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U.S. retailers fire up Canadian real estate; Presence driving up rents, more developments

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Illustrations: Spencer Platt, Getty Images Files / Target, which will open its first Canadian stores in 2013, has prompted a flurry of activity in retail real estate.;

TORONTO . U.S. retailers following discounter Target Corp. into a stillstrong Canadian market are driving up rents and perhaps prompting new retail developments that will accommodate rising demand.

Target will open its first Canadian stores in 2013 after it signed a $1.83billion deal in January to buy up to 220 Zellers leases from Hudson's Bay Co. Likely new U.S. entrants include Kohl's, Macy's, Dick's Sporting Goods and J. Crew, while companies like TJX Cos., Limited Brands Inc. and Lowe's Cos. Ltd. are enlarging their presence.

"The value of retail space in Canada is worth more the day after we announced the Target deal than the day before the deal was announced," said Richard Baker, governor of Hudson's Bay Co.

"All of the store space next to a Target is worth more because their cotenant is Target instead of Zellers."

Target's arrival will be the biggest expansion of U.S. retailers into Canada since Wal-Mart Stores Inc. and Home Depot entered the market in 1994, and it has already prompted a flurry of activity in the retail real estate market, including multiple bids, intense negotiations and competition for assets.

The Canadian retail sector outperformed its U.S. equivalent during the economic downturn. The housing market stayed strong, so there was no crisis of consumer confidence, although the Bank of Canada has grumbled about high domestic debt levels.

Canadian office vacancy rates, a sign of the health of the real estate market, have fallen to 7.8% at the mid-point of 2011, from 9.9% a year ago, research from Avison Young shows. In the United States, they fell to 12.6% from 13.6%, according to the commercial real estate company.

Canada's mall owners - RioCan, Primaris, Calloway, Cominar and Retrocom - might be the biggest winners as they seek new deals with anchor tenants whose popular brands draw in shoppers.

"Limited supply of real estate will put upward pressure on rates. Retailers are already feeling that," said Daniel Baer, Canadian leader of consumer products at Ernst & Young.

"You already see jockeying going on in malls where U.S. retailers are willing to pay more than market rates to get certain locations."

But there's a flip side - U.S. retailers have some leverage in lease negotiations because their brand names are strong.

"You're looking for a discount. A lot of these [U.S. retailers] will see themselves as a draw," said Ricky Hernden, a senior research analyst at CB Richard Ellis.

Mr. Hernden said rising demand could result in new properties being built, although it would take several years for municipal approvals for new projects to go through.

Rick Pennycooke, principal at real estate consultancy Lakeshore Group, which advises several U.S. and Canadian retailers, said the entry of more U.S. players was changing the real estate game in Canada, but it was hard for the new entrants to get a big, quick bite of real estate.

One work-around has been acquisitions, which give new entrants critical mass in the Canadian market in one swoop.

"Acquisitions like the Target-Zellers transaction give retailers an immediate platform, on a national scale, to launch their Canadian initiative with multiple, highly desirable locations," said Sheldon Freeman, a partner at law firm Goodmans who has advised on retail acquisitions.