Avoid This 10%-Yielding REIT

Description

I like big yields and I cannot lie. But before we go chasing after every massive yield we see, due diligence is always necessary to ensure that these big payouts have the fundamentals to sustain them. **Cominar Real Estate Investment Trust** (TSX:CUF.UN) is one such company which might not pass the litmus test.

Six straight quarters of declines

Almost two years after American retailer **Target** shuttered its Canadian stores, Cominar's Q3 2016 marked the sixth straight quarter of declines in its same property net operating income (defined as income after operating expenses from properties the REIT has owned for more than a year) at -3% year over year.

Segment-wise, office and industrial NOI declined 6.1% and 5.4%, respectively; retail was the sole shining star, managing to grind out a 14% gain. Furthermore, Cominar's management has guided a 4% same-property NOI decline for Q4, meaning it's going to get worse before it gets better. Naturally, the NOI issues have led to problems with Cominar's cash flow: recurring funds from operations declined 10.4% to $68 million from $76 million from Q3 2015.

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Cominar's Year-over-year NOI (quarterly); Source: Author generated based on company filings

Why the bad numbers?

The most obvious answer is that Cominar is having problems acquiring and retaining tenants; office and industrial occupancy for Q3 came in at 89.7% and 93.9%, respectively, versus 91.1% and 94.4%, respectively, last year, dragging down the recovery in the retail segment. Moreover, although committed occupancy ticked up to 92.2% from 92% (those actually paying rent were more like 88%), renewal rates dropped to 55.2% from 69.7% in Q3 2015.

I expect these challenges to persist into 2018 due to low oil prices and a supply glut in the Montreal office market. Furthermore, Canadian heavyweight **Bombardier, Inc.** has warned that roughly 10,000 jobs in Quebec could be at risk as the company "streamlines operations," putting a further damper on provincial economic growth.

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Weakness in office and industrial dragging down retail (Source: Company Filings)

What's the verdict?

The cash flow woes and increasing leverage have forced management's hand into a $200 million equity raise earlier this year, as its senior debentures were downgraded from stable to negative. Moreover, the equity raise can be viewed as an act of desperation, given the stock's discounted valuation to peers (12 times 2017 AFFO vs. 13 for commercial REIT peers) and its own net asset value per share of 18 vs $13.76/per share as of writing. The company also reinstated its DRIP to cope with the biggest specter looming over it: its ridiculous 108% AFFO payout ratio.

Yes, you read that correctly.

Cominar is paying more than it actually generates in funds from operations after recurring expenses to attract investors. While the new DRIP has staved off a dividend cut for now (as long as it has 30% enrollment, according to management), the need to aggressively get bodies into its vacant spaces as well as the capex to remain competitive mean that there is immense pressure on management to keep the huge payout and still meet guidance.

I personally don't like it when payouts are contingent upon DRIPs, and, for that reason, I'm out.

CATEGORY

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