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REITs still have right stuff to go far in investment game

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A couple of weeks ago, a concerned Philip Reichmann, head of the massive O&Y real estate group, was urging his minority investors to accept a $2-billion deal for the portfolio because he believed the market was peaking.

Now, some industry players are saying that the decision by the O&Y REIT (real estate investment trust) minority investors to turn down the deal is an indication that, far from finished, there's plenty more gas left in the REIT tank.

If O&Y investors believed they might not find anything better to invest in, it means there might still be more upside potential left for quality real estate investments.

Arni Thorsteinson says he believes that, too.

"It shows there is still significant interest when the largest institutional investors in North America decide, in their professional judgment, that this is not the time to sell," said the veteran Winnipeg real estate manager/investor/developer.

Thorsteinson continues to successfully raise money and acquire properties in his two REITs -- Huntingdon and Lanesborough -- and as long as interest rates remain low, he believes there will be an appetite from investors for yield-producing REIT units. Between the two REITs, he has raised more than $200 million over the last 24 months. Huntingdon just closed a $100-million offering late last month and since then has announced the acquisition of 11 properties for close to $160 million.

"We obviously believe there are good acquisition opportunities in Canada," Thorsteinson said. "As long as interest rates stay low we think there is tremendous institutional and retail demand for investment trusts. They are very attractive."

REITs, which were created in Canada in the mid-1990s, are publicly traded entities that invest in income-producing real estate where the income earned flows to the unitholders before it is taxed, giving regular investors the same kind of income enjoyed by direct owners of such properties. They also have restrictions on debt ratios and are required to distribute virtually all distributable income to unitholders.

Thorsteinson points to a couple of recent examples of Australian institutional investors partnering with Canadian REITs in a couple of important deals in the last several months, as further indication that REIT opportunities are significant in Canada.

An analyst who specialized in REITs at one of the bank-owned Bay Street firms, who asked that his name not be used, said that conditions for REITs is fairly strong, but suggested that pension funds and foreign liquidity are providing competition for the REITs that they have not had to endure over the last five to six years.

"The Canadian REIT market cap has doubled in the past couple of years to about $20 billion now," the analyst pointed out.

"But there are more sources of capital out there who can afford to pay more. REITs don't have the competitive edge they used to have and the rate of growth has started to slow down."

But that does not mean there is not still a lot of liquidity in the market and a persisting appetite for the yield that REITs generate.

"We believe there is exceptional demand for REITs," said Kevin Hooke, head of corporate finance at Wellington West Capital, which has sold significant pieces of both Huntingdon and Lanesborough offerings.

Hooke said the stability of the cash flow is what is driving demand.

That demand is generally believed to be sustainable, at least in the medium term. Whereas in the past hot commercial real estate markets led to the inevitable collapse -- the late '80s boom leading to the early '90s collapse -- the thinking is that better discipline prevails in the market now, eliminating excesses that might have occurred in the past.

"The volatility has always come from the supply side, not the demand side," the Bay Street REIT analyst said. "This time around supply growth has been controlled. There is a a lot more discipline in the market."

Another factor suggests the success of REITs breeds more success.

"Buyers are more sophisticated and more substantial," Thorsteinson said. He mentions names like Skalbania and Campeau and others whose leveraged acquisitions in the late '80s helped jack prices up to unsustainable levels.

"Now the buyers are institutions, publicly owned corporations and REITs who are pretty cautious about what they buy," Thorsteinson said.

In the days of the limited partnerships, Thorsteinson himself might not have been quite so cautious, but to ensure the income yield investors are looking for, REIT managers have to make sure they make the right acquisitions at the right price.