

hanley wood

# Developer

The Business of Creating Successful Sustainable Communities

March/April 2008

( plus )

Universal Design  
Goes Mainstream

Streetcars Drive  
Expansion

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Good Will With  
the Web

Federal Realty shares  
the secrets to its  
wildly successful  
urban destinations.

## ShopTalk

Donald Wood,  
President and CEO,  
Federal Realty  
Investment Trust

Federal Realty squeezes every last bit of value out of its retail assets.

By Kathleen Stanley

# Portfolio Power

**I**n Maryland's affluent Montgomery County, a close-in suburb of Washington, D.C., weekend plans for lots of folks often involve heading "downtown."

But their downtown destination is nowhere near the White House, Georgetown, or any of D.C.'s other time-honored attractions. For these suburbanites, downtown means a multi-block area of Bethesda, Md., that's bounded by street names that conjure small-town America instead of urban action: Elm Street, Woodmont Avenue, Arlington Road, Bethesda Avenue. This downtown's most recognizable feature and meeting place is a fountain, ringed by benches, that sits in front of a Barnes & Noble.

There's nothing particularly engaging about the fountain, and the Barnes & Noble behind

it is just like the hundreds of other stores in this bookseller's chain. But there's something special about this redeveloped urban corner, located in an area that was once better known for hardware stores and re-upholsterers than art galleries and chic restaurants.

**"We're a big believer in mixed-use. We try to buy those retail destinations that have great development opportunities."**

— DONALD WOOD, PRESIDENT AND CEO,  
FEDERAL REALTY

The area is called Bethesda Row, and it has totally shifted the city's center away from what used to be its most active corridor, Wisconsin Avenue. It has drawn people in droves over the past decade and made the mixed-use project, now in its ninth phase, a phenomenal success.

Teenagers, young singles, new parents, baby boomers, and retirees all flock to the project for movies, shops, restaurants, and apartments—the massive, county-owned parking garage can barely accommodate the influx of nighttime traffic.

But odds are that very few who visit Bethesda Row have any idea that a local real estate company called Federal Realty Investment Trust is responsible for their much-loved downtown.

With Bethesda Row and other well known projects such as Pentagon Row and the Village at Shirlington in Northern Virginia, as well as Santana Row in San Jose, Calif., the company has found that urban infill sites are lucrative locales for redevelopment. Indeed, the firm, which has a market cap of \$4.11 billion, has proved that the right type of project can revitalize a neighborhood and spark long-term economic growth.

## QUALITY AND QUANTITY

Federal Realty may not be a household name among shoppers, but Wall Street, along with other retail developers and

owners, is certainly aware of the company and its long-standing reputation in the real estate industry.

Rockville, Md.-based Federal Realty is an equity real estate investment trust (REIT) specializing in the ownership, management, development, and redevelopment of high-quality retail assets. It owns a portfolio of 82 shopping centers totaling 18.2 million square feet primarily in three markets: the Northeast, the Mid-Atlantic, and California.

Chicago native and former State Department economist Samuel Gorlitz founded Federal Realty in 1962 as one of the first REITs. Originally, the company owned and managed multifamily assets but it shifted its focus to retail properties in the 1970s. Gorlitz managed the company until 1980 and stayed actively involved as a board member until 1999.

“For years, this company was run by a really special guy who really had a retail vision and insisted from the beginning on quality,” says Donald Wood, Federal Realty’s president and CEO. “So while most companies grew up and bought

large portfolios—and with any portfolio comes some stuff that’s good and some stuff that’s bad—we didn’t do that. It was a one-off strategy for over 40 years.”

Federal Realty’s portfolio is widely recognized across the industry for its quality. “When we look at retail, one of the most important things that we focus on is looking at the surrounding demographics of different [shopping] centers and companies,” says Merrill Lynch research analyst Steve Sakwa. “You quickly notice when you compare Federal against its competition that Federal’s portfolio is far and away the highest quality. The company leads the pack in terms of rental growth, and the same for net operating income. Their portfolios consistently deliver better rental growth on a year-to-year basis.”

The numbers speak for themselves. For 2007, Federal Realty generated funds from operations of \$206.8 million, or \$3.63 per diluted share, compared to \$181.9 million, or \$3.35 per diluted share, in 2006. That’s a 14.6 percent year-over-year increase. The REIT’s same-center operating income in 2007 was up 4.9 percent, and at the end of the year, its overall portfolio was 96.7 percent leased compared to 96.5 percent at year-end 2006.

Among retail REITs, Federal Realty says it has one of the highest internal growth rates. Nearly 80 percent of the firm’s earnings growth is derived internally, specifically through rental increases on properties that it already controls. That makes it better able to weather poor economic conditions, Wood says. “Having the security of being able to rely primarily on internal sources for annual earnings growth allows us to be far more selective when it comes to new shopping center acquisitions and development opportunities, which, by their very nature, are less predictable and more risky,” he adds.

Since its founding in 1962, Federal Realty has paid



( the developer )

## Donald Wood

■ **Title:** President and CEO

■ **Age:** 47

■ **First job:** Started his own landscaping company in high school and sold it for \$10,000 after college

■ **Best advice someone gave you:** “Keep it simple. You’ll get lots of advice and opinions. The trick is to filter out the stuff that doesn’t matter, and focus on the concepts that do.”

■ **Leadership philosophy:** “Let leaders lead and leverage the organization. Let out the rope as responsibility is earned.”

■ **Favorite quote:** “The best executive is the one who has sense enough to pick good people to do what he wants done and self-restraint from meddling with them while they do it.” —Theodore Roosevelt

■ **Favorite book:** *Moneyball: The Art of Winning an Unfair Game* by Michael Lewis

quarterly dividends continuously and has increased its dividend rate for 40 consecutive years—the longest record in the public real estate industry.

### MANAGING THE RISKS

With a portfolio that consisted primarily of grocery-anchored shopping centers in dense, urban areas, Federal Realty began focusing on mixed-use properties in 1990.

“I believe the leadership of this company ... saw earlier than anybody else the future of mixed-use,” Wood says. “If you only buy great stuff in infill areas, it’s not too big a jump to say, ‘If we could just get people living and shopping and experiencing life where they lived, boy, we’d have something special.’”

Wood, an energetic leader with a background in the hotel and gaming industries, knows a thing or two about mixed-use development.

“But the way we did it might not have been smart,” he admits. “We went full-bore toward mixed-use and forgot about our roots, forgot about the great stuff that was in our portfolio. And we structured those mixed-use deals in a very risky way. It was all us, no partners necessary. That was to the detriment of the company. We put the company in a risk position that didn’t have to be.”

Wood pauses for just a moment in his spacious office, a sunlit space at Federal Realty’s main headquarters, and the ghost of Santana Row, the REIT’s mixed-use project in San Jose, Calif., practically wafts overhead. Federal Realty started Santana Row in 1997—the best of times—and finished it in 2002—the worst of times.

Though Santana Row is now considered wildly successful, there were some dark days in its history—Silicon Valley’s dot-com bust, the attacks of Sept. 11, and a devastating construction fire. After the fire and amid pressure from analysts and investors, Federal Realty’s then-CEO Steven Guttman resigned and Wood succeeded him in 2003.

“It’s not that Santana Row was a risky mixed-use project,” Wood says. “Santana Row was a great location, and that takes out risk more than anything else.

The difference was the scope. It was very broad. Our company had never done 10 buildings, a hotel in the middle, residential on top of retail, and 1,200 apartment units. This was going to be a \$600 million project in a company that only had market

capitalization of \$2 billion.”

Federal Realty was in the middle of developing Santana Row when Wood joined the REIT in 1998 as CFO. “What I found was a real passion for great real estate, but limited skills with respect to how to put it

## Smells Like Green Spirit

Federal Realty focuses on sustainability.

**F**ederal Realty is one of the oldest retail REITs in the nation, but its green building efforts are ahead of its time. From LEED certification to New Urbanism to oil recycling, the firm is evaluating, operating, and developing a broad range of sustainability initiatives.

And the company’s efforts are getting noticed. In February 2008, Federal Realty won a coveted Charter Award from the Congress on New Urbanism for following New Urbanism principles at its projects. It was one of only 14 companies to be honored.

“Across the board, we are looking to leverage our expertise with infill mixed-use development to maximize access to public transportation as we build, expand, or improve our new and existing properties,” says Federal Realty’s director of construction Bill Morrow.

Beyond New Urbanism, the REIT is pursuing LEED certification for a number of properties. For example, at Federal Realty’s Linden Square project in Wellesley, Mass., it hopes to achieve LEED Platinum certification for the multifamily component.

And at Santana Row, the company’s famed mixed-use project in San Jose, Calif., the company is developing a 65,000-square-foot building with office space above ground-floor retail. Scheduled for completion in mid-2009, the building is targeting to achieve LEED Silver certification.

Federal Realty also is helping its tenants go green by managing an oil recycling program for restaurant tenants at Bethesda Row in Bethesda, Md. The program collects cooking oil from restaurants and sells the oil so it can be used to manufacture biofuels.

—Jennifer Popovec



**Good to be Green:** At Bethesda Row in Bethesda, Md., Federal Realty incorporated New Urbanism principles and implemented a program that recycles used restaurant oil.

**“What I found [at Federal Realty] was a real passion for great real estate. [But] this company needed to have ... a course set that was more in tandem with its owners—the public shareholders”**

— DONALD WOOD, PRESIDENT AND CEO, FEDERAL REALTY



\$350 million project, which is slightly more than 10 percent.”

Federal Realty has structured its expansion of the Village of Shirlington in Arlington, Va., in much the same manner. It’s a joint development of The Bozzuto Group,

together and run it as a public company,” he says. “This company needed to have arms put around it and a course set that was more in tandem with its owners—the public shareholders. So we went back to our roots.” Those roots, Wood says, were a portfolio of quality retail assets that had a lot of intrinsic value and opportunity.

Federal Realty’s experience with Santana Row helped shape the company’s future. The firm learned a big lesson: Don’t take on huge projects alone. Its newest mixed-use projects are developed with partners. The 12.5-acre Rockville Town

Square, for example, is a public/private partnership with the city of Rockville, Md., Montgomery County, and RD Rockville (a partnership of Ross Development and DANAC Corp.) In this case, Ross Development’s president Scott Ross signed personally for the construction loan.

“At Rockville Town Square, we structured it so that we designed and planned the whole project, but someone else built it and took on the construction risk, and when they were finished they sold the retail back to us at a predetermined price,” Wood points out. “We invested \$40 million in a

Trammell Crow, and Arlington County. Like Rockville Town Square, the Village of Shirlington includes retail, residential, office, and civic development. Bozzuto and Trammell Crow are doing the residential; the county is adding civic improvements; and Federal Realty is handling the retail.

#### MINING OPPORTUNITIES

Federal Realty’s assets have always been—and continue to be—formidable. They’re located in great markets on both the East and West coasts, in first- and second-tier suburbs with excellent demographics.



**Team Play:** To develop Rockville Town Square in Rockville, Md., Federal Realty established a public/private partnership with the city and county. That way, the REIT was able to spread out its risk and invest only a portion of the total cost of redevelopment.

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With such strong assets, the REIT is concentrating on finding new development opportunities within its portfolio—either redeveloping its existing properties or intensifying the use of adjacent properties. It is also looking to acquire properties that have development possibilities.

“We look [first] for opportunities with things that we own,” says Federal Realty’s senior vice president of development Don Briggs. “The next offshoot is things that are adjacent to what we own.”

By systematically mining its own properties and building relationships nationwide, Federal Realty has been able to grow its business while maintaining the quality of its portfolio. “Every quarter we look at our portfolio,” says John Tschiderer, Federal Realty’s vice president of development. “Each property is looked at independently from the portfolio as a whole. We look to see if there are any opportunities that can be extracted or taken advantage of.”

For some properties that might mean a façade facelift; for others, a full-blown redevelopment. “One of the changes that happened when Don [Wood] assumed the leadership was the willingness to not always have to shoot for the stars,” Briggs notes. “It was a pragmatic decision that said that while something might not be the sexiest solution, it’s the right solution for the real estate and for its time.”

Federal Realty’s acquisitions group also keeps this development mantra in mind when acquiring properties. “We try to buy those retail destinations that have great development opportunities,” Wood says. “We’re a big believer in mixed-use. In our business plan, what we’re trying to do is find the right locations, ugly though they may be. We want something that produces some level of income—not a greenfield, but something where we can then work the entitlements and work our retail contracts. It’s a whole lot less risky to do that while there are people in there paying rent.”

And the REIT doesn’t wait for acquisition opportunities to come knocking. Federal Realty has put together a “hit list”—a compilation of nearly 1,000 locations, including shopping centers and

retail destinations, within its markets that it wants to own. “Once a property goes to a broker, who sends out thousands of brochures to say something’s for sale, we have no competitive advantage,” Wood points out. “We take a much more proactive approach: Our investment group creates relationships and gets to know folks who are owners. It goes back to the local angle.”

Federal Realty’s market knowledge and relationships definitely sets it apart from other REITs and private developers. “The people who end up being industry leaders over the long term are those who really focus on their market,” says Tom Bozzuto,

CEO of Greenbelt, Md.-based The Bozzuto Group. “Federal is really good at that. They know the national retailers and seem to have great relationships with them. They also understand what the local consumer wants. They seem to be particularly adept at that in the Washington area.”

That’s music to Don Wood’s ears. “In a lot of different industries, companies start becoming just about the numbers, and everything looks good on a piece of paper,” he says. “The greatest temptation is to forget that real estate is local.” ■

*Kathleen Stanley is a freelance writer living in Washington, D.C.*

( the company )

## Federal Realty Investment Trust

■ **Founded:** 1962

■ **Headquarters:** Rockville, Md.

■ **Market cap:** \$4.11 billion

■ **Portfolio size:** 18.2 million square feet across 82 shopping centers

■ **Notable projects:** Santana Row, San Jose, Calif.; Bethesda Row, Bethesda, Md.; Congressional Plaza and Rockville Town Square, Rockville, Md.; Pentagon Row, Arlington, Va.

■ **Largest project to date:** Santana Row—a mixed-use development featuring commercial, residential, and office space, as well as a movie theatre and boutique hotel. The more than 560,000 square feet of retail includes H&M, Burberry, Anthropologie, Gucci, and Diesel.

■ **On the boards:** Mid-Pike Plaza, Rockville, Md.; Pike 7, Vienna, Va.; Bala Cynwyd, Bala Cynwyd, Penn.



**In Fine Form:** Federal Realty overcame dozens of challenges to turn Santana Row in San Jose, Calif., into a true urban destination—and a model for its other developments.

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