1 Cheap REIT to Buy in June Yielding 7%

Description

While direct property ownership has been an accepted means of building wealth over the long term, there is a multitude of drawbacks associated with being a landlord. A better way to gain exposure to real estate is by investing in a quality real estate investment trust (REIT). Listed REITs not only provide greater liquidity and diversification but also give investors access to classes of property that they would not normally be able to invest in.

One that stands out because of its juicy 7% yield is **Slate Office REIT** (TSX:SOT.UN), which provides the opportunity for investors to gain exposure to office real estate. This is typically a difficult class of property for individual investors to access because of the significant amount of capital required to purchase a single office property.

Immediate outlook for office real estate is soft

Fears of weaker economic growth and an increasingly poor outlook sparked by the emerging trade war between China and the U.S. as well as escalating geopolitical risk have been weighing on office REITs. That poor outlook has seen Slate Office REIT roughly handled by the market, seeing it lose 22% over the last year with most of that decline occurring since late 2018. This has created an opportunity for investors to acquire a quality income-producing REIT at an attractive valuation.

While the immediate outlook is poor, over the long term, demand for office properties class will soar once economic growth returns and employment rises. This will be buoyed by the expansion of online shopping and e-commerce, which will drive demand for administrative and logistical floorspace. A general lack of investment in the development of commercial real estate since the global financial crisis a decade ago means that a supply shortage could arise if demand expands significantly, thereby driving rents higher.

That will be a boon for Slate Office REIT, which is in the midst of a strategic restructuring aimed at unlocking value for unitholders. The REIT recently slashed its distribution by 47% as part of its turnaround strategy aimed at strengthening its balance sheet, enhancing the returns on its property portfolio, and delivering value for investors. That distribution cut is another reason for the market's harsh treatment of Slate Office REIT.

Nonetheless, management has undertaken a range of initiatives to unlock value for investors, including selling non-core properties and embarking upon a unit buyback. The latest divestment is the sale of two properties in Manitoba for $21 million, which will close during the second quarter 2019. Those proceeds will be used to reduce debt and boost available liquidity to fund future property acquisitions as well as the buyback of units.

It is here that Slate Office REIT's considerable appeal as an investment becomes apparent. Management has introduced a unit-buyback program, having committed $11.3 million to date to acquire 1.8 million units because the REIT is trading at a deep discount to its net asset value (NAV). At the end of the first quarter 2019, Slate Office REIT had a NAV of $8.49 per unit, which is almost 42% greater than its current market value, highlighting the considerable potential for capital growth that exists.

Foolish takeaway

It is rare for a REIT like Slate Office REIT that owns a portfolio of quality real estate to trade at such a significant discount to its NAV. This doesn't reflect the solid performance reported for the first quarter, including ending the period with an occupancy rate of 87.7% and a 19% year-over-year increase in funds from operations (FFO).

While investors wait for Slate Office REIT's units to appreciate, they will be rewarded by the regular monthly distribution yielding 7%. Importantly, that distribution appears sustainable with a trailing 12-month payout ratio of FFO of 95%**,** which, going forward, could fall to as low as 53% because of the recent distribution cut.

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