

News
Top News Stories
REIT.com Exclusives
REIT.com Video
Daily Executive News Summary
REIT Magazine
Company News
From The Media
Index Data

Home > News > REIT.com Exclusives

## REIT.com Exclusives

### Robinson: CRE Investors Want to Avoid "Catching a Falling Knife"

By Allen Kenney

(November 23)—Scott Robinson currently serves as a professor at the New York University School of Continuing and Professional Studies and an assistant director with the NYU REIT Center, part of the school's Schack Institute of Real Estate. Previously, he held positions with Standard & Poor's as senior analyst of REITs and vice president of corporate and investment banking at Citigroup.

Robinson recently spoke with REIT.com about some of the trends in the behavior of REIT stocks relative to the commercial property market, as well as what lies ahead for publicly traded commercial real estate.

**REIT.com:** Historically, how does the REIT market "move" in relation to the direct commercial property market?

**Scott Robinson:** The public markets for real estate securities, specifically REITs, tend to move in advance of underlying fundamentals. Academically speaking, I would say you would generally see a six-month gap, depending on the underlying property type. Property types with shorter lease terms, such as lodging and multifamily, may experience a shorter gap, while property types with longer lease terms, notably office, would experience a longer gap.

Additionally, the movement of direct commercial real estate is generally less volatile than the REIT market, because the direct market valuations are typically determined by appraisals, or internal readjustments based on yield expectations, as compared to stock prices. Stock prices reflect the ever-changing yield expectations of many different investors, which results in greater volatility in valuations.

**REIT.com:** What do you think contributes to this phenomenon?

**Robinson:** The public markets tend to be a little more forward thinking, meaning that if REIT investors believe property fundamentals are going to deteriorate, they will sell out of their positions of those stocks that could be negatively impacted by this deterioration. The reverse is also true. It's the old adage, "Buy on the rumor, sell on the news."

**REIT.com:** Is that what we're seeing now in the REIT market? Publicly traded real estate companies appear to be recovering, while the overall market for commercial real estate remains in a downswing.

**Robinson:** Yes, generally speaking. However, I think investors have become a little too optimistic in their thinking of when a recovery of property fundamentals will begin. If a recovery is imminent, then higher stock values today are justified. But if a recovery and corresponding investment opportunities are further out, then REIT stock prices may have become a little too expensive.

Most investors are not yet sure when property fundamentals will recover. Many analysts are expecting earnings to contract further in 2010, reflecting a recovery that is a little further down the road. This uncertainty has been reflected in the higher volatility of REIT stocks. I think it is likely that REIT valuations will remain volatile until property fundamentals clearly enter into the recovery phase.

Further, most investors haven't adequately distinguished between top-tier and average management teams; REIT valuations continue to move up and down in relative terms. As property fundamentals begin to bottom-out, investors will come to appreciate high-caliber management teams and their ability to out-perform the broader REIT sector. Those companies that have deep operating and leasing teams, have better access to accretive acquisitions and communicate more effectively with investors will be rewarded with higher earnings multiples. Conversely, average management teams will be penalized with lower multiples.

Having said that, this has been one of the most confounding economic and capital market corrections we have experienced. Nothing has played out as analysts have expected. So nobody is completely sure what lies ahead for REITs.

**REIT.com:** When will we see an uptick in transaction volume? Have you been surprised by the relative lack of deals in the current environment?

**Robinson:** That is, literally, the multi-billion dollar question. During times of economic uncertainty, investors need price discovery. Nobody wants to be a first-mover in a volatile climate. Whether you're talking about lenders selling or making loans, or investors buying commercial property, they would rather buy on the upswing than get cut trying "to catch a falling knife."

While the wide array of government initiatives have done a commendable job of shoring up confidence in the financial system, one of the many unintended consequences is a lack of urgency by lenders to shed poor credit-quality loans. Many lenders find it economically more pleasing to "extend and pretend" a marginally performing loan, rather than sell it into the secondary market. The result is a general lack of transactions; owners aren't being forced to sell by lenders. Additionally, lenders aren't willing to take additional real estate risk by making new loans. Without available acquisition financing, investors are unlikely to make new acquisitions.

up with potentially over-valued assets.

I applaud those REIT management teams that took their "dilution" lumps and issued equity earlier this year; nearly \$19 billion of follow-on equity has been issued. While some companies may have overreacted and issued too much, the capital markets were telling them to issue equity so that they could ultimately de-lever. Add to this nearly \$8 billion of unsecured debt issued thus far in 2009. Some of this capital has been used to tender bonds, some was used to meet near-term debt maturities and some has been appropriately kept as "dry powder" to meet future debt maturities and serve as acquisition capital.

The net result of this capital activity is a superior credit profile and well-positioned balance sheets.

**REIT.com:** Do you foresee many private portfolios being taken public?

**Robinson:** Without a doubt. Regardless of the appetite of lenders during the next six months to 24 months, I believe the public markets will be an extremely attractive avenue for the recapitalization of private portfolios. Those portfolios will come from over-leveraged operators, who are unable to fully re-finance debt maturities, as well as private fund vehicles looking to shed significant amounts of assets so as to redeploy the capital for other uses.

Many seasoned REIT watchers believe the current size of the REIT universe is too large; some in fact prognosticated a contraction by this point during the dark days of March and April in 2009. IPOs, M&As, and LBOs are natural milestones in the lifecycle of public real estate. I think we are once again at the early stage of that lifecycle and should expect a period of healthy IPO activity in 2010 and 2011.