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REPORT

REITs

REITs Raise $15 Billion in New Capital To Pay Down Debts, Brace for the Future

In a process that resembles swimming upstream in a debt-swollen financial river, dozens of U.S. real estate investment trusts have raised more than $15 billion dollars, mostly since REIT stock prices began an impressive rebound in March.

Much of that new cash is going toward repayment of debt, which will help bolster the companies' balance sheets. Historically REIT debt-to-equity ratios have hovered around 45 percent, but they have risen substantially as stock prices dropped over much of the past two years, reaching an industry average of more than 60 percent late in 2008. The debt ratio for equity REITs as of May stood at 55.6 percent, according to the National Association of Real Estate Investment Trusts.

Rich Moore, a REIT analyst at RBC Capital Markets, told BNA the market itself was largely responsible for the REIT recapitalization effort. ''There was a perception by the market—and you could say it's right or wrong—that most of these REITs had too much leverage,'' Moore said. ''So what they did was to right-size the balance sheet, if you will. And now that the balance sheet is . . . for most of these guys, right-sized, there's no real reason for them to issue additional equity until such time as they either buy or build something new. [They are] not going to build something new for quite some time.''

Ron Sturzenegger, managing director and global head of real estate, gaming, and lodging for Bank of America Merrill Lynch, generally agreed with that point of view. His firm served as the lead underwriter for 40 REITs that issued offerings this spring. Many REITs, Sturzenegger said, ''had debts coming due; they had revolvers that maybe were going to expire in late 2009, maybe somewhere in 2010. Maybe they had one-year extensions, which would have gotten them into 2011. They had some term loans that may have been coming due. They had some [commercial mortgage-backed securities] debts coming due between now and 2011.''

All of these firms had shorter-term financial needs and sought capital to address them, Sturzenegger said. Their options were to liquidate assets, which they preferred not to sell, borrow more money from banks, which were reluctant to lend, or raise equity.

''We pursued holistic solutions, where we laid out very clearly between now and 2011 how much capital was needed and then we went to the equity markets and we raised that amount of money . . . '' Sturzenegger said. ''We pretty much only raised enough capital to get these REITs stable through 2011. We did not raise them excess cash for them to go out and be buyers of assets.''

Larger REITs Raise Capital. NAREIT data indicate that 46 REITs, or just over 34 percent of the 134 companies listed on the FTSE NAREIT index of equity and mortgage REITs, recapitalized in the first half of 2009 alone. Of that total, 43 are equity REITs, which raised $13.552 billion, and three are mortgage REITS, which raised $2.112 billion. The mortgage REITs include Chimera Investment Corp., Redwood Trust Inc., and Anworth Mortgage Asset Corp. Moore said most of the REITs that were in a position to conduct a secondary offer this year already have done so.

''There are some REITs that didn't get around to doing their equity [offerings],'' Moore said. ''You may see those guys come out, so there could still be some equity offerings, and likely will be, by the way. But it won't be to the magnitude that we saw in the last nine months.''

Although REITs of all sizes representing all major industry categories conducted equity offerings, a significant share of the total was raised by some of the largest companies. Of the total dollar amount of secondary offerings, $7.207 billion, or 46 percent, was raised by seven big REITs that issued at least $500 million in stock each.

Some industry observers have speculated that at least a handful of REITs could use the new capital to help fund purchases of distressed industry assets, which are expected to be in abundance as the recession continues to unfold.

In a statement announcing its April 22 public offering, Vornado Realty Trust indicated that one of its motivations was to defray some of its debt, but it also hinted at a potential strategy to use the new resources for future purchases. ''Vornado intends to use the net proceeds from the offering for general corporate purposes, which may include repayment of indebtedness and acquisitions,'' the company statement said. The company declined to comment further on its business strategy.

Vornado sold 15 million common shares at $43 per share, plus an additional 2.25 million common shares purchased by the underwriters as an over-allotment. The company raised $741.75 million in the offering.

Simon in Strong Position. Among the REITs in the most favorable entrepreneurial situations is Simon Property Group Inc., a major regional mall operator that manages more than 300 properties. Simon, the largest U.S. equity REIT with market capitalization of just over $15 billion, raised nearly $1.7 billion in two offerings in March and May.

Sturzenegger said he thinks Simon may be the only REIT to raise capital this spring that is likely to be in buying mood in the near term.

''Simon is one of the only that I would say to have raised debt that they actually have dry powder.'' Sturzenegger said.

Moore had a somewhat different take on the potential for other REITs to pick up new assets. ''There are a lot of REITs—Simon is chief among them—that have a balance sheet that is certainly capable of making acquisitions at this point,'' he said. ''I think they all started with the notion that they wanted to make sure that they're safe . . . ''

However, Moore noted that once investors are convinced a REIT is financially secure, ''they could waltz out there and make some acquisitions. But I've got to tell you the acquisitions are not going to occur until there's more health in the debt markets.''

In short, despite the recent run of equity offerings, commercial real estate (CRE) still relies on a combination of debt and equity to function normally. Although traditional lenders such as banks and insurance companies continue to lend to the industry, the all-important market for commercial mortgage-backed securities remains in limbo. A federal initiative in the form of the Term Asset-Backed Securities Loan Facility (TALF) is being implemented and may begin to inject new life into the debt markets in the coming weeks.

Investors Wary of Leverage. Yet Moore noted the industry's approach to acquisitions itself has changed as investors exhibit less interest in highly leveraged purchases.

''The problem with an acquisition is you have to pay for it,'' Moore said. ''You pay for part of it with equity and you pay for part of it with debt. And the part that you pay for with debt is now less than it used to be. In other words, you used to be able to pay for it with 75 percent debt and now you can only pay for it with 50 percent of debt. But you still have to find debt . . . So none of these acquisitions is going to occur until the debt markets open up again.''

Sturzenegger said potential sellers continue to weigh their options and will not begin disposing of distressed assets until later this year or early in 2010 when lenders no longer extend maturing loans. At that point, he said he anticipates a new round of REIT secondary offerings as the stronger companies gear up to find bargains.

To the extent that the next chapter in REIT activity involves consolidation, Sturzenegger said he expects to see them acquire assets held by private investors rather than properties now owned by other REITs.

''There may be some consolidation within the REIT sector, but I think the real consolidation is going to be outside,'' Sturzenegger said. ''The fact that these [equity] REITs have gone out and raised $13 billion in the worst real estate market we've seen since 1991 tells me that they've got staying power and that they have investors who want to see them succeed. So as some of the private guys finally get to that level of distress, I think . . . the purchasers of real estate will be the public REITs because private guys can't raise any equity.''

Access to Debt Markets. Not all of the capital market activity this spring has been on the equity side. Six REITs have issued a total of $2.393 billion in debt since March 20. They include Simon ($1.25 billion in two issuances), Ventas Inc. ($200 million), Digital Realty Trust Inc. ($260 million), Alexandria Real Estate Equities Inc. ($225 million), Host Hotels & Resorts Inc. ($400 million), and BRT Realty Trust ($58.3 million).

Again, Simon was the biggest single player in this arena. Sturzenegger explained that the company's strategy was to replace some of its shorter-term debt with longer-term maturities of seven to 10 years. Further, he said, Simon wanted to make a statement about its liquidity by proving to the market that it could raise debt capital.

Not all REITs will have success in the debt or equity markets, at least not immediately. In a June 23 special report, *U.S. Equity REIT Liquidity Update: Hold the Applause*, Fitch Ratings said that, ''Recent unsecured bond issuances do not constitute a panacea for REIT liquidty, as the unsecured bond market remains unattractive to most equity REITs.''

Fitch noted that it ''believes the maintenance of sufficient liquidity represents the primary credit risk to U.S. equity REITs despite recent opportunistic actions to reduce financial pressures.'' The report described availability of financing for REITs across the various capital markets as ''tenuous,'' and noted that commercial real estate performance has deteriorated, while significant debt maturities await the industry just over the horizon in 2011. Further, uncertainty about net operating income capitalization rates continue to haunt the CRE sector and suppress the availability of debt secured by institutional investors, according to Fitch.

Although the Fitch report acknowledged that the recent successful secondary offerings ''have enabled REITs to reduce leverage and bolster liquidity since the beginning of 2009,'' it added that ''opportunities are company-specific rather than broad for the sector . . . ''

Advantages of Public Markets. Industry analysts suggest that the ability of REITs to go to the public capital markets gives them an advantage over private equity funds in gearing up for future acquisitions. Also, many private operations became notably overleveraged during the heyday of real estate investment and strain today just to stay afloat, let alone plan for expansion.

Moore, however, said the market for commercial real estate could follow any number of scenarios.

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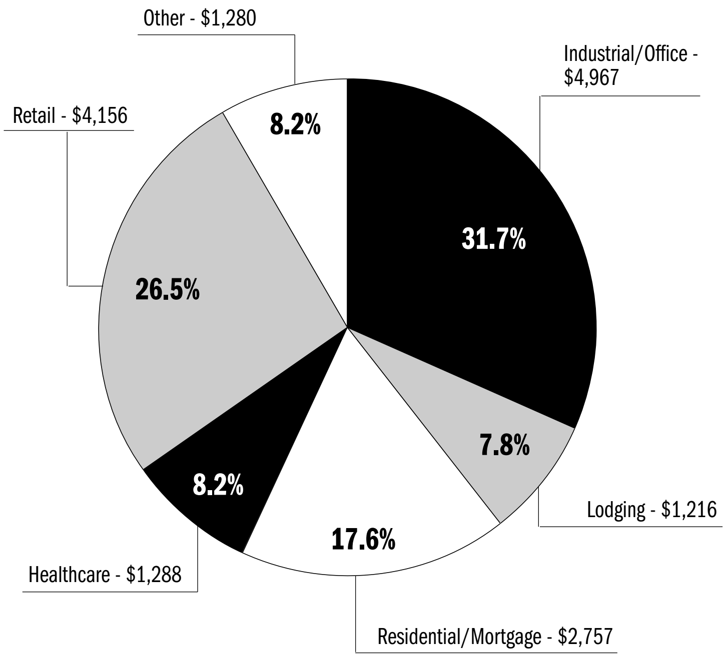
REIT Secondary Stock Offerings – First Half 2009

Millions of Dollars

Healthcare

HCP, Inc.	$440
Ventas, Inc.	$350
Health Care REIT, Inc.	$233
Senior Housing Properties Trust	$109
Cogdell Spencer Inc.	$81
Medical Properties Trust, Inc.	$75



Industrial/Office

ProLogis	$1,154
Boston Properties, Inc.	$863
AMB Property Corporation	$576
Duke Realty Corporation	$575
SL Green Realty Corp.	$406
Alexandria Real Estate Equities, Inc.	$308
Brandywine Realty Trust	$254
Kilroy Realty Corporation	$201
BioMed Realty Trust, Inc.	$191
Highwoods Properties, Inc.	$151
DCT Industrial Trust Inc.	$117
Parkway Properties, Inc.	$99
Corporate Office Properties Trust	$73

Lodging

Host Hotels & Resorts, Inc.	$500
Hospitality Properties Trust	$231
LaSalle Hotel Properties	$170
LaSalle Hotel Properties	$125
Sunstone Hotel Investors, Inc.	$104
DiamondRock Hospitality Company	$86

Residential

Chimera Investment Corporation	$811
Chimera Investment Corporation	$622
Redwood Trust, Inc.	$298
Camden Property Trust	$285
Redwood Trust, Inc.	$250
American Campus Communities, Inc.	$208
Equity LifeStyle Properties, Inc.	$153
Chimera Investment Corporation	$75
Anworth Mortgage Asset Corporation	$56

Retail

Simon Property Group, Inc.	$1,150
Kimco Realty Corporation	$747
Simon Property Group, Inc.	$543
Weingarten Realty Investors	$459
CBL & Associates Properties, Inc.	$403
Regency Centers Corporation	$325
Tanger Factory Outlet Centers, Inc.	$142
Inland Real Estate Corporation	$120
Equity One, Inc.	$107
Kite Realty Group Trust	$92
Acadia Realty Trust	$69

Other

Vornado Realty Trust	Diversified	$742
Mack-Cali Realty Corporation	Not Specified	$288
Washington Real Estate Investment Trust	Diversified	$123
Digital Realty Trust, Inc.	Specialty	$98
Investors Real Estate Trust	Diversified	$30

January	$605	April	$6,419	Quarter One 2009	$2,296
February	$263	May	$4,982	Quarter Two 2009	$13,368
March	$1,428	June	$1,967	First Half 2009	$15,664

Source: NAREIT

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''There's a lot of equity capital sitting on the sidelines, so I think that equity capital in the private world is there, but I think [private equity funds] struggle with the same situation [that faces REITs],'' Moore said. ''Unless you're going to pay 100 percent equity for something, good luck finding the debt to go along with it.''

BY RICHARD COWDEN

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