Canadian Real Estate Investment Trusts: Should You Invest?

Description

Despite expectations that bond yields in Canada would increase in 2014, they have actually declined considerably since the start of the year. For example, the 10-year Government of Canada benchmark yield has declined from 2.77% at the end of 2013 to 2.07% on August 18. Meanwhile, the yields on quality Canadian real estate investment trusts, or REITs, have declined considerably less, opening a potentially interesting investing opportunity.

Except for during times of serious economic distress, lower bond yields should improve the attraction of other income-producing assets. The obtainable yields on REITs have, over time, exhibited a fairly stable relationship with government bond yields, measured either as a ratio or a spread. This relationship does not hold during times of macro-economic distress, as was noted during the market turbulence of 2008-2009.

Different yield rates for different investments

Compared to the 70-basis-point decline in 10-year government bond yields, the dividend yields on some of the prime REITs in Canada have declined considerably less since the start of the year. The table below indicates the movement in the dividend yields on selected REITs.

Name	Yield on Dec. 31, 2013	Current Yield	Change in Basis Po
10-Year Canada Government Bond	2.77%	2.07%	-70 basis points
RioCan REIT	5.69%	5.27%	-42 basis points
Cominar REIT	7.81%	7.54%	-28 basis points
H&R REIT	6.30%	5.83%	-47 basis points

Sources: Bank of Canada and Thomson Reuters

Based on this historical relationship, the dividend yields on the REITs should have declined considerably more — meaning prices should have risen more. This results in attractive upside potential should bond yields remain at current levels or decline further over the next few months. Alternatively, should bond yields increase from these levels, there should be limited downside in these REITs given that they have only partially followed bond yields down.

RioCan Real Estate Investment Trust (TSX: REI.UN) is the largest listed REIT in Canada and owns more than 340 retail properties in Canada and the U.S. This REIT has an excellent track record of consistent dividend payments, although growth has been slow over the past few years. Consensus estimates indicate a dividend of $1.43 for the next 12 months (monthly distribution) and a dividend yield of 5.3%.

Cominar Real Estate Investment Trust (TSX: CUF.UN) owns a diversified portfolio of 526 office, retail, industrial, and mixed-use properties, and is the largest property owner in Quebec. This REIT has an excellent track record of consistent dividend payments, although growth has been slow over the past few years. Consensus estimates indicate a dividend of $1.46 for the next 12 months (monthly distribution) and a dividend yield of 7.5%.

H&R Real Estate Investment Trust (TSX: HR.UN) owns and operates a portfolio of 41 office properties, 109 industrial properties, and 168 retail properties, as well as a 33% interest in another 168 properties. This REIT used to have a good track record of consistent dividend payments until it halved its payment in 2009, and is only now getting back to the pre-2009 dividend level. Consensus estimates indicate a dividend of $1.36 for the next 12 months (monthly distribution) and a dividend yield of 5.8%.

Is it time to buy?

Canadian bond yields have declined significantly since the start of 2014. REIT yields have not declined to the same extent, possibly creating an interesting investing opportunity.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:HR.UN (H&R Real Estate Investment Trust)
2. TSX:REI.UN (RioCan Real Estate Investment Trust)

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