Value Investors: 2 Top REIT Picks for 2019 (and Beyond!)

Description

Every single sub-sector that makes up the **TSX Composite Index** will likely finish 2018 lower, with some down as much as 30%.

There is one exception though, and that's real estate. Through December 18, the sector posted a total return of nearly 9%. Compare that to TSX Composite itself, which was down 8.5%. That's a 17.5% outperformance.

It's easy to see why investors are turning to real estate during this tumultuous time. Sure, interest rates going up are a risk, but real estate offers dependable income, inflation protection, and not much in the way of volatility. After all, people are going to need places to live and work, no matter what the underlying economy does.

But not every REIT has rallied this year. Allow me to highlight two of the laggards — companies with huge potential to soar next year.

Artis

Artis REIT (TSX:AX.UN) committed the unthinkable sin in the fall. It cut its annual distribution in half from $1.08 per share to $0.54.

The company is facing challenges from many different directions. Its bet on Calgary downtown office space has not worked out, which in turn has pushed down earnings. It is spending to expand a number of properties, including converting one of its Calgary office towers into residential suites. This reduced the amount of cash it could afford to spend on the dividend.

Management didn't just cut the dividend, however. They came up with an ambitious plan that would see the cash saved from the payout put to higher use. Items on the agenda include spending $270 million to buy back shares, selling some $1 billion worth of non-core assets, and paying down debt with the cash saved from the dividend cut.

Another reason to be bullish is insider buying. Ron Joyce, the billionaire investor who built Tim Hortons into a fast-food empire, has purchased 900,000 shares in the last two months. CEO Armin Martens and CFO James Green have also been snapping up shares.

Finally, we have the discount to net asset value (NAV). Artis's management team estimates the company's fair value is approximately $15 per share, net of debt. Shares currently trade hands at $9 each. That is a big discount.

Morguard REIT

Morguard (TSX:MRT.UN) has been one of Canada's cheapest stocks on a price-to-NAV basis for years now. The current NAV is approximately $26 per share, while shares languish at $11. The stock is also a great value on a price-to-funds from operations perspective too, with that ratio checking in at under seven times.

Morguard is also suffering from exposure to the Alberta market. The company owns 8.4 million square feet worth of space; just over two million square feet is located in Alberta, with a strong focus on the Calgary office market. That's not a good place to be right now.

The parent company **Morguard Corporation** has been steadily adding to its position, as the subsidiary's shares have cratered in the past six months. The parent purchased 670,031 shares in late November, and added another 76,000 a couple weeks later. Morguard's billionaire CEO Rai Sahi has also been purchasing shares personally over the last month.

Unlike Artis, Morguard hasn't cut its dividend. The current payout is $0.08 per unit each month, which is good enough for a 9% yield. The distribution appears to be safe, too, with a payout ratio of 82% of adjusted funds from operations.

The bottom line

Both Artis and Morguard REITs represent great value at today's prices. Each also pays investors a nice dividend to wait, while shares move closer towards NAV. Both these companies should see their share prices recover in 2019, which will translate into a nice total return once we add back each REIT's generous dividend.

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