Prologis

Recently, ***Geoffrey Dobrmann****, publisher of The Institutional Real Estate Letter–Europe, spoke with* ***Gary Anderson*** *and* ***Guy Jaquier*** *of Prologis. The following is an excerpt of that conversation.*

It's been several months since AMB and Prologis joined forces. What were the driving factors behind the merger?

Jaquier: Our business models, cultures and approaches were just very similar. We were both US-based global firms. We both traded on the New York Stock Exchange, which dictates a high-level approach to governance and transparency. We were both vertically integrated operators focused solely on industrial. We both had a development side, as well as a private capital business. By becoming one entity operating on four continents, we are able to deliver better service to our global customers, which in turn allows us to provide our current and potential investors with fund offerings covering a broad risk/return spectrum. So it was a natural combination of those factors.

If the companies were so similar, what were the advantages of merging?

Anderson: It expanded our relationships with large, repeat multinational customers. Becoming one entity enhanced our common platforms in North America, Western Europe and Japan, and rounds out our market coverage. Legacy Prologis had businesses in the UK and Central and Eastern Europe, whereas AMB was in China and Brazil. It also improved our credit profile and cost of capital. Lastly, running a global network is expensive. Combining the companies created about 20 percent overall reduction in costs. In the end, it became very clear that the two companies combined were much stronger than either of the companies separately.

Although you say the cultures were similar, it's always a challenge to merge two companies. What are you doing to make the transition easier?

Jaquier: This merger brings together two great organizations to form an even stronger global industrial real estate company. We have approached it by pinpointing the strengths and weaknesses of each company, and building on the stronger components. For example, Prologis was historically a developer that became an investment manager. AMB was historically an investment manager that became a developer. Therefore, when we are outlining the best practices for our development activities, we lean more toward the legacy Prologis approach. When looking at investment management, we are adopting more of what AMB was doing.

What are the competitive advantages of the new Prologis?

Jaquier: On the operations side, the combined platform has about 600 million square feet under management on four continents. There is no other platform that can offer its customers the ability to deal with one service provider, owner/operator and developer on four continents. On the private capital side, we can offer an unparalleled array of products where investors can choose to allocate among mature and emerging markets, among global and regional geographies and along the risk spectrum from core to opportunistic. When you look at the risk/return spectrum and the different geographies that an investor can travel with us, there really is nobody else in the industrial space that can offer what we offer. In addition, investors can invest directly with an operator that has people on the ground — a unique opportunity we believe creates significant added value.

Gary Anderson, as Prologis' chief executive officer for Europe and Asia, oversees all aspects of business performance in Prologis' European and Asian operations.

Guy Jaquier is the chief executive officer for Prologis Private Capital. He oversees Prologis' private capital funds and joint ventures with leading institutional real estate investors.

ABOUT PROLOGIS

Prologis is the leading global provider of industrial real estate, offering customers approximately 600 million square feet (55.7 million square metres) of distribution space in markets across the Americas, Europe and Asia. The company leases its 3,500 industrial facilities in 22 countries to manufacturers, retailers, transportation companies, third-party logistics providers and other enterprises with large-scale distribution needs. As of 30 June, 2011, Prologis managed $48 billion in combined total assets.

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Anderson: It always comes back to the people. We've got 1,300 highly focused real estate professionals on the ground in all the markets that we're invested in. We truly are an operator. There is a huge difference between operators and allocators, and I would always put my money on the operators.

How do you balance the interest of shareholders against the interest of your private investors in your funds?

Jaquier: The REIT is always a significant co-investor — and many times is the largest investor — in every fund, averaging a 30 percent to 35 percent investor stake. There is no better way to align interest than co-investment capital. We have real money at risk at the asset level, so it is not an issue of paying attention to the private side and not paying attention to the public side. Shareholders and private investors alike benefit as we are focused on both.

How do you decide if a deal goes to the REIT or a fund?

Jaquier: First, the balance sheet will never take precedence over a fund. Second, our Investment Committee administers a formal Allocation Policy that ensures an equitable allocation process. When a deal is approved by the committee, we look through our list of funds, and if a fund has capital available for that market or that strategy, it gets the deal.

What is your philosophy in respect to risk management?

Jaquier: We believe risk can be managed if you pay attention. We know that leverage is bad in a downturn, so most of our funds are operating at 50 percent or less loan-to-value. We know that it is very difficult to manage risks that you don't know you have, and the best way to understand the risks is to have your people on the ground and in the buildings. That is where we think being an operator and having our own real estate staff is a distinct advantage.

We're still muddling along with the recovery. What does demand in the logistics space look like?

Anderson: Things have been looking quite positive. Rents and occupancies are moving up across the world, and customer sentiment is improving. Global trade is picking up and inventories are being restocked at a faster rate than you might think. Our occupancies increased 80 basis points last quarter. The most recent dip, however, might dampen our customers' enthusiasm, although so far we haven't seen a slowdown.

With all the sovereign debt problems in Europe, do you still see opportunities there?

Anderson: We've been dealing with the sovereign debt crisis for quite some time, and our business has improved quarter over quarter over quarter. However, that doesn't mean we haven't been affected. Although the need for space hasn't been impacted very much, the decision making process has become more drawn out. The guys on the ground who want more space have to make the case to an exec team that is more affected by macro forces and slower to ratify expansion. That does affect us.

Jaquier: Some European economies are doing very well. Many European markets did not get overbuilt in the last cycle, and many European companies have not seen the cutbacks that we have seen in some other markets. So it has been relatively stable during the downturn.

Anderson: During the past 25 years, there has been a shift of manufacturing from Western Europe to Central and Eastern Europe, as well as a trend in building pan-European distribution as opposed to resale distribution. That trend will continue for the next 20 or 30 years. The pockets that are particularly strong right now in Western Europe are Germany, France and Sweden. In Central and Eastern Europe, it's Poland. So we've got four markets that continue to perform very well. Other markets such as the Czech Republic, Slovakia and the United Kingdom are also improving.

You've mentioned that Europe wasn't overbuilt. Does that mean you'll be doing development, and if so, where?

Anderson: We will be building in the four strong economies that we've already mentioned, as well as looking at more opportunistic markets, such as Slovakia. It's a smaller market, but it's very tight right now in terms of logistics. As for build-to-suit, we are looking at places where customers can't get what they need unless someone with our development capability delivers it. Those places run the gamut with respect to market location.

Where do you see the opportunities in Asia?

Jaquier: The two big opportunities right now are China and Japan. China's growth story has been going on for a while, and we think it will continue for a while longer. The logistics networks and distribution space are a decade behind where they need to be. We see big development opportunities there. Japan has a different story. In the near term, the recent natural disaster has exposed the need for redundant facilities and heightened the demand for state-of-the-art, Class A logistics space. Longer term, the opportunity is being driven by a number of other factors, including the outsourcing of manufacturing to China and the shift to a more service-based economy. This has led to substantial growth in the 3PL market and an increased demand for modern logistics properties in key infill markets — stock that is relatively limited. With our portfolio in Japan, Prologis is uniquely positioned to meet that demand.

What types of strategies are you looking at in Central and South America?

Jaquier: Brazil is a really strong development opportunity with a growing economy and middle class and very little Class A logistics space. Mexico is also an interesting market. Despite the headlines, the economy — especially the manufacturing sector — is doing quite well. We are seeing fundamentals strengthening, with vacancy rates coming down and rental rates stabilizing, or even increasing, in places like Mexico City and Monterrey.

Finally, what are your prospects in the United States?

Jaquier: Vacancy rates have been coming down for the past several quarters. Rental rates have started to increase in some of the stronger markets and concessions have started to come down. Our customers are near capacity, so they are going to need new space. We have not seen much development, if any, in many markets, and that has been holding down vacancy rates. All of these factors make the US a very good place for logistics today.

Most investors seem to favour office and multifamily, with industrial far behind. What are you saying to potential investors about the industrial investment opportunity?

Jaquier: The recovery for industrials has indeed been lagging sectors like apartments, but this means that there is more upside in where we are with occupancies and rents.

Anderson: Generally, the industrial markets have stabilized and declines have begun to reverse. There has been no new supply in our sector for nearly three years, and markets are tightening as economies around the world are slowly recovering, and the need for additional space is growing. Besides the improving fundamentals story, investors like the fact that industrial is a high cash-flow business that has relatively stable occupancy levels.

What is the private capital side of the business doing over the next year or so?

Jaquier: First of all, we have a number of funds that are expiring, and we will be restructuring those relationships. We also have a few funds that we may be restructuring as growth vehicles. As far as new products, we expect to launch both a stabilized portfolio and a development fund focused on Japan, as well as a Canada fund. Our existing open-end funds in the United States and Europe have been quite successful in raising new capital, and we will be investing on behalf of those. So it will be a mixture of launching new funds and restructuring or winding up others.

Why are investors interested in Prologis today?

Jaquier: Investors have taken a step back about 10 years to a time when track record, values and ethical obligations mattered. Before the crash, some people got carried away with the excitement of the times and gave complete discretion to managers who were not career fiduciaries and who maybe weren't aligned as well as they should have been. Now investors want to have a good sense of who you are, what your values are, and how you handle yourself and other people's money. The executive team at Prologis goes back decades in this business. You can see what we have done, you can see how we view our relationships. We've made investment mistakes like everyone else, but you can see that we've handled ourselves ethically and took our fiduciary responsibilities to our investors seriously. I think that gets you something today. ❖