Can Canada's Top REITs Survive the Death of the Shopping Mall?

Description

It's tough to be a traditional retailer in 2016.

The big elephant in the room is the Internet, of course. As more and more people get comfortable with buying stuff online, retailers are starting to feel the pinch. Web-only sellers don't have to pay for expensive mall space, cashiers, or merchandising specialists. It's also much easier to scale up a business that only operates online.

It's pretty obvious there's too much competition in the traditional space. Many formerly prominent retailers have closed their doors in Canada over the last couple of years. The big one was **Target** Canada, but it has been joined by other names like **Sony**, Jacob, Danier Leather, Grand and Toy, Mexx, and Future Shop, among others.

It's obvious which direction the trend is going. Retailer after retailer is reporting numbers that show a small same-store sales gain only if you include their online sales. Without the benefit of these sales, many of these companies would be slowly shrinking.

While that's ultimately good news for Canada's top retailers–it shows they can adapt with the times and compete with some of the online-only behemoths–it's probably not great news for Canada's retail REITs. Less foot traffic ultimately means fewer stores.

How will this trend affect two of Canada's leading retail REITs, **RioCan Real Estate Investment Trust** (TSX:REI.UN) and **Smart REIT** (TSX:SRU.UN)? Let's take a closer look.

Two very different stories

I'm fairly confident that both RioCan and Smart can adapt to this new world. But if I were to wager on one of these companies exclusively, it would be the latter

Smart has carved out an interesting niche. It has **Wal-Mart Stores, Inc.** (NYSE:WMT) anchoring more than 50% of its 138 location portfolio, which translates into 27% of its annual rent coming from the world's largest retailer. That's some six times higher than its next largest tenant.

This concentration has worked out pretty well. Because Wal-Mart attracts so much foot traffic, other retailers have flocked to these locations, even ones that directly compete with the behemoth from Arkansas. This phenomenon, plus Smart's relatively new portfolio, has pushed occupancy to above 98%. Smart owns the kind of locations that retailers want.

And unlike a clothing store or a electronics retailer, Wal-Mart has evolved into selling a lot of food–something that's not currently available online. Even if we get to the point where people order food from the web, it makes sense for a chain like Wal-Mart to deliver it from a store rather than from a warehouse somewhere.

RioCan is much more diverse than Smart; no retailer accounts for more than 5% of its gross rental income. **Loblaw** is its largest tenant. It, along with wholly owned subsidiary Shoppers Drug Mart, accounts for 4.7% of RioCan's rental revenue. Other household names follow with **Canadian Tire**, Wal-Mart, **Cineplex**, and Winners rounding out the top five tenants.

Investors like this diversity, but I'm not so sure. RioCan is much more dependent on some of the same retailers that are most affected by online competition. This isn't to say the company is hurting, because it's in fine shape. Compared to just about every other REIT, a occupancy ratio of 94.8% is pretty good. But it pales in comparison to Smart's 98.6% occupancy.

One thing RioCan does have going for it is its development program. It owns dozens of properties that are sitting on some valuable land, especially in the Toronto area. There are plans to redevelop many of these properties, erecting multi-use buildings with retail on the bottom and condos on top. Since the land has been long paid for, these new developments can be built at a much lower cost than comparable projects.

Ultimately, I think both Smart REIT and RioCan don't have anything to worry about in the short term. Both companies own fine portfolios and easily generate enough cash to pay their 4.7% and 5.0% dividends, respectively. But over the long term, if I was concerned about online retailing really hurting the shopping mall, I'd rather own Smart REIT because of its larger Wal-Mart exposure.

CATEGORY

1. Dividend Stocks
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TICKERS GLOBAL

1. NYSE:WMT (Wal-Mart Stores Inc.)
2. TSX:REI.UN (RioCan Real Estate Investment Trust)
3. TSX:SRU.UN (SmartCentres Real Estate Investment Trust)

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