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From left, president and CEO Jeffrey Olin, chairman Frank Mayer and senior vice-president Andrew Moffs of Vision Capital Corporation, which is heavily invested in commercial and industrial real estate.

E-commerce retail a real estate opportunity

VISION SEES PROFIT IN INDUSTRIAL SPACE

JONATHAN RATNER

As investors who are focused on finding real estate that's cheaper in the stock market than it is on the property market, the portfolio management team at Toronto-based **Vision Capital Corporation** sees several attractive opportunities these days. Those include the global industrial real estate sector, Class A shopping malls in the U.S., the seniors housing market and the value-add portion of the Canadian apartment industry.

Jeffrey Olin, Vision's chief executive, along with chairman Frank Mayer and senior vice-president Andrew Moffs, manage the Vision Strategic Opportunity Fund LP, where these themes are reflected in the portfolio's current holdings.

The portfolio managers are particularly bullish on industrial property globally, noting that logistics and e-commerce-driven real estate, is a major beneficiary of the shifts in consumer activity.

"It involves big box logistics, all the way down to the last mile," Olin said, noting that three times as much industrial space is required to service e-commerce retailers than is needed for bricks and mortar store operators.

In a store, the stock keeping unit (SKU) is kept in the store. For e-commerce companies, the SKU is kept in a warehouse. Similarly, if you return an item purchased in store, it stays there, whereas an online return goes to a warehouse.

"The demand is voracious, absorption is very high, and vacancy rates are low," Olin said.

The team at Vision tracks the supply of industrial real estate very closely, since it is relatively easy to build. They noted that in Toronto, rates had been flat for decades, but in the past two years, rents were up about 10 per cent annually.

"Getting the right form of real estate, in the right location, is critical," Olin said, highlighting how Fortune 1000 companies are quickly becoming more in tune with the importance of supply chain management.

He also noted that municipalities aren't big fans of industrial properties as they have the lowest tax base of all real estate sectors, are difficult to obtain zoning for, create additional traffic, along with other transportation and infrastructure issues.

Some of Vision's favourite names in the sector include **Prologis Inc.** (PLD/NYSE), a major global player with a market cap above US$33 billion, along with some Canadian names.

One of those companies is Vancouver-based **Pure Industrial REIT** (AAR.UN/TSX), which received an $8.10 per share cash bid from Blackstone Property Partners in early January.

"We think this takeover underscores one of the themes we've been discussing for 24 months in industrial," Olin said. "There is no sign of this abating."

Another fund holding, **Dream Industrial REIT** (DIR.UN/TSX), doesn't own much of the big box industrial space with 30 or 40-foot ceilings that the market was buzzing about a year or two ago. But it does have smaller locations that are closer to city cores, which are experiencing the highest rent growth.

"You can't build new industrial space in these inner city locations, and they are critical to serve the last mile of e-commerce distribution," Olin said. "You need different types of facilities for different uses. The big-ceiling-height facilities are more regional distribution facilities, and you don't need this for the last mile."

Dream also has a new U.S.-based chief executive, an attractive dividend yield well above seven per cent, and Vision thinks the stock is really cheap.

A somewhat more contrarian trade is the firm's investment in **GGP Inc.** (GGP/NYSE), which owns 100 of the top 500 regional malls in the U.S. They include the Fashion Show Mall in Las Vegas, Water Tower Place in Chicago, and the Ala Moana Centre in Honolulu, which is one of the top 10 traffic generators in the world.

"There is nothing wrong with this real estate. However, those that read the Wall Street Journal every day, see an article about how retail is falling into the ocean," Olin said. "So the stock market has treated GGP shares — along with Taubman Centers Inc., Macerich Co., Simon Property Group Inc. — four high-quality mall operators in the U.S., as if they are the same as a strip mall in Trois-Rivières, Quebec."

He noted that GGP has generated quarter-over-quarter, and year-over-year same-store net operating income (NOI) growth of four to six per cent, while sales per square foot are also rising, as are both cash flow and occupancy rates.

Fifty-six per cent of the U.S. population lives within a one-hour drive of a GGP mall, and while the closure of Macy's and Sears locations (among others) has devastated some malls, GGP sees the changing retail landscape as an opportunity.

Olin noted that the company is getting rid of Sears stores that have $5 per square foot rent tied up forever, and they're replacing them with Zara, H&M, grocery stores and cinemas that come with $30 to $70 per square foot rents, and are improving the malls.

Vision also believes Brookfield Property Partners LP, which in November made a US$23 per share offer to buy the 65 per cent of GGP it doesn't already own, will end up paying more.

"This is an initial bid," Olin said. "They've done this six times in the past five years, whether it be Canary Wharf or Brookfield Residential, the independent committee meets, and they increase the bid. We're highly confident of an increased bid."

Financial Post