INVESTMENT FUNDS

REAL ESTATE INCOME

QUARTERLY COMMENTARY

December 31, 2020

In 2020, real estate investment trusts (REITs) underperformed the market overall with a return of -13% for the TSX REIT index as at December 31, compared to a return of +5.6% for the TSX index. The trust index and Canadian market index (S&P/TSX) in December were -2.6% and +1.7%, respectively, which followed a strong November (+18% and +11%) when better than expected COVID-19 vaccine trial results were announced. Although vaccine distribution so far has been slower than expected, we expect the pace of vaccinations to improve throughout 2021 as we move towards a full re-open. Having said that, we think the pandemic will have a longer-term impact across all 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.

Even apartment REITs, long thought of as defensive by investors, have not been immune. Despite outperforming the TSX REIT index since the COVID-crisis began, apartments underperformed over the late summer due primarily to concerns over lower near-term immigration and government intervention. With the uncertainly surrounding timing of vaccine distribution, we think immigration could be delayed near-term, which would be a near-term negative as immigration is by far the most important long-term value driver for apartment REITs, in our view. Having said that, the Canadian government did announce significantly higher immigration targets over the next three years in October, with an aim to accept 401,000/411,000/421,000 permanent residents vs. a prior target of 351,000/361,000/N.A. These significantly higher targets reassure us that any pause in immigration near-term would not signal structural shift, but rather a timing-related issue as we get through the pandemic.

We also note apartments have continued to outperform both before and after the positive vaccine trial news. The Canadian apartment REITs generally have assets that are more affordable than the market average, with rents below market-average, so are better positioned to withstand continued economic weakness. 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 throughout the crisis.

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. Despite improved visibility for vaccine distribution, we do think the debate about telework is here to stay for the next few years, as both companies and employees will continue to experiment with different hybrid working models, which we think could result in greater volatility for Office REIT share prices. It will, however, take some time for things to fall into place because of the long-term nature of leases. All the same, we remain under-invested in this sector as we expect the debate around the longer-term impact of telework to continue.

Retail trusts are clearly suffering because of the situation caused by the pandemic. In terms of performance, the retail trusts have suffered the most to date but have recently begun to recover. Previously, we noted that 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 lockdown, with the real test to be in Q4 in terms of how tenant sales perform. However, with recent mandated government shutdowns in certain parts of the country due to COVID outbreaks, this trend is reversing sooner than expected, but given the positive vaccine trial news which came out around the same time, our assumption retail REITs would outperform entering the holidays has largely played out. However, given 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 underweight in 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 we are overweight includes CRT.un, which recently reported ~99% rent collection. Its strong rent collection is due to the fact Canadian Tire accounts for ~91.5% of total rent, which is reporting record sales and store productivity. Throughout the pandemic, we have also been selectively adding certain diversified REITs in place of distressed retail, such as AX.un, which at times was trading below the valuations of distressed retail REITs, despite having better rent collection and long-term fundamentals due to its significant exposure to industrial real estate.

Finally, the industrial real estate trust sector is the sector that has performed the best since the slowdown caused by the pandemic. Some of the companies have exposure to e-commerce, as they invest in storage and distribution centres needed to deliver these goods. The Fund is well exposed in this sector, with a weight higher than the index. With the overperformance, we have started to take some profit in that sub sector, but we remained overweight.

Overall, this leads us to believe that the Fund is well positioned for the eventual recovery. 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.

Additionally, we have continued 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 December 31, the Real Estate Income Fund earned a year-to-date return of 5.5% higher than the return of the TSX REIT, on a gross return basis. The Fund's annual distribution rate was 4.5% as at the same date and the 10-year Canadian bond rate was 0.68%. 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

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- 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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