TFSA Investors: Should You Buy This TSX REIT Before it Undergoes Transformation?

Description

Real estate investment trusts (REITs) are one of the best asset classes to invest in as inflation fears rise after record COVID-19 government stimulus packages. The rationale is simple: Real estate values rise with inflation, and lease agreements do have embedded inflation adjustment clauses. Resultantly, both investor income and capital could remain protected during bouts of high inflation.

That said, buying into a **TSX**-listed REIT when it is about to undergo a significant transformation could produce good results for income investors. Such inflection points may mean higher and safer future distributions or higher valuation multiples for quick capital gains. This scenario happened at **Artis REIT** recently, and investors are up 30% since my recommendation in October last year.

One somewhat similar opportunity could be available today.

Cominar's valuation recovering post-COVID-19 and an upcoming review

Cominar Real Estate Investment Trust (TSX:CUF.UN) is one beaten-down Canadian REIT that pays one of the safest distributions on the **TSX** today, yet with a deep discount on its units that could soon be reduced if the market approves of the trust's yet-to-be-announced strategic review.

Cominar is one of the largest diversified REITs in Canada with a portfolio of 310 retail, office, and industrial properties totaling 35.7 million square feet of leasable area.

The trust's enclosed retail malls bore the full brunt of COVID-19 related rent collection challenges during lockdowns in 2020. This led to a painful 50% cut to its monthly distribution down to $0.03 per unit in August last year.

The good news is that Cominar 's same-property net operating income more than recovered to pre-pandemic levels during the first quarter of this year. The trust reported a 0.4% growth in same-property net operating income (NOI) for the last quarter. Although in-place occupancy levels slightly decreased to 91.2% from 91.7% by December last year, rent collections for Q1 stood at over 98% by early May.

Most noteworthy, Cominar pays one of the safest REIT distributions on the TSX today. The trust's adjusted funds from operations (AFFO) payout rate was just 45% for the first quarter, leaving ample room for trustees to do something better for income investors this year.

Further, the REIT embarked on a strategic review of the business in September last year. Although no timeline has been given, it's highly likely that management could announce new strategic actions this year.

If trustees restore the previously cut distribution back to pre-pandemic levels, the current yield on Cominar units could jump to a staggering 7.3%. More changes could be announced, and if the market approves of them, the deep discount to net asset value (NAV) on Cominar's units could narrow and make way to some capital gains.

Cominar units currently trade at a 35% discount to net book value. The REIT's current monthly distribution yields a respectable 3.6% annually.

Time to buy?

Cominar REIT has created a concerning history of capital destruction. The recent distribution cut follows two cuts in 2017 and another in 2018. It's sad that Cominar has cut its distribution four times in as many years. The earlier distribution cuts were accompanied by strategic reviews too. This makes investors skeptical whether the upcoming review will be "the one." Management has to get it perfectly right this time. However, we can't blame them for COVID-related losses.

I wouldn't expect Cominar to cut its distribution anymore while it undergoes another strategic transformation. Malls are opening up post the coronavirus pandemic and the trust only paid less than half its distributable cash flow last quarter. There is ample room for a distribution increase near pre-pandemic levels. A full reinstatement can easily increase the yield to 7.3% any day.

That said, the trust's recent debt ratio of 54.5% gives Cominar little room to fund its growth by tapping cheap debt. Any growth initiatives in a strategic refocus could mean significant equity raises. Given the deep discount on units, such a move could be painfully dilutive for current investors. However, there is no timeline given for the ongoing review no guarantee that any transaction or change could come out of it.

Until then, continued recovery in a post-pandemic world should drive some capital gains on Cominar units. Both capital gains and distributions are best enjoyed in a Tax-Free Savings Account (TFSA) for maximum benefit.

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