



## REITs at 50% Discounts

### Description

Owning real estate investment trusts (REITs) is a great way to earn rental income without having to scout for the best properties, screen tenants, or manage properties.

It's even better if you can find cheap deals to get the most out of your dollar. However, you've got to be careful about what you choose. Although both of the following REITs are priced at 50% below their book values, one is riskier than the other. They offer yields of 5.5% and 12.4%, respectively.

#### Morguard North American Residential REIT

**Morguard North American Residential REIT** ([TSX:MRG.UN](#)) had its initial public offering in 2012. Since then, it has built a portfolio of over 13,000 suites across 45 multi-unit residential properties in North America.

Specifically, the REIT has about \$2 billion worth of assets. Its portfolio of properties includes 31 low-rise and mid-rise apartment communities in the United States and 14 Canadian residential apartment communities in Alberta and Ontario.

Morguard North American Residential REIT's book value is \$21.8 per unit. At \$10.85, the REIT is discounted by 50% from its book value.

In the third quarter that ended on September 30, the residential REIT's adjusted funds-from-operations (FFO) payout ratio was below 68%, which is reduced from the 88% in the same period in 2014.

Additionally, with a high occupancy rate of 95.7% (specifically, 99% in Canada and 94% in the United States), its FFO stream should remain stable. So, the REIT's 5.5% yield remains safe.

#### Dream Office REIT

**Dream Office Real Estate Investment Trst (TSX:D.UN)** is Canada's largest pure-play office REIT. It has 24.1 million square feet of gross leasable area across 34 cities and diversified rental income from 2,200 tenants.

About 71% of its net operating income (NOI) comes from central business districts. Its top tenant, **Bank of Nova Scotia**, contributes 7.3% to its gross rental revenue and has a weighted average remaining term of 9.3 years. The REIT's top 20 tenants have an average credit rating of AA-.

One concern unitholders may have is that Dream Office has 26% of NOI from Alberta. Still, the REIT's occupancy rate was 92.8% in the second quarter, which continues to remain at least 4% higher than the national office average.

With a book value of \$33.3 per unit, at about \$18 the REIT is discounted by 46%. However, its consensus net asset value is \$29.71, indicating it's discounted by 39.4%. It's more prudent to go with the more conservative estimate. Even so, it's still cheap.

At about \$18, Dream Office REIT yields 12.4%. With an adjusted FFO payout ratio of 95%, there's little margin of safety for its distribution.

### **Tax on REIT income**

If you're buying REIT units in a TFSA or an RRSP, you do not need to worry about the rest of this section. However, if you want to learn about a REIT's tax-advantaged nature, read on.

REITs pay out distributions that are unlike dividends. Distributions can consist of other income, capital gains, foreign non-business income and return of capital. Other income and foreign non-business income are taxed at your marginal tax rate, while capital gains are taxed at half your marginal tax rate.

On the other hand, the return of capital portion reduces your adjusted cost basis. This means that that portion is tax deferred until you sell your units or until your adjusted cost basis turns negative. So, if you buy REIT units in a non-registered account, you'll need to track the change in the adjusted cost basis. The T3 that you'll receive will help you figure out the new adjusted cost basis.

Of course, each investor will need to look at their own situation. For instance, if you have room in your TFSA, it doesn't make sense to have investments in a non-registered account to be exposed to taxation.

### **Conclusion**

If you want a safe yield, go with Morguard REIT, which is in the more stable industry of residential REITs and has a lower payout ratio. By buying Dream Office, you're taking on higher risk for the higher yield.

REITs can boost a portfolio's income and work well as a part of a diversified portfolio.

### **CATEGORY**

1. Dividend Stocks
2. Investing

## TICKERS GLOBAL

1. TSX:D.UN (Dream Office Real Estate Investment Trust)
2. TSX:MRG.UN (Morguard North American Residential Real Estate Investment Trust)

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