UNDERSTANDING THE ROLE OF ADAPTIVE REUSE IN REAL ESTATE INVESTING

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In recent years, adaptive reuse strategies — which transform an existing structure to allow it to serve a new purpose — have become popular in the real estate portfolios of Canada's largest public sector defined benefit pension plans.

Indeed, repurposing old buildings can provide stronger returns to institutional investors than ground-up developments, but only in certain circumstances, says Daniel DeMonte, chief executive officer of the Flat Iron Building Group Inc. "As an investor, you have to figure out if the spend is worth it. What's the operating benefit? Will people be more willing to rent a space?"

According to figures from Flat Iron, a Toronto-based construction company involved in both types of projects, it's less expensive to repurpose an existing building than to replace it with a new one, but there isn't an enormous price difference. "Right now, construction costs are pretty high," says DeMonte. "A new build can cost about $600 per square foot compared to about $450 for adaptive reuse."

One of the other advantages offered by adaptive reuse projects, which are most frequently pursued in dense metropolitan centres, relates to regulations, he adds. "You may want to build within zoning limits, but if you're knocking a building down, getting approval could take between six and 18 months."

In addition to these advantages, DeMonte says adaptive reuse strategies also have significant drawbacks. The most significant is that projects are often prone to budget-busting scope creep. "It often happens when work building and tearing away parts of a structure begins before there's an understanding of the existing structure. You have to look above the ceiling to find out where the overruns will be."

A strong due diligence process can also help unveil hidden features that add value to buildings, he adds. "We're working on redeveloping an old Toronto post office and, during the due diligence process, we found it contained a hidden waffle slab — a sound-dampening cement wall that adds depth to a building. The decision was made to expose it as an architectural feature."

A recent report from the Ontario Teachers' Pension Plan highlighted its strategy for raising property values through adaptive reuse projects making existing building carbon neutral. It's an approach with which DeMonte is familiar. "If you're retrofitting a building to make it net zero, you really have to do your homework. Some buildings can't use triple glazing because of weight limitations. . . . If you're working on an older building, you probably need to replace the breaker panels if you're going to make it net zero."

Another adaptive reuse strategy several real estate arms of public sector DB plans are using combines the repurposing of old buildings to create new downtown neighbourhoods in metropolitan centres. In 2019, Cadillac Fairview — whose parent company is the Ontario Teachers' — acquired the East Harbour Project, which is transforming a former soap factory into a new commercial, retail and residential area in East Toronto.

A similar approach was adopted by the Ontario Municipal Employees' Retirement System's real estate arm, Oxford Properties Group, in 2022, when it entered a joint venture to transform a former naval facility into a new life sciences campus. More recently, the Caisse de dépôt et placement du Québec's real estate arm Ivanhoe Cambridge entered a joint venture to redevelop a 122-year-old textile factory in Melbourne into the core of a 14-hectare mixed-use neighbourhood.

According to DeMonte, these strategies have the potential to provide exceptional returns. "When people are looking at adaptive reuse, there needs to be a vision for the property."

He says an excellent example of this strategy paying off can be seen in Toronto's Liberty Village, a newer neighbourhood filled with apartment towers that surround repurposed industrial assets. Interest in the neighbourhood began to grow after a former carpet factory was transformed into a residential space. "There was, probably, a very limited return on the purchase of the factory, but it was a long-term play. It brought in artists and the area . . . soon became very eclectic. That pushed interest in the surrounding areas."

A similar long-term strategy using new buildings can be used outside of metropolitan centres, he adds. His company is currently building facilities for TPC Osprey Valley, a golf course and about a half-hour north of Toronto Pearson International Airport. "The owner has a vision of creating a vibrant community around that asset."