



Could This REIT Cut its 10%-Yielding Dividend Payout Soon?

Description

Cominar Real Estate Investment Trust (TSX:CUF.UN) has been paying a hefty \$0.1225 monthly dividend for the past 30 months with a current annual yield of 10%. This great yield has become unsustainable. Could it be cut any time now?

Cominar is the third-largest, diversified, closed-end Canadian REIT which owns a diversified portfolio of 539 office, retail, industrial, and mixed-use properties — the majority of which are in Québec.

The REIT's properties are mostly situated in prime locations and benefit from high visibility and easy access by tenants. Cominar has a great history of consistent distributions per unit. However, management has been unable to organically grow book value per unit. Recent poor leasing performance has affected its income and payout ratios.

Occupancy rates continue to be subdued

Cominar used to achieve over 94% portfolio occupancy averages in the past, yet it sat at 92.2% as of September 30, 2016. The large downfall has been a result of its poor office and retail performance. The REIT took a big hit back in 2015 when **Target** decided to exit Canada.

Payout ratios now at significantly unsustainable levels

Cominar's adjusted funds from operations (AFFO) have been falling since Q3 2015 while distributions have been increasing during the same period to Q3 2016. The REIT's payment ratios of AFFO have increased from 94.2% in Q3 2015 to a glaring 108.1% in Q3 2016. The full-year 2014 payment ratio of AFFO was not bad at 89.7%, but it increased to 94.2% in 2015.

The full-year 2016 payment ratio of AFFO may exceed 100%!

Through the first nine months of 2016, Cominar earned \$1.06 per share in AFFO while paying out \$1.1025 per share to investors. That doesn't look good.

Huge debt overhang

Cominar's debt ratio increased from 50% in 2012, climaxed at 56.1% in 2014, and then fell to 53.9% by year-end 2015. Due to the threat of a credit-rating downgrade early in 2016, management scrambled to make some quick repayments to reduce the debt. The credit ratio then improved to 51.8% by September 30, 2016.

However, management reduced debt by selling more units and reinstating the dilutive dividend-reinvestment plan (DRIP) to raise more cash capital with shares selling well below net book value, and they left the huge monthly payouts untouched.

Threat of increased interest rates

Cominar's 2015 annual report outlined that much of the REIT's debt payable bore interest at fixed rates. A 25-basis-point increase in the average interest rate on variable interest debts, all else equal, would have resulted in a \$2.1 million increase in net income.

Since Cominar has a significant amount of its debt at fixed rates and has spread maturities over several years, it could manage rate movements in the short run. However, due to the current low occupancy rates and the high distribution-payout ratio, an increase in interest rates could mean a distribution cut.

Investor takeaway

The market is currently extremely pessimistic about Cominar due to external interest rate concerns, uncertainty about retail demand, the potential for a distribution cut, and the REIT's low occupancy rates.

You may want to keep your investment in Cominar for the long term. The REIT has great properties, is reasonably diversified, and has a good history. If a cut occurs, the REIT may become further undervalued, presenting an even better buying opportunity or a chance to increase your position.

Management may want to keep its payout as stable as it has been since 2012, but it can't continue paying out that which it does not have. A payout cut seems inevitable.

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Date

2025/09/04

Date Created

2017/02/15

Author

brianparadza

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