

Compliments of David Sugarman & Angela Augsbury, Sales Representatives

Coldwell Banker Rhodes and Company, Brokerage

www.sweetdeal.info

Mid-sized players tread cautiously in U.S. market

The Globe And Mail
Tue May 11 2010
Page: B7
Section: Report On Business: Canadian
Byline: David Milstead
Source: Special to The Globe and Mail

It's nice to be nimble in real estate investing, but Canadians are learning that size and scope - and a tolerance for risk - may be the key to taking advantage of distress in the United States commercial market.

There's been no shortage of confirmation of this trend, as Brookfield Asset Management seems poised to win the battle for bankrupt Chicago-based mall owner General Growth Properties, and RioCan, the country's largest REIT, continues the U.S. expansion it launched in 2009's fourth quarter.

However, it appears to be a game mostly for the big players. Small- to mid- sized firms do not seem to have developed an appetite for dipping into the U.S. market. And if the spirit is willing, the complexities of the U.S. downturn present a unique set of obstacles, Canadian real-estate professionals say.

"Investors are looking for comfort in some signs of recovery in the U.S.," says Milton Lamb, chairman of the national investment team for Colliers International and one of the authors of the firm's periodic investor-sentiment survey.

In the most recent survey, released last week, Canadian investors say their home country offers the best risk-adjusted returns because of the strength of the market. "The flip side is because of the dislocation in the U.S., there's greater opportunity for greater returns - and they're demanding a risk premium for that," Mr. Lamb said.

Mr. Lamb says Canada's major pension funds are "actively investing," buying directly or through joint-venture partnerships. Real estate investment trusts, or REITs, are also active, and the major life insurance companies, Sun Life and Manulife, have such significant U.S. business "there's no reason they shouldn't" buy U.S. properties, he said.

American investors, in Colliers' global survey, have pegged the U.S. market to be at its rock bottom. But Mr. Lamb says that's not enough to sway Canadians. "Our natural inclination is we'd rather buy just as it's coming off the bottom rather than try to buy exactly at the bottom."

George Carras, president of tracking firm RealNet Canada Inc., says a couple of his clients are focusing on apartment buildings in the U.S. because, they say, cash flows are more stable than those of office, warehouse or retail properties.

The "deep pool of investors" who acquire Canadian apartment buildings keep prices high and yields low, Mr. Carras said, and his clients see opportunity for higher returns south of the border.

Otherwise, "I have clients who had gone to the States who have returned to Canada," Mr. Carras said. "They view Canada as stable, while those who are going down to the U.S. are opportunistic."

Karen Barry, president of Barry Commercial Real Estate in Calgary and chairwoman of the Canadian Commercial Council of Realtors, discussed the question with her board last week at The Globe and Mail's request. "We certainly have a wait-and-see attitude at this time," she summed up.

A significant problem, she said, is that many of the distressed properties in the United States are changing hands through the sale of notes or loans, not through a real-property transaction. That means the buyer does not own the building outright - unless, of course, one goes through the process of foreclosure.

Canadian real-estate investors may have healthy balance sheets here at home but they can't escape the financial challenges of the United States if they're relying on American financing, said Fred Harris, of commercial mortgage company Canada ICI Capital in Calgary.

Compliments of David Sugarman & Angela Augsbury, Sales Representatives

Coldwell Banker Rhodes and Company, Brokerage

www.sweetdeal.info

"My clients tell me it's very difficult to secure what they consider reasonable financing down there," he said. They're putting down equity of 35 per cent to 40 per cent, whereas in Canada they might be able to put down 25 per cent to 35 per cent, Mr. Harris said.

"Here you can have a lineup of three to four people wanting to finance you. Down there, I don't think that's happening," he said.

An alternative to all of these ways to invest in U.S. properties is buying into an investment fund. Colliers' Mr. Lamb says "there are significant amounts of U.S. funds coming up to Canada trying to get Canadian capital to go back to the U.S. It's easier to come to an area that's done well

and pitch them on investing in real estate, rather than go to an area that's been hurt and ask them to invest in real estate."

If there's a perfect example of a Canadian investment vehicle positioned to take advantage of the U.S. market, it may be Brookfield's Opportunity Funds.

David Arthur, the manager of the funds, say they try to acquire quality properties at 40 per cent to 80 per cent of replacement cost and add value through additional tenants or spending more on the property. It has made \$1.8- billion in purchases since 2006 - 20 million square feet, the majority in office buildings - and 90 per cent of its holdings are in the United States.

"For the reasons we're all familiar with - the dislocation in the U.S. - there are more opportunities there: owners forced to deleverage by their banks; corporate owners wanting to move real estate off their books to free up capital for business purchases; and banks wanting to remove real estate from their balance sheets," he said.

"One of the things we look for is larger deals across multiple markets that require a large amount of capital," he said. "We think that plays to our strengths."

NOT READY TO LEAP

Here are the top four reasons Canadians aren't flocking to take advantage of the turmoil in the U.S. commercial real estate market, according to Karen Barry, chairwoman of the Canadian Commercial Council of Realtors:

Bundling

It's not typically the properties themselves that are for sale. Banks and other note holders are selling the loans, which can mean multiple distressed properties across a number of U.S. cities are bundled into one transaction. A potential Canadian buyer would have to foreclose and go through the courts to be the property owner. And "a medium-size investor would have to be knowledgeable in more than one (geographic) market, so that's a real obstacle."

Difficult financing

It can be hard finding the money, particularly if a U.S. bank needs to be involved. "If financing is difficult in Canada, it's more so in the U.S."

Stressed tenants

Commercial properties can be only as good as the tenants who provide cash flow. And it's far from clear that the U.S. businesses that will be tenants are on the upswing and will continue paying rent.

Taxes, U.S.-style

Compliments of David Sugarman & Angela Augsbury, Sales Representatives

Coldwell Banker Rhodes and Company, Brokerage

www.sweetdeal.info

There are always tax implications in the buying and selling of real estate, and adding another revenue agency - specifically, the U.S. Internal Revenue Service - results in a layer of complexity that isn't there in a domestic transaction.

David Milstead

© 2010 CTVglobemedia Publishing Inc. All Rights Reserved.