

KITE REALTY GROUP TRUST
Form 10-K
March 02, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

x Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2011

o 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: 001-32268

Kite Realty Group Trust
(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of incorporation or organization)

11-3715772

(IRS Employer Identification No.)

30 S. Meridian Street, Suite 1100
Indianapolis, Indiana 46204
(Address of principal executive offices) (Zip code)

(317) 577-5600
(Registrant's telephone number, including area code)

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common Shares, \$0.01 par value | New York Stock Exchange |
| 8.25% Series A Cumulative Redeemable Perpetual Preferred Shares | New York Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act. Yes o No x

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Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 of Section 15(d) of the Act. Yes ☐ No ☒ x

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 ☒ x No ☐ o

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 ☒ x No ☐ o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒ x

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 the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ o Accelerated filer ☒ x Non-accelerated filer ☐ o Smaller reporting company ☐ o

(do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act) Yes ☐ o No ☒ x

The aggregate market value of the voting shares held by non-affiliates of the Registrant as the last business day of the Registrant's most recently completed second quarter was \$291 million based upon the closing price of \$4.98 per share on the New York Stock Exchange on such date.

The number of Common Shares outstanding as of February 24, 2012 was 63,622,095 (\$.01 par value).

Documents Incorporated by Reference

Portions of the Proxy Statement relating to the Registrant's Annual Meeting of Shareholders, scheduled to be held on May 9, 2012, to be filed with the Securities and Exchange Commission, are incorporated by reference into Part III, Items 10-14 of this Annual Report on Form 10-K as indicated herein.

KITE REALTY GROUP TRUST
Annual Report on Form 10-K
For the Fiscal Year Ended
December 31, 2011

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PART I

ITEM 1. BUSINESS

Unless the context suggests otherwise, references to “we,” “us,” “our” or the “Company” refer to Kite Realty Group Trust and our business and operations conducted through our directly or indirectly owned subsidiaries, including Kite Realty Group, L.P., our operating partnership (the “Operating Partnership”). References to “Kite Property Group” or the “Predecessor” mean our predecessor businesses.

Overview

Kite Realty Group Trust is a full-service, vertically integrated real estate company engaged in the development, construction, acquisition, ownership, and operation of high-quality neighborhood and community shopping centers in selected markets in the United States.

We conduct all of our business through our Operating Partnership, of which we are the sole general partner. As of December 31, 2011, we held an 89% interest in our Operating Partnership with limited partners owning the remaining 11%.

As of December 31, 2011, we owned interests in a portfolio of 54 retail operating properties totaling approximately 8.4 million square feet of gross leasable area (including approximately 2.9 million square feet of non-owned anchor space) located in nine states. Our retail operating portfolio was 93.3% leased to a diversified retail tenant base, with no single retail tenant accounting for more than 2.9% of our total annualized base rent. In the aggregate, our largest 25 tenants accounted for 38.1% of our annualized base rent. See Item 2, “Properties” for a list of our top 25 tenants by annualized base rent.

We also own interests in four commercial (office/industrial) operating properties totaling approximately 0.6 million square feet of net rentable area, all located in the state of Indiana. The leased percentage of our commercial operating portfolio was 93.3% as of December 31, 2011.

As of December 31, 2011, we also had an interest in five in-process development or redevelopment retail projects. Upon completion, these projects are anticipated to have approximately 0.8 million square feet of gross leasable area (including approximately 0.2 million square feet of non-owned anchor space). In addition to our in-process developments and redevelopments, we have future developments, which include land parcels that are undergoing pre-development activities and are in various stages of preparation for construction to commence, including pre-leasing activity and negotiations for third-party financings. As of December 31, 2011, these future developments consisted of three projects that are expected to contain 2.0 million square feet of total gross leasable area (including non-owned anchor space) upon completion.

In addition, as of December 31, 2011, we owned interests in various land parcels totaling approximately 101 acres. These parcels are classified as “Land held for development” in the accompanying consolidated balance sheets and are expected to be used for future expansion of existing properties, development of new retail or commercial properties or sold to third parties.

Significant 2011 Activities

Financing and Capital Raising Activities. As discussed in more detail below in “Business Objectives and Strategies,” our primary business objectives are to generate increasing cash flow, achieve long-term growth and maximize

shareholder value primarily through the operation, acquisition, development and redevelopment of well-located community and neighborhood shopping centers. In 2011, one of our primary objectives was the cost effective and opportunistic strengthening of our balance sheet to allow access to various sources of capital to fund our future commitments. We endeavor in 2012 to continue improving our key financial ratios including our debt to EBITDA ratio. We ended the year 2011 with approximately \$38 million of combined cash and borrowing capacity on our unsecured revolving credit facility and Fishers Station revolving line of credit. We will remain focused on 2012 financing activity and will continue to aggressively manage our operating portfolio and development pipeline.

During 2011, we successfully completed various financing, refinancing and capital-raising activities including the following significant activities:

Unsecured Revolving Credit Facility

- In June 2011, we entered into an amended and restated three-year \$200 million unsecured revolving credit facility with a one-year extension option. Terms of the agreement include pricing at LIBOR plus 225 to 325 basis points depending on the Company's leverage and an expansion feature allowing up to \$300 million of total borrowing capacity, subject to certain conditions.

Secured Financing Activity

- In December 2011, we closed on a \$16.8 million loan secured by the Eastgate Pavilion property to replace the existing secured variable rate loan that was scheduled to mature in April 2012. The loan has a maturity date of December 31, 2016 and a variable interest rate of LIBOR plus 225 basis points;
- In August 2011, we closed on \$82 million of nonrecourse loans secured by our Bayport Commons, Eddy Street Commons, Hamilton Crossing, Boulevard Crossing, Publix at Acworth, and Naperville Marketplace properties. Each of these loans has a ten-year term and a fixed interest rate of 5.44%;
- In March 2011, we closed on a \$7.8 million loan secured by land held for development in Naples, Florida. The loan has a 30-month term and a variable interest rate of LIBOR plus 300 basis points; and
- In March 2011, we closed on a \$21.0 million loan secured by the International Speedway Square property in Daytona, Florida. The loan has a ten-year term and a fixed interest rate of 5.77%.

Construction Financing

- Draws totaling \$15.7 million were made on the variable rate construction loans related to the Eddy Street, Commons, Cobblestone Plaza, South Elgin Commons, and Rivers Edge developments;
- In November 2011, we closed on a \$62 million construction loan to fund the construction of the Delray Marketplace development in Delray Beach, Florida. The loan has a maturity date of November 18, 2014 and variable interest rate of LIBOR plus 200 basis points, which reduces to 175 basis points when a coverage ratio of 1.0 is achieved; and
- In December 2011, we closed on a \$4.7 million construction loan to fund the construction of the Zionsville Walgreen's development in Zionsville, Indiana. The loan has a maturity date of June 30, 2015 and a variable interest rate of LIBOR plus 225 basis points.

2011 Development and Redevelopment Activities

- Rivers Edge in Indianapolis, Indiana was substantially completed and transitioned to the operating portfolio. This Indianapolis, Indiana center was successfully redeveloped and is 100% leased. The center is anchored by Nordstrom Rack, The Container Store, and buy buy Baby. Additional anchors Arhaus Furniture and an expanded BGI Fitness are projected to open in mid-2012;
- Cobblestone Plaza in Fort Lauderdale, Florida was substantially completed and transitioned to the operating portfolio. As of December 31, 2011, this Whole Foods-anchored center was 92.2% leased; and

- South Elgin Commons, Phase II, in Chicago, Illinois was completed and transitioned to the operating portfolio. This project is 100.0% leased and is anchored by Toys “R” Us/Babies “R” Us and Ross Stores and a non-owned Super Target.

As of December 31, 2011, we had five in-process development or redevelopment projects consisting of the following:

- Delray Marketplace in Delray Beach, Florida was transitioned to an in-process development in 2011. This center will be anchored by Publix and Frank Theatres along with multiple shop retailers including Charming Charlie’s, Chico’s, Jos. A Bank, Max’s Grille, and White House | Black Market. The Company closed on a \$62 million construction loan in November 2011 to fund future costs. The Company anticipates that total project costs of the development will be \$93 million, of which \$51.7 million had been incurred as of December 31, 2011;
- Oleander Pointe in Wilmington, North Carolina was acquired in February 2011. Subsequent to the acquisition, we executed a lease termination with the old anchor and a new lease with Whole Foods and transitioned the property to an in-process redevelopment. The Company anticipates its total investment in the redevelopment will be \$5 million, of which \$1.7 million had been incurred as of December 31, 2011;

- Four Corner Square/Maple Valley near Seattle, Washington was transitioned to an in-process development in 2011. In addition to the existing center, we also own approximately ten acres of adjacent land for the expansion of the shopping center. The center will be anchored by Johnson's Home & Garden, Walgreens, and Grocery Outlet. The Company currently anticipates its total investment in the redevelopment and expansion will be approximately \$23.5 million (net of projected property sales), of which \$11.2 million had been incurred as of December 31, 2011;
- New Hill Place – Phase I in Raleigh, North Carolina was transitioned to an in-process development in 2011. This center will be anchored by Dick's Sporting Goods, Marshall's, Michael's, and Petco and a non-owned Target. The Company anticipates its total investment in the development will be \$57 million, of which \$17.1 million had been incurred as of December 31, 2011; and
- Walgreens in Zionsville, Indiana was transitioned to an in-process development in 2011. The Company anticipates its total investment in the single-tenant development will be \$5.2 million, of which \$2.4 million had been incurred as of December 31, 2011.

2011 Acquisitions

- Oleander Pointe, a 52,000 square foot, retail shopping center in Wilmington, North Carolina, was acquired in February 2011 for a purchase price of \$3.5 million. The Company is currently redeveloping this property, and the Whole Foods anchor is scheduled to open in May 2012;
- The Centre is an 81,000 square foot shopping center located in Carmel, Indiana, a suburb of Indianapolis. In February 2011, we completed the acquisition of the remaining 40% interest in the property from our joint venture partners and assumed leasing and management responsibilities. The purchase price was approximately \$2.2 million, including the settlement of a \$0.6 million loan made by the Company; and
- Lithia Crossing, an 87,000 square foot, retail shopping center in Tampa, Florida, was acquired in June 2011 for a purchase price of \$13.3 million.

2011 Cash Distributions

In 2011, we declared quarterly cash distributions of \$0.06 per common share with respect to each of the four quarters. We also declared quarterly cash distributions of \$0.515625 per Series A preferred share with respect to each of the four quarters.

Business Objectives and Strategies

Our primary business objectives are to increase the cash flow and build or realize capital appreciation of our properties, achieve sustainable long-term growth and maximize shareholder value primarily through the operation, development, redevelopment and select acquisition of well-located community and neighborhood shopping centers. We invest in properties where cost effective renovation and expansion programs, combined with effective leasing and management strategies, can combine to improve the long-term values and economic returns of our properties. The Company believes that certain of its properties represent opportunities for future renovation and expansion.

We seek to implement our business objectives through the following strategies, each of which is more completely described in the sections that follow:

- Operating Strategy: Maximizing the internal growth in revenue from our operating properties by leasing and re-leasing those properties to a diverse group of retail tenants at increasing rental rates, when possible, and redeveloping or renovating certain properties to make them more attractive to existing and prospective tenants and consumers or to permit additional or more productive uses of the properties;
- Growth Strategy: Using debt and equity capital prudently to redevelop or renovate our existing properties, selectively acquire additional retail properties and develop shopping centers on land parcels that we currently own where we believe that investment returns would meet or exceed internal benchmarks; and
 - Financing and Capital Preservation Strategy: Maintaining a strong balance sheet with sufficient flexibility to fund our operating and investment activities in a cost-effective manner; funding sources include borrowings under our existing revolving credit facility, new secured debt, accessing the public securities markets when conditions are favorable, with internally generated funds and proceeds from selling land and properties that no longer fit our strategy, and investment in strategic joint ventures. We continuously monitor the capital markets and may consider raising additional capital through the issuance of our common shares, preferred shares or other securities.

Operating Strategy. Our primary operating strategy is to maximize revenue and maintain or increase occupancy levels by attracting and retaining a strong and diverse tenant base. Most of our properties are located in regional and neighborhood trade areas with attractive demographics, which has allowed us to maintain and, in some cases, increase occupancy and rental rates. We seek to implement our operating strategy by, among other things:

- increasing rental rates upon the renewal of expiring leases or re-leasing space to new tenants while minimizing vacancy to the extent possible;
 - maximizing the occupancy of our existing operating portfolio;
 - maximizing tenant absorption and minimizing tenant turnover;
- maintaining efficient leasing and property management strategies to emphasize and maximize rent growth and cost-effective facilities;
- maintaining a diverse tenant mix in an effort to limit our exposure to the financial condition of any one tenant or any category of tenants;
- monitoring the physical appearance, condition, and design of our properties and other improvements located on our properties to maximize our ability to attract customers;
 - actively managing costs to minimize overhead and operating costs;
- maintaining strong tenant and retailer relationships in order to avoid rent interruptions and reduce marketing, leasing and tenant improvement costs that result from re-tenanting space; and
- taking advantage of under-utilized land or existing square footage, reconfiguring properties for better use, or adding ancillary income areas to existing facilities.

We employed our operating strategy in 2011 in a number of ways, including increasing our total leased percentage from 92.5% at December 31, 2010 to 93.3% at December 31, 2011, through the signing of over 490,000 square feet of new leases in 2011. We have also been successful in maintaining a diverse retail tenant mix with no tenant accounting for more than 2.9% of our annualized base rent. See Item 2, “Properties” for a list of our top tenants by gross leasable area and annualized base rent.

Growth Strategy. Our growth strategy includes the selective deployment of resources to projects that are expected to generate investment returns that meet or exceed our internal benchmarks. We intend to implement our growth strategy in a number of ways, including:

- continually evaluating our operating properties for redevelopment and renovation opportunities that we believe will make them more attractive for leasing to new tenants or re-leasing to existing tenants at increased rental rates;
- capitalizing on future development opportunities on currently owned land parcels through the achievement of anchor and small shop pre-leasing targets and obtaining financing prior to commencing construction;
- disposing of selected assets that no longer meet our long-term investment criteria and recycling the resulting capital into assets that provide maximum returns and upside potential in desirable markets; and
-

selectively pursuing the acquisition of retail operating properties and portfolios in markets with attractive demographics which we believe can support retail development and therefore attract strong retail tenants.

In evaluating opportunities for potential acquisition, development, redevelopment and disposition, we consider a number of factors, including:

- the expected returns and related risks associated with investments in these potential opportunities relative to our combined cost of capital to make such investments;
- the current and projected cash flow and market value of the property, and the potential to increase cash flow and market value if the property were to be successfully re-leased or redeveloped;
- the price being offered for the property, the current and projected operating performance of the property, the tax consequences of the sale and other related factors;

- the current tenant mix at the property and the potential future tenant mix that the demographics of the property could support, including the presence of one or more additional anchors (for example, value retailers, grocers, soft goods stores, office supply stores, or sporting goods retailers), as well as an overall diverse tenant mix that includes restaurants, shoe and clothing retailers, specialty shops and service retailers such as banks, dry cleaners and hair salons, some of which provide staple goods to the community and offer a high level of convenience;
- the configuration of the property, including ease of access, abundance of parking, maximum visibility, and the demographics of the surrounding area; and
- the level of success of existing properties in the same or nearby markets.

In 2011, we were successful in executing new leases for anchor tenants at multiple properties in our development, redevelopment, and operating portfolios. We signed leases totaling 99,000 square feet with Dick's Sporting Goods, Marshall's, Michael's, and Petco to anchor our New Hill Place – Phase I development near Raleigh, North Carolina. We also signed leases totaling 42,000 square feet with Home Goods and DSW at our Plaza at Cedar Hill operating property in Dallas, Texas and a 30,000 square foot anchor lease with Whole Foods at our Oleander Pointe redevelopment property in Wilmington, North Carolina.

Financing and Capital Preservation Strategy. We finance our development, redevelopment and acquisition activities seeking to use the most advantageous sources of capital available to us at the time. These sources may include the sale of common or preferred shares through public offerings or private placements, the reinvestment of proceeds from the disposition of assets, the incurrence of additional indebtedness through secured or unsecured borrowings, and investment in real estate joint ventures.

Our primary financing and capital preservation strategy is to maintain a strong balance sheet with sufficient flexibility to fund our operating and development activities in the most cost-effective way possible. We consider a number of factors when evaluating our level of indebtedness and when making decisions regarding additional borrowings, including the purchase price of properties to be developed or acquired with debt financing, the estimated market value of our properties and the Company as a whole upon consummation of the refinancing, and the ability of particular properties to generate cash flow to cover expected debt service. As discussed in more detail in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," recent market conditions have heightened the need for most REITs, including us, to continue to place an emphasis on financing and capital preservation strategies. Our efforts to strengthen our balance sheet are essential to the success of our business. We intend to continue implementing our financing and capital strategies in a number of ways, including:

- prudently managing our balance sheet, including reducing the aggregate amount of indebtedness outstanding under our unsecured revolving credit facility so that we have additional capacity available to fund our development and redevelopment projects and pay down maturing debt if refinancing that debt is not feasible;
- extending the maturity dates of and/or refinancing of our near-term mortgage, construction and other indebtedness. Subsequent to December 31, 2011, we retired \$45 million of our 2012 maturities, leaving \$11 million to be addressed over the balance of the year. We are pursuing financing alternative to enable us to repay, refinance, or extend the maturity date of this loan;
- staggering our maturities with long-term debt on recently completed projects;
- entering into construction loans typically prior to commencement of construction to fund our in-process developments, redevelopments, and future developments;

- raising additional capital through the issuance of common shares, preferred shares or other securities;
- managing our exposure to interest rate increases on our variable-rate debt through the use of fixed rate hedging transactions and securing property specific long-term nonrecourse financing; and
- investing in joint venture arrangements in order to access less expensive capital and to mitigate risk.

Business Segments

Our principal business is the ownership, operation, acquisition and development of high-quality neighborhood and community shopping centers in selected markets in the United States. Historically, the operations of the Company have been aligned into two business segments: (1) real estate operations and development activities, and (2) construction and advisory services. Over the last several years, the Company made a strategic decision to reduce its third party construction and advisory services activity. As a result of this decision, the Company has not entered into any new significant construction or advisory contracts in 2011. The operations of this segment are de minimis for the year ended December 31, 2011, and the Company expects they will remain so in the foreseeable future.

Competition

The United States commercial real estate market continues to be highly competitive. We face competition from other REITs and other owner-operators engaged in the development, acquisition, ownership and leasing of shopping centers as well as from numerous local, regional and national real estate developers and owners in each of our markets. Some of these competitors may have greater capital resources than we do; although we do not believe that any single competitor or group of competitors in any of the primary markets where our properties are located are dominant in that market.

We face significant competition in our efforts to lease available space to prospective tenants at our operating, development and redevelopment properties. The nature of the competition for tenants varies depending upon the characteristics of each local market in which we own and manage properties. We believe that the principal competitive factors in attracting tenants in our market areas are location, demographics, rental rates, the presence of anchor stores, competitor shopping centers in the same geographic area and the maintenance, appearance, access and traffic patterns of our properties. There can be no assurance in the future that we will be able to compete successfully with our competitors in our development, acquisition and leasing activities.

Government Regulation

We and our properties are subject to a variety of federal, state, and local environmental, health, safety and similar laws including:

Americans with Disabilities Act. Our properties must comply with Title III of the Americans with Disabilities Act, or ADA, to the extent that such properties are public accommodations as defined by the ADA. The ADA may require removal of structural barriers to access