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Why Middlefield Capital real estate whiz Dean Orrico is bullish on Canadian REITs. U.S. ones, not so much

SHIRLEY WON || NOVEMBER 26, 2024

Dean Orrico, President, CEO and portfolio manager at Middlefield Capital Corp. is bullish on Canadian REITs.PAM LAU/THE GLOBE AND MAIL

Dean Orrico has never been far from the property business. Growing up, he'd listen to the shop talk among close family friends who were developers or builders. During high school, he got summer jobs on construction sites. After earning an MBA, he landed a job in 1996 as an analyst with Middlefield Capital when Canadian real estate investment trusts were just going public.

That window on the REIT world has served him well—his Middlefield Real Estate Dividend Class mutual fund and Middlefield Real Estate Dividend ETF MREL-T unch -

, whose assets total $210 million, have outpaced the S&P/TSX Capped REIT Total Return Index since 2011. We asked Orrico why he's more bullish on Canadian than U.S. REITs, and why he likes the seniors' housing sector.

What is your strategy to beat the S&P/TSX Capped REIT index?

Our goal is to outperform over time, but we think that index has flaws. For instance, Canadian Apartment Properties REIT CAR-UN-T +0.53% is about 16% of the index, but we think anything above 8% is excessive. That's why we have that REIT capped near that lower level, even though it's well-positioned and we know management well. Canadian REITs represent about 80% of our funds, with the rest mostly in the United States. If I find attractive names outside of Canada, I will own them.

Why are you more bullish on Canadian REITs than on their U.S. counterparts?

Canadian REITs trade more cheaply than U.S. ones. The latter moved higher more quickly in anticipation of interest rate cuts. Here, it's a bit of a catchup trade as rates are falling, and that's generally a tailwind. The federal government wants to reduce immigration because of a housing shortage, but strong demand and a limited supply of new apartments and condos will keep an upward pressure on rents. The supply for new grocery-anchored shopping centres is also tight as many retail REITs use their land to add housing, and construction costs are rising. In Canada, there are some $200 billion in guaranteed investment certificates, term deposits and high-interest savings accounts because people could get a 5% yield. When that yield comes down, money is going back into REITs.

What Canadian REIT sectors do you like?

We like apartment REITs like CAPREIT, Killam Apartment REIT KMP-UN-T +1.03%, Minto Apartment REIT MI-UN-T +0.41%, InterRent REIT IIP-UN-T +1.97% and Boardwalk REIT BEI-UN-T +0.62%. Most provinces have rent control, but Alberta doesn't. Boardwalk, which has more than 50% of its portfolio in Alberta and benefits from higher rents, is one of our largest weights. I also like retail REITS, such as First Capital REIT FCR-UN-T +0.50% and RioCan REIT REI-UN-T +1.06%, because major grocery tenants are looking for more space because of a lack of new supply.

Chartwell Retirement Residences and Sienna Senior Living are top holdings. Why?

Both seniors' housing REITs suffered from higher costs and lower revenue during the pandemic. They couldn't show empty units to prospective tenants, so occupancy levels fell to about 75%. Costs rose because they had to use agencies to hire more employees. Their occupancy rates have now risen to around 89%. We think that could hit the mid-

90s over the next few years. You’re also seeing the impact of an aging population on seniors’ homes.

Dean Orrico's Middlefield Real Estate Dividend Class mutual fund and Middlefield Real Estate Dividend ETF, whose assets total $210 million, have outpaced the S&P/TSX Capped REIT Total Return Index since 2011.Pam Lau/The Globe and Mail

What U.S. REITs do you like?

We own SBA Communications SBAC-Q -0.99% and Crown Castle CCI-N -0.42%, which are cell-tower REITs. Cellphones have become more powerful, and their utility will increase. Artificial intelligence will drive demand for cell towers and data centres, too. Given the computing power that AI requires and the data it creates, that will require more storage, so we own Equinix EQIX-Q +0.24%, a data-centre REIT. We also like Welltower WELL-N -0.80% and Ventas VTR-N -0.73% because their seniors’ homes benefit from an aging population.

Office REITs have been hurt by the work-from-home trend that came out of the pandemic. Are they on their death bed?

They are not dead, but you need to be very patient for the recovery in the office sector. You still have more supply than demand in major centres. We don’t own any in our REIT funds because it’s just not an attractive opportunity. But we do own investment firms Blackstone and Brookfield, which are indirect ways to get office exposure.