Meeting your match

Developers need to offer a wide choice of strategic approaches to meet the requirements of the diverse capital sources now seeking a home in logistics real estate, argues Panattoni Europe CEO, Robert Dobrzycki. Stuart Watson reports

In demand: logistics is enjoying attention from all kinds of investors

Broad-based demand for logistics real estate investments means a wide variety of investors are looking to find a niche that fits their individual capital requirements in a sector where assets can be hard to access at attractive pricing. Robert Dobrzycki, chief executive of the European arm of international developer Panattoni, briefs *PERE* on strategies for marrying logistics markets and assets with the capital partners that suit them best.

***PERE**: What types of capital are currently keen to grow their exposure to logistics real estate?*

Robert Dobrzycki: Almost all of them: sovereign wealth, insurance companies, pension funds, private wealth. Logistics has become very popular recently and that popularity is growing mainly because of the retail e-commerce shift that is happening. However, the preferences of those investors for different asset types, risk profiles and geographies form a kind of three-dimensional matrix that can be used to match them with different types of investment.

There are several asset types within our business: e-commerce fulfilment centers, big-box single-let buildings, last-mile logistics hubs, multi-let estates and production and light assembly buildings. Then, of course, you have investors that have core, or value-added, or opportunistic strategies. We are active in the UK, Germany, Poland, Czech Republic, Slovakia and Romania, and we see investors with different geographical focuses, too.

Meanwhile, we are seeing a big drive in Central Europe to create production and e-commerce fulfilment facilities that serve not only the local markets but also western European

Dobrzycki: the developer takes the risk

markets. The same big companies are signing the same long leases in Central Europe that they would in Western Europe and using those buildings to serve the West. But because institutional, core, long-term money is showing up from all over the world and creating a supply-demand dynamic that favors the West, there is a pricing gap on either side of the German-Polish border, even for the same product of the same quality with the same tenant serving the same consumer base.

PERE: How do those different types of investors feel about taking on development and leasing risk?

RD: The simple way to access the market is through competitive bids organized by an investment broker, but it is expensive and it can be time-consuming too, because you never know whether you will be the winning bidder. Developers can offer access to product through their development pipeline. That off-market access is priced differently, and you can be pretty sure you will access the product. But you have to go through the process of working with the developer.

Usually, the developer will take on board the development risk. That is our job. After that, pricing is about letting risk. If there is no letting risk then there is a different return expectation. By accessing product by forward-funding a long-term let you access it at a better price than by buying an income producing standing investment – if the yield for an income producing asset is 5 percent, by working with a developer you can access the same type of lease length, tenant and covenant at 5.5 percent.

However, if the developer builds speculatively for the investor then the leasing risk is shared and the investor can expect a higher return.

Ultra-core investors are not willing to go into the development phase at all, and core investors usually buy completed buildings or forward-commit. Core-plus and value-add investors are happy to do development and are sometimes happy to take on leasing risk, especially those with value-added risk profiles and those core-plus investors that are specialists in the industrial market. It is not that product with leasing risk represents a big proportion of what they do, but specialists in the asset class are happy at the edges of their portfolios with the higher returns they get from investing in speculative development.

"Many European core and core-plus investors are looking into development. For them it is a way of getting the same product at more efficient pricing"
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Pricing has become so tight and so aggressive – especially in the UK – that if you buy income-producing assets at a 4.25 percent yield and you can develop speculatively at 5.5-5.75 percent, it is a big difference. If you feel comfortable with development, then that is an easy discount to take. Pricing, especially with the pressure from Asian investors, which are looking for any yield, has got to the point where many European core and core-plus investors are looking into development. For them, it is a way of getting the same product at more efficient pricing. You also have a higher probability of getting your hands on the asset because you are not part of a competitive tender of 10 investors chasing the same building or project.

PERE: What capital structures work best, and why?

RD: As a developer, you can work through the relationships that you have or you can capitalize projects building-by-building. The latter is usually tougher and less efficient, but sometimes developers, including us, do that too. Offering a model that helps different investors access different strategies allows you deeper access to the investment market as well as to a broader base of tenants and product types. By covering as much of the market as possible you can serve a client – which might be a very big company – that wants a 50,000-square-foot production facility, as well as being able to serve a company like Amazon in multiple locations around Europe for one million or 1.5 million-square-foot fulfilment centers.

For example, at Panattoni we usually take an individual project approach with the large fulfilment centers, while with the smaller deals we try to set up a program or strategy with the investor. It could be an assembly strategy or a development and assembly strategy. We might enter into a joint venture with an investor which would then finance a number of developments until we reach a critical mass of smaller deals. Then, when the joint venture has assembled a large multi-country portfolio it can always exit based on open-market pricing, which generates a nice return for both developer and investor. Sometimes there is a value in scale.

To offer that kind of broad menu of development-led strategies you need very strong, large local teams on the ground. In general, fund management businesses can have smaller teams and a more centralized system. For a development strategy you have to have access to land, to tenants and to the local sub-markets. That can be a challenge because it generates a lot of overheads and the development business is cyclical. Developers always have to watch how much development they do versus the overhead that they have. □


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