1 Very Good Reason to Sell These REITs Right Now

Description

REITs are hot right now, but should they be trusted? If you already own real estate (i.e., your own house), adding an REIT to your stock portfolio may end up increasing your exposure to this historically unstable industry to an unnecessary degree.

However, overexposure through pre-existing home ownership is not the only reason to stay away from REITs. Keep reading to see what the following stocks have in common, before we summarize why it's such a big issue for low-risk investors in the TSX index.

Morguard REIT (TSX:MRT.UN)

With a market cap $756 million, Morguard REIT offers some defensiveness through size. However, combing through its data turns up some unwanted surprises. For starters, while a one-year past earnings growth of 8.5% is positive in a competitive space, its five-year average earnings-growth rate is negative.

While its dividend yield of 7.71% is high and has 10-year stability, Morguard REIT carries a high level of debt at 85% of net worth. Since this is not well covered by Morguard REIT's operating cash flow, it makes other indicators seem less palatable, such as a low 5% past-year ROE and the fact that insiders have only sold shares in the past three months.

Agellan Commercial REIT (TSX:ACR.UN)

While returns of 27.5% for the past year beat the Canadian REIT average of 11.7% for the same period, a decent track record is let down by a mediocre balance sheet: the level of debt compared to net worth is 55.8%. This puts Agellan Commercial REIT inside the high-debt danger zone; additionally, insiders have only sold shares in the past three months, and significantly so.

With a P/E of 6.4 times earnings, this REIT feels undersold, though a P/B of 1.1 times book is slightly over the odds, with the average REIT trading at book value. While a dividend yield of 5.68% may tempt real estate bulls, Agellan Commercial REIT's future performance is expected to be negative by 3% in terms of earnings in the coming one to three years.

Artis REIT (TSX:AX.UN)

A $2 billion market cap places this REIT in a whole other category from the previous two, adding instant defensiveness to its stats. Sadly, it underperformed the Canadian REIT average for the same 12-month period and its level of debt compared to net worth has increased over the past five years from 99.7% to the current 104.3%.

Artis REIT's negative one-year past earnings-growth rate is ameliorated somewhat by a 9.3% five-year average, though that figure is not significantly high. In terms of value, a P/E of 12.3 times earnings shows overvaluation compared to the Canadian REIT average of 7.5 times earnings, though a P/B of 0.7 times book is acceptable. Meanwhile, a dividend yield of 4.92% is on offer, and a 17.1% expected annual growth in earnings beats Morguard REIT's 12.5%.

The bottom line

Debt is a disease when it comes to stocks — it automatically hikes up the risk inherent in your investments, and if you can't find an REIT that doesn't hold close to 100% of its own net worth in debt, it might be best to steer clear. There are arguably better investments to be had on the TSX index, with less risk and higher returns, though the Agellan Commercial REIT comes close with its lower debt level.

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