



3 9080 00589045 1

CANADIAN INVESTMENT IN THE U.S. REAL ESTATE MARKET

by

William Richard Evans
H.B.A., Business Administration,
The University of Western Ontario, Canada
1983

Submitted to the Department of Architecture
in partial fulfillment of the requirements for the
degree of Master of Science in
Real Estate Development at the
Massachusetts Institute of Technology
October, 1989

© William Richard Evans 1989

The author hereby grants to M.I.T. permission to
reproduce and distribute publicly copies of this thesis
document in whole or in part. *WRE*

Signature of author

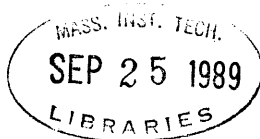
William Richard Evans
Department of Architecture
July 31, 1989

Certified by

James McKellar
Professor
Department of Architecture
Thesis Supervisor

Accepted by

Michael Wheeler
Chairman
Interdepartmental Degree
Program in Real Estate Development



Rotch

Acknowledgements

This thesis represents the effort of a Canadian student possessing previous employment experience with one of the major Canadian developers referred to within this research. Research was conducted over a two-month period, during which time the author spent considerable time interviewing in Canada.

The Canadian real estate development industry, in general, is extremely private and tightly controlled by a relatively small number of companies. Very little has been documented on the industry and therefore interviews were a critical component of this research effort. A variety of Canadian industry participants agreed to be interviewed and I thank them for their interest and cooperation. Specifically, I would like to acknowledge the following individuals and companies:

Bernie Ghert, former President of Cadillac Fairview Corporation; David King, former President of Campeau Corporation; Neil Wood, President of Markborough Properties; Ian Rankin, President of Trilea Centres Inc.; Donald King, President of Marathon Realty; Benjamin Swirsky, President of Bramalea Limited; Lorne Braithwaite, President of Cambridge Shopping Centres Limited; James Bulloch, President of Cadillac Fairview Corporation; Harry Rannala, Analyst, McClean McCarthy Limited; and Donald Tigert, Analyst, Burns Fry Limited.

I also would like to express my appreciation to my advisor, Professor James McKellar of the Center for Real Estate Development at the Massachusetts Institute of Technology.

Finally, I am greatly indebted to my wife for her editorial assistance and patience throughout this research experience.

CANADIAN INVESTMENT IN THE U.S. REAL ESTATE MARKET

by
William Richard Evans

Submitted to the Department of Architecture on July 31, 1989 in partial fulfillment of the requirements for the Degree of Master of Science in Real Estate Development.

ABSTRACT

The nature, scope and diversity of Canada's largest real estate development companies were evaluated. Ten specific development companies were identified and profiled. Particular emphasis was placed on how these Canadian development companies have amassed such considerable real estate investments in the United States. Specifically, differences between the two nations' real estate markets, reasons for considerable Canadian investment in U.S. real estate, and the success of various investment strategies were identified and evaluated.

It was found that Canadian investment in U.S. real estate has been considerable over the past twenty years and is projected to continue to grow in the future. In addition to reasons why international capital has been attracted to the U.S. real estate market, Canadian developers had strong experience with operating regional offices from a distance, a national banking system which was prepared to advance funds on the basis of corporate credit, and excellent experience in dealing with heavily regulated domestic real estate markets. A number of potential U.S. investment strategies for Canadian companies to pursue were evaluated and recommended for specific types of Canadian real estate development companies and real estate products.

Thesis Supervisor: James McKellar
Title: Professor, Department of Architecture

Table of Contents

	page
CHAPTER I: INTRODUCTION	6
CHAPTER II: FOREIGN INVESTMENT IN THE UNITED STATES	
Overview	9
Foreign Investment in U.S. Real Estate	12
Notes	17
CHAPTER III: CANADIAN REAL ESTATE DEVELOPMENT INDUSTRY	
Overview	18
History	19
U.S. Investment Rationale	26
Canadian Industry Outlook	31
Notes	35
CHAPTER IV: THE CANADIAN DEVELOPERS	
Carena Developments	37
Olympia and York Developments, Ltd.	39
Campeau Corporation	42
Trizec Corporation	45
Bramalea Limited	50
BCE Development	52
Marathon Realty Company, Ltd.	53
Markborough Properties, Ltd.	55
Cambridge Shopping Centres, Ltd.	56
Cadillac Fairview Corporation	57
Notes	60
CHAPTER V: U.S. INVESTMENT STRATEGY	
Overview	62
Canadian Developer Strategies	65
Internal Development	72
Asset Acquisition	74
Corporate Acquisition	78
Partnership	82
Notes	86
CHAPTER VI: CONCLUSION	88

CHAPTER I

INTRODUCTION

Canadians have been investing in United States assets for years. Starting in the early 1970s, particular emphasis on investment in U.S. real estate began. Since its inception, Canada has played an increasing role in the U.S. real estate market.

This research was a result of the author's desire to investigate the nature and extent of Canadian investment in U.S. real estate and particularly the manner in which it has been made. The neighboring U.S. market represents a tremendous opportunity for Canadian development organizations, many of which have both succeeded and failed in their U.S. endeavors.

This research is broken down into six chapters. This chapter will briefly summarize the conclusions extracted from this experience. Chapters II and III will provide a detailed overview of foreign investment in the United States and the Canadian real estate development industry respectively. In Chapter IV, ten of the largest development companies in Canada will be profiled, emphasizing their respective ownership and the scope of U.S. activity. Chapter V evaluates in detail the strategies utilized by these Canadian firms in making U.S. real estate investments. Finally, and most importantly,

Chapter VI presents conclusions drawn by the author based on this research.

A summary of conclusions reveals:

1. Although largely unseen, the investment of Canadian developers in U.S. real estate is significant. As a nation Canada ranks among the top five foreign investors in U.S. real estate markets. Much of its investment activity has been concentrated in major metropolitan U.S. cities in the form of office buildings, shopping centers, industrial facilities, hotels, nursing homes, and residential product.
2. Canadian developers have been drawn to the U.S. market for a variety of reasons. Limited growth opportunities within their domestic market, a national banking industry willing to lend based on corporate credit, and a history of successfully operating Canadian subsidiary regional offices from a distance have in part all contributed to considerable U.S. investment activity.
3. The Canadian development industry is uniquely distinct from the American industry. Ownership of the major development companies is concentrated in very few hands and all companies are fully diversified by product type and possess national operations. Furthermore, these companies have had to adapt to the regionally-driven U.S. market and its business and ethical morality compared to their Canadian experience. Canada's real estate assets have not attracted international demand to the extent U.S. assets have, and therefore much more rational pricing levels exist for Canadian assets.
4. As a group, Canadian developers are among the largest in the world and domestic competition has forced them to become extremely aggressive and creative. The majority of companies have investments in U.S. real estate ranging from 30%-90% of their total asset base.
5. Canadian developers are very private and busy companies which are hesitant to share information concerning their operations for competitive reasons.
6. Four major investment strategies have been utilized by Canadian developers to gain access to the large and diverse U.S. real estate market.

Specifically, these are internal growth/ development, asset acquisition, corporate acquisition, and partnerships. In order to be successful in the U.S. utilizing any of these investment strategies, a Canadian company must match its historic skills and expertise to the appropriate strategy.

7. Internal growth/development has been and will continue to be a successful strategy for Canadian development companies in the U.S. office, industrial, and residential markets. This strategy has proven to be ineffective for U.S. shopping center investment.

8. Asset acquisition has also been successful in the past in capitalizing on unique market opportunities. Given the huge current and future demand for U.S. real estate and resultant excessive pricing levels, this strategy has become of secondary importance.

9. Corporate acquisition and short-term partnership strategies with U.S. developers have been and will continue to be the most effective means of entering the regional, relationship-driven U.S. shopping center industry.

10. Canadian investment in the U.S. real estate market must have an opportunistic premise. There is no such thing as the "perfect deal." It is a very long-term and difficult process. Those Canadian companies that master the challenges will be the industry leaders of tomorrow.

CHAPTER II

FOREIGN INVESTMENT IN THE UNITED STATES

Overview

Throughout the 1980s, world economies and financial markets have become increasingly integrated. This integration, in large part, is the result of numerous technological advances being made in information processing. In fact, most businessmen currently agree that world markets, to a significant degree, have become "globalized." This situation has allowed foreign investors to invest enormous sums of capital in the United States economy in both portfolio investments and direct investments, which include real estate.¹ The extent of foreign investment was adequately illustrated by the U.S. Commerce Department's recent U.S. Direct Investment analysis for 1988. The department defined direct foreign investment as "takeovers, new business ventures, and reinvested earnings." For the first time in history, total foreign direct investment in the United States surpassed that by U.S. firms abroad. The resultant analysis is presented in Table 1.

Table 1
U.S. Direct Investment
1988
(U.S. billion)

	In U.S. by foreign	Outside U.S. by U.S.
All countries	\$328.9	\$326.9
European community	193.9	126.5
Japan	53.4	16.9
Canada	27.4	61.2
Other Europe	22.5	25.7
Latin America/Caribbean	17.0	49.3
OPEC Members	6.2	10.2
Middle East	5.8	4.1
Australia/N. Zealand/S. Africa	5.6	15.2
Other	3.2	23.5

The \$328.9 billion of direct investment by foreigners represents a 21% growth compared to 1987 levels.

Furthermore, U.S. direct investment abroad only grew 6% to \$326.9 billion. The precise ranking by country was as follows:²

1. Britain
2. Japan
3. West Germany
4. Canada

In 1988 alone, foreign investors spent \$65 billion on United States assets versus \$40.3 billion in 1987.

Additionally, the number of large transactions in excess of \$1 billion doubled from 6 to 12 in 1988. The bulk of this incremental investment came from the British (\$21.5 billion), Japanese (\$14.2 billion), and the Canadians (\$10.4 billion).³

It is important to understand the reasons for this large and increasing foreign appetite for U.S. assets. Paramount to this growth has been the steady improvement in the United States economy over the past seven years, fueling higher levels of return available in this country versus foreign countries. The United States also represents a very large and diverse market possessing one of the most unrestricted economies in the world. Both of these above considerations have assisted in creating a very liquid world market for U.S. assets, enhancing both disposition opportunities and the timing of these dispositions. Additionally, the United States is characterized by a very stable political structure, highly skilled labor force, and in most cases a far less onerous tax system. Finally, given both the \$150 billion federal budget deficit and a \$120 billion annual trade deficit, the U.S. requires and relies on foreign sources of capital to finance its economy.⁴ Without foreign investment, the United States economy would be severely crippled. As a final note, foreign investment in the U.S. has become a very popular concern recently. Many states have begun

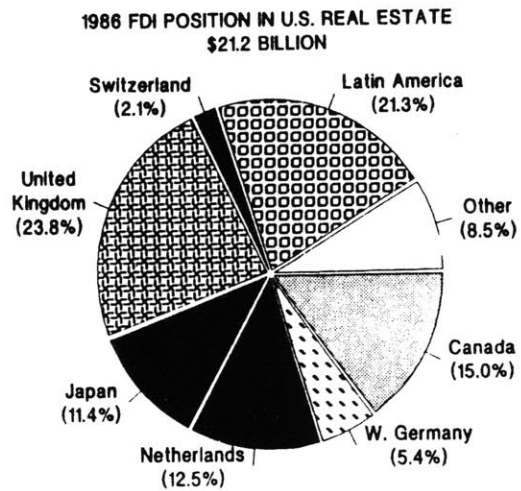
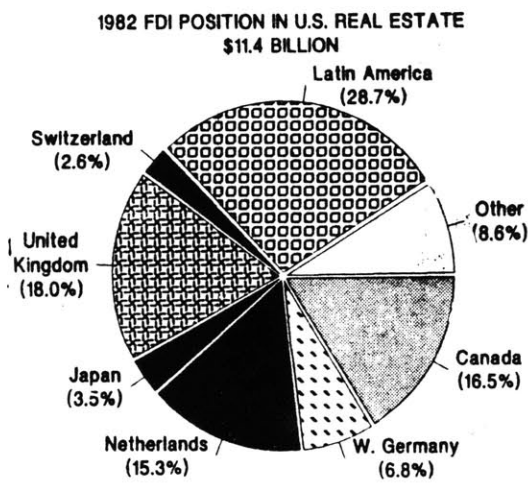
lobbying for more stringent review of foreign investment. As of yet, however, no formal action has been proposed or taken.

Foreign Investment in U.S. Real Estate

Included in this foreign preference for United States assets is a particular emphasis on real estate. Between 1982 and 1986, foreign direct investment in U.S. real estate has nearly doubled from \$11.4 billion to \$21.2 billion.⁵ This trend has continued through 1987 and 1988 and is expected to continue further into the future. Although, when examined separately, the amount of foreign real estate investment is staggering, in aggregate perspective it still represents less than 1% of America's total real estate.⁶ This percentage does increase, however, as the focus narrows to the central business districts of major cities in the United States. This type of investment is characteristically the most common form of foreign investment to date.⁷ Table 2 graphically illustrates the relative positions of international foreign direct investment in U.S. real estate. In 1982, foreign investment in real estate was primarily controlled by Latin America (28.7%), the United Kingdom (18.0%), and Canada (16.5%).⁸ By 1986, although the same three parties controlled the majority of foreign-owned U.S. real estate, an extremely aggressive investor had emerged. This nation was Japan. During this five-year period, Japan increased

Table 2

Total Foreign Direct Investment Position
in U.S. Real Estate
by Country of Foreign Investor
1982 vs. 1986



its ownership position, relative to the rest of the world, from 3.5% to 11.4%.⁹ The only other foreign nation to increase its relative share was the United Kingdom, fueled by British investors. By 1989, Japan had surpassed Canada and was second only to Britain in terms of U.S. real estate investment activity.

Foreign investment has grown considerably over the past decade. Foreign investment in real estate has remained at approximately 10% of total direct foreign investment. There are a number of key reasons for this retained share. Some reasons are similar to those of American investors, such as portfolio diversification, attractive rates of return generated through property value appreciation, tax savings via depreciation, and a growing income stream adjustable upwards by increasing rents. Other reasons are unique to the foreign investors themselves. As discussed, many foreign countries do not possess economies and governments which are as conducive to real estate investment as in America. Many of these countries have experienced very high levels of inflation and their investments in financial assets have experienced poor performance levels. As opposed to financial assets, real estate offers an excellent hedge against inflation. Another fundamental reason is the fact that the U.S. dollar has declined substantially in relation to many world currencies. This has caused the price of dollar

denominated assets to appear very low, particularly real estate. This issue is magnified when applying it to Japan. Not only has the U.S. dollar fallen significantly in relation to the Japanese yen, but in Japan land is such a scarce commodity that similar product, when it trades-- which is rare--commands prices forty to fifty times greater. Thus, quality real estate investment opportunities in Japan are very hard to come by. This scarcity of quality product has also occurred in a number of other nations as well. By virtue of its large size and depth, the U.S. real estate market also offers an opportunity for foreigners to learn new development and financing techniques, generate attractive returns, and add to their stock of human capital. Finally, even though the 1986 tax code severely undermined the U.S. real estate industry, the U.S. code still offers many foreigners advantages compared to the treatment similar assets receive at home.¹⁰

When analyzing foreign investment in U.S. real estate, Japan in particular seems to stir the American public's emotions since it is so visibly active, rich, and powerful. During the past six years the Japanese have been akin to the "new kid on the block." Unlike the Japanese, both the British and the Canadians have been buying America's real estate for years. Canadians have never received the kind of attention the Japanese have received, despite the

country's significant direct real estate investment position in the United States.

Based upon this introductory review of foreign investment in the U.S., and specifically direct foreign real estate investment, the remainder of this research will focus on Canadian direct investment in the United States real estate market.

Notes for Chapter Two

1. National Association of Realtors, Foreign Investment in U.S. Real Estate, The New International Landlords (Washington, DC: National Association of Realtors, 1987), p. vii.
2. "An Uncertain Welcome for Investors in the U.S.," Globe and Mail, July 3, 1989, p. B1.
3. "This Land is Their Land," Time magazine, June 12, 1989, p. 51.
4. "An Uncertain Welcome," p. B1.
5. National Association of Realtors, p. 11.
6. National Realty Committee, America's Real Estate (Washington: National Realty Committee, 1989), p. 52.
7. Lawrence Bacow, Understanding Foreign Investment (MIT, 1987), p. 4.
8. U.S. Department of Commerce, Bureau of Economic Analysis, quoted in National Association of Realtors, p. 14.
9. U.S. Department of Commerce, quoted in National Association of Realtors.
10. National Association of Realtors, pp. 15-17.

CHAPTER III
CANADIAN REAL ESTATE INDUSTRY

Overview

Canada's population is approximately one-tenth the size of America's population base. In fact, the entire Canadian population approximates that of the state of California. Additionally, most of its population is spread out along the U.S. border. Both of these factors have important ramifications pertaining to the Canadian real estate industry. These factors have resulted in many companies developing a national presence of operations as well as venturing south to the larger U.S. marketplace to facilitate growth.

The Canadian Institute of Public Real Estate Companies (CIPREC) includes a broad membership of industry participants and currently estimates the total asset base of its members to be \$65 billion.¹ Its membership specifically includes most of Canada's large real estate investment and development companies, real estate subsidiary companies of public companies, large privately owned real estate development companies, trust companies, life insurance companies, and banks. In addition to these participants, large pension funds, construction companies, foreign investors, and individual investors play an active and significant role in the industry.

This research has been intentionally defined to examine the U.S. investment practices of the largest Canadian public and privately owned real estate development companies. This definition was established for the following three reasons. First, a fractionalized sample of the industry was required given the time and scope restraints of this research effort. Secondly, this sample represents the most active and substantial participants in the Canadian industry. Finally, this sample includes the recognized leaders of the industry and, as a result, some of the most successful and wealthiest men in the world are its senior executives.

History

Starting with virtually no money, the top Canadian developers have within the past forty years planted the maple leaf throughout Canada, the United States, and England, and are investigating opportunities in South America, Europe, and Hong Kong. As a group they have become one of the world's largest real estate developers.²

Many of the large development organizations today started out in the 1950s in the homebuilding business. The business was rapidly expanding due to the demands of the post-war baby boom generation. The following table highlights the men who founded companies that would grow to become some of the largest development organizations in the country.³

Table 3

Founders of Canadian Real Estate Companies

Company	Founder
Campeau Corporation	Robert Campeau
Bramalea Limited	Tom Spriggs
	Magnus Paulson
	Donald Kerr
Daon Developments	Graham Dawson
	Jack Poole
Oxford Development	Donald Love
Fairview Corporation	Charles Bronfman
	Leo Kolber
Cadillac Development	Allen Diamond
	Joseph Berman
	Jack Kamin
Carma Limited	Roy Wilson
	Albert Bennett
	Howard Ross
Olympia and York Development	Albert Reichman
	Paul Reichman
Trizec Corporation	William Zeckendorf
	Eagle Star Insurance
Marathon Realty Company	Canadian Pacific
Markborough Properties Inc.	Brian Magee
	E.P. Taylor

All of these men were bright, aggressive and energetic entrepreneurs. In terms of representing this generation's zeal, William Zeckendorf stands above the rest. "There probably has never been anybody as colorful, as daring, as outrageous, as innovative, or as controversial on the North American real estate scene as the high-living, hard-driving Zeckendorf."⁴

All of these firms undertook extremely aggressive diversification programs to facilitate growth. This was diversification in terms of both product and geographic location. These companies, for the most part, represent the backbone of the Canadian real estate development industry in 1989. Each company has expanded its asset base to well in excess of one billion dollars through significant investment, primarily in Canada and the United States. Furthermore, a number of the companies have ventured into new industries, primarily natural resource based, to assist in diversifying the cyclical risk of their corporations' cash flows. Specific examples of this form of diversification include Olympia and York's purchases of interests in Brinco Ltd., Bow Valley Industries Ltd., Noranda Mines Ltd., and MacMillan Bloedel Ltd.⁵

Throughout the sixties and particularly the seventies, it appeared that all the Canadian development companies were making substantial gains in net worth as a result of their ambitious investing. A considerable amount of this

investment was in the U.S. Throughout this period very little strategic planning was conducted. The developers as a group were still extremely entrepreneurial in nature. All of the companies possessed very high debt-to-equity ratios and very few financial controls were utilized. "The companies were having the times of their lives, and the banks were backing them up 100% of the way since the bankers were very interested in growth as well."⁶ However, all of the land and construction loans were outstanding in the form of variable rate debt which eventually resulted in severe problems for the industry in the early 1980's when interest rates rose to greater than 20%.

Many of the firms had acquired substantial land positions as opposed to quality income generating assets. "A number of smaller developers went broke while larger companies were forced to restructure, sell assets, or be bought out."⁷ There are a number of good examples of this type of industry consolidation. At the top of the list is Oxford Developments. In the late seventies, the company was primarily financed by three institutions. These were Great West Life, Confederation Life, and Canada Trust. "Based upon its substantial expansion and acquisition program, Oxford was probably leveraged to the greatest extent of any of the large Canadian real estate companies."⁸ The three institutions repeatedly expressed concern, to Oxford's principals, over the company's

financial exposure. Concerned about its investors' potential withdrawal, Oxford's chairman made a \$26 per share offer for the company and took it private. In order to finance the buyout, Oxford was forced to sell assets. Specifically it sold its respected shopping center division to Great West Life (70%) and former Oxford Shopping Center executives Lorne Braithwaite and Donald Priddle (30%). These executives subsequently sold 20% of the 30% to a group of Canadian institutions. This transaction was the base of operations for what is now known as Cambridge Shopping Centers Ltd.⁹

Another significant example of industry consolidation in the early eighties was the purchase by Bell Canada Enterprises of substantially all of Daon's real estate holdings. The resultant company born out of this transaction would be Bell Canada Enterprises Development Coproration (BCED). The cause once again was related to Daon's extremely aggressive investment program prior to the adverse changes in the North American economy. Additionally, BCED followed up in 1985 with a U.S. \$1.1 billion purchase of Oxford Development's United States income property portfolio.¹⁰

It is important to emphasize that although the above transactions illustrate the industry's reaction to the last recession, many development companies both large and small experienced similar severe problems.

One final consolidation worthy of record, unrelated to adverse market conditions, was the merger of the two companies Cadillac and Fairview in 1974. At the time, Cadillac was primarily a home-builder while Fairview was a commercial developer. It was felt that the merger of the two companies would create a solid company with combined assets and management capable of taking on very large-scale projects. The merger was quite successful and indeed the company went on to develop large-scale projects throughout North America under the name Cadillac Fairview Corporation.¹¹

Table 4 highlights the major Canadian development companies and their respective current financial positions. The companies have been ranked according to total asset size. Two of these companies are private companies. Olympia and York Developments, has been private since its incorporation. Cadillac Fairview recently became privatized following the sale of virtually all of its U.S. assets in 1987 to JMB Realty and a syndicate of institutions led by Copley Real Estate Advisors.¹² Finally, Marathon Realty is a wholly-owned subsidiary of Canadian Pacific and Markborough Properties, is controlled by the Hudson Bay Company.

Table 4

Major Canadian Development Companies
(\$ Canadian millions)

Company	Year	Assets	Debt	Equity	Cash Flow
Olympia & York*	1988	\$NA	\$NA	\$NA	\$NA
Campeau**	1988	14295	13008	88	146
Trizec	1988	8618	6500	1312	275
Bramalea	1988	3765	2653	887	108
Cadillac Fairview*	1987	3393	1804	258	45
BCE Devt.	1987	3069	1927	685	17
Marathon***	1987	2033	1517	443	76
Cambridge	1988	1626	1093	510	43
Markborough****	1988	1481	1118	293	15
Coscan	1987	772	501	102	16
Tridel	1987	665	373	143	39
Carena	1987	655	176	472	31
Oxford	1987	650	156	146	(843)
Hammerson	1987	594	68	410	33
JDS	1988	342	109	221	7
Royal LePage	1987	328	147	85	36
HCI	1987	315	160	105	34
Atlantic Centers	1988	289	186	90	11
Ivanhoe	1987	278	190	74	39
Four Seasons	1987	196	82	69	24
Carma	1987	101	48	49	(4)
Melcor	1987	171	117	26	6
Revenue Prop.	1987	84	64	14	5
General Leasing	1987	81	51	18	2
Journey's End	1987	76	27	36	8
Viceroy	1988	27	5	20	7

* Private company

** \$US currency presentation

*** Wholly-owned subsidiary of Canadian Pacific

**** Wholly-owned subsidiary of Hudson Bay Company

Source: Harry Rannala, Canadian Real Estate Industry (Toronto: publisher, August 1988), p. 9.

Despite Canada's smaller population and limited markets, a number of the top Canadian firms are as well capitalized as the largest developers in the United States. The main reason for this fact is that many Canadian firms have aggressively diversified into varied real estate product in the larger United States market. Of the twenty-six companies highlighted in Table 5, eighteen, or 75%, possess considerable real estate investments in the United States. Furthermore, the top ten companies all have possessed U.S. real estate investments, with the exception of Cambridge Shopping Centres Limited. However, Cambridge Shopping Centres Limited has been actively pursuing retail real estate investment opportunities in the United States for the past two years.¹³ Author Susan Goldberg made the following observation:

In 1973, the Canadians had virtually no assets in the United States. By 1982, at least half of their assets were south of the border. By 1985, 75 percent of the assets of many of these firms will be in the U.S. They are not neglecting Canada, but the United States' larger population and its older cities yield many more development opportunities.¹⁴

United States Investment Rationale

Developers have an attitude of invincibility. Decision makers run these companies and if there isn't anything major to decide on, they create something. They are always thinking in the future. -- David King, former President of Campeau Corporation

Many of these Canadian development companies are still run either by their founders or by the seasoned executives who were responsible for building these businesses to their

current grand scales. Despite the size to which their assets have grown, these companies are still guided by a very small group of individuals. Ego always has and always will play a very large role in the real estate development business. The ability to make deals in the tough, competitive and visible United States real estate market went a long way towards stroking these egos. The importance of this force on explaining the Canadian developers' entrance into the U.S. cannot be overstated.¹⁵

Unlike the vast majority of U.S. developers, the Canadian companies grew very quickly to create a national presence. Based on the Canadian market's limited size and population, the national market began to be viewed as "the market"--particularly when tenants began to take on geographic diversification. A strong example of this is the national presence of Canadian department stores. The important result of this geographic diversification was that Canadian developers became very effective at operating the regional offices of their businesses from a distance. Hence, in relation to U.S. diversification, the question simply became, "If we can effectively go East and West, why not South?"¹⁶ In addition to geographic diversification by Canadian developers, the competitive nature and limited size of the market resulted in the majority of developers diversifying into new products. The most duplicated product diversification was from residential into office,

retail, industrial, and major mixed-use projects. Some of these developers also entered into retirement lodges, nursing homes and hotels. This diversification allowed these companies to develop skill within each market segment which assisted them greatly in establishing diversified U.S. portfolios.

With a number of very capable people competing against one another in a small community, a Canadian developer had to be good to survive. This environment produced a survival of the fittest syndrome. With first class office buildings across the street from each other, developers had to try to outdo one another to draw attention and tenants to their project. Canada has been a fabulous school where you were either good or got knocked out.¹⁷

Another important explanation for the Canadians' entrance into the U.S. market was capital. Prior to 1972, there did not exist distinct capital gains tax treatment associated with the sale of real estate assets. Instead, sale proceeds were simply treated as ordinary income and taxed at ordinary income rates. This provided a significant disincentive to sell assets. "Based upon the success of these companies, huge capital bases were built up."¹⁸ Furthermore, in order to minimize taxes through deferral, the companies were forced to continue to grow in order to generate deductions from new projects under development to offset taxable earnings of the corporation. Thus, the companies were constantly looking for new development opportunities to reinvest this substantial capital base. "Canada's opportunities were limited by

quantity and competition and therefore these developers looked to the larger U.S. marketplace."¹⁹

Probably the most critical reason for U.S. investment was the developers' relationships with the Canadian banking industry.

Canadian banks provided a huge advantage to developers desiring to invest in the United States. Their practice of lending money on corporate credit as opposed to specific assets made geographic diversification much easier relative to U.S. asset lending practices. When entering a new U.S. market, no new financing relationships had to be established. The developers were able to move very quickly on deals.²⁰

The Canadian banking system is quite different from the U.S. system. As opposed to the thousands of primarily regional U.S. banks, the Canadian banking network was national in scope and dominated by five major banking institutions. These institutions were the Royal Bank of Canada, Canadian Imperial Bank of Commerce, Toronto-Dominion Bank, Bank of Montreal, and the Bank of Nova Scotia. Based upon the Canadian people's propensity to save, these five institutions were eager to expand their loan portfolios with successful developers who had built up solid track records with them.²¹

As alluded to previously, there existed a fierce rivalry in Canada among developers for limited opportunities. This existence pushed their creative talents to successfully compete in the marketplace. International reputations began to develop from their

creative projects which assisted them in winning many development proposal designations in United States cities.²²

In general, much tougher zoning and regulatory red tape existed in most Canadian cities compared to the cities of the United States. In terms of U.S. investment, this factor had two important results. First of all, in U.S. cities such as Dallas and Houston, where very little regulation existed, minimal regulation offered Canadians the opportunity to "get into the ground much quicker," thereby eliminating certain approval risks. Secondly, in U.S. cities where strong building regulations existed, such as those in California and Massachusetts, the Canadians' experience was quite valuable in terms of successfully tackling the politics of development in these cities.²³

In the mid-1970s, as Canadian investment in the U.S. was on the rise, the U.S. real estate market experienced a severe decline in value. Most notable was New York City, where the entire city was facing potential bankruptcy. This economic reality provided many excellent buying opportunities for the asset-rich Canadian development industry. With a legal system, customs, and general set of business practices in the U.S. similar to those in Canada, the transition to investment south of the border did not include any significant barriers. As Bernie Ghert, former President of Cadillac Fairview recalled, "It was not as if

we were investing in France." Furthermore, convenient communication and travel to the U.S. market was readily available.²⁴ "In the seventies everyone got into the act. You saw others doing it and figured they were making money at it--at the time it was the thing to do."²⁵

Canadian Industry Outlook

The outlook for the Canadian real estate development industry is mixed. The continuation of the current economic cycle following the financial crisis in October 1987 suggests this cycle possesses the fundamentals for continued growth and longevity. Furthermore, the severe decline in the value of publicly-listed equity and fixed-income investments which occurred in October 1987 resulted in an increased emphasis on real estate investment. Real estate values held up well during this period of economic uncertainty, thereby reinforcing the importance of real estate as an integral component of a balanced investment portfolio.

The deregulation of the Canadian financial markets to include schedule B banks and foreign investment dealers will provide a new source of demand for the industry. This fact, coupled with the execution of the free-trade agreement with the United States, should have a positive impact on both real estate values and Canadian product acceptability and liquidity in the international marketplace.²⁶

In both Canada and the United States, the majority of markets have become extremely mature. In other words, most cities have been built-out in relation to demand--if not overbuilt. This situation will limit the number of large real estate development projects to be undertaken in the future. Furthermore, tax reform in both Canada and the United States has had a moderating effect on the level of new building commitments.²⁷ In the United States, TRA 86 removed a number of tax-driven incentives previously available to real estate investors. The new act basically eliminated the U.S. real estate syndication business. Depreciation schedules were extended, new classifications of income type were defined, and significant deductions previously allowable from taxable income were eliminated. In Canada, real estate tax reform has also been instituted which should slow the level of future development activity. "Unlike in the U.S., once the Canadian government starts in a direction it never stops and usually accelerates its programs following implementation."²⁸ Specific legislation impacting future development activity in Canada is as follows:

- Financing costs of land held for development or under development will be capitalized for tax purposes until the income earned from the land offsets the carrying cost, or until the land or project is sold. Previously, these expenses could be immediately deducted for tax purposes. Soft costs associated with development will be treated in the same manner. This is being phased in over the next five years.

- Capital gains tax on the sale of income property increased from 50% to 66.6% on June 30, 1988. This will rise to 75% in 1990.
- Capital cost allowances cannot be deductible until a new building is considered to be substantially in use.
- Proposed "value added" tax on the sale of income property real estate and on rental income received from a building or land will have a significant impact on profitability until leases expire and are rewritten to pass on this additional cost.²⁹

However, as the eliminations of these real estate tax advantages are phased in, so too will be the decline in the overall level of corporate income tax rates. Taken together, the result is an apparent shift in the risk structure of real estate investment in North America.

As Harry Rannala, from McClean McCarthy stated,

Without the ability to write off carrying costs, developers will require a higher level of pre-leasing before committing to a project. The project will require a higher equity component to offset the anticipated working capital reduction which the portfolio will experience as it becomes taxable. The incentive and economic ability of carrying a land inventory will also be reduced.³⁰

Tax reform in both countries should result in a decline in development activity in the short term. As markets begin to tighten, and rental rates associated with real estate product increase, enhanced property values will improve the risk-reward trade-off, causing a renewed level of development activity. During this interim period, developers will search for income property acquisitions to

allow them to build up tax shelter and provide future growth. Based upon reasons previously outlined in this reaserch, Canadian developers will continue to look towards the United States real estate market to generate this future growth.

Finally, as development activity begins to increase, many companies may find selling assets to non-tax paying institutions, such as pension funds or offshore investors, an attractive alternative versus carrying these investments in a fully taxable position. One long-time industry observer predicted the following result: "The industry in general will evolve into much more of an institutional game."³¹

Responding to the allure of growth and profit opportunities in the American real estate market, virtually all of Canada's largest developers have ventured into the U.S. market. These developers are profiled in the following chapter.

Notes for Chapter III

1. Telephone interview with Ron Daniels of the Canadian Institute of Public Real Estate Companies, June 19, 1989.
2. Susan Goldberg, Men of Property (1981), p. 13.
3. Goldberg, various pages.
4. Goldberg, p. 52.
5. Peter Foster, The Master Builders (Key Porter Books, 1986, p. 259.
6. Interview with Harry Rannala, McClean McCarthy Ltd., Toronto. July 5, 1989.
7. Interview with Harry Rannala.
8. Goldberg, p. 151.
9. Interview with Lorne Braithwaite, President of Cambridge Shopping Centers, Toronto, June 22, 1989.
10. Interview with Harry Rannala.
11. Interview with Bernie Ghert, former President of Cadillac Fairview Corporation. Toronto, July 4, 1989.
12. Interview with Bernie Ghert.
13. Interview with Lorne Braithwaite.
14. Goldberg, p. 13.
15. Interview with David King, former President of Campeau Corporation, July 5, 1989.
16. Interview with Bernie Ghert.
17. Ken Field, former President of Bramalea Ltd., quoted in Goldberg, p. 17.
18. Interview with Bernie Ghert.
19. Interview with Bernie Ghert.
20. Interview with Harry Rannala.
21. Interview with Bernie Ghert.

22. Goldberg, p. 16.
23. Interview with Bernie Ghert.
24. Interview with Bernie Ghert.
25. Interview with Bernie Ghert.
26. Harry Rannala, Canadian Real Estate Industry, p. 2.
27. Interview with Harry Rannala.
28. Interview with Harry Rannala.
29. Interview with Harry Rannala.
30. Interview with Harry Rannala.
31. Interview with Harry Rannala.

CHAPTER IV

THE CANADIAN DEVELOPERS

This research component is designed to provide a brief profile of each of Canada's largest real estate development organizations. Additionally, each company's respective ownership position and existing investments in the United States real estate market will be identified.

Carena Developments Ltd.

Carena Development's shares trade publicly on both the Toronto and Montreal stock exchanges under the symbol "CDN." Although on its own Carena Development's total assets are \$655 million, Carena's corporate investments represent real estate development companies with total assets in excess of \$9 billion.¹ When viewed on this basis, Carena is one of Canada's largest publicly listed real estate companies. The company is an investment holding company as well as a considerable merchant banking operation. In 1988, fifty-seven percent of its gross income was sourced from its investments while the remaining forty-three percent came from its merchant banking operation.² In addition to its indirect interest in major Canadian developers, it also has direct interests in numerous real estate development projects including office buildings, shopping centers, and land developments.

Carena's merchant banking operation includes advising management on acquisition and finance, arranging financing,

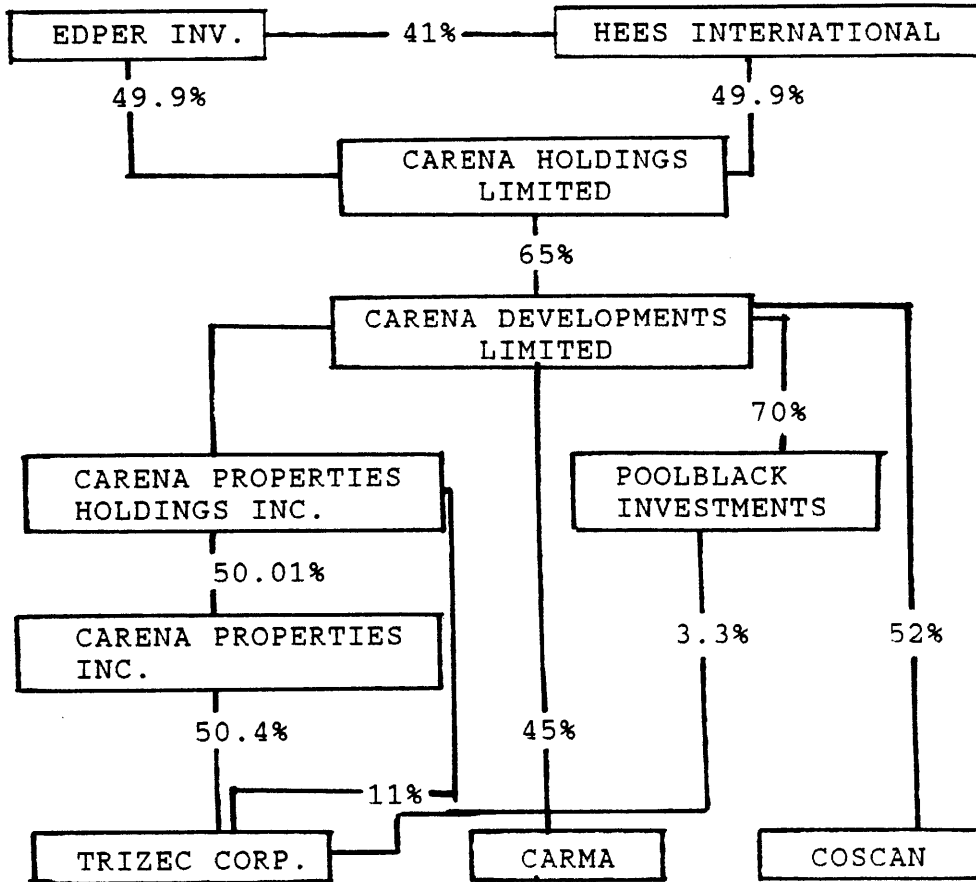
and equity participation in the deals it becomes involved with. Partnerships are generally structured with a personal guarantee from Carena's partner and a first mortgage charge on the project. Carena receives an equity interest ranging from 20% to 50% depending on the associated level of assumed risk. Carena's clients are all experienced developers with at least five years of experience and a net worth of at least \$10-15 million. This segment of its business is active in a number of U.S. markets. These markets are major metropolitan areas in Minneapolis, New York, Dallas, Washington DC, and Southern California.

As discussed, Carena maintains a significant investment in a number of major Canadian developers as well. Specifically, these companies are Trizec (38%), Coscan (52%), and Carma (45%). Through its investment in Trizec, the company benefits from Trizec's corporate investments in two major U.S. developers. This relationship will be elaborated on later in this paper.

The ownership of Carena Developments can be traced back to Hees International and Edper Investments (Bronfmans). The following table illustrates its respective ownership position.³

Table 5

Carena Development's Ownership



Olympia and York Developments

Olympia and York Developments is a private company. As a private company very little is known of their overall financial position. In a recent Forbes article, the net worth of the company was estimated to be \$8 billion.⁴ The company is owned and managed by the Reichman family of Toronto, which is one of the wealthiest families in the world. Its business success was founded through real estate development. Beginning in the fifties, following their arrival from Tangier, they started a tile-importing

business. This led to the construction of their first warehouse facility associated with this business. From then on, Paul and Albert Reichman devoted their careers to becoming one of the largest real estate developers in the world. In terms of traditional real estate developers, the company is an anomaly. From 1965 to 1975 the company built an impressive Canadian real estate portfolio including First Canadian Place, the largest building in the Commonwealth and the tallest bank building in the world (72 stories). In 1977, the company entered the United States real estate market to buy the "Uris Package" of eight New York City office buildings for U.S. \$320 million. This transaction was subsequently dubbed the "deal of the century"⁵ In 1980, again in New York City, the company was awarded developer designation to develop the eight million square foot Battery Park City in Lower Manhattan--"the largest private commercial development in the world."⁶

The company's business also includes corporate investments in a variety of real estate and non-real estate entities. An extensive account of the interests Olympia and York holds would be a study in itself. Briefly the major companies it possesses an interest in are as follows:

Table 6

Olympia and York Developments
Corporate Investments

Company	Industry
Bramalea Limited	Real estate
Block Brothers	Real estate
English Property	Real estate
Trizec Corporation	Real estate
Cadillac Fairview*	Real estate
Campeau Corporation	Retail/real estate
Carena Properties Inc.	Real estate
BCE Developments	Real estate
Canada Northwest Land	Natural resources
Brinco	Natural resources
MacMillan Bloedel	Natural resources
Noranda	Natural resources
Bow Valley Industries	Natural resources
Gulf Canada	Natural resources
Trilon	Financial services
Abitibi-Price	Newsprint
Hiram Walker	Liquor/beverages

* interest divested in 1987.

This by no means represents a complete listing of the Reichman's corporate empire. It has simply been provided to illustrate the vast extent of investment holdings, particularly within the North American real estate industry. As a final note, at the time of this research, the company had recently purchased a 67% controlling interest in BCED, and is in the midst of tendering the remaining 33% of the company's outstanding common stock.⁷

Campeau Corporation

Campeau Corporation is a substantial Canadian public company whose shares trade on the Toronto, Montreal, and Nasdaq stock exchanges under the symbol "CMP" (Nasdaq symbol "CMAFC"). From its humble beginnings as a homebuilder in Ottawa, Ontario, Campeau Corporation, through acquisition and development, has become a distinguished real estate development and retailing company operating department stores, supermarkets, shopping malls, and commercial office and mixed-use properties across the United States and Canada. Its operations encompass more than sixty-four million square feet and generated 1988 revenues in excess of U.S. \$8 billion. Through its 1986 investment in Allied Stores Corporation and 1988 acquisition of Federated Department Stores in the United States, Campeau is now one of the largest department store retailers in North America. Combined, these two companies operate nine divisions in more than 250 locations throughout the United States. Each division commands a strong market presence and is a well-established name in each of the communities in which it operates. Campeau also owns Ralph's Grocery Company, a 137-store supermarket chain with U.S. \$2.4 billion in total 1988 sales and a key market position in Southern California. The foundation of this company is its quality retail and commercial property portfolio. This portfolio includes office buildings,

shopping centers, industrial facilities, and land in both the Canadian and United States real estate markets. "The company's real estate strategy is to grow through the development of new projects and the expansion of existing properties located in selected, high-growth urban centers in Canada and the United States."⁸

Campeau, of all the Canadian developers in 1989, is by far the most aggressively leveraged company. As a result of its two recent U.S. acquisitions, the extent of its U.S. investment is illustrated in Table 7.

Table 7

Campeau Investment Segmentation
1988 (U.S. \$ millions)

	Canada	United States	Total
Assets	\$992	\$12,848	\$13,840
Revenue	169	8,499	8,668
Operating Profit	107	774	881

Source: Campeau 1988 Annual Report

The bulk of this high level of U.S. investment is in the department store business. The geographic location of this investment in the United States is depicted in Table 8.

Table 8

Department Store Assets

Department Store	Location	Square Feet
Lazarus	Ohio, Indiana Kentucky, West Virginia, Michigan	8,265,000
Maas Brothers	Florida, Georgia, South Carolina	5,875,000
Abraham & Strauss	New York, New Jersey	5,344,000
Stern's	New York, New Jersey, Philadelphia	4,478,000
Burdines	Florida	5,254,000
Jordan Marsh	New England	5,054,000
Rich's/Goldsmith's	Georgia, South Carolina, Alabama, Tennessee	6,216,000
Bon Marche	Pacific Northwest	4,581,000
Bloomingdale's	National	4,518,000 49,585,000

Source: Campeau Corporation 1988 Annual Report

Campeau's direct interest in U.S. real estate includes 2,653,000 square feet of shopping center space in Massachusetts, Washington, and New Jersey. Furthermore, the company owns 746,000 square feet of office product and 719,000 square feet of business park product. The majority of these two uses are located in the state of California.⁹ It is also important to note that under its new wholly-owned subsidiary, Campeau Development Corporation, the

company is proceeding with major shopping center projects in Massachusetts and New York. Additionally, in a joint venture with the Edward J. DeBartolo Corporation, the company intends to develop additional shopping centers and expand existing centers over the next several years.

The company is 53% owned and managed by its founder Robert Campeau. The only other major shareholder, outside of the Campeau family, is Olympia and York Developments, which currently controls approximately 25% of the company on a fully-diluted basis.¹⁰

Trizec Corporation

Trizec Corporation's shares trade publicly on both the Toronto and Montreal stock exchanges under the symbol "TZC." In 1976, Trizec was extremely close to bankruptcy-- it could not meet its payroll. Its then controlling owner, English Property, was also in financial difficulty caused by the weak English real estate market at the time. The result was the sale of English Property's controlling interest in Trizec to Peter and Edward Bronfman (Edper Investments). The Bronfmans placed Harold Milavsky in charge of turning the ailing company around, which he has done very successfully. In 1979, Olympia and York Developments acquired control of English Property, providing the company with a substantial interest in Trizec Corporation. This acquisition was very controversial, causing bad feelings between two of the most powerful and

influential Canadian families.¹¹ The current ownership of Trizec will be outlined later in this section of the research.

Trizec is Canada's largest income property developer, with operations geographically diversified throughout North America. In addition to its own portfolio of office buildings, shopping centers, retirement lodges, nursing homes, and hotels, the company also has major equity interests in a number of Canadian and United States development companies.¹²

The principal focus of Trizec's business is to own and manage commercial income properties for long-term investment and to expand the portfolio through the development of new projects, the expansion and renovation of existing properties, and through acquisition. The company concentrates on two key sectors of the North American real estate industry. First, office and mixed-use properties in downtown commercial business districts in major metropolitan centers. Secondly, retail centers in urban and suburban markets across Canada and the United States.¹³

The distribution of the corporation's operations between Canada and the U.S. is illustrated in Table 9.

Table 9

Trizec Investment Segmentation
1988 (Cdn \$ millions)

	Canada	United States	Total
Assets	\$3,874.5	\$3,548.3	\$7,422.8
Revenue	626.4	467.0	1,093.4
Operating Profit	384.5	279.3	663.8

Source: Trizec Corporation 1988 Annual Report

Corporate investments made by the company include a 70% interest in Bramalea Limited, a 25% interest in the U.S.-based Rouse Company of Columbia, Maryland, and a 100% ownership of the Hahn Company of San Diego, California. Bramalea Ltd. is a large diversified developer in Canada and the U.S., while both Rouse and Hahn are primarily U.S.-based retail real estate development companies.¹⁴

In aggregate, the amount of Trizec's investment in the U.S. is substantial. Table 10 illustrates the geographic presence of Trizec Corporation in the United States real estate market.

Table 10

Trizec Corporation
U.S. Investments

California	Washington
Colorado	Oregon
Texas	Nevada
Georgia	Montana
Missouri	South Dakota
Connecticut	Utah
Michigan	New Mexico
Minnesota	Iowa
Tennessee	South Carolina
North Carolina	Virginia
Pennsylvania	Maryland
New Jersey	Alabama
Florida	Illinois
New York	Arizona

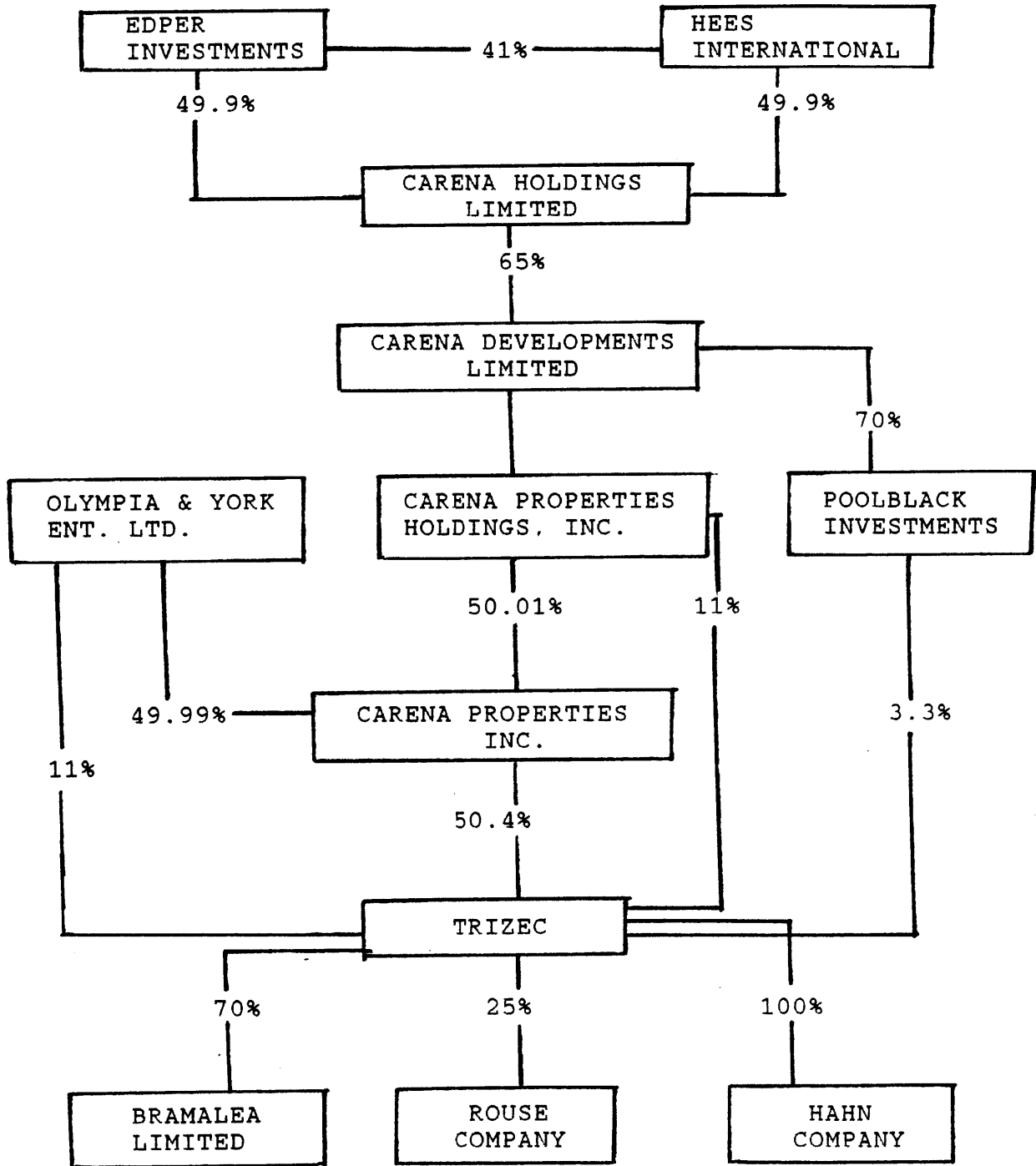
Source: Trizec Corporation, 1988 Annual Report

It is important to note that in addition to Trizec's direct investments in the U.S., mentioned above, the wholly-owned Hahn Company is the fifth largest shopping center developer in the U.S. and the largest on the West

Coast. Hahn currently owns and operates fifty retail centers in seventeen states totalling 36.8 million square feet of retail area. Twenty-eight of the fifty centers are in the state of California. Furthermore, the Rouse Company owns and manages a portfolio of seventy-five retail centers in twenty-five states totalling forty-five million square feet of retail space. Rouse is also recognized as a leading innovator in inner-city retail development with major projects in the downtown areas of thirteen U.S. cities.¹⁵

The major shareholders of Trizec trace back to the Bronfmans (Edper), and the Reichmans (Olympia and York). A detailed ownership breakdown is presented in Table 11.

Table 11
Major Trizec Shareholders



Source: Interview with Harry Rannala, July 5, 1989

Bramalea Limited

Bramalea Ltd. shares trade publicly on both the Toronto and Montreal stock exchanges under the symbol "BCD." "The company is a major diversified developer of office buildings, shopping centers, hotels and industrial properties. The firm also has significant land inventory and home building operations in Ontario and southern California."¹⁶ This factor makes Bramalea unique, since it is the only major diversified real estate company to remain in the residential housing sector of the market.¹⁷ Three major events have occurred in the company's recent history. These events include the sale of a controlling equity investment to Trizec, the writedown and deconsolidation of its major investment in the oil and gas industry, and the purchase of Trizec's Canadian shopping center subsidiary. Trizec's Canadian centers were combined with the company's to form a wholly owned subsidiary named Trilea Centers Inc.¹⁸ In addition to Trilea Centers Inc., the company recently acquired a 34% interest in JDS Investments Limited (JDS). JDS is a developer of shopping centers, office and mixed-use buildings located primarily in the Metropolitan Toronto region.

Bramalea Ltd. entered the U.S. office development industry in 1979 and since that time has developed 3.2 million square feet of leasable commercial space. The company maintains a very successful home-building operation

in Southern California and recently expanded this presence by acquiring one of the state's largest homebuilders. The company also owns and manages approximately 4.8 million square feet of retail space in 11 U.S. shopping centers. A number of these centers are in smaller regional markets. Tables 12 and 13 illustrate, first, the distribution of the corporation's operations between Canada and the United States, and the geographic diversity of the company's U.S. assets by use; the source for both tables is Bramalea's 1988 annual report.

Table 12

Bramalea Limited Investment Segmentation
1988 (Cdn \$000)

	Canada	United States	Total
Assets	\$2,411,300	\$951,000	\$3,362,400
Revenue	547,100	231,200	778,300
Operating Profit	227,600	62,500	298,100

Table 13

Bramalea Limited U.S. Investments

Office	Retail	Residential	Land
California	Alabama	California	California
Colorado	Colorado	Florida	Florida
Texas	Florida		Georgia
	Maryland		
	Michigan		
	Pennsylvania		
	South Carolina		
	South Dakota		
	Texas		

The ownership of Bramalea Ltd. is controlled by Trizec Corporation's 70% interest in the company. The ownership of Trizec Corporation has been previously described in this paper.

BCE Development Corporation

BCE Development's (BCED) shares trade publicly on both the Toronto and the Montreal stock exchanges under the symbol "BD." The company's activities are primarily confined to the development and management of prime office and retail income properties. The company also holds substantial residential land acreage. Activities are concentrated in major North American cities. The bulk of its U.S. real estate assets were acquired from Daon and Oxford Development. Its major business focus has been to effectively deal with these assets. "Aggressive leasing efforts, renegotiation or refinancing of prohibitively expensive mortgages, tax-motivated financing undertaken to monetize significant tax loss carryforwards, asset sales, and new project development have represented its recent operations."¹⁹ Its geographic presence in the U.S. by product type is depicted in Table 14; its source is the company's 1987 Annual Report.

Table 14

BCE Development U.S. Investments

Office	Retail	Residential	Land
Colorado	Illinois	California	California
California	California	Florida	Idaho
Arizona	Washington		Washington
Minnesota	Minnesota		
Illinois			

BCED was formerly owned in majority (67%) by Bell Canada Enterprises. As of the date of this research, Olympia and York Developments had recently acquired BCE's 67% controlling interest in the company. Furthermore, Olympia and York Developments was attempting to also tender the outstanding shares of the company for \$2.80 per share.²⁰

Marathon Realty Company Limited

Marathon Realty is a wholly owned subsidiary of Canadian Pacific Limited, a diversified major Canadian corporation. The company develops, owns and manages income-producing properties in both Canada and the United States. Specifically, at the end of 1987, the company's interest in property included 12.7 million square feet of community and neighborhood shopping centers, 11.3 million square feet of office product, and 4.1 million square feet of industrial, aviation-related and residential developments.²¹ Three distinct business units operate within Marathon. These are shopping centers; buildings (office, industrial, aviation); and land. The ten shopping

centers in the U.S., located in the south central United States, total 5.5 million square feet. In this business segment the company is in partnership with the Herring Group. In 1987, the partnership acquired interests in six additional centers in the South-central U.S. market totalling 3.5 million square feet of additional retail space. Marathon also holds considerable office and land positions in the U.S. Table 15 identifies the markets the company operates within the U.S., and Table 16 depicts the company's U.S. investment in relation to its overall investment activity. Both charts are derived from Marathon Realty 1988 Review.

Table 15

Marathon Realty U.S. Investments

Office	Retail	Industrial
California	Texas	California
Georgia	New Mexico	Georgia
Oregon	Mississippi	
	Arkansas	
	Oklahoma	
	Louisiana	

Table 16

Marathon Investment Segmentation
1988 (Cdn. \$ millions)

	Canada	United States	Total
Assets	\$1,174	\$766	\$1,940
Revenue	334	76	410
Operating Profit	191	30	221

Markborough Properties, Inc.

Markborough Properties Inc. is a wholly-owned subsidiary of the Hudson Bay Co., a diversified company with substantial investment in the Canadian department store industry. Markborough Properties develops, owns, and manages office and mixed-use, retail, industrial, hotel, and residential product. In the United States, its real estate activities are confined to office, mixed-use, and land development. The company was recently reorganized into three distinct business groups: shopping centers, urban development, and community development.²² The company has a significant investment in eleven master-planned communities in the United States and Canada. These projects are in various stages of development and represent one of the largest and most diversified portfolios of its type in North America.

The company has an interest in 16.5 million square feet of shopping centers, office buildings, and industrial properties. Additionally, it holds more than 12,000 acres of land. The extent of this investment located in the U.S. is presented in Table 17. Table 18 presents the bulk of this troubled U.S. investment portfolio, geographically, by use. Both tables are based on information from Harry Rannala, pp. 251 and 254 respectively.

Table 17

Markborough Investment
Segmentation
1988 (Cdn \$ millions)

	Canada	United States	Total
Assets	\$936	\$542	\$1,478
Revenue	173	58	231
Operating Profit	104	(201)	(97)

Table 18

Markborough Properties
U.S. Investments

Office	Industrial	Land
Colorado Nevada	Arizona	Arizona California Colorado Florida Texas

Cambridge Shopping Centres Limited

Cambridge Shopping Centres shares trade publicly on both the Toronto and Montreal stock exchanges under the symbol "CBG." The company was founded through a leveraged buyout of Oxford Development's shopping center division in November 1980. The buyout was led by Lorne Braithwaite and Don Priddle who currently serve as President and Executive Vice President of the corporation respectively. Both men were previously affiliated with Oxford Developments prior to this purchase.²³

The company is a real estate developer with a geographically diversified portfolio of Canadian regional shopping centers and, to a lesser extent, office and mixed-use properties. The portfolio of fourteen million square feet extends from Newfoundland to British Columbia. As of the date of this research, the company did not own any assets in the United States real estate market. However, the company definitely intends to make a considerable investment in the U.S. market and has been actively pursuing U.S. retail-based investment opportunities for the past two years.²⁴

The company is owned primarily by institutions. The specific ownership is as follows:

CN Railroad pension fund	27%
Major institutions	45%
Management	9%
Public float	19%
	100%

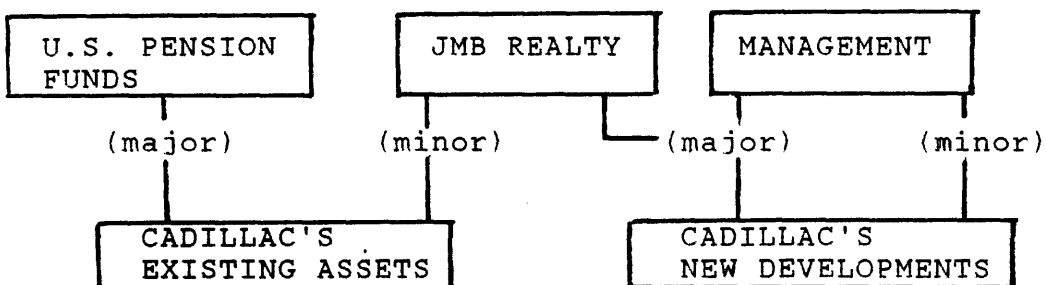
Source: Phone interview with Lorne Braithwaite, July 20, 1989

Cadillac Fairview Corporation Limited

Cadillac Fairview was, up until 1987, a diversified public real estate development company possessing substantial investments in the United States real estate market. The major shareholders of the company were Olympia and York (25% Reichmans), and CEMP Investments (50% Bronfmans). "Based on the desires of the controlling shareholders' family members to convert their substantial investment into cash, the company was sold."²⁵

Substantially all of the company's U.S. assets were sold in a two-tiered transaction to JMB Realty and a syndicate of investors arranged through Copley Real Estate Advisors. Only twelve U.S. assets remain under the control of the new private Canadian asset-based Cadillac Fairview. Furthermore, James Bulloch, President of Cadillac Fairview, stated "The twelve remaining U.S. assets the company owns will be sold or dividended out to our major shareholder, JMB--Cadillac now is strictly a Canadian company. Any good U.S. deals that come my way I'll simply pass on to JMB."²⁶

The company develops, manages, and owns thirty-five million square feet of office, mixed-use, retail, and business park product. Finally, the ownership of the company is as follows:



The previous profiles of the top ten Canadian developers provide insight into the competitive forces in the Canadian real estate market. Due to the tremendous ownership concentration in relatively few hands, there exists fierce rivalry and competition among these "players." Each developer seeking investment opportunities in the United States real estate market has implemented a

variety of investment strategies. These strategies are outlined in Chapter V.

Notes for Chapter Four

1. Harry Rannala, Canadian Real Estate Industry, p. 303.
2. Rannala, p. 304.
3. Interview with Harry Rannala, July 5, 1989.
4. Forbes, July 1989, p. 128.
5. Peter Foster, The Master Builders (Toronto: Key Porter Books Ltd., 1986), p. 259.
6. Foster, p. 260.
7. Interview with Harry Rannala.
8. Campeau Corporation 1988 Annual Report, p. 1.
9. Campeau Corporation 1988 Annual Report, pp. 43-44.
10. Interview with Don Tigert, Burns Fry Limited, Toronto.
11. Susan Goldberg, p. 56.
12. Rannala, p. 142.
13. Trizec Corporation 1988 Annual Report, p. 5
14. Interview with Harry Rannala.
15. Trizec Corporation 1988 Annual Report, pp. 25, 45.
16. Trizec Corporation 1988 Annual Report, p. 33.
17. Trizec Corporation 1988 Annual Report, p. 37.
18. Rannala, p. 188.
19. Rannala, p. 170.
20. Interview with Harry Rannala.
21. CIPREC 1988 Annual Report. p. 26.
22. CIPREC 1988 Annual Report, p. 24.
23. Interview with Lorne Braithwaite. President of Cambridge Shopping Centers, Toronto, June 22, 1989.
24. Interview with Lorne Braithwaite.

25. Interview with Bernie Ghert, former President of Cadillac Fairview Corporation, Toronto, July 4, 1989.

26. Phone interview with James Bulloch, President of Cadillac Fairview, July 10, 1989.

CHAPTER V
INVESTMENT STRATEGY

Overview

Up to this point, this study has concentrated on the relative international significance of Canadian investment in the U.S. real estate market, why and when this investment has been made, who the major developers were making this investment, and specifically what investments were made where in the U.S. marketplace. Probably the most interesting and revealing question this final chapter will address is how these Canadian developers amassed such substantial U.S. real estate holdings. Particularly, what strategies were utilized, if any, in order to break into the large and diverse U.S. real estate marketplace? Whether these investments have been successful and what has been learned from the Canadian's U.S. investment experience are two other fundamental issues in this research effort.

The majority of the research for this chapter was conducted in the form of personal interviews, with a variety of individuals from six of the top ten Canadian development organizations which have significant investment experience in the U.S. real estate market. Many of these firms were initially reluctant to be interviewed and a number of firms simply refused. The main reasons for this reluctance were being too busy, having little interest in the academic world, and having a strong desire to keep

private how the company approached the U.S. market for competitive advantage.

In general, a company looking to enhance its growth potential by investing in new markets faces a number of avenues to pursue. Simplistically, these avenues can be segmented into the following two general categories:

1. Internal growth/development
2. Acquisition of existing assets.

It is important to note that assets being acquired are not merely physical and tangible, but intangible as well. Very often it is these intangible assets which possess the most value for the investor. Good examples of intangible assets include goodwill, reputation, historical relationships, market knowledge, and management expertise. Much has been written relating to the costs and benefits of these two general approaches to investment.

Internal growth enables the investor to remain 100% in control of his activities. All management and control systems are established according to the existing operation's historical operating philosophies. This provides the expanding organization a terrific sense of continuity. However, this strategy possesses serious obstacles as well. The incremental nature of internal growth can cause it to be extremely expensive. A substantial up-front investment is required to develop the business and long lead-times are generally involved before

any return from the investment is realized. Finally, the intangible aspects of investment require a lot of time and effort to successfully establish in order to compete in any new marketplace.

The acquisition of existing assets provides a number of advantages when expanding an organization into new markets. Very often "economies of scale" can be realized if the acquisition is of assets involved in a similar business undertaking. Additionally, "economies of scope" are generally acquired. Economies of scope represent the sharing of specialized know-how. Much of this know-how relates to immediately benefitting from the intangible asset base of the acquired entity. This factor becomes extremely important and beneficial if this sharing benefits both the acquiror's and the acquiree's operations. Finally, acquisition provides an instant sense of market presence and power--a very attractive foundation for future growth.

This avenue of investment also includes a number of obstacles. First of all, there may be an acute unavailability of appropriate acquisition candidates in the marketplace. Second, significant premiums generally must be paid to secure control of this type of opportunity, if available. Third, very often the pricing of the investment is based on limited information resulting in the purchaser's not really understanding what has been acquired

until the transaction is completed. Very often one does not get what one bargained for. Finally, this form of investment has considerable transaction costs associated with it, which are often difficult to accurately anticipate.¹

Canadian Developer Strategies

The Canadian industry will be very reluctant to discuss U.S. investment strategy with you because there wasn't any strategy--they just did it and are embarrassed to talk about it.

Bernie Ghert, former President,
Cadillac Fairview Corporation

The real estate business is 100% opportunistic--there is no such thing as a fucking strategy when it comes to investing in real estate, whether in Canada or in the U.S.

Benjamin Swirsky, President
Bramalea Ltd.

The above two quotations are very representative of the overall responses received to questions about U.S. real estate investment strategies utilized by Canadian development organizations. Furthermore, with very few exceptions, each company president interviewed, when asked how and why they invested in the U.S. responded like this:

A lot of senior management spent their winters in Florida and felt that by investing in the region, more time could be spent in the sun.

Despite the nature of these initially general sentiments towards investment strategy in the U.S. real estate market, most developers interviewed went on to discuss how their firm entered the market, and the difficulties encountered.

They then made intelligent reflective observations which in large part form the foundation of their current strategy towards investing in the U.S. marketplace.

In discussing their U.S. experience, almost all of the developers interviewed expressed common themes, particularly as to how they view the U.S. market in general. All were very quick to point out that, contrary to the common sentiment that the U.S. market is one huge market opportunity, the U.S. is actually a collection of extremely distinct regional markets. As Donald King, President of Marathon Realty, pointed out:

The U.S. real estate market is not one large market as many profess it to be; instead it is a series of regional markets, each with significant cultural and economic differences--you should never try to be in all markets!²

Furthermore, to most Canadian developers, the fact that U.S. markets were technically foreign was irrelevant and inconsequential:

The U.S. real estate market is not a foreign market.³

In my mind, the border doesn't exist, the North American market is a set of sub-markets--if I like the looks of a deal, in any of these sub-markets, we go.⁴

Although initially downplaying the foreign nature of the U.S. real estate market, when probed further with additional questions, these developers began to reveal some clear distinctions between investing in Canada versus the U.S. One important distinction was the manner in which U.S. business practices differed from those in Canada.

A different morality exists in the U.S. real estate marketplace. In Canada there are fifty guys who control the business and a handshake means a deal. Down in the U.S. much more caution is required. U.S. companies don't lie, they just don't tell you the truth--they don't tell you anything.⁵

The U.S. real estate market is much more competitive and cut-throat than in Canada. I can't tell you how many times I've been scooped on deals based upon outstanding favors, relationships, and history among U.S. real estate companies. In the U.S. a deal is never done until it's executed in blood.⁶

Further distinction between the two countries' markets included the severe overbuilding which took place in the U.S. prior to TRA 1986, fueled by the huge syndication business which was primarily tax-driven.

A lot of "careless capital" existed, and in part, still exists, in the U.S. Historical REIT and Savings and Loan policies, coupled with a former tax policy that fueled the tax-driven syndication business, resulted in severe overbuilding. The damage has been done and its debris is spread out through most U.S. major metropolitan areas. We didn't see this in Canada at all.⁷

Additionally, for reasons previously outlined in this study, the American real estate market has become a preferred investment vehicle for a number of foreign buyers. As a result, this increased demand has driven prices for product to extremely high levels. The impact of this occurrence on Canadian developers investing in the U.S. was strongly expressed by Neil Wood, President of Markborough Properties:

You cannot buy existing real estate assets today in the U.S. International competition for assets has driven prices out of sight. You must look for development opportunities where you can create some value.

In Canada, unlike the U.S., most major real estate development companies are public companies. This fact has important ramifications in terms of the manner in which they approach U.S. investment. These companies are very concerned about maintaining improved earnings and cash flow for their wide range of owners. Although this is a short-term strategy, it prevents any adverse movement in the corporations' underlying common stock. However, this mentality also prevents these companies from aggressively entering the U.S. marketplace to facilitate growth in the long run.

The public nature of many Canadian development companies prevent them from being opportunistic in their approach to investment in the U.S. There is no such deal as the perfect deal, much like there is no such thing as a perfect wife.⁸

Another long-term industry observer reinforced this situation in stating:

Today a public company cannot buy 5% yield assets with 11% financing.⁹

Two final obstacles to Canadian real estate investment in the U.S. surfaced through discussion. First, the regional nature of the U.S. industry has resulted in U.S. developers, within each region, establishing extremely strong control and influence over industry participants such as tenants, brokers, and contractors. The adverse result of this situation was put forth by James Bulloch, President of Cadillac Fairview Corporation:

U.S. developers are very regional in nature with long-standing relationships in place which makes it very tough to break in and find a good deal. Your ability to succeed in the U.S. is tied directly to your ability to put experienced and connected people in place within specific regional markets.

Secondly, in general, the U.S. marketplace is generally much more litigious. In many markets this fact represents an added risk associated with real estate development compared to the Canadian market:

In the United States, after gaining approvals you've got the court system to deal with. No matter how inane, individual suits can hold you up and cost big money in time--In Canada, an approval is an approval.¹⁰

Overall, investing in the U.S. markets is not as easy as many initial comments from large Canadian developers suggested. Each market is very distinct within the U.S. and in relation to Canadian markets. as Donald King, President of Marathon Realty, observed:

Investing in the U.S. real estate market is a very tough thing to do--a lot of Canadians including Jack Poole (Daon) and Don Love (Oxford) experienced how tough it can be returning to Canada with their tails between their legs. It's not like picking cherries off a tree!¹¹

Harry Rannala of McLean McCarthy Ltd. described the U.S. market as being a "deck heavily stacked against Canadians." In light of these difficulties and challenges, it is interesting to examine how these Canadian developers structured specific investments in the U.S. marketplace.

First, it should be noted that almost all of the principals of the companies under study were reluctant to

be interviewed. After much persistence, six companies agreed to participate in this study but not without requesting that certain information not be printed. Not surprisingly, the four firms who refused outright to be interviewed were controlled in part by the Reichman family of Toronto. This family is extremely private in nature and unfortunately, despite numerous attempts, were not willing to participate in this study--nor were the executives charged with running their various businesses. However, wherever possible, these organizations' strategies are documented based exclusively on public information.

The investment strategies pursued by Canadian developers in the United States can be broken down into two main categories. These categories are 1) internal development and 2) the acquisition of existing assets. Internal development involves the establishment of a subsidiary office in the U.S. mandated to identify new development opportunities. Acquisition of existing assets involves three broad categories of investment. These categories are as follows:

1. Direct purchase of a 100% interest in a completed U.S. real estate asset, or asset under development.
2. Direct or indirect purchase, in whole or in part, of an interest in a U.S. company involved in the real estate development business.
3. Establishment or purchase of a partnership relationship with a U.S. developer to pursue U.S. real estate opportunities.

Table 19 summarizes the major U.S. investment strategies pursued by these Canadian development organizations.

Table 19

U.S. Investment Strategies

Internal Development

Campeau Corporation
 Cadillac Fairview
 Bramalea Limited

Acquisition of Existing Assets

Assets	Companies	Partnerships
Olympia & York	Carena Devels.	Cadillac Fairview
Bramalea Ltd.	Campeau Corp.	Marathon Realty
Marathon Realty	Trizec Corp.	Bramalea Ltd.
Campeau Corp.	Olympia & York	Markborough Props.
Trizec Corp.	Cambridge S.C.s	Carena Devels.
Cadillac Fairview	Bramalea Ltd.	Campeau Corp.

The above table is based on the deals discussed with company officials and available public information. Two major observations became immediately apparent. First, the bulk of Canadian investment in the United States has been accomplished via the acquisition of existing assets in a variety of forms and structures. Second, many of the firms have pursued a number of strategies in the U.S. market. The importance of this fact will be revealed later in this paper.

Outlining a detailed description for each company's investments in the U.S., for each strategy, is not appropriate for the purposes of this research. Instead, for each strategy, a Canadian's investment which adequately represents the approach will be highlighted. Additionally,

reflective analysis by a variety of executives will be presented.

Internal Development

Between 1974 and 1982, Cadillac Fairview Corporation undertook an aggressive internal growth strategy in a number of U.S. markets. The company set up five regions in the U.S. and established subsidiary offices in each. The Canadian market was segmented into two regions. Each of the U.S. regions were loosely defined:

Principals of each region were left to establish the boundaries of their respective turfs based upon the projects they undertook.^{1 2}

The principal of each region was sent down from Canada to hunt for deals and hire additional U.S. staff as required. Each region was given an open mandate in terms of product type including office, retail, residential, and industrial. Development deals were being entered into within each region at a very fast pace. Each region reported directly to the head office in Canada. Bernie Ghert, former president of Cadillac Fairview, offered the following sentiments:

The overall results of this strategy were disastrous. Within each region only one product type investment performed well--the product type which the subsidiary's principal had experience and expertise in--the rest were a joke.

In 1982, the company refocused its strategy to include only major shopping centers, office buildings, and industrial parks. Furthermore, the company realigned responsibility

for the entire North American market according to product type.

Each product type requires a completely different set of skills and relationships to successfully compete.¹³

Thus, the company was able to capitalize on management's particular product expertise by placing qualified principals in charge of all markets in North America.

In the case of major mixed-use projects, the controlling group was the one with the majority use in the project--other groups would assist with their respective uses on a fee basis.¹⁴

This adjusted strategy worked well for both office and industrial projects. In the case of retail, the competitive nature of the regional relationships in the U.S. shopping center business required further strategy refinement. The company needed to buy into these relationships and did so successfully by forming a joint-venture partnership with Peter Lebowitz.

Lebowitz had been in the U.S. shopping center business for a while, knew his way around, and had established a history of contacts with a number of U.S. regional department stores--We put up the money and gave him a 25% carried interest in U.S. projects he put together.¹⁵

The importance of a shopping center investment strategy, distinct from other product type strategies, will be elaborated on further in this paper. "This shopping center strategy was tremendously successful for Cadillac Fairview."¹⁶

In support of internal growth as a strategy, Bernie

Ghert, former President of Cadillac Fairview, made the following observation:

With acquisitions and joint ventures, you often don't know what you've bought. It is difficult to adapt systems and problems always arise in management down the road.

He further stated:

You have to look at the strengths of what you are and strive to capitalize on those strengths. Cadillac Fairview's strength was its ability to develop real estate, and therefore internal growth enabled the company to capitalize on this strength.

Further suggestions on the successful implementation of an internal growth strategy focused on development regulation and location. Most major U.S. metropolitan areas have been severely overbuilt for reasons previously discussed. Therefore, the only good markets left in the U.S. are markets in which historically there have been severe development regulations. By concentrating your investment efforts on these markets (New England, California), developers can drastically minimize adverse competition.¹⁷ Furthermore, the development of world class projects in prime locations, within these regulated markets, is strategically sound. Historically, these projects have experienced the highest levels of appreciation and will continue to do so based upon the ever-growing appetite of foreign investors for this type of product.

Asset Acquisition

In 1979, Bramalea Limited decided to pursue investment opportunities in the U.S. shopping center business. Based

on preliminary analysis, it concluded that the development business was too competitive since U.S. firms had each regional market tied up. Existing relationships would make its entry, through development, extremely difficult.¹⁸ The company decided that the acquisition of existing assets possessing value creation potential was the preferred strategy. The company established what it referred to as the "hit team." According to Ian Rankin, President of Trilea:

This team was composed of one senior and one junior executive mandated to go all over the U.S. to look for deals which fit our strategy--this partnership worked extremely well.¹⁹

Bramalea retail management had a history of effectively dealing with "troubled properties." Much of its initial Canadian portfolio had required substantial renovation and remerchandizing over the years. Ian Rankin explained:

Bramalea management had a real expertise in rejuvenating tired, old shopping centers and we felt we could successfully translate this expertise in the U.S. market. Besides, traditional U.S. developers were not interested in troubled properties at the time.

No market research was performed prior to investment, since deals anywhere were difficult to find. The company was determined to find an opportunity anywhere it could. Once the "hit team" had identified an opportunity, a small group of Canadian management were sent down to assist with due diligence and closing.

These individuals were known well by the corporation, trusted employees, and shared the company's way of thinking.²⁰

The pricing of these assets was based on 9 to 11% capitalization rates on income in place. This pricing was advantageous since these properties were, in many cases, half empty. Following closing, the "Dusting and Cleaning Team" was put in place to undertake modest cosmetic renovations to bring renewed life to the center and attract new tenants.

Dusting and cleaning typically entailed new carpets, signage, canopies, and colors. The entire program rarely exceeded \$1 million in total cost.²¹

Once the renovation was completed, the "Task Force," composed of a mall manager and leasing agent, was sent down to the mall to bring it back to life. Once substantially leased up, the "Task Force" would move on to another location that had been identified by the "Hit Team," and a permanent manager would be put in place. This process was repeated four times, establishing a portfolio held for long-term investment totalling 2.5 million square feet.

Rankin further explained:

All of these deals were extremely successful financially and some of the assets have been additionally expanded and renovated in order to bring the assets to current industry standards.²²

By 1984, however, the U.S. shopping center industry began to recognize these opportunities as valid investments. This increased demand for troubled assets caused prices to increase, reflecting redevelopment potential:

These deals were risky to start with and therefore when prices rose, this strategy no longer worked. There weren't any deals left.²³

In order to continue to compete in the U.S. shopping center business, Bramalea Ltd. went on to purchase a joint-venture interest in a partnership with a regional U.S. developer involved in four development projects. This partnership went on to develop twenty additional centers in the U.S.

Reflecting back on Bramalea's experience in the U.S. retail market, Ian Rankin made the following observations:

Strategies of Canadian firms are in large part a function of the skills and personalities of each individual company. There must be some synergy or experience to bring to bear based on the parent company's strengths . . .

You must look for opportunistic deals in the U.S. which unfortunately now are next to impossible to find based on current irrational pricing levels. Buy quality and take a longer-term view to build asset value

It has taken Bramalea ten years to establish a retail presence in the United States. Establishing presence on your own is a very difficult thing to do.

Olympia and York Development's acquisition of eight Manhattan office buildings (the Uris Package) in 1977 is another strong example of the opportunistic investment approach required to successfully follow an asset acquisition strategy. These buildings were purchased at a time when New York City's economic future appeared dismal. Real estate investors from all over the world looked at this package and decided to pass on it based on New York's bleak financial condition.

The deal would soon look shrewd. In another couple of years it would look brilliant. In four years it would be called "the deal of the century," ranking in real estate mythology right up there with the Louisiana Purchase. It would be recounted in real estate circles in the same hushed tones that Peter Minuit's original purchase of Manhattan Island for U.S. \$24 was told to wide-eyed schoolchildren.²⁴

An additional, more current asset acquisition strategy was put forth by Bernie Ghert, former President of Cadillac Fairview Corporation:

Real estate assets owned by the troubled savings and loan institutions, particularly in Dallas and Austin, Texas, are available at 50%-80% of replacement cost and are of very high quality despite vacancies. The acquisition of these assets is an excellent strategy to pursue but it holds unique problems for Canadian investors. To gain access to these deals you must become integrated into the local business community. For Canadians, distance represents a real problem. Additionally, the sale of a foreclosed S&L asset forces the institution to book a loss on the loan at today's market value. Thus, many S&Ls are waiting for markets to improve causing the number of available deals to be limited. However, deals are being done, but it's extremely tough to capitalize on them as a Canadian developer.

Corporate Acquisition

In January of 1986, Campeau Corporation began investigating corporate acquisition opportunities in the United States. This strategy in large part was a result of Robert Campeau's dissatisfaction with the outlook for the Canadian economy and political policies in general. Additionally, the much more free-enterprise American economy, growth forecasts, and international liquidity for assets were all strong motivators of this strategy. Prior to 1986, the company had made a number of real estate

investments in the U.S. in the form of internal development, asset acquisition, and partnerships: "In aggregate the company achieved limited success."²⁵

The company's founder and one other vice president spent the first half of 1986 evaluating potential target companies in the U.S. to acquire. Many of these targets were analyzed and put forward for consideration by a prominent New York-based investment bank. The target was not limited to real estate companies and in fact a number of industries were considered. However, an industry with some synergistic relationship with real estate development was perceived as strategically optimal. This process led to the eventual focus on the American retailing industry. At the time, the industry was beginning to consolidate, a number of companies were widely held, and professional management, geared towards short-term financial results, had kept their balance sheets essentially clean--relatively little long-term debt was in place. Additionally, despite the fact that the company viewed a retail investment alone as the fundamental premise, significant synergy was also anticipated by combining the company's real estate expertise with acquired retailing assets. By mid-year the company identified Allied Stores Corporation (Allied) as their investment target. Allied not only possessed over twenty regional department and specialty store divisions,

but also owned five major U.S. shopping centers and much of the real estate on which its store locations existed.

Over time, Campeau acquired a 4% interest in the company quietly on the open market, while it continued to analyze Allied's operations based upon public information. Consultants were brought on board the acquisition team as required, all of them being U.S.-based companies with considerable expertise in the merger and acquisition industry. Once relatively comfortable with its evaluation of Allied, Campeau approached the chairman of Allied in September, expressing an interest in purchasing its five regional shopping centers. Relevant information was supplied to Campeau management and a quick evaluation of these assets was undertaken. The resultant offer made for the centers was harshly rejected and, overall, Allied was not taking the Canadian company's efforts too seriously. The result was that in October 1986 Campeau launched a hostile takeover bid for the entire company and successfully closed the U.S. \$3.6 billion transaction on December 31, 1986. Much of 1987 was spent restructuring the company. Bank, junk, and mortgage refinancing of acquisition debt was put in place and eighteen department and specialty store divisions were sold to reduce borrowings associated with the acquisition. The "new" Allied was composed of four strong regional department

store divisions, managed by a completely renewed executive team.

The acquisition was considered a huge success by virtue of its common shares doubling in value. On April 1, 1988, Campeau completed a similar U.S. \$6.6 billion acquisition of Federated Department Stores, a much larger U.S. retailer, and has undertaken similar restructuring. The residual operations and management of the two retailing companies have subsequently been combined to create one of the largest department store retailers in North America.

It is too early to comment on the long-term success of this overall strategy, even though remarkable progress has been made. The company has established a formidable presence within the regional retail real estate business and has already embarked upon a number of projects, utilizing its retail franchises, through its new wholly-owned subsidiary Campeau Development Corporation in the U.S. The transaction costs and default risk of this type of strategy are formidable.

Another example of a corporate acquisition strategy involved Trizec Corporation's entrance into the U.S. retail real estate market. In November 1980 Trizec purchased the Hahn Company of San Diego, California and later in 1981 purchased a 20.5% interest in the Rouse Company of Columbia, Maryland. Trizec's interest in Rouse has been subsequently increased to 25%. Both these corporate

acquisitions provided Trizec with instant presence and market power and despite initial difficulty, both have been quite successful.²⁶ Once again, the price premium, management, and financing risks associated with this strategy are significant.

Partnerships

In the mid-eighties, Marathon Realty decided to investigate an investment in the U.S. shopping center industry to assist in the company's future growth. The company chose to pursue a partnership strategy with a local U.S. developer because it recognized the importance of buying an introduction, skills, management, and time.²⁷ Donald King, president of the company, made the following observation:

Shopping center investment is an investment in a business versus office or industrial which are primarily project investments. To succeed in the U.S. shopping center industry you must acquire the relationships and regional knowledge to compete.

All markets were potential candidates for the company's U.S. entry. Following considerable effort, the company identified a Dallas-based firm called the Herring Company which had an existing operation in the Southern United States. The opportunity emerged based on adverse economic conditions within the company's operating regions. "In short, the Herring Company needed cash." A Master Partnership was entered into in which Marathon purchased a 70% interest in existing malls and development sites.

Donald King explains, "It was a marriage of convenience."²⁸ The agreement also stipulated that Marathon reserved the right to acquire the balance of the partnership at the end of five years. Marathon deliberately chose to limit its initial investment to 70% in order to "get into the local fabric" and maintain existing management continuity. Day to day operation of the Herring Marathon Group was left to Mr. Herring and his team. However, Marathon was given board representation and approvals over major investment decisions. To date this partnership controls interests in six million square feet of retail space.²⁹

In 1988, Marathon purchased the remaining 30% interest in the Partnership. The main reason for the accelerated buyout was "a desire expressed by Mr. Herring for personal tax reasons." A few senior Herring executives left the business, including Mr. Herring himself. In Mr. King's opinion,

We accomplished our objective in terms of buying into the market and view the effect of our increased control as a booster taking off into orbit.

In reflecting on this strategy of entry into the U.S. market, Donald King made the following observation:

I view our investment as successful despite the continued sluggishness of the southern U.S. economy. It is very important to carefully outline and define your dreams with your partners. Stick to your knitting where you do it well--stay regional in the U.S. . . .

It's better to have U.S. citizens managing your U.S. operations to avoid the "green card syndrome." Many of the Canadians sent down to manage U.S. projects ,

after receiving their green card, were picked up by other U.S. development companies--the card in itself holds a lot of power for Canadians.

Both Bramalea Ltd. and Markborough Properties have utilized joint-venture partnership strategies in the U.S. as well. As alluded to previously, Bramalea Ltd. entered into a joint-venture with a U.S. "middle market" developer named Ainbinder.³⁰ This company had strong relationships in place with K-Mart and J.C. Penney in midwestern markets and was looking for a money partner to expand further. Ainbinder's business specialized in "middle market" centers ranging from 150,000 to 200,000 square feet. Bramalea purchased a partnership interest in four development projects. This partnership went on to develop twenty shopping center projects.³¹

Overall the results were terrible--most of the projects went into the ground at 10% interest rates and out of the ground at 20%.³²

Ainbinder vanished from the deal, leaving Bramalea to take on all the Partnership's liabilities. The assets were subsequently packaged and sold as a syndication, prior to TRA 1986 in the U.S. Ian Rankin, President of Trilea Centers, made the following observations:

It took a lot of hard work and time to get out from under this deal and the company certainly did not recoup its initial investment. In hindsight, all we really bought was an entree into nickel and dime towns--we probably should have looked for a developer involved in larger projects in major U.S. metropolitan areas.

Markborough Properties has invested in a number of joint venture partnerships in the United States. In all cases management problems have resulted in the company buying out its partners' interests. Neil Wood, President of Markborough Properties, had the following insight into U.S. investment and joint-venture partnerships:

To be successful in the U.S., you must do your homework, buy or acquire local knowledge, understand the market, competition, and demand. Most importantly you must put good management in place--there is no substitute.

In the long run, partnerships never work out. If they do they work by good luck rather than good management. Employee status with incentive compensation is the most effective means of managing real estate investment relationships in the U.S.

One final partnership strategy was suggested by many of the developers interviewed. This strategy entailed aligning the Canadian developer with a U.S. life company or pension fund. However, despite some attempts, this is extremely difficult to do. With a huge stock of successful U.S. developers, within each regional market, there is very little rationale for these institutions to select a Canadian company.

Notes for Chapter Five

1. Strategic Management Journal, November-December 1987, p. 47.
2. Interview with Donald King, President of Marathon Realty, Inc., Toronto, July 20, 1989.
3. Interview with Neil Wood, President of Markborough Properties, Toronto, July 19, 1989.
4. Interview with Benjamin Swirsky, President of Bramalea Ltd., Toronto, July 18, 1989.
5. Interview with David King, former President of Campeau Corporation, Toronto, July 5, 1989.
6. Interview with Ian Rankin, President of Trilea Centres Inc., a wholly-owned subsidiary of Bramalea Ltd., Toronto, July 21, 1989.
7. Interview with Neil Wood, President of Markborough Properties, Toronto, July 19, 1989.
8. Interview with Bernie Ghert, former President of Cadillac Fairview, Toronto, July 4, 1989.
9. Interview with Harry Rannala, Toronto, July 5, 1989.
10. Interview with Donald King.
11. Interview with Donald King.
12. Interview with Bernie Ghert.
13. Interview with Bernie Ghert.
14. Interview with Bernie Ghert.
15. Interview with Neil Wood.
16. Interview with Neil Wood.
17. Phone interview with James Bulloch, President, Cadillac Fairview Corporation, July 10, 1989.
18. Interview with Ian Rankin, President of Trilea Centres, Inc., Toronto, July 21, 1989.
19. Interview with Ian Rankin.

20. Interview with Ian Rankin.
21. Interview with Ian Rankin.
22. Interview with Ian Rankin.
23. Interview with Ian Rankin.
24. Peter Foster, The Master Builders (Toronto: Key Porter Books, 1986), p. 41.
25. Interview with David King.
26. Interview with Harry Rannala.
27. Interview with Donald King, President of Marathon Realty, Toronto, July 20, 1989.
28. Interview with Donald King.
29. Interview with Donald King.
30. Interview with Benjamin Swirsky.
31. Interview with Ian Rankin.
32. Interview with Ian Rankin.

CHAPTER VI

CONCLUSIONS

International investment in America's real estate market has increased considerably over the past ten years. This heightened investment activity has caused excessively high pricing levels and growing concern by Americans over foreign investment in general. Although less than 1% of all America's real estate is foreign-owned, foreign ownership of product located in major U.S. metropolitan areas is much higher.

Canada ranks among the top five world nations controlling investments in U.S. assets, including real estate. The Japanese have recently been the most aggressive foreign investors in U.S. real estate. However, Canadians have been investing significant capital into the U.S. market for the past fifteen years. This level of investment has been largely unseen since, in many ways. Canada is not perceived as foreign in relation to other world investors. Canada's cultural and linguistic foundations are similar to those of the U.S., it is perceived as a friendly neighbor, and no recent history of aggression between the two countries exists. Canada has never represented an economic threat to the U.S. in any form.

Despite the current overbuilt nature of many American real estate markets, Canadians will continue to seek real

estate investment opportunities in U.S. markets. The relative size of the American market, economic performance, political policies, and international liquidity for its assets will continue to draw Canadians south of their border. Canadians were uniquely drawn to the U.S. real estate market for the following fundamental reasons. The limited size of the Canadian market forced companies to establish a national presence, thereby developing skill at operating development subsidiaries from a distance. This fact, combined with limited growth potential domestically, resulted in their entry into U.S. real estate markets. Furthermore, the entrepreneurial backgrounds of Canadian developers, coupled with a banking system more than willing to lend funds based on corporate credit versus specific assets, fueled Canadian investment in U.S. real estate markets. Non-business forces, such as the love of a challenge and the ability to spend more time in southern U.S. climates, were also apparent.

A number of major differences exist between the two countries' real estate environments. First of all, the ownership of the Canadian development industry is tremendously concentrated in very few hands, compared to the wide-ranging regional ownership pattern in the U.S. In Canada, if companies are not owned in part by the Reichman or Bronfman families, then in many cases institutional ownership is in place, which tends to take a more short-

term view towards real estate investing. Additionally, Canada is a relatively homogeneous marketplace, while the U.S. market is made up of a great number of economic and culturally distinct regional markets. Throughout these distinct markets a much more questionable business and ethical morality exists which makes adapting initially very uncomfortable for Canadians. Furthermore, the international demand for U.S. real estate assets, combined with a tax policy, prior to 1986, has resulted in severely overbuilt major metropolitan cities and very high and irrational pricing levels compared to those in Canada. Finally, in the U.S. there is a much more litigious civil environment, which can cause real problems for Canadian developers. However, on the whole, a much less regulated development process is encountered in the U.S., with a few exceptions in specific geographic locations such as California and Massachusetts.

The Canadian developers as a group are very entrepreneurial and have developed extremely creative and opportunistic investment strategies as a result of intense competition within the limited Canadian market. Their focus in the U.S. has included various product types primarily within major U.S. metropolitan areas experiencing strong growth levels. Many have also concentrated on cities possessing intensive real estate development regulation in order to minimize adverse competition. Of the ten large

companies profiled in this study, the vast majority currently have at least 30% of their total asset base in the U.S. However, levels of investment segmentation are as high as 90% in some instances.

Throughout this research effort, almost all of Canada's leading developers were reluctant to share information and experience. This fact in itself offered further validation of the very private and controlled nature of the Canadian industry. The industry itself is not at all academically oriented and is concerned over sharing its various approaches to U.S. investment for fear of sacrificing each company's respective competitive advantage. Much of what was revealed through interviews was restricted from publication.

This research identified four main investment strategies pursued by Canadian companies in the U.S. real estate market. Specifically, these were internal growth/development, asset acquisition, corporate acquisition, and partnership. Almost all of the companies highlighted had, in the past, utilized two or more of these investment strategies. The fundamental conclusion from this extensive U.S. investment experience was that to be successful as a Canadian company investing in the U.S., the strategy pursued must capitalize on the existing skills, expertise, and strengths of the investor. Those developers which have been successful in the U.S. have all

recognized this concept and accordingly adopted an appropriate investment strategy.

A strategy of internal growth/development in the U.S. has been successful in the past and will continue as a preferred strategy of development companies whose true strength is in developing real estate, as opposed to financial deal-making. Trusted management possessing specialized expertise within one real estate product type must be utilized. Each product type demands a completely different set of skills and therefore management of U.S. real estate assets should be segmented by product type rather than geographic location. Finally, this strategy has rarely been successful for Canadians in the U.S. shopping center business. The regional nature of the business and historic relationships among U.S. developers and retailers, make this strategic approach unwarranted. Therefore its adoption should be limited to office, industrial, and residential investment by Canadian companies possessing development ability as a fundamental strength.

Historically, an asset acquisition strategy has been successful in capitalizing on unique market opportunities in the U.S. In some cases tremendous value has been created very quickly. However, based upon the high current and forecasted levels of international demand for U.S. real estate product causing prices to be extremely high, this

strategy possesses limited opportunity going forward. In today's U.S. market, these unique asset acquisition opportunities are pretty well non-existent. However, one should always be on the lookout for these unique market situations as a secondary investment strategy in the U.S. Finally, as with internal growth/development, this strategy is less appropriate for shopping center product since, in general, by simply purchasing assets one does not acquire the required relationships and management expertise to successfully compete in the U.S.

Strong evidence exists in support of a corporate acquisition strategy to successfully enter the U.S. real estate market. Trizec Corporation in particular has demonstrated this strategy's appropriateness for their financial deal-making orientation. This strategy has been successfully utilized to gain access to the U.S. shopping center business, since it provides an opportunity to purchase long-term experienced management and associated relationships. Once again, the success of this strategy in large part depends on a Canadian company's experience and ability to operate in the high-risk U.S. merger and acquisitions environment. In the future, this strategy will continue to be utilized by Canadians, particularly those seeking U.S. shopping center investments.

The final investment strategy identified through this research was the establishment or purchase of a partnership

interest with an established U.S. real estate developer. The research suggests that historically this strategy is destined to fail in the long term. Management of this type of relationship in the long run is a "nightmare." Conflicting vision, systems, and investment criteria between U.S. and Canadian partners are extremely difficult to manage successfully. However, in the short term, this strategy represents a very effective means of entering U.S. regional markets, establishing a presence, and benefitting from established relationships. Provision to buy out the U.S. partnership interest within five years is recommended in order to secure control of the investment in the long term. This strategy is also attractive for U.S. shopping center investments and will continue to be utilized by Canadian developers in the future.

In aggregate, a Canadian company seeking investment opportunities in the U.S. real estate market must be opportunistic in its approach and never expect to uncover the "perfect deal." This type of investment is very difficult to manage successfully and should be made with a view to build long-term asset-value. If the physical development of real estate product is a Canadian company's main strength, then an internal growth/development strategy for office, industrial, and residential product should be pursued. Put trusted, experienced individuals in place and provide them with equity participation. Despite the

internal strength of a Canadian development company, U.S. shopping center investment should be pursued through either corporate acquisition or the creation of a short-term partnership with a credible U.S. developer with an objective to secure control in the long term.

As a final note, the author believes that Canadians will continue to aggressively pursue U.S. real estate investment opportunities in the future. The North American real estate market will increasingly represent one large and diverse opportunity. Canadian developers who strive to develop this mentality and skill will among the industry leaders of tomorrow.