Rise of e-commerce retailers drives growth for industrial REITs

SHIRLEY WON
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The promise of quick deliveries by e-commerce retailers such as Amazon has sparked a race to rent suburban fulfillment centres or smaller warehouses closer to customers.

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Investing in warehouses, storage facilities and factory buildings may sound like a snooze, but industrial real estate investment trusts (REITs) have emerged as attractive opportunities for generating income and growth.

In large part, that's because the promise of quick deliveries by e-commerce retailers has sparked a race to rent suburban fulfillment centres or smaller warehouses closer to customers. And industrial properties are being leased for newer uses, ranging from growing medical cannabis to housing high-tech data centres.

“It’s been the hottest REIT sector in North America over the past couple of years in terms of total return,” says Jeffrey Olin, president, chief executive and portfolio manager at Toronto-based Vision Capital Corp., who oversees the firm’s real estate-focused funds. “We think it’s in the early innings. Demand for new industrial square footage to keep up with the growth in e-commerce sales is significant.”

Online retailers need three times more warehouse space than bricks-and-mortar stores for inventory and dealing with returns, he says. “Demand is voracious, not only from retailers like Amazon, but also from couriers like Federal Express.”

However, the supply of industrial-zoned land can be constrained in certain markets due to municipal opposition, he says. “Industrial has a lower tax base than residential and creates traffic and infrastructure challenges.”

Within the industrial sector, he favours Atlanta-based Americold Realty Trust (COLD-N), the world’s largest operator of temperature-controlled warehouses. The company has a strong management team and will benefit from the rising demand for cold storage as consumers want more fresh food, Mr. Olin says. “This REIT trades at the same cash-flow multiple as the U.S. industrial REIT sector but has twice the growth.”

Another attractive REIT, he says, is Malvern, Penn.-based Liberty Property Trust (LPT-N), which has been selling its office buildings to become a pure-play industrial REIT. This REIT trades at a discount to its net asset value (NAV), which is rare now in this sector, Mr. Olin notes.

The market is taking a wait-and-see approach to Liberty Property Trust’s strategy, he notes. “We believe it will largely complete that transformation by the end of this year … and that the stock is worth US$60 a share.”

Lee Goldman, a senior portfolio manager with Toronto-based Signature Global Asset Management, a division of CI Investments Inc., is also upbeat on industrial REITs. “They have the best fundamentals of any sector in the real estate market now.”

Online shopping, which represents 10 per cent of overall retail sales in the United States and about 7 per cent in Canada, has been growing strongly in both countries at a rate of 10 per cent or more a year, says Mr. Goldman, who co-manages CI First Asset Canadian REIT ETF (RIT-T).

A recent report from real estate services firm CBRE Group Inc. indicates that the supply of Canadian industrial properties is tight with the vacancy rate at an all-time low of 3.1 per cent versus its historical average at 5 per cent to 6 per cent, he says. “Rents are now going up rapidly.”

Among Canadian REITs, he likes Toronto-based Granite REIT (GRT-UN-T), which owns properties in North America and Europe. Kevan Gorrie became the company’s CEO officer last year after a stint as CEO of Pure Industrial REIT, which was acquired by New York-based Blackstone Property Partners in 2018.

Granite REIT, the properties of which were spun out from Magna International Inc., has reduced its exposure to the auto parts giant to about 50 per cent – and that could fall to 20 per cent in a few years, Mr. Goldman says. Granite REIT, he adds, trades at a slight premium to its consensus NAV of about $61.50 a share.

Mr. Goldman is also positive on Toronto-based Dream Industrial REIT (DIR-UN-T), which trades at a modest premium to its consensus NAV of about $11.70 a share. Brian Pauls, a U.S. real estate professional who became that REIT's CEO last year, has spearheaded its foray into the U.S., which now makes up one-third of its assets.

Although Canada doesn't yet have a REIT leasing to cannabis growers, San Diego-based Innovative Industrial Properties Inc. (IIPR-N), which leases property to U.S. medical marijuana producers, has turned heads with its shares surging sharply during the past year.

"I wouldn't be surprised if something [like this REIT] does list in Canada," says Mr. Goldman. The risk, he says, is what happens to a property if the cannabis grower doesn't do well and must vacate its premises.

Industrial REITs once didn't garner much attention because of the lack of rent increases, but that has certainly changed, says Dennis Mitchell, CEO and chief investment officer at Toronto-based Starlight Investments Capital LP, which focuses on real estate investments.

Rent growth has spurred development of modern facilities focused on distribution and logistics, while some older buildings have been repurposed into data centres driven by demand for internet services, says Mr. Mitchell, who manages Starlight Global Real Estate mutual fund and its exchange-traded fund counterpart.

Although Canadian industrial REITs typically concentrate more on acquisitions and can offer investors yield and stability, U.S. REITs tend to focus on both development and acquisitions so they can offer more "longer-term growth and value creation," he says.

Given the sector's tailwinds, valuations are generally pricey, Mr. Mitchell says. "Industrial REITS in North America look expensive versus historical multiples and other REIT sectors. However, if you look at the growth that they offer, it is far superior to most of the other real estate subsectors."

Mr. Mitchell is bullish on San Francisco-based Prologis Inc. (PLD-N) even though it trades at a significant premium to its consensus NAV of just more than US$73 a share and is expensive relative to its historical multiples. Prologis, which has assets in the U.S., Canada, Europe and Asia, is "probably the largest, global industrial-focused REIT in the world," he says.

Prologis has very high-quality assets, a large development pipeline and joint ventures with pension plans and sovereign-wealth funds, he adds. It recently did a US$4-billion

deal to buy Industrial Property Trust, a REIT controlled by Denver-based private equity firm Black Creek Group LLC.

Outside of North America, Mr. Mitchell likes London-based Tritax Big Box REIT PLC (BBOX-L), which builds large logistics facilities in Britain. “Amazon is one of its largest tenants. … [Tritax] has a very young portfolio that is fully-leased with long-term tenants that provide strong growth.”

Tritax trades cheaply, partly due to the British government’s threat to leave the European Union unilaterally by Oct. 31 if there’s no withdrawal deal. Tritax’s operations “have yet to be impacted by Brexit,” he notes.

Although industrial REITs are in a sweet spot, there are other potential headwinds beyond Brexit. As some are more leveraged to global trade, any fallout from the U.S.-China trade war “could conceivably impact their occupancy levels and cash flows,” Mr. Mitchell says. “And a recession, of course, can too.”