Winnipeg Free Press

A hotbed of REITs
An alternative to owning real estate

Sun Nov 26 2006

GEOFF KIRBYSON

JOE BRYKSA / WINNIPEG FREE PRESS

There are subtle differences when comparing REITs to other investments, said Claude Tetrault of Bieber Securities.

UNLESS you've been living in a van down by the river the last few years, chances are you've heard the Winnipeg real estate market is on a bit of a roll.

But it's not just new home construction and sales of existing houses that have been humming along.

The Manitoba capital has also developed a reputation as a being a hotbed of real estate investment trusts, or REITs.

For the uninitiated, REITs are equity investments that use the pooled capital of investors to purchase and sometimes manage income properties, such as hotels, apartment buildings and shopping centres.

REITs, which are traded on both the Toronto Stock Exchange and the TSX Venture Exchange, offer a number of benefits over owning real estate itself.

First, they are significantly more liquid -- that is, they can be bought and sold easily -- than buildings and land. Second, they allow investors exposure to non-residential properties, such as hotels and malls.

Charlie Spiring, CEO of Wellington West Capital, says REITs also offer tax-efficient income, but it's the ability to own a piece of something they could never pay for on their own that attracts many investors.

"A lot of people can't afford or don't want to own a whole building but you can get access to one or more buildings by being part of a REIT," he says.

Spiring says REITs are good investment tools for clients, particularly since the federal government's recent announcement of a new tax structure for their close cousins, income trusts, by 2011.

"REITs were left alone. There's a modest scarcity value to them because the trusts have a 50-month life left. I think they're getting some attention and will continue to get attention as time goes on," he says.

The rationale behind leaving REITs with more favourable tax treatment is because they're largely passive investments. That is, they own buildings and receive rental income from tenants, but they don't tend to operate the tenants' businesses.

Shant Poladian, Toronto-based real estate analyst at Canaccord Adams, the global capital markets group of Canaccord Capital Inc., says while he expects most REITs will ultimately escape higher taxation, the seniors housing and hotel sectors may not be so lucky.

"They may be perceived as more of an operating-type business so there's some risk some restructuring might be required. It remains to be seen to what degree they have to adapt," he says.

Poladian says investors should investigate the individual real estate sectors before investing in particular REITs. For example, it would be preferable to own units in an apartment-focused REIT rather than one specializing in hotels during an economic recession because hotel occupancy spikes when consumers have lots of money to spend.

Claude Tetrault, vice-president of corporate finance at Bieber Securities, cautions there are some subtle differences when evaluating REITs against other investments. For example, while it's common to look at net income as a key performance measurement for bank stocks, that's not the case with REITs during their first few years of operation.

The reasons are complicated, but essentially REITs must depreciate their buildings rapidly for tax purposes, which adversely affects their net income in the early years. (Once a REIT has been around for five or more years, however, net income is a good indicator, he says.)

The key thing to look at is funds from operations, or FFO in REIT-speak, which is net income before depreciation.

"What's more important than net income is the cash flow they generate and distribute to shareholders," he says.

Tetrault says higher-yielding REITs aren't necessarily better, either. He says the yield generally reflects liquidity and risk.

"The lower the yield, the more liquid and less risk there is in the investment," he says.

Kevin Strong, manager of the Winnipeg office for the TSX Venture Exchange, says of the more than 40 publicly traded companies that are based in Winnipeg, five of them are REITs.

"That's a higher proportion than you would find across the country," he says.

Three of them, Lanesborough, Huntingdon and Temple, are run by Arni Thorsteinson. Lakeview Hotel's CEO is Keith Levit while Westfield is headed up by Armin Martens. A sixth REIT, Whiterock, is now based in Toronto.

The combined market capitalization (the number of outstanding units multiplied by their price) of the six is closing in on $700 million. Not bad, Tetrault notes, for a bunch of outfits that started out as capital pool companies with less than $1 million of seed money.

Just as with any investments except a government bond, REITs come with some risks. The biggest concern a REIT has is not receiving rental income. That can happen if local and general economic conditions take a turn for the worse or competing buildings emerge on the market.

Here's an alphabetical snapshot of the six real estate investment trusts (REITs) that have been brought to

market out of Winnipeg.

(Closing prices as of Thursday)

A snapshot of Winnipeg's REITs scene

Huntingdon REIT: The middle sibling in Arni Thorsteinson's REIT family, one-year-old Huntingdon has quickly compiled $450 million worth of office and industrial buildings and shopping centres. Its units (HNT.UN/TSX) closed at $2.35 and their range over the last year has been $2.01 to $2.90. Its annual distribution is 28 cents per unit, which produces a yield of 12.02 per cent.

Lakeview Hotel REIT: Launched in April 2004, Lakeview's business model involves ownership, management and licensing of hotel properties. Its units (LHR.UN/TSX Venture Exchange) closed at $4.05, with a 52-week low and high of $2.30 and $4.50 respectively. Its distribution is 44 cents per unit per year, making for a yield of 10.60 per cent.

Lanesborough REIT: The oldest of Thorsteinson's REIT family, Lanesborough has built up a portfolio worth $400 million, primarily in apartment buildings, in four years. Its units (LRT.UN/TSX) closed at $5.70, with a 52-week low of $5 and a 52-week high of $6.85. Its distribution is 56 cents for a yield of 9.67 per cent.

Temple REIT: The newest of Thorsteinson's troika, Temple, or TREIT as he prefers to call it, made its first acquisition in the hotel sector in August. The $21-million Temple Gardens Hotel & Spa is the building block to what he hopes will become $500 million worth of hotel properties. Its units (TR.UN/TSX Venture Exchange) closed at $4.40. Its low over the last year is $2.90 while its high over the same period is $5.50. Its distribution is 56 cents per unit per year, making a yield of 12.73 per cent.

Westfield REIT: The only REIT in Canada focused solely on commercial real estate in Western Canada has built up its portfolio to more than $500 million in two-and-a-half years. CEO Armin Martens predicted earlier this year that it would top $1 billion by 2011. Its units (WFD.UN/TSX) closed at $15.20. Its low over the last year is $10.95 while its high is $15.75. Its distribution is $1.05 and its yield is 6.89 per cent.

Whiterock REIT: The Toronto-based REIT was brought to market by Wellington West Capital 18 months ago. Its portfolio of office and retail properties in Quebec and Atlantic Canada is worth about $380 million. Its units (WRK.UN/TSX) closed at $12.22, with a 52-week low of $9.00 and a 52-week high of $15.88. Its distribution is $1.12 per unit per year, making for a yield of 9.14 per cent.

geoff.kirbyson@freepress.mb.ca
