# Fortis Inc. Is Buying Slate Office REIT Units. Should You?

## Description

Early this month **Fortis Inc.** (TSX:FTS) announced it is buying over 4.7 million units of **Slate Office REIT** (TSX:SOT.UN) at $7.40 per unit, equating to an investment of $35 million. Fortis also just sold its office properties to Slate.



The first thing you would notice about Slate Office is its high yield of 10.7%. Secondly, its market capitalization is only 105 million.

Once Fortis picks up all those units, it would receive a regular monthly income of about $295,000. Should you follow Fortis's lead and invest in Slate Office today? First, let's learn about its business.

### The business

Slate Office invests in non-core office properties because it finds value there. These non-core assets make up 66% of Canada's office space inventory, and they're often overlooked by big investors. So, Slate can buy them at significant discounts.

Slate buys downtown and suburban office assets, and it only targets assets that have stable operating fundamentals and strong tenant profiles. Specifically, it has strict acquisition criteria. Assets must

- be located in business centres across the country with sustainable/improving economies;
- be situated in strategic office nodes with limited risk of new development and a history of stable vacancy;
- be tenanted by quality businesses with strong credit profiles; and
- be accretive to adjusted funds from operations (AFFO) per unit on a leverage neutral basis.

### Management

Slate Asset Management L.P. has a proven track record of creating value in the office sector. Between 2005 and 2011 it co-invested and managed Blackstone's $865 million Canadian office portfolio.

Management aligns with investors because it owns about 20% of Slate Office REIT.

**A growth opportunity**

Between the third quarter of 2014 and the third quarter of 2015, the REIT has grown from 28 properties located in Ontario (38%) and in western Canada (62%) to 49 properties spread across Atlantic Canada (46%), Ontario (33%), and western Canada (21%). It is achieving 90% occupancy across its properties.

These 49 properties include the $430 million portfolio acquired from Fortis that is 10% accretive to AFFO per unit.

Although Slate owns 14% of properties in industrial, retail or others, it plans to build a pure-play office REIT, and is gradually scaling back on non-office properties. There's plenty of room for Slate to grow yet!

**Compared with peers**

Among its publicly traded peers, including **Allied Properties REIT**, Brookfield Office, **Dream Office REIT**, and **Northwest Healthcare Properties REIT**, Slate Office offers the highest yield at 10.7%. Dream Office is in the second place with a 9.2% yield.



Slate Office's 2015 payout ratio is estimated to be 86%, second to Allied Properties, which has the lowest estimated payout ratio of 74%.

Because Slate Office focuses on non-core office properties, it doesn't come as a surprise that it has the lowest implied enterprise value per square foot of $139. For comparison, the second-lowest is Dream Office at $273. Further, Slate's implied cap rate is the highest at 7.8%, with the second-highest being Northwest Healthcare Properties at 7.2%. As well, Slate is also priced the cheapest in terms of the AFFO multiple.

**Conclusion: should investors buy today?**

If you're comfortable investing in a small-cap company, Slate Office surely make sense for any value and income investor. With a well-covered 10.7% yield today, it's not difficult to get over 15% annualized returns for the next few years with Slate Office's kind of growth.

If you do decide to invest in Slate Office, hold it in a TFSA or RRSP to avoid any tax headaches. Also, remember to set a limit order as far into the future as possible because its units are less liquid than its big-cap peers.

**CATEGORY**

1. Dividend Stocks
2. Investing

**TICKERS GLOBAL**

1. TSX:FTS (Fortis Inc.)

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