Long-Term Investors: It's Time to Get Very Excited About These Great REITs

Description

While the market continues to steadily climb higher, bargain hunters are beginning to get discouraged. There simply aren't loads of insanely cheap stocks any longer.

But that doesn't mean there aren't bargains. Many sectors are still substantially off their all-time highs, as investors are skeptical their fortunes will improve anytime soon. These are the places bargain hunters should look.

One such sector includes Canada's top REITs. These stocks are still well off highs set a few months ago, as investors are worried about the long-term health of many businesses that rent the underlying real estate. I'm the first to admit the short term still looks pretty murky, but these companies should be fine in the long run. All they need to do is make it through today's tough times.

There are some massive potential rewards for investors who pick the right REITs. Let's take a closer look at two top names — super-cheap companies that have interesting upside potential.

Slate Retail REIT

There are cheap REITs, and then there are companies like **Slate Retail REIT** (TSX:SRT.UN), which is in a class all on its own. Despite offering a lot of positives, Slate's shares are ludicrously cheap.

Let's start with the basics. Slate Retail REIT owns grocery-anchored real estate in the United States, focusing on secondary cities like Denver, Atlanta, and Charlotte. In total, the portfolio has 76 different properties spanning almost 10 million square feet of gross leasable space.

Slate is well positioned to endure even a long-term bear market in retail real estate. Approximately half its rents come from grocery stores, pharmacies, and other businesses that remained open during the pandemic. That alone gives the company a great start.

The company earned approximately US$1.20 per share last year in funds from operations. Its U.S.-dollar denominated shares trade hands at $6.41 each, giving us a price-to-earnings ratio of just over five times. Shares also trade at just 65% of book value.

The big question is whether Slate can maintain its current dividend — an annual payout of US$0.864. The payout ratio is around 70% based on last year's earnings, and Slate is flush with cash after selling some non-core assets in 2019. I think the 13.3% yield is safe, provided the economy bounces back relatively quickly.

H&R REIT

H&R REIT (TSX:HR.UN) has been one of the hardest-hit REITs in the entire sector. Shares are still down more than 50% compared to just a few months ago, while many other names have recovered much more.

H&R is extremely diverse, both in types of assets and geographic mix. It owns more than 41 million square feet of gross leasable space, including office, retail, industrial, and residential real estate. Its holdings span both sides of the border, with further growth potential in the U.S. residential space. H&R also plans to build mixed-use property in Toronto.

One big issue impacting H&R shares today is the company's exposure to the Calgary office market. It's largest asset is The Bow, the city's largest office tower. In total, more than 20% of its portfolio is located in Alberta, something the market doesn't like very much right now.

But here's the interesting part: H&R shares currently trade hands for a little more than $10 each. Shares have a net asset value of approximately $25 each. This makes H&R one of the cheapest REITs on the entire Toronto Stock Exchange. Even if we value the Alberta properties at zero — which is extremely negative — the stock still has a net asset value of above $16 per share.

The company also pays a succulent 14% dividend. I'd say this yield is much less safe than Slate's, and it could very well be cut if the economy doesn't improve shortly. But even if the payout is halved, investors who get in today will still lock in a solid income source.

The bottom line on these two great REITs

Sometimes, value investing is a lonely pursuit. With shares of both Slate Retail REIT and H&R REIT down so much, you'll likely hear the naysayers question even thinking about these stocks. After all, stocks don't fall that much without a big impact to the long-term outlook.

But over the next three to five years, these great REITs should outperform their peers, as the economy returns to normal. That should translate into fantastic returns for patient investors.

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Date
2025/08/25
Date Created
2020/04/30
Author
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