Disguised Corporate Capital Wreaks Havoc in Real Estate

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Shareholder equity and corporate debt are paying for extensive office and retail development that should not be taking place.

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Hard as it is to believe, new office buildings are going up in some of the nation's most overbuilt office markets. In Dallas, for example, JC Penney, Oryx Energy, EDS, Northern Telecom, and other corporations have recently built 6 million square feet of office space. In similar fashion, expanding retailers whose market value is based largely on store growth—companies like Circuit City, Home Depot, Pace, Price Club, Sam's, Wal-Mart, and Kmart—are building new stores or anchoring new shopping centers in markets in which retail space is in great oversupply.

The capital for these projects is coming from Wall Street in the form of shareholder equity and corporate debt. Wall Street is funneling capital or credit to build real estate for which there is no market demand and, in most cases, cheaper alternatives are available.

Corporate additions to office supply typically occur in larger markets, and in most cases are driven by executives' egos. If it means vacating existing quarters in the same market, the construction of a new corporate headquarters has the same effect on supply as would a new speculative office building.

Corporations own 65 percent of commercial real estate in the United States, according to Arthur Andersen's 1991 report, *Who Owns America?* What is frightening about this particular source of construction capital is its unpredictability. It is unrelated to the supply/demand equation. The use of capital to build office space when so much existing space is available is inefficient and wasteful. It would be far better to invest the money in production equipment or training. Responsible corporate executives with changing space needs should seek to adapt existing buildings.

On the retail front, most retailers are more concerned with sales growth than they are with an improving bottom line. Phar Mor got as far as it did by using store growth to mask its lack of earnings growth. On the local level, construction lenders were only too happy to find a national public company to anchor their developer client's new shopping center.

Wall Street finally caught on to Phar Mor's game, but other retailers are playing the same game and may find themselves out of business before another two years elapse. And when they do, stores will close, leases will be abrogated, and lenders and landlords in general will take huge losses because of their erroneous assumptions about the creditworthiness of anchor retailers.

This form of capital investment destabilizes retail markets in small towns and large metropolitan areas alike. Available supply does not matter. If Wal-Mart wants to enter a market, nine times out of ten it will build a new store. The same goes for Kmart, Home Depot, Circuit City, and most of the national retailers that are aggressively pursuing a strategy of rapid store growth.

With few exceptions, the retail expansions occurring in 1993 are not using the stores vacated by enterprises that failed earlier. They are building beautiful new stores or becoming the anchors in new shopping centers that will add thousands of square feet of speculative space to saturated markets. In some markets, of course, more retail space is needed and market demand at a prime location is underserved. But in general, communities throughout the United States are overstored.

In sum, corporate capital is wreaking havoc in many real estate markets. It is available in overbuilt metropolitan areas to build corporate office facilities, which continue to add office supply to the markets. It is available to underwrite the credit of retailers seeking to expand into new store space and new shopping centers no matter how much more space (and how many more stores) the local populations can support. It is an unpredictable factor in real estate markets. Office and retail investors and lenders, beware. ❖

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