

FEDERAL REALTY INVESTMENT TRUST

Form 10-Q

May 08, 2014

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

✓ QUARTERLY REPORT PURSUANT TO THE SECTION 13 OR 15(D) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2014

OR

.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the transition period from to

Commission file number: 1-07533

FEDERAL REALTY INVESTMENT TRUST

(Exact Name of Registrant as Specified in its Declaration of Trust)

Maryland

52-0782497

(State of Organization)

(IRS Employer Identification No.)

1626 East Jefferson Street, Rockville, Maryland

20852

(Address of Principal Executive Offices)

(Zip Code)

(301) 998-8100

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ✓ Yes .. No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ✓ Yes .. No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ✓

Accelerated Filer

..

Non-Accelerated Filer o (Do not check if a smaller reporting company)

Smaller reporting company

..

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

.. Yes ✓ No

The number of Registrant's common shares outstanding on May 5, 2014 was 67,271,589.

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QUARTERLY REPORT ON FORM 10-Q
QUARTER ENDED MARCH 31, 2014

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PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

The following balance sheet as of December 31, 2013, which has been derived from audited financial statements, and unaudited interim financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles (GAAP) have been omitted pursuant to those rules and regulations, although the company believes that the disclosures made are adequate to make the information not misleading. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the company's latest Annual Report on Form 10-K. In the opinion of management, all adjustments (consisting of normal, recurring adjustments) necessary for a fair presentation for the periods presented have been included. The results of operations for the three months ended March 31, 2014 are not necessarily indicative of the results that may be expected for the full year.

Table of ContentsFederal Realty Investment Trust
Consolidated Balance Sheets

	March 31, 2014 (In thousands, except share data) (Unaudited)	December 31, 2013
ASSETS		
Real estate, at cost		
Operating (including \$281,602 and \$265,138 of consolidated variable interest entities, respectively)	\$ 4,815,667	\$ 4,618,258
Construction-in-progress	572,986	531,205
	5,388,653	5,149,463
Less accumulated depreciation and amortization (including \$20,974 and \$19,086 of consolidated variable interest entities, respectively)	(1,383,520)	(1,350,471)
Net real estate	4,005,133	3,798,992
Cash and cash equivalents	75,699	88,927
Accounts and notes receivable, net	92,769	84,838
Mortgage notes receivable, net	55,287	55,155
Investment in real estate partnership	32,140	32,264
Prepaid expenses and other assets	130,921	145,062
Debt issuance costs, net of accumulated amortization of \$10,261 and \$9,535, respectively	13,698	14,056
TOTAL ASSETS	\$ 4,405,647	\$ 4,219,294
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Mortgages payable (including \$209,742 and \$202,782 of consolidated variable interest entities, respectively)	\$ 658,264	\$ 588,456
Capital lease obligations	71,665	71,671
Notes payable	300,910	300,822
Senior notes and debentures	1,361,098	1,360,913
Accounts payable and accrued expenses	157,357	156,270
Dividends payable	53,310	52,385
Security deposits payable	13,122	12,772
Other liabilities and deferred credits	105,285	100,283
Total liabilities	2,721,011	2,643,572
Commitments and contingencies (Note 7)		
Redeemable noncontrolling interests	110,368	104,425
Shareholders' equity		
Preferred shares, authorized 15,000,000 shares, \$.01 par: 5.417% Series 1 Cumulative Convertible Preferred Shares, (stated at liquidation preference \$25 per share), 399,896 shares issued and outstanding	9,997	9,997
Common shares of beneficial interest, \$.01 par, 100,000,000 shares authorized, 67,267,030 and 66,701,422 shares issued and outstanding, respectively	673	667
Additional paid-in capital	2,114,666	2,062,708
Accumulated dividends in excess of net income	(637,638)	(623,795)
Accumulated other comprehensive loss	(1,960)	(1,417)
Total shareholders' equity of the Trust	1,485,738	1,448,160
Noncontrolling interests	88,530	23,137

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Total shareholders' equity	1,574,268	1,471,297
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 4,405,647	\$ 4,219,294

The accompanying notes are an integral part of these consolidated statements.

Table of ContentsFederal Realty Investment Trust
Consolidated Statements of Comprehensive Income
(Unaudited)

	Three Months Ended March 31,	
	2014	2013
	(In thousands, except per share data)	
REVENUE		
Rental income	\$ 166,193	\$ 152,616
Other property income	3,400	3,268
Mortgage interest income	1,235	1,265
Total revenue	170,828	157,149
EXPENSES		
Rental expenses	37,130	29,501
Real estate taxes	18,700	17,572
General and administrative	7,704	7,057
Depreciation and amortization	43,850	40,517
Total operating expenses	107,384	94,647
OPERATING INCOME	63,444	62,502
Other interest income	25	30
Interest expense	(23,137)	(27,405)
Income from real estate partnership	213	312
INCOME FROM CONTINUING OPERATIONS	40,545	35,439
DISCONTINUED OPERATIONS		
Discontinued operations - income	—	403
NET INCOME	40,545	35,842
Net income attributable to noncontrolling interests	(1,792)	(1,254)
NET INCOME ATTRIBUTABLE TO THE TRUST	38,753	34,588
Dividends on preferred shares	(135)	(135)
NET INCOME AVAILABLE FOR COMMON SHAREHOLDERS	\$ 38,618	\$ 34,453
EARNINGS PER COMMON SHARE, BASIC		
Continuing operations	\$ 0.58	\$ 0.52
Discontinued operations	—	0.01
	\$ 0.58	\$ 0.53
Weighted average number of common shares, basic	66,615	64,692
EARNINGS PER COMMON SHARE, DILUTED		
Continuing operations	\$ 0.57	\$ 0.52
Discontinued operations	—	0.01
	\$ 0.57	\$ 0.53
Weighted average number of common shares, diluted	66,773	64,847
COMPREHENSIVE INCOME	\$ 40,002	\$ 37,457
COMPREHENSIVE INCOME ATTRIBUTABLE TO THE TRUST	\$ 38,210	\$ 36,203

The accompanying notes are an integral part of these consolidated statements.

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Federal Realty Investment Trust
Consolidated Statement of Shareholders' Equity
For the Three Months Ended March 31, 2014
(Unaudited)

	Shareholders' Equity of the Trust					Accumulated Dividends in Excess of Net Income	Accumulated Other Comprehensive Loss	Noncontrolling Interests	Total Shareholders' Equity
	Preferred Shares	Amount	Common Shares	Amount	Additional Paid-in Capital				
(In thousands, except share data)									
BALANCE AT DECEMBER 31, 2013	399,896	\$9,997	66,701,422	\$667	\$2,062,708	\$(623,795)	\$(1,417)	\$23,137	\$1,471,297
Net income, excluding \$764 attributable to redeemable noncontrolling interests	—	—	—	—	—	38,753	—	1,028	39,781
Other comprehensive loss - change in value of interest rate swaps	—	—	—	—	—	—	(543)	—	(543)
Dividends declared to common shareholders	—	—	—	—	—	(52,461)	—	—	(52,461)
Dividends declared to preferred shareholders	—	—	—	—	—	(135)	—	—	(135)
Distributions declared to noncontrolling interests	—	—	—	—	—	—	—	(985)	(985)
Common shares issued	—	—	455,735	5	50,153	—	—	—	50,158
Exercise of stock options	—	—	18,610	—	1,392	—	—	—	1,392
Shares issued under dividend reinvestment plan	—	—	4,908	—	515	—	—	—	515
Share-based compensation expense, net of shares withheld for employee taxes	—	—	86,355	1	221	—	—	—	222

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Contributions from noncontrolling interests	—	—	—	—	—	—	—	65,350	65,350	
Adjustment to redeemable noncontrolling interests	—	—	—	—	(323)	—	—	(323)
BALANCE AT MARCH 31, 2014	399,896	\$9,997	67,267,030	\$673	\$2,114,666	\$(637,638)	\$(1,960)	\$88,530	\$1,574,268	

The accompanying notes are an integral part of these consolidated statements.

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Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended March 31, 2014		2013 (In thousands)
OPERATING ACTIVITIES			
Net income	\$40,545		\$35,842
Adjustment to reconcile net income to net cash provided by operating activities			
Depreciation and amortization, including discontinued operations	43,850		40,624
Income from real estate partnership	(213	)	(312
Other, net	1,532		1,776
Changes in assets and liabilities, net of effects of acquisitions and dispositions:			
Increase in accounts receivable	(6,716	)	(2,458
Decrease (increase) in prepaid expenses and other assets	689		(93
Increase (decrease) in accounts payable and accrued expenses	1,811		(402
Decrease in security deposits and other liabilities	(2,336	)	(7,284
Net cash provided by operating activities	79,162		67,693
INVESTING ACTIVITIES			
Acquisition of real estate	(308)	—
Capital expenditures - development and redevelopment	(74,097	)	(33,367
Capital expenditures - other	(9,834	)	(9,460
Distribution from real estate partnership in excess of earnings	92		—
Leasing costs	(3,944	)	(2,723
Repayment (issuance) of mortgage and other notes receivable, net	51		(125
Net cash used in investing activities	(88,040	)	(45,675
FINANCING ACTIVITIES			
Repayment of mortgages, capital leases and notes payable	(2,842	)	(12,095
Issuance of common shares	51,615		32,542
Dividends paid to common and preferred shareholders	(51,714	)	(46,884
Distributions to and redemptions of noncontrolling interests	(1,409	)	(1,295
Net cash used in financing activities	(4,350	)	(27,732
Decrease in cash and cash equivalents	(13,228	)	(5,714
Cash and cash equivalents at beginning of year	88,927		36,988
Cash and cash equivalents at end of period	\$75,699		\$31,274

The accompanying notes are an integral part of these consolidated statements.

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Federal Realty Investment Trust
Notes to Consolidated Financial Statements
March 31, 2014
(Unaudited)

NOTE 1—BUSINESS AND ORGANIZATION

Federal Realty Investment Trust (the “Trust”) is an equity real estate investment trust (“REIT”) specializing in the ownership, management, and redevelopment of retail and mixed-use properties. Our properties are located primarily in densely populated and affluent communities in strategically selected metropolitan markets in the Mid-Atlantic and Northeast regions of the United States, and California. As of March 31, 2014, we owned or had a majority interest in community and neighborhood shopping centers and mixed-use properties which are operated as 89 predominantly retail real estate projects.

We operate in a manner intended to enable us to qualify as a REIT for federal income tax purposes. A REIT that distributes at least 90% of its taxable income to its shareholders each year and meets certain other conditions is not taxed on that portion of its taxable income which is distributed to its shareholders. Therefore, federal income taxes on our taxable income have been and are generally expected to be immaterial. We are obligated to pay state taxes, generally consisting of franchise or gross receipts taxes in certain states. Such state taxes also have not been material.

NOTE 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

Our consolidated financial statements include the accounts of the Trust, its corporate subsidiaries, and all entities in which the Trust has a controlling interest or has been determined to be the primary beneficiary of a variable interest entity (“VIE”). The equity interests of other investors are reflected as noncontrolling interests or redeemable noncontrolling interests. All significant intercompany transactions and balances are eliminated in consolidation. We account for our interests in joint ventures, which we do not control, using the equity method of accounting. Certain 2013 amounts have been reclassified to conform to current period presentation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, referred to as “GAAP,” requires management to make estimates and assumptions that in certain circumstances affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and revenues and expenses. These estimates are prepared using management’s best judgment, after considering past, current and expected events and economic conditions. Actual results could differ from these estimates.

Recently Adopted Accounting Pronouncements

In April 2014, the FASB issued ASU 2014-08, “Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity.” ASU 2014-08 amends the definition of a discontinued operation to include only the disposal of a component of an entity that represents a strategic shift that has or will have a major impact on an entity’s operations and financial results. The standard also requires additional disclosures about discontinued operations as well as disposal transactions that do not meet the discontinued operations criteria. The standard is applicable prospectively for all disposals initially classified as held for sale in periods after adoption. We adopted the standard effective January 1, 2014, and there was no impact to the current period financial statements. In future periods, the adoption will result in most individual property disposals not qualifying for discontinued operations presentation and thus, the results of those disposals will remain in “income from continuing operations.” Properties sold prior to January 1, 2014, are not subject to ASU 2014-08 and therefore, continue to be classified as discontinued operations using the previous definition.

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Consolidated Statements of Cash Flows—Supplemental Disclosures

The following table provides supplemental disclosures related to the Consolidated Statements of Cash Flows:

	Three Months Ended March 31,	
	2014	2013
	(In thousands)	
SUPPLEMENTAL DISCLOSURES:		
Total interest costs incurred	\$28,703	\$30,241
Interest capitalized	(5,566	) (2,836
Interest expense	\$23,137	\$27,405
Cash paid for interest, net of amounts capitalized	\$20,463	\$30,315
Cash paid for income taxes	\$208	\$294
NON-CASH FINANCING TRANSACTION:		
Mortgage loans assumed with acquisition	\$68,282	\$—
Shares issued under dividend reinvestment plan	\$450	\$450
See Note 3 for additional disclosures relating to The Grove at Shrewsbury and Brook 35 acquisition.		

NOTE 3—REAL ESTATE

Effective January 1, 2014, we acquired a controlling interest in The Grove at Shrewsbury, a 187,000 square foot shopping center in Shrewsbury, New Jersey, and Brook 35, a 99,000 square foot shopping center in Sea Girt, New Jersey for a gross value of \$161 million. Our effective economic interest approximates 84% and was funded by the assumption of our share of \$68 million of mortgage debt, 632,000 downREIT operating partnership units, and \$13 million of cash (which was in an escrow account at December 31, 2013). We incurred \$2.0 million of acquisition costs, of which \$0.9 million were incurred in 2014 and included in "general and administrative expense" for the three months ended March 31, 2014.

We have entered into an agreement to acquire the interest of one of the non-controlling interest holders in The Grove at Shrewsbury in 2015. As this non-controlling interest is mandatorily redeemable it has been classified as a liability of approximately \$9 million and is included in "other liabilities and deferred credits" on the March 31, 2014 consolidated balance sheet. An additional non-controlling interest holder has the right to require us to acquire its interests in The Grove at Shrewsbury and Brook 35 at the then current fair market value beginning on January 1, 2017.

The purchase price has been preliminarily allocated to real estate assets, debt, other liabilities, and non-controlling interests. The purchase price allocation to all acquired assets, liabilities, and non-controlling interests will be finalized after our valuation studies are complete.

NOTE 4—REAL ESTATE PARTNERSHIP

We have a joint venture arrangement (the "Partnership") with affiliates of a discretionary fund created and advised by ING Clarion Partners ("Clarion"). We own 30% of the equity in the Partnership and Clarion owns 70%. We hold a general partnership interest, however, Clarion also holds a general partnership interest and has substantive participating rights. We cannot make significant decisions without Clarion's approval. Accordingly, we account for our interest in the Partnership using the equity method. As of March 31, 2014, the Partnership owned seven retail real estate properties. We are the manager of the Partnership and its properties, earning fees for acquisitions, dispositions, management, leasing, and financing. Intercompany profit generated from fees is eliminated in consolidation. We also have the opportunity to receive performance-based earnings through our Partnership interest. Accounting policies for the Partnership are similar to accounting policies followed by the Trust. The Partnership is subject to a buy-sell provision which is customary for real estate joint venture agreements and the industry. Either partner may initiate this

provision at any time, which could result in either the sale of our interest or the use of available cash or borrowings to acquire Clarion's interest.

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The following tables provide summarized operating results and the financial position of the Partnership:

	Three Months Ended March 31, 2014 2013 (In thousands)	
OPERATING RESULTS		
Revenue	\$5,018	\$4,949
Expenses		
Other operating expenses	2,110	1,817
Depreciation and amortization	1,487	1,369
Interest expense	839	842
Total expenses	4,436	4,028
Net income	\$582	\$921
Our share of net income from real estate partnership	\$213	\$312
	March 31, 2014	December 31, 2013 (In thousands)
BALANCE SHEETS		
Real estate, net	\$169,848	\$170,867
Cash	2,937	2,210
Other assets	5,420	5,668
Total assets	\$178,205	\$178,745
Mortgages payable	\$56,862	\$56,922
Other liabilities	3,891	4,100
Partners' capital	117,452	117,723
Total liabilities and partners' capital	\$178,205	\$178,745
Our share of unconsolidated debt	\$17,059	\$17,077
Our investment in real estate partnership	\$32,140	\$32,264

NOTE 5—DEBT

In connection with the acquisition of The Grove at Shrewsbury and Brook 35 on January 1, 2014, we assumed mortgage loans with a face amount of \$68.3 million and a fair value of \$73.8 million. The mortgage loans are secured by the individual properties with the following contractual terms:

	Principal (In millions)	Stated Interest Rate	Maturity Date
Brook 35	\$11.5	5.46 %	July 1, 2014
The Grove at Shrewsbury (East)	45.4	5.82 %	October 1, 2017
The Grove at Shrewsbury (West)	11.4	6.38 %	March 1, 2018

During the three months ended March 31, 2014, the maximum amount of borrowings outstanding under our \$600.0 million revolving credit facility was \$4.0 million, the weighted average borrowings outstanding was \$0.3 million, and the weighted average interest rate, before amortization of debt fees, was 1.07%. At March 31, 2014, there was no balance outstanding. Our revolving credit facility, term loan and certain notes require us to comply with various financial covenants, including the maintenance of minimum shareholders' equity and debt coverage ratios and a maximum ratio of debt to net worth. As of March 31, 2014, we were in compliance with all debt covenants.

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Except as disclosed below, the carrying amount of our financial instruments approximates their fair value. The fair value of our mortgages payable, notes payable and senior notes and debentures is sensitive to fluctuations in interest rates. Quoted market prices (Level 1) were used to estimate the fair value of our marketable senior notes and debentures and discounted cash flow analysis (Level 2) is generally used to estimate the fair value of our mortgages and notes payable. Considerable judgment is necessary to estimate the fair value of financial instruments. The estimates of fair value presented herein are not necessarily indicative of the amounts that could be realized upon disposition of the financial instruments. A summary of the carrying amount and fair value of our mortgages payable, notes payable and senior notes and debentures is as follows:

	March 31, 2014		December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(In thousands)			
Mortgages and notes payable	\$959,174	\$979,326	\$889,278	\$912,251
Senior notes and debentures	\$1,361,098	\$1,421,343	\$1,360,913	\$1,397,731

As of March 31, 2014, we have two interest rate swap agreements with a notional amount of \$275.0 million that are measured at fair value on a recurring basis. The interest rate swap agreements fix the variable portion of our \$275.0 million term loan at 1.72% from December 1, 2011 through November 1, 2018, and effectively fix the rate of the term loan at 3.02%. We assess effectiveness of our cash flow hedges both at inception and on an ongoing basis. The effective portion of changes in fair value of the interest rate swaps associated with our cash flow hedges is recorded in accumulated other comprehensive loss and is subsequently reclassified into interest expense as interest is incurred on the related variable rate debt. Within the next 12 months, we expect to reclassify an estimated \$4.2 million as an increase to interest expense. Our cash flow hedges become ineffective if critical terms of the hedging instrument and the debt instrument do not perfectly match such as notional amounts, settlement dates, reset dates, calculation period and LIBOR rate. In addition, we evaluate the default risk of the counterparty by monitoring the credit-worthiness of the counterparty. When ineffectiveness exists, the ineffective portion of changes in fair value of the interest rate swaps associated with our cash flow hedges is recognized in earnings in the period affected. Hedge ineffectiveness has not impacted earnings as of March 31, 2014, and we do not anticipate it will have a significant effect in the future. The fair values of the interest rate swap agreements are based on the estimated amounts we would receive or pay to terminate the contracts at the reporting date and are determined using interest rate pricing models and interest rate related observable inputs. The fair value of our swaps at March 31, 2014 was a liability of \$2.0 million and is included in "accounts payable and accrued expenses" on our consolidated balance sheet. The change in valuation on our interest rate swaps was \$0.5 million (including \$1.1 million reclassified from other comprehensive loss to interest expense) for the three months ended March 31, 2014 and is included in "accumulated other comprehensive loss."

A summary of our financial liabilities that are measured at fair value on a recurring basis, by level within the fair value hierarchy is as follows:

March 31, 2014				December 31, 2013	
Level 1	Level 2	Level 3	Total	Level 1	