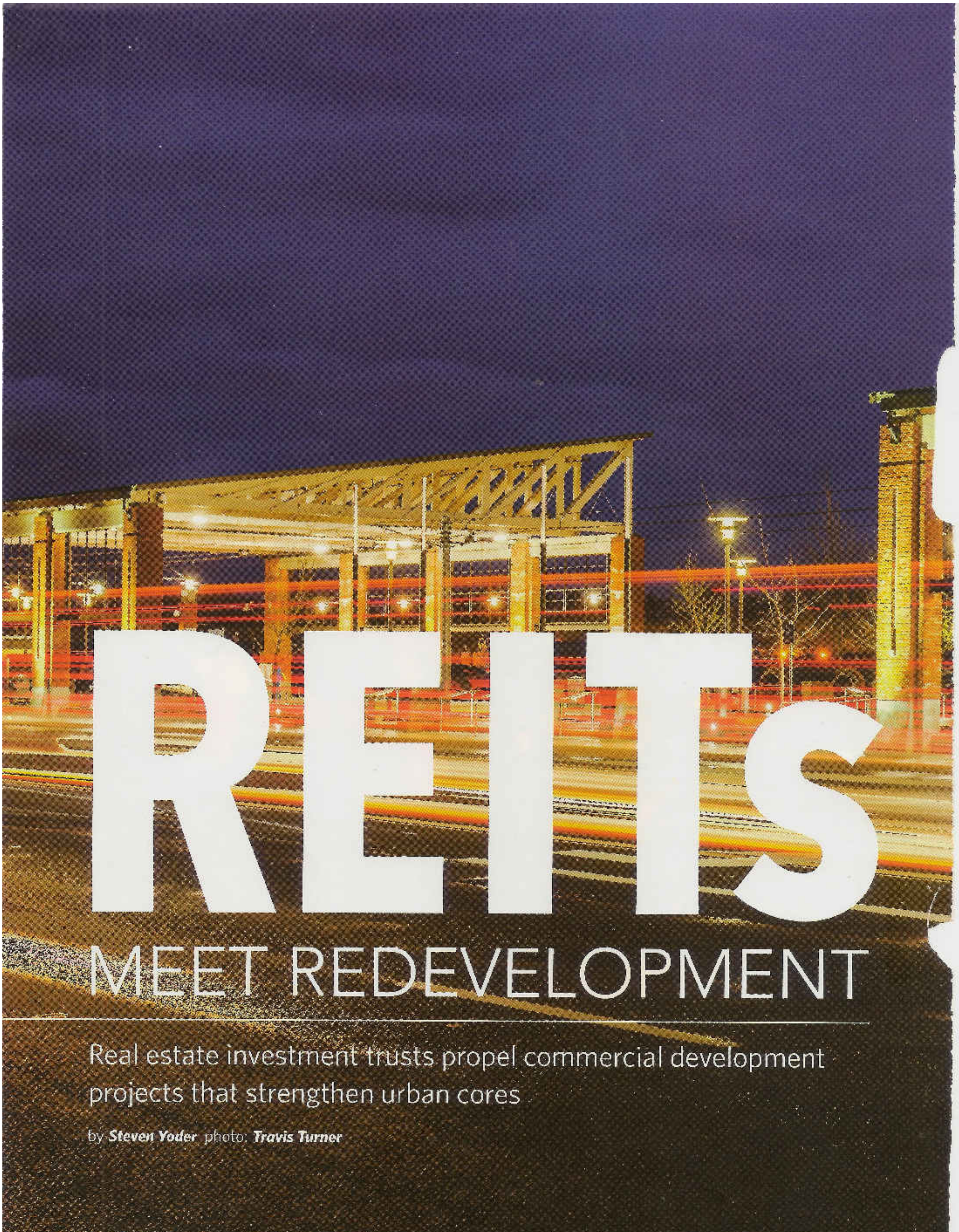
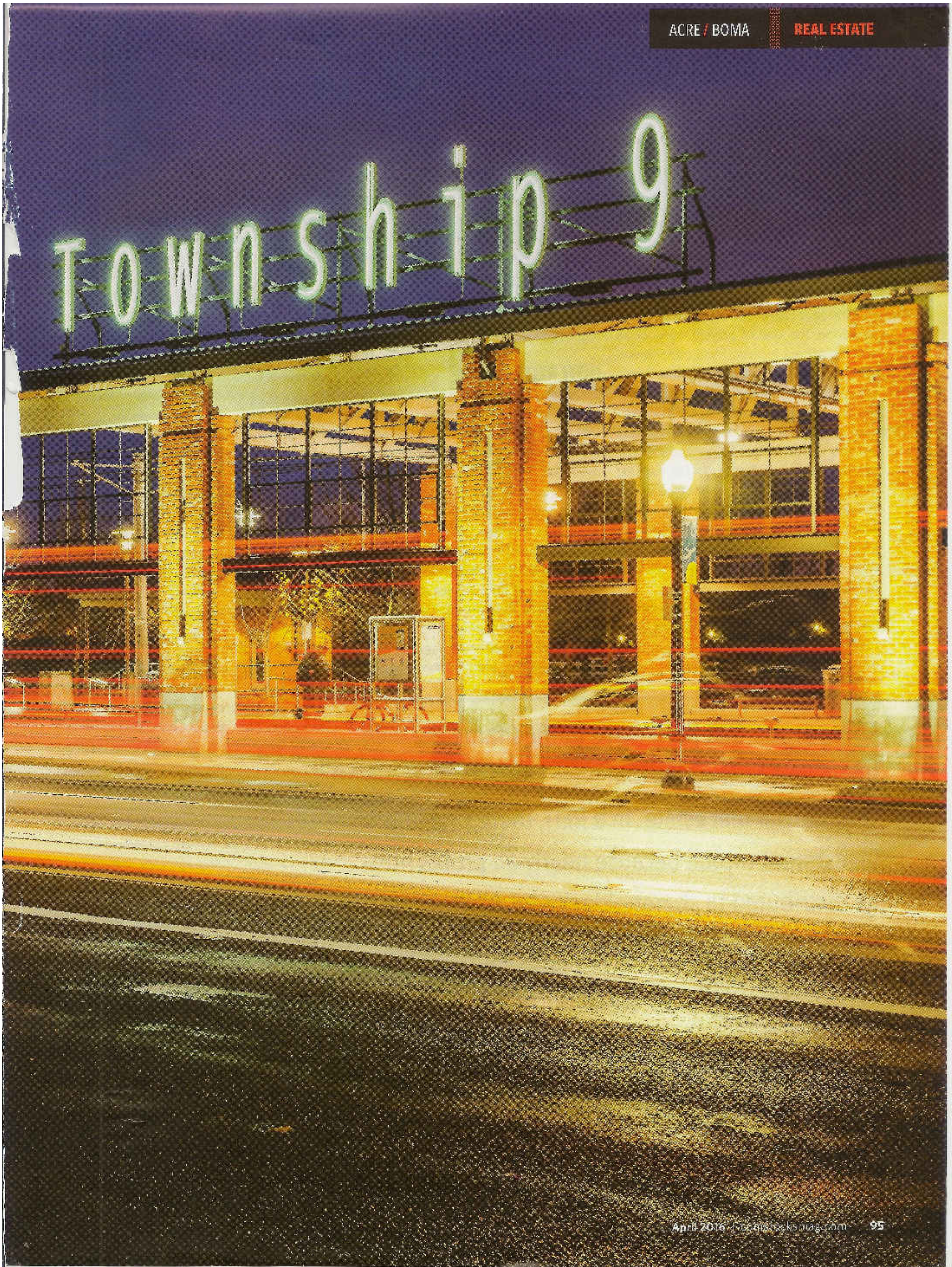


REITS MEET REDEVELOPMENT

Real estate investment trusts propel commercial development projects that strengthen urban cores

by ***Steven Yoder*** photo: ***Travis Turner***


Township 9

Digging the vibe at the Township Nine development in the River District starts with the mountain bike park. Sitting on land in the development that won't be built out for another few years, the six acres of dirt mounds, pump tracks and a cross-country trail are "more fun than should be legal," in the words of one city councilman at the park's opening last Halloween.

The park captures the culture of Township Nine, the kind of project many cities want to attract to keep millennials downtown. That means walking and bike trails, easy access to mass transit, proximity to the urban core, green space, inviting common areas and environmentally friendly building codes. When finished, the development will be home to 2,400 housing units, 840,000 square feet of office space, 150,000 square feet of urban retail, and 20 acres of parks and open space. Construction starts in a couple of months on a boutique hotel and a combination coffee bar/bike shop.

The fuel for potential growth engines like Township Nine is up-front capital. Since the end of redevelopment funding in 2011, projects like it have to look harder for financing. But the project just got an infusion of new money in February. That's when the real estate investment trust of Gold River-based First Capital Real Estate Investments bought a 92-percent stake. "What a development like Township Nine needs is a money partner," says Steve Goodwin, who invested in the project with business partner Ron Mellon in 2000. "We needed a big daddy to come in… and that's what First Capital is," he says.

Around the country, REITs like First Capital's have been ponying up money for urban-core commercial development projects. Along the way, they also may be making the commercial real estate market more stable and transparent.

HOW REITS WORK

REITs operate something like mutual funds for real estate. Investors buy into a commercial real estate portfolio managed by the REIT and earn a share of the income produced through their investment, without the headaches of managing real estate themselves. Most REITs are traded on major stock exchanges and invest in a range of types of commercial properties: apartments, hospitals, hotels and so forth.

Because of the tax rules governing how they function, REITs operate unlike any other players in the real estate market. Most are publicly traded, must register with the U.S. Securities and Exchange Commission, and have to publish periodic financial statements summarizing their operating performance and investment and financing choices. They have to pay out at least 90 percent of their taxable profits in dividends each year and their shareholders pay taxes on those dividends, allowing the REIT to avoid taxation itself. Their management and decisions are scrutinized by analysts and the financial media, which affects their share prices. And just like mutual funds, good management and consistent performance bring a higher stock price.

Some argue that REITs have helped tame the wild boom and bust cycles that once characterized commercial real estate. In a REIT, there's no idle investment capital because nearly all profits must be distributed to shareholders, says Michael Grupe of the National Association of Real Estate Investment Trusts.

A "CIVILIZING" INFLUENCE?

Those features are why some argue that REITs have helped tame the wild boom and bust cycles that once characterized commercial real estate. In a REIT, there's no idle investment capital because nearly all profits must be distributed to shareholders, says Michael Grupe of the National Association of Real Estate Investment Trusts. When a REIT wants to invest in a commercial development project, it has to raise capital from potential equity and debt partners — investors, investment banks, lending banks, and so on. "That's a different paradigm than if you're sitting on cash," says Grupe. "You have to convince your equity partners, and you're not going to do so unless you have a good case."

That could translate to sounder commercial investments. In a paper published in the spring 2013 *Journal of Portfolio Management*, for example, three researchers described their study of how the growth of REITs since the mid-'90s has affected the construction of new commercial buildings in both strong and weak markets. REITs, they noted, have a relatively simple structure, must be transparent because of their reporting requirements, and are scrutinized by industry analysts, rating agencies, and others.

The researchers concluded all of that public information has helped inoculate the commercial market against the twin contagions of euphoria and panic. When new office construction is announced in Washington D.C., share prices of REITs that hold Washington office property drop because of possible oversupply. That signals construction lenders, who then clamp down on additional loans. The authors found statistical evidence that the problem of overbuilding was increasingly restrained as the share of commercial properties owned by REITs rose.

Grupe agrees, and he contrasts commercial construction during the boom and bust of the late '80s, before REITs emerged as major market players, with that of the Great Recession. The office-building boom of that era led to a huge oversupply of commercial space and empty skyscrapers in cities nationwide. But during the recent recession, the commercial market mostly emerged healthy while the residential market fell through the floor. The difference, he says, was that REITs helped price the commercial market correctly before the crash, so there wasn't much overbuilding.

MORE CAPITAL, CHEAPER

At the local level, for developers there's an advantage to working with REITs: cheaper capital. Because REITs are generally run by large companies that have the financial ballast to weather economic storms, they're a safer bet for investors than an individual developer, says Steve Bergsman, author of the book *Maverick Real Estate Financing*. While every project is different, less risk usually means lower fees and interest rates, he says.

Nationwide, REITs are increasingly becoming sources of capital to transit-oriented redevelopment projects like Township Nine that are breathing new life into downtowns. And because of their size and transparency, REITs make good partners for such projects, argues Grupe.

First Capital's REIT appears to have stepped in at the right time for Township Nine. Getting conventional financing for a project in a redevelopment area isn't usually easy, says Daniel Corfee of Sacramento-based Preferred Capital Advisors. But the project fits well with a strength that First Capital brings to its REIT, says First Capital founder and managing partner Suneet Singal — the ability to add value to commercial projects.

To that end, First Capital's REIT is focusing not just on buying cash-flowing assets, but those to which his company can add worth over time with capital improvements. "As we're building out [Township Nine], we're creating a tremendous amount of upside in comparison to what those assets trade for in the market today," says Singal.

Township Nine will take about five more years, though a lot of the toughest tasks have already been done, Singal says. Because of that, the investment by First Capital's REIT offers the project that rare commodity — long-term, patient capital. "Even though it's a good market, it still takes time," says Corfee. "You don't want to have to rush through it because your capital has a maturity date on it."

First Capital's REIT funding is doing something else, says Goodwin — turning the eyes of big-money investors to Sacramento. Singal, he says, "is like the town crier who's out there saying, 'You need to start taking a look at cities like Sacramento.'"

Steven Yoder writes about business, real estate and criminal justice. His work has appeared in The Fiscal Times, Salon, The American Prospect *and elsewhere. On Twitter @syodertweets, and online at stevenyoder.net.*