



# building blocks for REITs

*clockwise from top left:*

**DONALD WOOD**

President and CEO

*Federal Realty Investment Trust (FRT)  
Retail properties*

**WILLIAM C. BAYLESS JR.**

President and CEO

*American Campus Communities Inc. (ACC)  
Student housing*

**MARK R. KELLER**

CEO

*Republic Property Trust (RPB)  
Office properties*

**MARC HOLLIDAY**

President and CEO

*SL Green Realty Corp. (SLG)  
Commercial and residential properties  
Gramercy Capital Corp. (GKK)  
Commercial real estate specialty financing*





**PETER SLATIN**  
Editor and Publisher

*The Slatin Report and the Forbes/Slatin  
Real Estate Report*

An average of \$2.16 billion worth of REIT shares trade each day at the NYSE. The 185 listed REITs have a combined market capitalization exceeding \$390 billion. This burgeoning sector, according to SNL Financial LLC, has outperformed all major stock indices for six straight years. To delve into the success of the industry, *nyse magazine* gathered six CEOs for a roundtable discussion moderated by Peter Slatin, editor and publisher of the *Slatin Report* and the *Forbes/Slatin Real Estate Report*.

### *What are the biggest challenges facing the REIT industry?*

**DONALD WOOD:** The potential for tenant bankruptcies, higher interest rates, high construction costs and high costs of acquisitions. We all deal with those. On the retail side, we try

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SCENERY ILLUSTRATION BY  
ANDERS WENNGREN

REIT CEOs reveal that their industry's greatest challenge — and opportunity — involves building on its success.

*above:*

**MITCHELL E. HERSH**  
President and CEO

*Mack-Cali Realty Corp. (CLI)  
Office properties*

*right:*

**NICHOLAS S. SCHORSCH**  
Vice Chairman, President and CEO

*American Financial Realty  
Trust (AFR)  
Banks and financial institutions*





to make each one of those things a little less risky for our own company by choosing quality real estate.

**WILLIAM BAYLESS:** Overbuilding in individual markets is an issue. Given the operational intensity of the student-housing business, we are concerned that inexperienced companies entering the industry might not have success, which could then taint investors' perception of the sector. We believe investors will come to recognize the importance of management's expertise and understanding of the business.

**NICHOLAS SCHORSCH:** Rationalizing the balance sheet is a huge challenge in our segment, which focuses on financial institutions. Most people tie our business future to mergers and acquisitions. We have enough size to focus on creative acquisitions, development of relationships and growth.

At the same time, the REIT industry faces other issues. One is our identity. We're all talking about the real estate business. But every one of us is different. If New York real estate weakens, God forbid, it doesn't mean every other geographic sector will follow.

There's a lot of opportunity for investors in the real estate industry.

**MARK KELLER:** The thrill of the hunt, getting deals no one else sees — that creativity remains crucial.

**MARC HOLLIDAY:** Mostly REITs need to make sure we don't become a victim of our own successes, if we want to maintain star status within the investment community. That's a major issue with how much market penetration REITs have achieved. The successes are great as long as you keep thinking of what you are going to do over the next few years to sustain that momentum. Otherwise, you risk reaching a peak.

**MITCHELL HERSH:** The greatest challenge is something that none of us here controls: The U.S. domestic economy needs to remain competitive in the global marketplace. What keeps me up at night is not necessarily the micro-level details; it's more the macro-level details. We see the U.S. business environment changing — it is now easy to transport jobs that occupy office space, shopping malls and so forth to India and Asia.

### *How long have investors been interested in REITs?*

**WOOD:** This industry really started around 1992 from the public perspective. The great thing that ever happened for us was the

tech bust, as investors looked to REITs to fill their portfolios. Also the accounting change in the early part of the century got everybody focused on how important dividends are.

**HOLLIDAY:** In 2000, when the tech sector was booming, REITs couldn't get any attention. We were doing great, but nobody cared.

### *What are the benefits of being a public company?*

**SCHORSCH:** The long-term nature of a public company is something we all benefit from. We were a private-equity company early on, which required us to sell assets to meet investors' capital return time horizon and then to generate capital from many of the same participants. A public company is a much more stable platform for real estate.

**HOLLIDAY:** SL Green could never be sitting here in 2006 with 20 million square feet if not for the public markets. We just could not have raised enough capital in the private markets. So if your goal is longevity, growth and stable income, I just don't see how that occurs in the private markets.

**BAYLESS:** Student housing is in its relative infancy from a public market's perspective. When working with major universities, being



a public company adds credibility. We also believe most consolidation will occur from public companies buying private portfolios.

*Whether public or private, REITs are vulnerable to interest-rate fluctuations. How do you manage against rising rates?*

**HERSH:** In many senses we're viewed as financial companies, and it's clear that as the 10-year Treasury bond moves so do REIT stocks. The fact that the industry's track record is almost impeccable with respect to performance and dividend payments shows predictability. But as investors find alternative fixed-income investments, particularly Treasuries, that might outstrip REIT dividend yields, further competitive pressure will be placed on capital.

**HOLLIDAY:** Only in a real estate roundtable will you find people complaining after just finishing a five-year tear! We've outstripped the S&P in each of the past six years. You have every other industry in America looking at real estate saying, "How the hell do these guys do it?" But that's what makes this business so fun. We get up every morning and say, "How can we do better?"

*How do you get credit when people say, "They are just riding the wave of low interest rates"?*

*"The greatest thing that ever happened for us was the tech bust, as investors looked to REITs."*

**DONALD WOOD** *President and CEO, Federal Realty Investment Trust (FRT)*



*"Our industry is maturing to a point that investors can count on it, and it is an option in any interest-rate climate."*

**MARK R. KELLER** *CEO, Republic Property Trust (RPB)*

**HOLLIDAY:** That's not unique to the REIT industry. A lot of capital-intensive industries are riding the downward crest of the wave. But we've shown that we know how to deploy capital, make returns and be leaders within the business community. When you look at SL Green's dividends, we trade like a growth stock. So that's the only mitigating factor a lot of us have. Sure, interest rates will eventually go up, but if they do, rental REITs will grow faster than the interest-rate increases because people will buy fewer houses and rent more. I think people are

voting with their dollars and saying that they think rate increases are going to stay relatively modest over the next several years.

**KELLER:** Our industry is maturing to a point that investors can count on it, and furthermore it is an investment option in any interest-rate climate.

**WOOD:** If you look out over the next 10 or 15 years, from a public real estate perspective the dynamics look awfully good. That doesn't mean that within those 10 years we're not going to see cyclical changes as a result of rising rates. Sure, we are. But it really does get back to the long-term view. If investors don't want to buy their own office buildings or their own shopping centers, and they want to invest publicly, then the macro conditions for REITs look favorable. Today there is a real estate option in a small percentage of 401(k)s, but it's increasing, and that's only the tip of the iceberg.



**BAYLESS:** Our sector has probably seen the greatest change from a cost-of-capital perspective. Five years ago, most companies in the student-housing business had venture funds as partners. Our average cost of capital was double-digit. Today, with the public market access and interest from institutional investors, companies in our sector have a single-digit weighted average cost of capital, which enables growth and leads to more opportunities.

### *Why is there little consolidation in the public REIT sector?*

**HERSH:** There are several reasons. Management teams have a long-term stake in this industry, especially those carrying forward family legacies. In addition, stock multiples trade within much closer ranges nowadays. Acquisitions are less attractive when almost every company in a specific sector is trading within plus or minus one multiple of another. It is difficult to structure an accretive merger on an all-stock basis due to this, regardless of the positive aspects of good portfolio overlays and the synergies that could be created.

**SCHORSCH:** If you were to acquire a typical company, the buyer consolidates the other company's overhead, obtaining savings in operating expenses. A single management team focused on a larger platform can create lots of operating synergies. But this has not been the trend in the real estate industry.

**WOOD:** We have 250 employees in a \$4.5 billion company. We're signing long-term leases that have natural increases built into them over time, no shopping centers go on strike, and no machines break down. Since this is not a labor-intensive business, the synergies are not high when combining portfolios.

### *Do you see a risk of overdevelopment?*

**BAYLESS:** We see a lot of overbuilding in peripheral submarkets three to five miles from campus, where land is plentiful and

there are few zoning restrictions. To insulate ourselves from this, our investment criteria focus on proximity to campus, product differentiation and in-fill locations with barriers to entry.

**KELLER:** Commercial real estate always has the risk of overbuilding. During the last cycle, vacancy rates rose well into the double digits in almost every market, including downtown Washington, D.C. Most of that's been absorbed — it's amazing the amount of absorption that's occurring. As rents start to climb, you'll see a little bit of development take place, and before you blink an eye, you're going to see another vacant office building.

**HERSH:** If capital is available and the ability to build exists, you always run that risk. I like to think that we operate in markets with fairly high barriers to entry — mainly the Northeast corridor and in Jersey City. Over time, as markets firm and rents improve, we'll see the opportunity to build into that market, because we're virtually the only developer that can build given our current land holdings.

**WOOD:** In retail, I can't overemphasize the importance of high barriers to entry. Supply does get added in the periphery. But we're focusing on the notion of redeveloping what you already have in the right location, without any additional land cost.

**HOLLIDAY:** In Manhattan you have the opposite, which is if the barriers are too high and the markets are too constrained, occupancy costs will reach a level where your

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**WILLIAM C. BAYLESS JR.** *President and CEO, American Campus Communities Inc. (ACC)*

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MARC HOLLIDAY *President and CEO, SL Green Realty Corp. (SLG) and Gramercy Capital Corp. (GKK)*

biggest risk is not new projects but an exodus of tenants. So with rents rising, you have to have enough product on the periphery to meet companies’ growing occupancy needs.

## *How important are joint ventures?*

**BAYLESS:** Joint ventures with public institutions are very important to us. Last quarter we announced that Arizona State University had selected us to develop 3,000 to 4,000 beds on campus, nearly a quarter-billion dollars of development. University partnerships provide the ultimate captive audience.

**SCHORSCH:** About a year ago we decided to sell off development assets that we generated through our pooled acquisitions. We entered into a joint venture with Och-Ziff in which it is putting up 85 percent of the money to develop our noncore assets. We are not a merchant developer of these assets on a stand-alone basis, but we do generate a significant pipeline of development assets. So we are basically allowing them to access our real estate pipeline on a long-term basis.

## *What would you say to someone contemplating a REIT IPO?*

**KELLER:** I rang the bell this morning for our IPO, so I believe I have the most recent experience. You need to focus more on your business plan than ever before. It’s a discipline that is quite exciting as you walk through the

process. The infamous road show is really about defining your plan. Be prepared to be a better company. Know your markets, know your competitors, and run your operations a little bit tighter than ever.

**SCHORSCH:** It has been a very important evolution for us since we went public in 2003. The market expects us to move and evolve almost more quickly than more mature companies. New public companies face a high level of market expectations as to what they’re going to achieve. Meanwhile, the level

of shareholder knowledge is greater than it’s ever been. It keeps you on your toes, and public-company transparency is healthy for the real estate business.

**HOLLIDAY:** I’ve done this twice, and the second time you’re better at it. The reason I’m such a big fan of public markets is the instant credibility you get as a public company. The No. 1 benefit of being public is offering investors the ability to pick up a phone and trade their shares. Public markets have taken real estate out of the dark ages and turned it into an industry with professional management.

**WOOD:** If you can marry consistent, stable, sustainable earnings growth with a business plan that allows you to deliver returns on a quarterly basis and also take advantage of the public markets, you have something special. □

