



Opportunity of a Lifetime to Buy Canadian REITs

Description

If you thought the stock market took [a big hit to the chin](#) over the past month, wait until you see what happened to the Canadian REITs, which got utterly obliterated amid the “everything sell-off” sparked by the coronavirus crisis.

Sure, REITs are lowly correlated to the broader equity markets, but as I’ve warned in many prior pieces, this low correlation (or low beta) is essentially nullified during times of extreme market turmoil. Real estate is seen as a “safe haven” by many, but when there’s a panic-induced crisis and a rush for cash, all bets are off the table with the REITs, leaving conservative income investors exposed to amplified downside in a market meltdown.

Many Canadian REITs have large distribution yields, and their shares tend to be less prone to less volatility relative to equities. That is, until the market crashes, and REITs are tossed out alongside everything else.

After the REIT wreck, there’s now a huge opportunity for income investors to get more yield for less.

Which Canadian REITs are being more impacted by COVID-19?

As the pandemic continues dragging on into April, some landlords are bound to have a bit of difficulty collecting their monthly rent from some of their more financially stressed tenants. Canada saw one million EI applicants last week, and with many Canadians living paycheque to paycheque, it’s not a mystery as to why shares of residential REITs like **Canadian Apartment Properties REIT** ([TSX:CAR.UN](#)), also known as CAPREIT, nosedived.

CAPREIT has exposure to some of the frothier areas of the Canadian market like Vancouver and Toronto, both of which are in a rental state of emergency. Rents are so ridiculously high in the Greater Vancouver or Toronto Areas such that deferred rent payments will be more of a concern relative to other residential Canadian REITs, even with timely stimulus provided by the federal government.

If you’re renting a \$2,200 two-bedroom apartment in Vancouver, a \$2,000 monthly COVID-19 relief

cheque from the government isn't going to allow you to pay your full rent when you take into account other living expenses at this most critical time. As such, I'd say shares of CAPREIT, which only fell 38% from peak to trough, will take more of a hit compared to the likes of a diversified office-weighted REIT like **H&R REIT** ([TSX:HR.UN](#)), which plunged over 65% from peak to trough.

I'd argue that CAPREIT is going to have a much harder time collecting rent from individual residential tenants in expensive markets like Vancouver or Toronto than H&R, which collects its rent primarily from office, retail, and industrial tenants.

Yes, small- and medium-sized retail businesses are being shut down, and many are at risk of going under, as everybody looks to self-isolate at home. But some of the larger office and retail clients (like **Canadian Tire**) have more access to liquidity and a greater capacity to continue paying their rents through these tough (and likely temporary) times. It will be the H&R's tenants, I believe, that will absorb most, if not all, of the blow from the disruption caused by COVID-19.

Moreover, when the pandemic ends, and Canada becomes fully open for business, the cash flows of the retail and office tenants would be first to bounce back. As for the residential tenants financially affected by COVID-19, their cash flows may not return to normal nearly as fast.

As such, I see H&R as one of many [severely undervalued](#) Canadian REITs that allows investors to lock in a colossal yield (currently yielding 16.3%) alongside what could be sizeable capital gains once the coronavirus dies down. As for CAPREIT, I think its shares could stand to pullback further given the minimal damage shares have endured and an arguably greater vulnerability to the disruption caused by COVID-19.

Foolish takeaway

H&R is one of those Canadian REITs that provides income investors with an opportunity of a lifetime, whereas CAPREIT still leaves a lot to be desired following after the violent REIT wreck. The REITs present compelling value at this juncture, but make sure you pick your spots wisely!

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