APRIL 9, 2007 | WWW.FORBES.COM

Forbes

Urban Renewal Redux

When most insurers have abandoned real estate, Nationwide's BRIAN ELLIS is making progress developing blighted areas.

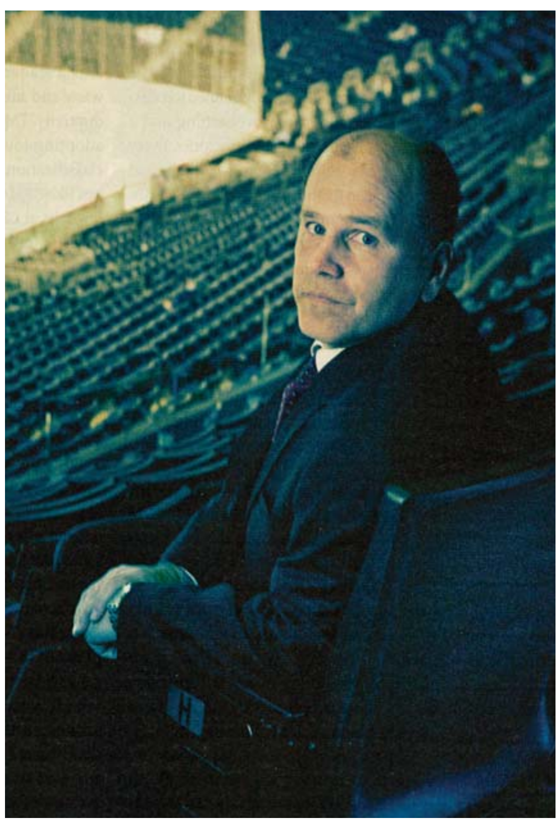
By Mark Tatge

Urban renewal has a checkered history. For every story of reinvigorated downtowns such as Baltimore's harbor district (courtesy of a private developer called the Rouse Co.), there are abject failures like the wasteland that is Camden, N.J. (other developers).

Stepping into this dicey area is insurer Nationwide Group, which is striving to turn around a blighted section of its headquarters city, Columbus, Ohio—thus far with some success. Over the past three years its development arm, Nationwide Realty Investors, has logged 16% to 21% annual returns on equity. There have also been what you might call psychic rewards. Although the insurer's $1.3 billion of real estate holdings in Columbus and elsewhere amounts to a tiny portion of its $160 billion in assets, the real estate drive has won the company plaudits.

The odd aspect to this is insurers are getting out of direct real estate investment. While rent income can be lush in good times, it often takes a dive during bad stretches, as vacancies mount. Plus, large buildings are hardly liquid investments. Insurers used to be active developers, and got burned in the real estate debacle of the early 1990s.

One example is Prudential Insurance, which back then bailed out of its ambitious plans for new office buildings in New York's Times Square, a then seedy locale that since has gone on to glory. Last October MetLife sold its Stuyvesant Town and Peter Cooper Village residential complexes in Manhattan for $5.4 billion. Today most life insurers are like Nationwide, with less than 1% of their invested assets in direct real estate investments, says analyst Andrew Edelsberg of insurance rating agency A.M. Best.



Brian Ellis inside the arena.

STEPHEN WEBSTER FOR FORBES

As a predominantly property-casualty insurer, Nationwide is an anomaly. The big real estate players have been life insurers like Pru and Met, whose payouts to customers, plotted by actuarial tables, are more predictable than those of property-casualty carriers, living at the grim whims of nature.

Nationwide is blazing new territory. The mutual insurer (meaning it's not publicly traded, though it owns nearly two-thirds of a life subsidiary that is) was known for its parochialism. But things began to loosen up ten years ago. In 1997 Nationwide named company veteran Brian J. Ellis to revive a defunct real estate subsidiary.

“There was an analyst, me and a secretary,” says Ellis, now 44. Today the crew, which has grown to 57 people, assesses commercial projects nationwide. What Ellis often finds are workout situations overlooked by other investors. He seeks to redevelop properties over a five- to ten-year period.

“Brian’s biggest advantage is that he doesn’t work for a company that has to meet earnings projections every 90 days,” says Robert A. Rosholt, Nationwide’s chief financial officer, noting that as long as Ellis continues to generate “midteen returns, we are happy.”

In Pittsburgh Nationwide partnered with Columbus developer Frank Kass to redevelop the former Homestead steel complex, covering 270 acres along the Monongahela River. This massive steelmaking tract, once owned by Andrew Carnegie, closed in 1986, is a Rust Belt relic. The $350 million project erected 2.3 million square feet of commercial space, including 60 retail stores, 23 restaurants, 235 apartments and a 22-screen theater. Occupancy is strong.

In Des Moines Ellis is constructing a $250 million headquarters and parking garage for Nationwide’s Allied Insurance unit. The 1.1-million-square-foot project is aimed at rejuvenating a shabby section of Des Moines with parks and public amenities.

Not all its projects are turnarounds, although some are iffy nonetheless. In Florida Nationwide is building 36 oceanside condominiums (priced $966,000 and up) and 54 boat slips in a marina development in Palm Beach Shores. Cost: $46.1 million. The Florida condo market is a wee overbuilt.

Ellis’ biggest project to date is the one in Nationwide’s back yard—a $650 million office and sports entertainment district anchored by a hockey stadium for the Columbus Blue Jackets. The development is 80% completed. Construction starts this year on a $55 million baseball stadium for the Columbus Clippers, a triple-A minor league team. Upcoming is a $50 million, 20-story condo tower, with units priced from $350,000 to $1 million. Nationwide has formed a partnership with Dispatch Printing, publisher of the newspaper, and private investors.

Ten years ago the arena site was a deplorable collection of empty parking lots and dilapidated warehouses. The centerpiece was a rotting 150-year-old limestone prison the state had abandoned. Commuters motoring downtown gaped at the ruins. The area, however, also just so happened to be across the street from Nationwide’s 38-story headquarters.

The hockey arena anchors Columbus’ new office and entertainment district.

Columbus (pop. 730,000) may be in better shape than most midsize cities. The town is the state capital, contains Ohio State University and is home to the head offices of Limited Brands, Cardinal Health and Wendy’s International. But the city has a familiar weakness: Easy freeway access to abundant, cheap and developable farmland has sucked many jobs out of downtown. What’s left: aging office buildings with a vacancy rate of 18% and very little retail or restaurant life.

In the mid-1990s Nationwide saw an opportunity. A group of Columbus area investors headed by John H. McConnell, founder of steel processor Worthington Industries, won the professional hockey franchise. The group needed a stadium. Nationwide agreed to build the $155 million, 18,000-seat arena and began assembling a 75-acre brownfield site nearby. Nationwide didn’t own all the land. The biggest piece, the 22-acre prison grounds, had been polluted by the metals, solvents and oil used by prison labor. Fortunately the city agreed to spend up to $10 million to clean up the parcel.

Since opening in 2000 the Arena District has been a big hit. At night restaurants and bars bustle with afterwork traffic, and moviegoers pour into an 11-screen multiplex. Some 4,200 workers fill the 1.3 million square feet of office space—95% leased at above-market rents of from $23.50 to $26 per square foot. The district has pulled tenants from both the suburbs and downtown capital square, where rents run from $18 to $22 a square foot.

Demand for housing has far exceeded expectations. Thus far 350 units have been built and sold, 109 more are under construction and 250 more on drawing boards. Some government handouts are helping this project take root. Venturesome homeowners receive a ten-year tax abatement. Employers moving downtown get a five-year tax holiday set at 50% of the income tax withheld from the paychecks of new workers.

It remains to be seen whether this complex will weather a recession and the end of the tax giveaways. But similar projects like the ones Rouse put up in Baltimore and in Boston’s Faneuil Hall area have become established. This may yield Nationwide financial as well as psychic rewards. **F**

Additional reporting by Emily Schmall.