Real estate investment

Strategies for growth


ALTAREA COGEDIM

At La Défense, the First tower, the tallest building on the right, designed by Kohn Pedersen Fox and SRA Architectes, has undergone an environmental makeover.

MARKET TRENDS | Comparative performances

In an 'era of less,' France offers opportunities

Has less become more? In their latest annual study of "Emerging Trends in Real Estate," PricewaterhouseCoopers and the Urban Land Institute herald 2011 as the beginning of the "Era of Less." Last year's pessimism persists, says the study, notably in the U.S. market, where factors hampering economic recovery include high unemployment, stagnating middle-class wages, restricted credit and government debt.

Opportunities exist, however, in both developing and mature markets. The BRIC countries (Brazil, Russia, India and China) have better resisted the recession — or rebounded more quickly — than much of the rest of the world, and their property markets reflect this. Brazil's commercial office market was one of the world's best performers in 2010, reports the global property consultant Cushman & Wakefield. In Russia, C&W found that transaction volumes attributed to domestic investors have outstripped the precrisis levels of 2008, and it expects the upward trend to continue.

Driven by China and India, the Asia-Pacific region has been the first to report an improvement in market fundamentals, notes Cushman & Wakefield, with declining vacancies and increasing rents in most markets in 2010. Canadian real estate avoided the worst excesses of the United States and recovered more jobs by the end of 2010 than it lost during the recession.

'France has the highest population growth in Europe,' says Eric Dumas, CFO of Altarea Cogedim

Pockets of promise exist in the mature European market as well. Although the property analyst DTZ foresees slow growth in gross domestic products within the euro zone, it expects modest rises in rents and capital values. It also reports a record $376 billion in equity available for global property investment.

According to Peter Hobbs, senior director of group business development for Investment Property Databank (IPD), a market analysis company, London and Stockholm real estate have started bouncing back. "Though the fundamentals may still be weak and rentals may still be down," he says," capital investment is strong and has been pushing prices up, especially in the first half of last year."

Madrid and Dublin are not good bets, he says, because of their weak local economies. Although Milan is attractive to investors, Hobbs says it has transparency issues. German property has no such problems, yet its evaluation practices are very conservative.

France is somewhere in the middle — less affected by the economic crisis than the United Kingdom, but more so than Germany. The French combination of higher yield than in Germany and lower volatility than in the United Kingdom makes it attractive to property investors, says Stéphanie Galiègue, managing director for IPD France and southern Europe.

The French residential market performed well in 2010, says Eric Dumas, chief financial officer of Altarea Cogedim, France's largest diversified property developer. One reason for this was its net population gain of 358,000, of which only 77,000 can be attributed to immigration. "France has the highest population growth in Europe," says Dumas.

Another factor spurring the French housing market, he says, is the growing divorce rate. In the Ile-de-France region (including metropolitan Paris and surroundings), half of all marriages end in divorce, so at least one party presumably has to find a new home.

The percentage of French homeowners is lower than the European average: 57.5 percent, compared with 66 percent, according to Eurostat. So owning one's own home is seen as positive, says Dumas, and growth potential is great. Many French households do not carry much debt, he adds, and fiscal incentives further motivate property purchases.

In addition, explains IPD's Galiègue, French insurance companies invest 15 percent of their capital in residential holdings, boosting that segment.

Like office markets everywhere, the French office market is cyclical, and is currently at the bottom of the trough, according to industry observers. What makes this market attractive is its size. The physical limitations of Paris's central business district mean supply is restricted and inadequate to demand. La Défense on the western periphery of Paris, however, has some long-term leases, quality tenants, large spaces and green buildings, characteristics not easy to find in the city center.

The stability of France's commercial sector reflects the stability of both its household spending and commercial rents. France is the European Union's second-largest market for retail sales, behind the United Kingdom but ahead of Germany, though Germany's population is larger. ■

THE FIRST TOWER | Energy-efficient and adaptable

A flagship of green transformation in Paris's La Défense business district

Elevators that generate their own operating energy. Buildings that heat themselves. Facades with different characteristics to maximize environmental efficiency. Features that once sounded like science fiction are becoming reality, thanks to technological advances and an environmental awareness that did not exist a few decades ago. Major new office buildings are being constructed in accordance with internationally certified green standards such as LEED (Leadership in Energy and Environmental Design) in the United States, Breeam (Building Research Establishment Environmental Assessment Method) in the United Kingdom and HQE (Haute Qualité Environnementale) in France.

These standards are increasingly being applied to new construction in order to help customers assess projects before signing leases or purchase agreements. The standards, however, are not applied only to new developments. Peter Hobbs, senior director of group business development for Investment Property Databank, an industry research company, says new construction represents 5 percent of the industry but garners 95 percent of attention. "Instead, the big issue is refitting existing stock," he says.

Refurbishing an existing building to bring it up to high environmental standards is more technically challenging than creating a new green building. Certification is also more challenging because assessment is supposed to begin at the drawing board, which cannot happen with a refit. Cost-effectiveness is also more complicated to calculate.

Jean-Frédéric Heinry, managing director of Altarea Cogedim Enterprise and an expert in sustainable development, illustrates this complexity in the case of the First tower, at La Défense, the Paris business district, which was officially delivered on Feb. 28. The former AXA tower had been "a typical property asset of the 1970s, not at all environmentally friendly," he says. The newly green structure has been nominated for a 2011 Mipim award in the refurbishing category; its developers would have liked to compete in the green building category as well.

The newly green structure has been nominated for a Mipim award

The tower's transformation began in early 2001, when AXA sought Altarea Cogedim's advice. Altarea Cogedim provided four scenarios: 1) a quick refurbishment. Altarea Cogedim advised against this because of the presence of asbestos (removal would be expensive regardless of any other improvements); 2) complete demolition, i.e., building from scratch. While this would have been attractive from a cost perspective, it would have meant as much as two extra years before a new tower could be occupied. That delay would have been a major disruption in La Défense; 3) retain the existing structure and change everything internally; 4) retain the general structure but change its image and everything else, including the way tenants "live" and how energy is consumed. This meant rethinking the entire building: floor plans, external look and human interaction.

Altarea Cogedim advised — and AXA selected — the fourth option, which allowed workers to stay in the building until the week before refurbishment began on Jan. 2, 2007. The entire refurbishing took four years. Aesthetic changes were secondary; the main focus was energy savings in heating, cooling and lighting. Each of the tower's four faces received a different façade to take advantage of specific solar and wind conditions. Windows were enlarged and skylights added on the protected-areas side to maximize natural lighting and make the interiors more comfortable. "We didn't want small windows, which can be more energy efficient but are not well received by building occupants," explains Heinry. "We were sensitive to the comfort of tenants and the spectacular views available to them."

Windows are double glazed, with low-energy coatings. While descending, elevators produce half of the energy they need.

The tower uses both public and private energy sources, enabling building managers to regulate peaks and troughs in consumption.

Nine months ago, Beacon Capital Partners, the new owner of First, rented 45 percent of the building to Ernst & Young, proving the wisdom of the refit strategy. Says Heinry: "It is very rare in the current economic climate to rent out so much space so far in advance of a property opening."

Hobbs of IPD lists the risks for developers who don't go green: They may be forced out of the market as customers turn to environmentally friendly buildings, they may be disadvantaged in terms of taxes and legislation, and they risk damaging their image if the public perceives them as indifferent to the environment.

"Developers used to calculate along the lines of, 'Will I get €10 more a square meter if I produce a green building?'" says Heinry. "Now we are far beyond that. You lose half your potential customers if you don't develop green projects. Green is the market of the future." ■

MIPIM | "Building connections"

Cannes conference welcomes investors

More than 4,000 investors will be represented among the 18,000 participants at the 22nd edition of Mipim (Marché International des Professionnels de l'Immobilier), being held at the Palais des Festivals in Cannes, March 8-11.

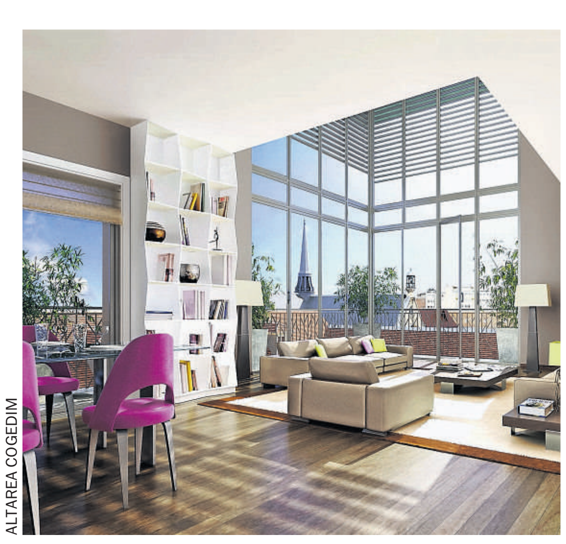
The show's theme is "Building Connections" among investors, developers, end-users, brokers, agents, architects, hotel groups, public authorities and property associations. Investment is, however, the underlying focus this year. Professor Nouriel Roubini, a noted international economist, is the keynote speaker. Several new features emphasize the growing importance of investors in the real estate industry. These include an investor's version of speed dating, called Investor's Power Meetings; an Investment Lab, a series of six interactive workshops that will review opportunities in high-potential markets; and Investor Quest, an investment competition based on a British television show.

The conference-rich program will present such themes as Finance, Beyond the Credit Crisis, Geographical Focuses, Sustainable Cities and Hotels, Tourism and Leisure. A closed-door mayors' think tank will discuss "Building the City Together: Urban Strategies and Integrated Solutions Implementation." The United Kingdom is this year's country of honor, and two sessions will examine the prospects for this attractive yet volatile market. ■


ALTAREA COGEDIM

Altarea Cogedim's Hôtel-Dieu project, Marseille.


ALTAREA COGEDIM


ALTAREA COGEDIM


DIDIER COCATRIX

Altarea Cogedim in action (from left to right): The Green One project for the BBC in Paris; residential development in Paris's Seventh Arrondissement; the Cap 3000 commercial center in France's Alpes-Maritimes.

OFFICE PROPERTY | Private-equity investment

Responding to pent-up demand

As the real estate industry recovers from the recession, institutional investors have shifted from speculative to safe real estate funds. "Core" funds focusing on low-leverage, well-leased buildings promising stable returns have gained favor over "opportunity" funds investing in new developments that may have greater risks but have the potential for higher returns.

Recent events are challenging this conventional wisdom. First, supply and demand are playing a role. Values have increased between 10 percent and 20 percent for core assets, says Stéphane Theuriau, chairman of Altarea Cogedim Entreprise, so investors are beginning to find them too expensive.

Equally significant, a 20-year study released in February by Nareit, the U.S.-based National Association of Real Estate Investment Trusts, found that real estate portfolios constituted of 100 percent core funds were actually "significantly riskier" than well-chosen public/private real estate portfolios. The latter consisted of a combination of private-equity core and opportunity funds, and publicly traded real estate investment trusts, or REITs. Core funds underperformed mixed portfolios both over the long term and during the turbulent past three years.

Private-equity funds are relatively rare in Europe, though they are common in North America and the United Kingdom. A year ago at Mipim, a premier event for real estate professionals held in Cannes, Altarea Cogedim Entreprise launched a private-equity investment opportunity in the French market. A margin fund rather than a volume fund that concentrates on asset picking, it utilizes the management team's expertise.

At this year's Mipim, Altarea Cogedim Entreprise will announce the progress made since then. As of mid-February, it had raised €350 million ($482 million), 20 percent of which is its own money. The rest comes from pension funds and other institutional investors. Its goal is €500 million, representing purchasing power of €1 billion, all of which will be concentrated on the Paris office market.

The company chose Paris because it is second to Tokyo in housing more Fortune Global 500 company head offices than any other city in the world.

In addition, says Theuriau, many developers have not undertaken new construction in Paris because of banks' cautiousness about lending, which will likely continue for another 18 to 24 months. Since it takes several years to deliver a new building project, there is a need for quality sustainable office real estate in Paris. "Operators like us think it is a good time to invest," he says. "The lack of new space is all over the news. We see a pent-up demand in two to three years."

Altarea Cogedim's fund will buy land and build or refurbish existing buildings (such as the First tower at La Défense) rather than buy existing long-lease assets. "Our fund has more risk but more reward potential than core funds," says Theuriau. "We are experienced creators of core products, and that is a major competitive advantage." ■

PROFILE | Altarea Cogedim

Three potent principles: Diversification, asset creation and enterprise

When the economy is booming, real estate strategy is simple. One borrows and buys, prices go up, one sells and, with any luck, makes a profit.

The true test of a property developer's strategy is when times are tough. By that measure, France-based Altarea Cogedim, a real estate investment trust, has an outstanding record. Since the company was founded in 1995, its year-on-year cash flow has grown by double digits, including over the past three years, when many realtors were struggling.

"We emerged from the recent crisis stronger than ever," writes Chairman and Chief Executive Officer Alain Taravella in the current annual report. In residential property, his company's market share has doubled to about 5 percent of the French market in volume and more in value. In commercial property, Altarea Cogedim is No. 3 in France, with €2.4 billion ($3.3 billion) in assets, mostly in France, but also in Italy.

Altarea Cogedim's three strategic principles are enterprise, asset creation and diversification. "Our entrepreneurial spirit has characterized us from the beginning," says Eric Dumas, the company's chief financial officer. "All members of our management team share the same DNA. We focus not on tomorrow, but on the day after tomorrow in terms of product, positioning and marketing."

The emphasis on asset creation means that Altarea Cogedim is not a purely financial operation. It produces its own assets and products, and has grown exponentially from a starting point of €1 million in assets in 1995.

Diversification differentiates the company from its competitors. It is the biggest real estate developer in France, with a presence in all three property sectors: residential, retail and office. Competitors may have a significant presence in one or two of these businesses but not all three, because conventional financial strategy has favored focused growth in real estate.

Since the three market segments perform at different points in the real estate cycle, Altarea Cogedim enjoys the flexibility of moving and mobilizing its resources to best advantage. For example, last year the residential market in France was buoyant, the retail sector (shopping centers) was stable and the office market was at the bottom of its cycle. "We use financial flows from all three areas," says Dumas. "This gives us a unique position of strength because we can be resilient in bad times and dynamic in good times."

Altarea Cogedim sees long-term growth in residential construction in France's main cities, including Paris, Lyon, Nice and Marseille. "Our financial situation is such that we can take advantage of opportunities in the residential market as they arise," says Dumas.

In retail property, the company is developing shopping centers that reflect changing patterns of consumer behavior. Customers today are better informed about prices than ever, thanks to the Internet. Consequently, retailers are under pressure to provide value for money in bricks-and-mortar shopping. So Altarea Cogedim is concentrating on both large-scale regional shopping centers, such as Cap 3000 in Nice, and retail parks where rents are 60 percent to 70 percent lower than for space at conventional shopping centers. "These are not outlet malls," says Dumas, "but real shopping centers, where the customer can have a quality shopping experience but at a lower price."

With a few exceptions, such as hotels, the office market has bottomed out, says Dumas. Because of its diversified holdings, Altarea Cogedim can take advantage of new trends in the office market. "We are using our knowledge, experience and in-house technology to position ourselves well for the market upturn," he says. ■

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