



Amid Interest Rate Worries, Killam Apartment REIT Soars: Here's Why

Description

Of the sectors most sensitive to interest rate movements, real estate investment trusts (REITs) stand out as some of the most volatile companies during interest rate hike or cut cycles. In general, REITs tend to perform similar to bonds or other interest-sensitive securities, with an inverse relationship to interest rates (when interest rates rise, REITs tend to underperform, and vice versa).

On Wednesday, **Killam Apartment REIT** ([TSX:KMP.UN](https://www.killamreit.com)) announced its Q2 2017 earnings alongside \$100 million worth of acquisitions agreed to since the end of the most recent quarter in addition to acquisitions completed during the most recent quarter.

Starting with Killam's earnings, the company announced net income of \$34.6 million compared to \$3.6 million during the same quarter last year due primarily to fair-value adjustments to the company's property portfolio. The company's same property revenue increase of 2% was supported by rental increases of 1.6% on average as well as reduced vacancy rates among existing properties.

Funds from operations (FFO) increased by more than 20% year over year as well due in part to lower interest expense charges; although Killam was able to improve its FFO by more than 20%, an influx of additional trust units relating to the conversion of a series of convertible debentures to equity resulted in FFO per unit which stayed relatively even year over year, although adjusted FFO per unit increased by nearly 7%.

Killam's deleveraging initiatives during this past quarter provided the company with significant room to engage in additional acquisitions, which are expected to be significantly accretive to cash flow and provide increased growth over the coming quarters. Of the acquisitions announced subsequent to the end of the quarter (during the quarter, the company made \$33.8 million of investments), Killam announced the following two acquisitions, which should provide significant value in the medium to long term:

1. The purchase of two new concrete buildings in Halifax totaling 134 units for \$31.6 million (or \$236,000 per unit), funded by the assumption of debt with the remainder paid in cash.
2. Two additional properties currently under construction in Edmonton totaling 296 units were

purchased for \$67.5 million (or \$228,000 per unit), with \$50 million being funded in CMHC-insured mortgages and the balance paid in cash.

These buildings have very attractive lease rates per square foot, and the majority of the two new properties in Edmonton are already pre-leased out. The net operating income (NOI) of these properties is expected to help Killam continue to trend upward in terms of NOI following the most recent earnings release, which showed a 3% NOI same property increase across the board — an impressive number compared to its peers.

Bottom line

Interest rates will continue to fluctuate, and REITs may indeed be a very difficult sandbox to play in for some time. That said, isolating one or two REITs that should outperform their peers and including them in a portfolio as part of a diversification program never hurts.

Stay Foolish, my friends.

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