



Are Canada's REITs a Once in a Generation Buying Opportunity?

Description

According to Alex Avery, Managing Director at CIBC World Markets, the Canadian REIT sector is a screaming buy.

On Wednesday, he joined Amber Kanwar on *Business News Network* to sing the praises of the sector. According to Avery, Canadian REITs are trading at a 15-year low when you compare the yield of the sector to the yield of the Government of Canada 10-year bond. The spread between REIT yields and the 10-year bond has recently jumped to 570 basis points, thanks to general weakness in the sector as well as strength in the bond market.

The last time the yield spread was so pronounced, the resulting out-performance was stunning. From April 2000 to October 2005, **RioCan**, the largest REIT in Canada, returned nearly 150%, and that's before the company paid any dividends. **H&R Real Estate Investment Trust** ([TSX:HR.UN](#)) didn't perform quite as well, but it still surged ahead more than 85%, again excluding dividends.

What was the return of the TSX Composite during that time? It lost a little over 3%, to put the performance of the REITs in perspective.

There are other reasons why Avery is bullish on the sector. When looking at funds from operations (FFO) compared to the underlying price of REIT stocks, the sector is the cheapest in Canada, trading at just 13 times FFO. In comparison, U.S. REITs trade at 18 times FFO.

A number of factors are keeping Canadian REITs down. Investors are concerned about a real estate bubble in the country. They're also worried that rising interest rates will send interest costs soaring, which will impact FFO. And the market is particularly skittish about Alberta, as both the economic weakness in the province as well as office space coming online in both Calgary and Edmonton don't bode well for the REITs that get a majority of their income from the province.

H&R REIT

While Avery admits those are serious concerns, he also thinks the market has overcompensated for them, creating a buying opportunity. He's a fan of H&R REIT, which is currently flirting with a two-year

low primarily based on concerns about its exposure to Alberta, which accounts for approximately 16% of its FFO.

But as Avery points out, the vast majority of the company's income from Alberta is protected by long-term leases, which can't be broken without paying massive penalties. And the company's exposure to the U.S. market more than makes up for any potential weakness from Alberta, as the decline in the Canadian dollar compared to the greenback has nicely boosted earnings from its U.S. subsidiary.

H&R has a current dividend yield of 6.5%, and has a history of raising the dividend, doing so 11 times since the financial crisis in 2009. The company's payout ratio was just 69% in the second quarter, which is one of the lowest in the sector. And its average commercial lease term is nearly 10 years long, which is one of the longest in the sector.

Cominar

Another REIT I'm a fan of is **Cominar Real Estate Investment Trust** (TSX:CUF.UN), with nearly 46 million square feet in net leasable space spread over 567 different buildings. The majority of that space is located in Quebec.

Thus far in 2015, Cominar has earned \$148 million in FFO, which works out to \$0.89 per share. During the same period, it paid out \$0.735 in distributions for a payout ratio of 82.6%. That's a pretty sustainable payout ratio, especially for a company that yields nearly 9%. It also puts the company on pace to trade at just 9.2 times 2015's FFO, which is one of the cheapest names in one of the cheapest sectors.

Investors are also getting a deal when you look at the value of Cominar's assets. The company has a book value of \$21.46 per share, a significant premium to the current share price of \$16.40. The market is a little concerned with the debt it took on to make a big acquisition about a year ago, but investors are getting quite well compensated for that risk.

Canada's REIT sector is on sale, that much is simple. I think investors should be taking a closer look at the whole sector, not just H&R or Cominar.

CATEGORY

1. Dividend Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

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

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