INVESTMENT FUNDS

REAL ESTATE INCOME

MONTHLY COMMENTARY

October 31, 2020

So far in 2020, real estate investment trusts (REITs) continue to underperform the market overall with a return of -24.2% for the TSX REIT index as at October 31, compared to a return of -6.1% for the TSX index. The trust index and Canadian market index (S&P/TSX) declined in October by 2.4% and 3.1%, respectively, as rising COVID cases and the U.S. election weighed on risk sentiment. Having said that, the S&P/TSX is almost at the same level as at the beginning of the year. As we know, the effects of the pandemic continue to be felt among the main real estate trust sectors, including residential (apartments), retail (stores and shops), office and industrial (warehouses) trusts. Longer term, we expect some asset classes to continue to benefit more than others.

As mentioned in our last comment, Canadian apartment REITs, long thought of as defensive by investors, have not been immune but generally have assets that are more affordable than the market average, so are better positioned to withstand continued economic weakness. The Canadian government also recently announced significantly higher immigration targets over the next three years, with an aim to accept 401,000/411,000/421,000 permanent residents vs. a prior target of 351,000/361,000/N.A. Immigration is by far the most important long-term value driver for apartment REITs, in our view. Given that long-term fundamentals remain intact, we see the situation in this sector as a long-term opportunity and we have added to our current holdings.

The impact of telework on office building trusts is yet to be defined; however, we can already tell that it will be significant. With teleworking going on much longer than initially expected, it is interesting to see sentiment shift increasingly negative by both landlords and tenants since the start of the pandemic. By most estimates, the broad-based return to the office is now expected to be in the spring of or mid-2021. We do caution; however, the longer we remain away from the office, the more normalized telework will become. We remain under-invested in this sector as we await details about the longer-term impact of telework.

Retail trusts are clearly suffering because of the situation caused by the pandemic. In terms of performance, retail trusts have suffered the most to date and have not yet begun to recover. Previously, we noted some of the more distressed retail REITs could outperform over the short term, given our view that rent collection would improve after the end of the confinement, the real test being in the fourth quarter in terms of how tenant sales perform. Based on third quarter data points by retail REITs, this has largely played out. However, with recent mandated government shutdowns in certain parts of the country due to the second wave, we could see this trend reverse sooner than expected. Given these concerns around long-term NOI visibility due to potential changes in consumer behaviour, we remain cautious longer-term. Once again, in the

Fund, we are underweighting this sector and target investments in companies with tenants that have only been slightly impacted by the pandemic, like grocers, and in trusts invested in better quality assets. For example, one of the retail REITs in which we are overweight is CRT.un, which recently reported ~99% rent collection in the third quarter (vs. second-quarter rent collection of ~98%). Its strong rent collection is because Canadian Tire accounts for ~91.5% of its total rent, which is reporting record sales and store productivity.

Finally, the industrial real estate trust sector is the sector that has performed the best since the slowdown caused by the pandemic, and the Fund continues to be well exposed in this sector, with a weight higher than the index.

Overall, this leads us to believe that the Fund is well-positioned for an eventual recovery, which could; however, be gradual. We also believe that the current situation calls for a focus on selecting high-quality REITs that have fallen in line with the rest of the industry, and that there is an opportunity to add some of them to the portfolio at very attractive valuations on a historical basis.

We continue to earn profits in the Canadian equities portion of the Fund, as several names have performed well over the last few months. This diversification in Canadian equities is very important as it allows the Fund to add value and surpass the TSX REIT index over the long term. Moreover, it is a major reason why the Fund has performed better than the REIT index since the beginning of the year.

As at October 31, the Real Estate Income Fund earned a return year to date of 6.1% higher than the return of the TSX REIT, on a gross return basis. The Fund's annual distribution rate was 4.9% as at the same date and the 10-year Canadian bond rate was 0.66%. REIT distributed returns are attractive to investors who are seeking income, which will support an eventual revaluation, especially in an environment where interest rates are so low.

We must remember that REITs are as risky as the equity market overall, as measured by the standard deviation because of, among other things, their high debt level. As a result, the Real Estate Income Fund may experience a certain level of volatility in these financially turbulent times.

MARC GAGNON, M. Sc., CFA

- Principal Portfolio Manager, North American Equities
- Joined iAIM in 1998
- More than 25 years of investment experience
- MBA in Finance, Université Laval
- Bachelor's degree in Business Administration, Université Laval

Main funds managed by the team

✓	Canadian Equity Growth
✓	Real Estate Income
✓	Global True Conviction
✓	Canadian Equity Growth Hybrid 75/25
✓	Global True Conviction Hybrid 75/25
✓	IA Clarington Canadian Leaders Class

iAIM snapshot

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- Major player in the asset management industry
- Manages $97 billion in general portfolios and segregated and mutual funds
- A team of 184 people, including 108 investment professionals (including 44 CFA charterholders)
- Composed of experienced managers who emphasize fundamental analysis, identification of value and long-term investing

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