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Real estate market stalls as ING retreats with sale

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When Summit REIT put its industrial properties on the block four years ago, one bidder blew away the competition with a stunning $2.1-billion cash offer.

The winner was a unit of Dutch financial giant ING Groep NV, and the deal for Summit's 450 warehouses and factories across the country gave it a much-coveted foothold in Canada's real estate market. But now the entire portfolio is on the market again, as ING looks to sell assets outside of its home market to bolster its balance sheet after the 2008 banking crisis shook it to its foundations.

The proposed Canadian sale is so big it has frozen other aspects of Canadian commercial real estate, as brokers and interested bidders around the country focus on getting a deal done.

Once a deal is done, other transactions are expected to follow. The sale, one of the largest of the past few years, is being closely watched as a gauge of whether those in the industry have faith in an economic recovery that appears increasingly tired. The company had hoped to close a sale by June, sources said, but the process is stretching into the summer as would-be buyers grapple with financing and try to decide on an eventual corporate structure. "What we are learning from all of this is that the professionals are still nervous," said Dennis Mitchell, a senior portfolio manager at Sentry Investments.

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A deal could trigger other real estate transactions

"What 2008 taught us is you need to have a macro call and if your forecast is for more deterioration, how much exposure do you want to take on in any one transaction?"

Earlier this year, insiders believed a new owner would form a new REIT through an initial public offering. But with new offerings receiving a cool reception amid turmoil in global markets, that option seems to be off the table. A public offering would likely have sought around $1-billion, which would have made it the second largest of the year after Athabasca Oil Sands' $1.35-billion IPO.

"If they tried earlier this year, I think they could have gotten a deal done," Mr. Mitchell said.

The most likely buyers are now private equity funds, a pension fund or a large U.S. REIT looking for some northern exposure. Toronto-based KingSett Capital, a private-equity real estate firm, is also considered a contender.

TD Securities is handling the sale, which could once again reach upwards of $2-billion.

"We believe a number of large institutions and REITs are vying for this portfolio and it is taking a lot of effort to understand the opportunities because it is so large," said Desjardins Securities analyst Jeff Roberts. "For an acquirer that is willing to roll up its sleeves and give the portfolio a lot of TLC, we believe there is substantial upside in cash flow and value in the portfolio, which may have been somewhat under-managed over the past few years."

A deal could also trigger other transactions in real estate, as the losing bidders set their sights on new targets.

Summit was the largest industrial landlord in the country when ING paid an 18 per cent premium to buy the company in 2006. The 33-million-square-foot portfolio was painstakingly built over several years, one property at a time. The Canadian holdings, co-owned by Netherlands-based ING Real Estate BV and ING Industrial Fund, a limited partnership that trades in Australia, has had a challenging year. Its occupancy rate was 88.6 per cent at the end of March, compared to 93.2 per cent last year. Average rents increased 0.3 per cent.

Its properties are typically one-storey buildings in major metropolitan areas and near airports that are home to such activities as warehousing and storage, light manufacturing, shipping and professional services. "Some of the properties are really good," said Mr. Mitchell. "Some are not. You're getting a mixed portfolio, but it's really quite nice in the Canadian context."

The portfolio is enticing because it would be next to impossible for a newcomer to replicate, said Avison Young vice-president Doug Johannson. The spec market – where builders construct buildings before tenants have been found – has been inactive for several years in Canada, keeping new supply low and vacancy rates relatively stable.

Industrial properties are among the most resilient of commercial properties, he said, because tenants tend to sign long leases and aren't mobile. In most Canadian markets, vacancy rates are hovering near 5 per cent.

That's why ING – which received more than $13.5-billion in government emergency aid through the crisis and has been selling assets to bolster its balance sheet and repay the loan – hopes to unload the portfolio in one large sale rather than hive it up into smaller pieces. "This is an incredibly unique asset," said Mr. Johannson, who is based in Calgary. "You want a critical mass in this industry, which is why ING bought it in the first place."