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Temple raises distributions amid good conditions

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Temple real-estate investment trust is doing the unthinkable and raising distributions. Is that even allowed in this kind of environment? You'd think not, given how rare it's becoming, but investors welcome it and I expect there may be more to come, hence a hearty recommendation of the units.

Winnipeg-based Temple owns hotels in Western Canada. Most of them are in Fort McMurray, which is quietly booming again. The REIT (TSX-V:TR.UN) got crushed in the downturn, naturally, but business has bounced back. Distributions were raised 20 per cent recently, giving the units a 10.1-per-cent yield.

Revenues are going up because demand for accommodation is rising as the oilsands expansion picks up where it left off in 2007. Interest rates are going down because that's the world we live in. CEO Arni Thorsteinson told me a recent refinancing took interest from 6.4 per cent to 4.9 per cent, which would allow an extra $2 million to flow to the bottom line. There are only 18.5 million units outstanding, meaning an extra 11 cents each. And that's partly how the REIT could afford to raise.

Thorsteinson has been in the real-estate game for a mighty long time and said he has rarely seen conditions this good. Interest rates are coming down, demand is going up, and other hotel REITs, such as Holloway and Royal Host, are winding down.

That means those with access to capital have lots of expansion possibilities and less competition in auctions than a few years ago, when all of these REITs were tripping over each other to grow at any cost (which explains why so many are winding down).

Not that growth can only come with acquisitions. There's more prosperity to come from existing assets. Occupancy improved dramatically in the recent quarter, yet is well behind the 79 per cent registered in the same quarter of 2007.

Thorsteinson sees 2012 shaping up like another 2007, as long as oil prices hold up reasonably well. Temple is not the same REIT as in 2007, it should be said. It had to issue a lot of new units earlier this year to pay down debt. But Thorsteinson apparently sees value, as he's been a big buyer at recent prices.

Besides improving conditions in Fort McMurray, there are other sources of internal growth. Temple spent millions refurbishing its Red Deer hotel, turning it into a four-star Sheraton with a huge convention centre. Red Deer, a prosperous little city midway between Edmonton and Calgary, has never had a four-star hotel. I expect it to do well, especially with the conference centre, which will draw from both cities and the local area, with a combined population of more than two million.

I'm stressing internal growth but, while Temple has not been an aggressive buyer, it has bid on some of the properties being auctioned off as former rival REITs liquidate, and I expect Temple to eventually succeed in some auctions. That would add cash flow but also diversify the REIT away from its heavy reliance on Fort McMurray.

That's a great piece of the business -- Temple has about 40 per cent market share by value (30 per cent by room count) and that position is protected as it's difficult to build new rooms up there because of a shortage of land and the cost of new construction. But it's volatile, and the REIT could probably raise its public market valuation by diversifying.

The balance sheet needs growth. There's a considerable amount of debt, but about 20 per cent is convertible, and indeed, the yield on the units is now greater than that of the convertible debentures, so expect the REIT to issue new units. This is good in that it eliminates debt but bad in that it's dilutive to unit holders. Barring acquisitions, there's a thumb pressing down on distributions per unit, limiting the increases somewhat. Fortunately, acquisition targets are relatively plentiful and affordable.

The risks? Pretty straightforward. Oil and to a lesser degree gas prices. Competition. The economy in general. Execution. Interest rates.

But all in all, the rewards seem to outweigh the dangers. Thorsteinson, who almost doubled his ownership recently to nine per cent, clearly thinks so.

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