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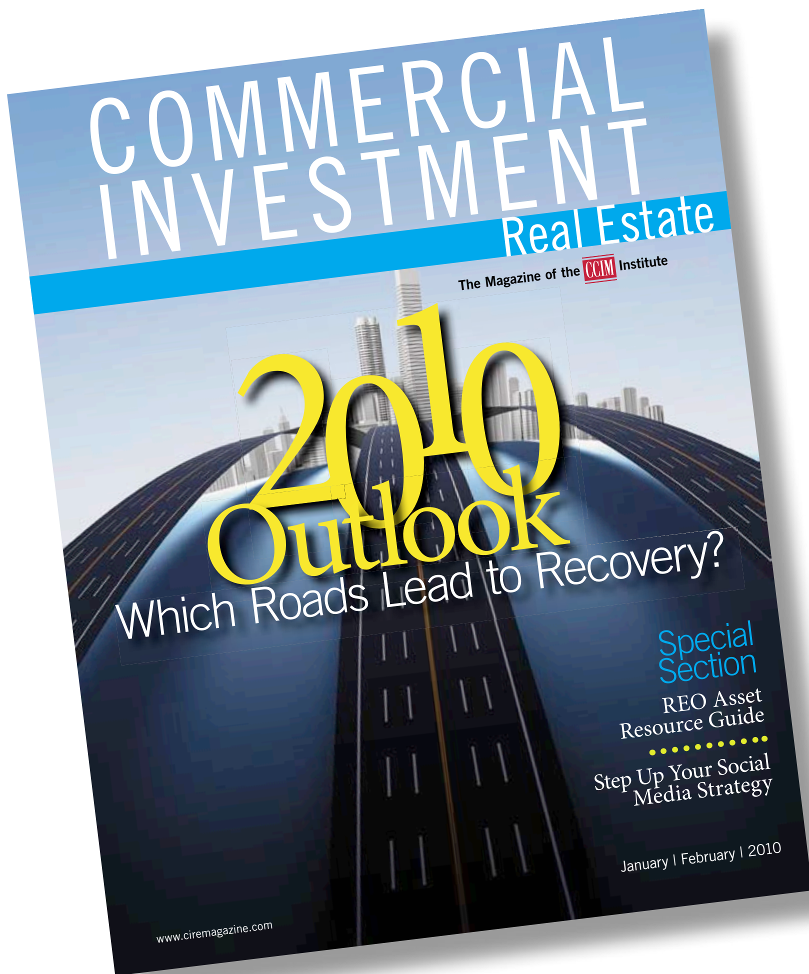

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REITs Rev Up

Real estate investment trusts gain traction for a coming buying spree.

by Michael Stuart

Amassing capital in a credit-restricted market topped real estate investment trusts' 2009 priority list, with more than $14.4 billion raised in equity issuance and another $6.7 billion in debt, according to Fitch Ratings. For the majority of REITs, these strengthened cash positions served to deleverage overstretched balance sheets. According to current statistics, U.S. REITs need to refinance approximately $20 billion of debt in 2009 and $33 billion to $40 billion in 2010, 2011, and 2012 each.

Debt Reduction

REITs have found creative ways to reduce their debt. For example, in September 2009 shopping center owner Macerich paid off $446 million in term notes that were due in 2010. Capital used for debt reduction was primarily from joint-venture sales proceeds ($275 million) and operating cash retained by reducing dividends and paying 90 percent of dividends in stock ($133 million). Industrial developer ProLogis priced an offering of $350 million in fixed-rate senior notes due Aug. 15, 2014, with an annual coupon rate of 7.625 percent and priced at 99.489 percent of the principal amount to yield 7.75 percent to maturity. The company is using the proceeds to repay a portion of the outstanding balance under its global line of credit and for general corporate purposes, which may include the repayment or repurchase of other indebtedness.

REITS' AVERAGE DEBT RATIO

Date	Ratio
Mar. 1, 2009	66%
Oct. 31, 2009	48%

Source: NAREIT

On the other end of the spectrum, certain REITs are seeking fresh equity to capitalize on the pending distressed-property fire sale. For example, Vornado Realty Trust and mall giant Simon Property Group elected to pay portions of their dividends in stock to conserve cash. Simon has raised a $6 billion war chest, according to Moody's. Additionally, some 80-odd investment funds have formed in recent months to take advantage of distressed properties. If these REITs can raise more capital through the volatile macroeconomic conditions, cheap commercial property deals with unusually high yields should be waiting for them as the market turns. In fact, capital-rich REITs are poised to be the ultimate bargain hunters for the many overleveraged and underfinanced distressed assets that will hit the market in the years ahead.

Capital Strategies

Despite the increasing number of available assets, finding equity in the current credit-restricted market remains a challenge, especially for small and midsize real estate investors and REITs. Many should consider pursuing the following nontraditional capital-raising options to gain a foothold in today's market.

Debt Financing. REITs in particular have had to become more creative in seeking debt capital. For instance, in August 2009 Maryland-based Federal Realty Investment Trust closed on a $265 million capital raise that is earmarked to pay down debt, pursue acquisitions, and fund redevelopment. The capital raise issued $150 million in five-year unsecured bonds carrying a 5.95 percent interest rate as well as an equity component of $115 million in common stock. Some of the proceeds will be used to pay down a $372 million term loan.

In another example, Simon recently sold $500 million of five-year unsecured bonds priced to yield 5.46 percent, bringing the total capital Simon has raised in bond and equity offerings since March 2009 to $3.4 billion. Its cash available for strategic acquisitions, including capacity on its revolving line of credit, is now in excess of $6 billion.

Stock Offerings. In July 2009, Apollo Commercial Real Estate raised $600 million in an initial public offering. Apollo's filing comes amid a spate of similar moves by other high-profile investment companies such as Alliance Bernstein and Western Asset Management, both of which have created REITs that have applied for IPOs in the past few months. One of the best-capitalized REITs, Tanger Factory Outlet Centers announced a secondary share offering of roughly $100 million in new equity.

At least 29 property REITs and real estate operating companies went to market with secondary or follow-on stock offerings in fall 2009, raising more than $8 billion in new financing — and no lender strings attached. The money raised is being used primarily to build up liquidity by reducing the outstanding balances on secured and unsecured

Jeremy Maude/Masterfile

lines of credit and repaying loans upon their maturity dates. However, some of the new money is being set aside for future acquisitions, redevelopments, and capital improvements. The latest round of secondary stock offerings is supplementing other efforts the companies have undertaken to enhance liquidity. Other efforts include raising more secured financings; dividend modifications in the form of cuts, partial stock dividends, and/or suspensions; and asset sales.

Block Sales. Other REITs are considering company sales of a block of common equity to a single or a limited number of third-party buyers. The terms of these transactions vary and are specific to the objectives of the individual company and purchasers involved. These transactions can offer a number of advantages to a company, including very short marketing periods with little or no associated market arbitrage risk. The downside risks include the actual cost of the capital, including control, which should be carefully weighed prior to sourcing capital in this manner.

REITs are gaining access to capital on reasonable terms.

Joint Ventures. Joint venture arrangements with pension funds, insurance companies, and other private equity investors are becoming an attractive financing alternative for developers and investors. The primary benefit is that companies only are selling a position in specific assets, not equity in the parent company.

In the past, Developers Diversified Realty Corp. sold portions of properties in which it held 100 percent ownership. By selling a percentage of the ownership to institutional investors, a REIT can release capital that is tied up in those properties. For example, in 2000, DDR converted the previously wholly owned Deer Valley Towne Center, a 460,000 square-foot shopping center in Phoenix, to a 50-50 joint venture with DRA Advisors, a New York-based institutional investment advisory firm. The Deer Valley joint venture was valued at about $26.7 million. DDR contributed the property and accompanying $18 million mortgage, and in return it received $4.3 million in cash from the DRA fund's equity contribution to the venture. DDR used those proceeds for a variety of purposes, such as financing a stock repurchase program, repaying existing debt, and funding equity requirements in ongoing development projects.

What's Next?

As evidenced by more than $20 billion in 2009 capital raises, financially sound REITs are gaining access to capital on reasonable terms. Additional REITs are likely to tap into the capital markets in the near term, but their success will depend on strong management and execution teams that are open to creative capital-raising options.

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