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Aggressive development: Inside the building and selling of a Toronto condo tower

By TARA PERKINS

The Globe and Mail was allowed to sit in on the development meetings for constructing and selling the Core Condos project in downtown Toronto

A man who makes a living helping the country's largest bank avoid risks is preparing to double down on a market that many people believe is on the verge of a nasty fall.

Babak Habibzadeh, a 29-year-old risk manager with Royal Bank of Canada, lives with his parents and bought his first condo two years ago. He rents it out and has been delighted with the returns to date.

So today he's buying another – a one-bedroom-plus-den, 601-square-foot unit on the 18th floor of a yet-to-be constructed building in Toronto called Core Condos that is scheduled to open in 2017. He's not yet sure if he will rent it out or live in it, but says it will be a sound investment either way.

"Are you excited?" the saleswoman asks him as he plows through a stack of paper in the sales office, outlining the $360,000-plus deal.

"In three years I will be," he says.

Toronto's condo boom has given investors plenty of reason to be excited over the past decade, with prices for new units soaring by more than 70 per cent, according to RealNet Canada Inc. But the recent news is not so encouraging: Sales volumes have declined for two years, a backlog of 18,000 unsold units hangs over the market, and price growth has flattened, even as new condo projects continue to pour onto the market.

The plethora of construction cranes that populate Toronto's skyline has made the city a prime exhibit for those who believe Canada's real estate market is in bubble territory and a crash is imminent. But on the other side of the debate are buyers like Mr. Habibzadeh and developers like CentreCourt Developments, the company behind Core Condos. They are betting their own money on the theory that the market is still far from saturation.

If they're wrong, the implications would extend far beyond Toronto. In December, the Bank of Canada singled out the market when outlining risks to the national economy and warned that "a sharp correction in the condominium market could spread to other segments of the housing market" with "significant repercussions on the real economy."

Finance Minister Jim Flaherty has warned for years of the dangers lurking in Toronto's condo boom. "I hear from some of them who are in the business of building condos that they don't really have a plan, they're just going to keep building them until people stop buying them," he told The Globe and Mail in April, 2012, two months before tightening mortgage rules to discourage real estate speculation. "It will lead to a crash."

But developers continue to see evidence that the supply of eager buyers is far from exhausted.

Andrew Hoffman, who launched CentreCourt in 2010, is confident he is providing housing the city needs. He points to growing numbers of young professionals who want to live downtown and the declining construction of houses and apartment buildings. "The question is, are we building more than the underlying demand requires? And I think the answer is no," he says.

In November, after securing a prime parcel of downtown land, he agreed to allow The Globe and Mail to sit in on development meetings for Core Condos. This is the inside story of how a condo is made. It is also a window on the economic forces driving one of the hottest segments of a national housing market that continues to defy expectations.

The money

The team at the top of CentreCourt is a blend of experience and youth. A lawyer by training, Mr. Hoffman spent 21 years at Menkes Developments Ltd., a prominent Toronto condo developer, where he rose to become chief operating officer before striking out on his own. His vice-president, Shamez Virani, is a 29-year-old who earned an MBA in real estate from Columbia Business School and did a stint at Goldman Sachs in investment banking before joining CentreCourt.

Core Condos is the duo's fourth project and, as with the previous developments, the two men began by searching for the right parcel of property. Location is key, but so is price because that determines both the cost of the condo units and the returns for the developers and their equity investors.

Mr. Hoffman and Mr. Virani checked out more than 50 properties before settling on a piece of land on Shuter Street, in the core of the city, close to the Eaton Centre and Ryerson University. It was owned by Bruce Feldman, a developer who has spent 28 years building shopping centres. Mr. Feldman bought the land in 2011, hoping to delve into condos for the first time, but ultimately decided he didn't want to do the project on his own. "It's just too complicated and you can make so many mistakes," he says.

Despite the apparent easy money to be made by developing condos in Toronto, many developers hit the market only to find out they can't sell enough units to get the bank financing they require to actually build. "Every year there have been guys who haven't been able to make money, because you really have to appeal to 100 or 200 or 300 individuals that want to own what you're building," says Michael Cooper, the chief executive officer of Dundee REIT and Dundee Real Estate Asset Management (DREAM), one of Canada's larger condo investors and developers.

It took Mr. Feldman roughly a year and a half to negotiate the city's rezoning process and win approval for a condo tower. He agreed to protect the heritage façade of townhouses that the city says are a rare example of Georgian styling, to replace rental units that were on the property, and to pay $1.6-million to the city for local improvements. Mr. Feldman also had to agree that his proposed building would have more than 80 parking spots – which meant taking on the expensive chore of digging down five levels to construct a parking garage.

The biggest single battle with the city was over height. "Our first proposal was for 33 storeys," Mr. Feldman recalls, adding that a city councillor "almost threw us out the door."

"They wanted to give us 21 floors, and I needed 24," Mr. Feldman says. He had determined that 24 was the magic number that would let him build enough units to achieve a solid return. "Just in case a mistake occurred or there were cost overruns or something, it gave a little bit of cushion and I needed that."

The city ultimately acquiesced, and by then Mr. Feldman was sure he wanted a partner to take the project to completion. Mr. Hoffman's CentreCourt agreed to buy the land, which is valued at more than $10-million, for the same price that Mr. Feldman paid, and to give him a portion of the development profits.

The moment the deal closed in November, the CentreCourt team sprinted into action. Mr. Hoffman was determined to plan the project, design the units and begin sales in just three months. He says taking too long reduces the annualized return for his investors, ultimately requiring him to charge condo buyers more.

In the condo business in Toronto, developers like Centre Court put up a small portion of the project's total cost, with a chunk of the rest coming from buyers who are willing to part with large deposits for condos that are still years away from becoming a reality.

In the case of the Core Condos project, total capital costs are expected to top $65-million. CentreCourt obtained $5.2-million of third-party financing early on, amounting to half the land's value. The balance of its costs will be funded by equity from the developer and its partners, largely institutional investors, until construction starts.

The money for construction is typically in the form of a bank loan, which will amount to a bit more than half of the total capital costs. Before granting a loan, banks generally require developers to have pre-sold at least 75 per cent of their units – which, among other things, means collecting a 20-per-cent deposit from buyers. One-third or more of the amount of the loan must be guaranteed by the developer and its institutional partners.

If everything goes as Mr. Hoffman plans, the institutions that put in the initial equity will enjoy a return of more than 20 per cent a year on their investment. In his previous projects, he's always managed to exceed that target, an impressive track record that has allowed him to attract some high-profile backers from the U.S. and Canada.

DREAM CMCC Capital Fund, which provides investment capital to developers, is one of the investors in Core Condos and is unfazed by talk of a potential correction in the market. "We've got a lot of people moving to Toronto and they need places to live," says DREAM's Mr. Cooper. "We're not going to have a big increase in single-family homes, so it's going to be in multi-family."

He acknowledges the market did get out of hand for a while as developers without a history of building condos in Toronto rushed to get in on the action. "We were starting to see just too much stuff," Mr. Cooper says. "As somebody said to me today, everybody who ever built a house in the 905 [area code around Toronto] became a condo developer downtown."

On average, about 20,400 condo units started construction each year in Toronto between 2008 and 2012. More than that are expected to come on stream in each of the next three years.

For now, the new supply is running well ahead of the underlying demographic demand. Will Dunning, a housing market analyst who is also chief economist for Canada's mortgage broker association, estimates that the Toronto area will require about 12,800 to 15,800 condo units annually in coming years. But he doesn't see a crash ahead. Today's building boom is making up for a lack of construction more than a decade ago, he argues, while long-term demand will continue to be strong and building is likely to slow.

In the meantime, Toronto has become known for having more high-rises under development than any other city in North America. The construction boom is taking place even as condo sales slow. The number of new units sold last year, 13,797, was down 22 per cent from the year before, and is far below a 10-year average of 17,727 sales a year, according to Urbanation Inc.

Some investors have decided to bow out of the market. "We've taken a hiatus on condos in Toronto since the beginning of 2012," says Martin Zieff, who runs Alcion Ventures, a Boston-based real estate fund that invested in CentreCourt's first two projects.

Profit margins on condos in Toronto "are thinner than you'd find elsewhere in North America," say Mr. Zieff, who started investing in Toronto condos in 1995. "I decided to stop investing in Toronto condos in 2011 because we saw the market getting sloppy and said, 'Why bother?,' " he says. "Why take that risk?"

The design

Armies of consultants are involved in designing a building: interior decorators, architects, mechanical engineers, structural engineers, electrical engineers. There are separate consultants for parking, garbage and even elevators.

At the start of November, Mr. Hoffman tells the team at Cecconi Simone, a Toronto interior design firm, that he wants the majority of the 220 suites in the planned building to be one bedroom units or one-bedroom-plus-dens under 600 square feet. His goal is to complete the final suite plans by Dec. 2, finish terrace design by Dec. 16 and leak renderings of the planned building to blogs by the second week of January to create buzz.

The developers and the designers hash out topics ranging from closet size to whether a balcony can be moved. They debate details of exhaust systems, coils, ducts and bulkheads.

A consultant says they can get away with two elevators, but the developers decide that buyers will demand the convenience and speed an extra elevator will provide, so they add a third anyway – at a cost of roughly half a million dollars, plus a big chunk of floor space that could otherwise have been sold on each floor.

They save money by maintaining the same kitchen and bathroom dimensions throughout the building, enabling them to buy in bulk. They make room for 24-inch built-in dishwashers, rather than 18-inch ones, because the larger ones are cheaper.

Toronto's condo boom has made buyers more demanding, especially the crucial market of young, single professionals. To distinguish one 600-sq.-ft. box from another a couple of blocks away, developers compete to tempt buyers with shared amenities, ranging from juice bars and yoga studios to pools and theatres. Among other things, the luxury features are designed to make units more easily rentable – a key consideration, since Mr. Hoffman estimates that about 60 per cent of buyers in his previous projects plan to rent out their units.

On Nov. 28, the team from Cecconi Simone present their vision for the building's shared facilities – including a gym, bean bag chairs, a café area with free coffee, a tiered sofa, and an outdoor fire pit.

"You nailed it, this is exactly the feel we were going for," Mr. Virani says.

"The only thing I worry about is the photo booth," Mr. Hoffman says. Mr. Virani notes that it's a popular item at a new club downtown. "I just worry about saddling the building with something that could break," Mr. Hoffman says.

"The only question I have is the pool table," Mr. Virani says. "I never really see people playing pool."

"I think it's a great way for people to socialize," Mr. Hoffman counters.

They decide the building will have both a photo booth and a pool table.

The building is ultimately about 20 per cent studios and 25 per cent two-bedrooms, with the remainder in Mr. Hoffman's "sweet spot": one bedrooms or one-bedroom-plus-dens.

The smallest units are about 390 square feet, not much bigger than the master bedroom in many suburban homes. There is one of those on each floor, designed to appeal to cost-conscious buyers. Such "micro' units are one reason the average size of a new Toronto condo has shrunk by 8 per cent over the past decade.

"There have been a lot of examples recently of this micro concept," Mr. Virani says. "We don't push those to unnecessary extremes; we think of it from a livability standpoint."

The selling

A condo's name is vital to its appeal. "We always start with the question, 'Will people say they live in that name?'" Mr. Virani says. "If they get in a cab, are they going to say, 'Take me to 1,500 such-and-such street, or to Tip Top Lofts?'" – the name of a condo project near Toronto's waterfront.

The CentreCourt team decides to name their project Core Condos to emphasize its location in the heart of Toronto. The process of branding and marketing begins.

"It's very much about standing out," says David Klusberg, vice-president of L.A. Inc, the advertising agency hired by CentreCourt. "There's a lot of competition." To whet buyers' appetites, the agency creates a "teaser website," where people can register for more information about the project as it becomes available.

In December, Mr. Virani sits down with key brokers, giving them a sneak peak of some renderings, hoping to create excitement. About 50 agents who sold multiple units of CentreCourt's prior projects come first. As the holidays close in, Mr. Virani does additional presentations for about 100 more agents. He tells them prices will range from the high $300,000 range for studios to about $775,000 for two bedrooms.

"Because we bought the land at the right price and we have the right execution on this, we want to be a value proposition to the buyer," Mr. Hoffman says. The building ultimately comes out at just under $600 per square foot, slightly below average for the Toronto market.

Mr. Hoffman and Mr. Virani are hoping to be the first major downtown launch in 2014 and are targeting a mid-January date, but just before the holidays they hear rumblings that another building might come onto the market sooner. They kick into overdrive.

On Friday, Jan. 3, they release plans, prices and a digital brochure to agents. The agents then pitch the project to prospective buyers and submit "worksheets" to the developers that spell out the units their clients want and which floors they prefer.

Some developments provide "platinum brokers" – the ones who handle the most condo business – with a head start, allowing their buyers first crack at units. Instead, the CentreCourt team blanket the market, accepting worksheets from any agent, in an effort to sell the project as quickly as possible.

Five nights after the Jan. 3 release, with worksheets in hand, Mr. Virani and Mr. Hoffman start to allocate units. A key consideration is who the agent is – one who sells lots of units will get priority over one who rarely dabbles in new condos.

By Sunday morning 80 per cent of the building is sold. The CentreCourt team decides to raise prices, bumping up the cost of a suites by about $10,000. By the end of the weekend, the developer has 185 deals, meaning roughly 85 per cent of the building has sold out.

Everyone is surprised. In a market that is supposed to be cooling, they have managed to go from closing on a deal to buy the land to selling nearly all of the project within about 10 weeks.

"Other developers might have a mindset that if they sold out within 30 days, they've underpriced it, left a lot of money on the table," Mr. Hoffman says. "We'd rather have 100 per cent sold, our deposits in, be very conservatively underwritten, and now focus on the construction."

Mr. Habibzadeh's real estate agent, Roy Bhandari, can't get over it.

"When the guys here told me they were launching on the third of January, I told them, 'You are absolutely crazy,'" he says, sitting in the sales office while Mr. Habibzadeh finishes his paperwork.

"I was literally still in my Christmas pajamas, and I'm like, 'Nobody is buying condos at this time of year, you've got to wait at least a couple of weeks.' But you know what? [They were right.]"

The development of Core Condos

2011

Bruce Feldman and partner buy two properties in heart of Toronto, near Church and Shuter streets, zoned for 10 storeys.

Summer 2012

Mr. Feldman begins the process to rezone the land.

September 2013

CentreCourt signs deal to buy the site, conditional on rezoning. Equity partners join in.

October

CentreCourt starts work with interior designers, ad agency, consultants (mechanical, electrical, structural).

Early to mid-November

Names and logos bandied about; a wind study in the works; deal for the land closes on Nov. 15.

Mid- to late November

Floor plans being designed; ad agency designs teaser website; consultants on traffic and waste disposal weigh in.

December

Suite plans are completed, renderings designed. Meetings begin with real estate agents.

Jan. 3, 2014

Suite plans, prices, renderings and worksheets are released.

Jan. 11-12 weekend

Saturday: Sales agreements start to be signed. Sunday: Prices are increased. By end of weekend, 185 deals struck.

What's next

Working drawings, permits, construction.