Allied Properties Real Estate Investment May Be Expensive, but it’s Worth it

Description

Compared to some other office REITs available on the market, **Allied Properties Real Estate Investment** (TSX:AP.UN) is expensive. As of June 30, its NAV per unit was $37.14, while shares trade for $40.90, about 9.6% higher. In my opinion, this premium is still worth it because Allied should continue to grow over the coming years with all signs positive.

At the end of Q2 2016, Allied Properties had $4.8 billion in investment properties. That grew by 13.5% to $5.4 billion in 2017. What’s remarkable is that while the number of assets grew, Allied Properties’s total indebtedness ratio actually dropped by 2.7% to 37.3%. Thanks to its annualized adjusted EBITDA increasing by 8.1%, its net debt as a multiple of annualized adjusted EBITDA dropped from 8.6 times to 8.4 times.

On the earnings front, conditions are strong too. Net income increased by 63.5% to $113 million from $69 million in Q2 2016. Funds from operations also increased by 7.4% from $42.5 million to $45.6 million.

So, what drove such strong growth for Allied? A few key metrics stand out:

First, leased area increased by 2.2% to 93.2% in the six months ended June 30 compared to the same period in 2016. Further, occupied area increased by 3.3% to 92.4% year over year. The average in-place net rent per occupied square foot is up 8.5% to $21.67, while maturing leases saw a 21.9% increase — up from 4% in the previous year.

Allied credits “material rent growth for office space in Allied’s primary target markets in Toronto.” In other words, Allied’s top market has high demand for office space. In an August investor presentation, Allied broke out its Toronto square footage in a unique way. Toronto accounts for 4.156 million square feet, but then there’s an additional 559,000 in the same region labeled as “Mission Critical.”

“Mission Critical” is the holdings of its subsidiary, Allied Data Centres, which has a wide variety of customers, including **Equinix,** Cologix, **Cogent,** Rogers Data Centres, and **IBM.** Essentially, it has rolled all of its data centre/IT clients into this subsidiary, which are in this half-million square footage.

The fact that such a major portion of its square footage is tied to such a high-demand product should excite investors. As a society, we are demanding more data, not less, so the need for more space by these clients is likely to occur. This should keep the demand for space up in Toronto, allowing rents to continue increasing.

Allied has also been working on other growth initiatives. A recent one that had good news last week was the sale of all condominiums at King Portland Centre, a joint venture with **RioCan Real Estate Investment Trust** (TSX:REI.UN). According to the press release, "RioCan and Allied expect the profitability of these units to exceed initial expectations."

All of this growth makes it possible for Allied to pay a comfortable 3.74% yield, which is good for a monthly distribution of $0.1275. Allied has historically increased the dividend in the last couple months of the year, with the last increase taking effect for the November 2016 payment from $0.1250 to the current $0.1275. Management hasn't announced a further increase, but with so many years of dividend increases, I expect another one soon.

In summation, here's what you've got: a strong REIT that is growing quickly with rents moving in the right direction. Although shares trade higher than the NAV, with so much growth, I believe the future is bright for Allied, and I believe you should buy.

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