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MIDDLEFIELD, CHOICE PROPERTIES DISCUSS REAL ESTATE OPPORTUNITIES

Executives from Choice Properties join Middlefield's Dean Orrico to share their outlook for REITs in Canada

These are uncertain times for some Canadian real estate investors as inflation and interest rates create mixed expectations for the year ahead. But for some real estate experts, the outlook is clear.

Middlefield Group is an independent equity income manager with a 40-year-plus track record. The firm has been running dedicated REIT investment funds for over a decade, which focus on large-cap real estate companies with stable operating income, low leverage, and growing levels of dividends.

With strong fundamentals and a steady financial footing, Choice Properties REIT is a great example of a long-term, high-conviction portfolio holding for Middlefield. The business prospects for Choice have never been stronger, allowing the company to target opportunities where so many of their competitors see challenges.

During a recent roundtable discussion, host Dean Orrico, CEO of Middlefield, was joined by Rael Diamond, CEO of Choice Properties REIT, and Mario Barrafato, Choice's CFO, for a conversation about investing in Canada's property market and what to expect in the months ahead. Orrico was recently interviewed by Wealth Professional to discuss the increasingly attractive investment opportunities in Canadian real estate. Orrico has 20+ years of experience in managing dedicated real estate solutions.

Choice is Canada's largest REIT, with 80 percent of its assets in the open-air, necessity-based retail sector, where many are anchored by the supermarket giant Loblaw. The Toronto-based company also boasts a growing number of assets in the industrial (15 percent) and residential/mixed use (five percent) spaces.

Orrico opened the discussion with a brief summary of the challenges facing Canadian real estate investors today.

"The real estate sector generally, and public REITs in particular, have really been challenged over the past 12 months with rising rates and concerns about a recession," he says. "Having said that, the fundamentals in the areas that Choice is focused on – retail, industrial, and residential – have really been as good as I've seen them in a long time."

Turning to Diamond, Orrico asked why there's a disconnect between what many investors believe is happening in the property market, and what is in fact happening.

Diamond said the main reason for the disconnect is that people see negative headlines about the housing market, and then assume that commercial property is having the same problems.

"But our grocery and retail assets have never been stronger," Diamond explains. "We just reported results last week – we got phenomenal rent spreads. We're getting sometimes triple the amount of rent we had from the previous tenant."

The strong performance in retail is underpinned by a stable foundation of sound business decisions going back years.

Barrafato says Choice's balance sheet is supported with $1.5 billion of liquidity, staggered debt maturities, an investment-grade credit rating, and a significant number of unencumbered assets that provide further flexibility.

"We've been resilient," he says. "The only thing right now is interest costs, but having the lowest debt in the industry, it just doesn't affect us that much."

Barrafato says Choice isn't dependent on lines of credit with variable rate loans, and managed to remain very stable throughout the sharp rise in interest rates.

> "Our grocery and retail assets have never been stronger"
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> Rael Diamond, CEO
> Choice Properties REIT

Diversified assets

Along with its strong balance sheet and lack of exposure to variable rates, Choice has benefitted from its diversification of properties across the retail, industrial, and residential sectors.

Diamond notes that Choice already has the largest retail portfolio in the industry, while continuing to build one of the biggest industrial businesses. Over time, he says Choice will expand its presence in the residential space as well, though it will take years.

"For industrial, we believe that over the next five to seven years, we can take it from 20 percent to 25 percent of our income," Diamond adds.

Choice has added about 500 acres of industrial land in the last several years. Together with the rest of their holdings, this gives them a number of opportunities in Vancouver, Alberta, and the area around Toronto, especially with Canada continuing to suffer from a limited supply of land.

"Canada has real supply constraints as well as continued population growth," Diamond says. "Given those two factors, there's a real need for more generic industrial space."

This combination of limited land and rising demand due to strong population growth is supporting Choice's retail assets as well, particularly with an anchor tenant like Loblaw serving as a big draw for consumer traffic.

Looking ahead
Referring to a recent announcement from Choice, Orrico noted that the company expects to be able to deliver total returns of eight to 10 percent over the next three to five years.

Orrico asked Barrafato how they plan to hit that target.

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> Choice Properties REIT

"Our distribution right now is about five percent, and that's been very stable," Barrafato says. "We have growth, and we're able to reinvest that growth and now that gets you about two to three percent. And then we have this development pipeline that can deliver about one percent additional growth every year. So that's how we reach that number."

Barrafato says since 2018, they have been focused on achieving several key goals, including fixing the balance sheet, improving asset quality, and building a development platform.

Then last year, Choice reached the point where they wanted to return some of that growth to their investors.

"Given the improvements we've made, we're going to have growth, and when we have growth, we'll share some with our investors," he says. "It's pretty important to us."

Choice Properties is a top 10 holding in Middlefield's real estate-focused ETF and mutual fund. Since various sectors in the real estate market differ significantly from one another (i.e., industrial and retail are doing extremely well while office remains very challenged), Middlefield believes that a portfolio of REITs needs to be actively managed to provide investors with better risk-adjusted returns.

Middlefield's real estate funds are well-diversified across commercial real estate issuers, primarily operating in the industrial, data centre, retail, senior living, cell tower, and residential sectors.

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> Dean Orrico, President & CEO
> Middlefield

The firm's real estate-focused mutual fund, Middlefield Real Estate Dividend Class, has won the Refinitiv Lipper Fund Award for best real estate fund for two years running (Best Fund over 5 Years in the Real Estate Equity category).

Orrico says, "We've been managing real estate and REIT portfolios since our founding over 40 years ago, and it's been decades since we've seen such a pronounced disconnect between current REIT trading prices and the extremely solid fundamentals in most real estate sectors, especially in Canada."

"When we compare the yield and attractive valuations in the public market, together with an imminent end to the interest rate hiking cycle, our portfolios are well-positioned to generate strong returns over the next six to 12 months."

Read the full article at www.middlefield.com