APRIL 2009

# What impact is the credit crunch having on the logistical real estate market and how could this affect its users?

*Written by Mari van Kuijk*

Barely a half year ago, Bart Vink of DTZ Zadelhoff concluded that logistical real estate was a “safe haven” in the Netherlands. DTZ went even so far to give this name to their own annual real estate report. However the developments of the past six months have radically challenged this conclusion and provided more than good reason for many well deliberated decisions to be taken on rent (extensions) and/or the development of real estate. In the future, tenants should not be surprised if the building they are renting changes owner (out of necessity) or if discussions on the cost of rent do not come to an easily acceptable solution for both parties as a matter of course.

There are essentially four stakeholders for a real estate property that is not on the user’s balance sheet.

1. Bank: provides (part of the) capital for the investment and possibly funding during the development
2. Investor: provides personal capital for the property and collects the rent
3. Developer: realizes / develops the property
4. User: tenant of the property.

Although a company can perform more than one role and all kinds of other parties are present in this market, we will use these four stakeholders to describe what we can expect over the coming years. One conclusion is already clear: logistical real estate is certainly being affected by the credit crunch as well!

**Banks**

It was the banks that got the ball rolling. In response to the financial crisis, capital has become (extremely) scarce. Because real estate depends so heavily on capital, banks have become far less generous when it comes to financing real estate. In addition, banks are also tightening the reins in relation to risk. Up to just recently bank funding up to 80% of total project funding was not uncommon, banks have now been quick to start requiring a deposit up to 40 or 50%. Banks are crucial for the real estate market because no single property is financed purely using personal capital. However, the leverage of loan capital is necessary to make the relatively low-yielding real estate sufficiently appealing over other investments. Banks will also be looking even more keenly at the quality of the real estate, which means that superior real estate (locations) will still be the least inconvenienced by this.

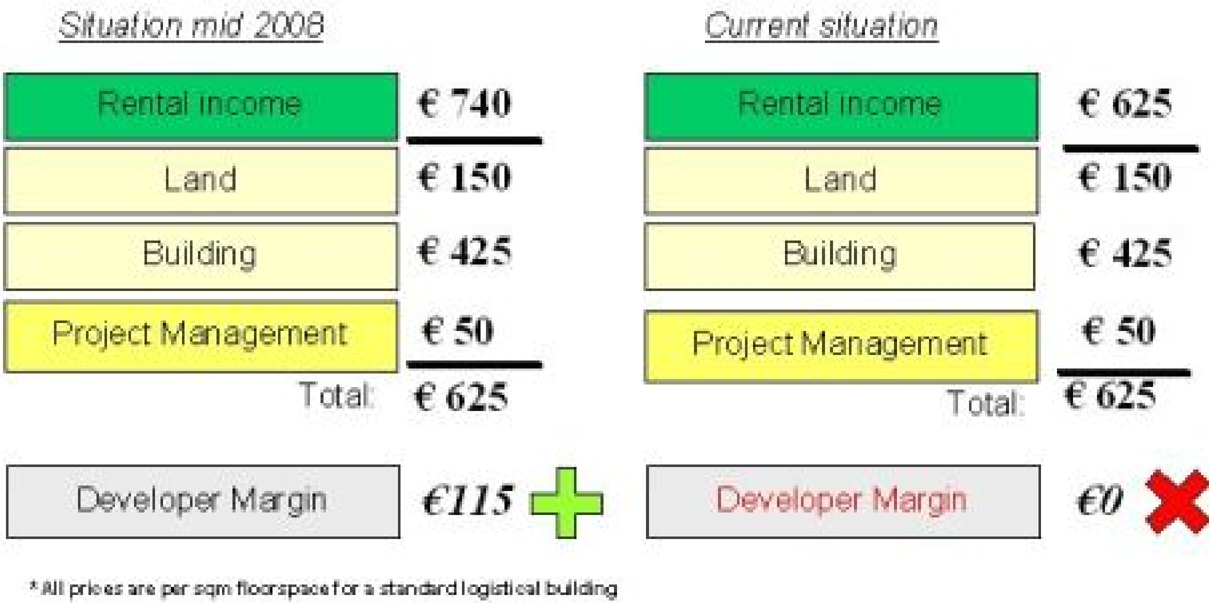
**Investors**

The investors will have to deal with a loan capital provider who requires more personal capital. This will mean that fewer premises can be purchased or developed with the same deposit. There is then the question of whether this will be interesting enough for (new) investors.

This also coincides with a broad-based devaluation of real estate, which started in the fourth quarter of 2008 as a result of the credit shortage. This is further exacerbated in 2009 with a deepening slump thanks to the decline in future rent flows because of the recession. In order to spruce up their balance sheets, additional repayments may be required by the banks, but investors are finding it difficult to acquire new capital in this market. What is more, the sale of one or more properties in the current market with falling prices is in itself a minor disaster. If this happens to also coincide with tenants going bankrupt, the latter anticipated being a somewhat frequent occurrence for 2009, you could witness the perfect storm. Therefore, the chances of some real estate investors finding themselves in major difficulties are unfortunately huge.

**Developers**

The developers have seen their world change dramatically in a short period of time as well. Their job is to develop premises, yet current market conditions are creating a situation where this is no longer financially viable. The upward trend of the Gross Initial Yield (GIY) means that developers cannot make a margin on new developments anymore. The enclosed figure showing revenues and costs per square metre reveals that they are operating at or below break-even level.




The only way in which developers will start developing again is if the price of rent goes up such that revenues (from rent) increase. However, in the current recession you can expect quite the reverse from users. Every company is looking at its costs, and this means its accommodation costs, too. The quest is for cheaper locations, not for more expensive ones. At present, charging a higher rent is completely unrealistic and therefore will not happen.

So, developers are halting their development activities (for the time being) and are waiting for better market conditions. This trend is highly visible already in that there have been no speculative developments since the fourth quarter of 2008.

Moreover, the rest of the new building development market (with tenants) is now starting to dry up in 2009. Only very specialised projects still have a chance of success because there are no alternatives available in the form of existing premises. Further demand will mainly be met by the market of existing premises.

An interesting position in this is occupied by the municipalities that grant industrial land. They too can improve the balance sheet by lowering the price of land. Of course, this is not good for the municipality's coffers in the short term, but it is consistent with a long-term approach for securing employment for the inhabitants.

**Users**
Finally, we end up with the tenants. In this grouping, the users have least problems, although this depends partly on whether you are a sitting tenant or about to become a new tenant. The point is that all stakeholders mentioned above need the tenants more than ever and this is the best position to be in, in the current market.

Sitting tenants can be confronted with a new owner of the real estate. This does not have to be a problem in itself, although the tenant (usually) has no say in such a sale. However buildings that are held by limited real estate partnerships require additional attention here. Important to watch for, of course, is whether it is a bona fide party and whether regular maintenance by the new owner will be continued in a decent manner. In addition, a change of owner may create possibilities to renew the tenancy agreement. Another opportunity in the current market lies in concluding new tenancy agreements, because a lot of real estate is becoming vacant.

**Scales tip in favour of the tenant**

Our opinion is that, to begin with, the scales are tipping in favour of the tenant, with the (average) level of rent in the market falling. At this present time, the cash flows from rental income are so crucial to investors that they have to settle for less in terms of the level of rent. A major additional risk in this market is that the investor and developer may run into trouble during the development. Do not underestimate the consequences that this could have for tenants. To overcome this risk, it may be worth considering handling the development in-house, thereby killing two birds with one stone. A solvent company in this finance market may find it easier to acquire capital at a more competitive rate than a property investor. What is more, you have a better overview of and handle on the risk management for the project. With a little bit of luck you will be able to sell your real estate at a nice profit in roughly five years when the market has settled down. If you are aware of the associated risks and this fits into your corporate strategy, it is a route certainly worth considering.

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