

BUSINESS AS UNUSUAL

How one commercial real estate developer is transforming downtown Calgary one building at a time BY MAX FAWCETT

■ If you build it, they will come. It's a foundational belief for supply side economists and hallucinatory Iowa corn farmers who have a troubled relationship with their father and a love for the game of baseball. But Frank Lonardelli? Not so much. He's the CEO of Arlington Street Investments, a Calgary company that does the commercial equivalent of infill development, taking old buildings in good neighbourhoods, parcelling them together and transforming them into something new and attractive. And to accomplish that, he's trying to do something that isn't traditionally done by developers of his size: sell the space before the shovels hit the ground.

It's not that it's not done at all, mind you. "When you're a student of real estate development, you go after the learnings and lessons of the guys who have lots of capital," Lonardelli says. "If you take a look at the two towers that went up on Eighth Avenue, you had massive publicly traded entities putting hundreds of millions of dollars into the deal. So they're going to wrap up someone like CNRL for seven floors. They're going to pre-lease." And even if they don't, with their deep balance sheets and relatively low cost of capital, they can afford a few months of post-completion vacancies. But companies of Arlington Street's size have a much narrower margin of error. "A small developer like me doesn't have that luxury," he says.

Likewise, smaller developers can't usually rope in a CNRL or a Suncor as an anchor tenant prior to construction. That's why, generally speaking, they tend to build first and bring in tenants closer to completion. Lonardelli is trying to change that way of doing

business with Arlington's current slate of projects, which include an ambitious four-storey commercial building at the heart of Calgary's 17th Avenue strip and a mixed-use project further south on Elbow Drive. His team has even gone so far as to build the commercial real estate equivalent of a pre-sale showroom, complete with renderings and proposed floor plans for prospective tenants to review. Even so, it's still a difficult sale sometimes. "I'm asking that tenant to make a decision on a site that still has a bunch of old buildings on it. You're saying, 'Don't worry – we're going to tear them down, but I need you to enter into a lease right now. And you're not going to move in for two and a half years.' Well, he's worried a lot of times about payroll. So for him or her to see out past 12 months? Very difficult."

"There are 44 million square-feet in the downtown core. Tell me how many B and C class buildings you can walk into and you go, 'Wow, is this ever a beautiful commercial building.' There aren't many."

—FRANK LONARDELLI, CEO, ARLINGTON STREET

Equally challenging, Lonardelli says, are the commercial brokers that businesses use to find space. He still has people coming through the building that houses his office on 8th Avenue, which was transformed from an old ramshackle 18,000-square-foot, 1970s-era building that housed the Tiki Tiki and Sam-buca Lounges into four storeys and 34,000 square-feet of Class A commercial space. They say it's exactly what they were looking for at the time he was pitching it – only they never heard about it from their agents. "Do the

agents have too much on their plate? Do they get blasted by new developments all the time? Do they not read their emails? Who knows? But there's no reason why a building ought not to be pre-leased, from my perspective. That paradigm isn't shared by most agents."

He understands why they might not be interested in what he's trying to sell. "Agencies are a transactional business, and the great agents are good at transacting. They're not thinking about the next two or three years; they're thinking about the next trade. So I don't begrudge the agents for that." Still, it's not hard to pick up on an undercurrent of frustration Lonardelli has with the unwillingness of people in his business to take risks. "The most significant challenge was getting the marketplace to believe that we would

do what we said we were going to do. It was convincing people that the renderings we were showing them were going to actually be materialized, and that we'd be able to pull it off. You go up and down the building and you walk into any of the spaces, and people are just blown away by what it looks like. And I'm sitting there saying, 'It's exactly what I told you we were going to do.'"

Then, of course, there's the money. And here, too, Arlington Street behaves a bit differently than its peers. "You have to understand



Arlington is developing The Windsor, a five-storey commercial building, at Elbow Drive and 50th Ave SW in Calgary. It's slated to open in late 2015

the DNA of a developer. A developer is, generally speaking, a maverick, because they're charting new territory. But they're not investor-friendly. They don't want to be told, they don't want to report, and they don't want to talk to investors. And most developers do not want to share in the upside. That's a problem." Arlington Street, Lonardelli says, is "fine" with bringing in partners and sharing some of that upside. "If your financial structure isn't investor-friendly, and if you don't have enough capital or it isn't well structured, all of those risks are magnified. The thing that kills you is a bad financial structure. You can do 90 per cent of the things right, but if you do 10 per cent of them wrong in this city with this sub [ordinate debt] market and in this commercial class, you're going to experience a lot of pain."

As it happens, Arlington Street

is building precisely the kind of spaces Calgary's commercial real estate market needs right now. While it has plenty of Class

A space in its current and future downtown mega-towers, that's not always the right fit for a tenant – even one with a growing operation. According to Susan Thompson, the business development manager of real estate and location at Calgary Economic Development, buildings like the one that holds Arlington's head office give them some interesting alternatives. "It provides options for companies that maybe don't want or can't afford that premium space," she says. "And they don't necessarily need it, either – a lot of the smaller companies can't even take a whole floor in one of those buildings because the floor plates are so big. In the new modern buildings, they're 20,000- to 25,000-square-foot floors, and they probably don't need that much space."

And while there's plenty of commercial space right now in the downtown core, Lonardelli says most of it is underwhelming. "There are 44 million square-feet in the downtown core. Tell me how many B and C class buildings you can walk into and you go, 'Wow, is this ever a beautiful commercial building.'

There aren't many." His goal, he says, is to create as many of them as he can. "What I try to do with my team is get out of Calgary – go to Vancouver, go to Chicago, go to New York, go to the UDI [urban development institute] conferences and say, 'What is it that doesn't exist in Calgary, and why? And what should we be doing about it?'"

Building a better commercial project – an iconic one, even – does cost more money. But, Lonardelli says, it doesn't cost that much more. "You don't have to spend a significantly larger amount of money on the creation of the development. But you ought to be spending a lot more money on design." And in the end – and perhaps even a lot sooner than that – he says it's an investment that pays off. "The practical aspect of it is that all the great buildings stand the test of time. Which means that when the market does what it always does in Calgary, which is go from a flowing boe of \$140 to \$40 and there's a tremendous amount of pain in the marketplace, people will gravitate towards quality." **AV**