Clarion Partners

Preparing for the European e-commerce wave

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Jonathan A Schein, senior vice president and managing director of global business development for Institutional Real Estate, Inc, recently spoke with **David Gilbert,** CEO and CIO of Clarion Partners, and **Alistair Calvert,** CEO of Clarion Gramercy. Following is an excerpt of that conversation.

Can you explain the strategic drivers behind the Clarion Gramercy transaction?

Gilbert: Clarion has been investing in industrial for 30 years. We have a leadership position among the handful of dominant managers in industrial investment in the US, and we also have 1,500 tenant relationships, many of which are global. In addition, virtually every one of our clients has some interest in investing offshore and we were getting quite a bit of inquiry from our investors, asking what our thoughts were about investing in Europe and whether we would at some point have the capability to invest there. So our goal was to facilitate our tenants' expansion needs at the same time as our clients' investment goals.

We met with eight or so leading mid- and small-cap investment managers dedicated to logistics and warehouse investing throughout Europe. Ultimately, we met Alistair and the Gramercy Europe team, who quickly distinguished themselves, one reason being their aspirations for growth. Both sides got very excited about combining forces and we ultimately purchased a majority interest in Gramercy.

Calvert: Gramercy has completed more than $3 billion of real estate investments since 2014. We were an established fund manager prior to this transaction with deep relationships across Europe to sustain a very active pipeline. In terms of our strategic drivers, we were recently independent, having bought ourselves out of the Gramercy Property Trust Group simultaneous with their acquisition by Blackstone, and we had a lot of inbound inquiries from firms looking to acquire a European logistics platform. There were a few things that made Clarion very different from everyone else. The success of the business itself was impressive, particularly the core-plus industrial sector that we know so well and operate in, so we knew they understood our business. Dave and the rest of the senior management team understood the complexities of Europe. Then there are the synergies of the tenant relationships, the developer relationships and a lot of common infrastructure — but no conflicts. Clarion doesn't have a competing business in Europe. Finally, the most important thing for us is that we sold a majority stake, but we have kept a very significant minority interest and plan to hold that indefinitely. This is a true, long-term partnership.

Had Clarion Partners invested in Europe in this particular asset class before?

Gilbert: Throughout my 30-year career in real estate investment, I have had personal responsibility for European investments at different points in time. And when Clarion was wholly owned by ING, we had interactions with their global resources, both in Asia and in Europe — and they had investments on an enormous scale in Europe. But Clarion itself has never invested in Europe. This is a really exciting and strategically important step for us as a firm.

Why is entering the European industrial space, which isn't quite as robust as in the US, strategically important for Clarion at this time?

Gilbert: The industrial business is global, and we fully expect to see the trends driving demand in the US and North America continue through Europe. We've long had our eye on this growing wave of new demand for contemporary industrial and logistics assets, mostly driven by e-commerce. Those tenants in particular often have quite unique needs, and much of the current supply is ill-equipped to meet those needs. In addition, we've observed our hundreds of tenants in the US spending a lot of time building out their supply chains throughout Europe and then, ultimately, Asia, so our focus on the sector is not a leap of faith. We are extrapolating from familiarity with what our tenants are doing in Europe; we know that they are some years behind the US. There will be tremendous demand for logistics assets, particularly those that are designed and built the right way, and that was the leading indicator that helped spike our interest.

Calvert: Another element is the low-interest-rate environment we have here in Europe. We closed a number of loans in August, for example, all of which were five-year, fixed-rate loans, all with all-in cost of debt of less than 1 percent. Another loan we are about to close will be somewhere between 0.7 percent and 0.8 percent all-in cost of debt fixed-rate for five years — so we have a dramatically lower cost of debt that is playing into cap-rate compression to a degree. There is a very strong argument that we are still making an outsize return relative to other asset classes. We don't assume cap-rate compression, but it feels like we are still getting good value in Europe.

You hear the term "last mile" in terms of logistics — is the Clarion Gramercy platform looking at this?

Calvert: Sure. "Last mile" gets used and abused in terms of the definition. European markets tend to be very densely populated geographies, so our assets tend to be very close to concentrated population areas. However, the majority would not probably fit the general perception of last mile. They are modern spec, high-quality, 200,000-square-foot to 600,000-square-foot logistics assets. We do have a reasonable number of infill locations, so it plays a part in the investment strategy, but more on an opportunistic basis rather than a true strategic basis. In our Dutch portfolio, for example, which is a very significant part of our total portfolio, there likely is not an asset that is more than 30 minutes from a major population center.

What trends are driving transaction velocity and pricing right now?

Calvert: There are fewer big-platform sales than there were two years ago, which is why European volume is down. You've got an extremely robust occupier market — more robust than we have ever seen — and that is driven by increasing demand and a development market that is not keeping up with that demand (and so perpetually reducing vacancy). In many of our prime markets, vacancy is down to basically zero, so the reason the volumes are down in the second quarter has nothing to do with the perceived value of the market. Rather, people simply are not selling.

That brings us to a more opportunistic environment. How is the speculative logistics development business in European markets?

Calvert: The speculative development market is actually reasonably strong. It is limited by getting permits, which is particularly difficult in France, Germany, and one or two other countries, because the local municipality wants to know who the occupier is, what jobs they are bringing, how skilled those jobs will be, etc. But we do build speculatively. In fact, we are just completing a spec deal in the Netherlands in the third-largest market there, and we are the only available modern spec asset in that entire market. It is quite extraordinary. We are in the process of closing a transaction south of Paris in a very similar situation — there is one other competing asset in that greater market. Where you can get the permitting, spec development is more compelling than it has ever been — it is speculative because it is ground up, but the fact that there is a queue waiting to occupy these spaces makes it a great position.

Are there certain markets you are looking at right now?

Calvert: We are very focused on the best markets in France, specifically Paris and Lyon. We are focused on Rotterdam, Utrecht, and Tilburg (and just recently acquired nine assets in those areas). We find northern Italy interesting, but very much limited to Milan, to Bergamo, to Piacenza — and Barcelona is one of the most compelling markets in Europe because of the lack of land due to the inconvenience of being sandwiched in by mountains and the sea. But we are also investing across quite a large number of countries that each have their own highly compelling markets, and we are seeing very strong rental growth in markets where there is very limited land supply.

In addition to e-commerce, what trends are likely to continue to reshape the logistics and industrial sector in European markets?

Calvert: The increased complexity of the supply chain overall — and that is B to B, and B to C, and it will soon be C to C, as well. This massive increase in complexity requires more space, and it requires space in different places, as the consumer demands forever-shortened delivery times.

What are Clarion's future capital raising plans around this sector?

Gilbert: Our role is to help Alistair and team to raise capital for strategies that would appeal to a wide range of investors globally. Gramercy has been managing European-based funds in a closed-end format, and Clarion Europe's plan would most likely be, in the coming years, to launch an open-end fund investing in industrial products in Europe.

What are your plans to grow the European platform beyond industrial? Where do you go from here?

Gilbert: The breadth of expertise that Clarion Gramercy has investing in Europe is very appealing. This is a team we are confident has the capability, over time, to invest in other property types under the same thesis of providing investment solutions for our global client base. What we want to make emphatically clear is that the opportunity in logistics here is immediate and it is very exciting, so it takes priority over any other initiatives. But we are confident we will continue to expand this business beyond industrial.

CORPORATE OVERVIEW

Clarion Partners has been a leading US real estate investment manager for more than 37 years. Headquartered in New York, the firm has offices in major markets throughout the US and Europe. With more than $51 billion in total assets under management, Clarion Partners offers a broad range of both debt and equity real estate strategies across the risk/return spectrum to its more than 350 domestic and international institutional investors.

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