Are TSX Apartment REITs Safe Buys Today?

Description

Up until now, apartment REITs have been one of the fastest-growing REIT classes in Canada. But are apartment REITs a safe investment during the COVID-19 crisis? Last week alone, a half-a-million Canadians became unemployed and applied for EI benefits. Will Canadians be able to continue to pay rent if they can't work?

Well, according to some recent research, around 70% of tenants have paid April's rent. This is not terrible. Additionally, we could see a short-term rebound in May, as laid off Canadians start receiving EI payments and other financial assistance.

During the crisis, many apartment REITs have tried to be flexible with tenants and have created rent-deferral programs. REITs have also delayed capital expenditures, rent increases, and dividend increases for now. Overall, investors can probably expect neutral to slightly negative FFO returns for the year.

Are apartment REITs investible right now?

So, are apartment REIT's attractive buys? Yes! The long-term trend for apartment REITs is outstandingly positive in Canada. Factors like population growth, rent control, and increasing development costs have led to a housing shortage in Canada's biggest cities. Canadian cities are growing, and affordable housing supply cannot keep up.

When investing, however, it is important to be cautious and weigh the short-term crisis pain with the long-term gain. Not all apartment REITs are equal. Look for REITs with extra liquidity, scalable operating platforms, strong rental markets, and a long history of accreting returns.

Buyer beware

First, some caution. **Mainstreet Equity** and **Boardwalk REIT** respectively, have 79% and 70% portfolio exposure to oil-sensitive provinces like Alberta. Unemployment in Alberta was higher than average prior to the crisis, and the trend will only intensify with the COVID-19 crisis.

Although these companies have posted good results in recent years, they will probably see higher than average rent deferrals and increases in bad debts. Fortunately, Boardwalk is well capitalized with $235 million of available liquidity (cash and credit lines). It should be able to weather this storm. Yet, in my opinion, its 4% dividend yield does not sufficiently compensate for the level of risk in its business right now.

The biggest REIT

During a crisis, bigger can truly mean better. **Canadian Apartment REIT** is Canada's largest REIT. Its size affords it scale, a proven management platform, national and international diversification, and a best-in-class balance sheet. It is sitting on $477 million of cash. This affords it greater flexibility to work with financially distressed tenants. It also gives it the ability to maintain its 3.3% dividend yield and still find some growth opportunities in 2020.

The best-quality apartment REITs

The quality of a REIT can also be beneficial during a crisis. **InterRent REIT** (TSX:IIP.UN) and **Minto Apartment REIT** (TSX:MI.UN) have have best-quality, best-located properties. Minto has some Alberta exposure, but most rents come from major cities in Ontario and Quebec. InterRent is only located in Ontario and Quebec.

Interestingly, these two REITs experienced the lowest stock declines during the market crash (as compared to peers). The quality of their assets were evidenced by how well their value upheld on the TSX.

InterRent has an excellent management platform, which has consistently accreted revenue and FFO growth. It has achieved an impressive FFO/unit CAGR of 23% for the past 10 years. InterRent has a conservative balance sheet with a debt to gross book value of 32.5%. It has access to a $115 million credit facility. InterRent yields 2.5% and has increased its distribution by 5-10% a year for the past five years.

Minto benefits from a strong development and intensification platform. As it repositions properties, it has seen its overall capitalization rate drop from 4.24% in 2018 to 3.92% in 2019. 2019 net asset value (NAV) increase by 17%.

This REIT consistently becomes more valuable. Its properties are positioned in highly sought after locations, so long-term demand for its apartments is not a concern. It has a conservative debt to gross book value of 39% and pays a well-covered (63% payout ratio) 2.5% yield.

The Foolish bottom line

While CAP REIT, InterRent, and Minto are not the cheapest REITs, they do have either best-in-class operations or best-in-class properties. These REITs have the best potential for significant growth after the COVID-19 crisis, and that is why I like them as buys today.

CATEGORY

1. Coronavirus
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. TSX:IIP.UN (InterRent Real Estate Investment Trust)
2. TSX:MI.UN (Minto Apartment Real Estate Investment Trust)

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