

## Angels in the out-basket

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Low caps, high prices convince even risk-seeking real estate investors to take chips off the table

Peter Mitham/Western Investor

An abundance of money, a shortage of assets and a rush of rookies are pushing down the returns for B.C. real estate investors and making it harder for lenders to support deals.

The trend has prompted many lenders to pull back, and even risk-loving “angel” investors aren’t rushing in to pick up the slack. Instead, the angels – so-called because of their willingness to step in where others fear to tread – are recouping their equity from past ventures and building their cash reserves until margins in the province improve.

“People have chased the rate of return on apartment buildings in Greater Vancouver down from seven per cent for blue-collar stuff a year or two ago to about 5.5 per cent. So I’m beginning to liquidate,” said David Andrews, a principal with Ward Jones of Vancouver-based Western Income Properties.

Western partnered with a host of 20 small investors assembled by Berkshire Securities Inc. last year to pick up a 10-building portfolio of apartment buildings for \$15 million, but given the current run-up in prices, Andrews said it’s time to move on.

“It’s fine to take your profit early,” he said.

Western’s portfolio has performed well for Andrews and Jones, who expect to deliver a healthy return to the investors who posted a total of \$5.5 million last year to make the apartment deal possible. But Andrews believes similar deals today are too late in the current cycle to have a worthy upside.

“There’s more money out than there is good investment,” he said. “People are buying properties at rates of return that do not make sense on current rents.”

The compression in cap rates is one indicator of the phenomenon.

The Vancouver office of Colliers International reports that cap rates across classes are closer together than ever before as investors seek the best return on a limited volume of available product.

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### Caps below five per cent

A year ago, cap rates for well-located properties running from downtown office buildings to food-anchored strip centres were between seven and 7.5 per cent. Today, cap rates for most classes of property now sit between 5.5 per cent and 6.5 per cent, though some apartment buildings are churning below four per cent.

Factor in higher mortgage rates, taxes and the like, and the returns get pretty slim.

That's prompted Andrews to begin selling off Western's portfolio and bank the gains to take advantage of the opportunities he believes will soon be available elsewhere, particularly in the U.S. Andrews isn't alone.

Earlier this year, Vancouver-based Churchill Investment Property Corp. executive vice-president Brad Wise made a similar point: "We're seeing a considerable opportunity on the disposition side of assets we've acquired in the last two to four years."

Nevertheless, the strength of the real estate market relative to other investment sectors means investors are still ready to lay down their money for whatever opportunities are offered. Where Churchill sees opportunities is in secondary markets on Vancouver Island and the B.C. Interior.

Similarly, Andrews doesn't believe the B.C. market has completely lost its appeal; he's simply looking for markets that have a greater chance of delivering better returns. If that means he has to sit on his cash for a bit, so be it.

"I'm heading to a higher percentage in cash than I've ever had before," Andrews said. "Not that I feel there's a crash coming in Vancouver. I expect a crash in San Diego, I'm expecting a crash in many of the U.S. coastal markets, and I want to be ready for it."

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### **Caution in deals**

While angels like risks, often charging a hefty premium on the loans they make, they're not fools. That's clear in the attitudes many lenders are taking today, noted Ross Porter, principal in the Vancouver office of Montrose Mortgage Corp.

"They're all starting to be a little more cautious on their underwriting," he said.

Relationships are consequently more important than in the past because lenders want to know the clients they're working with can deliver a return.

"It's the drive to deal with more seasoned, experienced people, as opposed to rookies. And there are a lot of rookies out there," Porter said.

Yet the discriminating attitude exists even in established relationships. Porter pointed to one client whom he warned against getting over-exposed.

"The pain I went through trying to tell them that they shouldn't think that just because they can do 15 or 25 units they can do 60 or 80 in a highrise configuration. A lot of guys get ahead of themselves, and that's where there's damage."

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### **Working with angel investors**

Typically, angels with an interest in real estate provide smaller investors with the funds needed to make a deal work until there's enough equity to secure funding from traditional lenders.

But with deals coming under greater scrutiny, and angels not typically rushing in where fools dare (unless they can get an equity stake in the project that makes the deal worthwhile), it's up to those seeking an angel's involvement to know how to welcome them.

David Andrews of Western Income Properties in Vancouver, who does much of his angel investing in the U.S., said most angels prefer to keep a low profile. That means investors needing their help have to seek out the relationship or network with an intermediary.

Then, building trust and cultivating the relationship requires a fair amount of patience.

"You build business relationships over time," Andrews said. "As people get more secure with each other, the amounts go up and the frequency goes up."