THE IMPLEMENTATION OF FOREIGN REAL ESTATE DEVELOPMENT OPPORTUNITIES: A CASE STUDY OF CANARY WHARF, LONDON

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SUBMITTED TO THE DEPARTMENTS OF ARCHITECTURE AND URBAN STUDIES AND PLANNING IN PARTIAL FULFILLMENT OF THE DEGREE MASTER OF SCIENCE IN REAL ESTATE DEVELOPMENT AT THE MASSACHUSETTS INSTITUTE OF TECHNOLOGY

AUGUST, 1987

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by ARA AFTANDILIAN and PATRICK CAMPBELL

Submitted to the Department of Urban Planning and Design and the Department of Architecture on 7 August 1987, in partial fulfillment of the requirements for the Degree of Master of Science in Real Estate Development.

ABSTRACT:

Canary Wharf is a current example of the implementation of foreign real estate development opportunities. In 1985, a consortium of American investment banks proposed the development of a financial office center outside the established city core, three miles east of the City of London. Canary Wharf was to include 12 million square feet of office and other commercial space developed over eight to ten years at a cost of £3 billion ($4.8 million). The project is located in the derelict Docklands area of London, where public economic incentives for redevelopment are being offered. The project aggressively seeks to fulfill recent surges in office demand from financial tenants, brought about by the deregulation of the London stock market and the emergence of London as a major international finance center.

An analysis of Canary Wharf and other previous and present American development attempts in foreign markets concludes that foreign development projects are more complex and more risky than local development attempts. Many non-development risks arise, relating to a foreign developer's lack of sufficient local knowledge. Other issues include political risk, exchange rate risks, taxes and other regulatory implications. The American developer seeking entry into foreign development markets must compare their skills and expertise to local competition and determine methods of compensating for deficiencies.

Some American developers have special skills and expertise which may give them a competitive advantage in foreign real estate markets. This expertise stems from experience with progressive projects in competitive and complex U.S. markets. But rigorous research into the additional risks inherent in foreign projects must be undertaken before it can be concluded that they will possess a clear advantage over local firms.

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ACKNOWLEDGEMENTS

The authors and the Center for Real Estate Development at Massachusetts Institute of Technology express their gratitude to Mr. J. Scott Lowry, Executive Director, and the entire Canary Wharf Development Company, Ltd. for their sponsorship of this study and the invaluable support and assistance they provided in the research segment of this work.

The authors also want to express their thanks to all of the real estate professionals interviewed during the research portion of this study. Over 50 professionals in Europe and North America, many of whom are not directly cited within, provided much of the information and opinions outlined throughout this thesis during numerous personal and telephone interviews during June and July 1987.

CHAPTER 1:

Introduction

In recent years the capital markets serving the real estate industry have become much more internationalized. Investment bankers and real estate professionals have discovered the benefits of tapping international capital markets for real estate development deals, acquisitions, and syndications. As a result, substantial savings in costs of capital have been realized through access to international capital markets. Similarly, many professional firms which consult to real estate developers, such as architects, planners, engineers, and others, have found that there is a strong foreign market for their services. They have been actively pursuing and receiving commissions in foreign countries for many years. Most American development companies have been and continue to be hesitant, however, to export their development expertise. This thesis seeks to explore why there have been so few successful international development projects led by American development companies. In the process it will also analyze the pertinent issues surrounding the implementation of American development expertise in foreign markets.

In the coming years, foreign development projects may prove to be more attractive to many North American development companies for a number of reasons. First, given the cyclical nature of most local real estate markets, overseas development skills and ventures may provide large development companies with an opportunity to geographically diversify, thereby reducing their risk exposure. Second, many economic forecastors feel that a considerable number of foreign real estate markets will grow at a more rapid pace than those in the U.S. and Canada. Third, U.S. developers may find that they have exceptional skills which may set them apart from, and ahead of, the local competition. Finally, as markets around the world become more internationalized, a development company's presence in many foreign markets may allow them the opportunity to provide special global services leading to a larger and more loyal international tenant base.

Many of the larger, internationally-known American development companies have attempted to develop projects abroad during the past ten to fifteen years. Some of these companies have been successful while many have experienced substantial difficulty and have not returned to foreign markets since their initial venture. Still, the exportation of American development expertise overseas appears to many real estate professionals to represent a tremendous future market for the American developer. In addition, we, and many other observers of the American development scene, believe that there are a number of distinctive traits which are relatively unique to the most successful real estate developers in the North American marketplace on which they should be able to capitalize in the global marketplace.

It was essentially this line of reasoning that led a small group of American investment bankers to establish the Canary Wharf Development Company in London in 1985. This group sought to construct a large, commercial office project which would total approximately 12 million square feet of space when built out over an eight to ten year period.

The master plan and organization of the Canary Wharf project sought to fully exploit the best traditions of the American real estate development process and to do so in a foreign environment where few competitors would be expected. The project was large by any standard, but in London it was considered gargantuan. One English professional summed up local opinion: "Only Americans would have the cheekiness to propose something like it."[1]

Besides the sheer volume of the project, the developers proposed a design scheme which was also revolutionary for London and quite consciously so. In classic American fashion, the consortium proposed that the project include the three tallest buildings in Europe in order to both lure prospective corporate headquarters and, "to establish the visual presence of the project on the London skyline."[2] They also planned to build a number of grand, new, urban spaces in the best tradition of Victorian London, including one which would be "twice as big as Trafalgar Square,"[3] and, would house the most state-of-the-art commercial office space in all of Europe. Building construction was to be accomplished in record-setting time due to the implementation of American fast-track construction management techniques.

The project resembled the most progressive American development schemes as it sought to fully exploit the local government's urban redevelopmnet incentives and relaxed planning policies. The Canary Wharf Development Company (CWDC) entered into what was essentially an English version of an American public-private partnership with the local London Docklands Development Corporation (LDDC). The CWDC benefited from the public agency's marketing efforts for the redevelopment of the Docklands area and an extremely streamlined planning approval process. Furthermore, they planned to take full advantage in their early marketing efforts of the effect the LDDC's property tax abatements and major infrastructure improvements would have on the project's bottom line. The initial office space was projected to cost approximately 40 percent less than the comparable center city rents due to the project's uniquely low land and taxation costs.

The marketing scheme for the project was agressive. Many conservative, native Londoners felt it bordered on brash - typical of an American response to the development of an innovative real estate project in a pioneering location. The Canary Wharf consortium felt that the project needed to: start with a bang; be perceived as progressing rapidly; and, maintain a high public profile in order to assure prospective tenants and public officials of the sincerity of the proposal. In addition, the consortium was very aware that the recent deregulation of the London stockmarket had granted them a narrow window of opportunity in which to secure prime tenants.

The Canary Wharf project was seen by locals as a good example of the implementation of American development expertise and the publicity of the project in the U.S. created envy among U.S. counterparts. The consortium was initially successful in its ability to proceed through immense political and economic barriers. Many locals labeled this a classic American "can do" approach. Unfortunately the project failed to live up to the expectations of the founding members of the development consortium. So great were the surprises that in July 1987, the entire project was sold to the Canadian-based, international development company, Olympia & York of Toronto, Canada.

This thesis will explore the special aspects and risks that were involved in this venture as well as other American ventures which were undertaken in foreign markets. It will analyze whether the Canary Wharf project is a good model for other developers seeking to export their development expertise. If not, what are the limitations which may be imposed on that expertise when going abroad?

Organization

An overview of the evolution of the London real estate market during the 1980's is initially provided. A detailed history of the Canary Wharf project is then presented as a case study. A retrospective history of previous American ventures abroad follows the case study, in order that analysis and conclusions may be drawn on a more general level. The analysis section then focuses on the evidence from the Canary Wharf project and other overseas development projects to examine the opportunities that were available to American development companies and their relative success or failure. Major non-market risks of foreign ventures are also analyzed including: exchange rates; taxation; regulation; and, cultural differences. Conclusions and recommendations follow. Possible areas of foreign opportunity are briefly outlined in the Appendix.

Methodology

On-site research was conducted during a two week visit to London and Paris during the months of June and July 1987. Many individuals, in both the public and private sectors, were interviewed. These included the management of the Canary Wharf Development Company and other individuals knowledgable with the London commercial property market. This research included site visits and a review of general commercial real estate practices and market conditions in London. Research was also conducted surrounding the events leading up to the October 1986 deregulation of the London securities markets, commonly referred to as the "Big Bang," and the specific effects of that deregulation on the local real estate market.

Questions posed to interviewees varied based on the specific expertise of the individual. Most interviewees were asked whether they felt Americans have specific areas of expertise or special skills that add value to development projects. Competitive advantages and disadvantages of American developers were also discussed including any possible barriers to entry. The ability of American developers to work within the standard development procedures of the London (or other foreign) market was discussed.

Research conducted in the United States included telephone interviews with American development and financial organizations who had been or were considering becoming involved with development projects in foreign countries. Development objectives and strategies were discussed in addition to personal and organizational experiences in foreign markets.

Scope

It is impossible to catalogue all of the prospective American developers who may have researched entry into the European market. It was difficult even to ascertain how many American development ventures were actually completed. Relatively few projects seem to have been completed at the time of this writing. Therefore, the evidence upon which this analysis is based is not extensive. However, some consistent trends and patterns had emerged from those offshore ventures which have taken place.

In order to attain a wider scope within this study, and to determine how a radically different culture may affect the success of foreign developers, on-site research was also conducted in Paris, France. In Paris, standard operating procedures for commercial development and the general Paris commercial market were reviewed, previous American attempts in this market were analyzed, and interviews were conducted with developers, chartered surveyors, and financial institutions.

We think that, although the examples cited throughout are primarily of development companies from the United States and Canada seeking to enter markets outside of North America, the lessons learned have general implications and could be applied to other international real estate development ventures.

CHAPTER 2:

Overview of the London Situation

The dynamics of the London office market changed greatly during the mid-1980's. Traditional methods of finance, design and construction were altered, sometimes radically, in response to changing market conditions. As demand for new office space grew rapidly, fueled primarily by demand from the the City's financial sector, rents skyrocketed and planning procedures were reluctantly loosened. In the process, the London market began to more closely resemble the office markets of many North American cities. This chapter provides a synopsis of the situation in London that the Canary Wharf Development Company encountered during its effort to develop the largest commercial project in Europe.

Rental Rates

The London office market, until approximately five years ago, had been quite conservative and placid. The Class-A market traditionally centered around the Bank of England within the historic City of London commonly known as "the square mile." There, large institutional banking, insurance and professional services firms traditionally sought to be located as close to the Bank as possible. Rent rates reflected these market forces.

Rents in London, relative to that of other world financial centers, have always been high. This has historically been attributed to the constriction on developable land proximate to the Bank and to the relatively limited supply of new space in relation to demand which traditionally resulted in very low vacancy rates.

Financing

Financing of London development traditionally was provided by large English institutions. Because cash-on-cash yields on class-A commercial office properties in the City were usually in the five to seven percent range, long-term debt financing had not been encouraged nor typically available to developers. Instead, most new projects were financed by short-term construction debt financing followed by a cash purchase of the completed project by an institutional investor, often an insurance company or a pension fund. Only a small percentage of properties were held by developers after completion and initial rent-up because of the large equity commitment required.

Financing constraints also effected the development of London in other ways. In addition to the financial arguments against debt financing because of the negative leverage or the "reverse yield gap" as it is called in England, most of the large institutional investors have been philosophically opposed to funding real estate debt. The real estate crash of 1973-74 caused a number of highly leveraged young developers to default on City properties and left their institutional lenders with a portfolio of overvalued assets. Commercial mortgages from institutional lenders had been practically non-existant since that point.

Institutional equity commitments for long term financing of specific projects usually came in the form of a "forward purchase commitment." Developers, unless they were highly capitalized themselves, had trouble securing construction loans without this takeout commitment. This financial leverage enabled institutions to exert a considerable amount of control over the entire development process. Many experts on the London real estate market felt that institutional conservatism was largely to blame for the lack of mixed-use projects, the relatively mundane architecture of most large office buildings and the limited scale of new development projects.

A number of related factors led to an effective cap on the size of new real estate developments in London of £50 to £100 million (approximately $80 to $160 million). First, British law prohibited a fiduciary from commiting more than five percent of a fund's assets to any one property investment. This restricted the pool of large, potential take-out sources to about six insurance companies and a similar number of pension funds.[4] Second, institutional investors typically have never been interested in pooling their funds to jointly finance a very large project. Most are very concerned with issues of control. They are reluctant to turn over control of their funds or their property to either a joint-venture partner or to an investment advisory firm. Third, relatively small projects on small parcels were considered easier to assemble and get through the planning approval process. Fourth, by their very nature smaller properties entailed less risk to the institution. Finally, development financiers did not feel there was much demand from tenants for very large buildings. This last point is the one which institutional investors liked to stress in defense of their real estate investment decisions.

Regardless of the true causes behind the limitations on the size of long-term real estate financing commitments in the U.K., the system continued to work reasonable well until the early 1980's, when, new forces upset the traditional process. First, institutions on their own or with the advise of portfolio analysts began to cut back on real estate in order to reduce that portion of their investment porfolio. More and more money was channeled into corporate equities and government-backed securities. Around the same time the market for office space began to change as tenants sought larger blocks of space within class-A buildings. The most far-sighted developers perceived this shift in demand and began to develop larger projects without long-term financing commitments. Some of the earliest large projects (£100 million or greater) were financed by extremely rich development entities which could essentially fund the development themselves. But others were built with commercial construction loans and only the hope of a long-term financing scheme.

Two competing long-term financing schemes had emerged since 1984 and both were being pioneered at the time of this study. The first involved the securitization of a project and the sale of commercial paper, commonly in the form of deep-discount bonds, preferred stock and common stock shares, with varying risk and return profiles. This market was being created by the large international investment banks. The £79 million syndication of Billingsgate/ Montagu House by

Goldman-Sachs in 1986 was the first application of this new vehicle. The second scheme was one which was being promoted by a number of London banks and large property services firms such as Richard Ellis. It was a uniquely British product known as Property Income Certificates (PINCs). This vehicle took advantage of certain aspects of British property law in order to create "unitized" shares in a large property's income stream. Both schemes had generated vociferous promotion by their proponents, and criticism by the opposing camps. But, no matter which vehicle was finally adopted, it seemed clear that the real estate finance market had radically changed.

Planning

Planning within the City, especially during the past 10-20 years, had also been quite conservative. Relatively slow growth in office space demand permitted the city planning officials the luxury of slow review and approval of new building proposals. Most planners in the City were averse to any new construction proposals which required the destruction of older Victorian buildings regardless of the older buildings' architectural merit. They also opposed projects that would alter the traditional scale of the City's urban fabric.

Not until 1985, with the deregulation of the London stock market impending, and after a number of highly respected planners had predicted that office demand in the City was burgeoning and could not be met within the constraints of the current planning restrictions, did the City of London planners consider loosening their development restrictions. It was between the time that the revised planning guidlines were proposed and their eventual adoption into law in late 1985 that the Canary Wharf proposal was first made public.[5]

London Docklands Development Corporation

The London Docklands Development Corporation, created in 1980, was given the mandate to facilitate and promote the economic redevelopment of approximately 8000 acres of obsolete and abandoned dockland in the East End of London. These docklands were primarily located on the north bank of the Thames and extended from the Tower of London 12 miles downriver.

The LDDC was granted a wide array of distinct powers and attributes all designed to promote redevelopment. Perhaps the most notable incentive was the establishment of an economic Enterprise Zone on the Isle of Dogs in 1982. Within this zone, in the center of the Docklands, all property taxes on new developments had been waived until 1992. In addition, 100 percent capital cost allowances were available in the first year for all new construction. These allowances, somewhat similar to U.S. investment tax credits, could be used to offset U.K. taxable income. These features were potentially worth millions of pounds in savings to property developers.

The entire Docklands area also provided developers with "one-stop" planning approval. The LDDC had superceeding power over the planning agencies of the four greater London bouroughs in which it was located and over all other planning districts which might normally claim jurisdiction over development proposals. A number of other onerous requirements, restrictions and surcharges had also been waived for potential development proposals in the area. The only borough-imposed stipulation which still applied was that all new structures conform to existing local building codes.

Economic incentives and the cutting of much bureaucratic red tape led to rapid redevelopment of the Docklands. When coupled with a very desireable location within the London metropolis, substantial public infrastructure improvements and the dynamic and charismatic leadership of Reginald Ward, the Executive Director, the pace of the Docklands rejuvenation was much faster than ever hoped.

Office Demand

Coincident with, and by no means independent of, this rapid growth in London docklands real estate had been a tremendous growth in office demand in the City. Much had been written about the deregulation of the London stockmarkets in October 1986, which was commonly referred to as "Big Bang." But commercial space demand by large banking and institutional tenants had already started to grow substantially two to three years before "Big Bang." This led rents to increase rapidly in the five year period from 1982 to 1987.[6]

As real estate costs in the form of both rents and property taxes began to rise sharply in the early 1980's, many tenants in the City began considering moving some of their operations out of the center of London. The newspapers were among the first to relocate their production facilities to the Docklands. Many other institutions followed. The first tenants to move were usually "back-office" or blue-collar production functions. Gradually, many small professional firms also found themselves being driven out of the City by high rents. Many of these companies soon discovered to their delight that they could occupy class-A new space in the docklands for less cost than the class-B space they abandoned in the center city. This rent-induced displacement probably did contribute substantially to the Docklands boom.

Relatively early in the Docklands rennaisance, many British developers became excited about the prospect of housing back offices and small professional firms in relatively low-density new construction in the docklands. However, none of them seem to have ever seriously considered luring the front offices and headquarters of major institutions to a high density development there. Many of them had been very successful at completing and filling two- to six-story office and light industrial structures in the Docklands, especially in the Enterprise Zone. At the time of this writing, a second generation of denser developments was also under construction by local developers. These projects were primarily mid-rise structures and were also speculative in nature. However, there was still considerable doubt whether the Docklands area could be a headquarters location versus back office space.

Although most of the developers, chartered surveyors, and planners in the City believed in June 1987 that the market was still very strong and would continue to remain so for at least the next few years, no rigorous econometric analyses were available to substantiate their intuition. None of the individuals that were interviewed knew of any current research which projected future demand based on underlying economic factors. Instead, these bullish demand reports were sustantiated primarily by intuitive analysis of macroeconomic factors or by extrapolation from survey interviews of various large tenants. All of these bullish projections generally concurred that the City would be able to absorb all of the new space presently under construction while maintaining healthy vacancy rates of less than five percent at least through 1989 or 1990. But analysts were much more leery of the vast number of new projects in the pipeline proposed for completion in three to five years.

Current Development Strategy

If all of the projects currently granted preliminary planning approval in the City were expidited and brought on line around the same time, the market might very well be flooded by 1991. For this reason and possibly others, most of the "old-line" develoment companies in London presently seemed willing to sit out most of the current development opportunities. Instead, the new, large projects in the City were being developed primarily by young and aggressive companies. The old, established companies appeared quite willing to sit back and enjoy the extrordinary increases in rents, cash flow and capital value which the current boom was causing. They were still building an occassional project, perhaps to keep their development staffs working, but their current strategy seemed to be to accumulate cash and wait.

The consensus leader among the new, young developers was a partnership known as Rosehaugh-Stanhope. This consortium was led by a developer, Stuart Lipton, and a financier, Godfrey Bradman. Their current flagship project was known as Broadgate: an office and mixed-use project over British Rail air rights at Liverpool Station. Built in multiple stages of from 100,000 to 650,000 square feet between 1986 and 1990, it was to total approximately 4,000,000 square feet upon completion.[7]

Broadgate set the standards for new London development in a whole range of areas. Stuart Lipton had taken the opportunity during the 1970's to spend a couple of years in the United States and study U.S. development methods. He had successfully imported fast-track construction techniques to the English market and was acclaimed for setting records for the brevity of his construction schedules. He had been impressed by the quality of design and professional expertise of the large American design firms, and had commisioned Skidmore, Owings and Merrill of Chicago to design the majority of the Broadgate project. The marketing center at the project site employed a state-of-the-art multi-media presentation which was as impressive and glitzy as anything currently in use in the U.S. The actual marketing of the development started very early, was aggressive, and was responsive to potential tenant's individual needs. As a result of this approach, Broadgate had leased space or garnered commitments from some of the largest investment banking and trading firms in the City, at rents much higher than originally projected.

Broadgate, while probably the leader in most of the new development processes being implemented in the city, was by no means the only American-style project currently under construction or on the drawing boards. In 1987, more and more developers were coming to terms with formerly recalcitrant labor unions and the pace of the construction process was markedly increased. They began to solve the problems of financing which had previously limited project size. The market began to accept pre-lease commitments, a hitherto unknown and utterly untenable concept. Some space commitments started to happen even before ground had been broken for the project because the tenants realized that it could offer them additional leverage in a hot market and could afford them substantial design imput. And, while the new developers were successfully innovating, the City planners were permitting more, larger, and more progressive projects.

Changing Market Conditions

The London development market changed a great deal between 1980 and 1987. It had grown a great deal more dynamic, more innovative, more expedient, and more responsive to market demands. It was growing more similar to that of the United States and Canada. This change and growth of the London development market would have major implications for American and other foreign developers who would seek entry. Clearly, the market now accepted a new, more innovative product. Thus, foreign developers with expertise in this type of product might have an advantage if they entered the market. However, since real estate is a business where temporary imbalance between supply and demand are often exploited quickly, this window of opportunity for American, and other foreign, developers could close just as rapidly. Any temporary competitive advantage that American developers held in terms of design, construction, finance, or marketing expertise rapidly faded as U.K. developers quickly adapted to changing market demands.

CHAPTER 3:

Canary Wharf, London, England: The Case

The Context

Canary Wharf is one of the largest, private commercial real estate development ventures in the world and the first attempt by American interests to develop a large-scale commercial project in Europe. The site is located on the former West India Docks, on the Isle of Dogs, approximately three miles east of the City of London along the River Thames.(see Exhibit 1.) The original master plans for this 71 acre site include a total of over 12 million gross square feet of space with an estimated project budget of £3 billion (approximately $4.8 billion).

Canary Wharf represents an optimistic attempt to meet tenant demand in the City of London as it matures into one of the three international financial centers in the world alongside New York and Toyko. In October of 1986, London's stock market was deregulated, culminating a five-year evolution of the City's financial services industry. The deregulation had been presaged by burgeoning growth in both the volume and the number of players in London's Eurocurrency, Eurobond, and Euronote markets. By 1985, the number of foreign banks with

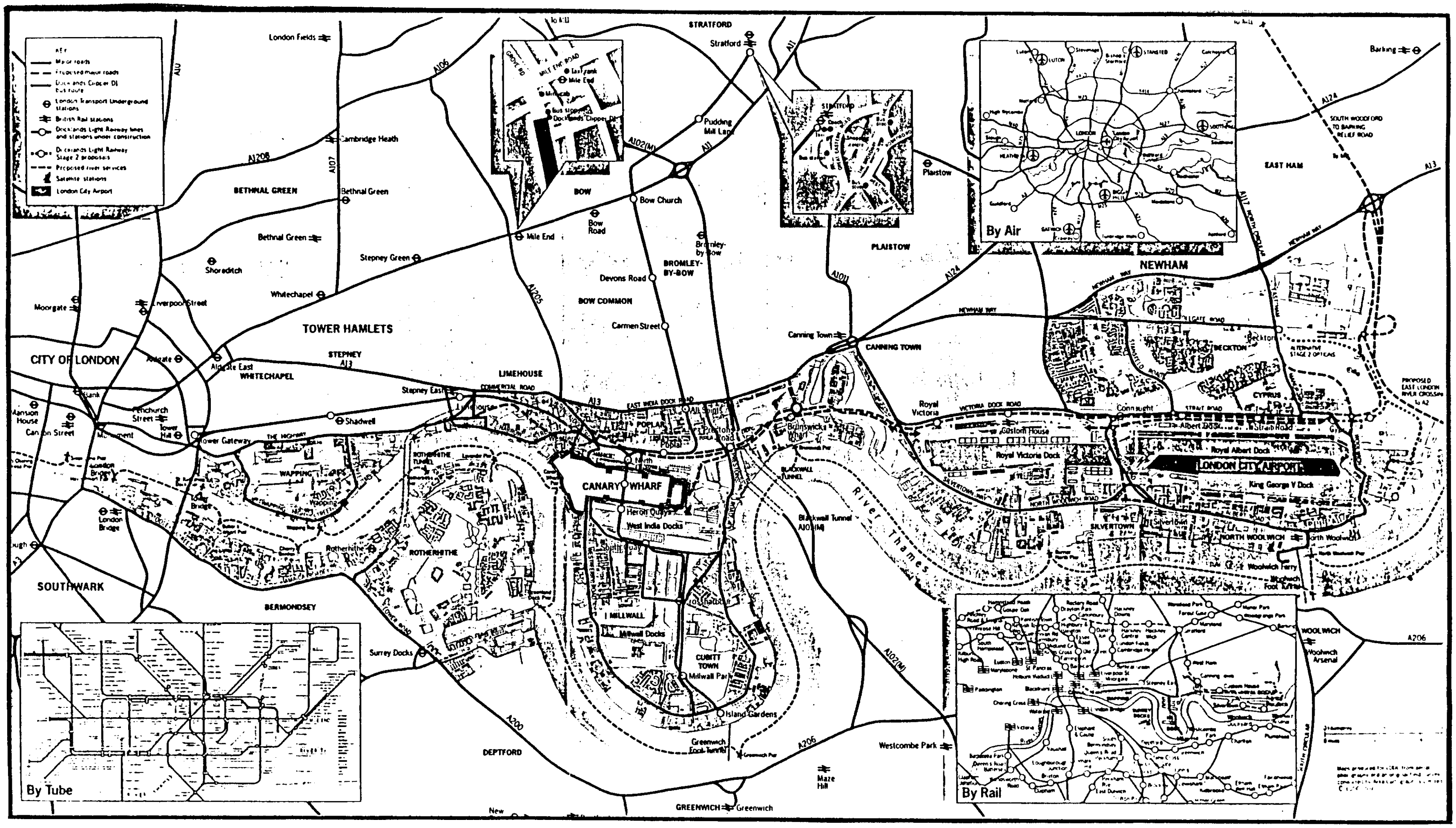

London Fields
STRATFORD
Stratford
Barking
Cambridge Heath
BETHNAL GREEN
Bethnal Green
Mile End
Bow Church
Pudding Mill Lane
Plaistow
EAST HAM
SOUTH WOODFORD TO BARKING RELIEF ROAD
By Air
Bow Road
Bromley-by-Bow
BROMLEY-BY-BOW
PLAISTOW
NEWHAM
Stepney Green
Shoreditch
Devons Road
BOW COMMON
Whitechapel
Moorgate
Liverpool Street
TOWER HAMLETS
Carmen Street
Canning Town
CANNING TOWN
BECKTON
CITY OF LONDON
Aldgate
Aldgate East
WHITECHAPEL
STEPNEY
LIMEHOUSE
Stepney East
Shadwell
Mansion House
Bank
Fenchurch Street
Tower Hill
Cannon Street
Monument
Tower Gateway
WAPPING
Wapping
POPLAR
Poplar
All Saints
Preston Road
Brunswick Wharf
Royal Victoria
Custom House
Royal Victoria Dock
Connaught
Albert Dock
Royal Albert Dock
LONDON CITY AIRPORT
King George V Dock
CYPRUS
PROPOSED EAST LONDON RIVER CROSSING
London Bridge
ROTHERHITHE
Rotherhithe
CANARY WHARF
Heron Quays
West India Docks
Blackwall Tunnel A102(M)
River Thames
SILVERTOWN
Silvertown
NORTH WOOLWICH
North Woolwich
Woolwich Ferry
Woolwich Foot Tunnel
SOUTHWARK
BERMONDSEY
MILLWALL
Millwall Docks
CUBITT TOWN
Mudchute
Island Gardens
Surrey Docks
WOOLWICH
Woolwich Arsenal
A206
A200
DEPTFORD
Greenwich Foot Tunnel
Westcombe Park
Maze Hill
GREENWICH
Greenwich
New Cross
By Tube
By Rail
A13
A11
A12
A102(M)
A124
A1011
A1208
A107
A106
A205
London City Airport
Docklands Light Railway
British Rail stations
London Transport Underground stations
Major roads
Proposed major roads
Proposed river services

Exhibit 1: Canary Wharf Location[8]

offices or other represention in London had grown to 463, exceeding the totals of both New York and Toyko. Over 200 domestic banks were also operating in the City. In addition, the average daily volume of currency trading in London had also begun to exceed the volume of both New York and Toyko ($60 billion according to an early 1985 survey by the Bank of England).[9] The London Stock Exchange's "Big Bang" and London's growing presence as an international financial center had caused an incredible increase in demand for office space by financial institutions.

The Henley Centre for Forecasting, the largest independent research group in Europe, estimated in 1985 that the annual average compound growth in the number of City of London jobs could exceed four percent over the next ten years due to Big Bang. If correct, that figure would translate into over 200,000 new City jobs, of which 60 percent would be in the financial services sector.[10]

In addition to the amount of new office space needed to meet the demand for projected employment growth, a new type of office space was needed as well. The large financial conglomerates seeking to do business in London required sophisticated office space, and they prefered that it be all under one roof. Buildings which met the needs of these tenants needed greater floor-to-ceiling heights to accomodate the cabling and HVAC systems necessary to support new technology, large open-spanned floor spaces for trading floors, and links to sophisticated telecommunications networks.

In early 1985, it seemed implausible that the City of London, specifically the historic center known as the "Square Mile," could accomodate either the quantity or the type of space required by these financial conglomerates. Historic conservationists and city planners had made development difficult in the city. Large developable sites were very difficult to secure, and if sites were secured, planning constraints prevented the amount of floor area that could be built. Into this dynamic market stepped the Canary Wharf Development Company.

The Genesis of the Project

Canary Wharf was first envisioned as a potential office site in early 1985 by Dr. Michael von Clemm, then chairman and chief executive officer of the London investment bank, Credit Suisse First Boston. He was looking at the blighted Docklands area as a site for a food processing plant for one of his private restaurant ventures. But instead, von Clemm, now chairman of Merrill Lynch Capital Markets, serendipitously saw the derelict warehouses, with large floor spaces, as possible trading floors for CSFB's growing London office space needs. The possibility of developing office and trading space to satisfy the requirements of financial tenants on the Isle of Dogs within a couple of miles of the London financial center, interested him enough to pursue the idea further.

Von Clemm soon contacted Archibald Cox, Jr., Managing Director of Morgan Stanley International, who was facing similar problems satisfying Morgan Stanley's office and trading space needs within the city. Cox did not share von Clemm's initial optimism for the site. Instead, he argued that substantial improvements to the area's infrastructure, especially the road and rail networks, would be required to successfully develop financial offices on the Isle of Dogs. Cox also felt that two to three million square feet of office space was required to achieve the critical mass, necessary to justify these infrastructure expenses. However, both of the firms' space needs were significant enough for the idea to advance to the next stage.

The primary lure of the site was probably the preexistence of the London Docklands Development Company (LDDC). To proponents such as the LDDC, the Docklands area represented the logical direction of city growth over the next few decades. The vast amount of land and water area within this industrial wasteland provided an exciting urban redevelopment opportunity in light of London's present and projected employment and residential growth. The Docklands area was not without problems, however, particularly in terms of access. But the LDDC and the Department of Transportation had planned to commit huge sums to the area's infrastructure, including over £500,000,000 ($800,000,000) on roads in the Docklands. The Docklands Light Railway (DLR) was also scheduled to begin operations in 1987 and it would provide direct rail service to and from the City of London. Other area transportation improvements would include the new London City STOLport (Short Take-Off and Landing airport), which would provide quick, direct service to many European cities when it began scheduled operations at the end of 1987.[11]

In early 1985, von Clemm contacted G. Ware Travelstead to obtain his imput on the project idea. Travelstead had been educated as an architect but had never received his license. He had, instead, formed his own interior architecture and design firm, The Travelstead Group. Based in New York, they specialized in investment bank trading space and other high-tech corporate interiors. Travelstead had also been affiliated with First Boston International's real estate division for nearly ten years, most recently as senior property advisor. Later von Clemm would state that it was Travelstead who conceived Canary Wharf as "the new Jerusalem."[12] By this he meant that Travelstead envisioned the transformation of the design program for Canary Wharf from being just a home for overflow office space for two investment banks to the current master plan of 12 million square feet of mixed-use, high-rise development. With this vision to rally around a development consortium was established.

The Organizational Structure

The Canary Wharf Development Company, was formed in 1985 as an American consortium comprised of First Boston International, The Travelstead Group, Credit Suisse First Boston, and Morgan Stanley International. G. Ware Travelstead, was chosen to head the consortium as Chairman. Each of these players had somewhat different motives for enlisting in the project, but they all shared two common interests: the lure of substantial profits and the ability to leverage the success of the project to increase their own prestige in the real estate development field.

Each of the consortium members believed the precursor elements of a profitable real estate venture were present. The financial revolution in London had created a huge demand for sophisticated office space and this demand was projected to continue, unabated, for some time. It was also clear from the experience of Credit Suisse First Boston and Morgan Stanley that securing large amounts of sophisticated office space in the City of London was difficult and would probably remain so. In addition, the consortium members were beginning to feel that having a downtown London address was no longer critical in light of recent telecommunication innovations. They felt that the huge influx of foreign banks, which were then flooding into London, did not hold strong, preconceived ties to center city locations.

In addition, the unique benefits of building under the umbrella of the LDDC in the Enterprise Zone made the project even more attractive to the consortium of investors. Working in concert with the LDDC would give the American consortium access to the local political knowledge and support that it severely lacked. Of primary importance was the fact that the LDDC would expedite the planning approval process. Given the historic difficulty of this process in London and the consortium's lack of local representation, this was considered critical. The substantial (but temporary) property tax and capital allowances which were available within the Canary Wharf site were also assets which could be utilized. With these benefits, coupled to Travelstead's vision, they embarked upon an aggressive design and marketing program in mid 1985.

A team of premier consultants was quickly assembled by the development company. The Chicago office of Skidmore, Owings & Merrill (SOM) was commissioned to execute the master plan of Canary Wharf in conjunction with consulting architects I.M. Pei & Partners, New York and associate architects YRM Architects & Planners, London. SOM was also commissioned by Morgan Stanley to design their building, while Credit Suisse First Boston commissioned I.M. Pei for their structure. The Canary Wharf Development Company also commissioned Kohn-Pederson-Fox of New York to begin schematic design of the first high-rise office tower which would reach a height of 850 feet. James Stirling, a prominent UK architect, was commissioned by the development company to design a 500,000 square foot building for an unnamed client/tenant.

Other members of the project design team included: landscape architects, Hanna/Olin, Ltd., Philadelphia; their consulting architects, The Sir Basil Spence Partnership, London;

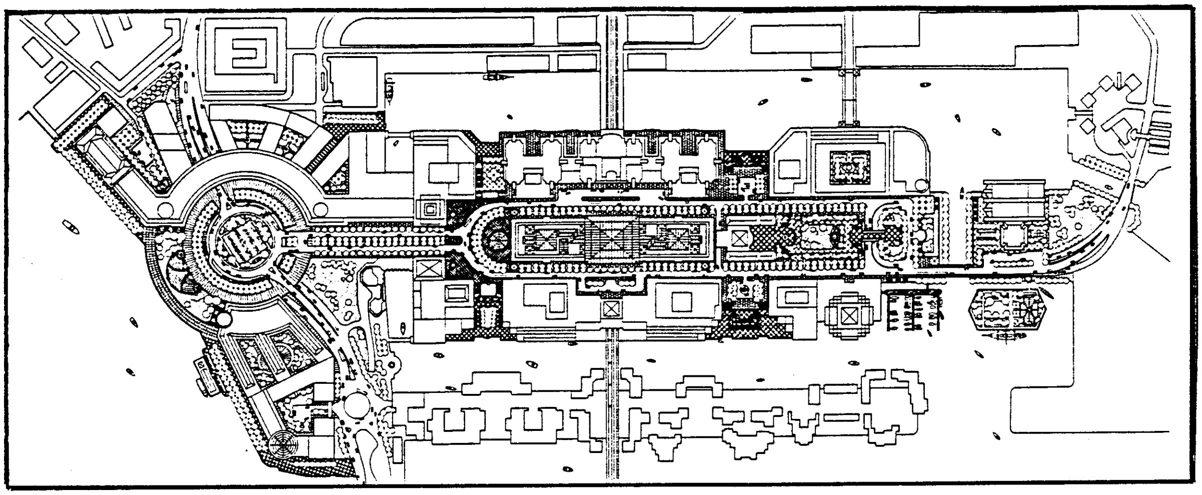
transportation consultants, Steer, Davies & Gleave, Ltd., London; and, civil and structural consultants, Ove, Arup & Partners, London. Bechtel Great Britain Ltd., London was designated the construction manager. They were to oversee the five largest construction companies in Britain: Taylor Woodrow Construction; Costain UK; Laing Construction; John Mowlem & Co.; and, Sir Robert McAlpine & Sons, which had been organized into a joint venture, Canary Wharf Contractors, for this endeavor. Leasing agents for the project included Savills, Richard Ellis, and Fletcher King, three prominent chartered surveying firms in London.

The Design Concept

The project was consciously designed to be of the highest quality in all aspects. The design of the building exteriors, the materials with which they were to be clad, the layout of all public spaces and all of the amenities to be provided to both the workers and the visitors to Canary Wharf, were to rival the finest available anywhere in the world. State-of-the-art building interiors and mechanical systems were designed to flexibly accomodate changing tenant needs. Planning of the site revolved around the desire to create a new urban district which would appear to be a natural evolution of traditional London city design, while beneath the streetscape, a complex system of roadways, and service areas would permit efficient operation of a dense, new complex. The mix of uses in the project were also arranged so as to promote both business efficiency and the dynamic, spontaneous pleasures of a complex urban environment.

To maximize the developable water frontage of the project and to insure it's efficient operation, the entire complex was organized around a six-story parking/service/circulation spine which would rise to six stories. On top of this spine, which crested at a height of approximately 80 feet above the water, would be built the main roadways. This exceptional height was dictated by a decision made early in the site design process. The planners decided the development would have to be built over the new elevated railway line which crossed the site. Individual buildings built later would "plug into" this service spine and have their main entries at the "ground level" 80 feet above the water. (see Exhibits 2 & 3.)

Exhibit 2: Canary Wharf Site Plan[13]



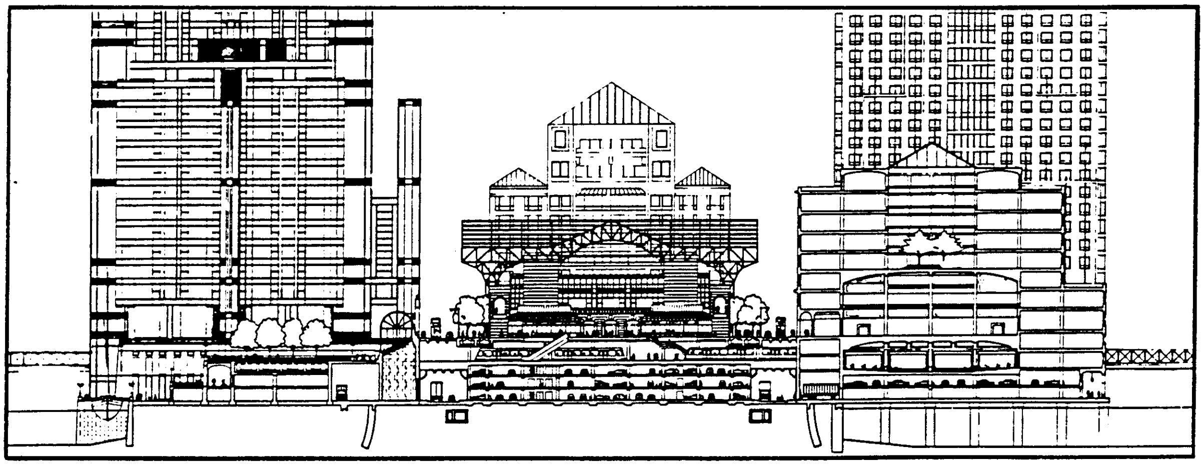


Exhibit 3: Canary Wharf Project Section[14]

Although the pro rata cost of this service core was reasonable, given the total square footage to be built, the design phasing dictated that a very large chunk of the infrastructure (approximately £300 million, or $480 million) be built first.[15] Some members of the design team recalled being concerned about this but that the developers assured them that their financial analysis showed the project could still be funded with this design.

In addition to the large upfront costs of the site infrastructure, the development company, as part of the negotiations with the LDDC, had also pledged to contribute £47 million ($73 million) to the budget for the construction of a tunnel extending the new rail line to London's existing subway system at Bank Station in the center of the city.[16] Because of the public perception of poor transportation access to the site, both the LDDC and the project designers considered this extention critical to the long-term success of the development.

A high-speed water taxi service was also scheduled to commence operations and provide direct access from the City of London to the Docklands as soon as the first buildings at Canary Wharf were completed. However, even with planned improvements to the Docklands' transportation infrastructure, many public and private critics felt that access to the Canary Wharf site would be very difficult, especially during the initial years following tenant occupancy. The consortium's transportation consultant projected in 1987 that for the Canary Wharf transportation access to work effectively, 70 percent of all commuters would have to use the rail system. The issue of accessibility to the site continually threatened to become the project's Achille's heel. There was little doubt among most of London's real estate professionals that, in the long-run, the Docklands area would become a thriving and successful commercial and residential area. However, resolution of transportation problems during the next few years, the crucial years for the success of Canary Wharf, remained uncertain.

Critical Events

A turning point occured in early 1987 when the LDDC and the Canary Wharf consortium announced that they would soon be signing the project's Master Building Agreement (MBA). The MBA represented the point of no turning back for the consortium. When it was signed, title to the project site would be conveyed to the developers in exchange for a £300 million commitment to assure the completion of the first phase of the project and the £47 million commitment for the railroad extention. All of the parties were eager to sign and get the project underway except for one problem; not one prospective tenant had commited to leasing space. Even Morgan Stanley and Credit Suisse First Boston were waiting to see if anybody else would be brought on board. The search for tenant commitments and the signing of the MBA turned into a "catch-22" situation. Prospective tenants were waiting to see whether the development company was willing to commit some serious money to guarantee that the project would be built. The developers were waiting for lease commitments before they would sign. What the development partners felt was just good business sense, the public and the market began to perceive as a case of cold feet.

To make matters worse for the consortium, since their project had been announced in 1985, the City of London planners had substantially loosened their planning controls. By 1987 a flood of new project approvals in the City had some real estate analysts beginning to suggest that there might be a glut of new office space in London by 1990 or 1991.[17]

In addition, in 1987, the Canary Wharf project no longer stood alone as a lower-cost alternative to prime center city locations. Following, or concurrent with, the Canary Wharf initiative, many local developers began to build first-class office space in the Docklands and in the fringe areas of the city. All of these projects were being designed to attract sophisticated users with many of the same technological advances planned for Canary Wharf. One such Docklands project was London Bridge City, a 2.5 million square foot office, retail, and residential project located on the southern bank of the River Thames across London Bridge. Begun in 1984, the second phase of this project was already under construction in 1987. A similar successful development, although not within the Docklands, was built by Greycoat Development over the Victoria Station in the West End. That site had also been considered an unacceptable front office location until Salomon Brothers moved their entire London office there in 1986. Phase II of the project was scheduled to begin in 1988. Other projects within the Docklands were to be located in the Royal Docks area, adjacent the new London City Airport. At the same time, Rosehaugh Stanhope and London & Edinburgh Trust, two prominent UK developers, were competing for a major site on the Royal Albert Dock. Rosehaugh Stanhope had proposed a £750 million ($1.2 billion) office, retail, and marina project for the site.[18]

Mixed Motives

The profit motive, common among all of the partners in the consortium was accompanied by a variety of other motives held by the individual participants. Credit Suisse First Boston and Morgan Stanley's primany interest was to satisfy current and future office space needs. Their primary profit would be realized through the substantial reduction in occupation costs that Canary Wharf offered in comparison to rents in the City. For them, profits and allowances from the development deal were secondary. In the initial conception of the deal, the opportunity for developmment rewards justified the risks. However, as the deal grew larger and more complex, and as the project delays due to the a lack of lease commitments continued, it became apparent to both these investment banks that the risks of the development deal were no longer justified. By June 1987, both of the investment banks had decided to withdraw from the development consortium, but they had continued to maintain their verbal lease commitments to the remaining partners, First Boston and Travelstead, if the project went ahead.

The motives of First Boston International and Travelstead also went beyond the initial profit incentive. Travelstead must clearly have seen this as an opportunity to make a name for himself within the international real estate marketplace.

His company, The Travelstead Group, prior to this endeavor, had never managed the construction or leasing of a commercial project in the United States or anywhere else in the world. They had acted as a consultant to First Boston on some of their development site acquisitions. But they had always relied on a real estate development partner to manage the building and leasing phases. Many observers in both London and New York speculated that this venture was an excellent opportunity for him to create quite a name for himself within the international development community and to generate substantial net worth by leveraging the vast financial resources of the other consortium members.

First Boston at the time of Canary Wharf's inception had also very little involvement in commercial development. The firm had a sizeable real estate investment portfolio, but the majority of this portfolio consisted of completed commercial office buildings in New York City. According to senior executives affiliated with First Boston, the organization was primarily interested in the Canary Wharf deal because it was a unique opportunity to reap a considerable profit from the unfulfilled office space demand within London's financial community. However, they also acknowledged that their lack of experience in new, commercial development, especially development of this scale, led them to realize that they had lacked a complete understanding of the complexities of the deal. Unconfirmed reports from within the organization have suggested that it was First Boston's senior administration that eventually ackowledged that the consortium, as it was then organized, might be unable to pull the project off. They urged the operating partners to look for a new joint venture partner who possessed significant development experience.

In July 1987, it was announced that the consortium planned to sell its interest in the project to the Canadian-based development company, Olympia & York. One week later Olympia & York signed the MBA with representatives of the LDDC.

Current Status

The status of the project, subsequent to the July 1987 sale to O&Y, was uncertain. There was speculation that Olympia & York would make substantial changes to the design of the project. Possible changes included building lower towers, reducing the height of the spine and restructuring the phasing of the project to reduce the initial infrastructure costs.

Initial reports in the real estate press speculated that the substantial financial strength of O&Y, a privately-held company with assets estimated to be worth US$7 to 10 billion had allowed them the luxury of signing the MBA without signed pre-lease commitments.[19] In addition, they had considerable experience to draw on having been the developers of a similar project, World Financial Center, in Battery Park, New York.

CHAPTER 4:

Previous American Ventures in Foreign Markets

Two prominent London real estate consultants expressed the notion that many previous forays by American developers into London and other European markets may have come about primarily due to the "ambiance factor." A common perception of foreign real estate professionals was that American developers were hasty in making the decision to attempt an overseas development project. An example of these perceptions might be something like this:

> A successful American developer, enjoying his newly-created wealth decides to "tour the Continent." While he's there he gets the urge to visit the local offices of his international real estate services company. He mentions to the brokerage executives that their city is quite beautiful and appears to have a healthy development market. They assure him that times have rarely been so good. When he asks about barriers to entry by foreign players such as himself and is told that there are no political or economic roadblocks to speak of he begins to wonder, "why can't I grab a piece of this action?"
>
> "After all, I've made a ton of money in much more competitive markets than this one. These guys don't even know how to exploit market demand. Just look at those vacancy figures of three to four percent. An aggressive developer could make a bundle here. And by using modern U.S. design and construction techniques I could leave the local competition in the dust."
>
> "Heck, if you've built one high-rise office building you've built them all." He goes back to his hotel room thrilled about the prospects for making a killing in this market and a short time later calls the brokers and instructs them to begin looking for a well-located

> development site. And so begins a long and often extremely frustrating venture....[20]

Although this was certainly not the case for all ventures into foreign real estate markets, some American attempts at developing competitive real estate projects overseas did begin in such a manner. Cursory observations of selected foreign cities and their real estate market would indicate that a talented American developer could be capable of building a very successful project there. However, success has not been the norm. There appears to be substantial obstacles to the entry of U.S. developers in foreign markets.

In the late 1960's, Paris development officials, both public and private, saw the need for a substantial amount of additional modern office space. Sensing that a high-rise tower would both fit their needs and convey the image that Paris was a modern international city, they sought out American development expertise to help build a new commercial landmark. Wylie Tuttle, a successful developer from the New York development company of Collins, Tuttle and Company embraced the opportunity, stating at the time, "Paris needs a skyscraper and the competition here isn't as strong."[21] He was invited to Paris by a consortium of both public and private sector interests to build the Tour Montparnasse, which at 52 stories, is still the tallest building in Paris.

Mr. Tuttle appeared quite skilled at the hard aspects of high-rise construction and successfully completed his tower on time and near budget.

He and his sponsors, however, were completely oblivious to the cultural and political repercussions of their project. Even at the time of this writing, twenty years later, the building is considered by many Parisians to be the scourge of the city skyline and, "American participation in the project seemed to underline what many dreaded as an increasing Americanization of the city."[22] The tower's utter insensitivity to the surrounding scale of the Left Bank was one of the primary reasons for the French government in 1975 to ban any additional highrise construction in the historic center of Paris. Instead, new highrise development was strongly redirected to the perimeter of the city beyond its historic boundaries. Most commercial high-rise development subsequent to the Tour Montparnasse focused on La Defense, a new urban center, five miles west of the city.

It was said that Tuttle also seriously misjudged the economic realities of the French real estate market. Despite numerous warnings that permanent debt-financing for such a project was unheard of in France he proceeded through construction fully intending to hold onto the building after its completion.

Instead, the local naysayer's predictions held true and eventually the tower was financed the same way most other commercial rental property were financed at that time. The building was converted into condominiums and it is now owned by an assortment of investors. It is not known whether Mr. Tuttle ever owned any of the condominium units.[23]

In the mid 1970's Trammell Crow, a very successful developer out of Dallas, Texas, also plunged into the Paris market. He and his firm built two high-rise office towers on the northeast side of the city near La Villette. Local real estate professionals who were familiar with the projects observed that although the towers were very well built and quickly constructed, they took forever to lease. It apppeared to them that the development company was oblivious to the fact that their site was in a quarter of Paris which had never been considered an acceptible office location. The project appears to have been a financial failure and an embarrassment to the development company.[24]

Trammell Crow was much more successful building a trade mart in the early 1980's in Brussels, Belgium. This project has approximately 1.4 million square feet of floor space and is the largest commercial structure in Europe. Crow backed this project financially and provided substantial design and development consultation to their local joint-venture developer.[25] The project got off to a slow start but eventually became a very substantial commercial success. Its success seemed to be derived not so much from the economics of the real estate development deal as from the developer's participation in the sales generated by the tenants in the wholesale market. Although this difference may seem trivial, especially to those readers familiar with the standard dynamics of an American retail project, it is not.

A critial factor in the success of this project and other international ventures was the ability of the developer to capture an untapped but willing market and capitalize on specialized expertise derived from previous experience. Crow's unrivaled knowledge in the design, construction and lease structuring of trade marts, a building type in which they had no European competition, allowed this. In addition, this project was unique because it involved the management of a business, similar to hotel development and management.

At the time a representative of the international division of the Trammell Crow Company was interviewed, their strategy was in two areas. First, the division sought trade mart development opportunities in other European cities where certain industries were concentrated or had major trade centers. Trammell Crow recognized their development, marketing, and management expertise in this product, although due to the large size of these structures, but they also sought local development partners in order to access local knowledge. Second, they had recently assembled a small portfolio of commercial real estate in Belgium and Germany and they planned to expand these holdings. Accordingly, they would established a local developer under the "Trammell Crow umbrella" to build and manage these properties. Trammell Crow prefered this strategy since local nationals "know local business customs, know the language, and have the contacts." Crow would provide financial, marketing, project and property management assistance in these ventures.[26]

Another group of American companies who had been active and successful in the development of foreign real estate were the large hotel companies: InterContinental, Hilton International, Westin, Hyatt International, Sheraton, and Marriott. Hilton International and Intercontinental Hotels were companies formerly owned by large U.S. airlines which recognized an unsatisfied demand for first-class hotel accomodations in newly discovered travel destinations during the 1960's and 1970's. Both strove to develop large business and tourist hotels in major cities throughout Europe and the world. More recently, both of the companies had been sold by the airlines which originally directed their expansion.

Hilton International, like many other international hotel companies, had become more of a management company than a hotel development and investment company. Most large hotel companies were publicly owned, and preferred to generate management fees. These fees produced substantial "bookable" earnings, as compared to hotel ownership, which often produced lower earnings and substantial tax losses. The parent company only maintained equity in the truly exceptional hotels with excellent profitability. As part of these hotel management agreements, the management company would assist in the development and opening of the hotel and then provide management, usually under long-term contract. The management company occasionally sought the development opportunity, but more often, others found the opportunity.

A representative of the development arm of Hilton International suggested that over the years the company had transformed into more of an international corporation than an American company with foreign properties. Hilton International had placed a large number of foreign nationals in executive positions and had decentralized most of their development decisions. Foreign nationals in their respective countries now made most of the development and operations decisions. These executives, including hotel general managers and divisional officers, had extensive international experience and contacts, and often were the source of deals for the company.[27]

An example of limited American involvement in international hotel development and ownership was American banks who were swapping equity in South American hotels for non-performing loans in those countries. Other instances of American real estate development and investment includes large American contractors (often defense-related) who were obligated to invest some of their foreign currency in specific countries in the Middle East.

Somewhat similar to the international hotel ventures have been the foreign ventures of John Portman and Associates of Atlanta. John Portman is both an architect and developer. His architecture and engineering company had designed overseas hotel and mixed-use projects for many years and his development company had built urban mixed-use projects in the U.S. prior to the decision to embark on similar foreign development projects. Portman Overseas, a subsidiary development company, created in April 1986, sought to capitalized on John Portman's worldwide design experience and reputation when seeking international development opportunities, primarily in the Asian Basin. In mid-1987 they were concentrating their development efforts on Shanghai Center, a $175 million mixed-use project in China.

Portman had provided design or development services on other projects sites in Singapore and Malasia. These developing nations, like China, were seeking to promote tourism and continued commercial development. Representatives of the Portman organization felt that development negotiations with these host governments had often been quite extensive especially when those governments had no experience with Western businesses, real estate standards or practices.[28]

In, 1986, the international development division of Walt Disney Enterprises commenced construction of a new Disney theme park 25 miles east of Paris. Similar to the development of Disney World in Orlando, the development company had again secured control of a huge parcel of approximately 4500 acres and they planned to develop a substantial number of commercial projects around the 150 to 200 acre theme park.[29] The precise terms of the development agreement ironed out with the French government were not available but it appeared that the government planned on providing substantial new services to the site.

At this early stage in the development process it was impossible to evaluate the success or profitability of this venture. Most French real estate experts did feel that the Disney company stood to reap enormous gains just from the appreciation in the value of land surrounding the park. Again, there were other important factors besides the development expertise and experience of Disney with this product. Disney also provided substantial experience in the marketing and management of the unique venture, and thus could utilize this expertise to secure international investment opportunities.

Disney has also completed a Disney theme park in Toyko, using its development and management expertise to establish a foothold in this market. This project was similar to both the Paris and Orlando parks in that the project included a proportionate amount of perimeter land development, especially for hotel and resort development projects.

Other American players active in development in Western Europe included some of the large investment banks. First Boston Real Estate's participation in Canary Wharf has already been detailed. However, similar to the strategy of the investment banks that were interviewed, First Boston sought Canary Wharf as a unique investment opportunity, with no other global implications. In addition, a representative of Salomon Brothers reported that they have taken equity positions in some projects in which they had raised capital and had been impressed by the pro forma profit projections. Salomon leaves the development management to the local joint venture partner, often the entity that originally brought them the deal for financing. Goldman-Sachs turned a few heads and assumed a fairly high profile in London development when they announced that they were willing to pay £92 million for the redevelopment site on which they planned to build their new headquarters. The economics of this deal were seriously questioned by other London real estate experts. As the sale was only announced in June 1987 and no construction costs were divulged, analysis of this venture was not possible.

More often than not real estate capital and expertise has traveled west across the Atlantic from Europe to North America and not the other way around. Lincoln Properties Company of Dallas has a representative headquartered in Geneva, Switzerland who is attuned to the real estate markets throughout continental Europe. However, his role has not been to seek out European development opportunities for Lincoln, a company nearly as large and diversified as Trammell Crow, but rather to locate European sources of capital which will be used to fund Lincoln's North American development ventures. When asked why Lincoln had not entered a European market the financier stated quite succinctly, "We prefer the market economies in the U.S." over the many political and governmental controls in Europe.[30] Lincoln's experience in Europe provides valuable insight into the central thesis question. Lincoln has had access to many deals in Europe and obviously have access to local sources of capital. However, the company has prefered U.S. investment.

As was previously mentioned, a considerable number of English development companies and institutional investors have been active in North American real estate markets for many years. French construction companies with development subsidiaries and various other European investors have also engaged in projects in the United States. Two large London-based chartered surveying firms, Jones Lang Wooton and Richard-Ellis have established offices throughout the U.S. and Canada to provide real estate brokerage and other professional services. All of these organizations, to a greater or lesser extent, felt that the real estate market in America offered some opportunities unavailable in Europe, including greater yields, more political stability, and more solid market economies. It was, and continues to be, true that North American developers pursuing opportunities in the opposite direction are swimming against the tide.

The New York office of Gerald D. Hines Interests, one of the largest development companies in the U.S., seriously considered entering the red-hot London development market in 1986. They went so far as to engage in three extended visits during which time their London development team performed extensive analysis of the market and found a potential redevelopment site which was available for purchase. However, when it came time to commit to the proposal they declined, and instead handed the opportunity off to a local developer with whom they had joint-ventured previously in the U.S. Explaining the logic behind this decision a representative of Hines said that upon objective analysis of both the profit opportunity and the corporate resources (primarily in the form of personnel) which would be involved in the project it became clear that far greater opportunities still existed for them in the New York market. Had they decided to pursue the project they had no doubts, he said, that they would have succeeded. But the New York market was, and seemed as if it would continue to remain, more lucrative.[31]

This representative went on to add that this didn't mean that all American development companies were better off staying in their own backyard. Some might be well-suited for a venture in London. However, those would probably be the companies who were more used to doing London-sized developments, who could capitalize on strong knowledge of similar projects, and whose home markets had gone soft. He agreed that if the Washington market slowed down a developer from there might be very successful in London. This may be due to the fact that Washington developers have experience in developed, competitive markets with smaller buildings and more stringent planning constraints.

From the examples just outlined, we found it impossible to stereotype previous American forays into foreign real estate markets. It also seemed clear that potential pitfalls were, and continue to be substantial. We have no doubt that lucrative development opportunities exist, but the more foreign the development environment, the more rigorous the research should be prior to commiting to what on the surface seems like a sure-fire deal.

CHAPTER 5:

Analyzing Foreign Markets and Development Opportunities

It is clear from the Canary Wharf case, and other testimony, that foreign real estate development ventures are more complex and therefore more risky than local endeavors. The sources of additional risk in these projects are many. On the broadest level, considerable additional risk is generated by the structural differences in the development arena itself. Even the United Kingdom, a country very similar to the United States, has basic differences in procedural, cultural, and financial systems commonly employed in their native development projects. Other countries' traditional systems are even more formidable.

Developers, eager to enter a hot new market, frequently underestimate these differences and overestimate their ability to understand and adjust to them. Detached analysis of the specific strengths and weaknesses of the individual firm is critical to minimizing this risk. Foreign markets are already populated with competitors who have their own strengths and weaknesses. Prospective new players must analyze how their skills compare to local competition. The complexities and additional risks associated with overseas projects must be assessed in addition to market and financial analysis which is required of any real estate development project.

Part I of our analysis addresses the additional risks associated with foreign development projects. Part II presents a logical self-evaluation process for the American developer seeking overseas ventures. This process includes an analysis of foreign perceptions and the means available to obtain sufficient local market knowledge. Part III presents a comparative analysis of American development skills versus foreign competition.

Part I: NON-DEVELOPMENT RISKS

It is often stated that throughout the United States, real estate is a local business. This is true in other countries as well. Any developer entering a foreign market must strive to understand the effect that local culture, politics, taxes, regulations, finance, planning, and labor will have on the success of their project. This is not to say that foreign or novel approaches to any of the afforementioned areas will not succeed. But, a basic understanding of the cultural aspects of a market, including possible attitudes toward alternative schemes, will greatly aid in correctly estimating the chances of a project's success.

American developers, accustomed to working in the dynamic American marketplace, may overestimate the willingness of foreign markets to accept new, and often time brash proposals. Trammell Crow has been exposed to both sides of this issue. Their Paris office towers failed for much the same reason that the Brussels Trade Mart succeeded. Both projects sought to radically alter the market, yet one was accepted very differently from the other. Non-developmental cultural issues may have been responsible.

Culture

Cultural differences exist within different areas of the United States and become apparent when developers attempt to build projects away from their home base. The cultural differences that exist throughout Europe and the rest of the world are much more pronounced.

The Canary Wharf Development Company (CWDC) took advantage of the many cultural similarities between the U.S. and the U.K. Problems arose, however, from their unsuccessful adaptation to the more inflexible aspects of English culture, tradition, and standard business processes. Many Englishmen attributed this to American arrogance, but the CWDC's approach, particularly the promotion of the project, would not have appeared arrogant to most other American development companies. Selling the "sizzle" of a project is an established American tradition. In the U.S., marketing enormous development schemes is usually more style than substance, especially in the initial stages, in order to keep the project moving forward in the political arena. Unfortunately, a major flaw in the consortium's effort was their failure to recognize that U.K. customs and culture look unfavorably on marketing hype combined with project delays. On the other hand, without such brazen tenacity and optimism, the project may have never made it past the concept stage.

Foreign developers often need to seek local joint venture partners in order to secure credible local knowledge in the feasibility and approvals stages. In foreign markets, as in the U.S., it is often a prerequisite to establish a political foothold. The London Docklands Development Corporation (LDDC) provided a base of local knowledge for the Canary Wharf Development Company. This was mostly in the form of planning assistance. The goodwill of the LDDC alliance did little to help clear the other crucial hurdle; securing prime tenants for the first buildings.

Political Change

Investment markets consider the United States the safest political haven in the world. This is evidenced by the strength of U.S. Treasury notes and bonds sold throughout the world and the increasing amount of foreign investment in the U.S. Commercial development opportunities in other countries may contend with substantially greater political risks. Any prospective foreign development project should be preceeded by a thorough analysis of political risk. This risk may be in the form of extreme political changes as is often the case in developing countries. Or, it may involve less drastic political changes due to the election of a new controlling party with a different political and social mandate. Both of these examples will affect a foreign real estate venture.

Political risks may manifest themselves in foreign exchange rates. Exchange rates, and their comparative volatility, can be an extremely important factor in offshore ventures. The strength of the U.S. dollar versus foreign currencies can cause signficant changes in world money markets. Exchange rates are even more important in real estate ventures due to the long-term nature of the deals. Major international banks currently offer means to manage or hedge exchange rate risk, however these methods are costly and rarely offer long term security. A rigorous analysis of exchange rate risk in a target market, and the factors that influence this risk, is crucial when considering overseas real estate development projects.

Taxes and Other Regulatory Issues

Taxes and other financial regulations related to real estate development differ throughout the world. France, for example, has a 18.6 percent registration tax on real estate transfers. These can have a serious effect on the liquidity and the market value of a real estate investment. In some countries legal limits are set on the amount of profit that can be withdrawn. Developers are restricted to maintaining their capital in these countries. Other foreign countries have special taxes on profits earned by foreign interests.

Differing foreign tax structures and business laws compound the difficulty of assessing projected returns from foreign real estate investments. Rigorous preliminary analysis of additional tax constraints involved in a foreign deal is essential.

Financing

The financial structure of a foreign development market is often directly linked to the tax and regulatory climate, particularly those regulations affecting banks and fiduciary trusts. Projects in the U.K. were scaled down to the regulatory limits imposed on British financial institutions. Foreign developers seeking to enter new markets must be aware of local financing sources, and the limits investors will place on development projects. Otherwise, developers must bring sources or methods of funding with them. Obviously, funds must be available at rates which will maintain a reasonable rate of return for the project.

Planning and Attitudes Toward Development

Related to politics, but more project specific, are the planning systems and the general attitudes toward development found in any overseas market. It is impossible to catagorize planners and public administrators as being pro- or anti-development based solely on their political inclinations. In the case of Canary Wharf, some of the most vociferous proponents of the project were the far left-wing planners in the Borough of Tower Hamlets. They knew this huge project would have some negative effects on the surrounding community, but they also recognized that it would shift growth eastward, counter to the traditional direction of growth in London. Eventually, it would lead to better transportation and government services in their area.

Similarly, Portman Overseas believed that communist China was serious about promoting Western-style economic development and that they will allow Portman to generate reasonable profits from the development of Shanghai Center. On the other hand, the French have decided to prohibit additional high-rise construction in the heart of Paris. They are also reluctant to allow the demolition of any existing structures in the center of Paris. London planners had a similar policy until market forces caused them to loosen restrictions and expedite the approval process.

When evaluating the underlyimg planning environment in any potential market, developers should understand that the actions of planners and politicians reflect social goals. Developers must strive to understand the underlying motives of these individuals in order to avoid potential pitfalls. Critical questions concerning specific planning policies should be reviewed, including current government attitudes towards foreign developers. These are not questions that are easily answered, particularly by consultants. They require a level of sophistication that can test the top officers in any organization.

Construction Labor and Management

Local factors which can greatly affect the decision to pursue a development project are labor relations and construction management. London, and all of England up until a few years ago, had a very bad reputation for its construction workers. Unions controlled the workplace and were considered overpaid and intransigent. Developers told horror stories of projects which took years longer than comparable, or larger, foreign projects. Recently a number of aggressive U.K. developers have proven the critics wrong. Stuart Lipton of Rosehaugh Stanhope led a new wave of local developers who have imported American construction management and fast-track design methods. They have created a process in which English labor and English contractors are now building projects as quickly as most are built in the U.S. The Canary Wharf consortium, aware of the criticism of English contractors' inability to deliver large projects on time, may have been guilty of overkill when it created a consortuim of the five largest contractors in the U.K. to be the general contractor for the project and then hired Bechtel as construction manager.

All real estate development projects require exhaustive market and financial feasibility analysis. Risks must be assessed and strategies must be devised to manage as many of these risks. Additional risks associated with foreign markets compound the difficulty of this process. Any developer considering foreign markets should evaluate all of these additional risk factors in order to project a reasonable rate of return. Rational investment decisions cannot be made until all of the above risks are taken into account.

Part II: EVALUATING DEVELOPMENT SKILLS

Many American development companies have specific skills which give them a distinct advantage in many foreign real estate markets. Yet local market knowledge and reputation is still a huge competitive advantage for the local developer. In evaluating whether to engage in an overseas venture, it is crucial to evaluate if the competitive advantage of possessing these skills offsets the disadvantage of having a lack of local knowledge and recognition.

Strong Suits

The developer must objectively assess their skills and expertise before entering a foreign market, including which skills or previous development experience they wish to exploit in this new market. The Canary Wharf Development Company believed they could create a high-rise office center in an area where local competitors only saw a blighted wasteland. They may have been correct. They also believed they could design and manage sophisticated office space better that local developers. This is much more doubtful. Finally, they felt they could dominate the market in new state-of-the-art office and financial trading space. This third premise was clearly naive and incorrect.

Foreign Perceptions

How the foreign market perceives the new developer's skills is as important as the developer's own assessment. Americans entering almost any foreign market will be preconceived as "doers". That is an international image and a preconception that may be helpful in inspiring market confidence. Yet it may also lead inadvertently to unreasonable expectations. This problem clearly plagued the Canary Wharf proposal. At some point, faith in the project began to slip when public expectations were not satisfied. To American developers experienced with the complexities in attempting to begin construction of a 12 million square foot, mixed-use project, a two-year start-up period is not unreasonable. But the English press, politicians and public did not understand what was involved in developing a project of this scale. All they knew was that Travelstead originally stated that construction would begin in early 1986 and as of July 1987, nothing had been built.

Other foreign preconceptions might be advantageous. For example, many Western European nations are very interested in rejuvenating the urban core of their second-tier cities, such as Manchester and Liverpool in Britain and Marseille and Lyon in France. Instead of infusing massive amounts of public money, the governments of these countries are interested in implementing American-style programs which harness market forces and private initiative in concert with public planning support. Partners for Livable Places of Washington D.C. has been quite active in continental Europe and England for the past few years, extolling the virtues of American-style public-private partnerships. Representatives of this organization think American developers with urban redevelopment experience would be greatly welcomed in such cities.

The ability to negotiate with public planning authorities is another skill which the more comtemporary planners and other public officials in the U.K. seem to expect from American developers. Depending on who is asked, Americans may also be expected to create more exciting urban spaces, more self-conscious architecture or use alternative sources of financing. None of these preconceptions are necessarily bad nor are they notions the prospective developer must seek to dispell. Developers should be aware, however, that their reputation may preceed them and it may dramatically effect their reception wherever they may go. It will not guarantee the final results.

Filling the Gaps

It would be naive for any developer to believe that they can gain a strong understanding of a foreign market in a short amount of time without local representation. The Canary Wharf venture ran into problems that reflected an ignorance of the local culture. And this was a venture in a country whose culture is relatively similar to that of the United States.

Large international real estate services firms may be a good source of knowledge on local markets but their motives may not be consistent with those of the developer. Their optimistic consultation regarding a foreign market's development opportunity may actually be motivated by an expectation of a much more lucrative exclusive leasing contract. These firms may also be so large that they will not readily offer personalized consultation. Their assistance will be more generic. Therefore, they may not treat matters such as cultural differences, political risk, or planning constraints with the same objectivity as a development partner.

Hiring local nationals who have recognized expertise in a foreign market, as professional staff, may prove difficult. Even if talented individuals can be found and lured away from their current endeavors, this may represent a larger commitment to a project and an individual than a prospecting development company is willing to initially make. Making significant employment commitments prior to initiating a project in a new market can be costly.

A joint venture between a large foreign developer and a local development representative, or development company, is an arrangement where commmon goals and objectives are more likely shared. In the foreign ventures that we examined, one of the most common formulas for success was for a foreign firm to complement their strengths and weaknesses through a joint venture agreement.

One final option is to form a quasi-partnership with a local redevelopment agency. This arrangement is similar to the Canary Wharf project. The public agency can expedite political and planning approval, aid in the assemblage of land targeted for urban renewal, mandate tax writedowns or other abatements, or, help secure low-priced financing. However, their goals may not always run parallel to those of the development company. They may want to expedite a project for political reasons rather than market need, they may not fully understand that projects must ultimately be leased at profitable rates, or, they may not be able to devote the same degree of attention to specific projects as a development partner. Consequently, it must always be kept in mind that having political support from a public agency does not protect a development company from all of its development risks. It may in fact increase the political risks.

Part III: EVALUATING THE COMPETITION

The following analysis compares the development skills of American developers and their foreign counterparts. It is based on our review of the Canary Wharf project and other American attempts at overseas development. It also includes feedback from numerous personal and telephone interviews conducted with individuals familiar with international real estate development. The following skills are examined and compared: project conception and market analysis; design; planning and approval; financing; construction; marketing and promotion; leasing; and property management.

Project Conception and Market Analysis

A skill which the best American developers demonstrate exceedingly well is the ability to identify market opportunity. Successful developers worldwide have this talent. However, the most visionary Americans tend to not only see an opportunity, but also to maximize these benefits. Developers which come to mind in this regard include James Rouse, Gerald Hines, Donald Trump, and the Disney Company. This vision and follow-through has enabled some of the best American development companies to create successful projects where such a project had never even been considered. This vision, sometimes unyielding and driven by ego and greed, has a downside as well. It has also caused many reckless developers to fail in their initial attempts.

In general, the United States does not have the planning constraints found in most European cities. Many cities in the U.S. embrace large development proposals to promote economic and employment growth. Aside from the cities that promote more stringent planning policies such as Boston, San Francisco and New York, developers have been able to build projects without much regulatory pressure. Consequently, American developers are not accustomed to, or willing to be turned down by regulatory agencies. Similarly, many American developers have a reputation for their tenacious attitude in not accepting defeat and will do anything within the political system for approval of their projects.

In response to a relatively open-minded market, American developers have been more aggressive in their creation of new development schemes. New approaches often lead the world market and set new trends and precedents in real estate development. Examples of this include festival marketplaces, intensive urban mixed-use projects, specialty retail centers, and four-season full-service resort development.

This willingness of American developers to identify and promote new and different approaches to development was demonstrated in London. Canary Wharf represented a classic American development proposal in that it was a bold move to create a new financial center outside the established financial core. It also typifies American efforts insofar as it is an urban redevelopment opportunity and a public-private partnership which involved extensive negotiations and exactions. Projects of this scale with enormous amounts of privately-funded infrastructure have been seen previously in commercial development projects in the U.S. and Canada. Although Ware Travelstead lacked the development expertise necessary to complete the project, he should be commended for the vision that fostered Canary Wharf.

Much reference was made in personal interviews to American developers who "maximize opportunity" and the American "can do approach" to development. Most interviewees discussed American experience with larger, more complex projects and higher risk preferences. American knowledge and experience with urban redevelopment was also discussed by many individuals. However, many interviewees confirmed our observations that many U.K. developers had already begun to adopt an "American approach" to real estate development.

Representatives from two prominent U.K. development companies stated that they had learned very much from America through direct experience in its real estate markets.

In contrast to their ability to maximize a development opportunity, especially when compared with their foreign competition, many American development companies exhibit a general weakness in the area of market analysis. They seem to rely on their optimism, and believe their product will outperform the competition. This tendency to disregard market information and build without proper analysis, sometimes referred to "cowboy development" in the U.S., would be extremely dangerous in foreign markets.

Design

American developers, in conjunction with their efforts to propose and build larger commercial structures, often promote the most contemporary architectural design. They also base many of their building design decisions on tenant needs and preferences. The competitiveness of the U.S. market has caused this awareness of tenant need in building design. Neither of these attributes have historically been the case with developers in London and other European cities. Planning constraints as evidenced in London, and in most

European cities, could inhibit the kinds of bold design that Americans are accustomed to. More emphasis is placed on contextual design in London, and in most European cities, than in U.S. markets.

Canary Wharf represents an excellent example of design based on the building requirements of financial sector tenants and the use of bold design in the promotion of a development. But much of this design expertise came from the design professional, not from the developer. In a competitive market, the foreign developer can contract just as easily with American design professionals as an American developer. This was currently the case with many projects in London. Not only do some U.K. developers realize the competitive advantage that the American design professional gives their project, American firms are eager to export their services. Trying to corner the market in progressive project design would be futile in most foreign markets.

Planning and Approval

London, Paris, and other European cities generally do not mandate that the developer pay exactions for transportation improvements, affordable housing, or public open space in exchange for receiving approvals. However, in contrast to

North America, most European cities exhibit very stringent planning controls. This may be because planners in these cities realize that their cities are much older, more fragile, more developed, and have more historical significance. For instance, in most European cities, a 100,000 square foot building in the central business district is still a very large building. It is extremely difficult to develop large buildings in the center of many European cities. Developers have resorted to the fringe areas in order to meet demand for larger tenant spaces.

Canary Wharf provided an excellent illustration of American willingness to negotiate with governmental agencies and assist in the funding of public infrastructure improvements. Interviewees generally concurred that a local developer would not have attempted to guide a tranportation improvement through Parliament. This was lauded as an incredible feat, especially since the bill was initiated by a foreign consortium. Also, most felt that the willingness of American development companies to pay large sums toward infrastructure improvements, thereby assuming even greater financial risk, was exceptional.

Financing

American developers have grown accustomed to using an expanding array of real estate development finance methods to fund large development projects in the United States. American financial institutions have been relatively quick to create and provide alternative sources of financing including accruing and participating mortgages, mortgage-backed securities and zero-coupon bonds. Therefore, American developers and financial institutions who understand and are already familiar with the costs and benefits of complex financing schemes, may currently have an advantage over more conservatively financed foreign ventures.

The ability of American development companies to arrange large amounts of debt and equity financing for large and complex development projects, however, is no longer a competitive advantage. European developers now have access to the same long-term funding sources as Americans. Rosehaugh Stanhope arranged medium-term financing from a number of commercial banks for the three million plus square foot Broadgate office project at Liverpool station in London. They are currently considering long-term financing with mortgage-backed securities issued through the Euromarkets.

The Canary Wharf project differed from most foreign commercial development because of the extensive amount the pre-construction and infrastructure costs associated with the first phase of the project. Prior to the sale to Olympia & York, financing of this initial phase was looked upon sceptically by local real estate professionals. None of the U.K. institutions that were interviewed expressed a desire to participate in this type of project. Projects such as this would require extensive equity funding from internal sources to cover the lengthy pre-construction period. In large projects such as Canary Wharf, sufficient capitalization of the developer is crucial in order to successfully finance and complete the venture.

Only a few North American developers appear capable of funding projects of this scope. This may create a competitive advantage for these developers. Olympia & York's purchase of the Canary Wharf development rights and their willingness to sign the Master Building Agreement, thereby committing to provide substantial infrastructure funding without pre-lease commitments, is evidence of this. Olympia & York exhibited similar financial strength at a critical jucture in a similar project when they agreed to guarantee the state revenue bonds issued in conjuction with the Battery Park City project in New York.

Construction

American development companies have embraced new construction techniques, employing new methods pioneered both at home and overseas to save construction time and expense. Construction management techniques developed in the U.S. have been studied and adopted by progressive development and construction companies worldwide. These new project management techniques allow very large urban commercial projects to be fast-tracked. This can substantially reduce construction time and save considerably on construction interest and other overhead expenses. The larger Japanese construction companies and a few of the larger European companies also utilize construction management and promote the use of novel fast-track techniques.

The Canary Wharf project was to employ a consortium of the largest U.K. contractors, managed by the American firm Bechtel. Fast-track techniques would allow $500 million of initial infrastructure and the first phase of buildings to be built in 27 to 30 months. The cost savings and marketing benefits available from significant construction streamlining such as this had spurred other development projects in London, most notably the Broadgate development by Rosehaugh Stanhope, to adopt fast-track construction methods.

Developers of large commercial projects throughout the world now have the option of hiring an international construction management company or a local construction company with advanced skills to take advantage of these cost-saving techniques. Many interviewees in Europe felt there were benefits in using construction management, fast-tracking and advanced construction techniques on larger commercial projects. But not all of the foreign developers that were interviewed seemed comfortable using novel construction management or methods. A few, select European firms had openly embraced these new methods. London & Edinburgh Trust had also begun to utilize fast-track construction methods at L'Anjou, a new office development in Paris. But the pace of adoption, especially in less dynamic markets, was slow. In these markets it appereared that an aggressive American development company could build projects faster than most of their local competition.

Marketing and Promotion

American developers are skilled in marketing and promoted aggressive development schemes. They have demonstrated in the U.S., and to some degree already in Europe, that new building types and development concepts can be introduced into established markets. Examples of sucessful, highly-promoted, U.S. projects include urban festival marketplaces, specialty retail centers and large-scale resort/residential communities. European examples of unique American development include the Brussels Trade Mart developed by Trammell Crow and the EuroDisney development east of Paris.

The Canary Wharf Development Company promoted its project extensively. Their marketing and promotion program deserves much credit considering the immense political and regulatory obstacles that stood in the way of the project. The Canary Wharf marketing campaign had to be as extensive as possible to convince sceptics that a project of this scale could be developed in the Docklands.

Just prior to the sale to Olympia & York, most interviewees were willing to acknowledge the skillful way in which the development company had promoted the project and brought it to its current stage of development. But they expressed much scepticism regarding the consortium's ability to secure lease commitments and sign the MBA. Many interviewees, including those very knowledgeable with large scale commercial development, in light of the numerous delays, had come to doubt whether the project would ever be built.

Leasing

The competitiveness of most American real estate markets, and the current problem of oversupply in many of these markets, has forced many American developers to devise, refine and employ creative leasing and marketing techniques. In contrast, very low historic vacancy rates in most European cities have fostered relatively staid leasing programs. But when the leasing climate changed dramatically in London, brokerage skills evolved rapidly as well.

The Canary Wharf leasing program was aggressive. At the time we conducted our research, the consortium's leasing effort had been under way for over two years. They had contacted thousands of companies throughout London, seeking to determine their interest in tenancy in the initial phase of the project. The consortium had published extensive promotional material, including large advertisements in European business magazines. The consortium had also retained three of London's best chartered surveyors as leasing agents. But they were up against stiff competition from other projects in a very hot market.

The consortium's leasing effort tended to underestimate the unwillingness of most U.K. firms to commit to lease space prior to construction. Pre-leasing had not been common in the London market. Some pre-leasing had occured recently. This had been in response to the recent increase in demand, but it had only occured in the most desirable office locations. London tenants still preferred to see construction in progress, especially in more risky areas such as the Docklands, prior to signing lease commitments. Prospective tenants for projects such as Canary Wharf often shared a great skepticism as to whether the project would ever be built. Canary Wharf's leasing team was unable to overcome this basic, cultural aversion to pre-leasing risk.

Property Management

Many commercial development projects, especially complex, mixed-use developments, require that their developers possess extensive property management skills. Some of the American companies present in foreign real estate markets are capitalizing on their previous experience in the development and the management of these projects. Assuming market acceptance, American developers who have experience in building and managing retail or mixed-use projects may be able to successfully implement projects of this sort in foreign markets.

The current situation of oversupply in many American real estate markets has led to an increased awareness of the importance of responsive property management. American developers are emphasizing dilligent property management to keep tenants in their buildings. Different market conditions throughout Europe, including low office vacancy rates and smaller commercial structures, have allowed many European building managers to place less priority on property management and tenant service.

Project Management and Market Experience

Much of our analysis has focused on possible competitive advantages for American developers in foreign real estate markets. These American development skills are acquired from exposure to and experience with the complex, dynamic, and sophisticated real estate markets in the United States. They are not necessarily due to the fact that Americans are better developers. Some American development skills also stem from exposure to and experience with more complex building projects. Foreign developers active in the U.S. and Canada, in response to the competitive market, have adopted American development techniques and compete very well with American developers.

As foreign real estate markets evolve and become more similar to each other throughout the world, the distinctive development skills of American companies will become less unique and less exploitable in overseas markets. Each new window of opportunity for a progressive development company in a new market will close more quickly. Success in a new market will then depend on having both innovative products and services and the ability to respond rapidly to changing market needs.

In addition to those just analyzed, there may also be risks with personnel. In some instances, it may be impossible to find ample information on all the important individuals and organizations who will be involved in an overseas project. One reviewer termed this "the tall, dark stranger with the charming foreign accent" factor. References will be hard to obtain or of questionable quality unless the entire project team is flown in from the U.S. This is one of the unique risks which must be accepted in every foreign deal.

American development companies have accepted the additional risks of foreign ventures in the past. Some have been very successful while others have not. Early, broadly-scoped research, followed by the formation of a realistically structured development team with well-written agreements can be key. Always, potential rewards must be commensurate with the additional risks. In essense, a foreign development venture should be analyzed the same way any potential business venture should be analyzed: coolly, realistically, and thoroughly, with optimism that problems can be overcome but always with the willingness to say "no" if the risks are not justified by the potential rewards.

CHAPTER 6:

Conclusions and Recommendations

American development companies seeking to enter foreign markets must be willing to undertake more rigorous research than usually required of projects in their home market. Besides conducting extensive market and financial analysis, analysis of a prospective foreign venture will entail exploration of a host of novel factors which will make the project's management more complex, more intensive, and more costly. This final chapter summarizes this process, and offers recommendations to American and other foreign development companies who may seek to develop property in foreign countries.

Local Knowledge

The initial step for the development company is to decide whether or not they want to seek foreign development opportunities. If the answer is yes, and the developer believes that specific market and product opportunities may exist, then the rigorous research process must begin. The importance of local knowledge has been stressed throughout.

The developer must learn the market(s) or ally with someone who already has sufficient working knowledge. Small cultural differences in the way business is transacted may make large differences in a company's market success. Take for example the subtle differences between doing business in the United States and the United Kingdom. The developer must understand the complexities of the local market in both the most general and the most specific terms.

Culture

Through knowledge of local market complexities and cultural prejudices, the developers can determine how the market will respond to their product. Some cultures may welcome progressive development schemes while others may never adapt and adopt them. The developer must understand that many foreign markets do not adapt as easily to new products as the United States.

Other Non-Development Issues

The American developer must understand the additional risks inherent in a foreign venture. Non-development issues may prevent entry of any foreign developer even when strong development opportunities exist in a market. Currency risk, political risk, taxes and capital export restrictions can have drastic effects on projected yields, liquidity, and the value of foreign real estate projects. These additional risks can only be assessed through access to local knowledge, thus reinforcing the need for extensive market research and local representation.

Another important issue is the use of corporate resources for these overseas ventures. Given generally smaller foreign development projects, especially in most European markets, the developer must determine if the potential returns from overseas projects justify expending limited corporate resources. Relocating corporate personnel in foreign markets may be very inefficient given the size and the complexity of the initial project. The developer must either undertake an initial project of large scale to justify the existence of a working office in that market, or they must make a long-term commitment of corporate resources and capital.

Competitive Advantages, Skills, and Expertise

Any developer, in order to suceed, in a foreign market must capitalize on their distinctive skills and expertise. These skills may include the ability to undertake larger, more complex development projects. This ability may be derived from previous development experience or be based on a higher risk preference in general. American developers also may be able to capitalize on their marketing and promotion skills, or their exceptional tenacity and ability to attack the complexities of development projects from many angles, if these are skills which differentiate them from their local competition. Entering developers might also capitalize on more basic development skills such as design, construction, or finance, based on the specific overseas market conditions.

Prior experience in unique development projects, especially those that required more intensive property management skills, may give the American developer a temporary window of opportunity in any foreign market, if the market will accept this new product. All of these factors relate to monopoly skills. Moving quickly to exploit innovation and temporary imbalance between market supply and demand can produce successful projects given market acceptance.

Rates of Return

A developer must insist on higher rates of return in foreign markets to compensate for additional risks. However, generally lower yields throughout Europe, and most other parts of the world, suggest that higher rates can only be derived when the developer has some sort of monopoly advantage. This monopoly can be derived from taking advantage of a temporary market imperfection, by developing unique and innovative development projects, or by having other advantages such as extensive experience, increased knowledge, or less expensive sources of capital.

Appraising Opportunities

Successful real estate development is the result of well-formulated strategies, probing analysis and good management. The same is true for overseas ventures. The initial decision whether to proceed with a foreign development project, should be objectively arrived at and include all of the following steps:

* Measure market opportunities.
* Assess all of the risks of the deal.
* Explore methods of minimizing or hedging these risks.
* Review opportunity costs of employing scarce corporate resources, both personnel and capital.
* Conduct a realistic appraisal of available development expertise, both in-house and consulting.
* Compare expertise relative to competitors in the market.

* Finally, verify that anticipated outcomes match the developer's motives for considering the venture. This should include agreement among the development partners on motives and the potential for development rewards.

Development opportunities can surface quickly in a foreign market. This was clearly the case with Canary Wharf. A temporary market shortage of financial office space inspired their entire effort. The process outlined above still should be implemented in cases such as this. This process is not necessarily burdensome. Some aspects can be expedited but none should be omitted. As we have seen, failure to assess any of the complex factors involved in attempting a foreign real estate venture can result in unfulfilled expectations. But well-researched overseas endeavors can yield exceptionally large rewards.

NOTES

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APPENDIX

CURRENT AREAS OF OPPORTUNITY FOR AMERICAN DEVELOPMENT COMPANIES

Based on the analysis of the comparative skills of American developers versus their foreign counterparts, there are areas of opportunity throughout the world for American developers. This analysis is based on field research in London and Paris, interviews with real estate professionals active in international markets, and a review of documentation on global investment opportunites provided by the international real estate advisory firms of Jones Lang Wootton and Richard Ellis.

The following discussion is a superficial observation of many foreign markets that may lead to the conclusion that there are immense global opportunities for American developers. This may be the case in some areas, however each specific area requires more extensive analysis as discussed within the analysis section.

London

The current boom in office space demand fueled by employment growth within London's financial sector has created enormous opportunity for sophisticated office buildings throughout the city. In addition, the financial conglomerates that are currently expanding each require very large amounts of space. American developers have extensive experience in this type of building. Presently, large buildings are receiving approval from city planning officials in order to meet this tenant demand. Historically, buildings approved by the city rarely exceeded 100,000 square feet. The size of these buildings was prohibitive to foreign developers attempting to establish operations in London.

Thus, current demand and planning consent is present for larger commercial structures. However, local developers have also seized this opportunity to develop commercial office product for financial sector tenants. Many larger office developments are currently being developed in the fringe areas of London by U.K. developers. Due to current projections for continued employment growth in the financial services sector, this development opportunity should continue for the next five years at a minimum. American developers, in addition to extensive experience in the development of larger, more complex structures, also bring with them financing capabilities for these larger projects. American banks seeking to expand foreign real estate loan portfolios are very eager to commit large amounts of capital for these projects. Current office yields of five to seven percent for London office buildings can be increased through larger structures in fringe areas of the city, due to decreased land assemblage costs.

The development of commercial office parks in suburban locations has recently become a trend in the U.K. These office parks resemble recent development in the U.S., with superior building and landscape design, increased tenant amenities, and modern office accomodation. Rosehaugh Stanhope, a market leader in greater London, is currently developing Stockley Park at Heathrow Airport. Retail activity also remains very brisk throughout the U.K. U.K. developers are currently attempting to develop large, regional shopping centers similar to those in the U.S. Many interviewees questioned why large American regional shopping center developers have yet to enter into the U.K. market based on the strength of this market and decreasing market opportunities for this product in the U.S. Thus, there appears to opportunity for American developers in this area, based on land availability.

The other major opportunity for American developers is in the area of urban redevelopment, similar to the redevelopment of American cities during the past two decades. Prime Minister Margaret Thatcher has placed urban redevelopment very high on her list of priorities. This is evidenced by the amount of Parliament action on the redevelopment of the Docklands area including government commitments on public infrastructure improvements and tax/capital costs allowances. Thus, the opportunity for American developers to establish public-private partnerships with governmental authorities for these redevelopment opportunities exists in the U.K.

Paris

Similar planning constraints exist in Paris, where the vast number of historically significant structures play an important role in the planning process. The inability to develop large commercial structures in the city creates both problems and opportunities for the American developer. The problem in this assessment is the great difficulty in securing development sites or buildings capable of extensive redevelopment or renovation, especially for the foreign developer without local representation. However, this great contraint also creates a substantial opportunity for modern office buildings. A low city-wide vacancy rate in office buildings and continued strong demand from American and multinational corporations creates the need for the development of sophisticated office buildings.

Currently, London & Edinburgh Trust, in partnership with the French development company Capital & Continental, are developing L'Anjou, a 135,000 square foot office building in the City of Paris. This project, a high-quality building with large, spanned floor areas, will command the highest office rental rates in the city (approximately $70 per square foot using current exchange rates) due to unprecedented demand for this accomodation. London & Edinburgh Trust's position in this partnership represents an excellent example of possible American involvement in Paris, or other growing areas of France. LET provides increased financing capabilities as well as design, construction, and other project management assistance.

Strong demand for commercial office parks exists along Paris' perimeter highway system. Foreign developers with existing relationships with American and mulitnational tenants could capitalize on build-to-suit office development opportunities. Capital & Continental, again in partnership with LET, is developing many build-to-suit office buildings with design and tenant features a few years ahead of local competition.

Similar retail opportunites, especially for regional shopping centers, exist throughout the Paris metropolitan area. This is not only due to strong retail demand, but also the continued expansion of the greater Paris highway system.

However, non-development issues are much more important in France than in the U.K. given the radical change in culture. A knowledge of local customs and the French language is considered essential according to those individuals interviewed in Paris. Also, there may be greater political risk in France than in the United Kingdom or Germany. The new conservative ruling party has had a substantial positive effect on commercial development. A change in this political orientation could cause somewhat different economic conditions. France also imposes more stringent regulatory laws, especially to foreign entities. This includes an 18.6 percent transfer or "registration" tax on most real estate transfers, thus imposing serious effects on the liquidity of a real estate investment.

Germany, Belgium, and other European Countries

Germany continues to enjoy strong economic growth, especially in the major cities of Frankfurt, Hamburg, and Dusseldorf. Frankfort, as the leading financial center of Germany, is a strong commercial real estate market due to the emergence of many international and American multinational firms in the city. Brussels is currently experiencing strong economic growth and a strong office market, partly due to the continued positive effects of an expanding European Economic Community, which is located in Brussels. Other major European cities, due to similar planning constraints found in London and Paris, enjoy low office vacancy rates and good growth in office rental rates. Current commercial office yields are still below those available in strong American markets yet are acceptable to many foreign investors.

Again, a more stringent analysis is required for American entry in these markets due to non-development issues discussed in the beginning of the analysis section. Strong cultural differences exist between these countries as well as differing regulatory requirements and business laws. Based on interviews conducted with individuals knowledgable with other European cities, local representation is considered essential. In addition, these cities are not likely to accept large-scale American commercial development for reasons not exclusive of their size. However, based on the recent success of Trammell Crow, the projected success of EuroDisney, and the experiences of American hotel companies, there may be opportunities for smaller, progressive American development schemes, especially where the American developer is capitalizing on their success in a specific business/building type such as festival marketplaces.

Far East

The increasing westernization of the Far East provides an excellent opportunity for American and other international real estate ventures. As seen in Portman's experience in Shanghai, many cities in developing countries, including communist countries, are attempting to promote tourism and urban commercial development. Portman's experise in international hotel development and their reputation for design excellence gives them an opportunity to promote these skills in countries that want development. American experience and existing relationships with many Japanese firms provide opportunities for American developers in the Far East. However, there are even greater differences in culture and standard business processes in the Far East.

Australia

Sydney, the largest city in Australia, is experiencing a substantial increase in commercial development, partly due to its emergence as a major tourist destination. Other major cities in Australia such as Melbourne, Brisbane, and Perth are experiencing similar increases in commercial development. Australia prospers from a vast availability of land and biological resources, which ultimately provides positive economic effects for its major international cities. Currently, a major redevelopment effort is also underway along Sydney's waterfront.

Summary

Much of the discussion provided above is based on verbal and written information provided by international real estate advisory firms. These firms, most of which are expanding their scope worldwide, are an excellent source of information and local knowledge for the international developer. However, as stressed throughout this thesis, this information should only be taken as introductory knowledge. The international developer must pursue rigourous research of market and other non-development issues, and seek proper local representation before attempting any venture in a foreign market.