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REITs - Worth A Look

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Markets

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Interesting REITS for your Portfolio

As a firm, Warren Financial normally focuses on large and midcap growth stocks. We like companies with a good story vis a vis their product or service or innovation, strong leadership, demonstrated strong revenue and earnings growth and a recent track record of positive earnings "beats" and "beat and raises". We like the total return that these types of companies generate for our clients, on average and over time.

In addition to growth equities, we also think there is a place in the portfolio for hard assets that generate "economic rents". (An economic rent is the extra amount of return generated by an asset due to its unique location, scarcity of other supply or innovation.). For example, in a dense metropolitan area there are only so many places allowed to have a cellular antennae. In the Bay Area of California there is only so much housing available and space open for building remaining, etc.

We have identified a half dozen REITs that we like: American Tower (AMT), SBA Corp (SBAC), Crown Castle Int'l (CCI), Equinix, Inc. EQIX **(EQIX) and CoreSite** COR **Real Estate (COR), Essex Realty (ESS).**

Why we like REITs

Real Estate Investment Trusts are designed to be income generators for investors. As an entity they pay no Federal income taxes and by law are required to pay out 90% of their returns to investors. In a world where bond returns are pushed to near 0% or negative and where Central Bankers are busily buying up Treasury bonds (essentially pushing cash into the financial markets and pulling out interest paying bonds), having an asset in the portfolio that generates a reliable income is highly desirable.

The income of REITs provides a nice counter to the deflationary actions of central bankers. The underlying assets that the REIT own also provide a nice hedge in the event we ever see inflation again.

The Cell Tower REITS: "AMT", "SBAC" and "CCI"

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The cell tower REITs generate revenue by leasing space to the major cellular carriers. Our thesis is that cellular carriers will continue to pay for space and for upgrades (for example 5G) to these tower providers. American Tower, SBA Communications SBAC and Crown Castle will continue to collect their economic rents by virtue of existing locations and limitations on growth due to congested urban locations and reluctance among communities to grant additional permits to replicate existing cell antennae towers.

Cell Tower REITs

Ticker	Description	US %Revenues
AMT	Founded in 1995, American Tower Corporation, one of the largest global Real Estate Investment Trusts (REITs), is a leading independent owner, operator and developer of wireless and broadcast communications real estate. Our global portfolio includes approximately 180,000 communications sites, including nearly 41,000 properties in the United States and approximately 139,000 properties internationally. In addition to leasing space on wireless and broadcast towers, we provide customized solutions through our in-building systems, outdoor distributed antenna systems and other right-of-way options, managed rooftops and services that speed network deployment. Headquartered in Boston, Massachusetts, American Tower has offices across the United States and in Argentina, Brazil, Burkina Faso, Chile, Colombia, Costa Rica, France, Germany, Ghana, India, Kenya, Mexico, Niger, Nigeria, Paraguay, Peru, South Africa and Uganda. (Source: https://www.americantower.com/company/)	Est. 50%
SBAC	SBA Communications Corporation (SBA) is a leading independent owner and operator of wireless communications infrastructure including towers, buildings, rooftops, distributed antenna systems (DAS) and small cells. Founded in 1989 and headquartered in Boca Raton, Florida, SBA has operations and offices in fourteen markets throughout the Americas and South Africa. We are listed on NASDAQ under the symbol SBAC and our organization is part of the S&P 500. SBA is also one of the top 20 Real Estate Investment Trusts (REITs) based on market capitalization. (Source: https://www.sbasite.com/English/company/about-sba/default.aspx)	Est. 80%
CCI	CCrown Castle is US based and US only operation with more than 40,000 cell towers, approximately 70,000 on-air or under-contract small cell nodes, and approximately 80,000 route miles of fiber. They have a presence in every major US market. In 2014 CCI converted to a Real Estate Investment Trust. According to their recent investor presentation their dividend yield is 3.3% with a 7-8% annual growth target in dividend per share.	Est. 100%

Source: %US revenue estimates are approximations derived from investor presentations • Created with Datawrapper

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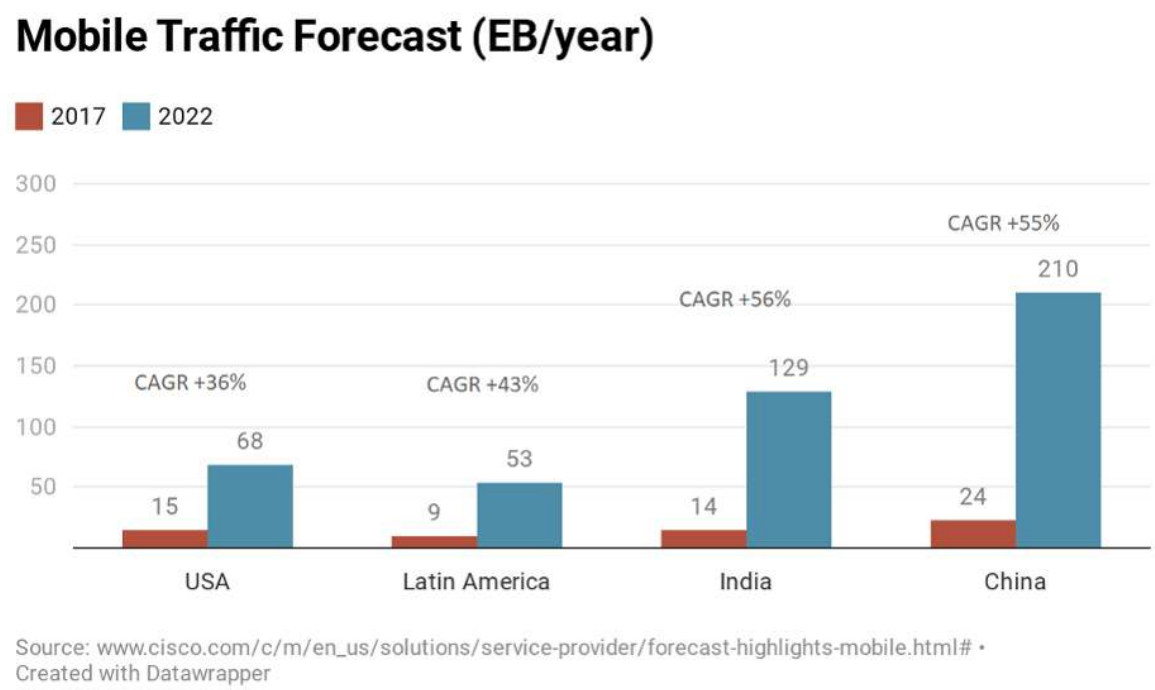
We like the secular trend of expanded usage of mobile devices carrying increasing amounts of data over wireless networks. Mobile Traffic in the USA is expected to grow +36% on a compound annual rate ("CAGR") in the period ending 2025 from 15 to 68 exabytes ("EB". 1 EB= 1 million terabytes).



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The volume of traffic is expected to grow, but so is the quality of the network experience. The future promise of technology companies is to deliver streaming video content seamlessly and instant and unlimited network responsiveness for “internet of things” realization.

Under the assumption that they will deliver these promises, the underlying growth in traffic and demand for reduced network latency put the tower companies in a fantastic position to collect economic rents for access to their wireless network infrastructure.

The Cloud REITs: “COR”, “EQIX”

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Cloud based computing and interconnection of networks is one of the top secular trends in information technology and computing. For the sake of efficiency in cost savings and achieving strategic advantage or even parity all sorts of companies are moving their computing and IT services to the cloud. The Cloud REITs earn revenues by leasing space and providing power, cooling, scale, redundancy and networking capability to their end clients of cloud providers, enterprises and networks service providers.

These Cloud REITs have strategic locations with proximity to their end clients in dense, hard to replicate economically critical geographies. In many cases they have advantaged pricing with utilities due to scale purchasing power. There are many attributes—size, proximity, scarcity of real estate available, expertise, and proprietary networking capability—that combine to provide the Cloud REITs an economic rent advantage or moat that would be very difficult and costly to replicate. They are sitting right in the middle of a secular trend that has years to play out.

Cloud REITs

Ticker	Description
COR	CoreSite Realty Corporation (NYSE:COR) delivers secure, reliable, high-performance data center and interconnection solutions to a growing customer ecosystem across eight key North American markets. More than 1,350 of the world's leading enterprises, network operators, cloud providers, and supporting service providers choose CoreSite to connect, protect and optimize their performance-sensitive data, applications and computing workloads. Our scalable, flexible solutions and 450+ dedicated employees consistently deliver unmatched data center options — all of which leads to a best-in-class customer experience and lasting relationships. (Source: https://investors.coresite.com/)
EQIX	Equinix owns or leases properties globally (5 continents and 26 countries) that enable tenants to house servers and networking equipment in a secure, cooled and power supplied environment. Equinix has 210 data centers in 55 metros with 99.9999% uptime. They house the most networks (1,800+), clouds (2,900+) and IT services companies on one platform with 9,700+ customers and 50%+ of Fortune 500. They have > 8,000 employees globally.

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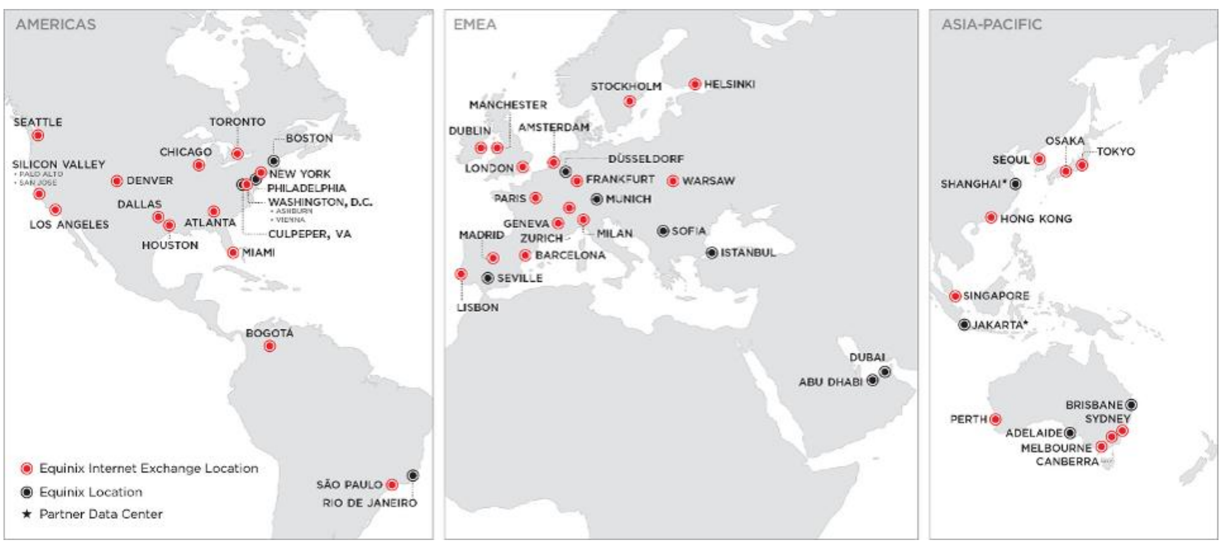
CoreSite is a US only proposition with concentration in Silicon Valley, Los Angeles and Virginia. It focuses on high performance data centers with network and connection density. They offer access to top public cloud providers.

EQIX Global Locations



EQUINIX.COM

Equinix is the 800 pound gorilla in the space having developed a global interconnected network of over 9.700 customers. They promise 99.9999% up-time and 100% renewable power pledge. Equinix is the most trusted data center for top cloud providers and have the largest share of any provider: they have 45% of Amazon AMZN Web Services "AWS" market share, 45% of Azure (i.e., Microsoft MSFT) market share, 49% of Google Cloud and 32% of IBM IBM softlayer cloud.

The Multifamily REIT: Essex Property (ESS)

Essex Property Trust owns apartments in highly desirable locations and have successfully ridden the secular wave of real estate appreciation on the West Coast of the USA

Multifamily REIT

Ticker	Description
ESS	Essex's beginnings go back to 1971, when real estate entrepreneur, George M. Marcus formed Essex Property Corporation. In 1994, with a portfolio of 16 multifamily communities, the Company made its public debut as Essex Property Trust, Inc. (NYSE:ESS). Essex is a fully integrated real estate investment trust (REIT) that acquires, develops, redevelops and manages multifamily apartment communities located in supply-constrained markets. The Essex portfolio is concentrated along the West Coast, including Southern California the San Francisco Bay Area and the Seattle metropolitan area.

Source: http://investors.essexapartmenthomes.com • Created with Datawrapper

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The properties they own are in highly desirable areas with significant job and economic growth and a limited supply of housing. As a result rents for their apartments are relatively high and growing by national standards but are considered a "deal" to the alternative of buying.

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Rent vs Own by ESS Major Metros

ESS Major Metros1	ZRI Median Rent	ZHVI	ZHVI 5 Yr CAGR	Est. Monthly PITI	Own/Rent %Premium
Seattle, WA	$2,026	$544,451	9.1%	($3,024)	49%
San Francisco, CA	$3,121	$1,141,029	6.9%	($6,200)	99%
San Jose, CA	$3,296	$1,253,398	6.0%	($6,798)	106%
San Diego, CA	$2,559	$628,519	5.6%	($3,471)	36%
Los Angeles-Long Beach-Anaheim, CA	$2,625	$697,203	5.4%	($3,837)	46%

Table: Troy Logan • Source: www.zillow.com/research/data/ • Created with Datawrapper

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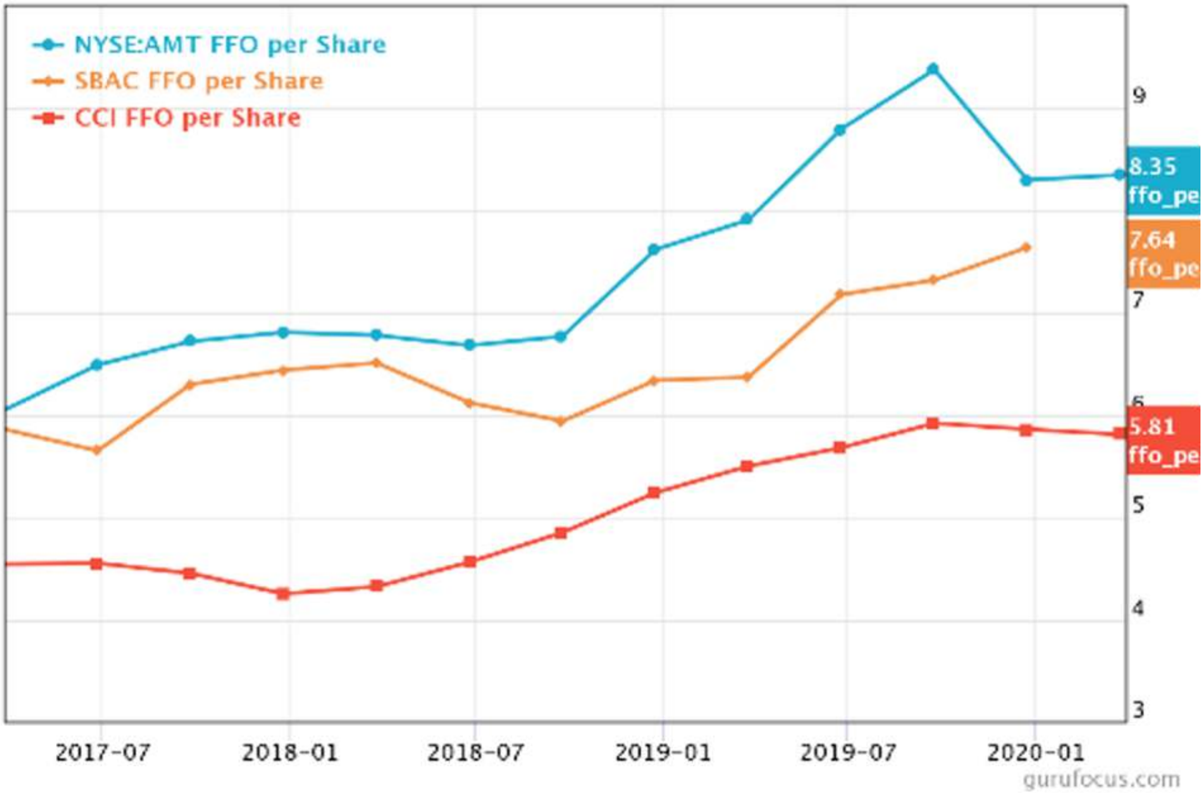
The table compares the monthly ownership cost (“PITI” = principal + interest+ property tax + insurance) for the median home in the respective metro area vs. median rents. The calculation is derived using Zillow’s median rental index and the Zillow Home Value Index. The Own/Rent premium in Essex Property areas is anywhere from +36% to +106%. Not surprisingly, Essex properties are located in major metros that have experienced substantial appreciation over the last 5 years with compound annual growth rates (“CAGR”) ranging from +5.4 to +9.1%.

Returns and Risk

The charts below (data source: GuruFocus (https://www.gurufocus.com)) present Funds From Operations (“FFO”) which is one of the accepted measures used in evaluating earnings for REITs. FFO adjust the net income of the REIT for non-cash charges and for gains/losses on asset sales in order to get a true picture of the earnings power and return of a REIT. In order to easily compare the different companies, the data are presented on a per share basis. We also show charts for the per share interest expense for each of the companies which is defined as annual interest expense per average diluted share.

FFO/Sh. (AMT, SBAC, CCI)



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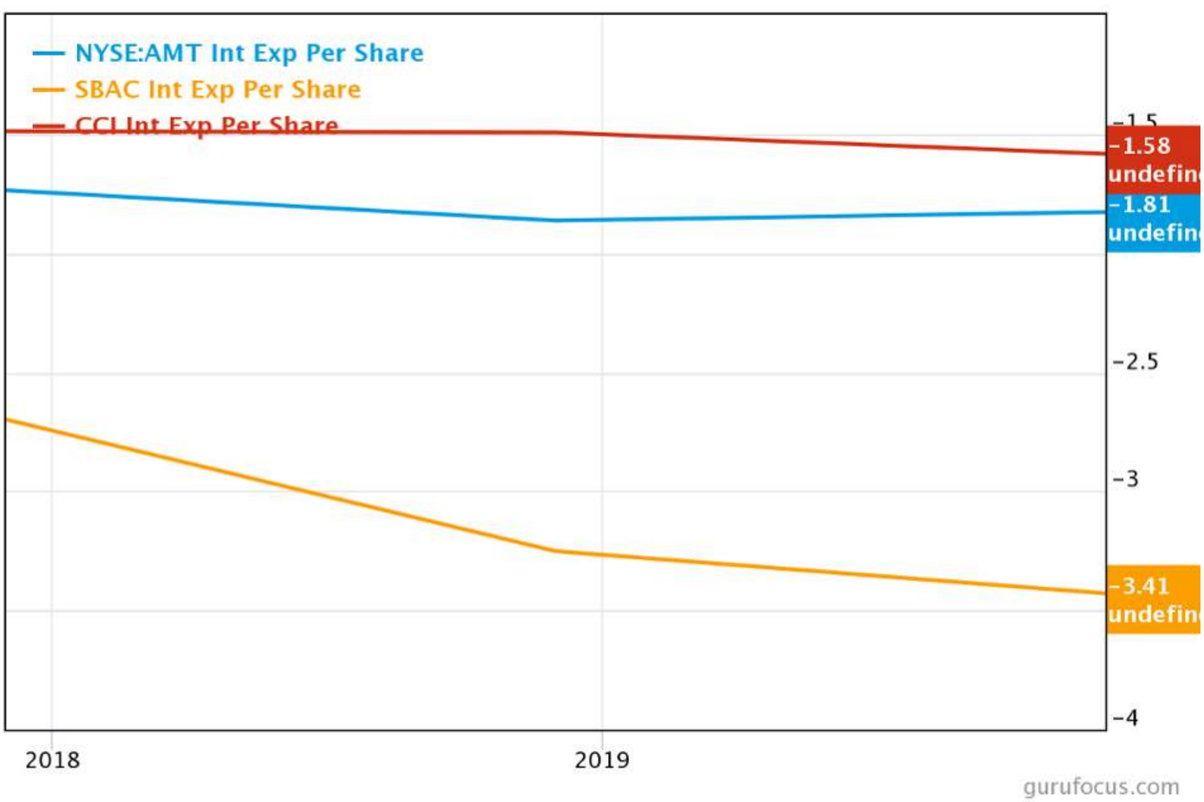
Interest Exp./Sh. (AMT, SBAC, CCI)



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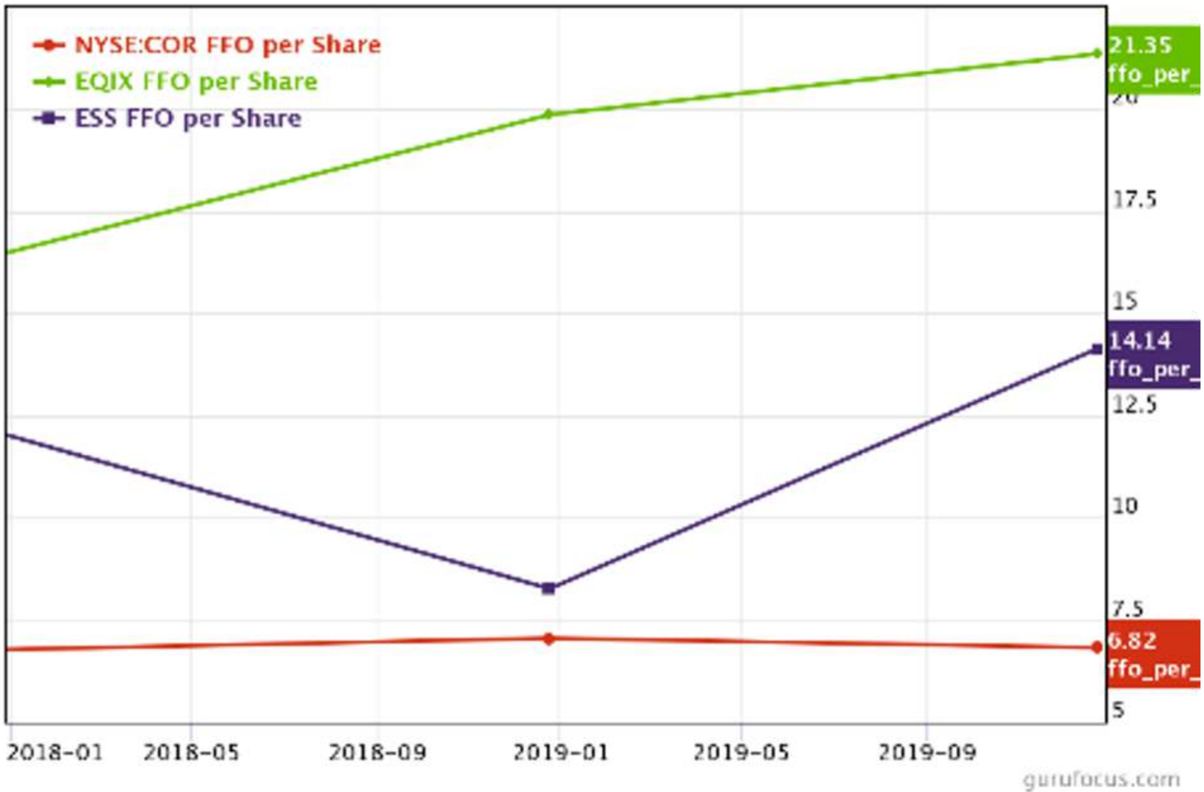
FFO/Sh. (COR,EQIX, ESS)



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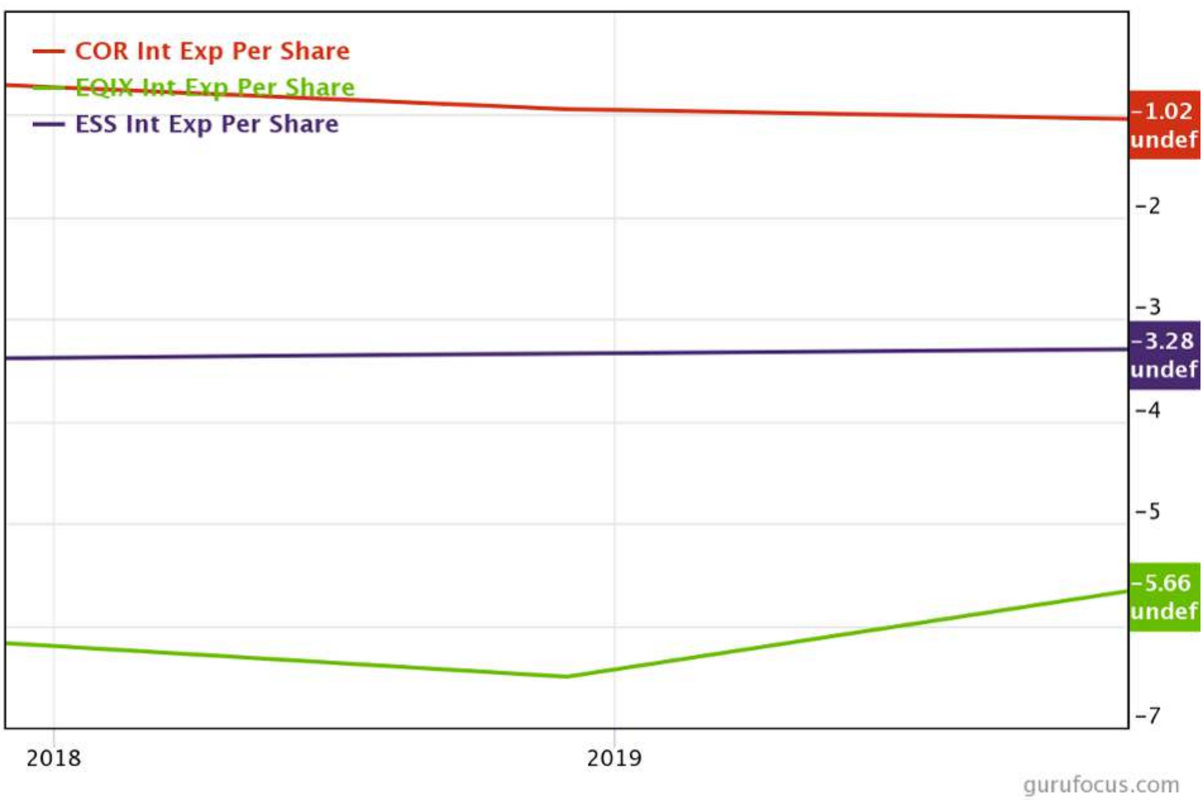
Interest Exp./Sh.(COR, EQIX, ESS)



GURUFOCUS

Earnings Growth, Value and Coverage Ratios

(1) Ticker	(2) Market Cap Billions	(3) April 30, 2020 Price	(4) P/FFO/Growth	(5) Price/FFO/Sh 2019	(6) FFO/Sh Growth Rate 3 Yr	(7) FFO Int Exp Coverage
AMT	$112.2	$238.00	1.66	27.64	16.7%	4.8
SBAC	$34.5	$289.92	2.04	37.95	18.6%	2.2
CCI	$67.5	$159.43	0.71	27.21	38.2%	3.7
COR	$4.6	$121.19	24.06	17.77	0.7%	6.7
EQIX	$60.2	$675.20	1.06	31.63	29.8%	3.8
ESS	$16.5	$244.10	1.00	17.26	17.2%	4.3

Table: Troy Logan • Source: derived from data using Gurufocus charts • Created with Datawrapper

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From Column 6 in the table above we see the earnings growth over the last 3 years ranges from +0.7% to +38.2%. With the exception of COR the REITS all have double digit earnings growth track records. In general we like investments that offer double digit growth potential and we look to a proven track record to support our assessment of future growth potential. All but COR currently satisfy that criterion.

The "PEG" ratio is used to measure the price you are paying for growth. We construct an adapted form of that measure in Column 4 by using the ratio of Price /FFO per share 2019 as the "price" (Column 5) to set over the 3 year FFO/Sh growth rate (Column 6). So, for example, the least costly price for growth is for CCI at 0.71 per unit growth and the most expensive growth is COR at 24.06 due almost entirely to the fact that COR hasn't grown earnings in the last 3 years. As a general rule most growth seeking investors would a like a PEG ratio under 2. All but COR and SBAC meet this criterion currently.

Finally we want to look at the credit risk of these REITs and to do that we construct a measure of interest expense coverage in Column 7. We take the FFO per share in 2019 as a ratio to the Interest expense per share in 2019 as a measure of times coverage. So, for example, COR is able to "cover" interest expense 6.7 times with Funds from Operations. The higher this coverage number the better and we're generally looking for 1.5 or 2.0 times or greater coverage. All of the REITS meet this criterion.

Summary

We believe there is a place in most investor's portfolios for income producing hard assets. We have narrowed the hundreds of choices down to a handful of picks that we believe have the ability to earn an economic rent and meet fundamental earnings growth, value and risk criteria.

I'd like to thank my colleague Troy Logan for his contribution to this article.

Talk with Warren Financial to find out more about investing in REITs and where they fit into your current portfolio.

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Randy Warren

Randy Warren serves as Chief Executive Officer at Warren Financial, a financial advisory firm originally founded in 1965 by his father. Today, under Mr. Warren's... **Read More**