"C condition in B locations"

The single defining feature of the multi-family apartment industry in Canada is that it doesn't have a single defining feature, although the closest it gets to a common denominator is its entrepreneurial energy — from the lone "mom and pop" operation to the vast rental apartment empires that span the country.

Bob Dhillon

Martin Zegray

Blair Tamblyn

THERE ARE THOSE WHO, FOR EXAMPLE, TURN SOW'S EARS OF decrepit apartment buildings, occupied by troublesome tenants, into silk purses of much higher rents, lower turnover and infinitely higher property values.

It can be a high-risk business that doesn't tempt all investors, certainly not pension fund and other institutional managers who would rather not grub around with building permits and general contractors. Unlike Bob Dhillon, president and CEO, **Mainstreet Equity Corp.** Calgary, which has since 1998 completely renovated and repositioned run-down apartment buildings in Vancouver, Edmonton, Calgary, Toronto, creating a niche "mid-market" collection of 4,200 apartments scattered among buildings rarely larger than 100 units.

The company buys single buildings and up to whole neighborhoods of apartments at a time, generally properties few others would touch, and always below market and replacement value. They buy them because they've been mismanaged and need extensive renovation to bring them up to market standards. Dhillon characterizes them as being in "C condition and in B locations. We're not the Four Seasons. We're the Holiday Inn Express of the apartment mid-market," he says.

That accounts for the Mainstreet part of the name. The Equity part represents the company's reliance on its own financing. "We grew the company from zero, without ever going to the capital market, to nearly $200 million of assets, without any equity dilution. We did 50 buildings before did a convertible debt issue.

"It's a neglected segment, with unbelievable opportunities. There is property out there to acquire, but you have to buy right, cut out the middle man by having construction crews in your back pocket, and have effective marketing and operating platforms," Dhillon says.

But it's not bulletproof. Buy underperforming buildings, he says, and you lose money. But at least there won't be any competition from pension funds and other institutional investors, who aren't interested in buildings with 60 units desperately in need of an expensive renovation and imaginative repositioning.

Dhillon says the company includes extensive energy efficiency measures in its renovations, which can cost up to $6,000 per interior for new hardwood flooring (in eastern Canada) and carpeting out west, (which confirms our differences). "The average Canadian will spend $150 more on rent a month to get a decent apartment. Not everybody wants to live in a dump."

He isn't the least bit concerned about losing tenants to condo rentals or home ownership. "Significant demographic shifts will create more renters. Immigration is increasing. There is in-migration from rural areas into cities. The population of Saskatchewan, for example, is declining but the population in Saskatoon is increasing. There is little if any new supply because apartments are trading below replacement cost," he says.

There likely isn't a significant apartment owner in Canada that isn't coming to grips with the rising cost of energy. Martin Zegray, senior vice-president, **Realstar Management**, Toronto, says the company has locked in energy prices by buying the volume of natural gas it figures it will need for a few years on the futures market. It is also installing energy consumption controls and regulators in its buildings.

That's understandable. Realstar's rents are typically $1,000 a month per suite and utility costs are typically $2,000 per suite per year, but have risen by 10 to 20 percent a year over the past five years. Meanwhile rents have been raised by about 2 percent per year for its tenants. Realstar has apartments in the three western provinces, Ontario, Quebec, Nova Scotia and Michigan.

Timbercreek Investments Inc.,Toronto, manages approximately $200 million worth of apartments, like Mainstreet Equity in terms of scale, mainly in multi-family real estate through private funds, predominately in the real estate sector, and was established a year later. Timbercreek also "buys assets in good locations which are not being operated to their full potential", as company president Blair Tamblyn puts it. "If you're organized and properly formulating your budgets you can squeeze an extra 5 or 10 percent out of those buildings".

Timbercreek has only sold one asset – its first acquisition, and only because it couldn't acquire anything else in that neighborhood.

"Cash flow is what drives our acquisition strategy," Tamblyn explains. "We're constrained by low cap rates, so we need a 7 cap building, given financing rates today, to generate our required yield. We look for buildings with some degree of problem, that is under managed or in a market that's in a bit of a trough.

"We start with landscaping at the curb and work our way into the lobby, the common areas and apartment units last. Energy conservation and efficiency? Yes, we manage energy in different parts of the building at different times of the day," he says.

"A year and a half ago we bought a building in Windsor because we thought the market was being unfairly penalized for the economic situation the city is in. We'll hold it for 10 or 15 years, and hopefully it will turn out to have been a sound investment," he says.

There is still "plenty of room to acquire assets, one-off buildings or small portfolios, improve them and add to a portfolio", he adds. Would Timbercreek venture into the United States? "If the fundamentals supported our model, yes, but not for now. There are plenty of opportunities in Canada." CAIR

Albert Warson