

Why Landlords Should Add Rental Apartment Buildings to Mall Properties

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As land becomes scarce and Canada’s population grows, shopping centre landlords are increasingly intensifying their properties by adding on-site residential buildings. Adding rental apartment buildings to mall properties is a smart move for landlords seeking to add value to their properties, says one expert.

Suburban Canadian malls are typically of a low density, featuring one or two-level retail buildings at the centre of expansive parking lots. There’s potential to add residential to the mix — according to Derek Lobo, CEO and Broker of Record at SVN Rock Advisors Inc., Brokerage, rental units are a desirable addition, more so than adding residential condominiums.

Rental buildings on mall properties is more common in the United States, where there’s a thriving “merchant apartment” building business. Some residential developers are partnering with mall landlords to add rental residential buildings, and Canadian mall landlords are expected to follow the trend.

Rental apartments are a source of ongoing cash flow for the landlord — rent is collected monthly from tenants, as opposed to a one-time gain from selling condominium units. Mr. Lobo noted that consistent rental revenue is desirable describing how landlords will continue to maintain ownership of the asset, unlike with a residential condominium. Rentals “monetize your land,” by adding value to the overall property noted Mr. Lobo, explaining how as a result, land becomes equity for securing additional construction financing. “That’s a beauty,” he said.

Mr. Lobo went on to describe how the cost of capital is the single largest expense in any real estate project. Apartments have the lowest capital cost of any asset class because of CMHC financing — today, a five-year mortgage on an apartment build is just 2.15%-2.8% (5-10 year terms as quoted by Vito Campisi of MCAP Financial), versus about 3.5% to finance a shopping centre.



(THORNTON PLACE IN SEATTLE. SURPLUS PARKING AT NORTHGATE MALL WAS INTENSIFIED TO CREATE A NEW RENTAL COMMUNITY. IMAGE: GOOGLE MAPS)



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Rental buildings also provide the mall landlord more flexibility, longer-term, than with condominiums. “If the retail platform becomes obsolete, or the area evolves from suburban to more urban densities, mall landlords have greater ability to adapt and redevelop. If you did a condo, once they’re sold, you are sunk”.

Adding residential to a mall property adds shoppers to the property, which is no doubt desirable, said Mr. Lobo. Having an on-site grocery store and other key retailers will serve the new neighbourhood, and fashion and other retail concepts are an added bonus for residents, and an attraction for marketing apartment buildings to end-users.

Mr. Lobo noted that landlords should ideally build rental apartment buildings at a higher quality than that seen in condominiums, to ensure the longevity of the rental building asset. High quality buildings will attract high-quality tenants, he said, and quality will negate potential wear-and-tear seen in many large condominium towers.

Demand for rental apartments isn't expected to go away anytime soon — quite the opposite, in fact. Demand for rental housing is expected to rise, noted Mr. Lobo, as households increasingly cannot afford to purchase homes. Real estate prices in Canada's largest cities continue to rise and as well, some people, ranging from Millennials to seniors, are choosing to rent for flexibility as well as other lifestyle choices. Mr. Lobo referred to these as 'discretionary renters'.



(2007 VANCOUVER OAKRIDGE CENTRE INTENSIFICATION PROPOSAL. NOTE: IMAGE IS USED AS AN EXAMPLE OF A MALL INTENSIFICATION, AND DOES NOT INDICATE THAT THESE BUILDINGS WERE INTENDED FOR RENTAL HOUSING. IMAGE: CITY OF VANCOUVER/IVANHOE CAMBRIDGE/WESTBANK)



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Furthermore, rental apartment buildings haven't been built nearly to the same degree as condominiums since about 1975, which means that renter demand, in many markets, is almost insatiable.

Rental residential buildings can add value to malls as well, noted Mr. Lobo — Pension funds and other institutional investors are increasingly seeking-out rental assets for long-term investment

returns, and many don't want to risk acquiring buildings from the 1960's and 1970's that could require significant upgrades. Newly-built high-quality apartment buildings might be the answer, making mall properties even more attractive to landlords as well as potential purchasers. Mr. Lobo has sold 24 newly-built apartment buildings, and structures joint-ventures between landowners, developers, and institutions.

Zoning in some cities even encourages residential intensification of mall sites — the City of Toronto, for example, has zoned shopping malls as mixed-use sites and as a result, a number of centres could see residential redevelopment. The Vancouver region is leading the country in adding residential to mall sites, given its constrained geography and housing demand, though currently most on-site buildings are being marketed as condominium.

Buildings can come in all shapes and sizes noted Marco VanderMaas, Director of Design at architectural firm Q4. He noted that there's a 'missing middle' in terms of housing density — cities such as Toronto have plenty of high-rises and low-rise (single and semi-detached) housing, but limited mid-rise buildings. The periphery parking lots in malls, particularly those adjacent to residential areas, can be intensified with residential housing that is suitable to families. Mr. VanderMaas figures that we'll see a number of malls demolished entirely over the next decade, as demand for a variety of residences takes hold in growing communities and furthermore, malls are also of a relatively low density, agreeing with sentiments expressed by Mr. Lobo.

Shopping Centres are also in 'built up' areas for the most part, so adding neighbourhood amenities may not be required. In some suburban areas, schools and transit are close to mall sites and as a result, adding family-friendly rental buildings could easily see 100% occupancy. Mr. Lobo noted that, at least to start, rental buildings could be built on the periphery of a mall site, so as to not disturb the central retail component. The centre of the mall site, however, could eventually see taller towers — shadowing of adjacent neighbourhoods would be less likely than with a tower on the periphery, which means fewer complaints from change-resistant neighbours. A mix of densities will attract a variety of new residents.

What's clear is that we'll likely see more rental apartment buildings on Canadian mall properties, as the trend plays out south of the border. Mr. Lobo and SVN Rock Advisors are hosting a panel discussion in conjunction with this year's ICSC Conference in Toronto. Mr. Lobo says: "In the session, we will give an insider's perspective on why new apartment construction is the best asset class with which to intensify your retail site. We will identify which sites are most ideal to intensify with new apartment construction, and then drill down with detailed and proven advice." That will be followed by a panel of experts from both the rental apartment and retail industries (including Retail Insider's Editor-in-Chief, Craig Patterson).