Is it Time to Buy the Dips in the Retail REITs?

Description

Thanks to the pullback from the highs in mid to late 2016, retail real estate investment trusts (REITs) **Smart REIT** (TSX:SRU.UN) and **Plaza Retail REIT** (TSX:PLZ.UN) now offer above-average yields of north of 5%.

Let's take a look at the REITs to see if the dips are an opportunity to buy some units on the cheap.

Smart REIT

As Smart REIT last reported at the end of 2016, the company had 142 shopping centres in Canada, one office, and one mixed-use property.

Smart REIT has 84 properties (58% of its properties) in Ontario, which is viewed as one of the most stable markets to be in. Another one of the company's strengths lies in its relationship with **Wal-Mart**, which anchors in 72% of the REIT's properties.

Wal-Mart is Smart REIT's largest tenant; it contributes 26.3% to its gross rental revenue. The REIT has about 7.5 years of average remaining lease term with the discount store.

Its overall portfolio has an average lease term of about six years and lease maturities that are spread out across the years through 2026, averaging 7.2% of total gross leasable area per year.

Smart REIT's other top tenants include **Canadian Tire**, **Loblaw**, and **Dollarama**, which contribute 1.6-4.4% of its gross rental revenue. Together, its top 10 tenants have an average remaining lease term of about 6.4 years.

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With a high occupancy of 98.3% and an adjusted funds from operations (AFFO) payout ratio of about 80%, Smart REIT offers a safe distribution of almost 5.3%. At about $32.40 per unit, Smart REIT trades at a reasonable multiple of about 14.6.

Plaza Retail

Plaza Retail has interests in 297 properties. It primarily develops, owns, and manages retail real estate in Atlantic Canada, Quebec, and Ontario.

One of the company's strengths lies in its relationship with Shoppers Drug Mart (owned by Loblaw), which contributes about a quarter of its base rent revenue.

Its second- and third-largest tenants are KFC franchisees (across six tenants) and Dollarama, which contribute 9% and 4.8%, respectively, to its base rent. Plaza Retail's portfolio has an average remaining lease term of about six years.

Plaza Retail is a rare gem in the REIT space because it has increased its distribution every year since 2004. (Only one other Canadian REIT has achieved the same.) In the last three years, it has increased its distribution per unit by about 4% per year on average.

With a committed occupancy of close to 96% and an AFFO payout ratio of about 80%, Plaza Retail offers a safe distribution of 5.6%. At $4.80 per unit, Plaza Retail trades at a reasonable multiple of about 14.2.

Investor takeaway

The REITs may continue to head lower. However, as of now, the dips offer an opportunity to get your hands on juicy yields of more than 5%.

If the two REITs continue to grow their distributions by 3-4% a year as they have in the last three years, they can deliver decent annualized returns of 8-9%, while paying safe, above-average yields. Between the two, Plaza Retail will more likely deliver the higher end of those ranges.

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