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Two Canadian office REITs slash payouts in the span of three weeks, spreading gloom throughout the sector

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Slate Office REIT **SOT-UN-T** **-1.66%** decrease is slashing its monthly distribution by 70 per cent, making it Canada's second publicly traded office building owner to cut its payout in the span of three weeks as vacancies rise and higher interest rates bite.

Slate, which owns office properties in Canada and the United States but derives half of its operating income from the Greater Toronto Area and Atlantic Canada, slashed its distribution to 1 cent per unit monthly from 3.3 cents after a strategic review. Slate's units, which trade on the Toronto Stock Exchange, dropped 25 per cent Wednesday and are down 43 per cent this year.

True North Commercial REIT **TNT-UN-T** **+2.69%** increase , which owns office properties across Canada but focuses on Ontario, slashed its own distribution by 50 per cent in mid-March. The REIT is run by Daniel Drimmer, one of Canada's largest property owners through a mix of private and publicly traded businesses. Like Slate, True North's unit price also tanked after the decision and its units are now down 45 per cent this year.

Higher interest rates have weighed on most real estate investment trusts because they carry mortgages often amounting to between 50 per cent and 60 per cent of their property values. Like homeowners, REITs usually only face higher rates when their mortgages come up for renewal. But some, such as Slate, had sizable exposure to variable-rate mortgages.

Across Canada's REIT sector, the weighted average interest rate on existing debt is 3.5 per cent, according to analysts at Canaccord Genuity. The current market rate for a five-year commercial mortgage is estimated to be 5.5 per cent.

Higher rates also affect REIT unitholders, many of whom are retail investors. When interest rates were ultralow, a REIT distribution yield around 5 per cent looked quite attractive. But now that the Bank of Canada has raised its benchmark rate to 4.5 per cent, ultrasafe guaranteed investment certificates pay roughly the same.

At the same time, office property owners are struggling to keep tenants because working from home has become more common. Slate's occupancy was 81 per cent when the REIT last reported earnings in February.

Slate and True North aren't the only REITs that have cut their distributions since the pandemic erupted. During the first and second lockdowns, a slew of REITs, *including RioCan and First Capital*, slashed their own because the economic outlook was so grim.

Yet some of the REITs that cut early have already started raising theirs, making Slate's and True North's recent decisions stand out.

The latest cuts also come from the office sector, which is struggling to win back investors. Before the pandemic, Allied Properties REIT **AP-UN-T** -0.22% decrease , a major office landlord, was one of Canada's best-performing real estate companies, but its units are now down 62 per cent from their record high set in February, 2020.

The recent dividend cuts add to the pain spreading throughout the sector.

In November, Romspen, one of Canada's biggest private mortgage lenders, with $3.2-billion in assets under management, froze investor redemptions, citing some trouble with loan repayments. Romspen's portfolio largely comprises construction and predevelopment loans, and it lends to borrowers across the United States and Canada.

A month later Blackstone REIT, one of the world's largest private investment real estate investment trusts, announced it had to limit redemptions on the fund because too many clients were asking for their money back.

The pain is now hitting publicly traded funds. Late last year, rental housing investor Starlight Investments, which was founded by Mr. Drimmer, paused distributions on two funds that specialize in U.S. properties, and now Slate and True North have been affected. Slate declined to comment for this story.