A Quiet Revolution

There seems to be a quiet revolution taking place in the real estate sector. For many years, hotel operators have leveraged off their reputation and have monetised their branding. In the hotel sector, to be a successful hotelier you need to be first class at running hotels but you do not necessarily have to own or even have a long lease of the underlying hotel real estate asset. A well-drawn management agreement will usually provide adequate security and the mutual financial benefit sought by the owner of the property and the operator.

In this modern technology driven world, this separation of "operation" from "ownership" is a tried and tested business model. No longer small start-ups, Uber and Airbnb have become household names with valuations of $68.5bn and $30bn, respectively, — valuations which are higher than many of their traditional counterparts. These "disrupters" have demonstrated that an innovative business model can make a significant impact on an established market. Airbnb is now one of the largest global accommodation businesses but it owns no hotels or apartments. Uber is one of the largest global taxi businesses but it owns no taxis or cars. Alibaba is the biggest online retailer but with no stock.

The real estate industry is ideally placed to take advantage of these innovative and successful business models. Intermediaries that have a proven track record in service delivery are embracing this new thinking. Traditionally, the property investment industry has been driven and constrained by the need to satisfy the demands of real estate lenders who have only been prepared to lend if:

a. there is a long lease;
b. let to a good tenant offering a strong covenant; and
c. on terms that provide a "clear" income for the owner.

With the opening up of the real estate lending market to new entrants, new thinking is emerging.

In the serviced office market, operators view with envy the hotel operating structure and evidence suggests that these providers are now exploring structuring their operations in the same way. Exploiting their core skillset in providing services, these serviced office operators are now pure operators and avoiding the heavy capital cost and administrative burden of actually owning the real estate from which these operations are run. By adopting this approach, service operators are able to significantly expand their operations. By utilising appropriately drawn management and operational agreements, asset owners can secure a healthy return from their real estate holdings if they are willing to explore new arrangements and are free of the constraint of having to satisfy a traditional real estate bank lender. Other areas of real estate investment that are open to this form of structure include PRS, student accommodation, elderly care and retirement living. In each case, these are all sectors where operational expertise is more important than actually owning the underlying property.

Clearly pursuing this line of operational investment involves a completely different mind-set from the financing point of view and will involve bankers and lenders being far more corporate and taking a far more business-like approach to real estate lending. It also requires the legal advisers to be more commercial in their approach and outlook than perhaps traditionally has been the case with real estate lawyers.

We can only hope that in the future all those involved in real estate from funding to conveyancing will have the vision to adapt to this new environment. That, in particular, real estate lenders will in future find the means to make funds available for development and construction, notwithstanding that the end product is to be occupied on an operational basis rather than on the terms of a traditional long lease.

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