



## Income Investors: Is This REIT's 6% Yield Worth Investing in Today?

### Description

After being hit by a [credit-rating downgrade](#) to junk and a 22% distribution cut in August 2017, which was followed by a further 36.8% distribution cut by March 2018 for a combined 51% reduction in monthly payouts, **Cominar REIT** (TSX:CUF.UN) equity units have had a fair share of trouble over the past 12 months. Are the REIT's fortunes changing as it implements a new business strategy?

Cominar significantly cut its distribution and sold 95 non-core investment properties, as it embarked on a new strategy code named Cominar 2.0 in an effort to turn around its ailing fortunes with a target to eliminate the deep discount on its equity units.

There have been some recent positives that could make one consider taking up the REIT's \$0.06-per-unit monthly distribution that yields 5.95% annually, but there are still reasons why the units still trade at 69.5% of their net asset value today.

Let's look at the positives first.

### Improved leasing performance

Cominar's committed portfolio occupancy level rose to 93.1% last quarter from 92.6% by December 2017. Leasing efforts are paying off, even after the hit from Sears store closures. Commitments will likely translate into rental income over the next 18 months, boosting net operating income (NOI) per unit.

The further growth in retention rate of expiring leases from 49.8% during the second quarter of 2017 to 57% by June this year is encouraging. It builds on the 43.9% achieved during the first quarter of 2018, showing sustained improvement. This reduces new client prospecting costs and improves occupancy level stability in the portfolio.

### Same-property NOI growth

The REIT's property portfolio is showing improved earning power with the return to positive same-property NOI growth recently. The 0.8% same-property NOI growth achieved during the second

quarter is favourable. This is huge, especially considering the 6.9% drop in same-property NOI in the retail segment is mainly due to Sears stores closures. The strong positive performance in the office and industrial and mixed-use segments managed to offset the weakness in retail portfolio.

### **Safer distribution**

Cominar's AFFO payout ratio fell to 78.3% for the second quarter compared to 118.5% during the same quarter last year. The distribution is much safer today, but the cause for that improvement isn't encouraging. The improved distribution quality resulted from two agonizing distribution cuts.

The REIT's reduced leverage to a debt ratio of 52% last quarter from 57.4% in December last year reduced equity risk in a rising-rate environment and is favourable for valuation.

That said, even after some positive developments noted above, the REIT's units are still priced at a deep 30% discount to their intrinsic value today.

### **Why does the discount persist?**

The core portfolio still underperforming.

The REIT's property portfolio continued to record declines in average occupancy levels over the past six months. In-place occupancy levels declined from 87.9% by December 31, 2017, to 86.9% by end of March 2018 and was recently down to 86.5% at the end of June 2018, led by rental losses from Sears store closures.

Although committed occupancy levels have improved, in-place occupancy is what matters most, as this is where the rental income comes from. That said, the REIT may be able to charge comparatively higher rental rates to new tenants in the space vacated by the old anchor tenants who usually pay discounted rates per square foot.

Further, diluted net income per unit declined 30.6% last quarter from a comparable quarter last year and is down 38.2% over the first half of the year. Excluding one-time expenses like consulting fees and transaction costs related to the new strategy, net income per unit was still down 20% last quarter from comparable levels last year.

Portfolio profitability has gone down on a per-unit basis, and recurring funds from operations per unit are declined too, even after a unit-buyback program was executed last year.

### **Foolish bottom line**

Cominar's reported growth in same-property NOI and lower leverage are favourable developments that reduce the risk of further distribution cuts, and a continued improvement in tenant retention rates improves future earnings quality.

That said, the persistent decline in overall profitability and free cash flow generation per unit support the heavy equity discount, presenting new investors with some margin of safety.

The current distribution looks worth investing in for a nearly 6% annual yield, but the REIT needs to arrest the cash flow and profitability declines in the near term for the units' valuation discount to disappear.

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