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Canadian REITs celebrate 20 successful years; The product of financial turmoil, REITs have become market stalwarts

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Illustrations: Canadian Tire / Canadian Tire Corp. has announced plans to launch a $3.5-billion REIT IPO later this year in an effort to unlock the value in its real estate holdings.;

this past June marked the 20th anniversary of the Canadian real estate investment trust (REIT).

REITs were a product of the turmoil that engulfed the real estate mutual fund industry in the early '90s. A redemption spree by investors in the face of tumbling real estate values motivated the federal government to pass legislation allowing a number of open-ended funds to convert to publicly traded REIT vehicles.

"What emerged from the ashes was an overwhelming success story in the Canadian capital markets," says Patricia Koval of Torys LLP's office in Toronto, whose lawyers were the legal architects of RealFund, the first Canadian REIT.

Indeed, between January 1998 - when REITs achieved a critical mass - and January 2013, the S&P/TSX Capped REIT Total Return Index stood at 494.3%, roughly three times the 167.1% achieved by the S&P/TSX Composite Total Return Index.

To a large degree, retail investors were among the beneficiaries.

"REITs gave the real estate market exposure to the average investor," says Stephen Pincus of goodmans LLP's Toronto office, another firm that has played a critical role in the evolution of REITs.

"Had it not been for REITs, institutional pools of capital like pension funds would have owned most Canadian real estate." A large part of REITS' success is their "flow-through" tax status.

"REITs are the only flow-through public entities that exist today," says John ulmer in davies Ward Phillips Vineberg LLP's Toronto office. "That means there is no tax leakage at the REIT level and the income is taxed only in the hands of the investors."

As well, because they are exchangetraded, REITs offer liquidity and growth potential.

"Institutional investors soon became comfortable with ReITs, especially after some initial concerns regarding the liability of unit holders dissipated," says Ms. Koval's colleague Simon Knowling.

Evidencing REITs' spectacular growth are entities like Artis, whose initial market cap of $4.2-million in 2004 has grown by a multiple of about 435 to $1.8-billion; RioCan, whose market cap when it converted from a mutual fund in 1994 was about $62-million and has now grown by a multiple of 118 to over $7-billion; and Pure Industrial, whose initial market cap of

$22-million in 2007 now stands at over $602-million.

REITs, of which there are now about 40, have also been a boon to a discrete sector of the legal profession.

"REITs are tremendous clients because by definition they must stay active to grow," says Lawrence Wilder in Cassels, Brock & Blackwell LLP's Toronto office. "So they make acquisitions and seek out financing regularly, and that translates into a lot of legal work."

Servicing REIT clients, however, does require a wide range of expertise.

"This is a very exciting area of practice because it brings together a number of different disciplines in ways that you often don't see in one product," Mr. Pincus says. "you need securities expertise, tax expertise, real estate, corporate structuring and M&A expertise."

The future of REITs also looks bright.

"As long as real estate fundamentals remain stable, REITs will stay strong because they fit a particular niche in market demand," Mr. ulmer says.

Particularly promising are crossborder REITs.

"IPOs that are too small to raise money in the u.S. come to Canada to take advantage of our markets, where issuers can size a deal as small as $75-million that u.S. markets, which typically lever pricing penalties on deals smaller than $250-million, just wouldn't support," Mr. Knowling says. "It's a trend that's gaining momentum as the complex cross-border tax issues are becoming simplified and understood.

"While cross-border REITs have been around for some years, current conditions are especially promising."

"The appetite of the u.S. for our REIT market has always been there," Ms. Koval says. "But now we've got a perfect storm with historically low interest rates, a population that is much more hungry for yield product than the average u.S. investor, a tax system that has become more amenable to cross-border and international structure and creative tax lawyers and accountants who have acquired the necessary expertise and made the whole thing work better."

Another growth area can be found among Canadian operating companies that have valuable real estate on their books. In July, Loblaw Cos. Ltd.'s new REIT raised $400-million in an IPO. As well, Canadian Tire Corp. has announced plans for a $3.5-billion REIT IPO later this year in the hope of unlocking the value of the company's property holdings.

According to Ms. Koval, the designers of the first Canadian REITs set out to create a product with longevity. They appear to have succeeded, in spades.