

## PROPERTY REPORT / INVESTOR PROFILES

# The quiet power of private investment

**With returns higher than institutional investors', private individuals or groups are a force**

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Large corporate real estate transactions may dominate newspaper headlines but it is private investors who dominate the market, say Canadian real estate insiders. And, while returns on institutional real estate investments have surged well into double-digit levels, private investors are pocketing profits twice as large.

"The press covers the huge deals, the public companies, the real estate investment trusts. It doesn't cover deals done by private investors and that is probably the most active segment of the market today," says Blake Hutcheson, head of the Canadian operations of broker CB Richard Ellis Ltd.

With a variety of options for high-net-worth individuals, and returns higher than for institutional investors, private individuals or groups are a significant force, especially for transactions under \$10-million. Private investment funds, particularly, are becoming popular vehicles.

"Private investors account for about 40 per cent of all transactions recorded across Canada and in many case they are pocketing returns in the 20 per cent to 30 per cent a year range," Mr. Hutcheson said.

By comparison, the most recent Canadian Property Index showed that institutional investors averaged a 12.9-per-cent return on all forms of property investment last year, compared with 8.4 per cent in 2003. Retail investment returns led with an average 16.9-per-cent annual return, followed by 14.4 per cent for industrial properties, 10.8 per cent for office and 6.1 per cent for residential. The index is maintained by the Institute of Canadian Real Estate Investment Managers/International Property Databank.

Private investment in real estate can cover a wide range of options, says George Carras, president of RealNet Canada Inc., which tracks real estate transactions across the country. They can include individuals buying or selling, partnerships, syndicates or even funds made up of individual investors or a combination of individual investors and institutions.

"What I can tell you is that private investors are by far the largest force in sales valued at \$10-million or less," he says. "Since we don't have a lot of large assets in Canada, \$10-million or less makes up the bulk of the market."

In the period ending last June 30, the most recent for which RealNet has statistics available, private investors accounted for 40 per cent of all transactions under \$10-million. In the under \$10-million range, they represent 75 per cent of all apartment sales and 45 per cent of all retail property sales.

The reason?

Real estate favours private investors, Mr. Hutcheson says. "The ability to use the capital cost allowance provisions [depreciation] to reduce taxes on all income is a lure. . . . In addition, a good investment can provide both cash flow and longer-term capital appreciation.

"Besides, just like mutual funds, there is a product that suits the needs of almost any high-net-wealth individual."

High net wealth is the key to investing in commercial real estate. Purchasing a \$2-million building will require about \$400,000 cash as a 20-per-cent down payment. Units in funds organized by wealth management companies or syndicators usually cost in the \$50,000 to \$250,000 range. Partnership stakes vary according to the size of the deal and the number of partners involved.

"Partnerships are usually structured with a general partner in charge and a number of limited partners," says Michael Cowie, executive vice-president at **Colliers International** in Toronto. By his own account, he has participated in about \$100-million worth of real estate partnerships in the past five years.

"They are usually structured on the basis where an investor gets a certain guaranteed return in the 7-per-cent to 10-per-cent range each year with a share of the capital appreciation when the property is sold. Taken together, the cash flow each year plus gain on the sale can reach into the 20 per cent to 30 per cent a year range."

Mr. Cowie recently closed one such deal, purchasing a commercial structure on the western fringes of the Greater Toronto Area for \$10-million. In that deal he had three partners and bought from a group with 11 partners.

Private investment funds have become increasingly popular with high-net-worth individuals, says Paul Braun, managing director of **CanFirst Capital Management** of Toronto. In 2002, for example, CanFirst organized a \$45-million, seven-year closed-end fund to invest in industrial properties. To date it has generated a 33-per-cent a year return in cash and capital appreciation. Minimum investment in that fund was \$100,000.

CanFirst this year raised a \$55-million fund, also aimed at industrial real estate investment, with units priced at \$250,000.

"We could easily have raised more," he says. "There is no shortage of private investors. The problem we face is a lack of supply of industrial properties to invest in. They have become tremendously difficult to find but we have a two-year window to invest the money, then a further five to improve the value of the assets and sell."

**Cumberland Private Wealth Management Inc.** is another company that has had considerable success with private real estate investment funds. In 1998, it organized a fund that acquired older industrial buildings in Toronto's King Street West and Spadina Avenue area, upgraded and improved them and eventually rolled them into a vehicle now known as Allied Property Real Estate Investment Trust. Original fund investors pocketed returns "significantly greater than 20 per cent a year," says Gerald Connor, Cumberland's chairman.

"There is money to be made in niche markets for private investors," he says. "We look at things in the \$5-million range. We want to acquire at about \$40 to \$50 a square foot, spend \$30 to \$35 in improvement and get a building valued at \$100 a square foot.

"We look to double our money in five years."

Cumberland raises a new fund valued at between \$20-million and \$30-million each year. If the fund cannot find anything to buy, then the money is returned to investors. If purchases are made, then the investment is locked in for up to seven years. Minimum investment is \$50,000.

In Halifax, **Future Inns Canada Inc.** has provided its investors with returns running between 20 and 30 per cent a year, says Sandy McEachern, vice-president. The company has hotels in Halifax, Dartmouth, Cardiff, Wales, plus one under way in Plymouth, England, and another two in the planning stages, one in Moncton, N.B., and one in Guelph, Ont.

All were financed and are now owned by individual investors, who purchased units ranging in value from \$150,000 for the original Dartmouth property to \$250,00 for the most recent Plymouth Future Inn.

The approach was based on syndications organized as tax-sheltered investments by the Journey's End chain in the mid 1980s.

The original Dartmouth property was 145 rooms and cost \$3-million. The new Plymouth Future Inn, by comparison, will cost \$11-million.

"Investors look on it almost like an annuity," Mr. McEachern says.

### Buyer break-down

Purchaser profiles for properties over \$1-million between January, 2000, and end of June, 2004.

	Apartment	Industrial	Office	Retail	TOTAL
Foreign	15%	3%	9%	5%	8%
Private	67%	32%	30%	46%	41%
Public & Institutional	17%	25%	55%	35%	36%
User	1%	40%	6%	14%	15%

*SOURCE: REALNET CANADA INC.*

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