RJ INsight

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REAL ESTATE & REITS

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REITs / REOCs

Assessing the risk of distribution cuts

Given the heightened risk of REIT/REOC distribution cuts in the current economic environment (driven by potential vacancy increases, potential rental rate declines and tight credit markets) we have performed an analysis on our coverage universe to determine the most likely candidates for distribution cuts in aweakened economy.

Our analysis encompasses a sensitivity analysis on the payout ratios across of our coverage universe assuming a 2% and 5% increase in vacancy rates in each REIT/REOCs property portfolio and a review of our commercial REIT coverage universe's balance sheet strength as it is our view that those commercial REITs with access to unencumbered assets would be able to obtain financing against those assets and in doing so would be able to meet their scheduled mortgage payments without having to cut distributions or raise equity. We have also taken into consideration unsecured debt maturities that would need to be replaced with alternate financing over the next few years. With approximately 20% of the Canadian debt market comprised by the CMBS debt market which has ceased to exist and with many traditional lenders unable to participate in the debt markets to the same extent as they have historically (insurance companies are now cash poor and overweight in real estate given the decline in their equity portfolios) we believe unencumbered assets are vital to access the debt markets to raise new sources of debt. With access to CMHC financing, balance sheet concerns are not as rife an issue for multi-residential REITs.

We have ranked the REITs/REOC in our coverage universe from most likely to least likely to cut their distributions in our view in Exhibit 1. A summary of unencumbered assets and expiring debt for our commercial REIT universe is summarized in Exhibit 2.

Finally, we reviewed Raymond James & Associates U.S. REIT coverage list for REITs that have cut or increased their distributions this year as we thought it would provide some insight on the most likely Canadian REIT candidates to cut their distributions, given the more rapid deterioration of fundamentals south of the border. We note that none of the retail REITs have cut their distributions and that two of the retail REITs have increased their distributions this year. The most common property type in the U.S. to implement distribution cuts was the office sector. Our review is summarized in Exhibit 3.

SECTOR SUMMARY

COMPANY / TICKER	CUR PRICE	RETURN	RATING / TARGET
First Capital Realty			**OUTPERFORM 2**
FCR-TSX	C $17.69	13%	**$20.00**
RioCan REIT			**OUTPERFORM 2**
REI.UN-TSX	C 13.80	27%	**17.50**
Primaris REIT			**OUTPERFORM 2**
PMZ.UN-TSX	C $11.63	12%	**$13.00**
Calloway REIT			**OUTPERFORM 2**
CWT.UN-TSX	C $9.71	85%	**$18.00**
Crombie REIT			**MARKET PERFORM 3**
CRR.UN-TSX	C $7.03	32%	**$9.25**
CAP REIT			**OUTPERFORM 2**
CAR.UN-TSX	C $13.17	10%	**$14.50**
Northern Property REIT			**MARKET PERFORM 3**
NPR.UN-TSX	C $17.17	5%	**$18.00**
Boardwalk REIT			**MARKET PERFORM 3**
BEI.UN-TSX	C $23.39	6%	**$24.75**
Allied Properties REIT			**MARKET PERFORM 3**
AP.UN-TSX	C $10.80	44%	**$15.50**
Dundee REIT			**MARKET PERFORM 3**
D.UN-TSX	C $12.23	80%	**$22.00**

Closing prices as of 01-Dec-08
All figures in C$, unless otherwise noted.
Sources: Raymond James Ltd.,ThomsonOne, CapIQ

Exhibit 1: Coverage List Ranking of REITs/REOCs Most Likely to Least Likely to Cut Distributions

Rank	Ticker	Name	AFFO/unit (FD) at 3Q08	Distr. / unit	DRIP participation	Occupancy 3Q08	Payout Ratio at 3Q08		Payout Ratio with 2% decline in occupancy		Payout Ratio with 5% decline in occupancy		Note
							No DRIP	With DRIP	No DRIP	With DRIP	No DRIP	With DRIP	
			2009E	2009E			2009E	2009E	2009E	2009E	2009E	2009E	
1	D.UN	Dundee	2.13	2.20	9.00%	95.8%	103%	94%	107%	98%	122%	111%	
2	CRR.UN	Crombie	0.94	0.89		94.8%	95%	95%	105%	105%	124%	124%	
3	CWT.UN	Calloway	1.68	1.55	14.50%	99.2%	92%	79%	97%	83%	106%	91%	
4	PMZ.UN	Primaris	1.19	1.22	3.80%	98.0%	103%	99%	115%	111%	130%	125%	1
5	AP.UN	Allied	1.46	1.32	17.30%	97.3%	90%	75%	96%	79%	106%	88%	
6	REI.UN	RioCan Including gains	1.39	1.38	24.70%	97.0%	99%	75%	104%	78%	112%	84%	
	REI.UN	RioCan Reduced gains	1.39	1.38	24.70%	97.0%	99%	75%	109%	82%	118%	89%	2
	REI.UN	RioCan Excluding gains	1.27	1.38	24.70%	97.0%	109%	82%	114%	86%	124%	94%	
7	CAR.UN	Canadian Apartment	1.10	1.08	17.80%	98.3%	98%	81%	108%	89%	126%	103%	3
8	FCR	First Capital	1.47	1.32		95.8%	90%	90%	96%	96%	106%	106%	
9	BEI.UN	Boardwalk	2.19	1.80		95.4%	82%	82%	87%	87%	99%	99%	4
10	NPR.UN	Northern Property	1.79	1.48		95.5%	83%	83%	85%	85%	89%	89%	5

Notes:

1. 3Q08 estimates for FY2009E AFFO assumes a decline in percentage rents to $3.1M from $3.6M in FY2009.
   Our estimates exclude the internalization of management costs which we estimate would reduce AFFO by $0.07 from $1.19 to $1.12. These items are treated as non-recurring.
   Percentage rent adds approximately $0.05 to AFFO/Unit and our sensitivity analysis assumes no % rents are received.
2. We estimate about $13M of fees and gains are recurring management fees and have reduced the remaining $27M in gains included in our 3Q08 estimate to $15M.
3. CAR margin is +/- 54% so a decline in occupancy results in a higher impact on AFFO than for BEI.UN.
4. BEI margin is +/- 62.5% so a decline in occupancy results in a lower impact on AFFO than for CAR.UN.
5. Assumes decline in occupancy in apartment portfolio only.

Source: Company Reports, Raymond James Ltd.

Exhibit 2: Commercial REIT Coverage List Balance Sheet Analysis – Summary of Unencumbered Assets, Unsecured Debenture and Mortgage Maturities

	PMZ.UN	CWT.UN	FCR	REI.UN	CRR.UN	D.UN	AP.UN
Debenture/Bridge Loan Maturity Schedule (convertible debentures listed with conversion prices, otherwise unsecured)							
	2014 - 5.85%, $100,000 **2014** - 6.75%, $6,104 $12.25 conversion price	**2010** - 4.51%, $200,000 **2013** - 6.65%, $117,692 $25.25 conversion **2014** - 6.00%, $4,828 $17.00 conversion **2016** - 5.37%, $250,000	**2011 -** 5.51%, $100,000 **2011 -** 5.67%, $100,000 **2012 -** 5.29%, $100,000 **2013 -** 5.51%, $100,000 **2014 -** 5.52%, $100,000 **2014 -** 5.47%, $100,000 **2017** - 5.50%, $233,000 $27.00 conversion	**2009 -** 5.29%, $110,000 **2010 -** 4.94%, $100,000 **2011 -** 4.91%, $200,000 **2012 -** 4.70%, $100,000 **2012 -** 5.70%, $120,000 **2013 -** 5.23%, $150,000 **2026 -** 5.95%, $100,000	**2009 -** 5.0%, $180,000* **2013** - 7.0%, $30,000 $13.00 conversion	**2014 -** 6.0%, $117,668 $41.40 conversion **2014 -** 6.5%, $3,275 **2015 -** 5.7%, $7,569	NA
Balance Sheet Value of Unencumbered Assets ($000s)	65,000	180,000	1,600,000	550,000	Negligible	NA	50,000**
Unencumbered Assets as Percentage of Gross Income Producing Assets	4.0%	5.6%	51.9%	10.6%	Negligible	NA	5.2%**
Cash on Balance Sheet ($000s)	96,658	21,196	6,502	19,539	$0	96,493	741
Credit Facilities Arranged ($000s)	120,000	260,000	350,000	313,500	150,000	55,000	70,000
Undrawn Amount under Credit Facilities as at Q3/08 ($000s)	120,000	42,155	175,000	254,911	26,841	55,000	45,339
Mortgage Maturity Schedule (% of mortgages maturing as at Q3/08)							
2008	0.5%	0.6%	3.0%	1.6%	NA	0.9%	0.6%
2009	2.5%	7.4%	7.8%	12.7%	3.1%*	11.1%	5.5%
2010	2.2%	4.1%	11.4%	12.9%	23.5%	2.9%	3.8%
2011	6.4%	7.8%	7.7%	5.1%	7.8%	11.6%	5.6%
2012	4.8%	4.7%	11.4%	10.7%	2.6%	15.1%	6.4%
Thereafter	83.6%	75.5%	58.7%	57.2%	63.0%	58.5%	78.1%
Mortgage Maturity Schedule (amount expiring as at Q3/08) - $000s							
2008	4,490	10,104	35,789	36,606	16,132	6,611	3,124
2009	22,353	121,683	92,695	296,972	120,285	83,863	27,777
2010	19,631	66,923	135,009	301,762	39,824	21,617	18,922
2011	57,093	127,632	90,535	118,976	13,216	87,538	28,317
2012	42,796	77,613	134,510	250,317	22,746	113,562	32,273
Thereafter	746,969	1,242,865	693,660	1,341,765	300,387	440,875	392,805

**Amount outstanding on $280mln bridge loan arranged for SLP acquisition*

*** Market value of assets; Percentage based on our valuation of Allied Properties' market value of assets*

****First Capital's debt ratios are governed by its debenture covenants*

Source: Company Reports, Raymond James Ltd., Discussions with Management Teams

FCR and REI.UN Least Likely Retail REITs to Implement Distribution Cuts

Amongst the retail REITs/REOCs FCR and REI.UN are least likely to cut their distributions in our view. FCR has one of the lowest payout ratios in our coverage universe. In addition, about 1.5% of their vacancy is due to redevelopment properties that are fully funded and scheduled to come online by the end of FY2009 that would act as a hedge against any occupancy loss during the year. Both FCR and REI.UN have the largest amount of unencumbered assets on their balance sheet (52% and 11% of the GBV of income producing properties respectively) that would allow them to obtain financing against those assets and in doing so they would be able to meet their scheduled mortgage payments without having to cut distributions or raise equity to do so. We note that REI.UN's 2009E AFFO payout ratio remains comfortable at 95%, excluding gains, even with a 5% decline in occupancy, once the DRIP is taken into consideration. In addition, REI.UN has announced their intention to restructure into a "stapled REIT" structure to meet the new "REIT rules" that come into effect in 2011 and would likely work any desired and/or necessary distribution adjustments into the new structure in our view. CRR.UN and CWT.UN are higher risk for distribution cuts under current capital market conditions as they have the lowest amount of unencumbered assets available. In addition, CRR.UN has a significant $180 mln bridge loan they need to refinance and CWT.UN has a $200 mln unsecured debenture maturing in early 2010. While PMZ.UN is home to a riskier tenant base (6% of revenues are generated by HBC and high proportion of fashion retailers) and is more sensitive to occupancy declines due to potential losses of percentage rent and the higher operating costs of enclosed malls, they have a strong balance sheet.

AP.UN Least Likely Office REIT to Implement a Distribution Cut

In the office space, D.UN is a likely candidate for a distribution cut as they are currently over-distributing. They had planned to grow into their distribution as Calgary office rents well above market were incorporated into the portfolio as leases rolled but in the current economic environment with Calgary office occupancy near historical peaks and a 17% increase in office supply entering the Calgary office market through 2011 this goal appears unlikely to be achieved. We are more optimistic on the sustainability AP.UN's distribution given the relatively low cost structure of the Class I office class and their conservative AFFO payout ratio which remains one of the lowest amongst our commercial REIT coverage universe.

Distribution Cuts Not Anticipated in the Multi-Residential Sector

In the multi-residential space, even with a 5% decline in occupancy both NPR.UN and BEI.UN's 2009E AFFO payout ratios remain below 100%. With a 5% decline in occupancy CAR.UN's 2009E AFFO payout ratio would exceed 100% including DRIP proceeds, however, we believe a 5% decline in occupancy to be unlikely.

Exhibit 3: Summary of US REIT Dividend Cuts and Increases from 2Q08 to Date

Ticker	Property Type	Occupancy 3Q07	Occupancy 3Q08	Occupancy Δ Y/Y	Pre cut '08E AFFO payout	Post cut '08E AFFO Payout	Time of Cut
Divident Cuts							
BDN-US	Office	94.2%	92.1%	-2.1%	99%	67%	4Q08 (Nov)
DFT-US	Office	100.0%	94.5%	-5.5%	99%	0%	4Q08 (Nov)
PKY-US	Office	92.3%	90.4%	-1.9%	121%	61%	4Q08 (Nov)
FR-US	Industrial	94.8%	93.7%	-1.1%	236%	82%	4Q08
LXP-US	Diversified	95.8%	93.8%	-2.0%	75%	41%	4Q08 (Nov)
		Occupancy 3Q07	Occupancy 3Q08	Occupancy Δ Y/Y	Pre Increase '08E AFFO Payout	Post Increase '08E AFFO Payout	Time of raise
Dividend Increases							
OFC-US	Office	92.8%	93.2%	0.4%	76%	84%	3Q08
DLR-US	Office	95.1%	95.2%	0.1%	70%	74%	4Q08 (Nov)
KIM-US	Retail	96.2%	95.4%	-0.8%	91%	100%	2Q08
O-US	Retail	98.3%	96.9%	-1.4%	93%	95%	3Q08

Source: Raymond James Ltd.

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