Canadian Investors: This Is the Only REIT You Need to Own

Description

Even though Canada's real estate bubble continues to make headlines — and rightfully so, at least according to this analyst — it's important for investors to realize the sector is still an important part of a diversified portfolio.

Besides, professional real estate investors are far more intelligent than the average Toronto-area condo speculator. While even smart investors make mistakes, for the most part, Canada's REITs are making sensible purchases of property that offer reasonable returns.

In other words, they're slowly making investors rich. Even if real estate hits a rough patch and values plummet, the average REIT has a conservative balance sheet and oozes cash flow. It'll be fine.

The only question remaining is, which REIT should Canadians own? Here's the case for making it **H&R Real Estate Investment Trust** (TSX:HR.UN).

The skinny

Many REITs focus their attention to just one part of the market. Some own office buildings, others, shopping malls, and so on.

This is usually an adequate amount of diversification. If the economy is weak in Alberta — like it is today — earnings from stronger places makes up for the weakness. This helps to ensure steady results and predictable dividends.

H&R has taken it a step further. The company owns all different kinds of real estate, both in Canada and the United States. The portfolio as it stands today consists of 38 office properties, 156 retail properties, 101 industrial locations, 12 residential complexes, and four projects under development. In total, the portfolio is worth $13 billion and stretches out over 44 million square feet.

The company also owns 33.6% of ECHO Realty LP, which owns 215 properties and 8.8 million square feet of space in the United States.

H&R is Canada's second-largest REIT, trailing only **RioCan**.

One other important thing to note: H&R's management group collectively own more than five million shares. It's nice to see CEO Thomas Hofsteder and his team eating their own cooking, so to speak. They have serious wealth tied up in the company.

Valuation

Although the numbers aren't exact, many investors use funds from operations to approximate a REIT's earnings and adjusted funds from operations as a proxy for free cash flow. Remember, REITs must adjust the underlying value of their properties on a quarterly basis, which creates huge swings in net income.

H&R just released its 2016 results, which were solid. Funds from operations totaled $1.93 per share on a fully diluted basis. Shares currently trade hands at $23.22 each, putting the company at 12 times funds from operations. That's an attractive valuation.

In addition, H&R has a current book value of $6.9 billion, while shares have a market cap of $6.6 billion. Serious investors don't want to pay much more than book value for a REIT.

Dividend

H&R pays an attractive 5.9% yield, which is a nice balance between giving investors a generous income stream today and having enough left over to invest in the future.

In 2016, H&R paid investors $1.35 per share in distributions. The company raised the payout slightly in December, which puts it on pace to pay $1.38 per share in 2017. Even if we use the updated payout and 2016's funds from operations, we still only get a payout ratio of 71.5% of trailing funds from operations. This is one of the lowest payout ratios in the REIT universe.

The bottom line

H&R REIT has it all. It has a diverse portfolio consisting of different kinds of real estate across North America. The company's payout is both attractive as a yield play and secure enough that investors don't have to worry. And, perhaps most importantly, the REIT's management team wants shares to go higher just as much as I do.

H&R has a home in my portfolio. Perhaps it should be in yours, too.

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1. TSX:HR.UN (H&R Real Estate Investment Trust)

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