NEW SOURCES AND TECHNIQUES IN SHOPPING CENTER FINANCING:

Three Case Studies

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Overview

A very dramatic change has been observed in the economic environment in which shopping center developers and retailers alike find themselves operating. Many of the traditional institutional sources for financing are just not available, either because the Bank has disappeared altogether or the "bloom" is off commercial lending. This new economic environment obviously has impacted on developers and investors at all levels.

Overlaying the different economic factors is the changing face of retailing itself. The emergence of "category killers" and "big box" retailers has ushered in a new era of low margin volume retailing. Development styles themselves are changing with retail "pads" taking priority over inline space.

To reinforce the practical nature of this research, developers of neighborhood, community and regional or super-regional shopping centers were visited through a "case study" method at different locations in North America to see how they have adjusted to these new parameters.

In the process, relevant sources and techniques were identified that are being applied for the financing of shopping centers in today's economic environment. These new sources and techniques have been organized in case form in the three cases that follow, starting with Case # 1 involving the condominiumization of a neighborhood shopping center. The second case study outlines the expanded use of trade credit being observed in community sized shopping center developments, and Case # 3 is an overview of the REIT (Real Estate Investment Trust) market that has been indicative of the trend towards equity as opposed to debt financing at the regional and super-regional level.

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■ Case Study # 1* The Neighborhood Shopping Center

(Centers up to 100,000 square feet)

"The Condominiumization of a Neighborhood Shopping Center"

Neighborhood shopping centers typically have been the bastion for the smaller entrepreneurial developer. It was our intention to study how these developers were adjusting to the new rules of the game and to assess how the financing problem was being solved at this level. In the process we have uncovered a unique situation that involves the condominiumization of a neighborhood shopping center.

Description of the Property

The center involved is a 14–year–old retail development with a rentable area of approximately 46,000 square feet. This center is built on a 3.16 acre site and has a typical "L"–shaped design with one free–standing restaurant pad. A more detailed description of the property is outlined in Exhibit I, "Project Description," Exhibit II, "Site Plan" and Exhibit III, "Neighborhood Map." Using today's typical average triple net rent of approximately $8.00 per square foot, and a capitalization rate of 11.5% (typical of similar shopping centers in the market), the center would have a value of $3,200,000.00. This would translate into approximately a $2,240,000.00 mortgage at a 70% loan to value ratio.

Today's replacement cost on a center of this nature would be in the $120.00 per square foot range, or $5.5 million, including land, building and all indirect construction costs. Comparing this to the value of the center it is easy to see why the economics of such centers are "offside" in today's market.

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*Case # 1: Although the actual details of the case have been preserved, the identity of the center has been purposely omitted to preserve confidentiality.

The center described is suited ideally to being condominiumized as it includes a number of small businesses with the following tenant mix:

Pet supply store	Jewelry store
Dress shop	Title registry office
National paint company	Restaurant
Law office	

Innovative Financing Technique

In assessing what approaches could be taken either to finance or market this center, the sponsors came up with a very intriguing solution. It was felt that in today's economic environment, lenders must be given a reason to lend against this type of real estate rather than reasons *not* to give the loan. In assessing the type of lending being done by the banks, there is a noticeable effort towards lending to small businesses as a way to diversify the banking portfolio. In fact, in many jurisdictions there are government backed programs targeted towards small business. In Canada, there is a Federal Government program which insures loans to small businesses up to $250,000.00 (see Exhibit IV, "Business Improvement Loans.") The program offers financing up to 100% to acquire assets necessary for the operation of the business subject to the borrowers' ability to service the debt and a proper credit history.

This shopping center was condominiumized through a process of having the center surveyed and registering a condominium plan with the local municipality. The individual bays in the center were then marketed in the first instance to the tenants using the small business loan program, and in the second instance to investors seeking a smaller commercial real estate investment.

Outcome

This center is being marketed at prices in the $78.00 per square foot range. The free–standing restaurant pad was sold as a stand-alone entity in the $1,000,000.00 price range. The aggregate sellout price is therefore approximately $4,100,000.00, which would translate to a capitalization rate of approximately 8.9%, as compared to a rental income investment capitalization rate of 11.5%.

The price point for sale to the tenants was arrived at by giving the tenant a price which would show a cashflow gain against current monthly lease costs. To convince the tenant further, a schedule outlining the monthly cash flow gain and the equity gain through retiring the mortgage was prepared for presentation to each tenant (Exhibit V, "Tenant Financial Benefits.") An outline of the benefits of retail condominium ownership was included in the investment package prepared for each tenant (Exhibit VI, "Benefits of Retail Condominium Ownership.")

Many of the same arguments that promoters of residential condominiums would use to attract renters to their property apply in this retail situation. (In other words, your rent contributes to mortgage reduction, you can take pride in your investment, etc.)

Most of the bays in the center are included in the Canadian Federal Government Small Business Loan Program. A few of the tenants declined to purchase their bay, but there was surprising interest from the investor community. A 1,500-square foot bay could be acquired in the range of $135,000.00. This size of investment definitely appeals to the smaller commercial investor who otherwise might not be able to participate in a commercial real estate investment.

As this case was being prepared, the shopping center was still in the process of being marketed. The major "national" tenants typically declined to purchase. However, this type of covenant on a lease was of more interest to the investor community, hence there was a certain compatibility in marketing to the tenants first, and then to investors. While the sponsors were "pioneering" in terms of the local market and sales proceeded a little slower than expected, there are precedents for similar developments in other major markets.

Issues Raised by this Case:

This neighborhood shopping center represented a particular combination of circumstances that benefited from a condominiumization approach. The marketing of the center in this manner clearly was driven by the availability of up to 100% financing for the tenants on a limited guarantee basis.

Clearly this approach would not work in larger centers that are best managed towards a singular strategy. There are a number of conflicting issues raised through having tenants with potentially competing interests as co-owners of a center. In addition there was also the issue of having investors owning some of the units with other potentially varied objectives.

Certainly there was an attempt to manage these conflicts through an initial set of condominium bylaws that allowed individual owners to "veto" alternate uses regardless of their proportionate share of ownership. The role of property management as a referee for potential conflicts clearly became more important than just being around for snow removal and landscaping.

In summary, the condominiumization of a neighborhood shopping center is a unique technique driven by the availability of financing while offering tenants an opportunity to improve cash flow and build equity in a commercial real estate investment.

Exhibit I:

Condominiumization of a Neighborhood Shopping Center Project Description

Site Data; Site Size:

Total land area is 3.16 acres more or less, zoning: CSC (shopping center district).

Site Topography:

The subject site is generally rectangular shaped. The site is level and conforms to other property in the immediate area.

Surrounding Properties:

The properties surrounding the subject property are commercial and industrial.

Building Description:

The building is a 14–year–old single story commercial neighborhood shopping center divided into 18 commercial retail units plus a free-standing restaurant pad located at one corner of the property (see Site Plan).

Basic construction is concrete block and giant brick, with the exterior having metal fascia and portions with brick facing. The roof is built up with a tar and gravel finish.

The windows and doors are double–glazed anodized aluminum units. The interior is dry wall with vinyl tile and broadloom floor coverings and T-bar ceilings.

The building is heated and air conditioned with rooftop units.

The total rentable area of the property is 46,182 square feet (more or less).

Exterior Improvements:

The lot is paved and lined with steel light standards. The lot has 2 islands with paving stones and landscaped with trees. In addition there is a landscaped area around the front of the property. There is a sidewalk around the front of the building. The back of the property has a concrete retaining wall and a wood fence. The area is paved and used as a driveway and loading and unloading area.

Exhibit II:

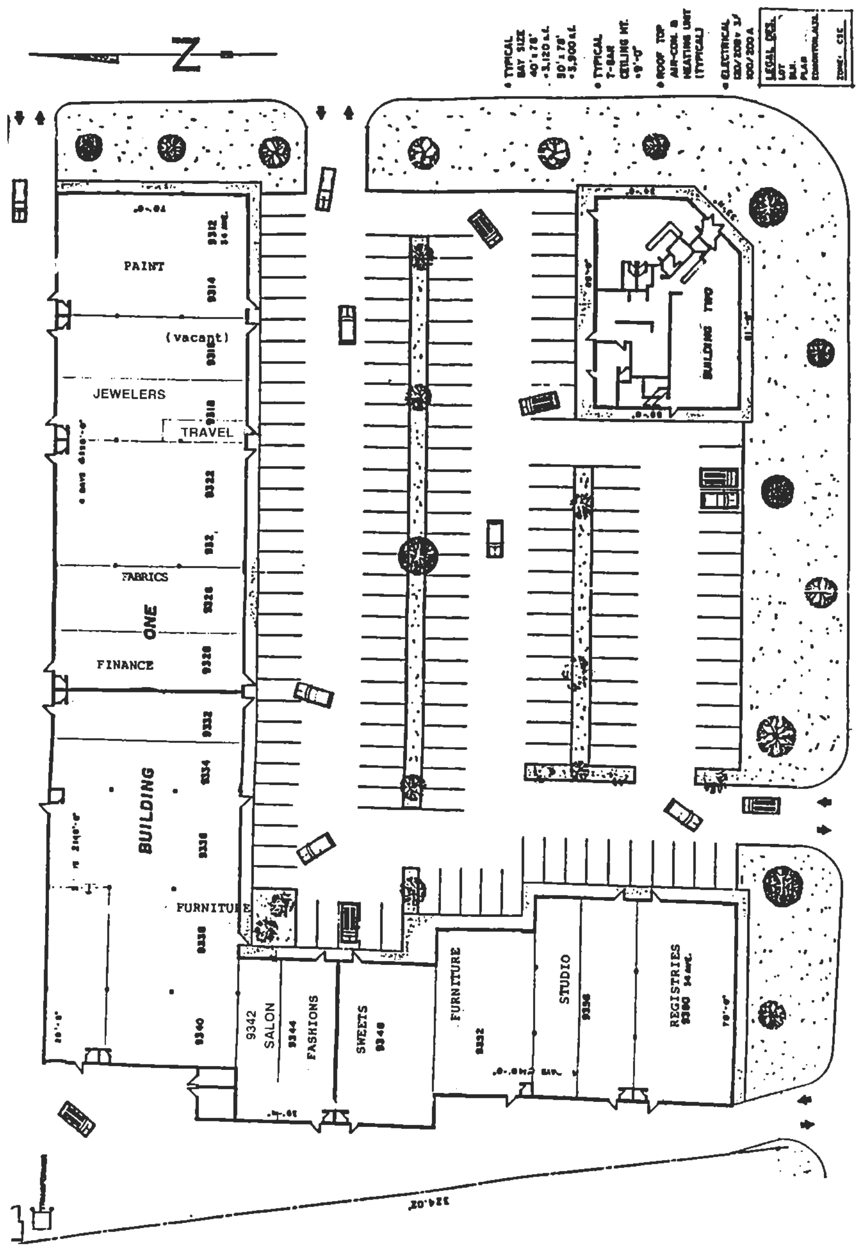

N
PAINT
(vacant)
JEWELERS
TRAVEL
FABRICS
FINANCE
BUILDING ONE
FURNITURE
9342 SALON
FASHIONS
SWEETS
FURNITURE
STUDIO
REGISTRIES
BUILDING TWO
324.02'

Exhibit III:

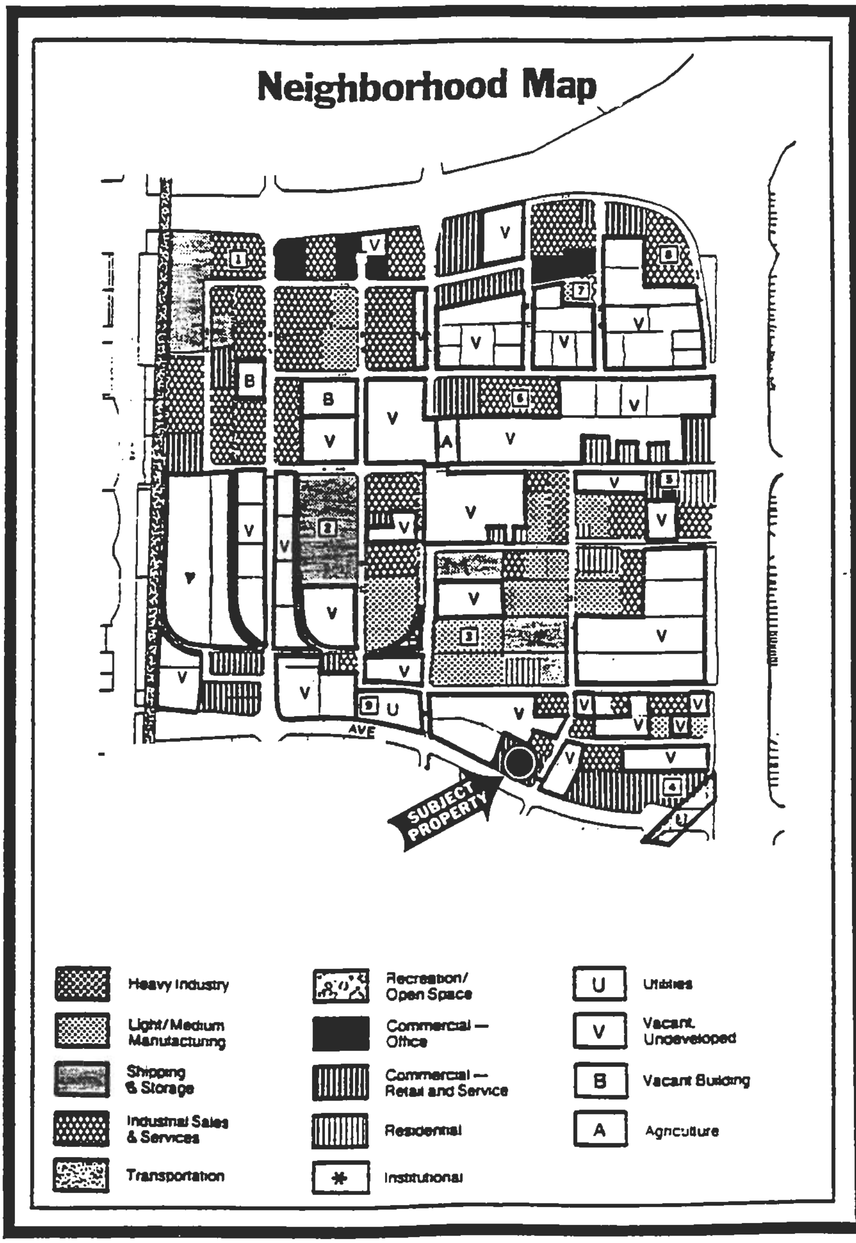

Neighborhood Map
AVE
SUBJECT PROPERTY
Heavy Industry
Light/Medium Manufacturing
Shipping & Storage
Industrial Sales & Services
Transportation
Recreation/ Open Space
Commercial — Office
Commercial — Retail and Service
Residential
Institutional
Utilities
Vacant Undeveloped
Vacant Building
Agriculture

Exhibit IV:

Business Improvement Loans

BUSINESS IMPROVEMENT LOANS

The *Small Business Loans Act* (SBLA) is a federal government program designed to help new and existing small business enterprises obtain term loans from chartered banks and other lenders toward financing the purchase and improvement of fixed assets.

These business improvement loans are made directly by approved lenders to small business enterprises. The SBLA provides for the sharing of loan losses, if any, between the lenders and the federal government. Loans may be transferred from one lender to another.

Definition

A small business enterprise is one with an estimated gross revenue not exceeding $5 million during the fiscal year in which the business improvement loan application is made.

Eligibility

Any small business enterprise operating for profit is eligible for loans under the SBLA program. This definition includes professional practices, but excludes farming, renting or purchase for resale of real estate, and charitable or religious enterprises.

Loan Purposes

Business improvement loans are available for the purpose of financing:

- the purchase of land necessary for the operation of a business enterprise (land loans)
- the renovation, improvement, modernization, extension, construction and/or purchase of premises (premises loans)
- the purchase, installation, renovation, improvement and/or modernization of new or used equipment (equipment loans).

Business improvement loans are not available for the purpose of financing:

- the acquisition of shares
- working capital (i.e. inventory, accounts receivable, etc.)
- existing debt, with the exception of refinancing fixed-asset purchases made up to 180 days prior to the loan application.

Terms and Conditions

The maximum amount of business improvement loans a borrower may have outstanding in aggregate under the SBLA and the *Fisheries Improvement Loans Act* may not exceed $250 000. Business improvement loans can be used to finance, at the discretion of the lender, up to 100 percent of asset acquisition costs until 31 December 1995 and 90 percent thereafter.

For floating-rate loans, the rate of interest cannot exceed 1.75 percent over the prime lending rate. For such loans, the interest rate fluctuates over the term of the loan with changes in the prime lending rate. For fixed-rate loans, the rate of interest may be fixed for the term of the loan at not more than 1.75 percent over the residential mortgage rate for the applicable term.

Borrowers must pay a one-time, up-front government administration fee of 2 percent of the loan, which may be added to the amount of the loan.

The maximum period over which a business improvement loan may be repaid may not exceed the economic life of the asset being financed up to a maximum of 10 years, with principal instalments paid at least annually or more frequently at the discretion of the lender.

All business improvement loans must be secured. The lender is obliged to take security on the assets financed in a form consistent with normal lending practices. The lender may not take personal guarantees for more than 25 percent of the original amount of the loan, and any such guarantees may not be secured with personal assets.

Lenders are expected to make business improvement loans with the same care as in the conduct of their ordinary business and to use normal commercial lending practices in drawing up agreements and in servicing these loans.

Where to Apply

Most financial institutions in Canada are authorized to make business improvement loans. Small business enterprises seeking assistance under the SBLA should discuss their financial requirements with the lender of their choice for advice on how their credit needs can be accommodated.

Additional Information

Further information on the *Small Business Loans Act* program is available from lenders, or:

Small Business Loans Administration
Industry, Science and Technology Canada
235 Queen Street
OTTAWA, Ont.
K1A OH5

Exhibit V:

Tenant Financial Benefits	
Client Name	**Registry**
Purchase Price	$278,382.00
Equity (10%)	$27,838.20
Financing (90%)	$250,543.80
Price Per Foot	78
Mortgage Amount	$250,543.80
Annual Interest Rate	8%
Amortization (Years)	20
Amortization (Months)	240
Regular Payment Amount	$2,075.40
Existing Lease Rate	$8.00
Square Footage	3,569
Current Monthly Lease Cost	$2,379.33
Cost of Financing on Purchase (Month)	$2,075.40
Cash Flow Surplus	$303.94
Monthly Equity Gain (Average)	$527.59
Total Monthly Gain (Surplus + Equity Gain)	$831.52
Effective Rental Rate	$5.20
Cash Flow Surplus (5 Years)	$18,236.10
Equity Gain (5 Years)	$31,655.24
Total Gain (5 Years)	$49,891.34

Exhibit VI:

Benefits of Retail Condominum Ownership

1. *Security of Location:*

By owning your own store location you are no longer a "tenant" and subject to the renewal option.

2. *No Lease Payments:*

It is commonly recognized that the sooner we can purchase our own home, the sooner we will begin to gain equity and start paying off our own mortgage versus someone else's. This can now be the case for your business.

3. *No Rent Increases:*

By owning your own premise you are no longer subject to increased lease rates and the demands of the landlord.

4. *Leasehold Improvements:*

The value that you have in your location is now yours. This now means that you will reap the benefits of any improvements you make. Under a lease, should you leave, the leasehold improvements are the property of the landlord.

5. *Control Over the Center:*

By being an owner in the condominium, you have the say as to what direction the management is given. Each owner has the same vote and therefore has as much say as any other tenant regarding how you want the center run, and what types of business will be allowed into the center.

6. *Real Estate Investment:*

It has been shown that much of the world's wealth has been achieved through owning real estate. Commercial real estate has traditionally been available only to large landlords due to the high price of purchasing a shopping center. The same opportunity is now available to individual retailers.

■ Case Study # 2 The Community Sized Shopping Center

(100,000 to 300,000 square feet)

"Making Use of Trade Credit"

The community sized shopping center market certainly has been impacted by a changing economic environment for real estate financing. This area of the development market has been home to the typical grocery/drug store-anchored center that is still enjoying growth in terms of new development in many markets in North America. Developers of this category of center have become comfortable working in different geographic markets. New strategies for development emerge as developers align themselves with retailers.

The typical financing scenario involved optioning the land; arranging a cost based loan supported by pre-leasing requirement typically placed with the banking sector. Finally, either during construction or at completion of the project, arranging a permanent fixed rate mortgage, typically placed in the life insurance or pension fund community. With traditional funding sources backing away from commercial real estate because of the "problems of the '80s," this case centers on how developers of community sized shopping centers have accomplished their development objective.

The Portland, Oregon, market place, which has shown sustained growth, was selected for study and the Vancouver, Washington, market was included as a microcosm of this trend. In the second example, a Canadian developer is profiled. Western Asset Management has been successful in building community sized shopping centers in both Canada and the United States.

I. The Portland Metropolitan Market

Portland, Oregon was selected as a metropolitan area that has remained as a relatively stable economic environment for real estate developers. Clark County in Washington State, just across the Columbia River from Portland, was chosen as the focal geographic area for the research. The United States Government has projected Clark County to be one of the faster growing areas in the Pacific Northwest. This growth is attributed to an expanding job market with greater diversification; a highly livable and clean environment; significant recreational opportunities in the area; available vacant land; good infrastructure; proximity to the Portland International Airport; and the advantageous tax structure of Washington in comparison to Oregon.

Although Clark County continues to mirror the growth in economic health of the Portland metropolitan area, it is gaining its own economic independence with the recent influx of several large electronics firms (Exhibit I presents an overview of the Portland retail market).

Not surprisingly, this growing and stable economic climate has not gone unnoticed by the retailing community. Most of the significant major retailers have expansion programs for the Clark County area. A new community-sized development was tracked through its initial financing phase.

Description of the Property

The proposed development is situated on approximately 10 acres of land and contains approximately 120,000 square feet of rentable area. The center is anchored by a 55,000 square foot major supermarket and a 30,000 square foot major drugstore; with the balance a blend of inline and "pad" space. The site has the following demographic profile:

	3 mile radius	5 mile radius
Population:	50,000	105,000
Households:	18,000	39,000
Average Income:	$34,000.00	$31,000.00

The site is on a major artery which enjoys traffic flows in the range of 42,000 vehicles per day. (A site plan of the project is included as Exhibit II.)

Development Procedure

The land was put under contract through an option agreement from the existing landowner. A pre-leasing program was commenced while the necessary municipal approvals were obtained. During this time frame, approximately four months, 70% of the project was pre-leased. It became obvious to the developer during this process that the normal banking facilities that had been available in the past for land acquisition were no longer available.

The developer took the approach of making a presentation to the major grocery anchor tenant in respect to supplying financing for the land acquisition. It was proposed that this land acquisition loan be secured by subordinated debt through the construction phase of the project. This would allow for a more traditional construction loan or the use of other trade credit sources for the ultimate financing of the project.

The tenant agreed to supply the financing for the land acquisition. This use of tenant financing as subordinated debt represents both an innovative source and technique in overcoming the financing obstacle. The tenant-developer relationship has been a fairly traditional barrier, which typically has not been crossed for financing purposes.

During further evaluation of the Portland metropolitan market, we found that most of the community sized shopping centers were being built by developers who had aligned themselves with major tenants who were supplying financing in one form or another. In some instances, major tenants were supplying working capital to smaller developers who used their expertise to acquire sites and put them through the necessary development process. In other instances, the tenant has become a true "partner" of the developer in a joint venture to acquire and develop the property. In still other instances, an initial acquisition loan is converted to a lease upon the completion of the project.

II. Western Asset Management

To confirm whether the trend towards the use of trade credit in the financing of community sized centers was indeed prevalent at a variety of locations, a successful developer who has worked both in Canada and the United States was interviewed. This developer is presently developing a site in a major urban setting in Florida. The site ultimately could accommodate approximately 350,000 square feet of rentable space. There is approximately 70% pre-leasing in place, all to tenants who could easily be described as major or national in scope.

In exploring with this developer how they planned to tackle the construction financing dilemma in today's market, it was noted with interest that they were in receipt of a proposal from a major contractor who had agreed to bridge the construction financing with their own banking facilities. This facility, provided by the contractor, will in fact negate the need for construction or interim financing. From the contractor's point of view, it was a competitive advantage to offer this financing as it precludes other, smaller contractors from bidding on this project.

Within the last two years, Western Asset Management has also completed a grocery anchored center in Edmonton, Alberta, using a similar vehicle. In this case, the project was pre-sold to a major Canadian investment fund with the price determined on a formula relative to the ultimate income achieved by the project. With this pre-commitment in place, a major Canadian contractor supplied the necessary construction financing to complete the project in exchange for a contract to build the shopping center. The developer no longer needed a construction facility from a bank but only had to make arrangements for the necessary financing for the acquisition of the land. The contractor's position was secured by mortgage until pay-out by the investment fund.

Issues Raised by this Case

The two scenarios portrayed in this case both represent extensive use of trade credit as a departure from traditional banking sources for land acquisition or construction financing. These represent innovative financing techniques that are employed in today's environment.

The use of trade credit is a significant departure from traditional relationships between developer/contractor and developer/tenant.

Within the context of shopping center development today, a more significant trend towards the sale of pads rather than the development of inline space was observed. The role of the developer in this instance is evolving as the source of expertise in obtaining municipal approvals and co-ordinating the predevelopment process, rather than landlord and end owner/investor.

Exhibit I:

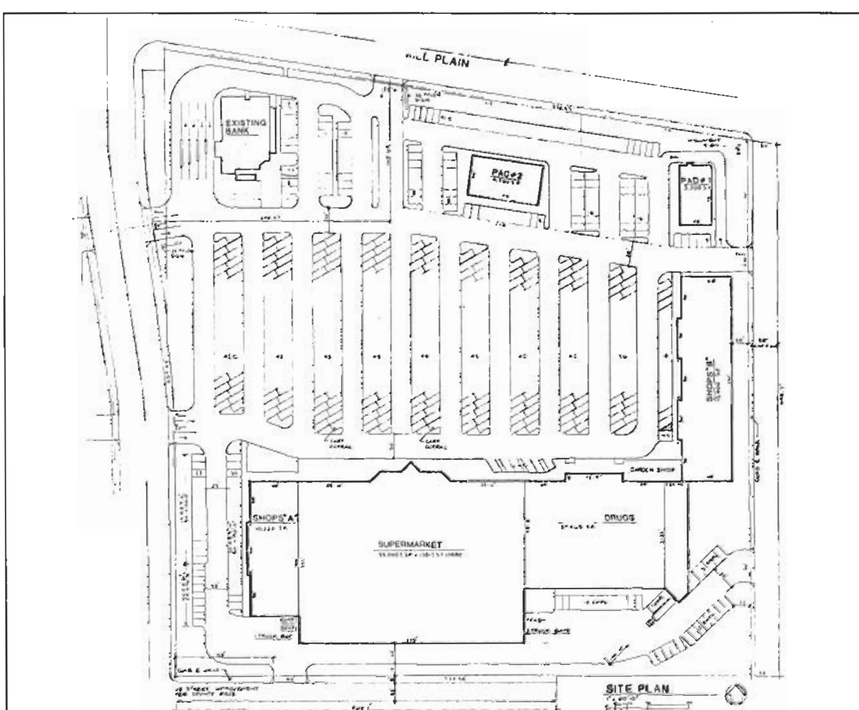
Overview Portland Retail Market

The Vancouver market area contains the cities of Vancouver and Camas, Washington. This market area is confined by the Lewis River on the north, the Columbia River on the south and west, and the Cascade Mountain range on the east. It is contained entirely within Clark County, Washington. North/South accessibility for the Vancouver market area includes I-5, I-205, and Andreson. East/West accessibility for this market area includes 78th Avenue, SR 500, Fourth Plain Boulevard, and Mill Plain Boulevard. This market area has the highest percentage increase in total households over a six-year period, second number of shopping centers in the seven areas reported herein, and the second highest total consumer expenditures. Retail space in the Vancouver market area totals 4,378,765 square feet in 52 centers for the fourth quarter of 1994. With 96,159 square feet remaining vacant in this market area, the fourth quarter vacancy rate is 2.20 percent.

Source: Norris, Beggs and Simpson Vancouver, Washington

Exhibit II:

SITE PLAN



▪ Case Study #3
The Regional and Super-Regional Center
(Over 300,000 square feet)

"A Resurgence of Reits?"

In assessing new sources and techniques in financing shopping centers at the regional and super-regional level, the research focus will be on REITs (Real Estate Investment Trust). After reviewing a number of REIT offerings that have been brought to the market, it is concluded that the most appropriate contribution that could be made for purposes of this research would be to provide a current overview of the REIT market. Observations are made to categorize REITs and to provide an outlook as to appropriateness of this financial vehicle in the future for the shopping center industry. There appears to be evidence that the interest in the REIT market may be starting to wane after an extremely successful 1993 performance.

Historical Overview[1]

The Real Estate Investment Trust is not a new form of investment vehicle by any means. In fact, the legislation which gave REITs tax and limited liability status similar to that of limited partnerships was signed by President Eisenhower in 1960. REITs are a creation of the tax system but operate much like publicly traded companies. Profits from rent or fees associated with the properties are passed on to shareholders as dividends. Because of this flow-through of income, REITs pay almost no tax (shareholders pay tax on their dividends).

The REIT Act of 1960 opened the door to equity from the capital markets for the real estate sector investment. While initial indications had predicted that $100 million might be raised in the first year, surprisingly after the first 13 months, over $200 million of REIT shares had been issued and another $100 million were in registration. By 1968 the combined assets of all REITs had grown to $1 billion.

Between 1968 and 1974, there was exponential growth in activity with assets totaling $20 billion in REITs by 1974. This dramatic growth mirrored the economic environment of the times, which much like the last five years had limited the funds available from traditional lenders, forcing the real estate industry to turn to the capital markets. Between 1969 and 1972, REIT offerings accounted for 11% of total corporate equity securities issued and sold in the United States.

Mortgage REITs became a major source of real estate capital, offering both construction and permanent loans. The debt to equity issue of REITs as a whole that had been 1.1 to 1 in 1968 rose to 3.4 to 1 in 1974. The highly leveraged REITs were hardest hit by the oil embargo recession that began in 1973; in an overbuilt market with interest rates rising, REIT earnings declined dramatically. Between 1976 and 1983, REIT assets remained fairly constant at about $8 billion. In 1984, the sale of REIT debt instruments began to climb with $2 billion of debt sold to the public in 10 offerings. The Tax Reform Act of 1986 was advantageous for the growing REIT industry.

In 1991 equity REITs had a tremendous year, producing an average return of 36%. In 1992 and 1993 industry growth was exponential. In 1993 REITs were a favorite of investors, raising approximately $14 billion. Forty equity REITs came to the market in 1993, raising approximately $8 billion (versus $1 billion in 1992). By the end of the first quarter of 1994, the NAREIT Index had a total market capitalization of $27.3 billion disbursed among 146 companies.

***A Resurgence of REITs*[2]**

Since 1960, when the REIT format was first created, REITs as a financial vehicle have had a bumpy ride. They flourished during the sixties only to crash in the 1973–1975 recession. They grew again during the 1980s, but this time they used borrowed money to take advantage of climbing real estate prices. When the growth slowed they were strapped for cash, which brought forward many foreclosures. The most recent growth period started in late 1992, but this REIT market seems to owe its success to many property owners having had debt maturing at the same time that the "traditional" capital sources (banks, insurance companies and foreign investors) had turned their backs on real estate finance.

This simplistic scenario is presented since it seems to suggest that the REIT structure is not a particularly new vehicle, but market conditions surrounding it have placed an unusual amount of interest in it between the fall of 1992 and the spring of 1994. The REIT market's growth and purge seems less dependent on the vehicle changing; rather, it seems to be that market conditions around it can change enough to cause investors and developers to view it differently over time.

The challenge is to review a REIT market that was extremely hot in the first half of 1994, and then cooled significantly in the second half of the year. If the REIT market is strongly influenced by specific market and environmental issues, then developers specifically must consider these issues before selecting the REIT format. Market issues include: interest rates, the flow of capital, and the general state of the real estate environment and how this produced the current REIT market.

***REIT Categories*[3]**

There are a number of interesting ways to categorize REITs. As Christopher Lee pointed out in the Winter 1995 *Real Estate Review*, the first dichotomy is to categorize REITs as Restructuring REITs versus Strategic REITs. Industry analysts have offered opinions that 30% to 60%

of the equity REITs brought to the market in the last three years were to solve the following problems:

(1) A form of workout;
(2) A reaction to lender pressures;
(3) In response to declining market conditions and an out-of-balance loan to value condition;
(4) To get capital out at peak value levels;
(5) A defensive strategy to avoid possible foreclosures or bankruptcy.

Mr. Lee indicates that the key to any successful REIT is its management company with a capacity to achieve transition from "answering to a few" to "reporting to many." Organizations that traditionally made unilateral decisions found themselves struggling with reporting requirements, limitations on managerial autonomy, and unnatural measures of financial performance. If the executives are new, if management is perceived as having trouble adjusting to the new reporting regulations, and/or if the leadership is lacking a vision, there will be a significantly reduced level of investor interest.

There are indications in the market place that investor interest in REITs is waning. Recently REIT returns have provided investors with an alternate yield plan. Mr. Lee reports that 53% of the 1993 REITs were trading below their original issue prices. A concern for REIT investors is how the market will react to the first failure of one of the newer REITs.

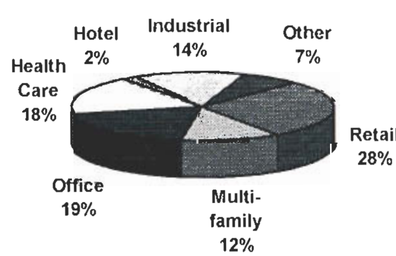
Impact on Shopping Center Finance

Of interest to the shopping center industry is the question of how much of the REIT-raised capital is being directed their way. Table 1 indicates

TABLE 1. REIT INDUSTRY BY PRODUCT TYPE

Equity Real Estate Investment Trusts by Product Type

Publicly Traded REITs as of September 1992



Source: Presentation by Keith M. Locker, Associate Director, Real Estate Investment Banking, Bear, Stearns & Co., New York, N.Y., to Deloitte Touche, December 7, 1994.

that 28% of the equity real estate investment trust, as of September 1992, is directed towards the retail industry.

A further analysis of initial public offerings of equity real estate investment trust between January 1991 and November 1994 indicates that 35% is directed towards the retail industry.

It is apparent that the new issue market has become a buyers' market as both prices and deal sizes have been cut. Bear, Stearns reports that of the 23 Initial Public Offerings (IPOs) completed after March 31, 1994, 10 were priced at discounts to the original filing range and only one was priced above the filing range. The average discount was 7.5% below the low end of the filing range. During the last several months a number of REIT IPOs have been postponed. Bear, Stearns outlines a number of factors currently impacting the U.S. REIT market, which include:

1. The increase in interest rates.
2. Capital outflows from real estate mutual funds.
3. A backlog of IPOs and registration.
4. Investors concern regarding "Positive Spread Investing" opportunities continuing into 1995.
5. Portfolio repositioning from growth to income.
6. Earning trends and results of "The Class of 1993."
7. Attractive opportunities in existing REIT trading at 12-month lows.

United States - Canada Comparison:

There are a number of differences between the Canadian and U.S. REIT markets. Technically in Canada there really isn't a REIT. As we have indicated the REIT is a creature of the American tax system. There is a hybrid vehicle in Canada, however, sometimes referred to as a CREIT. Table 2 outlines some of the differences between the REIT vehicle in the two countries:

The Canadian real estate market cycle has not reached the level of maturity of the U.S. with present rates being judged on yields. However, of significance to the shopping center industry, approximately 60% of the Canadian REIT capitalization is directed towards retail oriented product. Also there are some new IPOs in Canada with cross-border acquisition plans.

The Future of the REIT Market:

REITs have provided the real estate industry with liquidity, a source of capital, and - most important - a solution to the recession. Most industry analysts are predicting that a REIT shakeout is likely to occur within a fairly short period of time. A combination of over–inflated prices in conjunction with the competition for investment alternatives and the

TABLE 2. COMPARISON CANADA - UNITED STATES REITS

	Canada	United States
Tax status:	No specific tax legislation	Specific tax legislation
History:	1993	1960
Structure:	Closed End Trusts	Corporations/ Trusts
Liability:	Unlimited	Limited
Management:	Outside advised/ managed	Self-administered/ self-managed
Number of Companies:	4	175
Equity Market Capitalization:	$197.3 million	$37.1 billion

Source: Presentation by Keith M. Locker, Associate Director, Real Estate Investment Banking, Bear, Stearns & Co., New York, N.Y., Deloitte Touche, December 7, 1994.

institutionalization of what has been an entrepreneurial industry will be the chief contributors.

The United States market is far in advance of the Canadian market. REIT promoters are finding it difficult to achieve a spread between the non-public price and the pricing of the product at the public level. It is obvious that the economic conditions in the environment (including the increase in interest rates) are having an impact on the REIT market.

Need for Further Research

This overview of the REIT market has raised a number of interesting issues for further research. One important topic is to examine the impact of the Restructuring REIT versus the Strategic REIT. It would also be of interest to profile the impact of new securitization techniques that have been imposed recently upon developers by their creditors.

The REIT market is an important ongoing source for the acquisition of existing shopping centers. Future research on this topic could also study how much of the REIT market has been directed by major companies to "go public." Also of research interest is to determine the proportion of the existing REIT market that will be directed in the future towards the acquisition of existing shopping centers.

■ Research Notes

1. Fielder, Lawrence E. and Lambert T. Devoe, "The Explosion of Commercial Property Securitization," *Real Estate Review*, Winter 1995, 5–7.
2. Comments by Craig Schmidt, Partner and Director of Retail Research, TCW Realty Advisors, Los Angeles, California.
3. Lee, Christopher, "Letter to The Editor," *Real Estate Review*, Winter 1995, 3–4.

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