



## Is This RioCan Real Estate Investment Trust Deal a Game Changer?

### Description

In 2009, after the worst of the financial crisis was behind us, **RioCan Real Estate Investment Trust** ([TSX:REI.UN](#)) spent approximately \$1.2 billion on a portfolio of properties in the United States.

It's worked out to be a nice buy. Thanks to a recovery in real estate prices stateside and because the Canadian dollar has weakened significantly against the greenback, RioCan's management knew the company was sitting on a nice profit on the 49 properties it owned, which were mostly located in the northeastern states and Texas.

RioCan's management has publicly mused about selling the U.S. properties for a while and finally came to an agreement with Blackstone Real Estate Partners VIII last week to sell the portfolio for US\$1.9 billion. Based on current exchange rates, that works out to approximately \$2.7 billion.

Once all of the debts are paid off, RioCan will end up with approximately \$1.2 billion in fresh capital, with \$930 million of that as profit.

Some of the cash will be used to buy out the stake that **Kimco Realty Corp.** owns in 22 of RioCan's Canadian properties for a sum of \$238 million. The other approximately \$960 million will be used to pay down debt and to fund a Canadian expansion by both acquiring new properties and redeveloping older ones.

Interestingly, the stock barely moved on the deal. RioCan shares only rose 2% last week and still only trade 5% above the 52-week low, which was set in September.

What exactly does this deal mean for shareholders? I think it's very good news.

### A dividend increase?

RioCan used to be a poster child of rising dividends. It raised its dividend annually from 2000 to 2008, upping the payout from \$0.0875 to \$0.115 per share monthly.

Then the financial crisis hit. RioCan never cut its dividend, unlike some of its competitors. But it didn't

hike the payout either. It finally threw investors a bone with a small increase in 2013, raising the monthly dividend from \$0.115 to \$0.1175 per share. There's been nothing since, meaning there's only been a 2.2% dividend hike in the last seven years.

This puts RioCan in the bottom quartile of Canadian REITs when it comes to dividend growth over that time period. RioCan is even running behind when it comes to yield. Sure, shares currently yield an attractive 5.8%, but it's not hard to get dividends of between 6-8% on safer Canadian REITs. If you want to take on a little more risk, 10% dividends can be found.

This could all change with this deal. If RioCan uses, say, \$950 million to pay off debt that costs 4% annually, it adds \$38 million to its bottom line.

Though the first three quarters of 2015, RioCan has generated \$372 million in adjusted funds from operations (AFFO). This puts it on pace to generate \$496 million for the year, which works out to \$1.56 per share. If we add the \$38 million in interest savings, AFFO increases almost 8% to \$1.68 per share.

RioCan currently pays out \$1.41 per share annually in dividends. The payout ratio is currently 90%. After the transaction closes, the payout ratio is 84%. Thus, the stock could pay \$1.51 per share in annual dividends and still maintain a 90% payout ratio, which is a 7.2% hike.

### **The other option**

RioCan has another option with its new cash. It can use it to acquire more properties.

Let's say RioCan took \$500 million and used it to buy \$1 billion worth of new property. Assuming a 6% cap rate and borrowing \$500 million in new debt at 3%, RioCan could increase earnings by \$45 million annually and still have more than \$400 million left over to pay down debt.

Remember, RioCan has plenty of development opportunities it's already identified. The company's portfolio is filled with properties that can be easily redeveloped into multi-use buildings with retail on the bottom and condos on top.

These developments will come much cheaper than other buildings in the neighborhood because RioCan doesn't have to pay market prices for its land. Having things like water and power already on site help as well.

In short, a less-levered RioCan is good for investors. It allows the company flexibility to pay for some of its new developments, and I suspect long-suffering RioCan shareholders will be rewarded with a dividend increase. Investors should be happy about this deal.

### **CATEGORY**

1. Dividend Stocks
2. Investing

### **POST TAG**

1. Editor's Choice

### **TICKERS GLOBAL**

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nelsonpsmith

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