Eking Out E-Retail Rents from E-Commerce

Shopping Center Landlords Redefine Portfolios as Retailers Blend Brick-and-Mortar Stores with Online Sales

Faced with the relentless changes brought about by e-commerce, successful retailers are increasingly pursuing strategies to integrate their brick-and-mortar locations with robust online stores, using them in complementary ways to boost sales growth and provide more efficient distribution networks in hopes of engaging customers.

For their part, shopping center landlords are also having to change with the times. They can no longer count on new store openings to drive rent growth. And the changes retailers are making affect the size and physical makeup of stores and how rents are calculated and negotiated.

For now, at least, national retailers continue their expansion plans. By one landlord's count, more than 81,000 new stores are planning to open over the next 24 months. However, the amount of space retailers are taking is shrinking. Landlords that once counted on new store openings for rent growth are having to eke out growth, in part, by helping retailers increase sales in the stores the retailers are already in.

Meanwhile, landlords that once counted on large national 'goods' retailers to occupy their store space, are now seeking out more 'Internet-resistant' retailers, such as restaurants, service providers, even barbershops, doctors and grocery stores.
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“The role of town centers in our communities has evolved in terms of adding restaurants, adding experiential uses, adding more events and programs,” explained Stephen Lebovitz, president and CEO of CBL & Associates Properties. “Those are the types of things that we are focused on in terms of 'competing' with the internet, to make the mall experience as compelling as possible to our shoppers,” Lebovitz told analysts on his company’s fourth quarter earnings conference call earlier this month.

It's something that every shopping center owner is trying to get a handle on and understand, Lebovitz added.

On the distribution side, CBL is considering adopting the same-day delivery strategy that General Growth Properties, Macerich, Simon Property Group and Westfield have undertaken.

In one such example, last year GGP, joined forces with a new company called Deliv to provide same-day delivery service for customers that order online or purchase in the store. The program has been in place for about three months at nine of GGP's malls and more than 50 retailers have signed on with more in the pipeline.

Although it is still early the process, the initial results look promising, said Sandeep Lakhmi Mathrani, CEO of GGP told investment analysts this month.

“You should note,” Mathrani said, “over 90% of online shoppers have visited a mall during the same three-month period. In addition, consumers who shop e-commerce and the store, shop an average nine times a year compared to web-only shoppers who shop three times per year.”

SUPPLANTING CATALOGUES

Mathrani said he believes e-commerce is doing nothing more than taking over the role historically played by catalogues and retailers, and that landlords need to adapt their real estate to meet that trend.

According to Mathrani, e-commerce accounted for less than 9% of total retail sales last year. He believes the growth in e-commerce is primarily coming at the expense of sales previously made via catalogue and direct mail.

About half of online consumers have used a ship-to-store option when buying items online, and Mathrani said shoppers choose bricks-and-mortar retailers with an online store for a few reasons: The ability to return merchandise to the store; the push of a coupon or promotion to a smartphone when the consumer is near the store; and simply the instant gratification that comes from being able to buy online and pick up at the store.

“So hurrah for all the trees that we’re saving, and hurrah for a new channel being developed that allows retailers to globally expand their businesses through e-commerce, and to expand and improve their profitability and to really create a seamless transition across all channels,” said Art Coppola, CEO of shopping center REIT Macerich.

“The dot-com world and the catalogue world has been a source of great new retailers for our shopping centers, both in the past as well as the future. There are a number of retailers that were born in the catalogue world that now are some of our best brick-and-mortar retailers. There are Internet retailers that were born digitally, that now have great retail stores with us. There are digital pure-play retailers that never intended to have brick and mortar stores that have recently figured out that they need to have brick and mortar stores in order to really maximize their brand,” Coppola said.

“The best e-tailers are also the best retailers,” he continued. “And for a retailer to have solely a brick and mortar platform, they would not be strong. And likewise, retailers realize that they need multi-channel platforms (including) both full priced stores, off price channels, their e-commerce channels, and now social media which they use tremendously to increase their brand.”

With the changes resulting in more and more stores becoming distribution centers for goods sold online, national retailers see an opportunity to leverage their wide footprint of brick and mortar locations.

GGP's Mathrani said converting more expensive retail space to industrial use is not as counterintuitive as might seem.
“If the online inventory and the store inventory could be transparent, the retailer will not have to duplicate merchandise, will not have to duplicate real estate cost and will not have to duplicate manpower,” Mathrani said.

“As a matter of fact, if they’re able to service it from the store, it’ll be far more efficient way for them to operate. The other aspect you have to appreciate is that the goal here is to basically drive the traffic into the store so you get the additional sales.”

David Henry, CEO, president and chief investment officer of Kimco Realty Management, said bigger retailers favor converting portions of their stores to serve as fulfillment centers because they sell $1.30 to $1.40 in merchandise for every $1 that’s returned to the stores.

“All of that makes it an effective counterweight to e-commerce,” Henry said.

DETERMINING RENT FOR ONLINE SALES

With the changes, landlords are also coping with how the changes brought about by e-commerce are impacting leasing costs.

That’s easy said David E. Simon, chairman and CEO of Simon Property Group.

“They’d have to keep track of it,” Simon said. “That’s simple if [the product sold] goes through their POS [point of sale] -- and it’s going to have to if the inventory is in the store -- that’s a simple exercise. We have audit rights.”

Richard Sokolov, president and COO of Simon elaborated.

“We’re incredibly mindful of the role that our stores play in the distribution of their goods, whether online or store-based. And, frankly, if that store is any part of the distribution channel for that sale, it’s going to count in our sales,” Sokolov said. “The retailers understand that, and the retailers are emphasizing the convenience and location of their stores as a significant advantage in their ability to maximize their contacts with the customers and their sales. So they very much view their stores as an integral part of their business going forward, and they are working with us in a cooperative way to try and maximize.”

That may be easy if you’re Simon Property Group, the largest shopping center owner in the country, said Garrick Brown, national retail research director for Cassidy Turley. Not so easy perhaps if you are not.

“Many landlords are fighting to get percentage sales that somehow worm their way into Internet revenues,” Brown said. “But the big retailers are generally saying “No,” and most landlords are backing down, ultimately.”

“It is one thing if you have a solo shop with a website, but realistically how do you try to claim a piece of Williams Sonoma’s e-commerce revenues for one store, say in Colorado? Plus the landlords need the retailers now more than they need any one particular landlord,” Brown added. “So outside of a few major players like Simon, Westfield, Macerich and others, it is not like the landlords have all that much leverage.”

Cassidy Turley’s Brown said most shopping center owners understand that the strongest retailers are going to be those that master omni-channel retailing.

“They are the ones whose Internet presence is strong and profitable and also drives customers to their stores,” said Brown. “While their stores offer a great shopping experience that bring shoppers back and that their bricks and mortar locations also drive traffic to their websites.”
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First, the good news. Neighborhood centers and power centers saw sharply higher sales volume per square foot in the fourth quarter compared to 2006 -- the last year the U.S. retail market could be called truly healthy, noted Suzanne Mulvee, director of retail research for CoStar, who along with real estate economist Ryan McCullough recently presented CoStar's recent Fourth-Quarter 2013 Retail Review and Outlook.

Many strong retailers have lifted their profits to record highs, stocked up on cash and invested in technology to streamline operations against a backdrop of slow-but-steady demand growth. The U.S. retail real estate market absorbed 16 million square feet of net space in the fourth quarter of 2013, and the U.S. retail vacancy rate fell 10 basis points to 6.5%.

The total supply of empty retail space has fallen significantly since peaking at over 400 million square feet in 2010.

However, while the space availability picture for retailers is slowly tightening, a CoStar analysis of the composition of total vacant retail space reveals that much of the unused space is located in older, less desirable or isolated properties that few if any credit tenants would consider.

With location and occupancy factors taken into account, less than 22% of the 370 million square feet listed as vacant at the end of 2013 can be described as fully competitive and vital retail space, according to CoStar data, meaning the available options for most high quality tenants are much less than the overall vacancy would indicate.

According to CoStar's McCullough, national high-credit retail tenants prefer to locate stores within specific productive clusters or nodes of complementary retail to help draw traffic. Such property clusters, when supported by sufficiently strong demographics, performed better during the downturn and recovered faster than similar retail properties in isolated locations. For the same reason, national tenants also shy away from locating within centers with chronically high vacancies.

Removing the nearly 60% of centers that are relatively isolated -- defined as those with less than 500,000 square feet of surrounding retail located within a half mile radius -- along with the dead or dying shopping centers with vacancies of 40% or higher, leaves just 78 million square feet of highly competitive space across the country, McCullough said.

The vacancy rate in those clusters of productive space is just 3.5%, significantly below the national average, and comparable to the average 3.3% retail vacancy rate of the 2006-2007 period.

"With the good space in higher demand, you’re going to see a lot more competition, and we expect to see rental rates accelerate from here," McCullough said. "While the vacancy rate is coming down overall, there are certainly winners and losers," even within the same submarket.

**MALL MILLIEU**

The gap between top-performing and lower-quality mall properties was evident in recent fourth-quarter results and management discussions of large publicly traded mall operators such as Simon Property Group (NYSE: SPG), General Growth Properties (NYSE: GGP), Macerich (NYSE: MAC) and CBL.

GGP reported that Class B mall sales were flat on a year over year basis while its Class A mall properties posted healthy sales growth. Macerich said it continues to sell off less productive malls and cull its existing portfolio.

The gap is apparent in most markets. For example, the average mall vacancy rate in Memphis was 13% at the end of 2013. However, much of that empty space is in non-competitive properties. Vacancies for competitive space typically range between 2%-4%. In Memphis, the quality space has a vacancy rate of just over 4%, comparable to Seattle, where the overall vacancy rate is well below 8%.

Citi analyst Michael Bilerman, discussing CBL's fourth-quarter earnings, sees risk in further department store closings and declining mall sales, and longer-term secular risk in retailer demand for space in CBL's lower quality malls.
Mall owners and investors alike are closing watching the fortunes of the largest national chains, with Sears/KMart and JC Penney topping the lists. Sears has announced 8.3 million square feet of store closings, while JCPenney recently announced 33 additional store closings.

Other retail chains, including Fashion Bug, Blockbuster, Big Lots, Albertsons, Radio Shack, Sweetbay and Bloomingdale's are also rolling up significant amounts of space. However, offsetting those closures are announcements by 27 retailers and service providers that will open new stores, opening an estimated 63 million square feet, led by a diverse array of tenants ranging from AutoZone, Kohl's and Subway to discounters such as Dollar General, Family Dollar and Costco.

"We’re encouraged that the number of store openings is going to continue to far outpace store closings," Mulvee said. "This isn’t going to save the really bad retail centers; they should and will go away.

However, rising demand, combined with sales per square foot already at a level sufficient to drive rent growth, will result in continued improvement to shopping center fundamentals this year, Mulvee added.

Speculation Swirls Over Mega Cable Merger's Real Estate Impact
Comcast Will Look To Shave $1.5 Billion in Overhead, Operating Expenses
While it may be way too way early in the process of speculating on the ‘specific’ commercial real estate impact of the proposed $45 billion mega-merger of cable giants Time Warner Cable into Comcast Corp., that hasn't stopped speculation in real estate circles over where Comcast, one of the biggest corporate spenders on CRE in the last couple of years, is going to be looking for cost-saving synergies between the two firms.

Among the likely candidates could be Time Warner Cable's 133,214 square feet of headquarters space in Time Warner Center, an approximate 2.8 million-square-foot mixed use complex between West 58th and West 60th streets on Columbus Circle in New York City.

The property was recently acquired by its original developer, The Related Cos., via a sale/leaseback transaction.

The Time Warner Cable lease term runs through December 2016 and includes three, five-year extension options. TWC was already expected to vacate that space at the end of its lease in December 2016 and move in with its parent firm Time Warner, which has made "an initial investment" in acquiring more than 1 million square feet of available commercial space in 30 Hudson Yards, an office development by Related and Oxford Properties Group approved for construction at the southwest corner of 10th Avenue and 33rd Street.

Time Warner Cable’s lease at Columbus Circle had a stated rental rate of $91.27 per square foot, on a gross basis. Eliminating that lease cost going forward after 2016 could save Comcast Corp. about $12.2 million a year.

But that is a mere pittance to the $1.5 billion in synergies Comcast expects to gain from the merger.

"Our analysis includes run-rate synergies of approximately $1.5 billion in operating expenses and approximately $400 million in capital expenditures. This approximates 10% of both Time Warner Cable's operating expense base and its capital investment plan," said Michael J. Angelakis, vice chairman and CFO of Comcast. "Our target for realizing the full operating expense synergy impact is three years from closing, but we believe the realization can be frontloaded, with more than 50% realized in year one."

Angelakis breaks those cost savings down into three categories: overhead, operating synergies, and capital expenditures. The overhead synergies will come from cutting out duplicate costs, fees and services. Among operating synergies, Comcast identified such categories as network operations, consolidating onto a single content delivery network and information management system, programming, marketing, supply chain, warehouses, technical operations, tools and training, and cost of goods.

“The programming aspect is a minority of our synergies,” Angelakis said. “A significant part of synergies are obviously at a sort of headquarters corporate side, which obviously retain, but the reality is that there would be some synergy leakage to the extent that there’s a divestiture.”
Comcast and Time Warner Cable approved a definitive agreement for Time Warner Cable to merge with Comcast. The agreement is a friendly, stock-for-stock transaction in which Comcast will acquire TWC for $45.2 billion in equity value. Under the deal, Comcast said it is prepared to divest systems totaling 3 million subscribers.

**COMCAST A MAJOR BUYER OF CORPORATE PROPERTY**

Comcast has been one of the most active corporate buyers of property in each of the last three years.

Last month, Comcast announced plans to build a $1.2 billion skyscraper in Philadelphia, its second with developer Liberty Property Trust. The proposed 59-story, 1,121-foot tower would shoot nearly 150 feet higher than neighboring Comcast Center, the company’s global headquarters, itself one of the tallest buildings in the country outside of New York City and Chicago.

In November 2013, Comcast purchased 10 Universal City Plaza in Universal City, CA, for $395 million, or about $485 per square foot, from a joint venture of Normandy Real Estate Partners and Morgan Stanley & Co. LLC.

Also last year, Comcast acquired General Electric’s entire 49% common equity stake in NBCUniversal for $16.7 billion and included a separate deal in which Comcast purchased the properties used by NBCUniversal at 30 Rockefeller Plaza and CNBC’s headquarters in Englewood Cliffs, NJ, from GE for $1.4 billion.

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**U.S. Warehouse Market Poised for Even Bigger 2014**

Early Demand from E-Commerce Indicates Even Stronger Performance in the Industrial Sector

*By: Randyl Drummer*

Demand for U.S. warehouse space exceeded expectations in the fourth quarter of 2013, with absorption for the quarter reaching among the highest levels on record, and warehouse vacancy rates in the largest U.S. market fell to levels not seen since the early 2000s.

CoStar recorded net absorption of 58 million square feet of warehouse/distribution space within the 210 largest U.S. markets. Meanwhile, the 45 million square feet absorbed in the top 54 markets ranks as the sixth-highest quarterly reading on record -- and by far the strongest reading since the beginning of the recovery, according to analysis presented at the State of the U.S. Industrial Market 2013 Review and Forecast by CoStar Director of Industrial Research Rene Circ and Senior Real Estate Economist Shaw Lupton.

For the full year of 2013, total U.S. warehouse absorption reached 162.6 million square feet in the top 210 markets, surpassing 2012’s totals.

The U.S. industrial vacancy rate ended 2013 at 8%, a 95-basis-point decline from 2012, with 162 of 210 markets showing declines in vacancy. In fact, at 7.6%, the vacancy rate for the top 54 U.S. markets dipped slightly below the lowest quarterly vacancy of the last cycle. Almost every major market has seen year-over-year occupancy gains, led by a pair of Keystone State markets: Harrisburg and Lehigh Valley, PA.

"Right now, we're seeing vacancies on a national level lower than the entire period of the last cycle," said Rene Circ, director of industrial research. "You have to go back to before the bursting of the Internet bubble in the early 2000s to see vacancies for U.S. industrial space below that 7.6% number."

A total of 162 out of 210 markets showed positive net absorption for a total of 162.6 million square feet, a strong 39% increase over the 117 million square feet in 2012. Dallas, Inland Empire, Chicago, Atlanta, Columbus, Cincinnati and Memphis led the gainers, while Northern New Jersey lagged with 150,000 square feet of negative absorption.

**SPEC CONSTRUCTION RAMPING UP**

New supply, which hasn’t been a major issue in the warehouse market up until this point, is now beginning to ramp up. In the last year, most markets have started to move into what the analysts termed the late expansionary phase, where most major warehouse markets inevitably begin to see new construction exert pressure on occupancies.
Developers delivered 80.6 million square feet in 2013. However, the 82 million under construction at end of December has jumped to 98 million in the first few weeks of 2014. Four of the 18 big boxes larger than 900,000 square feet currently under construction, and 36 of the 50 buildings larger than 500,000 square feet, are being built on speculation.

The Inland Empire, CA and Dallas/Fort Worth warehouse markets are running neck and neck as the strongest in terms of both demand and new supply. About 9.4 million square feet was completed in the Inland Empire last year, and the 11.6 million square feet under construction at the end of has jumped to nearly 14 million in subsequent weeks. In addition, Houston, Chicago and Phoenix are also logging strong levels of new supply.

Asking rent growth was also very strong across most markets, with the national average of $4.81 per square foot up 2.5% over 2012. Growth was even stronger in the top 54 markets at 3.8%, showing that the recovery is catching a little better foothold in larger markets while continuing to drag a bit in smaller metros.

In certain supply constrained markets, year-over-year rent growth has been eye opening, including Edison, NJ at 9.6%; Los Angeles, 8.9%; Orange County, 7.9% and Miami, 7.5%. That said, there is runway for growth as rents are still well below their peaks in most markets.

**E-COMMERCE, LOGISTICS SCOUT FOR SPACE**

Retailers and logistics companies remain very active and e-commerce continues to drive demand for both pure plays like Amazon and among traditional retailers like Walmart.com, which took 1.2 million square feet in the recently completed Liberty Property Trust project in the Lehigh Valley, as well as another 788,000 square feet from Hillwood in the Alliance Park in the Dallas market.

Craig Meyer, president of industrial brokerage at JLL, dubbed 2014 “year of the distribution center” as a result of the high demand early in the year from e-commerce and other users who are in the market for large blocks of sophisticated space.

"Modern space with proximity to population centers and a robust logistics infrastructure will dominate the industrial real estate sector in 2014," said Meyer, who attributed 40% of current big-box industrial requirements as directly related to e-commerce -- a sector that’s growing globally by 20% annually as retailers develop new real estate models to support their omni-channel logistics models.

Among the more notable deals were retailer Restoration Hardware's lease for 850,000 square feet in Dallas’s Great SW/Arlington submarket. Other notable companies recently leasing space of more than 500,000 square feet include Deckers Outdoor Corp. in the Inland Empire, Sephora Americas in Baltimore, CEVA Logistics in Nashville, Trader Joe’s in Chicago, Excel Logistics in the Inland Empire, GENCO in Memphis, and Owens & Minor in Chicago.

CoStar's PPR forecasting and analytics company is tracking 160 new leases of more than 100,000 square for a total of 35 million square feet across the U.S. in 2014. As of January 2014, leases for new space that tenants will absorb in 2014 totals 92 million square feet.

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**Carl Icahn Returns to Real Estate as Florida Homebuilder**

It’s been almost five years since renowned corporate raider Carl Icahn dabbled in residential home building when he was then a director and stockholder in WCI Communities Inc. prior to its bankruptcy reorganization.

But now, it appears Icahn has found a publicly-traded back door to invest in the rebounding Florida housing market.

This month, Cadus Corp., a former yeast-based and other drug discovery technologies firm that Icahn controls and has been dormant for five years, prepped itself to acquire some dormant real estate.

In a filing with the Securities & Exchange Commission, Cadus reported that it believes that there may be opportunities to profit from purchasing land and residential homes for construction or renovation and resale where real estate values are expected to increase.
Cadus’ board began to explore such opportunities in Florida and now MB 2013 LLC, a wholly owned, indirect subsidiary of Cadus, purchased the company’s first two residential development sites in Florida, according to the filing.

One of the properties in Miami-Dade County was purchased for $3.45 million and the other for $2.2 million. No seller or exact property locations were identified.

As a result of the purchases, though, Cadus is no longer a shell company.

Cadus currently intends to concentrate its real estate acquisition, renovation and construction activities in Florida. While renovation or demolition may begin soon after an acquisition of a home is consummated, Cadus does not intend to begin construction of new homes until a number of properties intended for new home construction are acquired.

In some cases, the company said it may also acquire partially constructed or renovated homes for completion and resale or resell acquired homes or land without undertaking renovation or construction.

In its filing, the company said it believes that long-term fundamentals for home renovation and new home construction remain intact and the firm is encouraged by evidence of strengthening conditions in the housing market.

After several years of exceptionally weak demand for new and existing homes, the U.S. housing industry began to show some signs of improvement during fiscal 2012 followed by more solid and accelerated improvement during fiscal 2013. Single family average sales prices were up in most markets across the country during fiscal 2013.

Specifically, Florida’s housing market wrapped up 2013 with more closed sales, higher pending sales, higher median prices and a reduced inventory of homes for sale compared to the year before, according to the latest housing data released by Florida Realtors.

“Throughout 2013, the state’s housing market has demonstrated it’s in a solid recovery and gaining strength,” 2014 Florida Realtors president Sherri Meadows, CEO and team leader, Keller Williams.

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**In Search of Liquidity, Supertel Hospitality Shopping 19 Hotels, Plans Stock Offering**

Supertel Hospitality Inc. has re-initiated an underwritten public offering of $30 million shares of its common stock to help get it through the year.

Last September, the Nebraska-based hotel REIT was set to raise up to $115 million in a public stock offering but withdrew the offering citing unfavorable market conditions and pricing expectations. The costs of this offering and its failure to be completed had a severe impact on Supertel’s liquidity, the company said.

The company has been exploring other options to raise cash, but said to date has not been able to complete a transaction that will provide sufficient liquidity to satisfy its operating and capital needs this year.

In February 2012, Supertel obtained $30 million of preferred equity capital by issuing preferred stock to Real Estate Strategies LP, which is controlled by (IRSA) Inversiones y Representaciones Sociedad Anónima in Buenos Aires.

Supertel currently owns 69 hotels with 6,064 rooms in 21 states. Of its current holdings, 19 are listed held for sale.

Since Kelly A. Walters, its president and CEO, joined the company in April 2009, it has sold 54 hotels, primarily older, smaller midscale and economy hotels that did not fit its strategy to shift to upscale and upper midscale select service hotels.
**Blackstone Files $100 Million IPO for La Quinta Inns**

La Quinta Holdings Inc. has filed to raise up to $100 million in an initial public offering. The chain, which operates 836 hotels with about 84,000 rooms in 46 states, Canada and Mexico, was taken private by The Blackstone Group in 2006 for $3.4 billion.

The La Quinta offering is the latest in a string of hotel-related IPOs for Blackstone, which cashed in its investments in Hilton Worldwide and Extended Stay America by taking both firms public last year.

Since Blackstone acquired the Irving, TX-based La Quinta chain, it has expanded its franchise system by approximately three times, growing from 158 franchised hotels to 466 franchised hotels, with an additional 175 hotels in its pipeline. La Quinta owns the remaining hotels.

In addition, Blackstone invested $728 million in capital, $301 million of which was considered repositioning capital. The money included $145 million for improvements across the owned hotel portfolio, including $42 million to develop its flagship downtown Chicago property.

The company sold (or is holding for sale) 33 La Quinta hotels. The property sales have helped boost systemwide RevPAR across the remaining portfolio by 16.5% from $40.49 to $47.17 for the 12 months ended Dec. 31, 2012, compared to two years earlier.

With proceeds from the IPO, La Quinta hopes to boost Blackstone’s capital investment by continuing to optimize the performance of its owned hotels and continue to drive franchise growth.

Of the 175 franchised hotels in the pipeline, 80% represents new construction, rather than the conversion of an existing hotel.

The company said it believes there remains meaningful growth opportunities in the United States particularly the Northeast and Northwest.

**Kite Realty Cuts Transformative Merger Deal**

Making a bold bid to move into the upper echelon of U.S. retail REITs, Kite Realty Group Trust (NYSE:KRG) cut a deal to double its size in one transaction.

The Indianapolis-based real estate investment trust signed a definitive merger agreement to roll up Inland Diversified Real Estate Trust Inc. into a wholly owned subsidiary of Kite in a stock-for-stock merger with a transaction value of $2.1 billion and an equity value of approximately $1.2 billion.

The merger brings together two shopping center portfolios with a combined asset base consisting of 131 properties totaling 20.3 million square feet across 26 states. The combined company will have a total equity market capitalization of $2.1 billion and an enterprise value of $3.9 billion, based on the closing trading price of Kite Realty's common shares on Feb. 7, 2014.

According to John A. Kite, Kite Realty's chairman and CEO, the transaction will substantially increase the size and scale of the REIT's portfolio in its core markets while also enabling it to expand into several new markets.

"We visited about 90% of the NOIs so we have a very strong understanding of the assets and particularly obviously of the large assets," Kite said in discussing the transaction with investment analysts. "Over the last 10 years we have looked at lots of portfolios, and this is absolutely one of the highest-quality portfolios we have underwritten."

Kite said that a large acquisition offered the best opportunity to grow given the dramatic decrease in the construction of new retail space.

"Over the last few years, new deliveries of high-quality and overall retail supply has dropped dramatically," said Kite. "In 2006 to 2008 there was 550 million square feet of retail space delivered. In 2009 through 2012 only 142
million (square feet),” Kite said. “What this really means to us is the fact that we can assemble a portfolio of this nature (through an acquisition), otherwise you just can’t do it. In terms of trying to find something this quality, it is very difficult. That was one of the driving forces for us in this deal.”

In Inland Diversified, Kite is acquiring a portfolio of 57 retail properties that were 95.3% leased as of year-end 2013. A little more than 80% of the portfolio consist of power and community centers and about 20% are grocery-anchored. The average square footage for the shopping centers is 180,000 square feet, a size significantly larger than the current average of Kite Realty’s current properties.

“These are regional, powerful properties in very strong locations throughout the country and generally their properties are the dominant property in the particular submarket,” Kite said.

The valuation of the transaction has a projected 6.6% 2014 estimated cash capitalization rate and an implied purchase price of $195 per square foot, which Kite Realty believes is well below replacement cost.

Kite will assume $784 million of Inland Diversified debt as well as 69 million shares of operating partnership units. The cash on Inland’s balance sheet will primarily consist of the net proceeds expected from the sale of its single tenant net lease portfolio to Realty Income Corp. for $503 million. That deal is expected to close prior to the closing of the Kite merger, which is expected by early in the third quarter of this year.

The new markets Kite Realty is entering through the Inland acquisition include: Westchester, NY; Bayonne, NJ; Las Vegas, NV; Virginia Beach, VA; and Salt Lake City, UT.

SELECT ASSETS, LOCATION, SF
- City Center White Plains, NY, 365,905.
- Bayonne Crossing, Bayonne, NJ, 360,045.
- Centennial Center, Las Vegas, NV 857,831
- Landstown Commons, Virginia Beach, VA, 409,747.
- Draper Peaks, Draper, UT, 229,794.
- Miramar Square, Miramar, FL, 238,334.

Following the deal, the number of properties owned by Kite Realty will increase from 74 to 131, and the total portfolio size will increase from 10.1 million owned square feet to 20.3 million owned square feet.

The REIT believes it can achieve substantial administrative and operating synergies, including saving $17 million to $19 million by terminating external manager contracts and other cost savings.

As CoStar News previously reported one year ago, Inland Diversified started the process of disposing of its then $2.2 billion portfolio, before agreeing to sell its single tenant net lease portfolio to Realty Income Corp.

“This transaction achieves our goal of maximizing value and provides an opportunity for our stockholders to either remain part of the well capitalized combined company or liquidate their investment,” said Barry Lazarus, president and chief operating officer at Inland Diversified.

Also before the Kite merger, Inland Diversified is required to complete a 1031 exchange on certain single-tenant assets and redeploy $72 million of capital.

After the closing of the proposed merger with Kite, Kite expects to dispose of three multi-family assets owned by Inland Diversified, as well as Inland Diversified’s securities portfolio. It expects proceeds of about $95 million from the sale of non-core assets and around $61 million from selling the securities portfolio.

The proceeds from these sales will be used to further repay debt and delever the balance sheet.

Commenting on the transaction, Citi Research noted that, “while we are not typically fans of a REIT growing just for growth’s sake, we see benefits for Kite as a larger REIT.”

Citi noted the cost synergies, improvement in Kite’s leasing footprint, greater equity float and liquidity in the stock as well as reduced exposure to development/ redevelopment as a percent of gross asset value.
Capital Markets Round-Up

**AEW Capital Management** formed a joint venture with **Sealy & Co.** in Dallas. The new investment vehicle was formed to acquire value-add industrial assets in the Southwest and Southeast. The initial investments include a 20-building industrial portfolio in Texas and an industrial property in Atlanta. The 1.9 million-square-foot industrial portfolio consists of warehouse/distribution and flex properties, with the majority of properties in Dallas-Fort Worth area. In addition, there are four properties in Houston, San Antonio and Atlanta. The total portfolio is 91% leased. The joint venture will focus on assets and portfolios in major industrial markets with a defined investment size between $5 million to $100 million.

**Axxcess Capital Ventures** in Newport Beach, CA, and **American Colonial Capital LLC**, signed an agreement for Axxcess to source acquisition and development capital for ACC. Its ACC Fund I is a $200 million private equity fund focused on real estate investment in the domestic commercial, multifamily, hospitality, senior/ student housing sectors. American Colonial Capital is in Palm Desert, CA.

**Civitas Capital Group** in Dallas announced that the United States Citizen and Immigration Services (USCIS) approved two new EB-5 Regional Centers in Miami and Denver. Congress created the EB-5 Regional Center Pilot Program to facilitate residency and citizenship applications for foreign nationals willing to invest significant capital in job-creating investments in the U.S. Through its EB-5 Funds division, Civitas is currently the manager of five Regional Centers, which have funded or are in the process of funding hundreds of millions of EB-5 capital. Civitas is also the exclusive EB-5 partner for several Texas cities, including Dallas, Fort Worth, Laredo, and El Paso.

**DivcoWest** Fund IV received a $35 million investment from the New Mexico State Investment Council. The $750 million fund focuses on investments in growth-oriented markets with an emphasis on office and R&D properties.

**Exeter Industrial Value Fund III** also received a $35 million investment from the New Mexico State Investment Council. The fund targets smaller deal sized industrial properties. Fund III investment focus will be on Class A, big box warehouse, multi-tenant logistics, and business park properties.

**Elion Partners** in Miami completed the first close of Elion Real Estate Fund III LP at $62 million. The company is targeting a total of $125 million for the fund, which focuses on creating joint ventures with developers as well as acquiring value-add assets. The fund targets markets across the country, seeking to expand Elion’s current presence in nine states. The firm has set a two- to three-year timeline to complete its investments.

**Forefront Capital**, a New York-based private wealth management financial services firm that provides investment advisory, asset management and investment banking services to high net worth clients, launched its Forefront EB-5 Fund. The fund has a number of projects that are participating, which include a mixed-use real estate development project in Chicago (Superior- Wabash), as well as Tire Recycling projects in both New York and Indiana.

**Lodging Dynamics Hospitality Group** in Provo, UT, purchased its first hotel, a 102-room Staybridge Suites in Omaha, NE, for its equity fund, LD Hotel Group I LLC. The fund is raising $60 million to fund future acquisitions. The fund is acquiring Marriott’s, Hyatt’s, Hilton’s and IHG’s select service and extended stay brand properties.

**Rockpoint Core Plus Fund** was approved for a $100 million commitment on behalf of the Oregon Public Employees Retirement Fund. The Rockpoint fund has a targeted investment of $1 billion. The fund will invest in stabilized CRE assets with strong cash flows. It will primarily invest in office and multifamily assets.

**Vornado Realty Trust** is set to take up to $175 million of non-cash impairment losses for its fourth quarter. Its financial results will include a $162.2 million impairment on its investment in Toys R Us. Vornado previously reported that its fourth quarter 2013 financial results will include a net loss of $130.9 million representing its 32.6% share of Toys’ third quarter 2013 net loss. These combined losses totaling $293 million reduce the carrying amount of Vornado’s investment in Toys to its estimated fair value of $80 million. Separately, Vornado agreed to sell Broadway Mall in Hicksville, Long Island, NY, for $94 million. Vornado fourth quarter 2013 financial results will include a non-cash impairment loss of $13.4 million related to Broadway Mall.

**Wheelock Street Real Estate Fund II** is being considered for a $140 million investment from The New Jersey Division of Investment. The division previously committed $100 million to Wheelock Street Real Estate Fund in

### Future Availability Report

<table>
<thead>
<tr>
<th>Company</th>
<th>Address</th>
<th>City</th>
<th>State</th>
<th>Closure or Layoff</th>
<th>No. of Layoffs</th>
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