EXCERPTS OF RECENT MEDIA COVERAGE

REAL ESTATE PRACTICE

A SAMPLING OF BDO THOUGHT LEADERSHIP IN THE MEDIA FOR Q3 2014

COMMERCIAL PROPERTY EXECUTIVE

SINGLE-FAMILY REITS POISED TO SUCCEED

By **Carla Freeman**

The time for single-family REITs to prove that they have staying power may be here. The S&P Case-Shiller 20-City Home Price Index shows that home prices are currently near post-recession highs. The U.S. Census Bureau underscores this trend, recently stating that homeownership rates in the second quarter continued to trend lower, to 64.7 percent, down from 65 percent at the same time last year and 69.2 percent in 2004. As homeownership declines demonstrate the consumer's preference for rentals, the potential for growth and sustainability in this sector will bode well.

Rising national home prices impact not only potential homeowners but single-family REITs seeking to acquire new assets. As such, many single-family REITs whose initial approach was to acquire properties in bulk, irrespective of geographic location, are now developing more geographically focused strategies. This can allow them to scale internal property management platforms and move away from outsourcing contractors and maintenance staff, which can create operational complexities and decrease overall profitability…

Many single-family REITs are also now turning to securitizations to meet their funding needs. A securitization is a structured financial instrument, similar to a mortgage-backed security, where a pool of properties serves as collateral for the bond while interest payments are secured though operating cash flows from those properties. The investor receives a risk-adjusted rate of return on its investment while knowing he or she has an investment in a high-credit-rated debt. Although seemingly complex, securitizations can offer companies reduced cost of debt, which frees capital to fund growth.

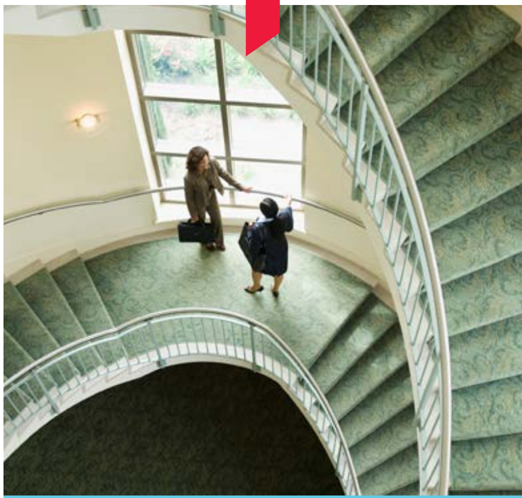
REAL ESTATE FORUM

RETURN OF THE M&A

By Jennifer LeClaire

The commercial real estate industry has seen waves of consolidation in the past, but 2013 and 2014 will go down in history books as a flurry of activity. So what's driving all the consolidation?…

Stuart Eisenberg, partner and real estate practice leader at professional services firm BDO,…says the lack of quality assets and competition for these assets is a major factor driving M&A activity in the commercial real estate industry.



BDO's Real Estate industry practice provides assurance, tax and advisory services to all sectors of the real estate industry in the United States and globally. BDO's international reach and extensive experience in addressing the business and compliance issues applicable to REITs and other real estate structures is supported by a network of of 1,264 offices in 144 countries.

Read more

"In fact, according to the **2014 BDO RiskFactor Report for REITs**, 94% of REITs cite strong competition for lessees and prime real estate as a top concern, ranking it the third risk overall for a second consecutive year," Eisenberg says. "Many real estate companies may see merging with and acquiring other firms as a way to navigate around the competition."…

The dealmakers are bullish on their mergers and acquisitions, but how is all this M&A impacting the commercial real estate? Is it good, bad or ugly? Maybe a little bit of all three.

According to Eisenberg, M&A activity has a number of positive effects in today's market. First, he says, it can be relatively less expensive to obtain new assets by means of an acquisition as opposed to doing multiple transactions. "Also, mergers and acquisitions can add fresh talent in addition to properties," he says. "Finally, this activity can establish the enterprise value for good operators that may be separable from the underlying real estate."

But it's not all pretty: "The potential downsides to increased M&A activity include reduced competition in the real estate industry, which may result in lower pricing," he says. "It could also make it difficult for smaller players with fewer resources to compete with their larger counterparts."

At this point, it's unclear as to what impact the flood of M&A activity could have on the overall competitive environment long-term. Although joining of companies may alter the pricing landscape and make it harder for smaller firms to compete, Eisenberg says it's too early to tell what the lasting affects will be…

With blockbuster deals happening almost left and right, how much more consolidation will the industry see? How much more can it take? Will this pace of M&A deals continue? Industry watchers do expect consolidation but there are factors that could slow the deal flow, perhaps in some sectors before others…

Eisenberg says a change in interest rates as well as risk tolerance on the part of buyers may impact this current trend. When looking at REITs in particular, BDO's report reveals that 85% of those surveyed consider mergers and acquisitions, joint ventures and partnerships to be a risk to their business, which underscores that, while there are many advantages to such activity, it can be a risky business move.

McKNIGHT'S

EVOLVING RISK IN THE SENIORS HOUSING SECTOR

By **Karen Stone, Mike Musick** and **Ben Hendren**

The face of today's seniors housing and healthcare industry is rapidly changing. Population demographics, shifting resident demands and attractive assets abroad are just a few of the factors coming together to provide new opportunity for players in this sector. However, this opportunity is not without its challenges and risks. **BDO** recently published its **2014 RiskFactor Report for REITs**, an annual study that analyzes the most recent SEC 10-K filings of the 100 largest publicly traded REITs in the U.S. Conducted since 2012, the study identifies the top risks among REITs.

This year's findings shed light and further underscore certain trends in the seniors housing and healthcare industry.

One of the major insights of BDO's study this year is that competition remains a serious concern among REITs. With 94% of surveyed REITs noting it as a top risk, it ranks third for a second consecutive year. This trend may also be surfacing in the seniors housing industry. The Administration on Aging states that by 2030, the number of people the age of 65 and above will account for 19 percent of the U.S. population. Not only that, the number of people with dementia is expected to grow to 11 million by 2040, according to 2012 Alzheimer's Disease Facts and Figures. This latter group of people will live for over 10 years on average with at least five comorbidities, which could cause their medical situations to be quite complex. When these statistics are coupled with the generational trend of fewer elderly parents living with family members, it is clear that demand for care is increasing and that seniors housing and healthcare operators will have to compete to attract residents from this growing population seeking care.

Closely linked to this concern around competition is the pressure to renovate and make property upgrades. BDO's report revealed that 82% of REITs cite operating costs and capital expenditures as a serious

▶ Read more

concern this year. Many seniors housing and healthcare properties are likely feeling pressure to undergo such facelifts as a way to differentiate themselves from the competition and make themselves more attractive to new residents…

Another compelling trend in the seniors housing and healthcare industry is the rise in investing in assets outside of the U.S. This seems to be occurring with increasing frequency. In early June, Ventas, Inc. announced that it is acquiring 29 independent living seniors housing communities located in Canada. Before that, Griffin-American Healthcare REIT II, Inc. bought a portfolio of 44 seniors housing facilities in the U.K. The sector's desire for high quality properties, geographic diversity and growth opportunity in prosperous markets is likely contributing to this growing trend. But this international activity brings its own set of obstacles. BDO's study underscores this point with the finding that 30% of REITs list risks that come along with international operations as a threat to business, up from 19% in 2012. Navigating the seas of foreign regulations and tax laws as well as business and cultural norms can prove challenging for many that choose to pursue opportunities abroad.

BDO'S CONSUMER BUSINESS COMPASS BLOG

RETAILERS RECONSIDER IN-STORE FLOOR SPACE, TURNING DEPARTMENT STORES INTO "MINI-MALLS"

By **John Tax**

As retailers balance the increasing need for varied products and the decreasing need for space, many large anchor tenants like Macy's and J.C. Penney are choosing to lease their square footage to specialty retailers, creating "stores-within-a-store" or "mini-malls."

These sublease arrangements can provide various benefits to the anchor tenants. For example, they can:

1. Enable retailers to offer their customers new, varied products;
2. Provide an opportunity to attract customers who may not otherwise frequent the store;
3. Increase sales per square foot by driving traffic to underutilized in-store space, thereby boosting revenue; and
4. Reduce leasing costs through the additional sublease income.

Given these advantages, analysts expect the trend will continue to accelerate in coming years. Still, these arrangements come with their own risks…

Landlords must consider the potential of violating co-tenancy provisions with other in-line tenants. If an anchor tenant signs more than one sublease tenant, a mini-store can be created. However, landlords acknowledge that other mall in-line tenants' foot traffic can often be dependent upon anchor tenants' business. Therefore, typical leases for in-line tenants provide that they will not be obligated to remain open or operating at full rent unless one or more anchor tenants are also operating. If the anchor tenant breaks its lease or ceases to exist either independently or as a result of the "mini-mall," issues can arise with other in-line tenants.

Landlords, as a result, have to control anchor tenants' ability to sublet their space. Since most anchor tenants want flexibility, landlords can meet them halfway by allowing them to assign to another national, single-occupant retailer. They may also allow anchor tenants to sublease space to no more than two outside retailers, while maintaining the appearance of a single operator.

To protect themselves from violating co-tenancy clauses, landlords carefully draft the co-tenancy language of the other in-line tenants' leases to protect themselves in the event that an anchor tenant vacates. It makes sense to keep the terms of the lease broad and avoid specifying the anchor tenant when discussing the requirements for another tenant's continued lease obligation…

Landlords are also careful to avoid violating anti-competition clauses that may be outlined in other in-line tenants' lease agreements. When anchor tenants begin conversations around subleasing their space, they should first consult with the landlord to confirm that their prospective subtenants are not selling any products or services that will compete with those of other in-line tenants. While this consideration has not proved to be a large

Read more

issue to date, it is certainly worth noting as this trend expands.

▶REAL ESTATE WEEKLY

THE TOP RISKS FOR REITs THIS YEAR

By **Stuart Eisenberg**

The **BDO RiskFactor Report for REITs** is an annual study that examines the most recent SEC 10-K filings for the 100 largest publicly traded REITs in the U.S.…

Eighty-seven percent of REITs note risks related to inadequate insurance and potential losses due to uninsured liabilities. An emerging risk for REITs is the expiration of the Terrorism Risk Insurance Act (TRIA), which was passed in 2002, after 9/11, and provides a federal backstop for terrorism losses and requires commercial insurers to offer affordable terrorism insurance.

While the Senate Committee on Banking, Housing, and Urban Affairs approved a bill to extend TRIA through 2021, if Congress does not pass it, this regulatory change could have a significant impact on operating costs and the ability to attain debt financing for deals. However, there is strong support on both sides to extend it, and, thus, the expectation is that it is likely to be approved.

A recent survey by the Mortgage Bankers Association suggests the impact could be huge: "of $1.5 trillion in outstanding commercial and multifamily mortgages, $1.1 trillion (70 percent) of mortgages required terrorism insurance."

This year, 89 percent of REITs cite the inability to sell properties quickly and asset illiquidity as a serious concern, up from 82 percent last year.

REITs are continuing to adjust to the new post-recession pricing environment across all locations and sectors, which is likely contributing to this continuing threat. Properties in prime areas such as New York City and San Francisco are typically priced relatively high to match the high demand.

What may be a concern is that the pressure to deploy capital will lead to situations where investors may bid too aggressively on properties and drive prices to levels that would prove difficult in the event they needed to liquidate quickly.

On the other hand, properties in secondary and tertiary markets may see less demand and have difficulty attaining debt financing, even for attractive properties. This potential lag time between transactions is a growing risk for many REITs.

CONTACT:

STUART EISENBERG
New York
212-885-8431 / seisenberg@bdo.com

BRENT HORAK
Dallas
214-665-0661 / lhorak@bdo.com

ALBERT LOPEZ
Miami
305-381-8000 / alopez@bdo.com

JAMES NESBITT
Washington, D.C.
301-634-0223 / jnesbitt@bdo.com

JOHN RAINIS
Chicago
312-616-4644 / jrainis@bdo.com

CHRISTOPHER TOWER
Orange County
714-668-7320 / ctower@bdo.com

ABOUT BDO

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, financial advisory and consulting services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through 52 offices and over 400 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multinational clients through a global network of 1,264 offices in 144 countries.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms. For more information, please visit www.bdo.com.