



3 Reasons to Buy These REITs Now

Description

The general decline in equity prices over the past few weeks has also made a considerable dent in the market valuation of Canadian Real Estate Investment Trusts (REITs). **RioCan Real Estate Investment Trust** ([TSX: REI.UN](#)), the largest of the listed Canadian REIT, lost about 7% and **H&R Real Estate Investment Trust** ([TSX: HR.UN](#)) about 8% from the recent peaks.

This may be a good opportunity to buy quality Canadian REITs. Below I present three reasons why this may be the case.

1. Lower bond yields should normally lead to higher REIT prices

While the wider equity market has been pulled down by concerns over global growth, bond yields continue to fall with the yield on 10-year Canadian government bonds dropping to 1.90% from a recent level of 2.30%. Except during times of economic distress, lower bond yields should improve the attraction of other income-producing assets.

However, the yields on the two high quality REITs listed in the table below have not declined to the same extent. The yield on RioCan, for example, is now almost 3.0 times the yield on the 10-year Canadian government bond – this ratio is 25% higher than the average over the past five years. Investors are either expecting bond yields to rise substantially over the next few years or economic conditions to weaken to such an extent that RioCan will not be able to sustain the dividend. Neither seems a plausible scenario, leaving me with the impression that REITs are currently undervalued compared to bonds.

| Name | Yield Dec 2013 | Current Yield | Change in Basis Points |
|--------------------------------|----------------|---------------|------------------------|
| 10-Year Canada Government Bond | 2.77% | 1.90% | -87 basis points |
| RioCan REIT | 5.69% | 5.60% | -9 basis points |
| H&R REIT | 6.30% | 6.30% | 0 basis points |

Sources: Bank of Canada and Thomson Reuters

2. Selected quality U.S. REITs have followed bond prices higher

In the U.S., bond yields have also declined sharply over the past few weeks with the 10-year U.S. government bond yield dropping to the current 2.15% from 2.97% at the beginning of 2014. In contrast to Canada, with the recent sell-off in U.S. equities, many of the better quality U.S. REITs have initially followed the market lower but have rebounded strongly over the past few days as bond yields moved lower.

3. RioCan and H&R own quality portfolios of U.S. and Canadian properties

RioCan owns a portfolio of 340 retail properties in Canada and the U.S. Around 16% of the current rental income comes from the U.S. property portfolio with the balance arising from the Canadian portfolio with a concentration of properties in Vancouver, Toronto, Ottawa, Calgary, and Montreal. **Loblaw**, **WalMart**, and **Canadian Tire** are the top three tenants by annualised rental income.

RioCan 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 and a dividend yield of 5.7%.

H&R owns a portfolio of 41 office properties, 109 industrial properties, and 168 retail properties, as well as a 33% interest in another 168 properties. Segregated by geography, 25% of the property operating income is derived from the U.S. component of the portfolio, 35% from Ontario, and 27% from Alberta. **Encana**, **Bell Canada**, **TransCanada Pipelines**, Canadian Tire, **Telus**, and the New York City Health Department are among the largest tenants.

H&R 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 and a dividend yield of 6.4%.

Is it time to buy?

Canadian bond yields have declined significantly since the start of 2014 suggesting that the yield on REITs should follow suit. In addition, Canadian REIT prices have declined in line with the recent equity market sell-off and have not bounced back as has happened with the prices of quality REITs in the U.S., possibly creating an interesting investing opportunity.

CATEGORY

1. Dividend Stocks
2. 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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