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EOP: Blackstone vs Vornado

Equity Office Property (EOP) was acquired by Blackstone. EOP was founded by Samuel Zell, a legendary real estate investor and it was primarily a REIT that acquired office buildings nationwide. I read a book which chronicled the rise of Blackstone and in the latter chapter, it explained the bidding war between Blackstone and Vornado for EOP. Blackstone made the initial bid and wanted to capture the frothy premiums baked into the asking price for the buildings. Some of the interested buyers of the buildings inside EOP's portfolio were quoting 3-4% cap rates, which is similar to a 25-35x P/E. Blackstone wanted to sell off the pricey buildings and hold on to the remaining buildings, which would be a discount to the price paid for EOP. Blackstone had experience in acquiring individual buildings, but they were able to scale their investments by acquiring REITS.

REITS essentially derive money by borrowing money and acquiring buildings, which pay out annual income as net rent. As long as the net rent is higher than the interest cost, there will be a positive spread, which will be paid out as dividend. The real money comes in when the REIT starts to sell off the buildings and this is exactly what Blackstone was looking for. It was very risky to acquire a real estate company at the top of the cycle, but they were able to unload roughly 60% of the square footage in the EOP portfolio, which almost paid off the acquisition cost. So, the remaining portfolio could be sold off later on, or Blackstone could earn reasonable dividends for the long hold. Of course, the dividend yield on a cash on cash basis may not be as attractive as the leveraged yield they would have received as a result of the LBO.

Vornado tried to bait their reel with a higher premium for the stock, but a good portion of the overall package was a stock for stock deal. Mr. Zell wanted hard cash, which Blackstone offered and already had the debt lined up to acquire EOP.