Cominar Real Estate Investment Trust: Is the 9.7% Yield Safe?

Description

There are some eye-popping yields being offered by some of Canada's real estate investment trusts.

Thanks to the latest sell-off from the sector, yields are getting very interesting. REITs that were paying a 5-6% distribution are now paying anywhere from 6-7.5%. And some of the so-called riskier REITs that were paying 7% or 8% dividends are now either solidly in double-digit yield territory, or close to it.

There are two ways investors can look at these types of companies.

They can assume the market is right and these kinds of dividends aren't sustainable in a low interest rate world. After all, both GICs and government bonds pay yields of only 1-2%.

Or investors can take advantage of the opportunity. Real estate is known to be a pretty steady sector, and Canada's economy isn't in such terrible shape. And REITs have been refinancing expensive mortgage debt for years now, locking in low rates. Perhaps these factors will allow them to maintain the high dividends.

It's hard to say which side will end up being right. Let's take a closer look at **Cominar Real Estate Investment Trust** (TSX:CUF.UN) to see if it can maintain its juicy 9.7% payout.

About Cominar

Cominar is Quebec's largest landlord. In total, it owns more than 45 million square feet worth of real estate, over 564 different retail, office, and industrial buildings. The majority of its holdings are in Quebec, but it also owns real estate in Ontario, Atlantic Canada, and Alberta.

Cominar shares are currently flirting with 52-week lows for a number of reasons. Firstly, the whole sector is suffering because investors are anticipating that interest rates will start heading higher as the U.S. Federal Reserve finally decides to hike rates. This will lead to higher funding costs for REITs, which will ultimately lead to a decrease in funds from operations, a key REIT profit metric.

And Cominar itself is dealing with some issues. It has been an aggressive acquirer of property over the last 18 months, including a $1.5 billion deal to buy shopping centres from Ivanhoe Cambridge, an arm of the Caisse de dépôt, Quebec's pension giant. Although Ivanhoe did take a $250 million equity stake in the company and another part of Quebec's pension plan financed an additional $250 million of the deal, investors were still concerned Cominar was sitting on too much debt after the deal closed.

One look at the balance sheet confirms this. Cominar values its portfolio at $7.5 billion, give or take a few million. It currently owes $4.4 billion against those properties. Cominar's 58.7% debt-to-assets ratio is higher than what the market likes to see. Most of Cominar's competitors are closer to the 50% debt-to-assets level.

The case for Cominar

While there are legitimate reasons why the market might be negative on Cominar right now, there are also plenty of reasons to be bullish.

From a book value perspective, Cominar shares are quite cheap. Shares currently trade hands at $15.10, while the book value is $21.50. That's a discount of nearly 30% compared to what the real estate is worth.

Even from an earnings perspective, Cominar also looks attractive. Thus far in 2015, the company has earned $1.15 per share in adjusted funds from operations, putting it on pace to earn $1.53 per share. That puts shares at less than 10 times the REIT's earnings, which is a great bargain in any market.

It also means that Cominar's yield is sustainable, at least for now. Cominar pays an annual dividend of $1.47 per share, which means it has a payout ratio in the 95% range. That seems a little high, but keep in mind that many of Cominar's shareholders opt to receive their distributions in the form of additional shares, since the company gives a 5% discount for doing so. It's a very easy way to supercharge dividends.

According to management, Cominar's cash distributions through the third quarter were just 64%. Thus, as long as many investors choose to keep taking dividends in the form of additional shares, there shouldn't be an issue with the dividend. I'd say you can trust Cominar's yield, but you should keep an eye on earnings, just in case.

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