



Revealed: This 7.9% Yielder Is Canada's Cheapest REIT

Description

There are two main ways for investors to make money in real estate investment trusts (REITs).

The first is to buy the finest names you can and hold them over the long term. These companies own terrific buildings in locations where demand for good real estate exceeds supply. It's no coincidence that these REITs tend to own a lot of Toronto-area assets. It's the hottest real estate market in the country.

The other strategy is one copied from some of the best real estate investors of all time. This method focuses on [out-of-favour assets](#), buying up shares of companies that own the most undesirable property. As real estate is generally a cyclical asset class, these buildings inevitably turn from being toxic to back in favour again. It's only a matter of time.

This type of distressed real estate investing doesn't just come with the benefit of outsized capital gain potential. These REITs often come with succulent dividend yields as well. Put the two together and you have a powerful combination.

Let's take a closer look at one of these unloved REITs, **Morguard Real Estate Investment Trust** ([TSX:MRT.UN](#)).

Incredibly cheap

There are two main ways an investor can value a REIT. They can look at the company's price compared to its earnings and compared to its net asset value.

Let's start with net asset value. Morguard's portfolio of 49 different office, retail, and industrial properties is valued at \$1.58 billion once we factor in all liabilities. Shares have a current market capitalization of \$741 million, putting the stock at a hair under 50% of net asset value.

In other words, investors are buying \$1 worth of real estate for \$0.50.

The stock is also cheap on a price-to-earnings perspective. Morguard judges its true profitability by using funds from operations (FFO) instead of net earnings, as the latter number is influenced by changes in the underlying value of the portfolio. In 2018, Morguard reported total FFO of \$1.56 per unit, putting shares at just 7.8 times FFO.

Why exactly is the stock so cheap, anyway? Some investors think Morguard is inflating the value of its Alberta assets, buildings that are struggling to find tenants in a weak economy. But total occupancy is still at 93%, and it hasn't really budged in a few years.

Other folks are concerned that some of Morguard's premier assets are regional malls in smaller cities like Red Deer, Grande Prairie, and Saskatoon. The trust also has a healthy exposure to the Calgary office market, which is experiencing some pretty significant vacancy.

While these are problematic, I don't think they're big enough to push a stock down to 50% of its net asset value.

Get paid to wait

One of the problems with waiting for cheap companies to recover is you don't earn much of a return during a process than can, at times, take years.

Morguard falls under this category as well. The company could trade at this discounted level for a long time if the Alberta economy doesn't recover.

Fortunately, investors are getting paid a handsome dividend while they wait. The current yield is 7.9%, which would be an acceptable return over the long-term even if the stock did nothing.

The dividend looks solid, too. The company pays out \$0.08 per share each month, or \$0.96 annually. After accounting for expansion projects in 2018, it earned \$1.14 per share in adjusted funds from operations, giving us a payout ratio of approximately 85%.

The bottom line

REITs don't get much cheaper than Morguard REIT. I believe that investors who get in today can count on a significant capital gain to go with their generous dividend. The only problem is any increase in the share price could take years to develop, but this analyst thinks it's worth the wait.

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1. Dividend Stocks
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1. TSX:MRT.UN (Morguard Real Estate Investment Trust)

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