Centurion Apartment REIT's acquisition of a 30-property apartment building in Montreal for C$965 million. In addition, Starlight Investments, acquired a 13-property apartment portfolio consisting of 1,806 units for C$650.3 million.

Investment activity in the office sector in 2022 was roughly in line with 2021 as companies consider their office space requirements for the future, taking into account levels

11 ibid.
12 ibid.
13 ibid.
14 ibid.
15 ibid.
16 ibid.

of work from home balanced with the return to the office. With return to work becoming more consistent, particularly for those operating in the downtown sectors, high-quality and well-located spaces continued to see strong demand. The most notable transactions were the sale by CPP Investments and Oxford Properties of the Royal Bank Plaza to Pontegadea Group (Amancio Ortega) for C$1.2 billion, which was hailed, by some, as the commercial real estate transaction of the year, as well as Allied Properties REIT's acquisition of a six-property office portfolio located in Toronto, Vancouver and Montreal for C$794 million from Choice Properties REIT. Group Mach's acquisition of a Cominar portfolio consisting of 19 office and two retail properties for C$607.9 million also stood out among the smaller number of deals.

Canadian real estate continued to be attractive for foreign investors, with C$1.4 billion of volume in foreign investment in 2022 (up from C$100 million in 2021).[17] The most notable foreign investment was the sale of the Royal Bank Plaza.

In the housing sector, Canada's real estate housing market started the year off strong and peaked in February 2022 following 2021's record-setting year when low interest rates and constrained supply fuelled a home-buying frenzy in Canada's largest markets. However, interest rate hikes amid higher inflation and a continued focus by governmental authorities to make housing affordable resulted in downward pressure on both activity and on prices, making 2022 a more muted year for Canadian residential real estate. This was particularly true for areas such as Vancouver, Toronto, Hamilton, Ottawa and Montreal.[18] Notwithstanding the decrease, many economists believed that absent any unforeseen events 2023 would result in a recovery in the Canadian housing market.[19] Although the national average home price is still down on a year-over-year basis, signs of recovery are already evident as provincial average home prices across Canada increased in April 2023 compared to the previous month.[20]

iv Outlook

Forecasts predict that the Canadian real estate market will be generally positive through 2023, with capital expected to return later in the year as interest rates and financial systems are expected to stabilise. A stable recovery for real estate business activity and an ease in the economic and interest rate uncertainty are expected to have positive impacts on issuances, M&A activity and commercial investment.

CBRE is reporting a prediction for an all-time high of investment volume for the full year of C$59.3 billion.[21] Growth in the capital markets in 2023 is likely to be driven by issuers in the industrial and multifamily sectors,[22] although we expect issuers across the board to take advantage of a more steady market. As the economy and cost of borrowing stabilises, and investor uncertainty dissipates, it is anticipated that issuers will return to the capital markets as a means of refinancing existing debt. For example, Dream Industrial REIT issued C$200 million of senior unsecured debentures on 22 March 2023, Primaris

17 ibid.

18 RBC Economics, 'Housing market correction widespread across Canada' RBC Real Estate Report, December 2022.

19 *Financial Post*, 'Housing prices have been declining, but 2022 wasn't catastrophic and 2023 is looking better', 20 January 2023.

20 Norada Real Estate Investments, 'Canada Housing Market Forecast: Will Prices Drop in 2023?', 30 May 2023.

21 CBRE Report, 'Canadian Real Estate Investment Forecast to Hit a Record High $59.3B in 2023', 1 March 2023.

22 JLL, 'Canadian Commercial Real Estate Outlook', January 2023.

REIT issued C$250 million of senior unsecured debentures on 29 March 2023, Northwest Healthcare Properties REIT completed a C$75 million offering of convertible debentures on 27 April 2023, and RioCan REIT issued C$300 million of senior unsecured debentures on 26 June 2023, all of which proceeds were used primarily to repay existing indebtedness. Renewed market confidence and sustained liquidity will assist in ensuring that demand for real estate assets will remain strong throughout 2023 and beyond.

II INVESTORS IN THE CANADIAN REAL ESTATE MARKET

Investors in Canadian real estate can be broadly divided into three types: institutional investors, consisting primarily of Canadian pension plans and life insurers; public real estate entities, most significantly in the form of REITS with a smaller number of listed real estate operating corporations; and private entities, including family-owned businesses, that develop or manage their own properties of varying scale, and, increasingly, large-scale Canadian and foreign private equity investors or other institutional capital funds.

i Institutional investors

Those Canadian pension plans and life insurers that invest in real estate typically comprise large, recognisable public pensions, which make direct investments in both domestic and global real estate; smaller public plans that rely on funds and external managers for their investments; and private corporate pensions or insurers that partake in both direct and indirect investing.

Canadian pension funds remain one of the largest real estate owners in Canada. These large Canadian pension funds and insurers have assets across all real estate classes, with prominent investment historically focused on Class A office space, premier urban shopping centres and office tower retail spaces in the major metropolitan areas of Canada, with some indirect engagement in development activities. While these investments have become increasingly global in scope, the Canadian pension plans have continued to demonstrate a heavy inclination to invest in Canadian real estate. This may be in part due to the ability of pension plans to generally hold Canadian real property assets on a basis free from Canadian income tax under specific tax exemptions for certain Canadian pensions and Crown entities (such as CPPIB), or the favourable market conditions for promising returns in the Canadian real estate space.

ii REITs

Public real estate entities in Canada commonly exist in the form of a REIT. A REIT is a trust that, upon meeting the criteria outlined in Canada's Income Tax Act (ITA), acts as a flow-through vehicle for Canadian income tax purposes. The real estate assets of the REIT are generally held indirectly by the REIT through an operating partnership. The first Canadian public REITs emerged in the 1990s as a solution to the collapse of Canada's real estate market. As of 31 December 2022, there were 40 Toronto Stock Exchange listed REITS with a total market capitalisation of just over C$80 billion.[23] While the Canadian REIT market remains small in comparison to its comparator market in the US, it is a continually evolving sector of the Canadian real estate landscape.

23 CIBC 2022 Report.

The majority of Canadian REITs are the product of smaller IPOs (typically under C$300 million) as compared to their US counterparts. Interestingly, this has had the effect of attracting a number of US-based cross-border REITs to the Canadian capital markets over the years. Canadian REITs own a full range of asset classes, such as office, retail, industrial and multi-residential. However, among the office investments, relatively few REITs own Class A office towers (which, as discussed above, are typically held by large institutional investors). REIT activity in the retail class remains largely concentrated within regional and local shopping centres. More recently, investment in multi-use developments has increased among the greater capitalised REITs.

The asset and/or property management of a REIT can be internally conducted through a trust's own executives and employees, or externally conducted by way of a manager under contract. The terms of the management agreement between a REIT and an external manager can be an important consideration in structuring an M&A transaction. Any acquirer of a REIT will have to be prepared to either assume those functions (if the management agreement is to be terminated) or make arrangements with the manager to continue in some capacity after a transaction closes. The Canadian real estate capital market tends to favour internalised arrangements, while sponsors typically prefer the fees flowing to them from an external management arrangement.

iii Private entities

Family-based private investors in real estate have significant industrial, retail and multi-residential holdings, but tend not to hold Class A offices or premium retail properties. Canadian private equity funds (other than pension plans or life insurers) that partake in real estate investing tend to focus their investments solely on real estate, and generally do not invest across all economic sectors.

Large-scale Canadian private equity investors in real estate still remain fewer in number and often manage funds that have a significant pension plan backing. Historically, these pension-backed private equity investors invested in real estate that requires active management or repositioning, or that are in the office asset class (although it continues to be rare for them to hold Class A offices) or in the commercial asset class. However, the increased development of condominiums seen across Canada in the past decade has largely been driven by private equity capital and pension funds. In recent years, the Canadian real estate market has also seen an increased level of activity from foreign-based private equity investors as evidenced by Blackstone's privatisation of Dream Global REIT in 2019 for an implied value of C$6.2 billion, becoming the largest-ever Canadian REIT M&A transaction; and, more recently, in 2022, the acquisition by GIC and Dream Industrial REIT of Summit Industrial Income REIT at a value of approximately C$5.9 billion and Pontegadea Group's acquisition of the Royal Bank Plaza for C$1.2 billion.

III RECENT TRENDS

i Foreign investment in Canadian real estate

In recent years we have seen an increased presence of US (or other non-Canadian) investors in Canadian commercial real estate. This trend of foreign investment continued in 2022, representing C$1.4 billion of acquisition volume and 6 per cent of total volume, an increase from C$100 million in 2021.[24] However, the ownership of residential real estate by foreign investors is proving increasingly challenging. Provincial and federal governments have been actively introducing new measures intended to curb foreign investment in Canadian housing at a time when the housing affordability crisis in Canada remains a real threat. On 25 October 2022, the government of Ontario enacted an increase on the non-resident speculation tax (commonly referred to as the foreign homebuyer tax), from 20 per cent to 25 per cent. Additionally, from 1 January 2023, a temporary two-year ban on foreign investors and homebuyers in Canada took effect, intended to pause foreign home buying for the two-year period and provide better opportunities for Canadians to purchase property. Commercial and industrial properties as well as most large-scale residential properties with more than four legal dwelling units are not impacted under this ban.

ii ESG considerations

Environmental, social and governance (ESG) matters continue to be an important issue for the industry and a prominent trend is the growing business demand for ESG investments in the real estate space.[25] For many institutional investors, ESG factors are becoming important criteria for making investment decisions and there is increased expectation for the same level of rigour and adherence to standards in the reporting of ESG data and metrics as reported financial information. An RBC survey of institutional investors reported that 81 per cent of Canadian respondents already use ESG factors as part of their decision-making process.[26]

Much of the value creation for real estate companies and other real estate industry players in the coming years is likely to centre on real estate issuers' ability to meet ESG demands. Achieving lower carbon emissions is one of the leading ESG priorities in the sector according to REALPAC's ESG Industry Report 2023.[27] Developers and REITs are among those setting net-zero targets for their operations and buildings with 37 per cent of REALPAC members now having set a net-zero carbon target and 75 per cent of members having integrated climate risks into investment decisions.[28]

Third-party rating and evaluation organisations such as Global Real Estate Sustainability Benchmark (GRESB) provide benchmarks and ratings to assist investors on assessing ESG performance and there is a trend towards integrated financial and ESG reporting. Real estate issuers are heavily focused on how best to advance and evolve their ESG practices, both operationally and from a governance and investor-facing and reporting perspective. As the challenge of combating climate change continues to be omnipresent in all aspects of business and our individual lives, it is expected that the coming years will see increased investment activity in sustainable real estate assets and projects.

The issuance of green bonds continues to increase steadily. For example, in April 2022, Dream Industrial REIT announced the closing of a C$200 million green bond offering of senior unsecured debentures, its third green bond offering, and in November 2022, OMERS Realty Corporation completed an inaugural C$600 million green bond offering of senior

24 ibid.
25 PricewaterhouseCoopers, 'Emerging Trends in Real Estate 2022' (2022) (PWC 2022 Report).
26 CBRE Canadian Real Estate Market Outlook (2022) (CBRE Canada Market Outlook 2022).
27 ESG Industry Report 2023, REALPAC.
28 Sustainable Biz Canada, 'In Canadian CRE, climate and diversity remain major ESG challenges', 9 June 2023.

unsecured debentures. Canadian Core Real Estate LP (BCI QuadReal Realty and RBC's partnership) also initiated its Green Bond Program in 2022 with a C$400 million senior note offering.

To further the focus on ESG, Canada's federal government indicated in its April 2021 budget its plans to require federally regulated pensions to disclose ESG considerations they use in their portfolio construction.

iii Real estate development by public companies

In the past five years, public Canadian real estate entities have increased their focus on real estate development opportunities, rather than only being engaged in acquisitions of existing properties. Several large public REITs and pension funds, either directly or indirectly, have begun or completed the building of office towers or mixed-use projects throughout the downtown Toronto core. Cadillac Fairview, which is controlled by the Ontario Teachers' Pension Plan, is constructing its expected C$1 billion downtown Toronto office tower, with completion pushing ahead steadily since the start of 2023. Allied Properties REIT and RioCan REIT continue to proceed with full development of The Well, a mixed-use residential, commercial and retail development located in Toronto, with its grand opening slated for 2023. Construction of the residential building is also advancing and is expected to be complete in 2023, where more than 90 per cent of the condominium component has been sold by Tridel and occupancy is scheduled for Q1 2024.[29]

iv Investor activism

There has been an increase in investor activism in the REIT sector due in part to increasing interest rates, lower returns and the fact that many REITs continued to trade at levels below NAV. Recent activism has taken various forms – including public proxy campaigns, behind-the-scenes pressure, and voting against say-on-pay resolutions. As investors continue to seek alternative ways to unlock value, this may be a signal that an increased level of activism may be on the horizon.

In November 2020, Artis REIT announced a settlement agreement with Sandpiper, which saw a retirement of the REIT's CEO and CFO and a refreshment of a majority of its board of trustees. In March 2023, First Capital REIT announced a settlement agreement with Sandpiper Group pursuant to which Sandpiper agreed to drop its public campaign to nominate four trustees to the REIT's 10-member board, doing so without winning a seat on the board. Also in the first half of 2023, H&R REIT entered into a settlement with K2 Principal Fund LP, pursuant to which K2 agreed to support the election of two new independent trustees and an increase the size of the board, and to withdraw their four nominees who were slated to stand for election at the next meeting. History shows that activism surges following periods of economic uncertainty.[30]

Canadian corporate law allows shareholders with a 5 per cent stake in a company to call for a special meeting, compared to the 10 per cent required under US law. Furthermore, in Canada, a shareholder can solicit votes from 15 other investors without issuing a proxy circular under what is referred to as the quiet solicitation exemption under the applicable rules. This allows a relatively small shareholder to gather powerful allies behind closed

29 Real Estate News Exchange, 10 May 2022.

30 Kingsdale, '2022 North American Proxy Season Review'.

doors. Taken together, these circumstances give activists a more accessible basis from which to launch their campaigns. Canada's friendliness to shareholder activism helps explain why activism within the real estate market has been undergoing a paradigm shift in recent years.

REITs are vulnerable to activists in part because they are not governed by corporate statutes, but rather by their own declaration of trusts. Consequently, in response to increased shareholder activism in recent years, a large number of REITs have adopted an array of important corporate governance enhancements. REITs need to continue to take particular proactive measures to ensure they are prepared to deal with activist investors.

IV TRANSACTIONS – TAX, LEGAL, FINANCING AND REGULATORY CONSIDERATIONS

i Income tax considerations

Investment in real estate in Canada (whether directly or indirectly, by a Canadian resident or non-resident) will have significant tax implications that vary depending on the individual or specific circumstances. Investors (and real estate entities) are advised to seek tax advice in connection with any potential investments or dispositions.

Disposing of taxable Canadian property

Non-residents of Canada are subject to tax under the Income Tax Act (Canada) (ITA) if they dispose of taxable Canadian property. Taxable Canadian property generally includes:

a Canadian real property;

b shares of corporations that are not listed on a designated stock exchange that derive (or derived at any time in the previous 60 months) more than 50 per cent of their value, directly or indirectly, from Canadian real property; and

c shares of corporations listed on a designed stock exchange or units of a mutual fund trust (including REITs) if, at any time in the previous 60 months, a non-resident (together with persons with whom it does not deal at arm's length and partnerships of which the non-resident or a non-arm's length person are a member) owned 25 per cent or more of the issued shares of any class or series of the corporation or units in the trust, and more than 50 per cent of the value of the corporation or trust was derived from Canadian real property.

Rental and other non-business income

Under the ITA, certain payments by Canadian residents to non-residents are subject to withholding tax at a rate of 25 per cent (subject to applicable treaty relief). In particular, payments received by a non-resident from renting real property in Canada are subject to 25 per cent withholding tax on the gross rent received. Other payments to non-residents that are subject to withholding tax include interest paid to non-arm's length parties, participating interest, interest subject to the thin-capitalisation or proposed anti-hybrid rules in the ITA, certain administration or management fees, royalties and dividends. The applicable rate of withholding is often reduced under a treaty. Most interest payments payable under a traditional loan held by an arm's-length non-resident lender are exempt from withholding tax under the ITA. Interest that is subject to Canada's thin-capitalisation or proposed anti-hybrid rules may also be deemed to be a dividend and subject to withholding tax.

REITs

REITs are designed to act as flow-through entities. Generally, a REIT will not be liable for Canadian income tax as long as it distributes all of its income to its unit holders. Distributions of REIT income to non-residents are subject to withholding tax at a rate of 25 per cent (subject to applicable treaty relief). Distributions by a REIT that are returns of capital may also be subject to withholding tax at a rate of 15 per cent. Generally, the gain realised upon the disposition of REIT units is not subject to Canadian tax so long as the unit holder (together with persons with whom it does not deal at arm's length and partnerships of which the non-resident or a non-arm's length-person are a member) hold less than 25 per cent of the units of the REIT (see 'Disposing of taxable Canadian property', above).

Land transfer taxes

Land transfer tax is a form of provincial (and in some cases municipal) tax payable by the purchaser of real property. Subject to certain exemptions, land transfer tax in Ontario is payable on every conveyance of land tendered for registration in the provincial land registry systems and every unregistered disposition of a beneficial interest in land. The rate of land transfer tax is determined according to the type of property being transferred and the total value of consideration paid. Purchases of land in the city of Toronto are generally subject to an additional land transfer tax. Ontario and British Columbia have lso introduced foreign buyer land transfer taxes which is generally paid by non-Canadian purchasers of Canadian residential property.

Property tax

In Ontario, municipalities are entitled to levy annual property taxes under the Municipality Act. In exchange for these taxes, municipal governments provide many city-based services. The calculation of municipal tax is dependent on the value of the property compounded by the 'mill rate', which is determined annually and based on the financial needs of the municipality. In the past decade, some municipalities such as Toronto and Montreal have introduced a municipal land transfer surtax. This municipal land transfer tax is paid, by the purchaser of real property, in addition to provincial land transfer taxes. British Columbia has also instituted a speculation and vacancy tax that applies to certain owners of residential property in certain regions of British Columbia, including Metro Vancouver. This tax generally applies at an annual rate of 0.5 per cent of the value of the property for Canadians, and 2 per cent for non-residents. Vancouver has also instituted an empty homes tax of 3 per cent annually, which was introduced to return empty or under-used properties to the rental market in Vancouver. Starting in 2023, an annual tax will be levied on vacant residences in Toronto as well at a rate of 1 per cent.

Underused Housing Tax Act

The Canadian federal government also imposes a tax under the Underused Housing Tax Act (UHTA). Generally, the UHTA will impose a tax equal to 1 per cent of the value of vacant or underused residential real property directly or indirectly owned by non-resident, non-Canadians.

ii Legal framework for public market transactions

There are two common methods by which a public Canadian real estate entity can be acquired.

Plans of arrangement

A statutory plan of arrangement is a court-approved voting transaction that can be effected by a Canadian corporation according to the laws of the jurisdiction in which the company was incorporated. A plan of arrangement is unique in that it can permit a buyer to acquire 100 per cent of the shares of a target company without having to require a buyer to make an offer, or enter into a share purchase agreement, with each and every shareholder of the target company. Instead, the purchaser is required to enter into an arrangement agreement with the target company, and when the plan of arrangement is completed, the purchaser acquires all of the outstanding securities of the target company in a single step. As such, it is unsurprising that a plan of arrangement is frequently utilised in friendly, non-hostile acquisitions.

Given that plans of arrangement are voting transactions effecting corporations, the REIT-to-REIT M&A context necessitates the presence of a corporation somewhere in the REIT structure. To date, courts have been accommodating in the flexible use of the plan-of-arrangement structure, even where a transaction is primarily a REIT-to-REIT M&A transaction. Moreover, a unique feature of REIT-to-REIT mergers is that to achieve a tax deferral, the requirements in Section 132.2 of the Income Tax Act (Canada) (ITA) must be met, which is generally facilitated by structuring the transaction to be implemented with a plan of arrangement.

Takeover bid

A takeover bid, the substantive equivalent of a tender offer under US securities laws, is a transaction in which a purchaser makes an offer for the securities of a target company directly to the target company's securities holders. As the support of the target directors is not legally required, a takeover bid is the only practical means to effect an unsolicited or hostile acquisition.

Each Canadian province and territory has adopted a uniform regime under which takeover bids are regulated. Under the Canadian takeover bid regime all non-exempt takeover bids (including partial bids) are subject to the following requirements:

a a mandatory, non-waivable minimum tender requirement of more than 50 per cent of the outstanding securities of the class that are subject to the bid, excluding those that are beneficially owned, or over which control or direction is exercised by the bidder and its joint actors (the minimum tender requirement);

b following the satisfaction of the minimum tender requirement and the satisfaction or waiver of all other terms and conditions, takeover bids will be extended for at least an additional 10-day period (the 10-day extension requirement); and

c takeover bids must remain open for a minimum of 105 days, unless the target agrees to a lesser period for the bid or another transaction.

Takeover bids are infrequently utilised for friendly transactions in Canada. Among REIT-to-REIT transactions, they are even rarer.

iii Financing considerations

Considerations and conditions in public market real estate transactions are generally similar to those in other public merger transactions, but real estate transactions will often include a condition addressing the necessary percentage level of mortgagee consents to the assumption of mortgages. For the most part, mortgagers tend to consent to the assumption of their mortgages, particularly where the acquirer is well regarded as a significant player in the real estate market.

The Canadian bought deal underwriting structure, in which underwriters agree to purchase all the offered securities under a prospectus, offers certainty of funding to a public REIT acquirer. As a result, a publicly traded REIT acquirer will often arrange a bought deal financing concurrently with the announcement of its acquisitions (whether of assets or other real estate entities, making the acquirer's financing contingent on the closing of the corresponding acquisition.

Public REIT-to-REIT merger transactions are typically in the form of unit-for-unit deals, with an assumption of the underlying mortgages of the target REIT. The equity portion of such a transaction can be sourced by way of available liquid funds, or can be financed through a bank facility, which would be subsequently repaid through a public debenture or the issuance of equity.

iv Regulatory considerations

As with other M&A transactions, there are two important regulatory regimes to consider in real estate investment and M&A.

Competition Act

Under Canada's Competition Act, mergers and acquisitions of all sizes and in all sectors of the economy are subject to review by the Commissioner of Competition. The Competition Act requires companies to notify the Commissioner of Competition, by way of a pre-acquisition filing, if a proposed transaction meets, or exceeds, certain asset size or revenue criteria. Generally, a pre-acquisition filing must be submitted if:

a the aggregate value of target's assets in Canada or revenues from sales in or from Canada exceeds C$93 million (in 2023); and

b the parties to the transaction, together with their affiliates, have either assets in Canada, or annual gross revenues from sales in, from or into Canada, exceeding C$400 million.

Upon receipt of the filing, the Commissioner of Competition has 30 days, although extensions are common, to review the filing to assess anti-competition concerns. Real estate, historically, has not been a sector in which the Commissioner has given refusals or divestiture orders.

Investment Canada Act

Under Canada's Investment Canada Act (ICA), certain acquisitions by non-Canadians of Canadian businesses are subject to pre-closing review. The application of the ICA is limited to those investments made by non-Canadians that involve an acquisition of control over a Canadian business.

For acquirers who are not a state-owned entity, the financial threshold that triggers the requirement for a pre-closing review under the ICA depends on the nationality of the investor. Nationals of a specified free trade party[31] that directly acquire control of a Canadian business are only subject to a pre-closing review under the ICA if the enterprise value[32] of the Canadian business exceeds C$1.931 billion (in 2023). Investors who hail from World Trade Organization (WTO) Member States are subject to a pre-closing review under the ICA if the enterprise value of the Canadian business exceeds C$1.1.287 billion (in 2023).

For acquirers who are state-owned entities, the book value threshold required to trigger a pre-closing review will depend on the nationality of the state-owned entity. State-owned entities from WTO nations are only required to file a pre-closing review under the ITA if the book value of the Canadian business that they are acquiring meets or exceeds C$512 million (in 2023). Non-WTO Member States directly purchasing Canadian businesses are required to submit a pre-closing review if the book value of the Canadian business exceeds C$5 million. An indirect control transaction by a non-WTO Member State for a Canadian business will require a pre-closing review only if the book value of the business exceeds C$50 million.

In those transactions where a non-Canadian investor gains control of a Canadian business that does not meet or exceed the financial threshold required to trigger the submission of a pre-closing filing, a notice of investment must be filed within 30 days of closing.

V OUTLOOK

Forecasts predict that the Canadian real estate market will be generally positive through 2023, with capital expected to return later in the year as interest rates and financial systems are expected to stabilise. A stable recovery for real estate business activity and an ease in the economic and interest rate uncertainty are expected to have positive impacts on issuances, M&A activity and commercial investment. Renewed market confidence and sustained liquidity will assist in ensuring that demand for real estate assets will remain strong throughout 2023 and beyond.

31 The European Union, the United States, Mexico, Chile, Colombia, Honduras, Panama, Peru, South Korea, Japan, Vietnam, Singapore, Australia or New Zealand.

32 The enterprise value of a business is calculated differently.