THE IMPACT OF PUBLIC CAPITAL MARKETS ON URBAN REAL ESTATE

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A Discussion Paper Prepared for
The Brookings Institution
Center on Urban and Metropolitan Policy

July 1998

ACKNOWLEDGMENTS

The Brookings Institution Center on Urban and Metropolitan Policy would like to thank the Annie E. Casey Foundation for its support of the Center's research and policy work on the role of the city in the new economy. The Center will examine how public and private sector policies as well as demographic and market trends affect central cities' ability to attract and retain jobs, businesses, and entrepreneurs and be competitive in the regional and global marketplace. As evidenced by this paper, the Center will also examine the impact of the changing world of finance and capital on urban revitalization and metropolitan growth. Over time, the Center will also explore the important role of public schools, safety, and quality of life in determining the fate of central cities.

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THE ROLE OF PUBLIC CAPITAL MARKETS ON URBAN REAL ESTATE

I. INTRODUCTION

A. Context for This Discussion

The premise of this paper is that understanding the dynamics of new forms of financial intermediation is necessary for understanding the dynamics of metropolitan area growth and urban economies in this country. Regional and local real estate markets are changing. Publicly-owned companies that control national or regional asset portfolios are becoming substantial buyers and sellers, and Wall Street -- rather than Main Street --financial intermediaries are assuming a greater role in financing commercial real estate development. These market changes are likely to affect what is built, where it is built, and for whom it is built. We are at an early stage in both the evolution of real estate markets, from ones dominated by individuals and privately-held entities to ones largely affected by publicly-owned companies, and in the evolution of real estate finance markets, from ones dominated by local or regional commercial banks, thrifts, insurance companies, and pension funds to ones more substantially governed by national investment banks and credit underwriters. The strategies of these companies and underwriters are clear in some respects but not in others. So, much about the probable results for the built environment and urban economies remains left to conjecture.

Meanwhile, private and public constituents who are not primarily involved in real estate development or finance continue to seek and pursue strategies that improve the economic, social, and environmental welfare of their cities, inner suburbs, and metropolitan regions. Their prospects depend in part on their access to capital to implement their strategies for community revitalization or viability, creation of economic opportunity, preservation or restoration of environmental resources, assurance of public safety, improvement of public education, and provision of equitable access to social and health services. These strategies may or may not conflict with, complement, or otherwise connect with the strategies being pursued by the emerging property owners and credit intermediaries.

This paper intends to facilitate a public understanding and discussion that will increase the prospects for greater harmony among the various private and public sector strategies that will benefit our urban and metropolitan communities economically, socially, and environmentally.

B. The Emerging Dynamics in the Real Estate and Real Estate Finance Sectors

The public capital markets are playing an increasingly significant role in financing the ownership and development of commercial real estate. Since 1991 real estate investment trusts ["REITs"] have emerged as substantial acquisitors of commercial real estate, and underwriters of commercial mortgage-backed securities have emerged as important sources of credit for the acquisition and development of commercial real estate. This paper notes the recent dynamics of the public capital markets in real estate finance and then discusses certain issues and opportunities that are likely to interest parties concerned with housing, community development, and urban growth policies.

REITs are corporate entities whose attributes are determined by the Federal Internal Revenue Code. Congress designed them to enable small investors to invest in real estate. Like a mutual fund, the REIT is not taxed on its corporate income, so long as it distributes 95 percent of its net taxable income to its stockholders each year. The REIT's stockholders are taxed on their dividend income. REITs are also subject to the regulatory jurisdiction of the Securities and Exchange Commission.

REITs can be privately or publicly held. They can own properties or make real estate secured loans, or do both. The following discussion focuses primarily on publicly held, equity REITs. REITs normally specialize in a property sector. They invest, for example, in hotels, commercial office buildings, apartment buildings, regional retail malls, commercial retail strip shopping centers, industrial warehouses, storage facilities, or other types of income-producing property. However, REITs may diversify their property investments.

Commercial mortgage-backed securities ["CMBS"] are a form of debt security, the terms of which are largely determined by negotiation among private parties. But, their terms are also influenced by the Internal Revenue Code's provisions regarding REMICs ["real estate mortgage investment conduits"] and more recently FASITs ["financial asset securitization investment trusts"]. Issuers of CMBS are subject to the regulatory jurisdiction of the Securities and Exchange Commission. CMBS represent interests in a pool of loans secured by mortgages on commercial, income producing properties. The loan payments are distributed to the securities holders in accordance with their relative priority of claim to the payments. The pooled loans may be secured by the same property type, such as commercial office or apartment buildings, or more typically by different types of properties.

Commercial real estate in the United States is primarily held by privately held entities or individuals rather than publicly owned companies. But the equity capitalization of equity REITs has increased to more than $160 billion, and substantial assets have moved into the control of publicly owned companies, primarily REITs. Last year alone, REITs acquired approximately $35 billion of investment-grade real estate. The greatest ownership by publicly owned companies exists in the hotel/gaming resort and regional mall property sectors.[1] Publicly owned companies control a smaller share of apartment and non-mall retail properties.[2] They control only a marginal share of the commercial office and industrial warehouse property sectors.[3]

At the same time as the capitalization of equity REITs has burgeoned, the volume of outstanding CMBS has skyrocketed. The cumulative outstanding CMBS indebtedness now exceeds $170 billion. Approximately one-half of the debt that supports the payments on outstanding CMBS is collateralized by multi-family properties.[4] Notwithstanding the mushrooming of outstanding CMBS securities, the CMBS market remains a relatively small source of the total commercial mortgage debt. In 1997, the CMBS market originated 13 percent of commercial mortgage loans.[5]

To date, equity REITs have been primarily acquiring existing, income-producing properties. However, as the REITs have pursued aggressive acquisition strategies, they have competed for properties and bid up their prices, so that in some markets the prices realized for existing buildings have triggered new construction. As the prices of existing properties have escalated, REITs have allocated increasing amounts of capital to the development of new properties. Depending upon their capital and management capacities, REITs have undertaken new development projects alone or with other developers and capital providers.

The equity ownership of the publicly owned REITs as of December 31, 1996, was split evenly between institutional and individual investors. [6] The rapid emergence of the publicly- and privately-owned REIT is attributable in substantial part to the interest of pension funds, life insurance companies, and other institutional investors in holding investment grade, income-producing real estate indirectly rather than directly. Institutional investors lost substantial amounts on their real estate investments during the severe

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[1] B. Ziering, B. Winograd, and W. McIntosh, “Tracking A Capital Market Transformation: Public Market Commercial Real Estate Penetration,” Real Estate Finance [Fall 1997] [hereafter Ziering et al.] at 18, 20.

[2] Ziering et al. at 20.

[3] Ziering et al. at 17, 19.

[4] March 20, 1998, interview with Sally Gordon, KPMG Peat Marwick.

[5] Federal Reserve Bulletin [December 1997].

[6] Paine Webber, REIT 1997 Review and 1998 Outlook at 16.

recession of the late 1980s and early 1990s. Their experience has persuaded them to search for a more easily liquidated form of investment.

The rapid emergence of the equity REIT and CMBS markets is also attributable to the credit crunch that occurred with the last recession. The credit crunch followed the overextension of commercial mortgage credit by commercial banks, thrifts, and life insurance companies. In response, regulators of these institutions increased their capital adequacy requirements. These, in turn, have motivated traditional portfolio lenders to hold the more highly rated interests in CMBS rather than simply in whole loans, as their credit risk is less and, therefore, their capital requirement is less.

The national credit rating agencies -- Standard & Poor’s, Moody’s, Fitch Investors Services/IBCA, and Duff & Phelps -- rate both CMBS and REIT securities. The ratings affect the marketability of the securities and the capital costs of their issuers. The Securities and Exchange Commission acknowledges the rating agencies’ status, but does not actively oversee them.

II. ISSUES AND OPPORTUNITIES

A. The REIT Market

1. The Benefits and Potential Implications of Economies of Scale

Managers of acquisitive REITS explain their merger and acquisition activities in terms of creating economies of scale. Increasing the scale of real estate ownership can affect many costs: capital, overhead, and operating. During the current phase of REIT capitalization and consolidation capital costs appear to be the most significantly affected by increasing scale. REIT managers are seeking to establish quickly the appeal of their equity and debt securities to institutional investors. Institutional investors, especially the larger pension and mutual funds, want to invest in REITs with large equity capitalizations in order to realize their goal of increasing the liquidity of their real estate investments.

During the last five years, REITs have been racing to achieve larger and larger capitalization thresholds. An equity capitalization of $1 billion currently appears to be the threshold desired to attract significant institutional investment. However, as REITs continue to consolidate and increase their appeal to a broader universe of institutional investors, the desired threshold is likely to increase to $5 billion and then $10 billion.

Maintaining profitability, of course, is necessary to REITs that are pushing the envelope of scale. Expansion of scale without a related improvement in income will not sustain the appeal of a REIT’s stock. If the appeal declines, the REIT’s cost of capital increases. The current “soft” market for REIT equity confirms this proposition. Institutional and other investors are not simply looking to see REITs scale up their assets if the acquisition prices reduce the REITs’ financial return below that of direct investment in real estate or other investments. In the current market, investors are looking more closely at the quality of REIT management to identify those best able to produce profits and not just asset empires.

As their assets increase, REITs also look for opportunities to increase their leverage by borrowing in the unsecured, corporate bond market. Equity Office, for example, during the first quarter of this year, issued $1.5 billion in unsecured debt. This is the largest unsecured REIT debt offering to date. During the second quarter of 1998, Simon DeBartolo followed with a $1 billion unsecured debt offering, and Equity Office issued an additional $750 million. Borrowing in the unsecured market enables a REIT to avoid all the transaction costs -- including title, tax, appraisal, and legal -- associated with borrowing in the secured debt markets. Borrowing also is advantageous at this time because interest rates are low and the market for REIT equity turned “soft” during the first half of this year.

The REITs that are pursuing economies of scale aggressively, like Equity Office and Equity

Residential, are not simply focused on reducing their capital costs. Like other large economic entities in other sectors (automobile manufacturing, for example), they are seeking to make more efficient use of third-party vendors of goods and services, such as suppliers of appliances and other furnishings to apartment REITs or the suppliers of marketing, leasing, accounting, appraisal, legal, and building maintenance services to all categories of REITs. They are also seeking to become efficient operating companies by simplifying their own management functions and reducing in-house staff. As their scale increases, they face the issue of whether to manage a function in-house or outsource its performance to third-party vendors, many of which are pursuing national consolidation strategies that parallel those of the REITs.

The capacity of a REIT to realize economies of scale is likely to vary with the type of property in which it invests. Strip or neighborhood shopping centers, for example, are less likely than regional malls to attract varied, national tenants. Therefore, the economies in marketing and leasing costs that they may realize are less. Similar variations exist among other property sectors. [7] Also, certain property types, like apartments or warehouses, have been perceived to date as more commodity-like. Realization of economies of scale will be more essential to the continuing competitiveness of REITs that focus on them, unless the REITs devise strategies that make their properties less commodity-like.

Evidence that REITs are beginning to realize economies of scale is emerging. Real estate finance journals are discussing merger transactions that produce operating savings. [8] Acquisitive REITs are reporting improvement in their operating margins that reflects successful cost reduction. Third-party vendors are renegotiating their contracts with REITs as well as consolidating in order to become national service providers with continuing leverage relative to the REITs that have become national space providers.

Unlike other sectors of the economy, such as commercial banking and life insurance, REITs generally are not yet reporting the adjustments in employment that are associated with their pursuit of economies of scale. This may be attributable to the lower employment levels in the real estate sector and the brevity of the period within which the current consolidation has occurred.

Logically, realizing economies of scale will benefit both the REITs and their tenants, if the REITs are operating in a competitive marketplace. REITs that achieve significant cost reductions as they increase their scale will be able to adjust more easily their rental rates in light of current market conditions. Larger scale and efficiency also may enable REITs to realize satisfactory returns on lower margins. Thus, if the rental market is competitive, the individual and business tenants of the larger, more efficient REITs may realize

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[7] Anthony Downs, "The Pressure on Public REITs To Grow Larger And Its Consequences," The Wharton Review [Spring 1997] [hereafter Downs] at 12.

[8] M. Bers & T. Springer, "Sources of Scale Economies for REITs," Real Estate Finance. [Winter 1998].

economic benefit from REITs' pursuit of economies of scale. Where occupancy costs of multi-family housing decline, such housing will become more competitive with single-family, owned-occupied housing, subject to the income tax advantages of the latter. Similarly, wherever REITs become the most efficient space providers, their performance will create an incentive for non-REIT property owners -- corporate and other -- to cede property ownership to the REITs. The rate at which this occurs will depend upon the success of REITs in realizing profit from their efficiency and sustaining the currency value of their stock for further acquisitions.

2. The Pursuit of Market "Dominance"

The emergence of REITs has triggered a spirited debate on the probable future scale of REIT control of real property assets. [9] The rapid expansion of highly acquisitive REITs, like Equity Office and Equity Residential, suggests that " the moon's the limit." However, as in other economic sectors such as automobile manufacturing, there are limits to the benefits of large scale. There are also limits to sustaining a rapid growth rate. In the case of REITs, the limits include the statutory requirement that the REIT distribute virtually all of its net taxable income to its stockholders. This requirement substantially constrains the retention of earnings for capital investment. This, in turn, requires the REIT to rely upon the issuance of new equity or debt securities to fund its expansion. However, in calculating taxable income a REIT is permitted to deduct the dividends paid to its perpetual preferred and common stockholders. It, therefore, can reduce the cash payout to its common stockholders by issuing perpetual preferred stock.

Notwithstanding its limitations, the REIT vehicle through calendar year 1997 has been an appealing means of creating regional or national real estate portfolios. Until this year, the equity market for REITs has been very favorable. Continually increasing equity values gave REITs a valuable currency for negotiating acquisitions.

Managers of acquisitive REITs commonly explain their merger and acquisition activity as the creation of a "dominant" position in a market. They clearly intend to communicate to investors that they are enhancing their capacity to maximize rental income. REIT managers reinforce this message by indicating their entry into markets that have one or more barriers to entry, whether attributable to geography, regulation, land costs, labor costs, or other factors.

What does market "dominance" mean in the real estate sector? Clearly, certain REITs have expanded their portfolios aggressively. Starwood Lodging and Patriot American in the hotel sector, Equity Office and CarrAmerica in the office sector, Equity Residential and AIMCO [Apartment Investment &

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[9] Peter Linneman, "Changing Real Estate Forever," The REIT Report [Autumn 1997]; John H. Vogel, Jr., "Why The New Conventional Wisdom About REITs is Wrong," Real Estate Finance [Summer 1997].

Management Company] in the apartment sector, Simon DeBartolo in the regional mall sector, and Crescent Real Estate and Vornado Realty in the diversified REITs sector come to mind. The numbers of properties or apartment units that these entities now control appears impressively large. But, none of these entities' acquisitions yet has triggered an extended antitrust review or challenge by the Federal Trade Commission or the Department of Justice.

Simon DeBartolo probably represents the current apex of dominance within a real estate sector -- regional malls in its case. It has created a national portfolio that includes control of several malls within a single metropolitan area and even subarea, as in Atlanta.

A commonly stated advantage of the scale of control achieved by Simon DeBartolo, and others to a lesser degree, is the ability of the REIT to negotiate the availability of space in multiple markets with major national or regional tenants. For both landlord and tenants, negotiation of national or regional market space needs can be highly efficient both in time and avoidance of costs of intermediaries.

Simon DeBartolo also illustrates a second potential advantage of market "dominance." Among REITs, it is developing a sophisticated strategy of pursuing not simply rental income from its market presence. It anticipates realizing a marketing advantage from consumer recognition of its "brand" of mall, which includes a particular mix of tenants and amusement activities. National consumer recognition, as in other sectors of the economy, presumably will enhance the attractiveness of the Simon DeBartolo malls to tenants, which in turn will improve the REIT's leverage relative to tenants. This leverage could enable the REIT either to share more costs with its tenants or realize income from joint marketing of new products or services.

REITs that invest in regional malls are not alone in seeking to establish a brand or franchise identification with consumers. Apartment REITs, such as Post Properties and the combined Avalon Properties/Bay Apartment Communities, are seeking to establish a common consumer perception of the economic, aesthetic, and quality of life advantages of living in any one of their properties. Successful implementation by apartment REITs of such a strategy will enable them to distinguish their properties from the commodity-like character of other, multi-family properties and thereby realize higher rent levels from their units.

Market "dominance" in the narrower sense of control of space within a local market normally is vulnerable to competition from competing space, including building conversion and new construction. In the absence of significant barriers to entry, a REIT's advantage in controlling a large percentage of space in a real estate sector within a local market may be only temporary. The time competitors require to create new supply would determine the period of advantage. This varies by property type. Apartment construction, for example, normally requires less time than does construction of Class A office buildings in a central business district.

If a market has or is perceived to have significant barriers to entry -- whether geographical, regulatory, or economic such as high land or labor costs -- then the period of advantage may be extended. REIT managers have a common self-interest in maximizing their rental income by discouraging competitors' entry into a market as long as possible. Therefore, when announcing portfolio acquisitions they are inclined to assert that the markets they are entering are difficult to enter. If they in fact are, the REIT may realize substantial economic advantage at the expense either of its tenants or their customers.

Taking advantage, even if only temporarily, of local real estate market conditions, is not a strategy unique to REITs. Other real estate investors have been playing this game for decades or centuries. The larger, publicly owned REITs, however, are now operating in a capital market place that demands continuing, high performance. This requires collecting and enhancing management talents and applying management strategies to the ownership and operation of real estate that are as aggressive, sophisticated and continuously profitable as those the public capital markets expect in other sectors.

3. Will REITs Acquire Brownfields?

REITs are acquiring property portfolios that generate the income that institutional investors expect from real estate. As indicated, REITs' acquisition strategies reflect an effort to establish their equity as a currency that institutional investors will want to purchase.

The implication of this strategy is that certain types of developed properties do not appeal to REITs. These include abandoned industrial or commercial properties with a history of contamination ["brownfields"] that discourages reuse or redevelopment. Normally, brownfields by definition are not income-producing properties, so they do not qualify as investment grade.

There are, however, certain exceptions to the exclusion of brownfields from REIT portfolios. The larger a REIT's portfolio, the greater its diversification of financial risk and the more likely these exceptions occur. If, for example, an industrial property with contamination risk continues to be occupied, a REIT may acquire the property. CenterPoint Properties has acquired a former AT&T facility in the Chicago metropolitan area, where AT&T leased back the space following the acquisition.

REITs might also acquire a portfolio of commercial properties that includes a brownfield site that is being redeveloped for new commercial uses. General Growth Properties acquired such a site in Waterbury, Connecticut, as part of its acquisition of the mall portfolio of the Homart subsidiary of Sears Roebuck & Company. The site was being remediated and redeveloped with the assistance of the State of Connecticut when the REIT acquired the Homart portfolio.

A REIT might also acquire a brownfield site following its successful remediation and redevelopment. Glimcher Realty of Columbus, Ohio, has acquired from MetroMall New Jersey LLC a manufacturers' warehouse outlet mall in Elizabeth, New Jersey, adjacent to the New Jersey Turnpike and Newark International Airport. MetroMall had taken the site through the remediation process.

REITs that elect to acquire properties in urban markets with high barriers to entry -- and what barriers are higher than federal and state requirements for removal of site contamination? -- are especially likely to consider the merits of acquiring a brownfield property after, during, or even before remediation. Such generally tight real estate markets as Seattle, Portland, San Francisco, Oakland, Boston, New York, and Miami are likely to offer brownfields reuse opportunities to REITs.

A review of the 1996 and 1997 Form 10-K reports of several larger office and retail mall REITs confirms that their portfolios include properties with remediation responsibilities. Of all the environmental risks that REIT managers must consider, the cleanup risk is one they most fully disclose. [10]

4. The Impact of REITs on Urban Growth Patterns

The discussion of the role of REITs in brownfields redevelopment leads to larger questions regarding the role of REITs in urban and metropolitan economic development:

- Will REITs finance or acquire projects that differ in any material regard from conventional development that is undertaken by less well capitalized and perhaps less well managed, non-public entities?

- Will REITs support the continuing economic viability of urban communities?

The following discussion primarily focuses on the behavior of equity REITs. There are market dynamics, some only emerging, that suggest that the norms of the real estate sector may transform, particularly as the consolidation of control of real estate assets and the role of publicly-held companies increase.

[10] See, for example, the 1997 Form 10-K Report of Beacon Properties Corporation at pp. 3-5 and F20 and the 1996 Form 10-K Report of Federal Realty Investment Trust at p. 19.

a. <u>REITs and Real Estate Growth Rates and Patterns</u>

Notwithstanding the rapid run-up in equity values of REITs through 1997, REITs are appropriately considered income rather than growth stocks. They have a self-interest in stable rents and the avoidance of oversupply of competing space that undermines rent stability. Some REITs, in their pursuit of rapid asset and income growth, have bid up the price of properties -- especially in the hotel, office, and apartment sectors -- and that behavior has prompted new construction. Other REITs have undertaken new development directly. The public markets, many assume, will notice and punish such behavior more quickly than private markets do, if it affects rent levels of REIT portfolios. Whether the public markets in fact will behave in this manner will depend upon whether REIT investors are well informed and willing to act on information that indicates oversupply conditions in the property markets in which the REIT has invested. [11] Observers note that the public markets have reacted to oversupply of apartment and office space in the Atlanta region by reducing the price earnings multiple of affected REITs. The decline so far this year in REIT equity values has been attributed in part to the prior aggressive bidding by REITs for developed properties.

The UPREIT ["Umbrella Partnership REIT"] structure of many REITs is also likely to affect the behavior of both REITs and those who develop and sell properties to them.[12] A seller that elects to receive limited partnership units in a limited partnership controlled by an UPREIT is able to defer capital gains tax until it converts the units to stock in the REIT. Such a seller has a self-interest in the prudent management of the REIT. More significantly, the seller has a self-interest in not undertaking new development that competes with the property that it has sold to the REIT.

REITs, of course, are not the only players in the market. In fact, in most markets, REITs control only a small percentage of total space. So, REITs can suffer from the speculative or overoptimistic behavior of others. At the least, however, REITs have reason not to overheat the markets in which they are present.

Second, as holders of real estate assets increase their portfolios and become more efficient asset managers, they increase their financial and managerial capacity to assume risk. Not all managers will improve as their scale of ownership increases. But in time the public markets will recognize and reward the better managers with higher valuations of their equity and allow those managers to assume greater risk through diversification into new property types or new geographical markets. The risk assumed also may be

[11] Downs at 8-9.

[12] An UPREIT or Umbrella Partnership Real Estate Investment Trust, is a vehicle which allows a REIT to acquire real estate in a tax-deferred transaction for the seller, provided all conditions are satisfied. The seller receives units in the umbrella partnership or operating partnership generally equal in value to that of the property (ies). This type of transaction has several benefits for the seller.

reflected in acquisitions of properties that pose greater challenges to appreciation due to their location, obsolescence, current vacancy or rent levels, current use, contamination risk, property tax liability, energy inefficiency, or other reasons. The better-managed companies will not necessarily acquire properties that the market considers high risk. But they will be better able to assume such risks than less well-managed and capitalized owners of real estate.

Third, land development growth controls may be considered compatible with the self-interest of better-managed and capitalized holders of real estate. Growth controls may discourage overbuilding that undermines the value of existing space. Observers of the real estate sector, such as ERE Yarmouth and RERC (in their annual Emerging Trends in Real Estate report) increasingly note that stable or enhanced property values are more likely in metropolitan markets that apply growth controls. [13] Growth controls tend to be anathema to property developers. However, as the managerial and financial capacity of a holder of real estate increases, its ability to exploit advantage rather than suffer disadvantage from growth controls increases. The larger, better-managed holders, therefore, may find growth controls as acceptable as Brer Rabbit found the briar patch.

Growth controls vary in their scope, rigor, and market impact around the country. Communities have different attitudes towards their benefits. So, national or regional REITs will be able to choose markets based in part upon their perceptions of whether or not the growth controls of a particular community create an opportunity or a barrier to their entry. Growth controls at the very least offer a market niche that some REIT managers will choose to exploit. [14]

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[13] ERE Yarmouth and Real Estate Research Corporation, Emerging Trends in Real Estate: 1998 at 8, 27.

[14] Downs at 16-17.

Growth controls do not assure success or lack of competition to REITs that elect to enter markets where they exist. The San Francisco Bay region has both stringent environmental regulations as well as geographical and cost barriers to entry. Certain apartment REITs, such as Bay Apartment Communities, have elected to respond to the strong housing demand in the area by undertaking vacant in-fill development and Class C apartment project conversions. Other REITs, including Essex Property and Irvine Apartment Communities, intend to exploit the opportunities that the Bay area's entry barriers create.

b. <u>REITS and Urban or Metropolitan Economies</u>

Will REITs support the continuing economic viability of urban communities? The answer is likely to depend upon whether the REIT specializes in a property sector and, if it does, what the sector is. Most REITs currently specialize by sector. Certain property types, such as Class A office, luxury hotel, and urban apartment are more likely to be located in or near central business districts. REITs that specialize in these property types have a self-interest in the continuing economic vitality of the urban areas in which they have invested.

REITs that specialize in property types that are more likely located in suburban areas, such as suburban office, non-luxury hotels, suburban apartments, regional and strip malls, storage, and warehouse, are similarly interested in the continuing economic vitality of suburban areas.

REITs, in short, become major stakeholders in the communities in which they invest. As they manage the costs associated with their ownership of property -- whether local property taxes, utility rates, or building maintenance and obsolescence -- they are in a position to influence those costs. They have a clear self-interest in reducing or limiting them. Depending upon the magnitude of a REIT's portfolio in a particular community, the REIT may be a major stakeholder able to influence whether and how the local economy deals with a particular cost. For example, the largest apartment REITs have a self-interest in controlling energy costs of their properties. They, like major industrial customers of utility companies, will want to exercise their leverage to obtain rate discounts and other favorable service terms. Major apartment REITs may also wish to become intermediaries in the supply of energy to their tenants. So long as REITs perceive that their operating costs are manageable and their rental income is supported by continuing economic activities in the urban or suburban areas in which they have invested, they have reason to maintain their stakeholder positions in those areas.

Property does, of course, depreciate and requires maintenance and improvement to sustain its competitive appeal. That in turn requires REITs to set aside capital reserves for maintenance and improvements. Publicly owned REITs operate in a market environment that continuously focuses on current financial performance. It remains to be seen whether REITs in both favorable and unfavorable capital market conditions will fund adequate reserves to assure the competitive appeal of their investments. If earnings decline, they may be tempted to divert funds to pay dividends. [15] For some REITs this is a current temptation.

Some REITs diversify into many property types. Crescent Real Estate and Vornado Realty are examples. Whether their self-interest is served by the continued economic viability of urban or suburban areas depends upon their property focus. Vornado is highly focused on urban properties, as illustrated by its acquisition of the Merchandise Mart in downtown Chicago. Crescent's portfolio includes both downtown and suburban office, casino, health care, and other properties.

c. <u>REITs and the Integration of Land Uses</u>

The typical specialization of REITs by property type raises the question whether their specialization will complicate an attempt by certain communities to achieve a more favorable integration of land uses that would reduce traffic congestion, improve job accessibility, and improve environmental conditions. The historical separation of land uses pursuant to local zoning codes common in the United States has contributed to the creation of an auto- and truck-dependent transportation system in most communities.

To date, managers of most REITs enjoy expertise in the ownership and development of a particular land use type. Especially as REITs focused on a similar property type have consolidated, investors, rating agencies, and analysts have been primarily concerned with the capacity of management to handle an ever increasing portfolio of similar properties. It remains to be seen which REIT managers possess the capacity that investors currently expect. Diversification by a REIT into a different property type raises yellow flags with the investment community. Will the REIT become distracted from its main line of business? Will it acquire and be able to integrate the management expertise needed for its investment in a new property type? REIT managers themselves may be wary of the risks of diversification. Barry Sternlicht, CEO of Starwood Lodging, for example, is reportedly concerned with the volatility of the earnings of the Caesars Palace casinos that Starwood acquired in its merger with ITT. [16] Starwood may wish to sell the casinos in order to continue to focus on the hotel sector in which it specializes.

Certain REITs own properties that include multiple uses, so their managers are accustomed to dealing with different types of tenants. Apartment REITs, for example, may own projects that include local convenience retail on the first floor. Office REITs may own properties that include commercial retail as well as office tenants. Retail mall REITs may have the greatest self-interest in developing strategies that include multiple uses within a mall property. Many retail mall properties are experiencing higher vacancy and space

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[15] Downs at 4, 22.

[16] <u>The Wall Street Journal</u>, March 5, 1998, at p. A17.

turnover rates as consolidation continues among retail tenants, as the “big box” retailers such as Wal-Mart expand into new retailing lines, and as the methods of effective merchandising of goods and services continue to evolve. Some mall REITs have converted former retail centers into commercial back office telemarketing centers. Others, like Federal Realty, are undertaking projects in communities where households want to live close to where they work and shop. So the retail mall developer is beginning to design projects that minimize auto dependency and integrate multi-family housing with commercial retail and office uses. Post Properties, primarily an apartment REIT, illustrates in Atlanta, Dallas, and Denver a similar movement toward the integration of apartment, local retail, and office uses. [17]

It remains to be seen which of the retail mall, apartment, office, and other REITs will respond to a potential demand in certain communities -- especially those in highly congested areas -- for greater integration of land uses to reduce traffic congestion, improve access of employees to jobs, mitigate retailers’ distribution costs, and improve air quality.

As REITs respond to this potential market demand, investors, rating agencies, and investment analysts will evaluate their strategies. The integration of land uses within a project adds complexity to the evaluation of the property’s cash flows and the credit risks that different types of tenants within the project present. The ability of REITs to manage the diversification of their cash flow sources will be essential. The credit analysis required of REIT managers and credit analysts will resemble that which underwriters, rating agencies, and investors currently are undertaking prior to the issuance or purchase of commercial mortgage-backed securities that are backed by diversified collateral types, including multi-family, retail, and office properties. The learning curve that Wall Street is experiencing in the CMBS market should facilitate the investment community’s acceptance of REITs that undertake integrated, multiple use projects.

5. Potential Competitive Effects of REITs on Housing Government Sponsored Enterprises

With the emergence of equity REITs, holders of real estate assets have expanded their means of finance beyond property -specific borrowing to corporate level borrowing. Equity Office and Simon DeBartolo illustrate the capacity of the largest REITs to issue unsecured corporate debt rather than rely upon borrowing collateralized by specific assets in the REIT’s portfolio.

The larger equity REITs now have access to a financing source that enhances their ability to manage their balance sheets and borrowing costs like other publicly owned companies. This access is also available to larger private REITs or other owners of real estate, if they are able to obtain satisfactory ratings from the credit rating agencies. Borrowing in the unsecured debt markets avoids various transaction costs of collateralized borrowing, such as title insurance, tax, legal, mortgage insurance, and appraisal costs.

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[17] “Healing a Hospital Campus,” Urban Land [April 1998] at pp. 41-42.

The access of equity REITs that own multi-family properties to the unsecured corporate debt market increases the financial market competition with which Fannie Mae and Freddie Mac, the two federally chartered housing government sponsored enterprises [“GSEs”], must contend.

Apartment REITs, particularly the larger ones, tend to own projects that exceed two hundred fifty units in order to realize more easily the management and cost efficiencies associated with larger scale. REITs also own less than 10 percent of the apartment projects exceeding 20 units.[18] Thus, Fannie Mae and Freddie Mac continue to have a large market to serve. The larger REITs also continue to obtain collateralized financing through the GSEs.

But the GSEs are now negotiating with both REITs and parties that anticipate selling to them transactions that may involve shorter loan amortization periods or reduced levels of project collateralized debt. So the GSEs are experiencing the effects of the increased financing options of REITs.

Mortgage REITs are beginning to emerge again as credit providers. If satisfactorily capitalized, they too may gain access to both the private or public equity and unsecured debt markets. They may define lending strategies that focus on market niches that are not well served by the GSEs. An affiliate of the Local Initiatives Support Corporation, the Local Initiative Managed Assets Corporation, for example, is converting to a privately-held, hybrid REIT that will acquire equity positions in, and make loans to, smaller, affordable multi-family and non-housing projects in low-income urban communities that the GSEs either are not purchasing or cannot purchase.

The increased capital availability in the private and public capital markets creates competitive credit sources for owners of multi-family properties that previously relied upon the GSEs for access to the secondary capital markets. This increased capital availability facilitates the financing of projects that the GSEs might not have underwritten earlier.

B. THE COMMERCIAL MORTGAGE-BACKED SECURITIES MARKET

1. Who Does and Who Does Not Benefit from the CMBS Market?

Borrowers able to gain access to the CMBS market clearly have benefited from the tremendous amount of capital available in the market. The market has matured into current conditions, where borrowers benefit from capital supply exceeding demand. The principal beneficiaries are owners of multi-family housing properties. Loans to these parties cumulatively constitute approximately one-half of the loans

[18] Ziering et al. at 19.

backing outstanding CMBS securities. Other beneficiaries include owners of commercial office, retail, warehouse, and other properties.

Borrowers have benefited both on loan price and other terms. The CMBS market has expanded the available credit sources beyond traditional depository and institutional lenders and secondary market parties such as Fannie Mae and Freddie Mac. The increased competition among creditors has enabled borrowers to negotiate more favorable terms regarding collateralization ratios, debt service ratios, prepayment penalties, and other matters.

The CMBS market first emerged in the early ‘90s with the massive, rapid disposition of thrift asset portfolios by the Resolution Trust Corporation and as a credit source for weaker borrowers that were unable to obtain credit from commercial banks, thrifts, and insurance companies. But, as the market has matured and credit conditions improved, the CMBS market has broadened to include borrowers that are able to obtain credit from traditional sources. The market now threatens to limit the commercial mortgage market share of these sources.

But the CMBS market has benefited commercial banks and life insurance companies as well. Both are major purchasers of CMBS securities. Also, both insurance companies and the investment banking affiliates of the larger commercial banks are major underwriters of CMBS securities.

The CMBS market enables commercial banks and life insurance companies to participate in the commercial mortgage market at less capital cost and risk, as they are able to purchase the AAA or other, more highly rated securities and look to other investors to assume the risks of the junior tranches or interests in the loan pools. Life insurance companies may elect to buy junior rated pieces at greater capital cost. The CMBS securities also enable the banks and life insurance companies to diversify their credit risks and match the maturity of their assets with that of their liabilities.

While the CMBS market has clearly benefited both borrowers and creditors, it to date has not benefited all classes of borrowers. Who has not benefited?

Those currently not participating in the market include parties seeking construction financing, small borrowers, owners of government-assisted and regulated multi-family properties, developers of mixed-use projects, and other borrowers that present unconventional risks. The market has matured and broadened significantly since the early years of this decade, so it is reasonable to expect that the market will expand further as underwriters seek to apply their information and financial management technologies to additional forms of credit extension.

The CMBS market does not yet provide financing for construction. Construction loans normally are drawn down over time in phased withdrawals, as construction proceeds in accordance with specific project specifications and budget. The loans require active oversight by the lender to assure the borrower's timely completion of the contemplated project. No income flows prior to project completion. The CMBS market currently involves credit extensions that are repaid from a property's income cash flows.

While the CMBS market does not fund construction loans, it clearly affects the construction loan market by making credit available for permanent or "takeout" financing, which in turn facilitates the availability and eases the terms of construction credit.

Small borrowers -- those seeking less than $1 million of credit -- do not currently have access to the CMBS market. The credit quality of small loans is not at issue. The market considers any loan under $5 million as small, and the definition keeps changing as the market participants seek to aggregate larger and larger pools at less cost. [19] As the market has matured, the competition among underwriters and their related need to reduce transaction costs has led to the underwriting of larger loans that are placed into larger pools. The competitive dynamic is similar to that among superregional and money center commercial banks, all of which are concerned with becoming more efficient in their credit origination. During 1997, CMBS underwriters assembled individual pools exceeding $2.2 billion. In doing so, underwriters were responding to their own need to drive down costs, investors' interest in buying more easily liquidated positions in larger issues, and rating agencies' desire for greater risk diversification in loan pools by borrower, geography, and loan type.

The traditional secondary market supported by Fannie Mae and Freddie Mac also treats loans under $1 million as small. For example, Fannie Mae's normal loan purchase threshold under its delegated underwriting program is $1 million.

Owners of rural multi-family projects are among the small borrowers who lack access to the CMBS market.

Owners of federally subsidized and regulated multi-family housing projects also lack access to the CMBS market, unless they are seeking to refinance as part of a conversion of their properties to market-rate housing. The concern of CMBS underwriters and rating agencies with the risk of termination of Section 8 or other project subsidies limits access to the market. Regulatory constraints and deed restrictions also inhibit access.

Owners of projects that are federally assisted under the federal low income housing tax credit program do have access to the CMBS market because the tax subsidy is considered more secure.

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[19] March 20, 1998, interview with Sally Gordon, KPMG Peat Marwick.

Owners of mixed-use projects may have problems gaining access to the CMBS market depending upon the complexity of tenant types in the project. Combining different uses within a project presents the creditor with different types of credit risks and different real estate markets to consider. CMBS underwriters and rating agencies have the same credit evaluation task as commercial banks and life insurance companies do in considering direct, whole loans to mixed-use projects. Particularly within the last year, as the volume of loan transactions financed in the CMBS market has mushroomed, underwriters and rating agencies have given first priority to transactions that are more easily and quickly underwritten -- the "plain vanilla" loans.

Certain borrowers, particularly smaller ones or parties that contemplate the possibility of needing to renegotiate, extend, or otherwise modify their loan terms, may not wish to seek credit in the CMBS market, because the securitization of credit does complicate relationships between borrower and lender. The borrower does not deal directly with the lender, as the lender is a collection of institutional or individual investors in the securities backed by the pooled loans. The borrower instead must deal with transactional intermediaries, including the trustee for the securities holders and the master and special loan servicers retained by the trustee to collect the loans.

Tax considerations add further complexity. Many CMBS securities are issued as REMIC securities in order to realize certain tax results. A borrower of a loan that is securitized as part of a REMIC issue cannot attempt to renegotiate, extend, or modify its loan in the absence of a loan default. The FASIT, when fully implemented, is expected to ease this problem by allowing CMBS underwriters to substitute performing loans for pooled loans in default.

Borrowers also may have difficulty negotiating with the loan servicer retained by the securities holders' trustee. Many servicers are receiving minimal fees for servicing very large volumes of loans backing CMBS securities. The servicers may lack sufficient financial incentive and administrative capacity to respond quickly to a borrower's request to renegotiate, extend, or modify its loan.

The investors in the junior interests in the CMBS pools assume the risk of first loss in the event of default on a pooled loan. These investors have the option of purchasing the loan out of the pool and negotiating directly with the borrower. Only institutional investors with loan collection capacity are likely to exercise this option.

2. Are There New Constraints on Speculative Financing?

Will the CMBS market be less prone to speculative lending than traditional credit markets historically have been?

Many observers consider this an open question that may be answered either this year or whenever credit markets cool down and credit quality is tested in a market downturn.

The consensus of market observers and participants is that the current market is "hot" and credit underwriting during 1997 became more questionable as credit oversupply conditions resulted in a torrid volume of securities issues -- $45 billion of CMBS issued during 1997, another $19.5 billion issued during this year's first quarter, and a total CMBS volume of $60 billion anticipated for this year.

In the current borrower's market, loan terms are easing. More significantly, the volume of transactions is swamping the credit rating agencies with rating requests. The agencies are the investors' guardians, since the investors rely upon the ratings in determining whether to buy securities. The pace of transactions does not allow for exhaustive review either by the rating agencies or investors of the probable valuations or long-term quality of the real estate that collateralizes the debt being securitized. Therefore, the rating agencies undertake an inspection of a small sample of the properties.

The rating agencies' capacity to evaluate the huge volume of transactions has been affected by their loss of staff to credit underwriters. The underwriters are able to offer greater compensation, which affects the ability of the rating agencies to retain more experienced staff.

The four major rating agencies -- Duff & Phelps, Fitch Investors/IBCA, Standard & Poor's, and Moody's -- also compete for the business of rating CMBS securities. Their desire for market share of the rating business affects how they undertake the business. Observers most often cite the willingness of the rating agencies during 1997 to allow smaller amounts of junior or subordinated interests in CMBS securities to support the higher rated interests as evidence that the agencies have eased the rigor of their underwriting requirements.

Notwithstanding the apparent easing during 1997 of the agencies' evaluation, investors apparently have continued to treat CMBS securities like corporate debt securities and relied on the agencies' rating rather than any due diligence inquiry of their own. Thus, the continued participation of institutional investors in the CMBS market generally has not been deterred by the reduction in required credit support of the more highly rated interests in the pooled loans. During the first quarter of this year, there apparently has been investor hesitation with respect to individual issues.

The rating agencies are not the sole guardians against credit excess in the CMBS market. Market observers and participants, also rely upon issuers' information disclosures. As the market has matured, investors have bargained for increased disclosures. Servicers of the pooled loans now report quarterly to investors on the status of each pooled loan. This kind of information is deemed to make transparent the quality of the loans being underwritten. It distinguishes the market from the traditional credit markets in which the status of individual loans was the proprietary information of the commercial bank, life insurance company, or other lender.

Investment analysts may also act as a cautionary influence, although their perspective is not objective like that of the credit rating agencies, as they are employees of the investment banks that are active underwriters of CMBS securities.

Credit markets historically run in cycles, and no one is suggesting that the CMBS market will not have up and down cycles. The suggestion is merely that the transparency of the marketplace will discourage speculative lending of the type that occurred during the 1980s.

Finally, it is important to remember that the CMBS market is only one of the sources of credit for commercial mortgage transactions. During 1997, it funded 13 percent of total commercial loan originations.[20] Thus, most of the commercial mortgage market is outside the CMBS market and is primarily represented by the direct lending activities of commercial banks and life insurance companies. The contour of the commercial real estate credit cycle will be determined more by these institutions' underwriting behavior than that of the CMBS conduits.

3. Competitive Impact of the CMBS Market upon the Housing Government Sponsored Enterprises

The emergence of the CMBS market has created new competitors for Fannie Mae and Freddie Mac. While owners of various types of property besides multi-family properties obtain credit in the CMBS market, cumulatively about one-half of all loans securitized in the market are collateralized by apartment projects.

The new competition has affected both Fannie and Freddie. Historically, the volume of Fannie's

[20] Federal Reserve Bulletin [December 1997]

multi-family loan purchase activity has substantially exceeded that of Freddie. In its 1997 annual report, Fannie reported that multi-family loans as a percentage of its net mortgage portfolio declined during the last three years from 6.2 percent in 1995 to 5.1 percent in 1996 to 3.9 percent in 1997. Freddie reported that for the same period such loans totaled one percent of its mortgage portfolio.[21] While Freddie historically has been more highly focused on the single-family loan market, during the last three years, its multi-family loan purchases have exceeded Fannie's.[22] Freddie noted in its 1997 annual report the increasing competition in both the single- and multi-family loan markets of private-label mortgage-backed securities due to the narrowing of the cost gap between private-label and GSE securitizations.[23] Fannie's decline in multi-family loan purchases during 1997 reflects this competition.[24]

The expansion of the commercial mortgage market has benefited borrowers. They have obtained credit more easily, less expensively, and otherwise on better terms by reason of the increased competition among credit providers. As noted earlier, the CMBS market does not serve all borrowers. But the CMBS underwriters do make loans to many borrowers traditionally served by the GSEs. And frequently in the current market conditions the CMBS conduits outbid the GSEs for multi-family loans. The conduits normally pool loans collateralized by different property types. Investors regard multi-family loans as higher quality credit risks than other types of commercial loans. The conduits want to include these loans in their pools as a means of improving the overall credit risk of the pool. To achieve this they apparently are willing to originate multi-family property loans at cost. This creates stiff competition for the GSEs.

The competition of the CMBS conduits has narrowed the loan spreads realized by the GSEs on the multi-family loans they have funded. It also has influenced the GSEs' underwriting policies. In the face of competition, the GSEs have had to review their policies and procedures and determine what changes they are willing to make to compete with the CMBS conduits. Freddie Mac, for example, has been willing to modify its requirement of current funding of capital replacement reserves.

The GSEs have maintained certain differences from the conduits' underwriting policies. Freddie Mac, for example, believes that it evaluates real estate collateral more carefully than the conduits do. Fannie Mae normally has required that borrowers currently fund capital replacement reserves; the conduits normally do not. Fannie Mae also limits the percentage of rental units in an apartment project that may be occupied by transients, such as students or military personnel; the conduits may not impose such a limit. Fannie Mae

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[21] Fannie Mae 1997 Annual Report at 45 and 68; Freddie Mac 1997 Annual Report at 19.

[22] Fannie Mae 1997 Annual Report at 32; Freddie Mac 1997 Annual Report at 29.

[23] Freddie Mac 1997 Annual Report at 15-16.

[24] Fannie Mae 1997 Annual Report at 32.

normally requires an 80 percent loan to value ["LTV"] ratio and a 120 percent debt service coverage ratio; the conduits may require less than a 75 percent LTV ratio and a lesser debt service ratio. Fannie Mae's delegated underwriting program materials indicate that it may allow variation from its normal underwriting requirements.

The GSEs face competition from the CMBS conduits in the speed of execution of transactions. The conduits have established the information technology infrastructure and loan delivery systems necessary to handle large volumes of transactions quickly.

However, whenever the credit cycle turns down, the GSEs will encounter different competitive conditions. In such a downturn they will be able to demonstrate their competitive financial strength and federal purpose of assuring credit availability in all mortgage market conditions.

The expansion of the CMBS market has also benefited the GSEs. It has created conditions that support the securitization of multi-family loans that they purchase. Because of the market's abundant capital and competitive conditions, GSE loan funding through securities issues has been more advantageous than GSE funding through cash purchase. During the two-year period, 1995 to 1997, the percentage of multi-family loans originated under the delegated underwriting program that Fannie Mae has funded through securitization in the CMBS market has increased from 20 percent to 90 percent.

The CMBS market by definition does not fund single-family mortgage loans. The GSEs continue to be the dominant, most efficient sources of secondary market capital for these loans. Their application of computerized credit scoring software systems to the underwriting of single-family loans has facilitated maintenance of their competitive advantage. It remains to be seen whether and to what extent the GSEs can extend to multi-family project lending credit scoring and other underwriting efficiencies now used in the single-family market.

III. CONCLUSIONS AND FURTHER INQUIRIES

Many of the market phenomena noted in this paper are not unique to the real estate finance sector. Consolidation of enterprises is occurring in all sectors. The emergence of public capital markets is occurring globally, especially since the Asian financial crisis occurred last year and the International Monetary Fund responded with massive loans conditioned upon the borrower countries creating more open, public markets.

Many of the issues discussed in this paper are also generic. These include the access to capital of smaller enterprises and institutions, the impact of financial changes on traditional capital providers in the primary and secondary markets, and the potential impact of changes in capital intermediation on the manner in which community constituents realize both their collective as well as individual aspirations.

Time and, more importantly, the passage of the real estate sector through a down as well as an up cycle will be needed to disclose more fully the sustaining dynamics of the REIT and CMBS markets. At this juncture the data support the following observations:

- Equity REITs are a highly useful intermediary for the acquisition of a portfolio of commercial real estate assets.

- The private credit rating agencies play a determinative role as “gatekeepers” in the public markets for REIT and CMBS securities.

- The consolidation of control of commercial real estate assets in the hands of regional and national portfolio managers will continue, although at a pace that is determined by capital market conditions and REITs' relative profitability.

- Regional and national REITs are becoming significant community stakeholders with a self-interest in the economic, environmental, and social health of the communities where they have invested. They, of course, can dispose of assets as well as acquire them. But REITs are not designed as intermediaries with rapid asset turnover rates. The stability and liquidity of the public capital markets will influence how easily disposition strategies are implemented.

- The ability of REIT managers to realize profits from their pursuit of economies of scale and "market dominance" will determine whether aggressive acquisition strategies are sustainable.

- If local real estate markets remain competitive, the cost reductions achieved by REITs through economies of scale are likely to benefit both them and their individual and business tenants. REITs, however, have a self-interest in operating in markets where real or perceived barriers to entry provide at least a temporary financial advantage to them.

- As the REIT and CMBS markets expand, the public capital markets and their institutional participants will exercise a greater influence over the real estate credit cycle and the rate and pattern of real estate development in metropolitan regions. It remains to be determined whether more than a few REITs, which to date normally have specialized by property type, will finance more highly integrated, multiple use developments.

- The CMBS market to date has primarily benefited conventional borrowers of amounts exceeding $5 million. Community development-focused financial intermediaries concerned with small, low wealth borrowers in urban areas do not presently generate commercial loans in a volume sufficient to be funded in the CMBS market.

- The REIT and CMBS markets create both new competition and financing opportunities for Fannie Mae and Freddie Mac in the funding of multi-family housing.

This paper is intended as an introduction to a public discussion. As interested parties engage in discussion, they will define additional, useful inquiries. Among the issues that might be usefully considered are the following:

- What is the probable impact upon local civic infrastructure and local political dynamics of the emergence of well-capitalized, publicly-owned national real estate companies and national, real estate capital markets?

- How will the dynamics of the public capital markets influence the strategies of major holders of real estate asset portfolios? Will portfolio managers take the long-term or short-term view? What will be the consequences of either view prevailing?

- Will the dynamics of the public capital markets cause a convergence of business strategies among real estate asset portfolio managers? With what results?

- What institutional or market developments need to occur in order for the CMBS market to reach down further to include smaller borrowers or other borrowers not currently served by the CMBS market?

- If the public capital markets do not respond adequately to the capital and credit needs of community constituencies or enterprises, will other financial intermediaries be likely to respond more adequately?

- Are the public capital markets or any of their institutional participants likely to develop underwriting methods that consider more fully the financial implications of conflicts or harmony between the strategies of managers of national or regional real estate asset portfolios and other community constituencies?

- Are REITs that seek to exploit the real estate market opportunities associated with regulatory barriers to market entry likely to oppose local regulatory reforms that "level the playing field" among local jurisdictions within metropolitan markets?

- Are REITs that hold major property portfolios in urban or suburban areas likely to be stakeholders that actively involve themselves in public issues such as the improvement in public safety and education that are likely to affect the longer term market appeal of their properties?