STATEMENT
OF
ELIZABETH I. HOLLAND
ON BEHALF OF
THE INTERNATIONAL COUNCIL OF SHOPPING CENTERS

ON THE

COMMUNITY CHOICE IN REAL ESTATE ACT

(H.R. 3424)

TO THE

FINANCIAL INSTITUTIONS AND

CONSUMER CREDIT

SUBCOMMITEE

OF THE

HOUSE FINANCIAL SERVICES COMMITTEE

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SUBMITTED BY:

INTERNATIONAL COUNCIL OF SHOPPING CENTERS

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Introduction

Good morning Mr. Chairman, members of the Subcommittee, and fellow citizens. My name is Elizabeth Holland and I am the chief executive of Abbell Credit Corporation – a 50-year old family business focused on real estate investment, development and management based in Chicago, Illinois. Abbell Credit manages a 1.6 million square foot portfolio comprised of shopping center, enclosed mall and office properties, including Merle Hay Mall in Des Moines, Iowa and Westgate Village Shopping Center in Toledo, Ohio.

I am here on behalf of the International Council of Shopping Centers (ICSC), and am the chair of the organization's Economic Issues Subcommittee. ICSC is the global trade association of the shopping center industry, and has 40,000 members in the United States, Canada and more than 77 other countries around the world, including shopping center owners, developers, managers, investors, lenders, retailers and other professionals. The shopping center industry is an important part of, and contributes significantly to, the U.S. economy. In 2001, shopping centers in the U.S. accounted for $1.18 trillion in retail sales (approximately one-half of non-automotive retailing in the U.S.), collected over $50 billion in state sales taxes and employed nearly 11 million people.

Thank you for inviting me here today to express ICSC's views on the *Community Choice in Real Estate Act* (H.R. 3424), and for holding another hearing on this very important issue.

Overview

Let me first say that ICSC strongly supports H.R. 3424. This bill, which was introduced by Representatives Ken Calvert, Paul Kanjorski and others in December, currently has 244 cosponsors, including many members of this Subcommittee.

H.R. 3424, along with its Senate companion, S. 1839, would prohibit the Department of Treasury and the Federal Reserve Board (collectively referred to as "the Agencies") from determining that real estate brokerage and management activities are "financial in nature" or "incidental to a financial activity", thereby preventing financial holding companies and financial subsidiaries (collectively referred to as "financial institutions") from engaging in real estate brokerage and management activities. These bills were introduced in response to the Agencies' issuance in January 2001 of Proposed Rules that would allow financial institutions to engage in real estate brokerage and management activities.

Our support of H.R. 3424, and corresponding opposition to the Proposed Rules, is based on several concerns. The first is that the *Bank Holding Company Act* ("the BHC Act"), as amended by the *Gramm-Leach-Bliley Act of 1999* ("the GLB Act"), makes it

clear, in its statutory language and legislative history, that real estate brokerage and management activities are not “financial in nature” or “incident to a financial activity”. Instead, such real estate activities are commercial in nature – activities which financial institutions are precluded from engaging in.

The second is that any major decision that would allow financial institutions to engage in real estate brokerage and management should be made by Congress, and not by the Agencies through regulation. We are also concerned that the Agencies issued their Proposed Rules so soon after the GLB Act was enacted.

The third is that, should the Proposed Rules be finalized and become effective, we are very concerned that some financial institutions might use their leverage in a manner that could negatively affect real estate management businesses across the country. This, in turn, could suppress competition and put many viable, longstanding real estate management firms out of business.

The GLB Act and Congressional Intent

In recognition of various regulatory and judicial decisions, the GLB Act amended the BHC Act to permit financial institutions to engage in certain additional activities, including securities and insurance services. It did so by adding these activities to the list of activities considered to be “financial in nature” and “incidental to a financial activity”.

The GLB Act, however, gives no indication, either explicit or implicit, that real estate brokerage or management activities are to be added to the list of financial activities. In fact, Congress addressed real estate-related activities in the GLB Act only when it inserted language to restrict national banks from conducting real estate investment or development activities through a financial subsidiary.

Nor did Congress state, or give any signal, that the longstanding separation between banking and commerce should be eliminated. Representative Jim Leach, one of the main sponsors of the GLB Act, made this clear by stating that the GLB Act continues to “repudiate” the mixing of banking and commerce. While both banks and commercial businesses can compete in financial services (e.g., auto manufacturers and banks can both offer auto financing), banks and commercial firms have long been prohibited from engaging in each other’s main businesses (e.g., auto manufacturers cannot make commercial loans, and banks cannot sell automobiles).

Although a limited number of thrifts, credit unions, and state-chartered banks engage in real estate management activities, these entities have more restricted and focused lending and investment powers than financial holding companies and other federally-chartered banking institutions. For example, thrifts and credit unions are subject to strict limits with regard to how much they can invest in management subsidiaries or organizations. Therefore, the fact that some of these entities engage in real estate management activities does not support the Agencies’ contention that such activities be expanded to larger, more powerful financial institutions across the country.

To be “financial in nature” or “incidental to a financial activity” within the meaning of the GLB Act, an activity must qualify either under Section 4(k)(4) of the revised BHC Act (which lists several specific, statutorily-defined activities) or Section 4(k)(5) (which lists three types of financial activities that the Agencies can further define).

Unlike banking, insurance and securities activities, real estate management is not specifically listed as a Section 4(k)(4) activity. This is the clearest indication that Congress did not intend for financial activities to be expanded to include real estate brokerage and management activities. If Congress had intended for such real estate activities to be considered financial activities, it would have been surely listed them in this section.

The three types of activities listed in Section 4(k)(5) are (1) “lending, exchanging, transferring, investing for others, or safeguarding financial assets other than money or securities”; (2) “providing any device or other instrumentality for transferring money or other financial assets”; and (3) “arranging, effecting or facilitating financial transactions for the account of third parties” (emphasis added).

In the context of the GLB Act, real estate is not a “financial asset”. Real estate is neither a financial instrument nor intangible property, like a stock or a bond. Therefore, the provision of real estate management services does not constitute “safeguarding financial assets”, nor does it constitute the transfer of “money or other financial assets”. Similarly, real estate management activities do not arrange, effect or facilitate a “financial transaction”. Instead, they are commercial activities that are performed after real estate transactions are consummated. Minor fiscal activities, such as the collection and remittance of payments to owners, are customary management services and do not constitute the facilitation of financial transactions.

Since real estate management activities do not constitute services specified under Sections 4(k)(4) or 4(k)(5), such management activities should not be construed by the Agencies to be “financial in nature” nor “incidental to a financial activity” under the GLB Act.

Procedural Concerns

The GLB Act also gives the Agencies the authority to determine what, if any, other activities are “financial in nature” or incidental to a financial activity”, and can therefore be engaged in by financial institutions.

Section 4(k)(3), however, states that the Agencies must examine several factors before determining whether an activity is a financial activity, including: the purposes of the BHC and GLB Acts; changes in the marketplace in which financial institutions compete; and changes in technology for delivering financial services. We do not believe that any of these factors have given the Agencies reason to treat real estate management services as financial activities.

The Report of the Senate Committee on Banking, Housing and Urban Affairs accompanying the GLB Act states "This authority includes authority to allow activities that are reasonably connected to one or more financial services… The authority provides the Board with some flexibility to accommodate the affiliation of depository institutions with insurance companies, securities firms, and other financial service providers while continuing to be attentive not to allow the general mixing of banking and commerce in contravention of the purposes of the Act" (emphasis added).

Real estate management has always been a commercial activity, both before and after enactment of the GLB Act, and is "not reasonably connected" to one or more financial services. Therefore, we believe that the Agencies erred in issuing Proposed Rules that would reclassify real estate management as a financial activity and erode the long-standing separation of banking and commercial activities most recently reaffirmed in the GLB Act.

Furthermore, significant changes to the GLB Act that would dramatically impact the real estate industry, such as expanding the definition of financial activities to include real estate management services, should be deliberated and legislated by Congress, not by the Agencies through administrative regulations. Congress has repeatedly treated real estate brokerage and management activities as commercial activities, and has indicated that banking and commercial activities should be separated. The Agencies, therefore, should not be overturning longstanding laws through the issuance of regulations.

We are also concerned that the Agencies issued the Proposed Rules too quickly after the GLB Act was enacted. Even if the Agencies agreed with the banking industry's argument that the definition of financial activities should be expanded to include real estate brokerage and management, the Agencies should have taken a more deliberative, timely approach to this issue before issuing Proposed Rules that would, without question, have a profound impact on the real estate industry.

Concerns about Conflicts of Interest Eroding Fair Competition

In addition to the technical arguments that real estate management activities do not constitute financial activities under the GLB Act, we are very concerned about the potential negative effects that the Proposed Rules could have on many shopping center developers and managers.

ICSC supports fair and healthy competition when it preserves the natural tensions that exist in a well-regulated and open marketplace. However, if a financial institution is allowed to participate in real estate brokerage and management activities, its objectivity could be compromised or completely eroded when it reviews a proposed loan that also gives it the opportunity to participate in the profits of project as a broker or a property manager.

For example, if a developer goes to a financial institution with a proposed project for construction or bridge financing, two scenarios could occur – both of which are highly problematic. In the first scenario, the developer agrees to contract with the

institution to provide real estate brokerage and management services (or is able to steer away such services from another provider). The institution would receive a 5-percent management fee on the gross income of the project once it is operational, as well as a 3-percent brokerage commission on all leases. In this case, the institution's objectivity in reviewing the financial soundness of the project is now suspect, if not completely lost, because the financial institution will profit from the operations of the finished project.

In the second scenario, the developer does not plan on having the financial institution participate in the leasing and management of the finished project (which is what currently happens in the marketplace). However, in order to secure financing to build the project, the developer provides the loan officers with extremely detailed information, including:

- The demographic support in the surrounding area;
- Its proposed tenants;
- The design and configuration on the site;
- The current competition in the marketplace;
- The niche the developer hopes this project will fill in order to be successful; and
- The weaknesses and potential pitfalls of the project (such as parcel assemblage, municipal or community opposition, or a land use or zoning amendment) and how the developer proposes to resolve these issues.

The developer provides this information to give the financial institution comfort that the proposed project will be sound and successful. This full and frank disclosure properly facilitates an objective credit analysis by the institution prior to issuing a loan.

However, if a financial institution can compete for brokerage and management contracts, it could discuss a proposed project with a "preferred" developer – one that would allow the institution to provide it with such services (should it get the opportunity to develop the project). This potential scenario would most likely keep the original developer, and others like it, from fully disclosing the project's potentials and pitfalls, and limit the institution's ability to accurately assess the risk of the project, to the detriment of its depositors. We believe that this problem could arise notwithstanding the use of confidentiality agreements. The limited usefulness of confidentiality agreements between competitors in other real estate contexts would also limit their usefulness in this context.

Real Estate Development & Property Management: A Distinction Without a Difference

As mentioned above, the GLB Act continues to prohibit banks and their subsidiaries from making real estate investments or being involved in real estate development. The Proposed Rule, on the other hand, would permit such institutions to engage in real estate management and brokerage activities. While these two rules may at first appear to be compatible, there are many overlapping or identical activities that are performed by property managers and real estate developers and investors.

Successful property management in the retail context involves many of the same functions as a real estate developer, including:

- Formulating and implementing a merchandising plan for the center to include stores that will succeed in the market;
- Overseeing and/or leasing the center consistent with the merchandising plan;
- Marketing the center to consumers, as well as within the retail real estate industry;
- Continually re-evaluating the project for further development and re-development in order to stay competitive within the market through renovations, tenant additions, expansions, and property acquisition; and
- Engaging in municipal and governmental entity relations and negotiations.

The role of a property manager, like that of a developer, is to keep the project competitive by continuing to develop and re-develop the project over time. If a financial institution is allowed to engage in property management, it would have to fulfill these responsibilities and would, in essence, be engaged in real estate development – an activity that is prohibited under the GLB Act.

Furthermore, a management firm's compensation is usually based on a percentage, typically 4 to 5-percent, of the gross receipts of a property. By taking a percentage of the gross revenue as the management company, a financial institution's fees will rise and fall based on the performance of the property. It will be "invested in" the performance of the real estate the same way as if it had an equity interest in the property. This interest would appear to constitute an "investment in real estate" – another prohibited activity.

For the above-mentioned reasons, the International Council of Shopping Centers strongly supports the *Community Choice in Real Estate Act* (H.R. 3424) and opposes the Proposed Rules.

Thank you for opportunity to address you today. I would be happy to answer any questions.