Slate Office REIT: 2 Investments for the Price of 1

Description

Slate Office REIT (TSX:SOT.UN) closed a transformational acquisition 15 months ago that saw the office REIT buy 14 commercial properties with 2.8 million square feet of gross leasable area for $430 million. Included among the acquired properties was the Maritime Centre, a 550,000 square foot office building in the heart of Halifax.

The deal created a national office REIT with 49 properties and 5.4 million square feet of gross leasable area. It literally doubled the REIT's asset base.

Fool.ca contributor Kay Ng recently recommended the REIT's shares, suggesting its focus on assets that can be acquired for less than replacement costs makes it an ideal investment for individuals interested in obtaining above-average yields.

Slate Office CEO Scott Antoniak suggested in a *Halifax Herald* interview earlier this year that his company would love to own B-class office buildings in the heart of downtown Toronto, but they're currently selling for 20-50% above the replacement cost of $350 per square foot—Slate paid approximately $105 per square foot for the Maritime Centre, well below new construction.

I was just in Halifax a few weeks ago. The Maritime Centre is in a prime location downtown. Although it's 40 years old, a little makeover will get those rents higher, not to mention the building's occupancy, in no time.

The most interesting part of its focus on B-class office properties is that they represent two-thirds of the office properties in this country. This means it's never going to run out of possible acquisitions, and when deals get done, it pays B-class prices for A-class locations.

In Halifax, where a billion-dollar shipbuilding contract from the federal government has put the town on an accelerated growth spurt, companies like Ikea, which is opening a 330,000 square foot store in Dartmouth next fall, are very excited about the city's future. Five years from now, Slate's investment won't just be considered transformational; I believe it will also be deemed timely as well.

However, whenever investors consider buying small caps with high yields, it's important to understand the risks involved.

Yes, Halifax is considered one of Canada's fastest-growing metropolitan cities at the moment with 2.9% GDP growth, but Slate also purchased buildings in Moncton and St. John's, two regions that aren't faring nearly as well. Rental increases won't be nearly as easy to come by in those two places.

The conservative play

Investors who want income but are concerned about REIT stock prices—Slate Office is up 24% year-to-date—might want to take a position in **Fortis Inc.** (TSX:FTS) instead.

Huh? Why, when you're interested in real estate, would you want to own Canada's largest utility?

Simple.

It owns 12% of Slate Office as a result of the $35 million investment it made in Slate in June 2015 at precisely the same time it was selling the REIT its 14 properties.

Fortis currently yields $3.6%; it's not quite the 8.8% that Slate provides, but then Slate isn't a $12 billion company with $29 billion in assets, 97% of which are in regulated businesses producing predictable returns.

The downside to this move? It's impossible to know how long Fortis will hang on to its investment in Slate. In the long run, no matter what happens to Fortis's investment, its stock is definitely not going to keep you up at night.

Can I say the same about Slate Office? Probably, but at least you have a reasonable alternative.

CATEGORY

1. Investing

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1. TSX:FTS (Fortis Inc.)
2. TSX:RPR.UN (Ravelin Properties REIT)

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washworth