

FEATURE Small-town malls overtake apartment buildings as potential income-producing investments

Retail hits REIT radar

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The rebound in commercial real estate markets over the past two years is making B.C. secondary markets a desired hunting ground for real estate investment trusts (REITs), which are looking everywhere from Courtenay to the Kootenays for deals – primarily retail properties.

While properties in the Lower Mainland are an essential component in the portfolios of all the major investors, the lack of supply that keeps asset values strong and cash flow steady also limits the opportunities for buyers to acquire additional properties.

Winnipeg-based **Temple REIT** picked up the 126-room Inn at the Quay hotel in New Westminster this spring for \$17.3 million, but it was the one hotel deal by a REIT in a province that was home to several such transactions – primarily in northern B.C. – at the height of last decade’s real estate boom.

“I know more would like to be here,” said **Tom Andrews**, senior vice-president with **Colliers International Hotels** in Vancouver, regarding REIT involvement in the B.C. hotel market.

The opportunities to purchase hotel assets are few and far between, however.

Meanwhile, strong demand for multi-family properties in the Lower Mainland has pushed most of these assets out of the range of consideration for REITs, whose investors want to see healthy dividends on a regular basis.

While many multi-family REITs came to



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B.C. during the mid-2000s in search of stable investments, steady appreciation in property values means there’s now greater upside in selling the sites and recouping the accumulated value. The cash is being redeployed in markets where capitalization rates – a measure of the buyer’s return on investment – are higher.

“They would love to be here,” said **David Goodman**, a veteran apartment broker and principal of **HQ Real Estate Services Inc.** in Vancouver. “[But] our numbers just aren’t compelling enough. ... They seem to be coalescing around Alberta and Ontario, where the yields are five, six, seven [per cent], as opposed to three, four, five [per cent in B.C.]”

Goodman points to REITs such as Calgary-based **Boardwalk REIT** and Toronto’s **TransGlobe Apartment REIT**, which recently went private, among those that have

sold B.C. holdings. Boardwalk’s attention is now on higher-yielding opportunities in Alberta and Ontario.

Toronto-based **Canadian Apartment Properties REIT** is now the biggest REIT in the province’s multi-family market, but Goodman pointed out that it’s stayed in the game thanks to an aggressive upgrades strategy.

“They go in and if they buy at a four cap, it’s really their intention to get it up to a 5.5 cap in about 18 months. But they spend a fortune – they refurbish, rehabilitate, retrofit.”

Small-town retail

Opportunities exist – both in prices and respectable cap rates – in the hinterland, where a number of retail assets have been snapped up this year. Secondary markets hit their stride during the recovery and now offer cash flow in spades.

RioCan REIT bought Chahko Mika Mall in Nelson for \$31 million and a cap rate of 6.7 per cent, for example, while **Primaris Retail REIT** paid \$45.2 million for Driftwood Mall in Courtenay. Both companies have sizeable portfolios in B.C., with Primaris also owning malls in Kamloops, Kelowna and Nanaimo.

While retirees favour these communities, many are also home to universities – Kelowna and Nanaimo, for instance – and are regional centres with a large catchment area.

The hotbed of Okanagan retail activity, Westbank, has also seen activity, with **Artis REIT** boosting its ownership position in two local retail properties – Westbank Hub Shopping Centre and Westbank Hub Centre North.

“Investment options are limited compared to what they were prior to the recession,” explained **Brady Fleguel**, a principal at Vancouver appraisal firm **Burgess Cawley Sullivan & Associates Ltd.** “There’s not a lot of [retail] being built right now. It’s a scarcity combined with being a bit of a safe-haven.”

The lack of new assets combined with a reluctance on the part of current owners to sell means cap rates have started to come down, but they’re still above what’s available in urban centres and double what big-city multi-family properties offer.

Fleguel pegged retail cap rates in secondary markets at approximately 6 per cent, while prime properties can be a percentage point below.

“We’re now seeing a compression of cap rates such that secondary and tertiary assets are trading for yields that are almost on par with the good stuff,” he said.

Retail is likely to remain on REIT menus so long as returns remain higher than other classes of assets. ♦