Could This TSX REIT Restore Pre-COVID-19 Distributions Before Year-End?

Description

The COVID-19 pandemic is abating in Canada, and the United States and the Canadian transport minister on Wednesday promised to provide details of plans to ease COVID-19 travel rules in the coming days. Vaccination programs are proving successful, and more than 60% of Canadians have received their first dose thus far. People's normal lives are being restored and this should be good news for income-focused real estate investors in a big way.

Several **TSX**-listed real estate investment trusts (REITs) announced distribution cuts during the first wave of the coronavirus pandemic in 2020. These included **BTB REIT**, **Cominar REIT**, **American Hotel Income Properties**, and **H&R Real Estate Investment Trust** (TSX:HR.UN). The list isn't exhaustive.

However, as business and travel restrictions eased, H&R REIT and other affected property trusts have seen operating results improve so far this year. Could its trustees restore the pre-pandemic distributions before the end of 2021?

Let's have a look.

Is H&R REIT due for a distribution increase?

H&R REIT owns a $13.2 billion portfolio of North American office, retail, residential and industrial properties comprising over 40 million square feet.

The trust cut its monthly distribution by nearly 50% in May 2020 when its rent collections (mainly from the retail portfolio) took a heavy pandemic hit. H&R REIT's retail portfolio contributes about 34% to the trust's rental income. The majority of retail rent comes from enclosed shopping centers that had to be closed during national lockdowns. Resultantly, rent collections declined to as low as 40% for April and 30% for May by May 14, 2020.

Since distributions are paid from cash flows received from monthly rentals, a distribution cut was necessary under the circumstances. The current distribution of $0.058 a month yields a healthy 4.2%

annually.

Fast forward to the first quarter of 2021 and rent collections have significantly recovered to over 90% in the retail portfolio. The trust's business conditions have improved drastically, and H&R's payout rate is among the lowest in the industry.

The trust's adjusted funds from operations (AFFO) payout rate was one of the safest in the industry at 53% during the first quarter of this year. This means H&R REIT only paid out just above half its distributable cash flow. As long as the monthly distribution remains fixed at current levels, the trust is retaining sizeable cash flows. These could help fund internal developments.

Most noteworthy, net income for the first quarter of 2021 increased to $159 million, up from a $1,0 billion loss reported for the same period last year. Net income was mainly a result of fair value gains on properties but as the economy continues to open up as the pandemic fades, the trust could be compelled to increase its annual payouts so as to avoid income taxes.

REITs are required to distribute 90% of their taxable income to investors, or else they lose their income-tax-exempt status.

If H&R REIT increases its distribution back to pre-pandemic levels, the annual yield could increase to a juicy 8.5%.

Could H&R REIT increase its distribution soon?

Although rent collections and the business environment has improved markedly for the trust, H&R REIT still faces challenges with occupancy levels and rent collections in its retail portfolio. First-quarter total rent collections were 92% and combined with rent abatements and low occupancy rates, management could take longer to increase the distribution back to pre-pandemic levels.

Moreover, some three single-tenant facilities were vacated in the U.S. and only a small portion had been leased at reduced rates by last month. Combined with some planned property disposals during the year, the trust's portfolio may not immediately support the full restoration of the previous monthly distribution.

That said, unless the trust intends to downsize its portfolio significantly, H&R REIT could increase its distribution soon as business conditions normalize post COVID-19. I'd buy units now and lock in a juicy yield.

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