



Avoid This REIT Until Canada's Recession Hits

Description

Debt is the underlying trigger for most economic downturns and recessions. By all measures, it now appears that Canada faces an insurmountable debt load. The debt to disposable income ratio in Canada rose to 175 percent at the end of September, expanding 27.7% since 2006.

Meanwhile, the country's key housing markets (where most of the household debt is concentrated) are facing either saturation or a downturn. The yield curve has inverted and the central bank has cut back its economic growth estimate. Also, the energy sector seems to be stagnating.

All signs point to a potential recession in the near term, which means that the capital market is heading for a possible shuffle. One area of concern is the commercial real estate market.

Real estate investment trust **Allied Properties Real Estate Investment** ([TSX:AP.UN](#)) is one of the most prominent commercial REITs listed in the country. The trust focuses on converting light industrial properties into modern work spaces for businesses of all sizes.

The trust currently operates 148 properties across 11 million square feet. About 79% of its gross leasable area (GLA) is based in either Toronto or Montreal, making the portfolio highly concentrated.

Neither Toronto nor Montreal has experienced the sort of downturn that has played out in Vancouver's property market. The commercial real estate sector in both cities remains tight and poised for growth in the near term. Toronto's technology sector has expanded at such a brisk pace that supply is unlikely to meet demand till 2021.

Nevertheless, an economic shock could push some businesses over the edge and discourage others from renting out premium office space. That could have an impact on AP's occupancy and lease renewal rates, which are currently at all-time highs.

And that isn't the only concern. Allied Property offers the lowest dividend yield of its peers and trades at higher multiples.

Recently, my [Fool colleague Kay Ng](#) pointed out that Allied Property's underlying fundamentals don't align with its market price. The stock currently trades at a price-to-funds-from-operations (P/FFO) of 21.75, while its average FFO growth rate over the past five years has been 2.3%.

In other words, the price-to-earnings (FFO)-growth (PEG) ratio is 9.45, indicating that the stock is tremendously overvalued. That makes the stock highly sensitive to the economic cycle.

A squeeze on the economy could be excellent for patient, value-oriented investors seeking an attractive entry point for Allied Properties. For the long-term, the REIT is still an excellent bet. It's been divesting from non-core assets to focus on exciting growth opportunities like data centers. Also, its strategy of converting light industrial buildings into millennial-ready workspaces keeps it ahead of the competition.

Bottom line

A number of macroeconomic factors now indicate an imminent recession in Canada. An economic downturn is bad for a wide range of industries, but it is particularly bad for commercial real estate.

Allied Properties is a robust REIT with an impressive track record, but much of its portfolio is exposed to the country's most heated commercial property markets. Meanwhile, the stock's market price is way ahead of its fundamental value. This means that patient investors may have the opportunity to buy this REIT at much better prices when (or if) a recession hits.

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