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All REITs get roughed up in mortgage meltdown

Even those with no subprime risk are hit; some stressed before turmoil

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Though SL Green Realty Corp., a real estate investment trust that owns more Manhattan office space than any other single large REIT, has no exposure to subprime residential loans, its stock was downgraded two weeks ago by a UBS analyst.

The reason: fears that the credit crunch could lead to job cuts at hedge funds and investment banks, which are among the big holders of midtown office space. That, in turn, could drive up vacancies and slow rental growth, both of which may affect SL Green's earnings.

The subprime crisis has dealt a significant blow to the share prices of all REITs, whether or not they are tied directly to the mortgage meltdown.

The Standard & Poor's REIT Index fell 16% in the three months ended July 31, while the S&P 500 dipped just 5%. How long it will stay in Wall Street's doghouse will depend on the length and severity of the credit crunch.

Guilt by association

Some of the hardest hit are mortgage REITs, which make loans for residential or commercial properties or buy and sell mortgage securities. Some, including Melville, L.I.-based American Home Mortgage Investment Corp., have already been forced into bankruptcy.

After seven years of stellar growth, the REIT industry was showing signs of stress even before the subprime market imploded. In the summer, Stifel Nicolaus & Co. analyst David Fick downgraded the entire sector to "negative bias." One of his concerns was that rising interest rates would pressure real estate values.

Rising rates also hurt REITs because the law requires that they distribute most of their dividends. As a result, they can't build a pipeline of new deals but must borrow money, sell stock or form partnerships with private equity firms.

The deepening problems with subprime loans have added to the pressure on REITs. More than anything else, the credit squeeze created uncertainty. Wall Street investment banks, which repackage and sell the real estate loans they make, have all but shut their lending activity.

"An awful lot of areas are being impacted, not because there's anything wrong with those particular REITs," says Lawrence Lo, director of the REIT Center at New York University's Real Estate Institute. "It's just because, even though money is available, lenders aren't lending because they don't know how to price their money."

So far fundamentals remain strong. In the real estate boom of the past few years, many trusts shored up their balance sheets by adding to their portfolios, says Philip Kibel, senior vice president of the real estate finance group at Moody's Investors Service.

Manhattan is mitigating

Morningstar analyst Jeremy Glaser says equity REITs that have a Manhattan focus are in especially good shape. "The New York area is easily the hottest for office, hotels and apartments," he says.

But deal activity could slow if the money crunch continues. REITs that specialize in commercial mortgages have already tightened underwriting guidelines, says Wayne Heicklen, co-chair of the real estate department at law firm Pryor Cashman.

Because trusts will have fewer opportunities to lend, analysts say, the trusts' profitability could suffer.

FEELING THE PAIN

Recent performance of New York area REITs (share price as of August 29 followed by the percent they are off their 52-week high)

EQUITY REITS

SL Green \$108.40; -31%

Mack-Cali \$39.63; -30%

Vornado \$100.56; -26%

MORTGAGE REITS

Newcastle Investment \$15.90; -52%

Capital Trust \$33.56; -39%

Gramercy Capital \$23.25; -38%

Source: Bloomberg News Service

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