Is Allied Properties Real Estate Investment Worth the Premium?

Description

Being a true value investor can sometimes be difficult, especially when the market is so strong. But as Warren Buffett, one of the world's top value investors, has repeatedly said, "It is far better to buy a wonderful company at a fair price than a fair company at a wonderful price."

And that's absolutely the case with **Allied Properties Real Estate Investment** (TSX:AP.UN). It trades at a hefty premium of approximately 17.6 times full-year 2016 funds from operations. Compared to some of its contemporaries, this is more than double, so obviously the business is expensive.

The net asset value is approximately $36 per share, up 10% from 2016. Obviously, with shares trading over $38, you're not getting any discounted real estate by purchasing this company.

However, we also have to recognize that, compared to some of its contemporaries, Allied Properties is an immensely streamlined operation. It is focused on core geographic regions that are experiencing strong economic growth.

As of March 31, it has 156 properties that account for 11.8 million square feet. Toronto, Montreal, and Calgary account for 4.6 million, 4.3 million, and a little over one million square feet in total, respectively. The rest of its network is in Kitchener, Winnipeg, Edmonton, Vancouver, Ottawa, and Quebec City.

For the most part, Allied Properties has had little problem filling its buildings with high-quality tenants. It has an occupancy rate of 92.6%, with Toronto at 95.9%, Montreal at 92%, and Calgary at 84.3% — this last one is to be expected because of lower oil prices having a negative impact on businesses in Alberta.

There are two reasons its occupancy is as strong as it is.

First, its tenants are well diversified. In Q1 2017, 18% of its revenue was generated from its top 10 tenants. When it was first getting started back in 2013, its top 10 tenants accounted for 49% of its rental revenue. The top three tenants are Equinix, **Ubisoft**, and **Desjardins**; they're not likely to leave anytime in the near future.

Second, there has been a strong trend towards urbanization in Canada. Of note, 83.2% of all Canadians live in areas with 10,000 or more people. In Ontario specifically, that number is 89.7%. It's obvious that more people are living closer to densely populated regions, which boosts the demand for office space.

So, here is the story about Allied Properties.

The yield is currently 3.94%, which gets you about $0.13 per share a month in dividends. As the company grows (and it has been through organic improvements and acquisitions), I anticipate the dividend is going to increase with it. And compared to others, this commercial REIT is very much a "sleep-well-at-night" type of stock. Nevertheless, investors have to feel comfortable with paying a premium for these shares. While it might not provide outsized returns like other companies, the underlying risk is smaller. Sometimes smaller gains without the risk are worth it.

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