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A milestone for Milestone

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The latest example of foreign assets being packaged up and sold as yield-generating investments to Canadian investors will be played out Wednesday when Milestone Apartments Real Estate Investment Trust closes its $200-million initial public offering, an offering based on 52 multi-family properties in the United States and predicated on a 6.50% yield.

The deal, the largest in Canada by a REIT with all its assets in the U.S. is noteworthy for another reason: Milestone is a U.S. REIT, in contrast to some recent other cross-border deals which have assets in both Canada and the U.S.

The Milestone deal, co-led by BMO Capital Markets and CIBC World Markets, is "a very robust structure," said Stephen Pincus, chair of the REIT and income securities practice at Goodmans LLP. The key elements to the Milestone transaction are:

- It is a made in Canada structure, that gives the issuer access to the local market including, for example, subsequent financings in the form of bought deals. In short, Pincus said, it's a Canadian issuer "that doesn't need to register with the SEC," but into which both Canadian and U.S. investors can participate;

- Milestone qualifies as a U.S. REIT. "There is no tax [to be paid] in the U.S.," said Pincus, noting that because Milestone has no Canadian assets, no tax is paid in Canada.

- For investors, one attractive feature in their return is so-called tax-advantaged return of capital. "It's like investing in a Canadian REIT, with high shelter. But if Canadians invested in a U.S. REIT, they wouldn't get the return of capital treatment," said Pincus.

- The structure allows the U.S. sponsors - or the initial shareholders - to hold a retained interest. "Here the retained interest can be held in any amount," said Pincus, noting that on Milestone the initial shareholders will have a 60% stake.

Milestone's deal continues a trend: for more than a decade there have been various waves of foreign assets, but especially from the U.S., being brought to Canada to satisfy the demand of income-desiring investors. "We have been busy on these matters for 12 years," said Pincus, who estimates that at least nine to 10 different structures, all designed to bring foreign income to Canada, have been used, with tweakings to the structures required following legislative changes, in Canada and the U.S.

Initially, the structures were developed to sell income participating securities, which offered a mixture of interest and dividends. Assets based on electricity production, medical facilities and bus transportation were all used as the basis for an offering.

But following the demise of the local income trust sector, investors' interest in that product waned with some issuers - including Atlantic Power - listing in the U.S. A number of oil and gas companies including Argent Energy Trust; Eagle Energy Trust and Parallel Energy Trust - which have all their assets in the U.S. - came north. Some of those foreign asset income trusts have fared better than others for investors.

REITs have been the most recent asset class to come north and find investors. Pincus has been involved with a number, including HealthLease Properties Real Estate Investment and Agellan Commercial Real Estate Investment Trust. Both are Canadian REITs with large U.S. components.

Pincus wouldn't be drawn into the longevity of the different structures. But one thing is clear: they will last longer if investors are making a decent return. Accordingly, only quality issuers need apply.

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