DSR 2022

DIVIDEND STOCKS ROCK

INVEST WITH CONVICTION, ENJOY YOUR RETIREMENT

EVERYTHING YOU NEED TO KNOW ABOUT REITS

A DSR BOOKLET

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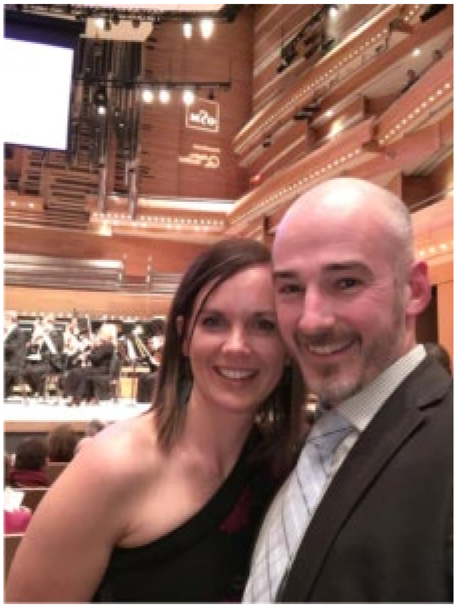
A LITTLE ABOUT ME



First, congratulations on taking action and taking care of your investment portfolio! I'm a passionate investor looking forward to connecting with other passionate investors.

My name is Mike Heroux and I'm the author of The Dividend Guy Blog, The Dividend Monk, and Moose Markets (yes, I thrive on staying busy!) along with being the co-owner and portfolio manager at Dividend Stocks Rock (DSR). I have an unusual sense of humor for a "nerdy finance guy". Before you decide if you trust me or not, let's get to the "boring & serious" stuff first.

I earned my bachelor's degree with a double major in finance and marketing, I completed a CFP (Certified Financial Planner) certification along with an MBA in financial services. I worked in the financial industry for over a decade including 5 years as a financial planner and another 5 as a private banker managing accounts for high net worth (read $1M+) clients.

Besides being a passionate investor, I'm also happily married with three amazing children, and I live in the beautiful province of Quebec, Canada. Since I'm French Canadian, and French is my native language, I have most of my writings in English edited to minimize any grammar or spelling errors. I started my online venture to capitalize on my education and professional background by educating people about investing. A most fortunate by product of this professional endeavor is that I can work from home which allows me to be able to spend more time with my family.

In 2016, I decided to leave everything behind and go for a 1-year RV trip across North America and Central America (we made it all the way down to Costa Rica). Upon my return in 2017, I quit my job as a private banker and invested all my energy in my online business. I would rather pursue my dream of helping people invest through my sites. Since then, I have been a full-time online entrepreneur.

You can read more about my investing journey here.

EVERYTHING YOU NEED TO KNOW ABOUT REITS

Since REITs are a different type of corporate structure, they deserve to be addressed separately. As a starter, they pay no corporate tax, but in return, they must meet certain guidelines. They must invest primarily in real estate and must pay out most of their net income as distributions (not dividends).

Should you have some in your portfolio?

How can they help you reach your retirement goals?

Are they a good protection against inflation?

We'll cover all those questions, and more. But first, let's discuss what REITs really are.

Different types of REITs

REITs can be good investments for income-seeking investors because they typically offer above-average dividend yields and can give an investor exposure to real estate without the typical difficulties of owning real estate directly (low liquidity, responsibility for maintenance, etc.).

Equity REITs

Equity REITs own and invest in property. They may own a diversified set of properties, and they generate income primarily in rent payments from leasing their properties.

Mortgage REITs

Mortgage REITs finance property. They generate income from interest on loans they make to finance property.

Hybrid REITs

Hybrid REITs do a bit of both, as they own property and finance property.

In general, REITs offer great investment opportunities by their nature. A growing economy leads to growing needs for properties. REITs can grow organically as the population requires more industrial facilities, healthcare centers, offices, and apartments.

As a REIT grows and its properties rise in value, management can also use leverage to invest in more properties or start new developments.

Furthermore, REITs present an easy-to-understand business model built around cash flow. REITs collect rents each month, making this model look like a money-printing machine.

WHY WE LIKE THEM SO MUCH

REITs are not only popular because they distribute generous dividends, but also because they are easy to understand. Investors can picture an apartment building or an office tower and see how tenants pay their rent monthly. They are willing to purchase units of those businesses in exchange for income and peace of mind.

The concept of being a landlord and having tenants is comparatively simple to understand. The company owns and manages Real Estate in exchange for receiving rental income from properties such as apartment complexes, hospitals, office buildings, timber land, warehouses, hotels, and shopping malls.

Most REITs are equity REITs. They must invest most of their assets (75%) into real estate or cash equivalents. In other words, they cannot produce goods or provide services with their assets. REITs must also receive 75% of their income from those real estate assets in the form of rent, interest on mortgages or sales of properties. REITs must also pay a minimum of 90% percent of their net income in the form of shareholder dividends each year. Therefore, the classic earnings per share and dividend payout ratios cannot be considered as the sole gage of the health of an REIT.

Sub-Sector (Industry)

REIT - Diversified	REIT - Mortgage	REIT - Specialty
REIT - Healthcare Facilities	REIT - Office	Real Estate - Development
REIT - Hotel & Motel	REIT - Residential	Real Estate - Diversified
REIT - Industrial	REIT - Retail	Real Estate Services

REITs offer a crucial advantage when it comes down to diversification. It's a rare sector offering you the possibility of investing ~30% of your portfolio while remaining widely diversified. REITs are present in several industries, allowing you to surf on many tailwinds simultaneously.

Would you like to participate in the rise of e-commerce? There are distribution warehouse REITs.

Do you think it's time to invest in the internet of things and the cloud? There are data center REITs.

The rise of demography makes you think about renting a condo? There are apartments REITs.

The best part is that each industry will react differently to economic news. Therefore, you can build a well-diversified portfolio with several different REITs in it.

Greatest strengths

Since these businesses must distribute most of their profits to shareholders, it is easy to understand how most of them offer a relatively high dividend income. This is one of the rare sectors where you can find "relatively safe" stocks paying 5%, 6% even 7%+. Investors must be careful, however, not to get too greedy, though. We often see REITs cutting their dividends due to either poor management or economic downturns.

REITs usually bring stability to a portfolio along with higher yield. This is a great sector to start with when you are looking for additional income. Real Estate brings diversification to any portfolio. Research has proved that REITs are not directly correlated to stock market movements over the long term, so this sector does add to any portfolio's diversification.

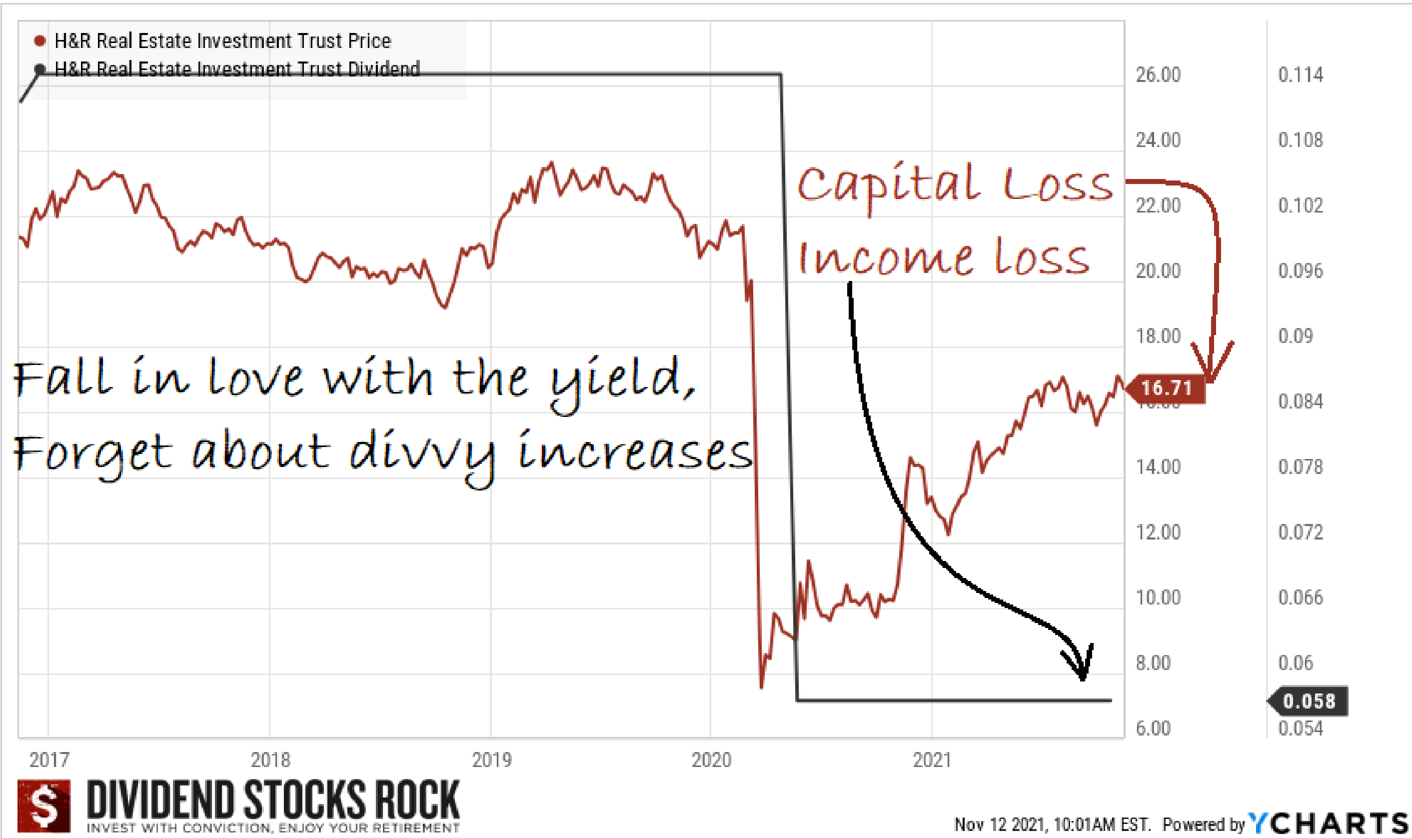
Finally, REITs offer a great protection against inflation. You have heard me say many times that REITs can pass along inflation to their tenants. In most cases, REITs have rent escalators included in their contracts. Rent increases are usually enough to cover inflation. Therefore, the REIT should be able to increase its distribution accordingly. And this is the key point: if your REITs offer good yield (over 5%), but don't increase their payout yearly, you are NOT protected against inflation. We have seen many REITs with generous yields cutting their dividend due to the pandemic. Many high yielders with no dividend growth will likely cut their dividend during tough times.

Greatest weaknesses

One of the REIT sectors' favorite ways to finance their new projects is to issue more units. Therefore, if a company purchases a property generating $20M per year but needs to issue more units to finance the purchase, you must look at the net outcome for unitholders. If the FFO per share drops, this is not necessarily good for you as it will affect the REIT's ability to increase its distribution in the future.

Be careful with REITs growing their funds from operations (FFO), but not their distribution. If the FFO per unit doesn't increase, the FFO payout ratio may flirt with 100%. At this stage, the distribution can be made for a while without increasing. However, we have seen many REITs in this situation cutting their distribution upon a recession.

RioCan (REI.UN.TO), H&R (HR.UN.TO), Cominar (CUF.UN.TO), Macerich (MAC), Sabra Health Care REIT (SBRA), and Ventas (VTR) are just a few examples to show that REIT distributions aren't safer than any other company's dividend. **A distribution cut doesn't only mean a loss of income, but usually a loss of capital too.**



Speaking of nothing being guaranteed, don't take a REIT share price for granted. While REITs offer a stable business model, they are not safer than other types of equities. Therefore, REITs should be treated at the same levels as any other dividend-paying stocks.

HOW TO GET THE BEST OF IT

While REITs are part of a short list of sectors that are perfect for retirees or other income seeking investors, it is important to understand that they cannot be analyzed using the same metrics as other sectors.

Funds from Operations (FFO) and Adjusted Funds from Operations (AFFO) are probably the most useful tools to analyze a REIT's financial performance. Those two metrics replace the earnings and adjusted earnings for a regular stock. While those are different metrics, it's all about cash flow and the REITs ability to sustain their dividends. We can find those metrics inside each REIT's quarterly report and subsequent earnings release. It is important to not only follow the FFO/AFFO in total but also to follow the FFO/AFFO per unit of ownership.

FFO = Earnings + Depreciation (Amortization) – Proceeds from Property Sales

AFFO = Earnings + Depreciation (Amortization) – Proceeds from Property Sales – Capital Expenditures

The use of the loan to value ratio (LTV) is a great tool to analyze the REIT's future ability to raise low cost capital. The LTV is easy to calculate from the financial statements, as you only need 2 measures of data:

LTV = Mortgage Amount / FMV of properties

You certainly don't want to invest in a REIT showing a high LTV. This means that their credit rating may be at risk and the price for future debt will be higher. In other words, it could mean less money for future dividends.

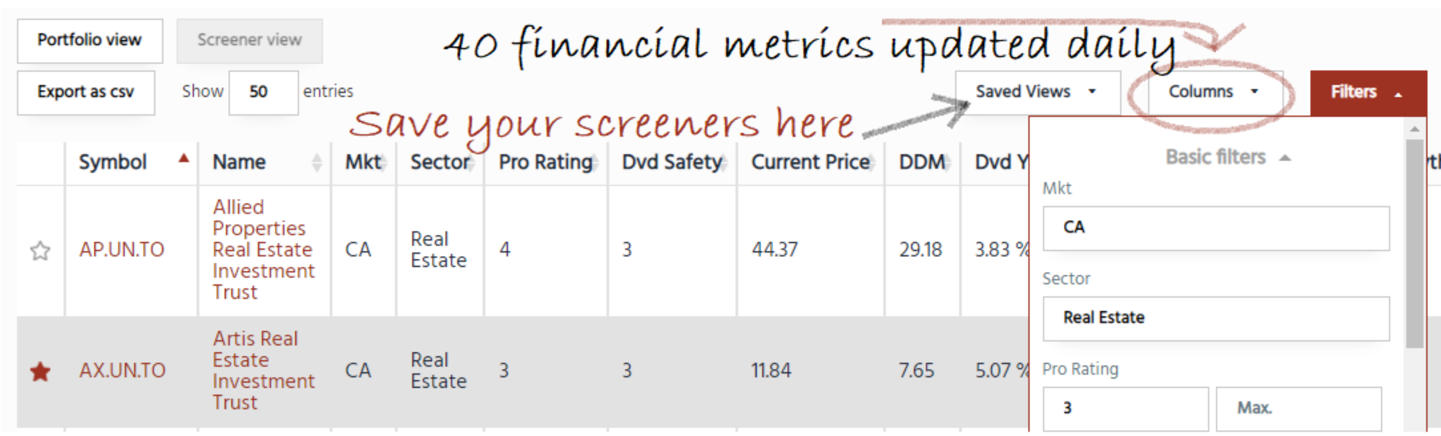
The last metric you must follow that is specific for REITs is the Net Asset Value (NAV). The NAV (usually shown per units) can be translated to the equivalent of a Price to Book ratio.

NAV = Total Property Fair Market Value – Liabilities

The ideal process is to compare a few REITs from your interest list against one another. This is how you should be able to find the ones with the best metrics. A lower than industry NAV is either a riskier play or a value play. The AFFO and LVT will tell you which one it is.

Are your REITs dividends safe?

To make sure your REITs dividends are safe, we use the DSR stock screener. The DSR stock screener has been created for Dividend Stocks Rock members. This tool helps them research through 1,100 dividend payers trading on Canadian and U.S. markets. It includes 40 financial metrics going from 1-year, 3-year and 5-year growth to an ESG score and the Chowder rule. If you are not a DSR member yet, you can find some metrics by using a free alternative such as FinViz.



Here are a few tricks:

- ✓ Select REITs with a minimum Dividend Safety Score of 3
- ✓ Review the stock card and check for the current (A)FFO payout ratio (quarterly update)
- ✓ Study the distribution trend (make sure it is relatively stable)
- ✓ Be careful with office REITs and shopping malls (variants are right around the corner)
- ✓ Be ready to sacrifice a bit of yield in exchange for steady growth (shield against inflation)

By using the same screener that you used for materials (note the EPS 5-year growth rate is useless for REITs), you will find several companies that offer a decent yield (above 3) with some dividend growth.

Medical Properties Trust (MPW) and CT REIT (CRT.UN.TO) could be interesting candidates offering a 5% yield. With over 80% of its assets invested in general acute care hospitals, MPW has developed strong expertise in this niche. Acute care facilities offer active but short-term treatments such as emergency services, intensive care, coronary care, cardiology, and neonatal intensive care. CT REIT offers a decent dividend growth rate policy matching and beating inflation. This makes it a perfect candidate for an income focused portfolio.

If you are looking for more growth and are ready to take on some volatility due to its small size, Canadian Net REIT (NET.UN. V) with a yield of ~4% is also a good candidate. Canadian Net REIT enjoys stable cash flows from its properties under the triple net lease formula (tenants take care of insurance, taxes, and maintenance costs).

Crown Castle International (CCI) and Granite REIT (GRT.UN.TO) would be great additions if you are looking for a REIT offering with a 3% yield, but also offering mid-single to high-single digit dividend growth rates. CCI has decided to solely focus on the US market. It invests massively in fiber to pursue small-cell communications sites. The idea is to establish a dominant position for the 5G technology that will require more small cells vs. big towers. GRT.UN has maintained a solid dividend growth policy over the past 5 years (4%+ CAGR). With its FFO payout ratio well under control shareholders should expect a mid single-digit dividend growth rate going forward.

The REIT sector is best for income investors

While you can find a few growth-oriented REITs (notably Granite REIT and Innovative Properties REIT), most of them will offer a relatively high yield and a stable business model.

Therefore, this sector will quickly become income-seeking investors' best friend. This portion of your portfolio could easily pay a 4% yield and increase its distribution enough to protect your buying power.

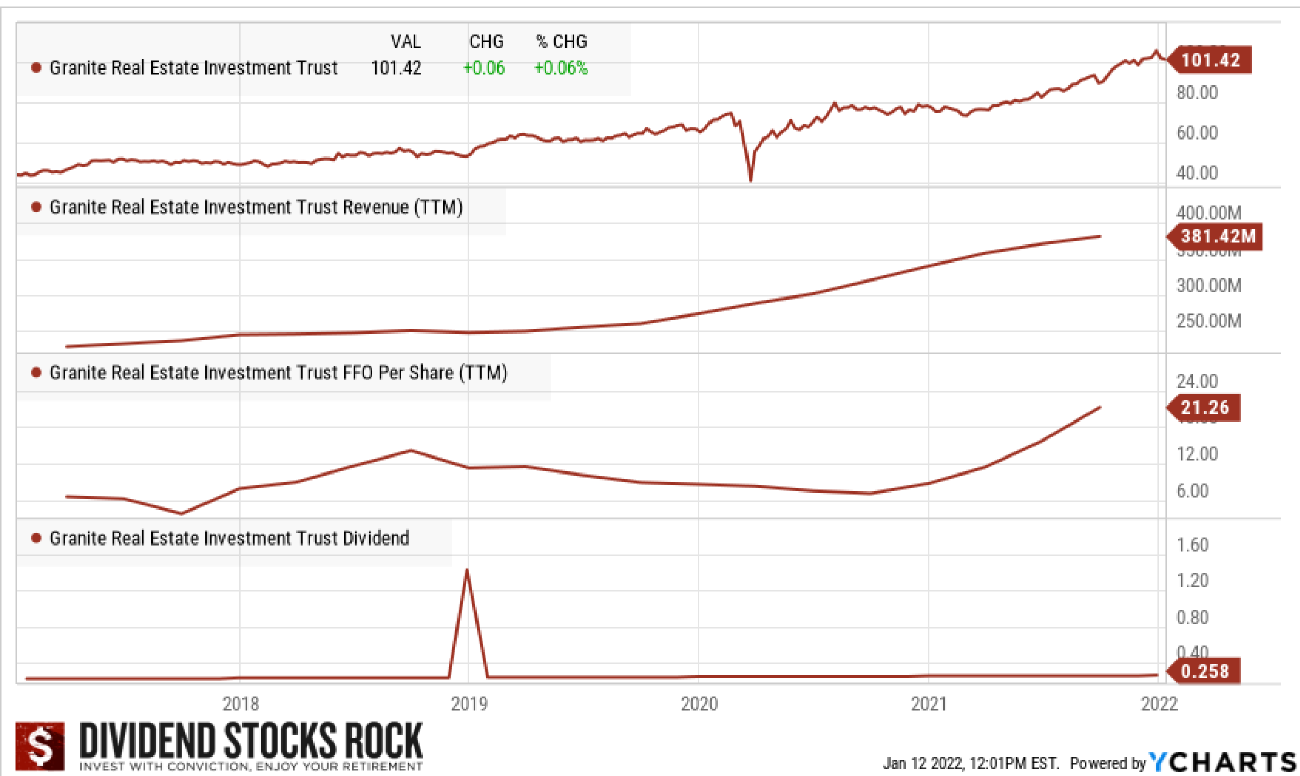
Target sector weight: For income-seeking investors, you can aim at 15% to 30% (if you invest in various industries). For growth investors, REITs could represent a 5%-15% portion of your portfolio.

BONUS FAVORITE PICKS

As a reward for reading my work, I'd like to share a few of my favorite REITs. I've selected them using the DSR stock screener.

Granite REIT (GRT.UN.TO)

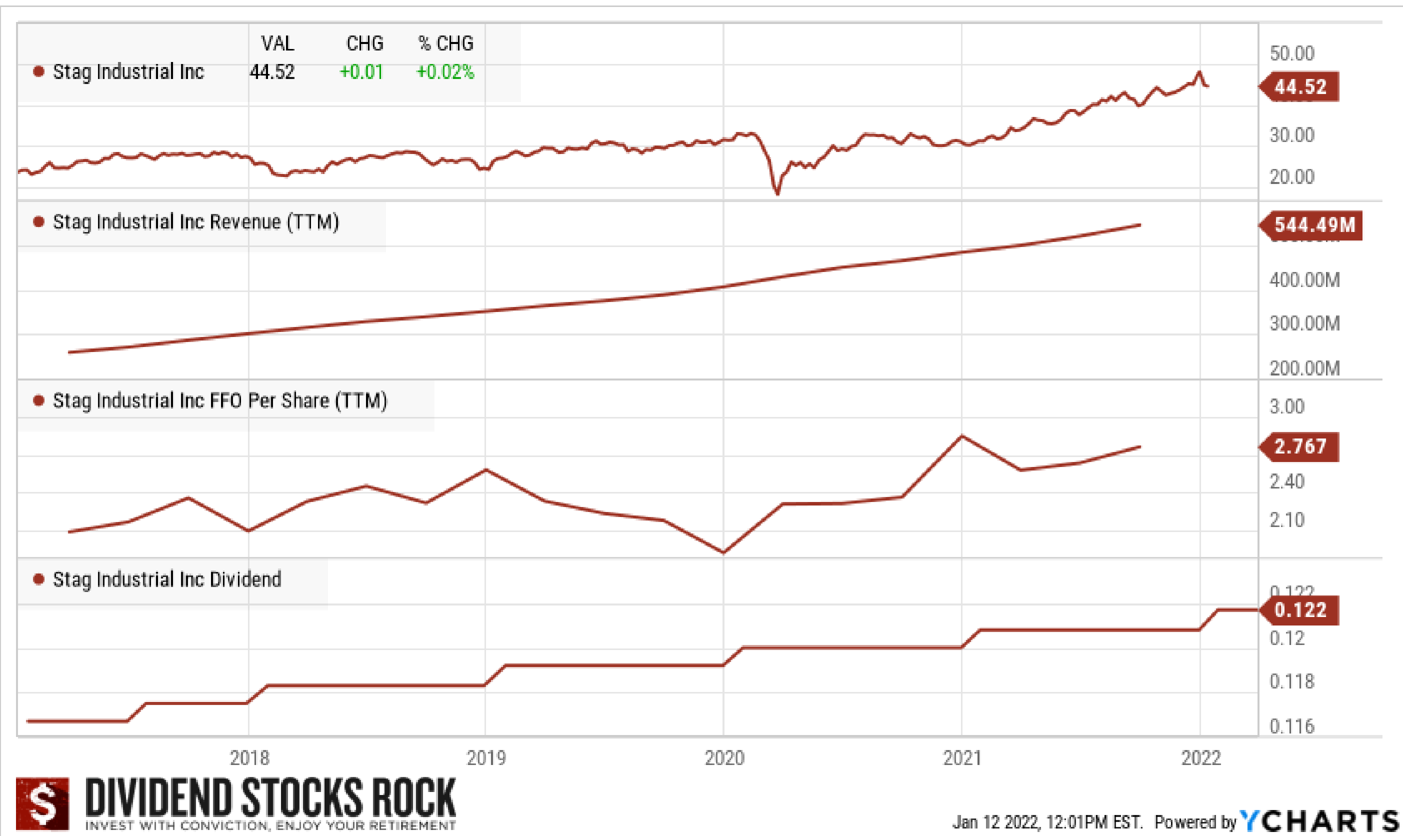
GRT used to be an extension of Magna International (MG.TO). Back in 2011, Magna represented about 98% of its revenues. It is now down to 34% as of August 2021 (with Amazon as its second-largest tenant with 6% of revenue). Management has transformed this industrial REIT into a well-diversified business without hurting shareholders. The company now manages 118 properties an increase of 21 over the past 6 months spread across 7 countries. The REIT also shows an investment grade rating of BBB/BAA2 stable. With a low FFO payout ratio (around 80%), shareholders can enjoy a 3%+ yield that should grow and match or beat the inflation rate. This is among the rare REITs showing an AFFO per unit growth while issuing more units to finance growth.



GRT has maintained a solid dividend growth policy over the past 5 years (4%+ CAGR). With its FFO payout ratio well under control shareholders should expect a mid single-digit dividend growth rate going forward. The company even paid a special dividend in 2019. In fact, if the Magna International business is doing well, GRT will perform and keep increasing its dividend. We issued a buy rating on Granite a while ago. It's still a buy, but the easy money has already been made on this security.

Stag Industrial (STAG)

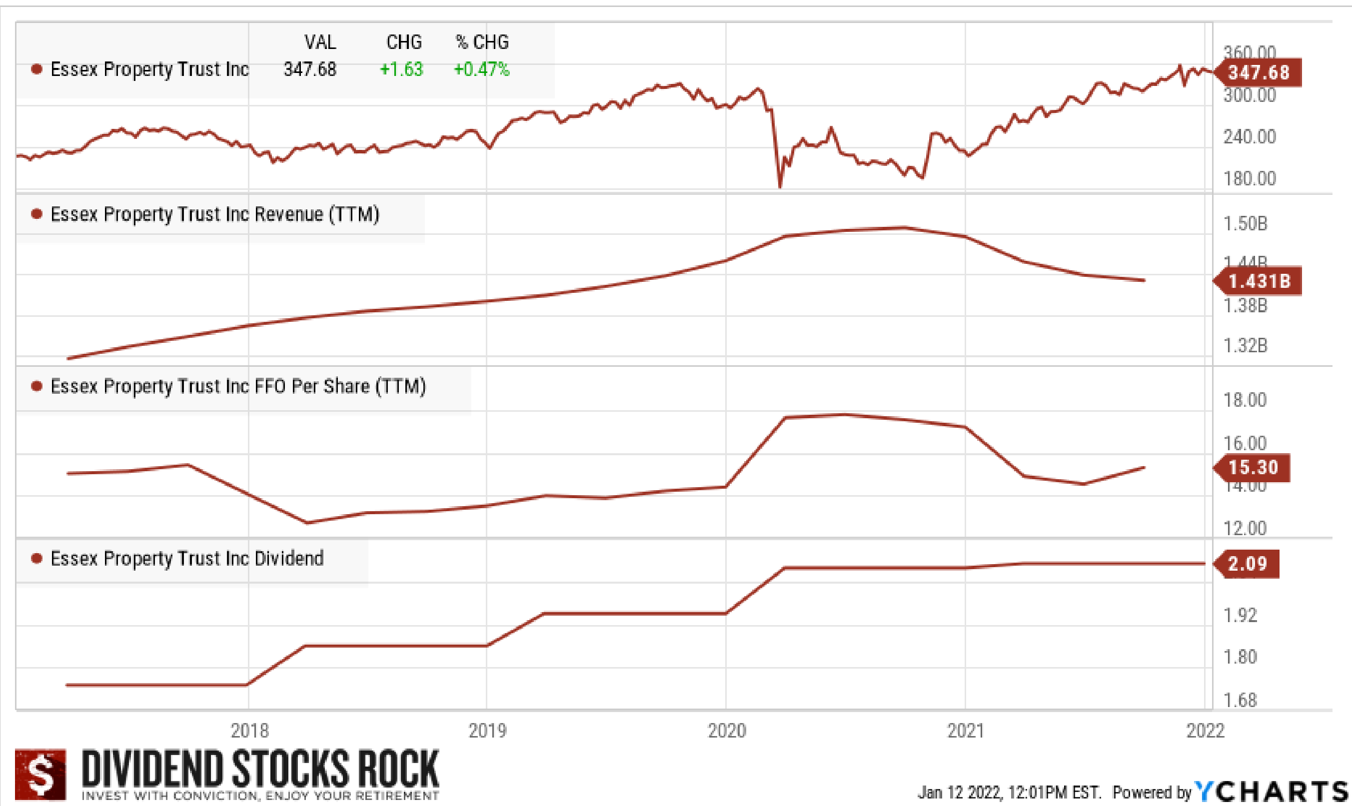
After years of being the ugly duckling, today Industrials are on fire thanks to e-commerce and the pandemic. While the growth of e-tenants' credit profile is important, the need for warehouse space keeps growing. STAG is one of the largest players in that field and uses its size and strong balance sheet to acquire more real estate in this market. The REIT shows 40% of its customers dealing in e-commerce activity. We appreciate STAG's highly diversified tenant base offering warehouses to multiple industries. Roughly 55% of their tenants' credit profiles are publicly rated and 30% of all tenants show to be investment grade companies. STAG focuses on smaller and individual properties. This enables the REIT to face less competition and improve diversification.



REITS need debt to grow, and STAG's debt keeps increasing every quarter. The company has more than doubled its debt to around $1.8B over the past 5 years. Still, STAG possesses a credit rating of BAA3 (Moody's) and BBB (Fitch). The issue with such an aggressive growth plan is not only the debt levels but also the risk of getting too big. There have been massive investments in the industrial REIT sector, and the participants in that market could possibly reach an oversupply point. We like the business and the monthly dividend, but we think there is little upside potential at this point. We see an issue with historic low cap rates, caused by high property prices and slow growing rents… stockholders should keep an eye on the Commercial Real Estate arena if they hold STAG.

Essex Properties (ESS)

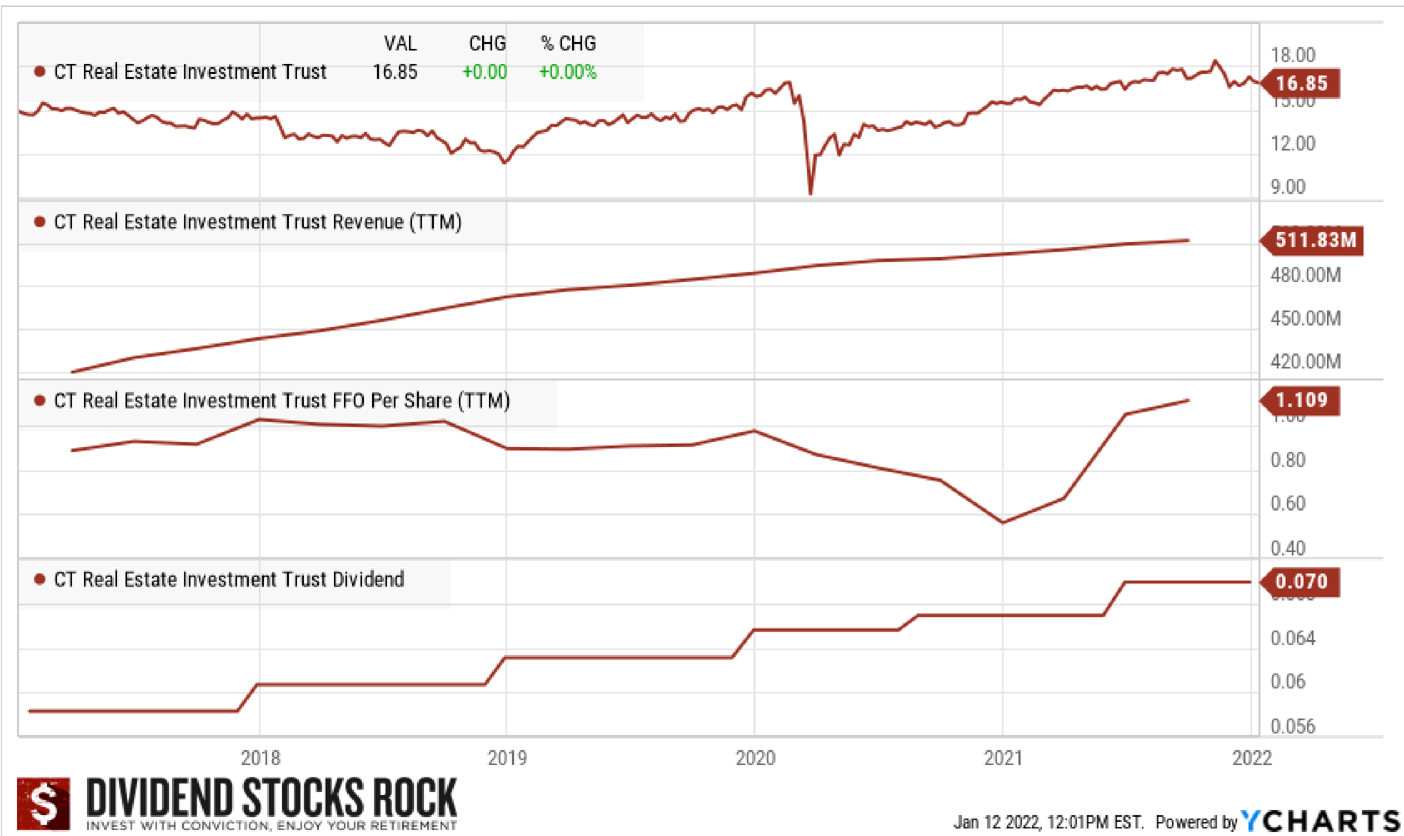
ESS is everything a REIT should be: they have a dominant position in a thriving market, a decent yield, and a stellar dividend growth history. Most income-seeking investors are looking at REITs with marginal growth opportunities but high dividend yields. If you are willing to invest in a company offering under 4% yield levels, then you will find ESS to be most attractive. Your income will be safe and protected against inflation. Plus, you will likely enjoy some value appreciation over the long haul. During the recession of 2008, ESS kept increasing its dividend while maintaining a strong FFO per share. The REIT positioned itself during the recession to make sure it thrived once the economy was ready to roll again. ESS regularly acquires apartment REITs and successfully integrates them into their business model. Finally, Essex is well-established in rich and growing markets in California and the city of Seattle. This REIT should ride on strong demographics and job growth tailwinds over the coming years.



This REIT has successfully increased its dividend annually since 1995. Essex has never missed a dividend increase since its IPO in 1994! It generates sustainable funds from operations (FFO) quarter after quarter. During their latest earnings report (ending March 2021), the REIT posted core FFO per share of $3.07 while paying a $2.09/share dividend. That equates to a 68% payout ratio. The most recent dividend increase (+0.5% from $2.078 to $2.09) was disappointing, but we expect future dividend increases to get back in line as the economy recovers. Shareholders can sleep well with a decent yield and a dividend increasing steadily year after year.

CT REIT (CRT.UN.TO)

An investment in CT REIT is primarily an investment in the real estate business of Canadian Tire. If you think this Canadian retail giant will do well in the future, but you are more interested in dividends than pure growth, CT REIT is the answer. The fact that CRT is paying a monthly dividend with a yield around 5% is highly attractive for income-seeking investors. On top of that, CT REIT shows a decent dividend growth rate policy matching and beating inflation. This makes it a perfect candidate for an income-focused portfolio. Canadian Tire has done well during the pandemic so far and CRT has proven the resiliency of its business model. It's a sleep well at night REITs that should please all income seeking investors.



This REIT continues to grow and show the low AFFO payout ratio around 75%. This means your distribution will likely continue to rise faster than the inflation rate going forward. Shareholders can expect to cash a solid 5%+ yield with a 2-3% growth rate. This is a perfect example of a sleep-well-at-night type of holding. After a small increase in 2020 (+1.5%), CT REIT came back strong in 2021 with a +4.5% increase. Keep in mind many retail REITs cut their dividend last year. CT REIT proved you can trust the company for your retirement plan.

FINAL THOUGHTS

REITs could be a fantastic asset to add to your portfolio. They are easy to understand, and their business model revolves around building a recurring income stream. At DSR, we cover 46 Canadian and 93 American REITs. That's enough to create a solid income-generating portfolio, isn't it?

Invest with More Confidence and Less Stress

If you are like most investors, you constantly struggle with the right time to invest in the right assets. When you have losing investments, you get stuck by paralysis by analysis. This confusion hurt your portfolio and prevent you from enjoying your retirement.

Just look at how Rick solved his investing struggles and reached investing peace:

> *“One thing that I, struggle with is knowing when to let go of a losing investment when it makes sense to do so. DSR provides quarterly updates of each subscriber's portfolio (PRO feature) that provide value and dividend safety ratings for each individual holding. This is a really helpful guide as to whether it is time to consider selling a loser. Another very useful feature is that his report also provides potential replacements with better ratings. This gives me an independent viewpoint of whether my holdings are the best ones to keep going forward.*
>
> *One great part of the DSR service is Mike's inter-activeness with his subscribers. He does this regularly through both newsletters and webinars. His webinars are highly interactive, with subscribers able to make comments and input questions as it goes. Each and every time I have sent a separate email to Mike's service he has personally responded with helpful input. I recommend this service to anyone who is focused on dividend stocks and values a separate analysis of their holdings to help verify their portfolio's value and safety.”*

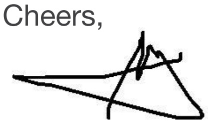
Rick Urquhart, DSR PRO members since September 25th, 2017.

If this membership doesn’t help you grow confidence and take actions with your portfolio, reply to any of DSR emails within the first 60 days of your subscription and we will send you back the money in full.

Click here and get access to DSR now*

You can forward this book to any of your friends who like dividend investing…

Cheers,



Mike, Passionate Investor

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