Canadian REITs Yielding Above 20%

Description

The current bear market is leading to the decimation of Canada's Real Estate Investment Trusts (REITS). Year to date, **S&P/TSX Capped REIT Index** is down 31.39% in 2020, placing it among the biggest losers of the year. One thing is clear, however: Canadian REITs are not immune to COVID-19 mitigation efforts.

The drop in share price is leading to record yields. Before the crash, real estate companies were among the best income stocks to own. These companies distribute a high percentage of earnings and are among the best yielding stocks.

In the current environment, these high yields are magnified. As of writing, there are approximately two dozen Canadian REITs yielding above 10%. Although a high yield can be attractive, investors must proceed with caution. There have already been a few distribution cuts in the industry, and more are likely on the way.

The top yielding Canadian REIT

As of writing, **Morguard Real Estate Investment Trust** (TSX:MRG.UN) is currently yielding 22.73%, which is tops among industry peers. Morguard holds $2.9 billion in assets and has a diversified real estate portfolio of 48 commercial properties across six provinces.

The company's high yield is not surprising. Morguard is among the worst-performing Canadian REITs and is down 63.44% in 2020. The company's portfolio is split between Office (23), Industrial (4) and Retail (21) properties.

Despite having fewer properties, the Retail segment accounts for 53% of revenue and net income. The company's high exposure to retail space is among the main reasons for its underperformance.

In 2019, the company ended the year with a distribution payout ratio of 88.1%, which was approximately 400 basis points higher than in 2018. In fact, Morguard's payout ratio has been on a steady rise over the past couple of years. It now sits more than 20% above the 67.1% it achieved in 2017, and above the Canadian REIT average of approximately 70%.

On the bright side, the company's debt-to-equity (DE) ratio currently stands at 88%, which is consistent with historical averages, and inline with industry peers.

Taking everything into account, Morguard's 22.73% yield is most likely at risk of a dividend cut or suspension. The company's high exposure to large shopping centers makes it more vulnerable than most.

A little-known growth REIT

At 20.25%, **PRO REIT** (TSX:PRV.UN) is the only other Canadian REIT currently yielding more than 20 percentage points. The company is one of the lesser known in the industry, having only just graduated from the **TSX Index** in April of 2019.

The company's track record is impressive. Since 2013, total assets grew from $70.2 million to $634.7 million as of the end of 2019. Not many REITs can lay claim to this type of growth.

In total, the company has 93 properties spread out across Retail, Industrial, Office and Commercial Mixed-Use segments. Once again, Retail leads the way accounting for approximately 36.7% of base rent.

On the bright side, 65% of the retail segment are necessity-based assets. This includes groceries, drug stores, banks, government and medical offices. This is good news, as all are essential services and very few are at risk of default. It counts Rexall, Sobeys, the Government of Canada and Shoppers Drug Mart among its top tenants.

Unfortunately, the company's high-growth profile has come at a cost. The company's payout ratio as a percentage of adjusted funds from operations is at 109%, among the industry's highest. Similarly, PRO REIT's 169% D/E ratio is almost double the Canadian REIT industry average.

Once again, we find ourselves in a situation whereby the likelihood of a dividend cut or suspension is high. On the one hand, the company does have a solid base of tenants. However, it is among the least financially stable Canadian REITs.

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Date
2025/08/18
Date Created
2020/04/07
Author
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